University of Strathclyde Business School

Designing and funding the devolved nations' policy responses to COVID-19

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Summary

Funding the devolved governments during the COVID-19 pandemic

The UK's three devolved governments, in Scotland, Wales and Northern Ireland, are responsible for designing and implementing large parts of the public health response to the COVID-19 pandemic in their respective territories, and significant elements of the economic response.

The devolved governments' fiscal frameworks protect their budgets against shocks that affect government spending needs in a similar way across the whole of the UK. The Barnett formula automatically provides them with a population-share of additional funding in England. Falls in devolved tax revenues are largely offset by equivalent-sized increases in block grant funding from the UK government.

The frameworks provide much less protection against shocks that have significantly different impacts across the UK. And strict limits on how much and for what purpose devolved governments can borrow mean devolved governments have limited budget flexibility.

In the early stages of the COVID-19 pandemic, the UK government applied the Barnett formula to its spending announcements in the normal way. But in the early stages of the crisis, two potential problems with the Barnett Formula emerged.

- The first was time-lags between English policy announcements and the confirmation of subsequent Barnett consequentials for the devolved governments.
- The second was the risk that the impact of the crisis and hence the spending needs of the devolved governments evolved differently from those of England.

In response to these limitations, the Treasury moved to a system of guaranteed funding for the three devolved governments in July 2020. These were minimum guaranteed increases in the devolved governments' block grants for the 2020/21 financial year.

By February the total COVID-19 funding allocations for the 2020/21 year were £9.7bn, £5.85bn and £3.3bn for Scotland, Wales and Northern Ireland, respectively.

The scale of the funding allocations means that the potential for one of the devolved governments to suffer a funding crisis has not materialised. Nonetheless, the allocations might be seen as inequitable if the spending needs of one or other of the devolved territories evolved differently from other parts of the UK during the pandemic. And funding guarantees are a stop-gap measure rather than a long-term solution to issues with the current fiscal frameworks, and may be considered unfair to England.

The impact of the COVID-19 pandemic across the UK's territories

At the outset of the pandemic, it was very possible to imagine that the health impacts of COVID-19 might have disproportionately affected some parts of the UK over others, perhaps reflecting underlying demographic or population health factors. It was also possible that the economic impacts of restrictions – even if applied uniformly across the UK – might have had geographically uneven impacts, given variation in the structures of the economy.

Indeed, the health incidence of the pandemic has not been identical across the four nations. However, fine tuning of grant allocations to the devolved authorities on the basis of differences in the demands placed upon health and social care services may have been impractical, given the rapid changes in infections and therefore the unpredictability of the course of the pandemic.

The economic impact of the COVID-19 crisis has been broadly similar across the UK nations. This reflects broad similarities in the extent of social restrictions, the degree of exposure of the economies to sectors most affected by restrictions, and the policies designed to mitigate the economic impact of restrictions.

Did the funding settlements constrain the devolved governments' policy responses?

The devolved governments are responsible for designing and implementing large parts of the public health response to the COVID-19 crisis in their respective territories. But key elements of economic support – notably the furlough scheme and equivalent support for the self-employed – are determined by the UK Government.

In autumn 2020, uncertainties around whether the furlough scheme would be available within a devolved nation if a devolved government felt the need to apply tighter restrictions than prevailed in England created significant inter-governmental tensions, and may have marginally influenced the timing of particular restrictions being applied in Scotland and Wales.

But major crisis around this issue was averted by the UK government's subsequent decision on November 5th to extend the original furlough scheme across the UK until March 2021 (since further extended to June 2021).

New streams of economic development funding: a different approach

New funding streams including the Levelling Up Fund, the Community Renewal Fund and the UK Shared Prosperity Fund (the initial, part-replacement for EU regional development funds), mark a significant change in fiscal relationships between the UK government and the devolved governments. In both cases the funds will ostensibly be allocated on the basis of 'needs', but the assessment of what constitutes 'need' has been developed by the UK government without consultation with the devolved governments.

This approach has been made possible by the Internal Market Act which provides a new means for the UK government to allocate spending in the devolved territories to areas which had previously been thought to be the purview of the devolved governments.

The effect is to circumvent not only the Barnett Formula but the devolved governments themselves. While it is unclear how the main Shared Prosperity Fund itself will be allocated, the Community Renewal Fund and Levelling-up Fund further extends the role of competitive bidding processes controlled by the UK government in the devolved nations. and replace it with a transactional, deal-making approach to regional assistance in which local authorities across the whole of Great Britain compete for funding. In the absence of co-operation agreements, the devolved nations may be anxious that this will undermine their activities and authority in economic development and associated policy areas, and potentially lead to overlaps or mismatches between schemes.

The forthcoming review of the Scottish fiscal framework

The Scottish fiscal framework is due to be reviewed by the Scottish and UK governments in 2022, following the preparation of an independent report in the second half of 2021.

To date, the two governments have been unable to agree the scope of the review. The UK government would prefer it to be relatively narrow, focussing on the detail of mechanisms for adjusting the block grant, and potentially the scope of forecast error borrowing tools.
The Scottish government would prefer the review was wider in scope, potentially also considering the scope of fiscal powers devolved, and issues around intergovernmental coordination.

At the moment it remains unclear how these differences will be resolved.

Conclusions

The devolved governments’ fiscal frameworks and settlements were clearly not designed with a shock like the COVID-19 pandemic in mind.

At the outset of the pandemic there were reasons to be concerned about the ability of the devolution funding frameworks to cope. As it happens, the devolved governments’ funding arrangements have largely coped with the COVID-19 pandemic. This is the result of a combination of luck, the huge sums of money provided by the UK government to address the crisis in England, and ad-hoc bypassing of the normal rules of the frameworks.

The ‘luck’ part of the equation reflects the fact that both the devolved nations have not been disproportionately negatively impacted by the virus in either health or economic terms.

But the shift away from the usual process of allocating funding by Barnett consequentials to the concept of funding ‘guarantees’ has also been important in providing the devolved governments the resources and flexibility they need to meet the evolving demands of the pandemic.

However, the COVID-19 pandemic has exposed some limitations and risks of the devolved funding settlements, and poses a number of questions for their future. For example, do the block grant adjustment mechanisms provide sufficient insurance against the risk of asymmetric shocks? Do the devolved governments have enough budgetary flexibility to respond to short-term fluctuations in need, or to vary policy in response to such events? To what extent is there a need for new arrangements for collaborative decision-making or improved communication on policy areas which are ‘reserved’ to the UK government? Can economic development policy operate effectively as an area of joint competency or does more direct UK government involvement in this realm pose a major problem for the devolution settlement and effective policymaking?

The aim of this paper has not been to answer these questions, but to lay out the issues that we will consider throughout the remainder of our one-year project. Addressing these issues will raise challenging questions around where the responsibility for managing various fiscal risks should lie, and the extent to which the answer to this question depends on the nature of the fiscal powers devolved, and the nature of constitutional arrangements more broadly.

1. Introduction

The UK’s three devolved governments, in Scotland, Wales and Northern Ireland, are responsible for designing and implementing large parts of the public health response to the COVID-19 crisis in their respective territories. This includes the nature and extent of social restrictions, contact tracing programmes, and vaccination rollout (although the vaccines were procured by the UK government).

The devolved governments are also responsible for designing and implementing large parts of the economic response, including support to businesses and other organisations through grants. However, the furlough scheme, similar income support schemes for the self-employed, and changes to the rates of Universal Credit, are policies of the UK government that apply UK-wide.

To fund most of their expenditure – including virtually all their COVID-19 expenditure - the three devolved governments rely on block grants from Westminster – although recent years have seen an increased share of the Scottish and Welsh governments’ budgets come from newly devolved taxes.

The funding settlements of the three devolved governments differ slightly from one another, reflecting differences in policy responsibilities, and various ad hoc arrangements that have been negotiated over the years. But the core elements of the devolved governments’ funding settlements are similar. Changes to the devolved governments’ block grants reflect per capita changes in spending by the UK government on ‘comparable’ public services in England. Through a complex block grant adjustment scheme, the budgets of the devolved governments are also insured against falls in devolved tax revenues, where equivalent revenues in England have fallen by a similar proportion.

A property of the funding settlements is therefore parity with England for funding changes (although not funding levels),[1] and insurance against revenue shocks that are symmetric across the UK. But it is fair to say that the funding settlements were not designed with a shock like the COVID-19 pandemic in mind.

