IPPR NORTH

REPORT

BORDERLAND

ASSESSING THE IMPLICATIONS OF A MORE AUTONOMOUS SCOTLAND FOR THE NORTH OF ENGLAND

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ABOUT IPPR NORTH

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1. INTRODUCTION

Scotland's relationship with the rest of the UK is changing. In May, the Scotland Act 2012 came into force giving the Scottish parliament *inter alia* a new Scottish rate of income tax and borrowing powers worth £5 billion. Moreover, in the autumn of 2014, a referendum will be held to ask the Scots whether or not they want to become independent. And even if Scots reject independence, as polls indicate they might, there are strong reasons for believing that the powers of the Scottish parliament, in particular its taxation and borrowing powers, will still be significantly strengthened in coming years.

This is because the UK government and other parties committed to the union look set to offer Scotland more powers should Scots decide to remain part of the UK – this scenario is what is known as 'devo-max' or 'devo-more'.[1] Indeed, both Scottish Labour and the Scottish Liberal Democrats have each set up separate commissions to explore what further powers might be devolved to the Scottish parliament. For the Conservatives, both prime minister David Cameron and the Conservative party leader in Scotland, Ruth Davidson, have indicated support for a UK-wide constitutional convention (Davidson 2012, Johnson 2012).

The precise nature of Scotland's future relationship with the United Kingdom will emerge over the course of the next few years. Our concern in this short report is not to take a view on whether or not the Scottish people should or will opt for independence or devo-max – that is a decision that is rightfully theirs to take. Rather, we seek to illuminate a more neglected aspect of this debate by assessing the implications of either an independent Scotland or a fiscally stronger Scottish parliament for the north of England, and the north-east of England in particular. Voices in the north of England, especially in the political and business communities, have begun to express serious concerns about how they believe greater powers would give Scotland a competitive advantage over the northern economy. In particular, they worry about the consequences for their economies of moves by a fiscally autonomous Scotland to cut taxes in order to encourage investment and business north of the border (see for example Hennesy 2012 and Lord Shipley in *The Journal*, 20 March 2012, quoted below). We will consider the extent to which these fears are justified by looking at the potential a more powerful Scotland might have to engage in aggressive tax competition.

We also briefly explore whether political and constitutional change in Scotland provides an opportunity for the north of England itself to argue for greater autonomy from the UK government in Westminster. Previous work by IPPR North has highlighted the extent to which the UK government over-privileges the south east of England: indeed, it may well be that the biggest threat to the north of England comes not from Scotland but from a centralised system of Westminster government that fails to respond adequately to the interests of the north (Cox and Schmuecker 2011, NEFC 2012 forthcoming). Following the recent failure of directly elected mayors – coming almost a decade on from the failure of elected regional government – the north of England will need to champion a feasible, deliverable form of decentralised government if it is to seize the opportunity presented by developments in Scotland.

1 Both of these scenarios are yet to be clearly defined; nonetheless we distinguish here between a continuing evolution of devolved powers to the Scottish parliament (devo-more) and a more radical and far-reaching devolution of powers which would deliver more-or-less full fiscal autonomy (devo-max). This is discussed further in section 4).

This report is divided into five sections:

- Section 2 outlines the concerns that are beginning to be articulated in the north of England about the prospect of a more autonomous or independent Scotland.
- Section 3 considers the relative position of Scotland and the North as things currently stand, comparing their economic positions and the level of powers available to each to shape their own futures.
- Section 4 outlines Scotland's constitutional trajectory, including the prospects for both independence and some form of 'devo-max'.
- Section 5 asks what the implications of a more fiscally autonomous Scotland might be for the north of England.
- Section 6 sets out some proposals for how the north of England can manage the potential risks posed by a more fiscally autonomous Scotland, including a new agenda for decentralisation within England.

2. FEAR IN THE NORTH?

The north of England, and the north east in particular, has worried on and off over the years about the consequences of a more powerful Scotland for its own political and economic position. Back in 1977, MPs from the north-east led an English backlash against the Scotland and Wales Bill in the House of Commons because they believed a devolved parliament in Edinburgh would give Scotland an unfair advantage over the North (McLean and McMillan 2005).[2] There has also been a long running sense – with much justification – that Scotland is over-generously funded (McLean et al 2008).

As Scotland debates its next constitutional move, concern is again growing in the north. Lord Shipley, the former leader of Newcastle City Council, has argued:

> **'[Scottish independence] represents a real threat to the region … if Scotland gets tax powers … and offers lower corporation tax. It could mean firms leave the region to move north of the border.'**
>
> Cited in the *Journal*, 20 March 2012

Such statements have been spurred not only by political developments and activity north of the border but also by a number of recent events that have seen inward investors choose Scottish locations over north-eastern ones – such as the renewables manufacturer Gamesa choosing Leith over Hartlepool, and Amazon choosing Edinburgh over North Tyneside. What is notable about these decisions is that they occurred as a result of the powers *currently* available to the Scottish parliament. In the case of Amazon, Scottish Enterprise's offer of a £1.8 million incentive – in the form of a grant to cover the training costs for new staff – no doubt influenced the final decision.

This in itself tells us something about the relative position of Scotland and the northern regions. Whereas Scotland has Scottish Enterprise to establish an economic development strategy and promote Scotland to inward investors, the roughly equivalent bodies in England –the regional development agencies, or RDAs – have been abolished by the current government. The point here is not to mount a defence of RDAs (their record at delivering for their regions was somewhat patchy) but simply to point out that northern regions currently lack an equivalent institutional vehicle for economic development. The newly established local enterprise partnerships are small, weak and under-resourced by comparison. They are intended as facilitators of collaboration and partnership rather than deliverers of economic development programmes. These institutional changes have coincided with a re-centralisation of many economic development functions – including inward investment – and the prospect of a national industrial strategy that focuses on investing where the greatest and most immediate return can be found, a principle that has not served the North well in the past.

If this is the advantage Scotland already has, some stakeholders in the North are beginning to ask what the implications of an independent or more autonomous Scotland might be. Concerns focus on a powerful neighbour that is able to cut taxes and drive damaging tax competition. Concern focuses particularly on major business taxes like corporation tax, which the SNP have said they would cut, should they have the power to do so.

2 The rebels voted down a timetable resolution that killed the bill. Jim Callaghan's government subsequently reintroduced two separate bills, one each for Scotland and Wales; these were enacted, but were defeated in referendums. In Scotland the critical factor was the imposition of referendum vote threshold whereby 40 per cent of the eligible electorate had to vote 'yes' for the vote to count. Despite there being a small majority in favour of devolution, this threshold was not met and so the vote fell. In Wales there was a large 'no' vote.

Furthermore, it is not simply the devolution of major tax levers like corporation tax that concerns people, but also smaller, seemingly less significant mechanisms. For example, Newcastle Airport has been quick to argue that devolving air passenger duty, and thereby allowing Scotland to lower or even abolish it, could damage prospects for international connections from Newcastle. Due to the proximity of Edinburgh airport, it is relatively easy for passengers to take their business north of the border if it is worth the time and cost of additional connecting travel to do so. The fear is that airlines will then follow, undermining the viability of airports like Newcastle and Durham Tees Valley.

The SNP – for understandable reasons – begs to differ. By contrast, the party believes Scottish independence would be *beneficial* for the north of England. Fiona Hyslop, Scottish external affairs minister, has told northern business leaders that independence would create a Scotland able to act as a 'beacon for progressive, social and economic change' in the north east and elsewhere. She added:

> **'The incredibly lopsided nature of the current UK economy affects both Scotland and the regions of England. The dominance of London and the south east skews UK government priorities to an extent which is deeply damaging to other regions.'**
> Hyslop 2012

She cited HS2 proposals as an example:

> **'A UK high-speed rail network that stretches less than a third of the way up the British mainland is extremely unsatisfactory. Many in Scotland and the north of England can clearly see the benefits of high-speed rail to their economies but are hugely concerned that their connection to that network could be more than a generation away.'**
> ibid

This paper attempts to get some perspective on these concerns, fears and opportunities. But before we do this, the next section briefly considers the relative positions of Scotland and the North as things currently stand, comparing their economic positions and the level of powers available to each to shape its own future.

3. COMPARING SCOTLAND AND THE NORTH OF ENGLAND

There is not a level playing field between Scotland and the north, with the Scottish parliament in possession of considerable powers to shape its social and economic destiny. In some ways this is far from surprising – Scotland is, after all, a nation. However, the disparities between these two parts of the UK are already sharp, and look set to grow.