The COVID-19 pandemic poses a number of risks or challenges to the funding of the devolved governments. Most obviously, these include the risk that the health or economic impacts of the pandemic fall disproportionately in one nation over others. If this situation arises, the lack of any explicit consideration of funding ‘need’ in current funding arrangements may lead to this nation lacking the finance required to meet the challenges posed by the pandemic, in turn posing risks to the wider UK. Moreover, the nature of the funding settlements themselves may limit the devolved governments’ ability to respond to the pandemic in a way that reflects their assessment of the risks, if for example the feasibility of public health restrictions is contingent on the level of furlough support that the UK government has committed to.

We have recently embarked on a year-long project to examine how effective the devolved governments’ funding settlements have been in enabling them to respond adequately to the COVID-19 pandemic as it has unfolded. We are also considering what changes to financing arrangements may be worthwhile to improve robustness to future shocks and support recovery from the current shock. The project will run from March 2021 to March 2022 and is being funded by the Economic and Social Research Council (ESRC) as part of UK Research and Innovation’s rapid response to COVID-19.

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[1] Funding levels are around 30% higher in Scotland and Northern Ireland and 23% higher in Wales. See Paun et al (2021) and Phillips (2021).

This report is the first output from the project. It aims are to highlight the funding issues that could have arisen as a result of the COVID-19 pandemic, assess whether they have in fact arisen, and how they have been addressed. The paper also looks forward to some emerging and imminent issues in devolved government funding, including the planned review of the Scottish fiscal framework later in 2021, and the changes to funding arrangements that may arise from the new Internal Market Act and the replacement of EU structural funds post-Brexit. But the aim of this introductory paper is to focus on the issues and questions that are emerging, rather than to suggest or propose changes – this will come during later stages of the research project.

The remainder of this report is structured as follows. Section 2 provides an overview of the way in which the funding frameworks of the UK's three devolved governments operate – how grant funding is allocated, what sorts of funding risks the devolved governments are exposed to and protected from, and what sorts of funding issues arose during the first year of the COVID-19 pandemic.

Section 3 examines how the health or economic outcomes of the pandemic have evolved in the four nations of the UK, looking in particular at whether impacts have been symmetric or asymmetric. Section 4 considers the extent to which the devolved governments' policy choices may have been constrained by the nature of the funding settlements, and the ways that the UK government operated various aspects of 'reserved' policy.

The remaining two sections begin to look towards the future. Section 5 examines the extent to which the UK government's proposals to allocate economic development funding directly to local authorities and other organisation in the devolved nations differs from the way that similar funds were allocated in the past – and considers what economic and political issues might arise as a result. Section 6 looks forward to the planned review of the Scottish fiscal framework, due to take place later in 2021, and considers what sorts of issues the review might need to cover. Section 7 concludes.

2. Designing and funding the response to the COVID-19 pandemic in the devolved nations

2.1 Devolved and reserved policy responsibilities

The COVID-19 pandemic has exposed the complexities of – and much confusion about – the division of responsibilities under devolution.

Since their establishment in 1999, the devolved legislatures in Northern Ireland, Scotland and Wales have exercised significant policy autonomy in areas including health, education, economic development, aspects of transport policy, the environment, and culture and sport.

Since the start of the COVID-19 pandemic, the devolved governments have been responsible for much of the public health response to it – including the extent of social restrictions, contact tracing and vaccination roll-out – as well as the design and administration of grant-based financial support packages and property tax waivers for businesses and third sector organisations).

But the UK's major policy responses relating to social security and the labour market – including the Coronavirus Job Retention Scheme, Self Employment Income Support Scheme and changes to Universal Credit rates and Statutory Sick Pay –, as well as loan-based business support schemes, are 'reserved' policy matters that apply across the UK. The UK government also funds most of the COVID-19 testing programme and the purchase of vaccines.

2.2 The funding of the devolved governments: the Barnett Formula

The devolved governments have gained additional revenue raising responsibility in recent years (of which, more later). But it remains the case that their spending envelope is determined largely by the size of the block grant that they receive from the UK government.

How is the block grant determined? In normal times, each devolved governments' block grant is determined by the Barnett Formula. The Barnett Formula takes the previous year's grant and in addition allocates the devolved governments a population-based share of changes in planned expenditure in England (or 105% of its population-based share in Wales's case).[2] For example, if the UK government announced an increase in spending on health in England of £100m, this would generate Barnett 'consequentials' of approximately £9.8m for Scotland, £5.6m for Wales and £3.4m for Northern Ireland to add to their existing block grants.

However, there is no guarantee that each nation's relative need for funding will be related to its population in such a mechanical way – especially if a shock affects it differently from the rest of the UK. In the context of the COVID-19 pandemic for example, differences in disease prevalence, in population-vulnerability to the disease, in behavioural response to the threats it poses and in economic impacts, could all, in principle, have led to different spending needs across the union – even if similar (or indeed identical) policies had been put in place.

In the early stages of the COVID-19 pandemic, the UK government applied the Barnett formula to its spending announcements in the normal way. By early July, the budgets of the devolved government had increased by several billion pounds as a result of the additional spending associated with the emergency economic and public health measures that the UK government had put in place in England.

The merit of the Barnett Formula is that it ensures that any spending announcement pertaining to England generates an immediate and population-adjusted equivalent uplift in the devolved governments' block grants. But in the early stages of the crisis, two potential problems with the Barnett Formula were identified.

- The first of these related to lags between English policy announcements and the confirmation of subsequent Barnett consequentials – not normally a critical issue, but much more important during a fast-moving pandemic.
- The second related to the risk that the spending needs of the devolved governments evolved differently from those of England. In these circumstances, the equal per capita allocations generated by the Barnett Formula would not in fact be equitable.

2.3 The move to funding guarantees

In response to the first of these limitations, the Treasury moved to a system of guaranteed funding for the three devolved governments in July 2020. These were minimum guaranteed increases in the

[2] This is very different from allocating them a population-based share of the overall *level* of funding. As discussed in Paun et al (2021) and Phillips (2021), a range of factors including higher baseline funding levels, differential population growth, and a previous flaw in the Barnett formula mean that the devolved governments receive a substantially higher-than-population share of funding. In Scotland and Northern Ireland, this leads to funding per person that is around 29% higher than what is spent in England on comparable services, while for Wales funding per person is around 23% higher.

devolved governments' block grants for the 2020/21 financial year. At the time they were first announced, the guarantees were £6.5bn, £4bn and £2.2bn for Scotland, Wales and Northern Ireland, respectively.[3]

If subsequent application of the Barnett Formula in response to UK government spending in England meant that the devolved governments should be allocated more than this, they would receive those additional amounts; but if the subsequent UK government spending decisions actually implied less funding than had been guaranteed, the guaranteed amounts would still apply, with no clawbacks.

These guarantees meant that the devolved governments could make financial plans in the knowledge that they would receive at least these minimum grant uplifts, even if the UK governments' eventual spending would have implied a lower allocation under the traditional Barnett formula approach. At the time, the guarantee for the Scottish Government provided £800m of additional resources over and above the uplift in the Scottish block grant that would have been identified at that point in time had Barnett been applied in the normal way.

The guaranteed amounts of funding for the 2020/21 financial year were increased by the Treasury on 9 October, 5 November, and 24 December, by this point having reached £8.6bn, £5.2bn and £3bn in Scotland, Wales and Northern Ireland respectively.[4] In February a further £2.1bn of funding for the devolved governments by HM Treasury, which could be spent in either 2020/21 or 2021/22, taking the total allocations for the year to £9.7bn, £5.85bn and £3.3bn for Scotland, Wales and Northern Ireland, respectively.

The move to guaranteed funding that is not explicitly linked to UK government spending allocations provides the devolved governments greater political flexibility to allocate funding in the ways they deem most appropriate. This is positive – under the normal operation of the Barnett Formula, the devolved governments tend to come under significant political pressure to closely follow the pattern of UK government spending.

The flipside of this is that it becomes extremely difficult, if not impossible, to know whether the devolved governments are fulfilling commitments to 'pass on' health related consequentials to the health budget, or local government consequentials to the local government budget.[5] The devolved governments know what minimum level of budget uplift they will receive, but not the source of that uplift in terms of specific UK government announcements. On balance however, the advantage of the additional political flexibility probably outweighs the additional challenges in monitoring spending commitments.