Most economic indicators find Scotland to be a more prosperous place than the north of England. While the three northern regions of England – the North East, the North West and Yorkshire and the Humber – lag behind UK averages considerably, Scotland tends to be at or just below average on most indicators.

Table 3.1 provides a snapshot of a number of economic indicators. Compared to the north, Scotland has a higher employment rate, lower unemployment, and fewer economically inactive people. It is worth stressing that these figures conceal significant variation within the three categories. The 'north' comprises the three northern regions but, if broken down further, you would see that the North East lags even further behind Scotland. Equally, if we looked at the Greater South East then the gap between this part of the UK, on one hand, and Scotland and the North on the other would widen significantly.

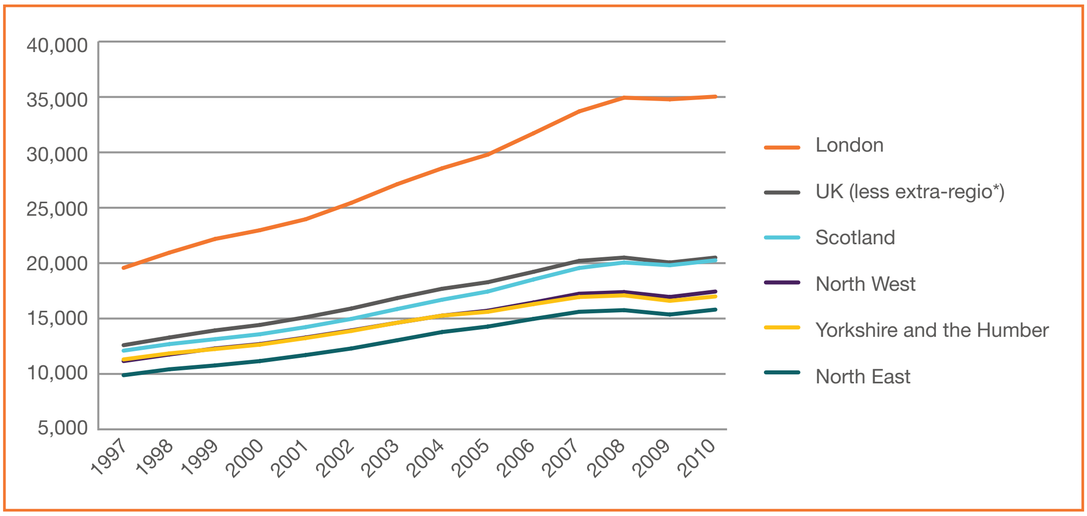
Table 3.1
Scotland and the North – key indicators

	Scotland	North	UK
Total population	5,222,100	14,843,600	62,262,000
Employment rate, 16–24 year olds	53.7	48.1	49.4
Employment rate, 16–64 year olds	70.9	67.7	70.2
Unemployment rate, 16–64 year olds	8.1	9.8	8.2
Economic inactivity rate, 16–64 year olds	22.9	24.9	23.5

Source: Annual Population Survey' (July 2011–June 2012) and 'Mid-year Population Estimates (2010) accessed via Nomis

This pattern is replicated in terms of economic output of the two areas. Figure 3.1 compares the gross value added (GVA) per head of the three northern regions individually with that of Scotland, London and the UK as a whole.

Figure 3.1
GVA per head (£, less extra-regio)



* Activities on the continental shelf are not classified as occurring in any particular nation or region of the UK, but are counted as being 'extra-regio' in official statistics. Attributing a share of this GVA to Scotland has the effect of increasing Scotland's GVA.

It shows that Scottish GVA matches almost exactly the UK average (and has done for a number of years now). By contrast, all three northern regions have GVA rates below the Scottish and UK average level – and indeed, the gap between them has grown over time. However, more striking is the gulf between London and the rest of the UK.

Despite this difference in overall economic performance, the northern and Scottish economies arguably have more in common with one another than they do with the Greater South East. Table 3.2 shows the proportion of people in employment employed in different sectors. Both Scotland and the North have more people employed in the public sector, distribution, hotels and restaurants and manufacturing compared to the Greater South East, where much of the employment is in banking, finance and insurance.

Table 3.2
Sectoral employment, 2011/12 (% of all employment)

	Greater South East	North	Scotland
Agriculture and fishing	0%	1%	2%
Energy and water	1%	2%	3%
Manufacturing	6%	12%	8%
Construction	7%	7%	7%
Distribution, hotels and restaurants	16%	20%	19%
Transport and communications	11%	8%	8%
Banking, finance and insurance	21%	14%	15%
Public administration, education and health	29%	32%	31%
Other services	7%	5%	6%

Source: 'Annual Population Survey' (April 2011–March 2012), accessed via Nomis

While useful in allowing us to compare the relative position of Scotland and the north of England, this data does not, of course, tell us whether Scotland's economic edge has anything to do with the devolution settlement that it enjoys. The GVA figures presented in figure 3.1 suggest Scotland was already performing at or near a UK-average level when the Scottish parliament was created, and there was no obvious 'devolution dividend', as economic output was growing steeply in all parts of the UK at that time. However, it is important to note that Scotland's ability to create an economic development strategy tailored to its needs precedes devolution, dating back at least as far as the creation of the Scottish Development Agency in 1975. This is important, as evidence from the OECD demonstrates the importance of institutional stability for economic development (OECD 2012). This gives Scotland a clear advantage over the English regions, which have seen economic development institutions and approaches change with nearly every government in recent decades (Schmuecker 2012, Tomaney et al 2012). While Scotland's ability to influence economic outcomes are not all-encompassing – its taxation and borrowing powers are limited – a further important point to note is that the creation of a Scottish parliament has provided Scotland with a powerful and vocal champion for its economic interests on a national and international stage.

There is one further area where Scotland has an advantage over the north of England: money. It's possible to argue about whether or not per-capita spending in Scotland has delivered better outcomes for Scots, but there is no question that Scotland has been the recipient of a greater share of public spending for many decades. Table 3.3 shows the total amount of identifiable public spending[3] that goes to each part of the UK, excluding social protection.[4]

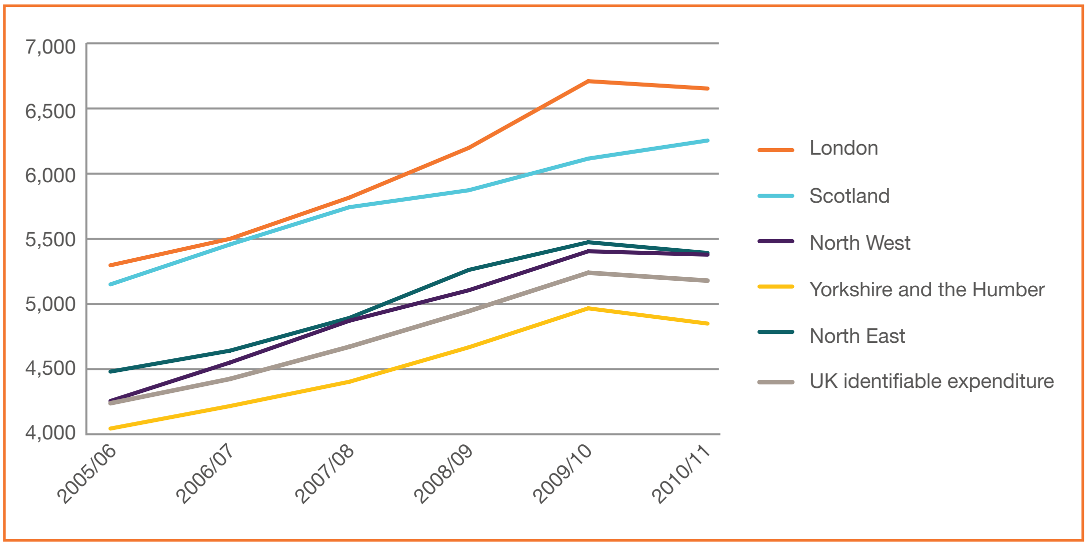
Table 3.3
Total identifiable public spending per head, excluding social protection, 2010/11

Northern Ireland	£6,277	Yorkshire and the Humber	£4,841
London	£6,647	West Midlands	£4,829
Scotland	£6,247	East Midlands	£4,498
Wales	£5,654	South West	£4,471
North East	£5,385	South East	£4,310
North West	£5,369	East	£4,372
England	£5,001	**UK**	**£5,173**

Source: HM Treasury, Public Expenditure Statistical Analyses (PESA)

And while all parts of the UK saw public spending increase substantially during the 2000s, the overall pattern of spending has remained relatively unaltered. A large element of the spending in Scotland (and Wales and Northern Ireland) is decided through the Barnett formula, which is used to calculate the size of the block grant that goes to those nations. Analyses have found the level of public expenditure received by Scotland (and indeed London) does not correspond to objective measures of need (see for example McLean et al 2008, ICFFW 2010).