Another issue is that this system could be seen as unfair to England. That is because the up-front funding guarantees, and the power to carry-forward the final element of these in February 2021 into 2021/22, not only provide both greater certainty and more flexibility for the devolved governments - they also provide more funding per person than in England. This is not only because the guarantees potentially exceed the amounts allocated to England. UK government departments serving England also have much less flexibility to carry forward underspends into subsequent years: significant underspends are instead clawed back by HM Treasury. The Treasury may choose to return this to departments by topping up budgets in subsequent years. But normally this would generate

[3] HM Treasury - https://www.gov.uk/government/news/scotland-wales-and-northern-ireland-receive-additional-coronavirus-funding-guarantee-from-uk-government

[4] Source: HM Treasury, UK Budget 2021/22

[5] https://spice-spotlight.scot/2020/11/12/covid-19-barnett-consequentials-guarantee-up-again-more-certainty-less-clarity/

additional Barnett consequentials for the devolved governments, on top of being able to carry forward their own funding. The funding guarantees and additional flexibility offered in 2020/21 are therefore best thought of as stop-gap measures, with the need to develop a longer-term solution that is also fair to England.

2.4 Differential spending needs

Whilst the timing challenge posed by the Barnett Formula was resolved through the funding guarantees, the question of what might happen if spending needs evolved differently was never addressed.

To an extent, this may be because the risk never materialised. As we explore in the next section, there is no obvious evidence that the pandemic has had a disproportionately greater impact on health services or economic activity in the devolved nations compared with England.

The fact that the health and economic outcomes of the pandemic have been relatively similar across the UK reflects both that the nations' economies and societies are closely integrated, and the fact that public health measures and economic policies have been relatively similar in the four nations. This latter observation in turn may reflect the fact that the nature of the devolution and funding settlement places constraints on the devolved governments should they want to operate a very different policy with regards to health restrictions – particularly in relation to interactions with the furlough scheme, policy which was determined by UK government.

In other words, there is a distinction between:

- Variation in spending needs (e.g. because the virus disproportionately affects one part of the UK more than other, e.g. in terms of the incidence of disease), and;
- Differences in desired responses to a given set of circumstances or spending needs (e.g. a desire for more stringent public health measures, or more generous business support, for a given incidence of the disease).

The ability of devolved governments to respond to both of these issues – which we return to in sections 3 and 4 of this briefing note – can be constrained as a result of the devolution settlement and fiscal frameworks.

2.5 Funding flexibilities and borrowing

It remains unclear what would have happened if spending needs in one or other of the devolved governments had diverged substantially from England. Whilst all three devolved governments do have some tax responsibilities to a greater or lesser extent, tax policy is not an effective way to raise emergency revenues in the short-term. And none of the devolved governments have any ability to borrow to fund discretionary spending on public services (although they each have limited powers to borrow to fund capital investment, and the Scottish and Welsh governments have limited ability to borrow to offset tax forecast errors).

If the COVID-19 crisis hit one or more of the devolved nations harder than England, there was therefore the possibility that they could be left with insufficient block grant funding, and with no way to address any shortfall themselves other than by making cuts to other spending.[6] In such circumstances, the UK government could choose to bypass the Barnett formula and top-up funding as necessary. Indeed, it would probably be in its interests – both from a policy and political perspective – to do so if the funded needed to address the COVID-19 crisis was obviously significantly higher in a particular part of the country. But even in this case, the devolved governments would have to wait until they were sure they would receive this funding top-up before they could start spending more money.

For these reasons, a number of analyses at the outset of the COVID-19 crisis (Ifan (2020), Phillips (2020))[7] suggested that the government should consider bypassing Barnett if necessary and temporarily relaxing borrowing rules to help better address any short-term asymmetric impacts.

In the early part of the crisis (before the move to funding guarantees), the Scottish Government argued the case for having a number of additional budget flexibilities. These included the temporary ability during 2020/21 to use capital funding for resource purposes; enabling the Scottish Government's existing borrowing powers for cash management to be used to fund discretionary spending; and increasing the drawdown limit from the Scotland Reserve.[8]

On one level the flexibilities requested were relatively modest and would not in principle have 'cost' HM Treasury anything. But the need for them was probably superseded by the move to the aforementioned guaranteed funding mechanism. The UK government never formally responded to the request.

2.6 Risks to devolved taxes

The COVID-19 pandemic hasn't just impacted devolved spending, but devolved revenues too.

The Scottish Parliament has set rates and bands of income tax in Scotland since 2017, and the Welsh Parliament took on more limited powers over income tax in 2019. Property transactions taxes (formerly stamp duty) and landfill taxes have been fully devolved in Scotland since 2015 and Wales since 2018.

There are plans to devolve air passenger duty to Scotland and to assign half of VAT receipts raised in Scotland to the Scottish Parliament, although both these plans have been subject to delays. A recently established Fiscal Commission will consider the scope for tax devolution in Northern Ireland.

A core property of the devolved funding settlement is that the UK government insures the devolved budgets against the risk of UK-wide revenue shocks. If tax revenues from devolved income tax or property transactions taxes fell substantially in 2020/21 as a result of the pandemic, that fall in tax revenue wouldn't have any budgetary implication for the devolved government as long as

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[6] Because Scottish and Welsh income tax rates need to be finalised before the start of the tax year, in-year tax increases would not be a realistic alternative.

[7] Ifan, G. (2020), 'Covid-19 and the Welsh Government Budget: Update No. 1', Wales Fiscal Analysis briefing, https://www.cardiff.ac.uk/__data/assets/pdf_file/0005/2132654/COVID19_Welsh_Budget_FINAL.pdf, and Phillips, D. (2020), 'Devolved governments need more flexible funding and greater borrowing power to tackle coronavirus effectively', IFS observation, https://www.ifs.org.uk/publications/14766.

[8] See letter from Kate Forbes to Chief Secretary to the Treasury, 24 June 2020, https://www.gov.scot/publications/coronavirus-covid-19---funding-and-fiscal-flexibilities-letter-from-cabinet-secretary-for-finance-to-chief-secretary-to-the-treasury/

equivalent revenues in the rest of the UK fell by the same proportion. More specifically, a fall in income tax revenue in Scotland or Wales of 10% per person (either relative to forecast, or relative to the previous year), would have very little impact on the devolved governments' budgets as long as rUK income tax revenues fell by 10% per person too.

But the devolved budgets are exposed in full to the risk that devolved revenues fall disproportionately compared to rUK. How real are the risks here? On the one hand, the larger public sectors in each of the devolved nations relative to England would tend to reduce economic exposure to the effects of the COVID-19 pandemic and associated lockdowns (indeed, more generally, the public sector is less cyclical than the private sector). On the other, greater exposure to the manufacturing sectors (typically more cyclical than other sectors) in Northern Ireland and Wales, the hospitality sector (particularly affected by public health restrictions) in Wales and Scotland, and the offshore oil and gas sector (which saw falls in prices during the first months of the pandemic) in Scotland could at least partially offset this. The OBR, for example, estimates that these effects roughly balance for Scotland,[9] although the Scottish Government illustrate that exposure to the oil and gas sector could impact Scottish revenues to the tune of several hundred million pounds.[10]

In the next section, we assess what the latest evidence shows about the extent to which the risk of weaker revenue performance in the devolved nations has emerged. For now, the key point is that the devolved governments are largely insured against the risk of revenue shocks that effect the whole of the UK. But they are exposed in full to any disproportionate impact on devolved revenues relative to the equivalent rUK revenues.

2.7 Summary

The devolved governments have limited abilities to flex their budgets in response to short-term uncertainties, although the move to funding guarantees in July 2020 largely seems to have mitigated the need for additional short-term flexibilities during 2020/21.

The devolved governments' devolution settlements and fiscal frameworks protect their budgets from UK-wide shocks to public spending or revenues – but only if the nature of the shock is broadly equivalent in each devolved nation as it is in England. In the next section we consider the extent to which the COVID-19 pandemic did affect the devolved nations 'symmetrically'.

3. Was the COVID-19 pandemic an asymmetric shock?

At the outset of the pandemic, it was very possible to imagine that the health impacts of COVID-19 might have disproportionately affected some parts of the UK over others, perhaps reflecting underlying demographic or population health factors. It was also possible to imagine that the economic impacts of restrictions – even if applied uniformly across the UK – might have had geographically uneven impacts, given variation in the structures of the economy.

In fact, there is now strong evidence that both the health impacts of the virus and the economic impacts of the associated public health restrictions and changes in behaviour have been felt very

[9] See OBR's Devolved taxes forecast, November 2020

[10] Even if devolved income tax revenues are disproportionately affected by COVID in 2020/21, the timing of budget reconciliations offers the devolved governments further insurance. Income tax shortfalls in 2020/21 relative to forecast will not impact the devolved Scottish and Welsh budgets until 2023/24

unevenly if we compare the experiences of small geographical areas.[11] But what about at the level of the UK nations?

3.1 Health outcomes

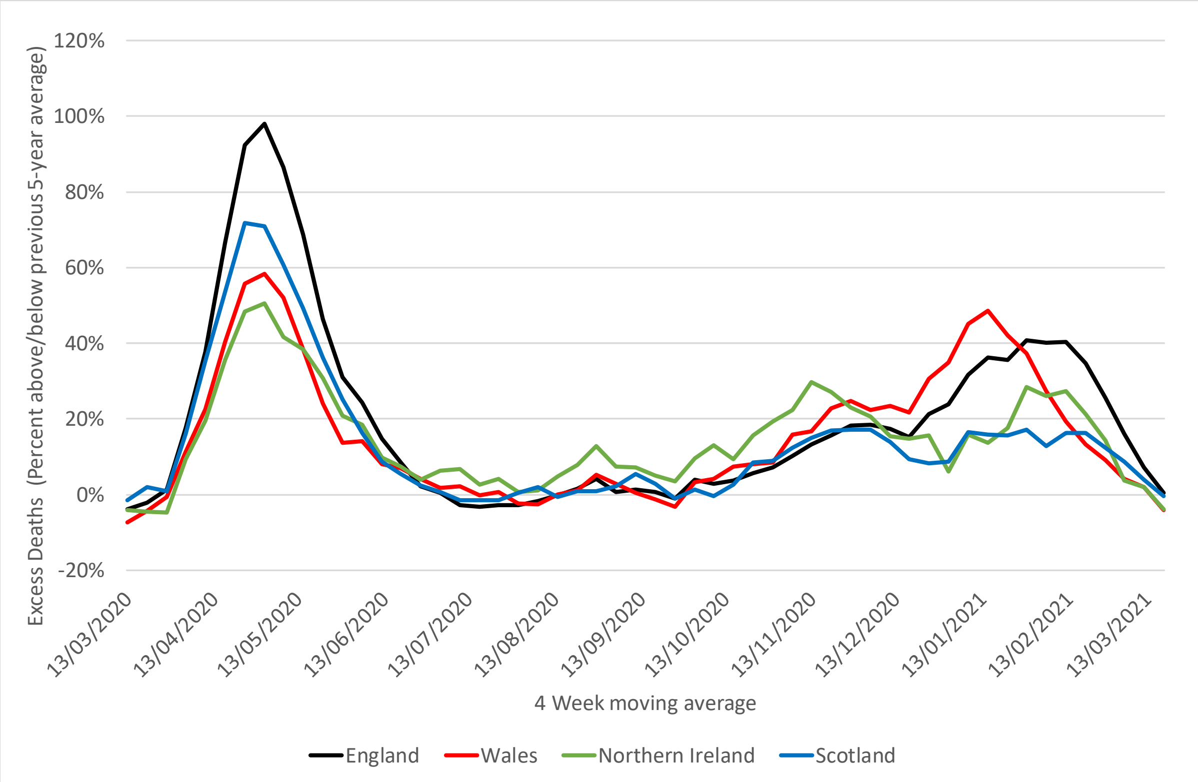
There is no single measure which summarises the additional demands placed on health and social care provision by the COVID-19 pandemic. Differences in reported cases may reflect differences in testing rates as well as differences in prevalence, for example. Differences in reported COVID-19 death rates may also be affected by testing and death certification policies. Perhaps the best indicator is overall "excess deaths", which can be calculated as the percentage increase in deaths relative to the previous five years for each week during the pandemic. This will not depend on COVID-19 testing or recording policies, and may pick up changes in deaths due to other causes (e.g. other diseases, accidents, etc.) that have also been impacted by the pandemic.

Excess deaths among the UK nations during the period of the pandemic are shown in Figure 1. A four-week moving average is used to smooth out fluctuations among the smaller nations. The timing is broadly similar, though during the first wave (largely covering the period April-May 2020), excess deaths were substantially higher in England than in the devolved nations. From November 2020 to February 2021, the pattern is more irregular, with Wales having the highest level of excess deaths in December 2020 and January 2021 but falling to the lowest level by the end of February. Scotland did not see the same increase in excess deaths between mid-December and mid- February seen to varying extents in the rest of the UK.

Overall, the pattern of excess deaths does not suggest that either the timing or the severity of the pandemic disadvantaged the devolved authorities given that the Barnett consequentials received during the pandemic were initially based on their population shares of the extra additional funding allocated to the Department of Health and Social Care in England, and subsequently based on up-front guarantees of at least this level. Indeed, if anything, the health effects of the pandemic appear to have been slightly less severe, particularly Scotland, and (during the major peaks at least), Northern Ireland.

[11] For example, COVID death rates have been twice as high in the most relative to the least deprived areas (see Johnson et al. 2021 'The IFS Deaton Review of Inequalities: a new year message'. IFS, January 2021

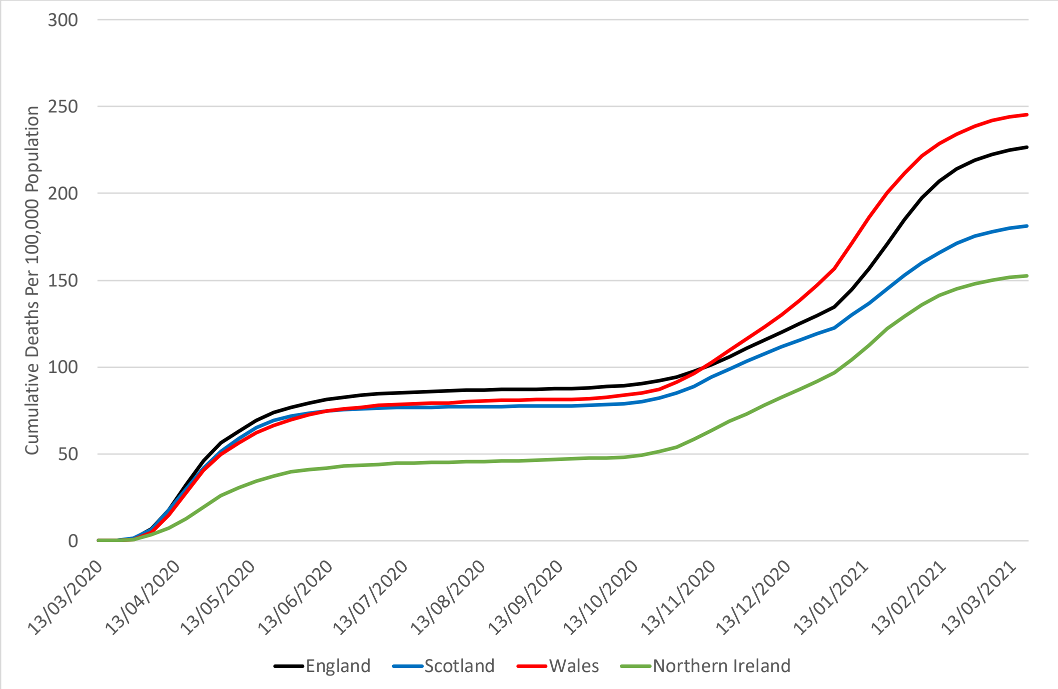
Figure 1: Excess Deaths among UK Nations 2020/21



Source: Office for National Statistics, National Records of Scotland and Northern Ireland Statistics and Research Agency Note: excess deaths are not age-standardised

Focussing solely on COVID-19 and taking a longer run perspective, Figure 2 shows deaths per 100,000 population since the start of the pandemic where COVID-19 was mentioned on the death certificate for each of the home nations. Despite the potential for differences in reporting policies between the nations, this is the best available measure if one wants to consider health and social care expenditures specifically related to COVID-19. It shows that by early April 2021 the cumulative death rate from COVID-19 was higher in Wales than in England, while Scotland and Northern Ireland experienced lower death rates.