Figure 3.2
Public spending in the UK, Scotland and the North, 2005/06–2010/11 (£ per head)



Source: HM Treasury, Public Expenditure Statistical Analyses (PESA)

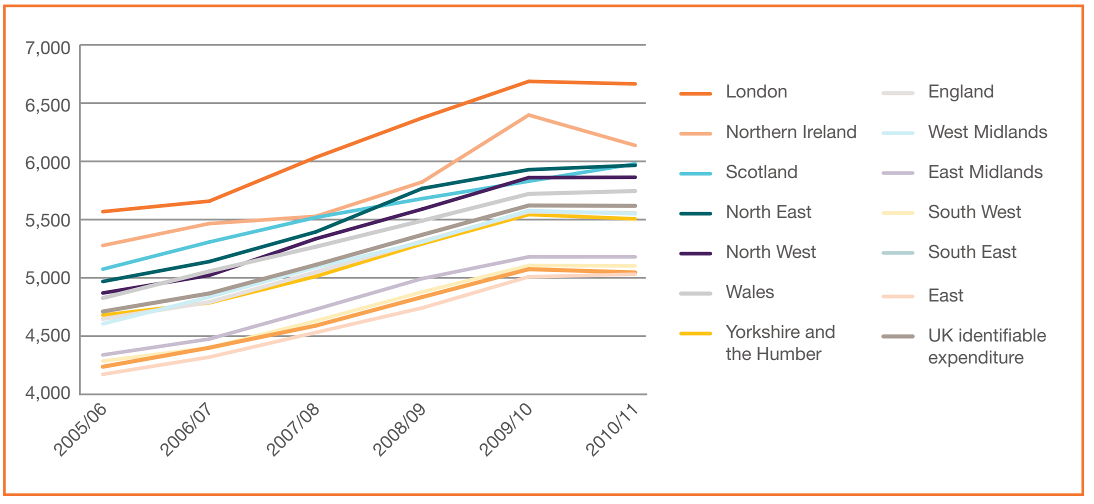
Looking at these figures in more detail to see how much is spent in different areas of government activity finds slightly differing patterns. Figure 3.3 looks at spending on the main public services (health, education and public safety). Here, spending per head is highest in London and Northern Ireland, although it should be noted that in both of these

3 HM Treasury divides spending into that which is identifiable and unidentifiable, that is, whether or not it can be identified as benefitting a particular area of the country, or whether it is for the benefit of the UK as a whole (such as most defence spending). The vast majority of spending (about 83 per cent) is identifiable.

4 'Social protection' refers to pensions and benefits; we exclude this spending as it is driven by need rather than government spending decisions as such.

places it is spending on public order and safety that drives the total per head to levels that are so much higher than in other nations and regions, for obvious reasons. After these two places, spending per head broadly follows a pattern of levels of social need, with areas where social needs are higher receiving more.

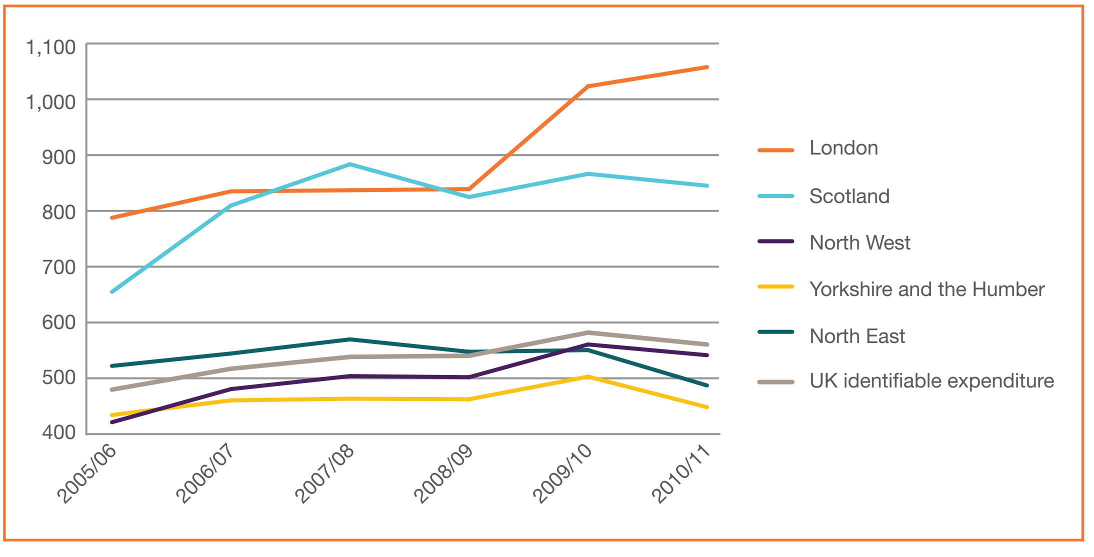
Figure 3.3
Spending on major services: health, education and public safety (£ per head)



Source: HM Treasury, Public Expenditure Statistical Analyses (PESA)

Perhaps more relevant for our purposes is how much is spent on what might be loosely termed 'economic affairs', by which we mean enterprise and economic development, science and technology, employment policies and transport spending (see figure 3.4). London and Scotland are the clear outliers here, with considerably higher spending per head in this area. This is despite these two areas having among the highest economic output, as the GVA figures showed (above in figure 3.1). This continual disproportionate investment in these areas serves to reinforce the same unbalanced patterns of economic performance.

Figure 3.4
Spending on economic affairs: enterprise, development, science, technology, employment policies and transport (£ per head)



Source: HM Treasury, Public Expenditure Statistical Analyses (PESA)

Indeed, looking at the data underlying figure 3.4 reveals that it is in transport and in science and technology where per-capita spending is particularly high in London and Scotland, as table 3.4 shows. Both science and technology and transport spending are key means of investing in future economic growth, improving the connectivity between areas and preparing the ground for future growth. Some of this current spending in London is due to additional investments linked to the Olympic and Paralympic Games; nonetheless, London has had the highest per-capita transport spend for many years. In the case of Scotland, transport is a predominantly devolved area, and sustained high levels of spending reflect decisions taken by Scottish governments to invest in transport – and, of course, the additional costs associated with the sparseness of some parts of Scotland.

Table 3.4
Spending on transport and science and technology, 2010/11 (£ per head)

	Transport	Science and technology
London	842	70
Scotland	540	70
Wales	367	37
Northern Ireland	362	40
UK	358	47
England	339	45
North West	334	38
Yorkshire and the Humber	264	38
East	247	56
West Midlands	244	31
North East	239	42
South East	231	47
East Midlands	218	39
South West	199	32

Source: HM Treasury, Public Expenditure Statistical Analyses (PESA)

It is high levels of spending on what might be considered more traditional activities linked to economic development and enterprise that pushes up per-capita economic investment in Wales and Northern Ireland. Within this total amount, for example, both devolved administrations were spending over £200 per head on enterprise and economic development in 2010/11, around twice what is spent on these policies in the North East, North West and Yorkshire and the Humber.

In short, there is a far-from-level playing field between the North and Scotland. Scotland has more tools at its disposal to develop its economy and is in receipt of more public money, despite being, overall, a more economically prosperous place than the North. Furthermore, it is not only Scotland that benefits disproportionately from the current arrangements: London too, with its high levels of public expenditure, prosperous economy and elected mayor to argue its corner in Whitehall, has a clear advantage over the north of England. What is more, the gap between the North and Scotland in terms of the institutional levers available is set to widen substantially over the next few years, as the next section explores.