Figure 2: Cumulative COVID-19 Deaths per 100,000 population since start of pandemic



Source: https://coronavirus.data.gov.uk/details/deaths. Extracted 3/4/2021

The experience of the pandemic has not been identical across the four nations. Consequently, the demands placed on the respective health and social care systems have not been identical. However, fine tuning of grant allocations to the devolved authorities on the basis of differences in the demands placed upon health and social care services may have been impractical, given the rapid changes in infections and therefore the unpredictability of the course of the pandemic.

Moreover, much of the need for spending to address the pandemic is not directly linked to the number of cases of COVID-19: it is to reduce the risks of transmission and to prepare for the worst. It is important to bear in mind too that the health costs of the pandemic are not directly proportional to the number of deaths, or even hospitalisations. Health and social care workers need to wear PPE whether 10% or 50% of the people they are caring for has COVID-19, and investment in temporary hospitals was probably prudent everywhere given uncertainty about how high caseloads would rise.

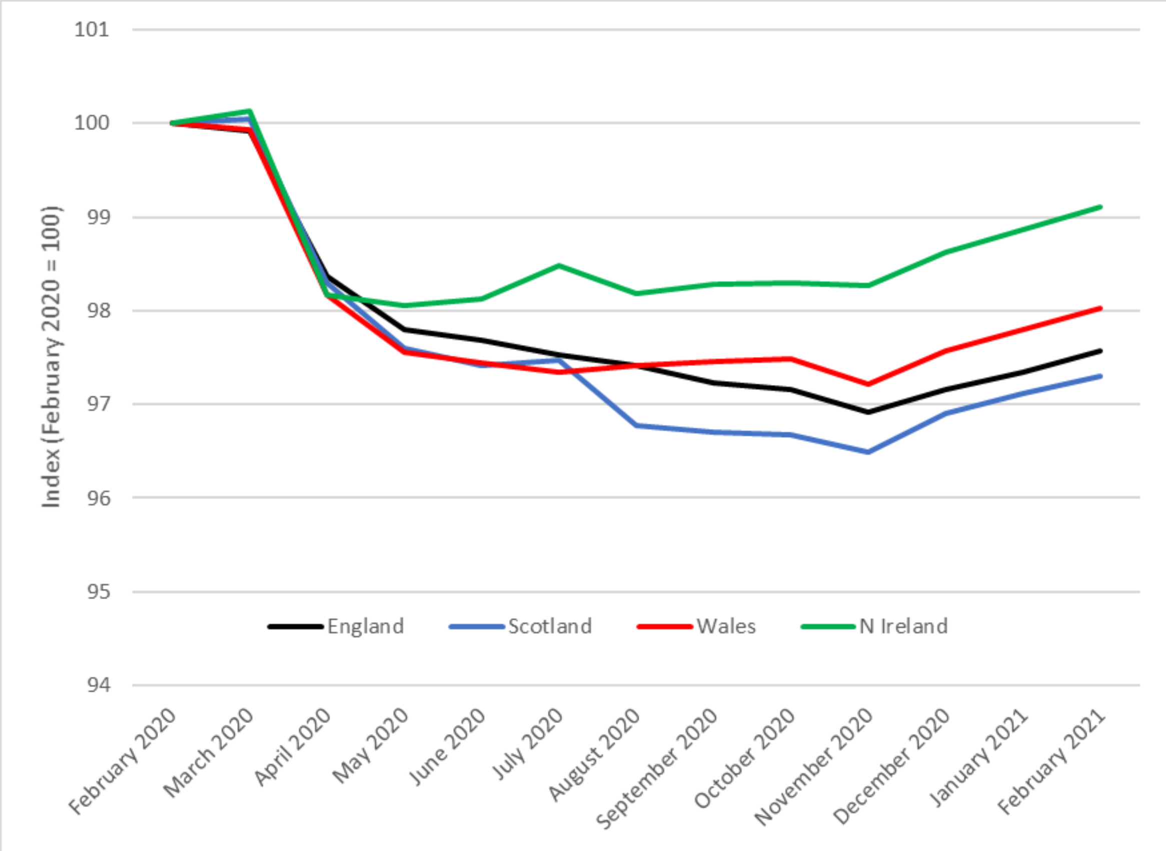
If COVID-19 incidence was *very* different, however, the sorts of preventative and mitigative spending (such as purchase of PPE, investment in health facilities, business support grants, etc.) needed could have differed significantly. And if the need for this spending were higher in one of the devolved nations, they would have found themselves unable to address it without a change in funding or fiscal flexibilities.

3.2 Economic outcomes

What about the economic impacts of the pandemic and associated lockdown measures? The short answer is that so far, at least, the economic impact of the COVID-19 crisis has been broadly similar for each of the UK nations. This is shown in Figures 3-7, which illustrate the evolution of employee numbers and aggregate earnings reported to HMRC, the share of workers furloughed, residential property transactions, and GDP (the latter only for Scotland and the UK as a whole).

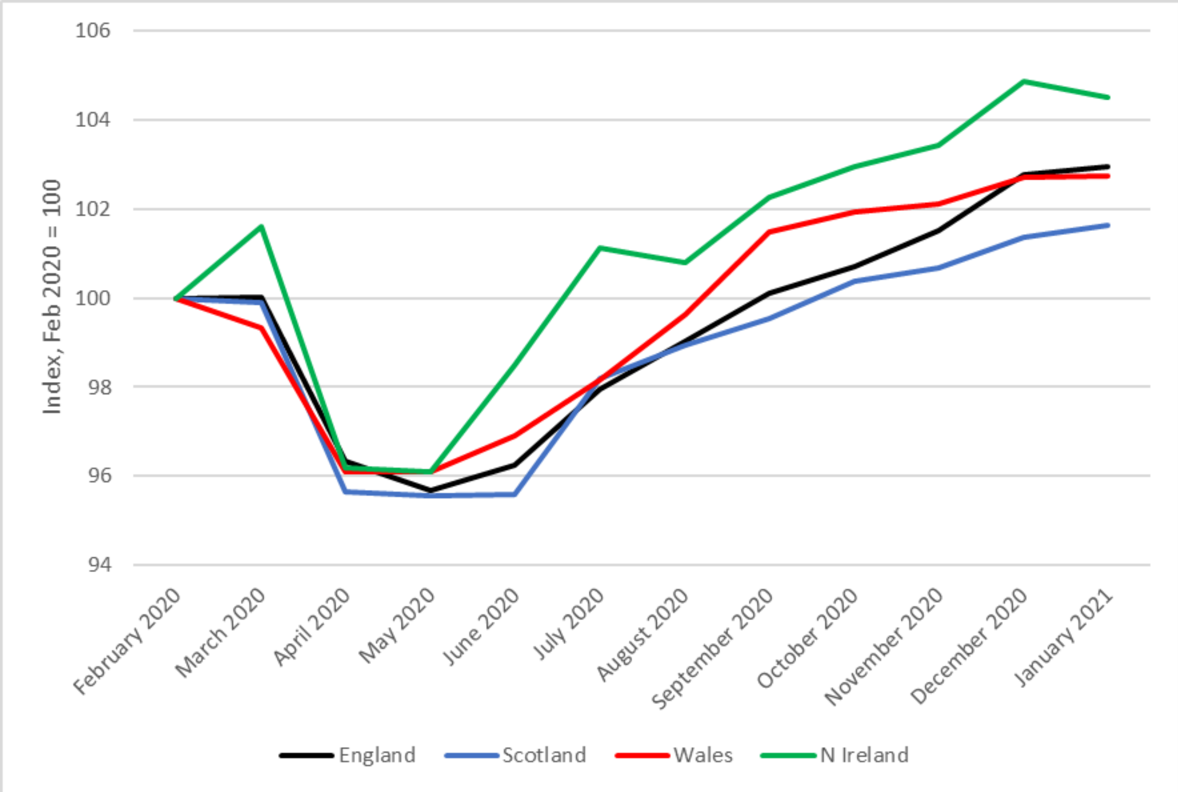
Compared to England, for example, employment and earnings have performed a little better in Northern Ireland and a little worse in Scotland, but the differences - a percentage point or so – are small. The proportion of employees furloughed has been similar and followed similar trends in each of the nations, with the only notably exception being higher furlough rates in England during its second national lockdown. Property transactions have also followed the same general path across the UK, although they initially fell more in the devolved nations than in England, but made up for this in late 2020 (with the exception of Wales). And GDP in Scotland has followed a very similar trend to GDP for the UK as a whole.

Figure 3: Employees (February 2020 = 100)



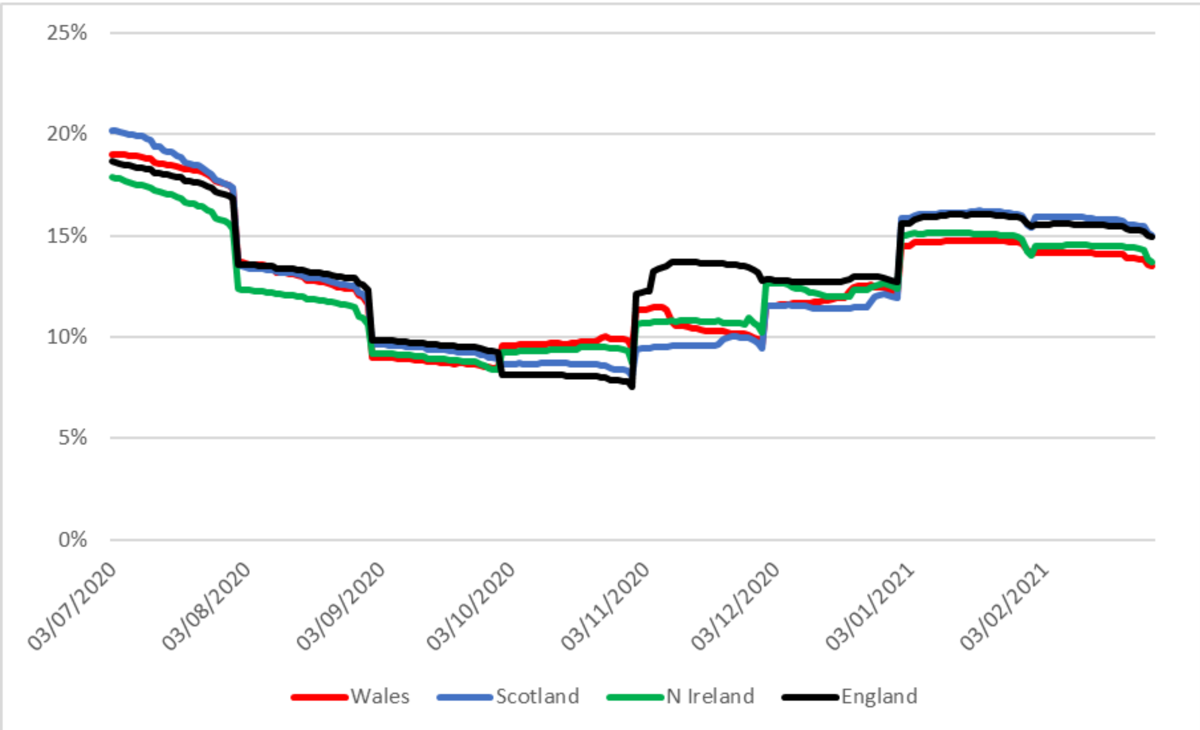
Source: https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/earningsandworkinghours/datasets/realtimeinformationstatisticsreferencetableseasonallyadjusted

Figure 4: Aggregate earnings (February 2020 = 100)



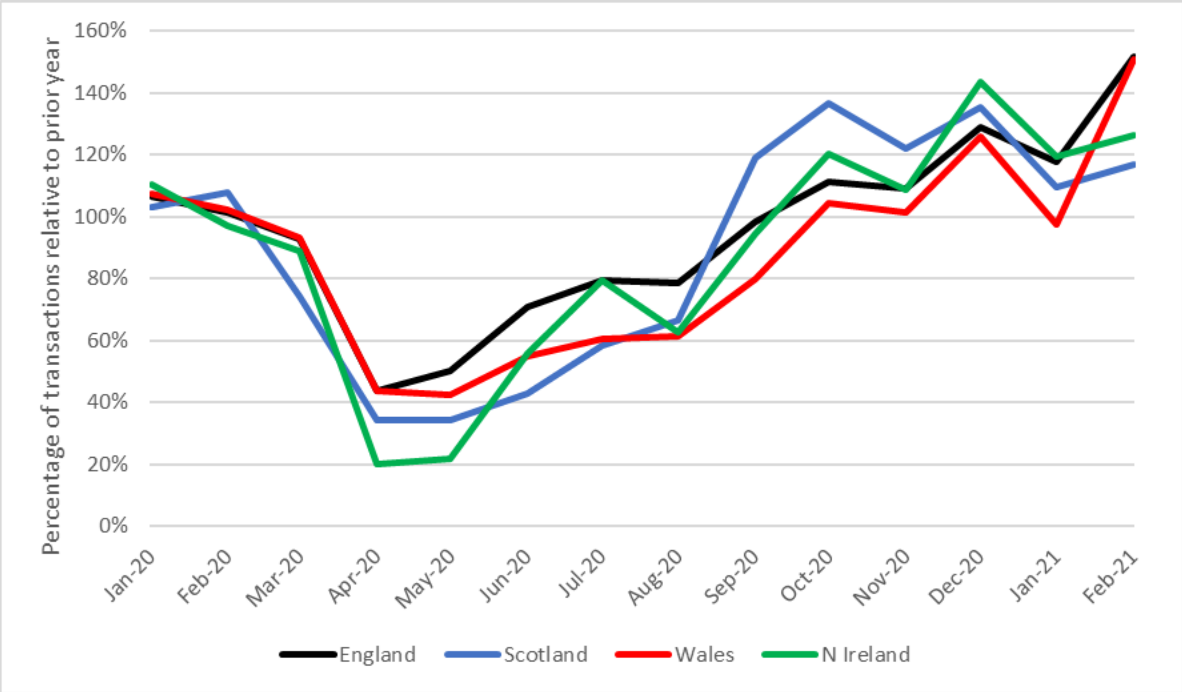
Source: https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/earningsandworkinghours/datasets/realtimeinformationstatisticsreferencetableseasonallyadjusted

Figure 5: Percentage of eligible employments furloughed



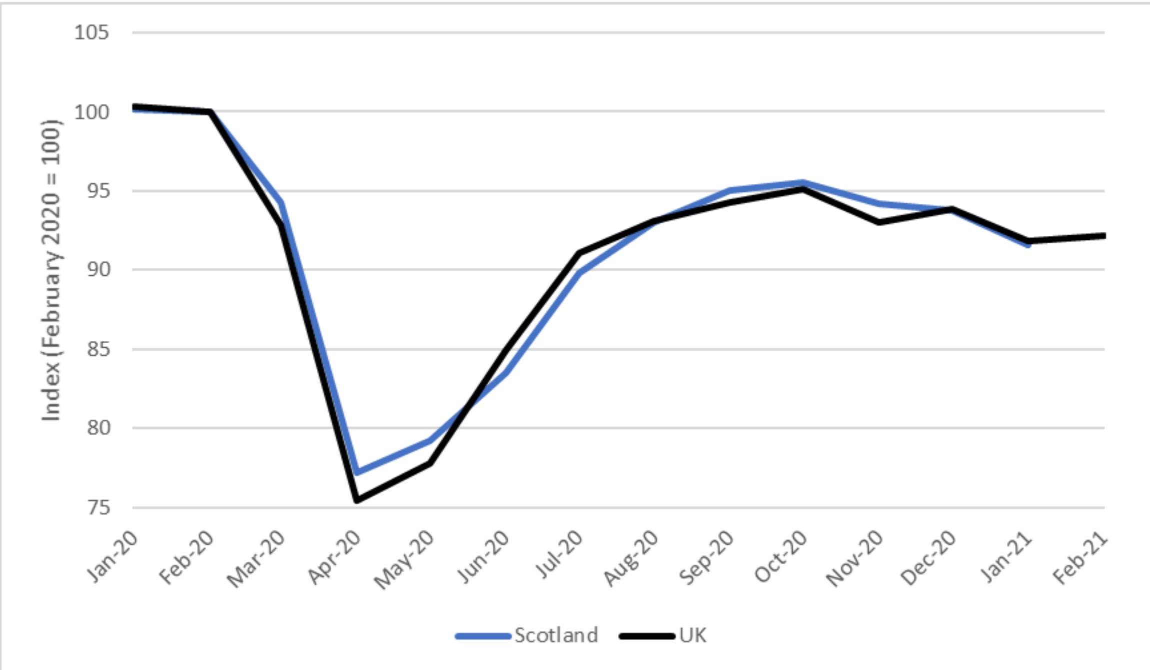
Source: https://www.gov.uk/government/statistics/coronavirus-job-retention-scheme-statistics-march-2021

Figure 6: Residential property transactions compared to same month in previous year



Source: https://www.gov.uk/government/statistics/monthly-property-transactions-completed-in-the-uk-with-value-40000-or-above

Figure 7: Monthly GDP level (February 2020 = 100)



Source: https://www.gov.scot/publications/monthly-gdp-january-2021/ and https://www.ons.gov.uk/economy/grossdomesticproductgdp/datasets/monthlygdpandmainsectorstofourdecimalplaces

4. Have the funding settlements constrained the devolved governments' policy responses?

The previous section analysed the impact of the crisis on health and economic outcomes, and concluded that there is limited evidence of asymmetric impacts of the crisis on one or more of the UK's devolved nations. These health and economic outcomes were implicitly assumed to proxy the relative 'spending needs' of the devolved governments.