4. CONSTITUTIONAL SCENARIOS FOR SCOTLAND

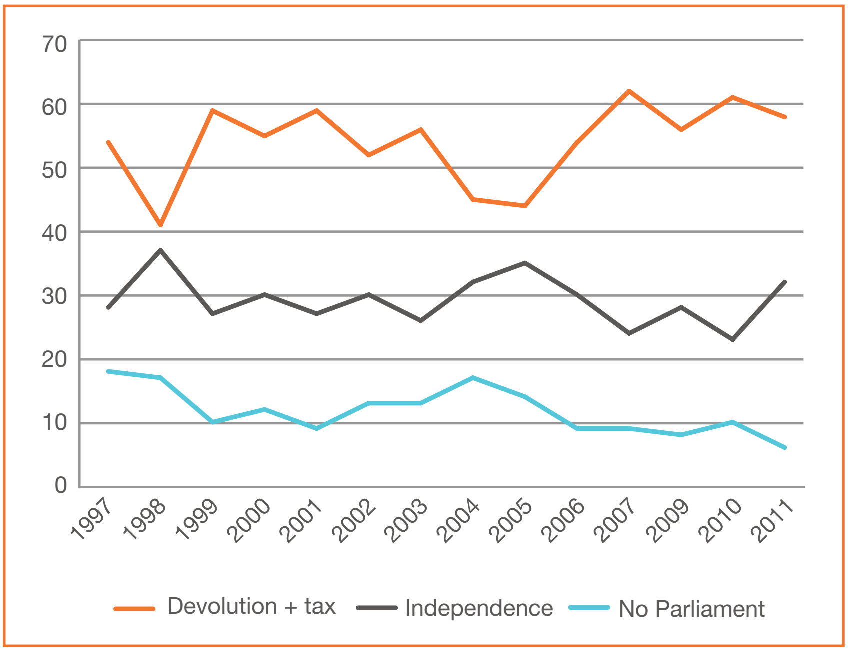
The debate over Scotland's constitutional future is highly contested and rapidly evolving. Nonetheless, there are some things we can say with some confidence about how things might pan out over the next few years.

The election of an SNP majority government in Scotland in May 2011 set in train a referendum to determine Scotland's constitutional future, to take place in autumn 2014. A deal has been done between the UK and Scottish governments whereby the Scottish people will presented with a straight yes/no choice on independence.[5] At the same time, the franchise will be extended to 16 and 17-year-olds for purposes of this referendum.

However, looking back over opinion polls (see figure 4.1), around a third of voters have consistently supported independence for Scotland. Overall, voters are generally more supportive of strengthening the powers of the Scottish parliament than they are of independence (portrayed as 'devolution + tax' in the graph). In recognition of this, the main unionist parties are saying that they will consider strengthening the powers of the Scottish parliament should Scots decide to remain a part of the UK. In other words, the UK government may try and encourage a 'no' vote with the promise of additional powers at a later stage. UK prime minister David Cameron outlined this position in a speech in Edinburgh in February 2012 when he said:

> **'[The Scotland Bill] doesn't have to be the end of the road. When the referendum on independence is over, I am open to looking at how the devolved settlement can be improved further. And yes, that means considering what further powers could be devolved. But that must be a question for after the referendum, when Scotland has made its choice about the fundamental question of independence.'**
> Cameron 2012

Figure 4.1
What Scots say they want: constitutional preferences, 1997–2010



5 There had been discussion of a multi-option referendum whereby voters are also presented with the option of 'devo-max' in addition to independence and the status quo.

This outcome is often referred to as 'devolution-max' or 'devolution-more' for Scotland. Whether it is 'max' or 'more' depends on the level of tax devolution involved. On a more radical interpretation of this option – such as that advocated by the Scottish government (Scottish Government 2009) – the Scottish parliament would become responsible for all of Scotland's domestic affairs, including for most taxes levied in Scotland, leaving control over financial regulation, the currency and monetary policy, defence and foreign affairs reserved at Westminster. In this scenario, Scotland would be almost fully fiscally autonomous: the Scottish parliament would be responsible for raising its own revenue for almost all domestic policy. As a less radical option, 'devolution-more' would involve more limited tax devolution than devo-max but would nonetheless see Scotland's fiscal power considerably enhanced from the current position (see table 4.1 which sketches out some possible variations).

However, the most important point to make is that despite its supposed popularity, the more powers option – be it 'devo-max' or 'devo-more' – remains undefined. To date, no 'settled will' has emerged around what such a settlement would look like in practice.

The SNP insists it is not their job to define a workable model for a proposal they themselves consider to be 'second-best'. Others, however, are making a start on this task.[6] The Scottish Liberal Democrats have set out plans for a more fiscally autonomous Scottish parliament that is responsible for raising two-thirds of its budget (Scottish Liberal Democrats 2012). Scottish Labour has announced its own commission under new Scottish leader Johanna Lamont, although they remain some way from developing their alternative offer for Scotland. And while Cameron has stated his willingness to look again at the powers available to the Scottish parliament, no further detail has been forthcoming. There are, however, signals that the Conservatives are considering the establishment of a UK 'constitutional convention' to look at further devolution to Scotland in the context of a workable settlement for all parts of the UK. Ruth Davidson, leader of the Scottish Conservatives, told a House of Commons select committee that:

> **'[A]ny convention or commission must look at the whole of the UK, rather than the distribution of powers between one territory's decision-making body and the UK Government, as has been the template in the past.'**
> Davidson 2012

Even if such a convention is established, should the Scots reject independence, any extension of the fiscal powers of the Scottish parliament would ultimately have to be negotiated between the Scottish and UK governments. It is likely then that the 2015 general election would become a platform for these competing visions for Scotland.

In this report, we do not propose to try to second-guess the outcome of such negotiations beyond suggesting that, in over-simplified terms, there are four main taxes that are of interest: personal income tax, VAT, national insurance contributions and corporation tax. Together these taxes account for approximately two-thirds of Scotland's tax receipts, according to the latest figures from the Government Expenditure and Revenue Scotland (GERS) dataset. VAT cannot be devolved within EU rules, which effectively rules this out of the negotiation. Further devolution of personal income tax is likely to feature, as the principle of a separate Scottish income tax has already been conceded following the Scotland Act 2012. Less clear is what might happen in relation to national insurance,

6 As well as the party political initiatives described here, Reform Scotland has set up the 'Devo-Plus' group, and IPPR is undertaking a project to consider what devo-max and devo-more might look like.

which is widely regarded as the payment mechanism for the welfare state (although in practice it is not this simple), leading some to argue that it should remain a UK-wide tax (Scottish Liberal Democrats 2012). This is likely to be an area for negotiation.

The biggest fight, however, is likely to be around the question of devolving corporation tax.

The UK government appears reluctant to devolve corporation tax for fear of introducing damaging tax competition between different parts of the UK – this is more of a concern with corporation tax compared to income tax as capital is more mobile than people. The SNP, however, wants control over corporation tax because it aspires to cut the rate, a move they believe will stimulate economic growth. And while there are ongoing negotiations about devolving corporation tax to Northern Ireland, these talks with the Treasury seem to have run into the sand – no doubt due, in part, to the possible implications for the debate about Scotland.

There may, however, be more appetite for further devolution of income tax. Indeed, a number of stories have emerged in the press that were briefed from the UK government, suggesting that it might be prepared to hand over income tax in full (which raised 23.5 per cent of Scottish revenue in 2010/11 – the single biggest source of tax revenue in Scotland) in return for retaining control of corporation tax at the UK level (see Nelson 2012).

The table below tries to sketch out in very broad terms the different constitutional options for Scotland.

Table 4.1
Constitutional options for Scotland and possible descriptions

Scotland Act 2012 & Scotland Act 1999	Responsible for public services but not welfare state (such as health and education) but not social security (40 per cent of identifiable Scottish spend). Controls 60 per cent of identifiable Scottish spend and significant autonomy over how it is spent. Scottish income tax: Scottish parliament will now raise 30 per cent of Scottish parliament revenue (up from 6 per cent under the Scotland Act 1999). Stamp duty and landfill tax devolved from 2015.
Devolution-plus	Extensive tax devolution: options include devolving control over all of income tax; corporation tax? Assigning some of VAT? Taxes to be reserved at UK level: NICs. Under this model Scotland would be responsible for raising around 60 per cent of Scottish parliament revenue. Implications for block grant?
Devolution-max	Scotland would be fiscally autonomous: raising close to 100 per cent of Scottish revenue (within some limits: for instance, VAT cannot be devolved under EU rules). Scotland would pay a grant to the UK government to cover shared services.
Independence	Independent state. Possible currency union.

Without doubt, there remains a great deal of uncertainty regarding the future of Scotland. One thing that *is* clear is that a fierce negotiation is still to take place between the Scottish and UK governments. There is an opportunity here for northern leaders to seek to influence this process, to try to ensure developments in Scotland do not place the North at an undue disadvantage. Achieving this requires those of us interested in the future of the North to make an assessment of what Scotland might be able to do with enhanced fiscal powers, and to make sense of a complex evidence base on the likely impact of any changes in tax competition. This is the subject of the next section.