On one level, the finding that spending needs have not diverged significantly across the UK nations is not surprising given the relatively uniform policy response that has been applied across the UK territories. Whilst social distancing restrictions have been applied slightly differently in the four nations, variation in the timing and extent of restrictions has been fairly limited.

But this observation in turn raises an important issue: has the policy response been uniform because the devolution settlements themselves constrain it to be?

There is a grey area between differential spending needs, and policy choice. If one territory has much higher levels or rates of infection, we might say that it has higher spending needs. On the other hand, it is possible to imagine that two governments, confronted with identical data on virus prevalence and health service load in their territories, might come to different views about when and how stringently to apply mitigating health measures, based on their preferences for various health and economic risks.

Between these two extremes are cases where some differences in prevalence of the virus or NHS capacity at a given time might induce one government to introduce preventative measures sooner or more comprehensively than in another territory.

But what if devolved governments feel constrained in their ability to set policy in relation to health restrictions – a devolved area of competence – because of the way their devolution settlements and fiscal frameworks operate?

Arguably, this nearly happened and was only resolved by a last-minute change in the UK government's view of the public health situation in England.

Wales entered a 16 day 'firebreak' lockdown between Friday 23rd October and Monday 9th November, in an attempt to reduce case numbers, which the Welsh Government felt were too high and growing too fast. At this stage, the UK government was trying to avoid an England-wide lockdown and had implemented a three-tier system of restrictions for different parts of the country.

At that time, the UK-wide furlough scheme required employers to pay 20% of wages, as well as pension and National Insurance contributions, even if businesses were forced to close because of public health restrictions. However, it was due to be replaced by a somewhat more generous 'job support scheme' from November 1st that would pay employees a lower fraction of their wages (67% rather than 80%) if the business they worked for was forced to close, but cover all their wage costs. For other businesses the job support scheme was set to require employees to work at least 20% of their usual hours, with employers covering 5% of the wages for any hours not worked.

The Welsh Government was concerned that its decision to enter the firebreak lockdown in October, in combination with the less generous furlough scheme then in place, risked redundancies.[12] Such

[12] See: https://www.bbc.co.uk/news/uk-wales-politics-54607893.

were the Welsh Government's concerns that it offered to reimburse the UK Treasury the difference in costs between the existing furlough and new job support scheme in order to bring the latter forward to the 23rd October in Wales. However, the UK government told the Welsh Government that this was not logistically possible. Concerns were also expressed that the 67% payment rate for fully furloughed workers under the new job support scheme beginning on November 1st was too low for many low paid workers.

Then on 31st October, the UK government announced that England would enter a four-week lockdown in November, and that the furlough scheme would be continued and made more generous, effectively returning to its original (first lockdown) characteristics.

The fact that changes to the employment support offer were made rapidly when it was announced England would enter lockdown caused political consternation in Wales and the other devolved nations. Frictions mounted further when the UK government initially refused to commit to continuing the more generous furlough in the devolved nations if they imposed lockdowns beyond the December 2nd date that had been set for the lifting of lockdown conditions in England.

For example, in her daily briefing on 4 November 2020, Nicola Sturgeon said: "We cannot have a situation where businesses are fully supported, rightly fully supported, when England enters a lockdown, but comparable support isn't made available, if all or part of Scotland, or Wales or Northern Ireland face similar restrictions." She argued that uncertainty around the availability of furlough policy was influencing the Scottish Government's decisions on restrictions.

The Treasury's reticence about committing to continuation of full furlough whenever a devolved government decided to enter lockdown is that, given that the direct costs of furlough do not fall directly on them, the devolved governments might be incentivised to enter lockdown too readily. Whether this is realistic is debateable – there are many other economic and political costs to lockdown. In this regard, Arlene Foster raised the possibility of adopting a threshold of infections that automatically ensures extra support from the Treasury if restrictions are imposed. This proposal therefore opens up the possibility that UK government funding support is responsive to the devolved governments' policy decisions, but only once some objective threshold of need is reached.

Ultimately, major political crisis around this issue was averted by the UK government's subsequent decision on November 5th to extend the original more generous furlough scheme across the UK until March 2021 (since further extended to June 2021, with a tapering of support to September 2021). Nonetheless, uncertainty around furlough policy during early autumn 2020, and the way in which it might or might not apply differentially across the UK in response to differential restrictions, did create further policy-making challenges and uncertainty for the devolved governments. But ultimately it seems unlikely that this uncertainty significantly affected devolved government policy responses - although perhaps Wales may have entered its circuit breaker slightly earlier (whether or not that would have materially impacted health outcomes is beyond the scope of the current paper).

5. The Single Market Act and new streams of economic development funding: a different approach

Brexit has, directly and indirectly, further complicated funding arrangements in the devolved territories.

The Internal Market Bill was introduced in 2020 partly to enable the UK government to allocate spending in the devolved territories to areas which had previously been thought to be reserved to the various parliaments, and became law – and hence the Internal Market Act – in December 2020. These areas include economic development, infrastructure, cultural activities and sport. Thus, the UK government has given itself explicit powers to directly spend in the devolved nations in areas where funding was previously provided by the EU and allocated to projects by the devolved governments.

The Internal Market Act can therefore be seen as enabling a range of UK government interventions that bypass not only the Barnett formula but the devolved administrations themselves. Perhaps most significantly, these interventions will include the UK Shared Prosperity Fund (SPF), the UK government's proposed replacement for EU Structural Funds. But they will also include: the Levelling-up Fund; the UK Community Renewal Fund (which is a temporary programme in 2021/22 to bridge between the cessation of EU Structural Funds and the SPF); the UK Community Ownership Fund; the Freeport Programme and the UK Infrastructure Bank.

Prospectuses for the Levelling Up Fund and the Community Renewal Fund were released with the 2021 Budget. These provide a useful, albeit indirect, insight into current UK government thinking on fiscal relations with the devolved authorities.

5.1 The Shared Prosperity Fund and the Community Renewal Fund

Replacement of the European Structural and Investment Funds (ESIF) was signalled in 2017 with the announcement that the "Shared Prosperity Fund" (SPF) would be introduced post-Brexit. It would broadly support similar objectives to the funding it replaced. In July 2018, the UK government committed to respect the devolved administrations in the operation of the SPF. In the Spring 2021 budget, it committed that the SPF would be worth around £1.5 billion per year and would be introduced in 2022.

EU-defined needs assessments underlay the allocation of ESIF funding to the nations and regions of the UK – although the UK Government had and made use of a degree of discretion, in particular, providing more to Northern Ireland, Scotland and Wales between 2014 and 2020 than they would have received under the EU's formulas. This approach set ESIF funding apart from the Barnett Formula and was particularly important for Wales, due to the fact that West Wales and the Valleys was assessed to be one of the poorest regions in Europe and hence entitled to particularly high levels of funding (in contrast, Wales has historically done well than Scotland and Northern Ireland from Barnett-determined block grant funding).

With access to ESIF now ended, and the design of the SPF yet to be settled, the Community Renewal Fund (CRF) has been introduced as a bridging mechanism for fiscal year 2021/22. This is effectively a pilot for the SPF and will be worth around £220 million. The CRF will prioritise investment in skills, local business, communities as well as supporting people into employment, thus sharing many features with ESIF.