5. THE IMPLICATIONS FOR THE NORTH OF ENGLAND OF A MORE FISCALLY AUTONOMOUS SCOTLAND

For the sake of the remainder of the paper, let us assume that Scotland becomes significantly more fiscally autonomous: that the Scottish parliament acquires full control over personal income tax and full control over corporation tax, alongside additional borrowing powers and control over a number of smaller taxes. This could occur under either a devo-max scenario or independence. In this world, is Lord Shipley right to raise concerns about the implications for the North?

To address this question we need to consider the following:

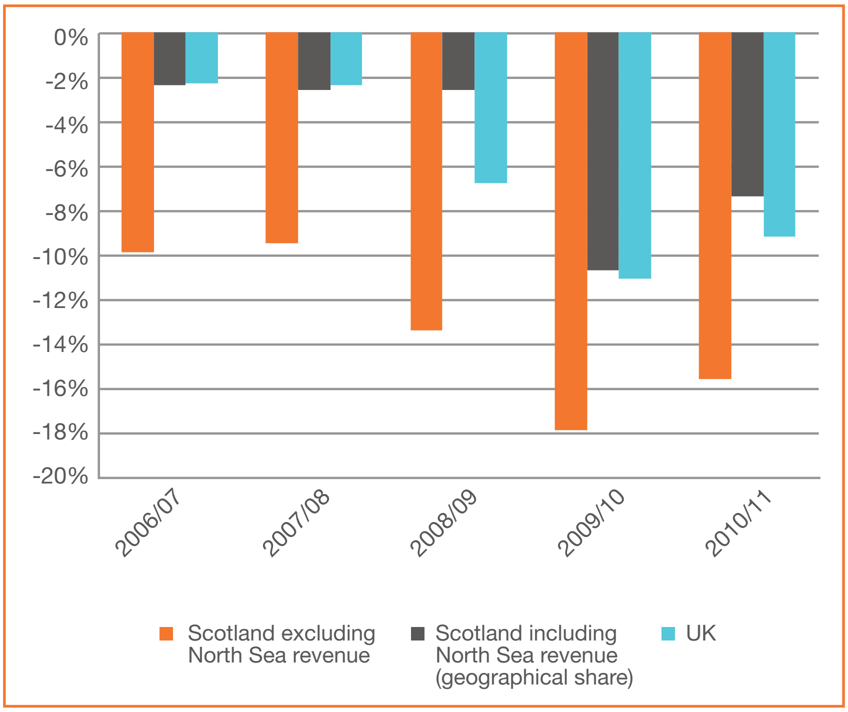
- Scotland's current fiscal position and whether it is likely to be able to engage in aggressive tax competition
- comparative evidence from other countries on tax competition both between and within states.

Scotland's fiscal position

Enhanced decision-making powers will only potentially have an impact if there is the willingness and ability to use them. If Scotland held greater taxation powers, and wished to cut tax rates, it would have to be able to offset the loss of revenue in the short term at least. This begs the question of whether Scotland is in a fiscal position that would enable it to do this.

Figure 5.1 profiles Scotland's net fiscal position since 2006/07. It shows that Scotland has been running a deficit in all of these years *even if we include revenue from North Sea oil.*[7]

Figure 5.1
Scotland's net fiscal position, with and without North Sea oil



Source: Government Expenditure and Revenue Scotland (GERS) 2010/11

7 Whether or not revenue from North Sea oil is factored into these calculations makes a significant difference to Scotland's fiscal position. Two methods of allocating this revenue are commonly used. The first is a straightforward per-capita allocation; the second is known as the geographical share. The latter draws on academic research to estimate how much revenue would belong to Scotland based on an assessment of Scotland's geographical share of the North Sea and an estimation of where, geographically, revenue is raised. We use the geographical share figures in this paper.

However, in the earlier years, the Scottish deficit was similar in scale to the UK's. The implications of this are clear: should an independent or fiscally autonomous Scotland wish to maintain its current tax and spend policy then, in the current context, it would run a 7.4 per cent budget deficit. Under an independence scenario, Scotland would presumably also inherit part of the UK's national debt, further increasing this deficit. In other words, should a more powerful Scotland wish to cut either income tax or corporation tax then the Scottish government would need to either cut spending, raise taxes elsewhere or borrow more.

Of course it may be, as the SNP argues, that a cut in taxes would spur economic activity and thus boost overall tax receipts, allowing the Scottish government to both maintain current levels of spending and reduce taxes. However, this relies on rather optimistic Laffer curve assumptions that have not been evidenced in other places (Bell 2012). Indeed, while we might argue about whether such growth might follow over time, in the current global economic climate it seems reasonable to suggest that, in the short term at least, Scotland's current fiscal position is likely to limit the government's room for manoeuvre.

If we take out Scotland's geographical share of North Sea oil then her budget deficit for 2010/11 shoots up to 14.7 per cent. This illustrates just how important oil receipts are to Scotland's overall fiscal position. But as others (IEG 2008, Zuleeg 2008) have pointed out, there are some significant challenges associated with a dependence on oil revenues. The first, as table 5.1 demonstrates, is that oil revenue is a highly volatile source. The second, illustrated in figure 5.2, is that oil is finite.

Table 5.1
Total North Sea revenue, UK, 1980/81–2010/11, in real terms (£m 2011)

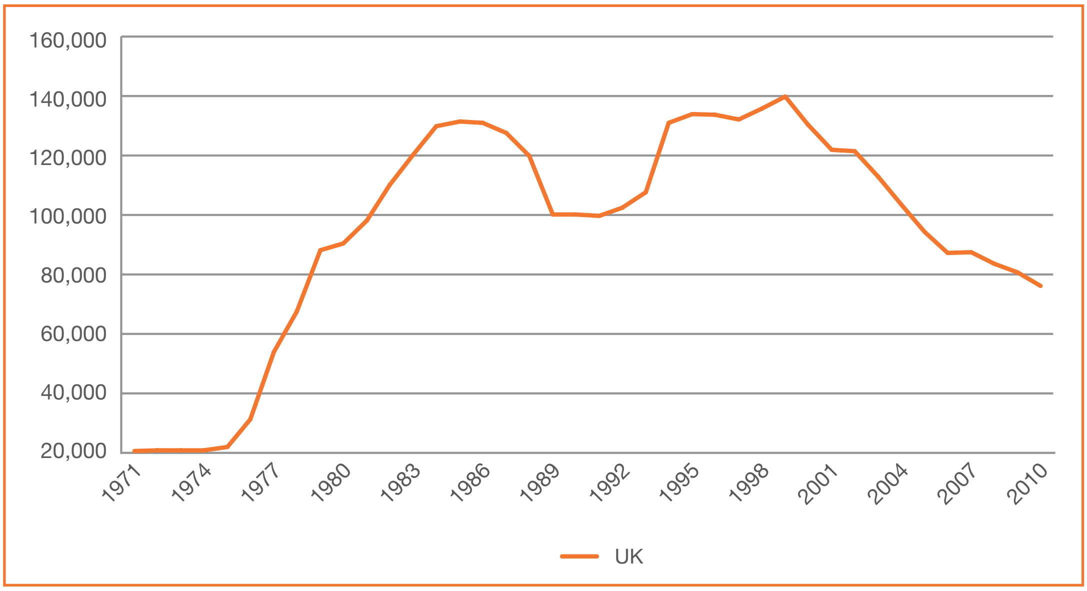
1980/81	12,616	1988/89	6,835	1996/97	4,957	2004/05	6,234
1981/82	18,654	1989/90	4,810	1997/98	4,754	2005/06	11,042
1982/83	21,780	1990/91	4,118	1998/99	3,489	2006/07	10,055
1983/84	23,098	1991/92	1,712	1999/00	3,500	2007/08	8,083
1984/85	30,971	1992/93	2,195	2000/01	5,909	2008/09	13,866
1985/86	26,687	1993/94	2,038	2001/02	7,147	2009/10	6,801
1986/87	10,780	1994/95	2,617	2002/03	6,522	2010/11	8,786
1987/88	10,471	1995/96	3,548	2003/04	5,332		

Source: GERS 2010/11; RPI from the Office for National Statistics; McLean calculations[8]

Table 5.1 shows that continental shelf revenue plummeted, beginning in 1986 and reaching a nadir in 1991/92, when the benchmark price reached a trough of US$23.25 in present-day money. When the oil price is low, high-cost production areas such as the North Sea reduce their production in favour of fields where oil can still be profitably extracted. In the most recent years for which data is available, oil and gas revenue recovered at the recent peak in oil prices, but to less than half, in real terms, of the revenue received annually between 1984 and 1986. As the oil price drops, so does the tax yield from the North Sea. Of course it is difficult to know what will happen in the future: prices could rise in response to world economic and political events, or they might fall. But the two points made above seem consistent: oil revenue is volatile and production is falling relative to the historic highs of previous decades.

8 Table 5.1 shows government tax receipts from the UK continental shelf since 1980. The numbers, which GERS presents in current money, have been rebased to show receipts in real terms, expressed in 2011 pounds.

Figure 5.2
UK oil and gas production, 1971–2010



Source: Bell 2012

The reason that this evidence on Scotland's fiscal position matters is because it helps us to understand the context in which a more fiscally autonomous Scotland will find itself. The clear message from this analysis is that, initially at least, should Scotland decide to significantly cut taxes, then it would face considerable fiscal pressures and would need to either cut spending sharply, raise taxes elsewhere or borrow – and in the current economic context there would be severe constraints on additional borrowing.

We can illustrate these pressures by looking at the example of corporation tax. The SNP aspires to cut the rate of corporation tax so it is 'significantly below the UK level' (Scottish Government 2007). Salmond has often spoken admiringly of the Irish example, citing Ireland as part of an 'arc of prosperity' around Scotland, along with Iceland, Norway, Finland and Denmark. Speaking to the Northern Irish assembly in 2007 he said:

> **'The remarkable transformation of the Irish economy in the past decade is well documented, and serves as an inspiration for Scotland, but there are others worth examining – whether it be Iceland, Norway, Finland or Denmark in that arc of prosperity around Scotland. Scotland's government believes very strongly that, with measures such as low competitive tax, we can match or even exceed that level of success.'**
> Salmond 2007

In Ireland, the headline rate of corporation tax was reduced in stages from 32 per cent in 1998 to 12.5 per cent in 2003. A number of prominent business leaders, such as Sir Tom Hunter and Jim McColl, have been vocal in arguing for Scottish corporation tax to be cut to between 12.5 per cent and 15 per cent (Smith 2011). The SNP, however, is committed to reducing the rate to 20 per cent, should the Scottish parliament gain the power to do so. (The UK headline rate of corporation tax is currently 24 per cent, due to fall to 22 per cent by 2014).

Both sides of the independence debate have produced projections to quantify the impact of such cuts. The Scottish government has argued that reducing corporation tax to 20 per cent would increase Scotland's economic output by 1.4 per cent and result in the creation of 27,000 jobs (Scottish Government 2011), while work done for the Scotland Office by HMRC projects that a cut to 12.5 per cent would result in a net revenue loss to the Scottish Government of £2.6 billion (HMRC 2011).

We do not wish to get mired in this debate. However, in order to try to get some perspective on these arguments, we carried out some indicative calculations of how much Scottish GDP would need to increase by in order to offset the reduction in revenue that would result from a cut in corporation tax (at least in the short term). We calculated the impact of cuts to 12.5 per cent and to 20 per cent, both with and without the inclusion of revenue from North Sea oil and gas[9].

Table 5.2
Corporation tax cut scenarios: indicative calculations

		Corporation tax revenue in 2010/11 (£m)	Corporation tax revenue in 2010/11 with a lower tax rate (£m)	Difference (£m)	GDP growth required to make up the difference
Corporation tax cut to 12.5%	*excluding* offshore revenue	£3,114	£1,390	£1,724	4.0%
Corporation tax cut to 12.5%	*including* offshore revenue	£6,982	£3,117	£3,865	7.8%
Corporation tax cut to 20%	*excluding* offshore revenue	£3,114	£2,224	£890	2.0%
Corporation tax cut to 20%	*including* offshore revenue	£6,982	£4,987	£1,995	3.9%

These figures underline just how difficult it will be for Scotland to make sharp reductions to its corporation tax rates: the scale of GDP growth that would be required to make up the revenue gap is, under some scenarios, very large indeed. These calculations do not factor in the behaviour change that may result from changes in the corporation tax regime; nonetheless, achieving GDP growth of between 4 per cent and 8 per cent would be an extremely tough ask, especially in the current economic climate.

Furthermore, should Scotland wish to emulate the Irish corporation tax rate, the context for Scotland is different to that which Ireland faced in the late 1990s. First, Scotland has a far more generous welfare state than Ireland, resulting in a higher public spending-to-GDP

9 To produce these indicative calculations we used data from GERS 2010/11 on corporation tax revenue, and calculated how much revenue would have been 'lost' to Scotland had the corporation tax rate been lower (the headline corporation tax rate for that year was 28 per cent). We then calculated by how much GDP would need to grow in order to make up the difference.

An important caveat here is that we have assumed that all pay the headline rate of corporation tax, and do not factor in the lower rate for small businesses. These figures should be treated as indicative only.

For each tax cut scenario we repeated this calculation, first to exclude offshore revenue and then to include the 'geographical share' of North Sea revenue (see note 7). When calculating offshore revenue, we assumed that the main corporation tax rate is the same on- and off-shore but that the 20 per cent supplementary charge on the North Sea oil industry is maintained.

ratio. In 2006, public expenditure as a proportion of GDP in Ireland was 34 per cent; in Scotland, it was 44 per cent (assuming oil) in 2010/11, according to GERS. Scotland has considerably greater public spending commitments to keep up.

Second, the global economic context has changed dramatically since Ireland embarked on its programme of cutting business taxes. When Ireland cut its taxes the world economy was booming; today, the outlook could not be more different.

Third, the initial economic success of the 'Celtic tiger' was not simply a product of the cut in corporation tax. It also coincided with a huge increase in the Irish workforce, as women entered the labour market, and substantial levels of support via the EU structural funds. Given the expansion eastwards of the European Union – and the relative prosperity of Scotland – these would not be available to the same degree.

As the Independent Expert Group for the Calman Commission noted:

> **'We are not convinced that allowing the Scottish Parliament to determine a Scottish rate of Corporation Tax would produce harmful tax competition because the scope to vary the rate is, in effect, constrained.'**
> Calman Commission 2009: 94

These constraints would be even greater in the immediate future if Scotland were to vote in favour of independence. This is because of ambiguity over Scotland's membership of the EU and because Scotland's fiscal position, as a small, indebted European economy, would be under close scrutiny from the international capital markets and credit ratings agencies. It would be at pains to appear fiscally credible in order to finance its debts, especially given, as we have noted above, an independent Scotland would generally be in deficit, even with high oil prices.

Because of these constraints, some in the North consider devo-more or devo-max to be a greater threat than independence, as that would be regarded as giving Scotland the best of both worlds: the ability to cut taxes while still receiving a transfer of funds from the UK government. However, on closer inspection, this assumption is also found wanting, for two reasons.

First, the Scotland Act 2012 has already set a precedent that cautions against this conclusion. The act gives Scotland the power and responsibility to vary income tax rates by plus or minus 10 per cent, and this has been accompanied by an equivalent cut to the block grant. It is then up to the Scottish government if it wishes to make up the difference in full by emulating UK income tax policy or, alternatively, by having a lower or higher rate, which would deliver a corresponding increase or decrease in the overall size of the Scottish budget. Following this precedent, devolution of corporation tax would be accompanied by further cuts to the Scottish block grant – certainly an arrangement along these lines has been discussed with regard to devolving corporation tax to Northern Ireland.

Second, precedent set in European law also means devo-max would not be the best of both worlds. In 1999, the Portuguese Azores region cut corporation tax in order to boost economic development in the area. But the risk to the Azores was reduced by a budget mechanism whereby any loss of revenue to the region as a result of the tax cut was offset by the central Portuguese state. The European Commission challenged this decision on the grounds that it breached state aid rules.

As a result, the European Court of Justice has ruled that fiscal decentralisation has to meet three tests of 'sufficient autonomy':

1. The body taking the decision must have institutional autonomy – in other words, it was taken by a separate institution to the central state.
2. The body taking the decision must have procedural autonomy – it must be able to take the decision without the involvement of the central government.
3. The body taking the decision must bear the consequences of it – the effect of the decision cannot be offset by fiscal transfers from the central government.

Furthermore, under a fuller form of devo-max there would be no grant from the UK government: the Barnett formula would cease to function for Scotland. It is not clear at what point along the path of greater fiscal autonomy grant reform would kick in. However, it seems unlikely that public opinion south of the border would tolerate continuation of Barnett *and* greater tax devolution: the uproar from England may well prove too much for the UK government to ignore.

This is not to say that there are no dangers for the north of England in the prospect of a more powerful Scotland, not least because it is impossible to foresee the fiscal situation of an independent or autonomous Scottish government in the decades ahead. In the longer term, if Scotland was to bring its budget back into balance then aggressive tax cutting may become more of a threat. But it is clear from this analysis that, in the short to medium term at least, Scotland's ability to sharply cut taxes would be constrained under any scenario. In the short term, then, the North should perhaps be more concerned about less grand gestures than halving the rate of corporation tax.

To return to the example of air passenger duty (APD) raised earlier, Newcastle Airport has been quick to raise the question of whether Scotland's ability to alter APD might impact on the sustainability of neighbouring regional airports. To put this in perspective, on current rates of APD, if Scotland were to abolish the tax entirely, the saving on a flight of up to 2,000 miles would be between £24 and £26, depending on the class of ticket. The saving on a flight of between 2,001 and 4,000 miles (say to north Africa, western Russia or Turkey) would be between £65 and £130, depending on the class of ticket. Presumably, passengers would calculate whether this saving made it worth the additional time and cost of travelling to Edinburgh airport in order to fly abroad or for visitors to come to the north of England. However, as many airlines are run on tight margins, it may not require a great deal of passenger movement for some routes to become unviable. Furthermore, if English APD were to increase at some point in the future then the incentive in terms of ticket costs would grow, and the concern then is that where passengers go, airlines will follow.

It would seem that smaller, more affordable tax cuts (such as changes to APD or increasing capital allowances) and spending decisions (such as how much to invest in attracting inward investors) will be more plausible for Scotland to enact. And so it may be that these more targeted cuts and incentives actually prove concerning for the North, as they would help Scotland to gain a competitive advantage in key areas.

International evidence

The international literature on tax competition suggests that it is far from a simple question of 'who cuts wins'. This section reviews some of the international evidence on the impact of fiscal decentralisation, and considers the impact of lower taxes on neighbouring areas.

It looks at the measures federal countries have put in place to manage negative tax competition.

Looking at international trends in corporation tax setting behaviour, the general trend has been downwards. However, it should be noted that there is limited value in comparing the top-line tax rates, as it is actually the *effective* tax rate that matters – that is, the actual level of taxation once tax allowances and tax credits are factored in. But the quality of the data available to make such comparisons is limited, making it difficult to gain a clear picture of the effect of tax competition (Varney 2007).

Nonetheless, internationally there has been a movement towards tax harmonisation, with the OECD developing initiatives to end harmful tax competition and the development of an EU code of conduct (Griffith and Klemm 2004).

A number of studies find evidence of harmonising behaviour at the sub-national level (where tax variation is allowed), suggesting a recognition that, ultimately, an environment of aggressive tax competition is likely to make losers of us all. For example, Ladd's (1992) study of the US and Büttner's (1999) study of capital income tax rates in Germany both find evidence of neighbouring areas mimicking each other's rates.

Where variation does occur, the international evidence of its impact on neighbouring areas is mixed. For example, a study on the impact of variations in sales tax in the US found that a variation of 1 per cent in sales taxes resulted in a shift of between 1–6 per cent of purchases from higher to lower tax areas, suggesting a negative impact on neighbouring areas (Due and Mikesell 1994). Yet, a similar study in Canada found little evidence of sales taxes changing shopping behaviours in the Ottawa/Hull area in the 1970s, when the differential was 3 per cent (Dufour and Vaillancourt 1982). However, it should be noted that behaviour change in shopping habits in response to sales tax changes is not necessarily a good guide to the impact of variation in income or corporation taxes.

There is also conflicting evidence of the impact of variations in income tax on migration. For example, income tax levels can vary widely between Swiss cantons, and while some studies find no impact on migration, others – by the same authors, but using a different dataset – find evidence of income tax rates influencing the location choices of young people and high earners (ICFFW 2010). Studies of local income tax variation in Denmark also find no impact on people's location decisions (ibid).

Finally, the neighbouring US states of Vermont and New Hampshire offer an interesting case in point. These two states have dramatically different tax burdens (Vermont is in the top fifth of states, New Hampshire the bottom fifth, when ranked by their tax burden) yet there hasn't been an outpouring of businesses or individuals from one state to the other (ibid).

A key reason why no clear picture emerges from this international research is that tax is only one factor taken into consideration when companies and individuals make decisions. The Tiebout theory suggests that this is because it is not simply the level of taxation but the level of services received as a result of taxation that influences decisions. This would certainly seem to be backed by surveys with major corporations. For example, an Ernst and Young survey of the factors influencing location decisions found that transport and logistics infrastructure, labour costs, telecoms infrastructure, potential productivity increase and the legislative and regulatory environment all rank above tax levels in importance (see Varney 2007).

The evidence would seem to suggest that tax competition alone is unlikely to see an outpouring of north-east businesses into Scotland. However, if Scotland is able to maintain a good business environment and skills offer, reducing its tax rate may serve to make it a more attractive proposition to businesses looking to invest.

How do other countries manage tax competition?

In reality, countries that do allow tax variation use a range of measures to manage the adverse consequences of tax competition. This is particularly common in federal systems. This section briefly describes three different approaches used to manage tax competition within states (see IEG 2008).

Switzerland

The Swiss system is based on the very extensive autonomy of the cantons. Direct corporate taxes are exclusively cantonal and personal income taxes are predominantly cantonal. There is a small federal income tax; cantons retain the basic power to tax income and wealth, while local jurisdictions levy property taxes and a surcharge on cantonal direct taxes. As a result, there is some tax competition and variation both among cantons and among cities, and tax competition has proved stronger at local rather than cantonal level. Experience suggests taxation can be an important incentive in attracting labour.

The Swiss system is built on an acceptance of considerable differences between cantons. There is open acceptance of competition between areas offering different income and corporation tax rates. However, there are costs to this competition: the canton of Zug (which has one of the lowest corporation tax regimes) has many holding companies which are registered there but not necessarily trading there or employing many people in the area. The effect of this competition is to drive down tax rates and reduce the revenue available to spend on services. As a result, Switzerland has developed some rules to manage any 'race to the bottom'. A 1948 'code of conduct' was built upon in 2000, requiring the cantons to adhere to a degree of tax harmonisation of the cantonal tax base. These reforms were followed by a new equalisation programme enacted in 2008. This redistributes resources from high to low cost areas and aims to mitigate negative effects of tax competition.

Spain

In Spain, there is considerable variation in the powers of the 'foral' regimes – the Basque Country and Navarra – compared to the other provinces. They have a high degree of fiscal autonomy, with responsibility for income, wealth, inheritance and corporation taxes; they also have considerable spending responsibilities. To mitigate the risks associated with competition, national law stipulates that these regions shall maintain an overall tax burden equivalent to that in the rest of Spain. As a result, the Basque Country, for example, has a rate of corporation tax that is only 2 per cent below the Spanish average. This is in large part because of the way the constitutional court has interpreted 'equivalent tax burden', which has had the effect of constraining tax variation. There has, however, been larger variation in tax allowances and tax credits, which has served to increase complexity. Although the Basque government attributes part of its relative prosperity to its freedom to tax at its own rates, it attributes other factors as being more important: investment in the labour force, a friendly regulatory environment and so on.

Among the other regions of Spain – the 'autonomous communities' – there has been a shift over time to complement their considerable spending responsibilities with more fiscal responsibility. A combination of tax assignment and fiscal decentralisation now means these regions are responsible for raising around half of their own revenue. In 2002, the Financing of the Autonomous Regions Act extended the requirement to maintain a common tax burden to the autonomous communities.

Canada

The 10 provinces and three territories of Canada together are responsible for more tax collection than the federal government and have considerable autonomy to vary taxation. Nonetheless, with the exception of Quebec, there is harmonisation of personal income taxes. With regard to corporation tax, responsibility is shared between the provinces and the federal government. The federal basic rate (there are differences for small firms as well as sectoral variations) is 19.5 per cent; the provinces' rates vary from 10 per cent (in Alberta) to 16 per cent (Nova Scotia and Prince Edward Island). Although these variations between provinces have given rise to some observed profit-shifting by firms (as well as a degree of observed tax competition between provinces), it is mitigated by federal rules that require companies operating in different provinces to allocate their income to each place according to an agreed formula, based on the number of employees in each place. There is some concern about the degree of complexity in the Canadian system that results from these rules and the fact that there are 10 provinces levying differing rates of corporation tax, which is in some cases collected by provincial authorities.

These sorts of codes of conduct and rules about a common tax burden could provide a pointer for the UK. Certainly, should Scotland adopt devo-max then the UK government is likely to push for some sort of check on tax competition. Even under independence, the SNP says that it will stick with sterling, which may raise the possibility of negotiating some sort of fiscal pact or interstate tax agreement.

Similarly, the drive within the EU towards tax harmonisation could act as a political constraint on tax competition. Given there is some uncertainty surrounding the status of an independent Scotland and whether it would have to apply for membership of the EU, membership may have to be sought, in which case the EU could use its political influence through these negotiations to limit aggressive competition on tax.

Overall, it would seem tax competition could pose a problem for the North, although the general business environment matters as well as tax rates. Leaders in the north of England need to think about what they can do to create the conditions for business to flourish, and how they can manage the potential risks posed by a more autonomous Scotland. This is the subject of the final section.

6. NORTHERN IMPLICATIONS

Over the next two years the debate about Scotland's future will gather momentum. There are signs that it is beginning to register with leaders and stakeholders in the North, and this is crucial. Should the people of Scotland choose to become independent then that is their choice. But should they choose to remain in the UK – as opinion polls suggest they might –then any deal that is struck which devolves further powers, including tax-raising powers, has to be one that works not only for Scotland but for the rest of the UK too. This means any deal on further powers also has to work for the north of England. This is not to argue that the North should stand in the way of the ambitions of the people of Scotland, but rather that the North should learn from them, as we set out in this concluding section.

To date, the extent of the North's engagement with the idea of a more fiscally autonomous Scotland has been to raise concerns about the prospect of tax competition. This is an important debate, but there is a wider issue at stake here too. After the Greater South East, Scotland is already far ahead of the North on many economic development measures, yet the gap in the institutional levers that are open to Scotland and the northern regions to develop their economies looks set to widen profoundly. This is a key issue for the north.

This report argues that, in the current climate, Scotland would be constrained in what she could do, particularly in respect of engaging in aggressive tax competition. In particular, the likelihood of Scotland being able to slash corporation tax to 12.5 per cent – as some leading Scottish business figures argue it should – seems remote, in the short to medium term. Indicative calculations carried out for this paper indicate that GDP growth of approximately 8 per cent would be required to make up the lost revenue – a tall order, especially in the current economic climate. The SNP's commitment to a 20 per cent rate of corporation tax looks more achievable, although this will require GDP growth in the region of 4 per cent – still a risky proposition. Furthermore, Scotland is a complex society and deep tax cuts would weaken its tax base, and that is something that comes with consequences.

Nonetheless, while a sharp reduction in corporation tax may be far less likely than feared by some, a fiscally autonomous or independent Scotland will have the potential to muster other capabilities to complement a targeted industrial strategy. Instead of lowering taxes across the board in an attempt to attract business, Scotland may engage in tax incentives, subsidies, and provision of public inputs to specific firms. These typical regional development policy instruments are far less costly than a universal tax cut. Indeed, it may well be that this kind of approach should be of greater concern to northern leaders: an accumulation of well-chosen smaller incentives could help Scotland to outshine competition south of the border. Given the north's proximity to Scotland, it may be the small things – such as capital allowances or air passenger duty – that prove to be more significant.

Furthermore, in the longer term, should Scotland bring its budget into balance then aggressive tax cutting may become more of a threat.

It is not for the North to stand in the way of further devolution to the Scottish parliament, or indeed independence, if that's what the people of Scotland choose. However, northern leaders do need to ensure that there are not detrimental consequences for the North as a result of how the Scottish debate develops. To this end there are two things we argue northern leaders should do.

First, **northern leaders should engage with the negotiations currently taking place about Scotland's future**. As Scotland's nearest neighbours, it is important that the North joins the debate – especially on the point of what devo-max looks like. If the Scottish people choose to remain part of the UK then there must be a negotiation between neighbours to identify a settlement that both sides would be happy with. To this end, the northern leaders should seek to engage with and influence the commissions initiated by the main political parties to consider what devo-max should look like. Should a UK constitutional convention be established, they should seek to participate fully. The north should learn from international experience here and argue that a more fiscally autonomous Scotland must sign up to a tax competition code of conduct, fiscal pact or common tax burden.

Second, the North should take a leaf out of the Scots' book when it comes to ambition. Northern leaders should argue that one way to ensure the North does not fall further behind as Scotland becomes more powerful is for it to be given greater control over its own economic future. **The north needs the tools to attract potential investors and to grow a vibrant and thriving economy in order to level the playing field a little with Scotland**. Rule from the centre is failing to deliver this: northern economic potential is not being capitalised upon, while investment continues to be sucked towards the Greater South East (NEFC forthcoming 2012).

Indeed, IPPR North's analysis of the infrastructure spending plans published with the 2011 autumn statement reveals the extent to which current processes of decision-making in Whitehall skews resources to the needs of the Greater South East. Given the role of infrastructure development in economic growth, this pattern of spending serves to perpetuate existing economic imbalances within England.

Table 6.1
North–South divide: planned capital spend in England (public £ per head), as announced alongside the 2011 autumn statement

Region	Public spend per head
London	2731
South East	792
East Midlands	311
West Midlands	269
Yorkshire and the Humber	201
North West	134
East	43
South West	19
North East	5
England average	**638**

Source: Cox and Schmuecker 2011

Furthermore, the English themselves are increasingly questioning whether Westminster and Whitehall can be trusted to promote their interests (Wyn Jones et al 2012). The overwhelming majority of the English electorate believe that the UK government 'looks after the some parts of England more than others' (see table 6.2). Unsurprisingly, when asked which part of England is the beneficiary of this bias, the answer is London. Perhaps the most eloquent testimony to the ubiquity of this belief is that it is shared by a clear majority of Londoners themselves. In the Midlands and the north, this is an almost universally shared view, expressed by 87 per cent and 89 per cent of respondents respectively.

Table 6.2
UK government looks after the interests of all parts of England equally/not equally, 2011 (%)

	England	London	Midlands	North
More or less equally	17	26	16	10
Looks after some parts more than others	72	58	74	77
Don't know	11	16	9	13
N	*1507*	*750*	*756*	*750*

Source: Future of England Survey (FoES)[10]

Table 6.3
Which parts of England are looked after better, 2011 (%)

	England	London	Midlands	North
North East	9	12	4	1
North West	8	11	4	1
Yorkshire and the Humber	6	9	2	2
East Midlands	4	8	2	3
West Midlands	6	9	3	4
East of England	8	7	7	7
London	**79**	**63**	**87**	**89**
South East	**62**	**49**	**65**	**76**
South West	26	14	26	41
None of these	0	1	0	0
Don't know	6	13	5	4
N	*1507*	*750*	*756*	*750*

Source: FoES 2011
Question: Which part of England is looked after best? (tick all that apply)

Part of the reason the depth of feeling is so strong in the North stems from a lack of voice and control (as well as the lessons of past experience). While London has its mayor and assembly and Scotland its parliament and first minister, northern city regions have under-resourced – and in some cases weak – partnership arrangements that are expected to drive economic growth and development.

There is a mismatch between the political and economic geography in operation in the north of England. As described in section 3, the North has little in common with the Greater South East in economic terms – indeed, it arguably has more in common with Scotland. Yet policy is almost comprehensively controlled by Whitehall, and decision-makers in the North control little in the way of economic or political levers. This means they are at risk of being left behind by dominant neighbours to both the north and the south.

Given the economic diversity of England, decisions about economic development need to be made at a scale that coincides with the footprint of the real economy – as defined by travel to work or travel to learn patterns – which broadly coincides with the north's

10 See Wyn Jones et al (2012) for full results and discussion.

city-regions (LGA 2007, HM Treasury et al 2007). It is at this scale that local authority joint working through combined authorities and local enterprise partnerships is beginning to emerge. If the UK government wants to even begin to level the playing field with Scotland, this is where a far more significant devolution of economic development decision-making powers needs to be achieved within England – including transport, skills and the tools needed to develop active industrial strategies (NEFC 2012 forthcoming).

But we must learn from recent history here. The common lesson of the 'no' votes to elected regional assemblies and elected city mayors is that Whitehall's offer of governance solutions without accompanying powers will not succeed. If the North is to take more responsibility for its own economic future, the demand for the devolution of greater powers must come from the bottom up – but Whitehall must stand ready to respond as powers are requested.

Scottish ambition should be an inspiration for northern leaders. They should seek to level the playing field somewhat by arguing that places in the North should be better able to shape their own destiny and to demand the tools that are needed to develop their economies. Furthermore, northern leaders should join the negotiation about what a devo-max settlement might look like, ensuring safeguards are built in to manage excessive tax competition. Through this route, we may achieve a rebalanced UK where all parts can prosper.

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