Rather than allocations being based on need, the Community Renewal Fund will be allocated competitively. In Great Britain it is to be allocated on a competitive basis with local authorities, county councils, the Greater London Authority and Mayoral Combined Authorities being identified as "lead authorities" empowered to submit bids. There will be a separate mechanism for Northern Ireland with a budget set at £11 million.

This is clearly a radical departure from both the Barnett Formula and the formula-based approach to allocating ESIF as far as Scotland and Wales are concerned. The lead department managing this competition will be the Ministry of Housing, Communities and Local Government (MHCLG). The competition will look to foster priorities such as skills, investment in local businesses, communities and places and helping people into employment. These are areas in which the devolved administrations have a role that is implicitly recognised in the Statement of Funding Policy published alongside the UK government's spending reviews.

The MHCLG has drawn up an index of 100 places that will be given priority in the competition. The index was formed by combining data on Gross Value Added per hour worked (given a 30%, and with higher levels being given lower priority), Gross Disposable Household Income per head (10%, lower priority), proportion of 16 to 64-year-olds with no qualifications (20%, higher priority), model-based estimates of the unemployment rate (20%, higher priority) and numbers aged 16-64 per square kilometre of dry land (20%, lower priority).

Of the 100 places, 12 are in Scotland and 11 in Wales. Thus, both have more priority places than their population weight would suggest, particularly so for Wales. How much funding will be allocated to Scotland and Wales will depend on the success of the bids constructed for their respective priority places.

5.2 The Levelling Up Fund

The Levelling Up Fund, announced at the 2020 Spending Review, is a £4.8 billion infrastructure fund intended to support town regeneration, local transport, culture and heritage. It is available across the whole of the UK. Expenditure will be spread over four years with a commitment that £4 billion will be spent in England and a minimum of £800 million across Scotland, Wales and Northern Ireland.

Early indications are that the devolved nations will receive a broadly population-based share of the fund, although this picture is evolving, which is what they would receive if the scheme was England-only and generated Barnett consequentials instead.

The MHCLG will again oversee the fund. Applications to the fund will come, singly or jointly, from local authorities or combinations thereof. MHCLG has already drawn up a three-fold prioritisation of UK local authorities for access to the fund, based on its assessment of the need for: economic recovery and growth; transport connectivity and regeneration. Across the whole of the UK, the first stage of prioritisation is based on an equally weighted index comprising measures of (log) productivity (negative weighting), unemployment (positive weighting) and skills (negative weighting). The second stage focuses on transport connectivity but utilises data only available for England, while the third uses information on vacancy rates for commercial property and dwellings. Failure to integrate connectivity data from Scotland has contributed to Orkney, Shetland and Highland being placed in the category least likely to benefit from the fund alongside areas such as the City of London.

5.3 Summary

Together, the Internal Market Act, the Levelling Up Fund and the Community Renewal Fund mark a significant change in fiscal relationships between UK Central Government and the devolved authorities. In both cases the funds will ostensibly be allocated on the basis of 'needs', but the assessment of what constitutes 'need' has been developed by the UK government without consultation with the devolved governments. Moreover, whilst needs are taken into account in bids to the Levelling-up Fund, this is within the context of an overall funding package to each territory that seems likely to be broadly based on population share.

With both funds the UK government has chosen to deal directly with local authorities in the devolved territories, effectively bypassing not only the Barnett formula but the devolved governments themselves. While it is unclear how the main Shared Prosperity Fund itself will be allocated, the Community Renewal Fund and Levelling-up Fund further extends the role of competitive bidding processes controlled by the UK government in the devolved nations (on top of the city and other growth deals negotiated over the last few years.

The amounts of funding involved with these funds are relatively small in context of devolved governments' overall budgets – albeit a sizeable proportion of economic development spending. However, the devolved authorities may be concerned that this process will extend to other areas of spending, given that the Internal Market Act provides wide latitude for the UK government to spend in areas previously delegated to them – including potentially education and skills, given its links to economic development. In the absence of co-operation agreements and joint decision-making, there may also be a risk of inefficient overlaps or mismatches between the UK government's and devolved governments' schemes. This may, in turn, constrain the design of the devolved governments' schemes, if they wish to minimise this risk.

6. The forthcoming review of the Scottish fiscal framework

This section discusses the issues associated with the upcoming review of the Scottish fiscal framework, although many if not all of these issues are likely to be relevant to the Welsh fiscal framework – and the framework to be developed for Northern Ireland – in due course. This review may provide an opportunity to make changes to the fiscal frameworks to make them more robust to future crises, and support medium-term recovery from the COVID-19 crisis.

The Smith Commission, set up after the independence referendum in 2014, recommended the devolution and assignment of several tax and social security responsibilities to the Scottish Parliament.

But the Smith Commission did not consider in any detail what operational changes might be required to ensure that the new fiscal responsibilities could be implemented and managed appropriately. The Smith Commission recommended that the 'devolution of further responsibility for taxation and public spending…should be accompanied by an updated fiscal framework for Scotland' (paragraph 94). The Commission did set out various principles on which the revised fiscal framework should be based. But it left the specifics of the fiscal framework to be negotiated subsequently by the two governments.

The Scottish Government's fiscal framework agreement was published jointly by the Scottish and UK government on 23 February 2016.[13] The fiscal framework covers issues including: how the Scottish Government's block grant should be adjusted to take account of the transfer of fiscal responsibilities; responsibilities for forecasting the devolved tax revenues and social security spending; the scope of budget management tools to manage forecast error (including borrowing powers and reserves); capital borrowing limits; processes for dispute resolution, and various other issues.

The fact that the Smith Commission report was published in January 2015, but the fiscal framework agreement was not finalised until February 2016 gives a sense of how fractious the negotiation of the fiscal framework was.

The key stumbling block during the negotiations was the mechanism for adjusting the Scottish block grant to take account of Scotland's new tax and spend responsibilities – the so-called block grant adjustments (BGAs). The Scottish Government preferred one method (known as Indexed Per Capita, which fully protected it from the risk of differential population growth), whilst the UK government preferred another method (known as the Comparable Method, which was slightly more consistent with the operation of the Barnett Formula). Neither method was obviously superior to the other in the way it met the principles identified by the Smith Commission (it turned out that some of the Smith Commission principles were mutually incompatible with one another).[14]

Eventually a somewhat oddly-worded compromise was reached. The fiscal framework states that (para 17):

'For a transitional period covering the next Scottish Parliament, the Governments have agreed that the block grant adjustment for tax should be effected by using the Comparable Model (Scotland's share), whilst achieving the outcome delivered by the Indexed Per Capita (IPC) method for tax and welfare.'

In other words, over the course of this parliament the Scottish budget would be determined by BGAs that had been calculated using the Scottish Government's preferred method; but BGA calculations according to the UK government would continue to be published alongside this, in order that comparisons could be made. The fiscal framework did not commit to one or other of the BGA mechanisms after the first term of the Scottish parliament – this was to be negotiated subsequently. By 2020, the Scottish budget was around £80 million better-off as a result of the BGAs being calculated by the Scottish Government's preferred method than it would have been if the UK Government's preferred method had been implemented.[15]

But whilst the calculation of the BGAs accounted for a disproportionate amount of negotiation time, other aspects of the fiscal framework received relatively little attention. Rules on borrowing limits and use of reserves to manage forecast error appear to have been based on relatively little by way of objective analysis – although to be fair there was of course little data available that might have informed the setting of these limits.

In the years since the fiscal framework was agreed, there has already been one year in which forecast error on income tax has exceeded the Scottish Government's annual forecast error borrowing limit. This occurred despite the fact that only two years of income tax outturn data has so

[13] https://www.gov.uk/government/publications/the-agreement-between-the-scottish-government-and-the-united-kingdom-government-on-the-scottish-governments-fiscal-framework
[14] For further details, see Bell et al. (2016) https://www.ifs.org.uk/publications/8212
[15] Source: HM Treasury's 'Block grant transparency' publication, July 2020

far been available since income tax was devolved in 2017/18; and before plans to devolve APD and transfer a proportion of VAT revenues to the Scottish budget have been operationalised.

Analysis by the Scottish Fiscal Commission indicates that that the normal £300 million per annum borrowing powers of the Scottish Government could be exceeded between one and four times per decade, and negative reconciliations greater than £600 million could arise up to two times per decade, as a result of income tax forecast errors alone.[16]

The two governments agreed that the fiscal framework arrangements set out in the 2016 agreement would be reviewed in 2022. The fiscal framework agreement states that the review 'will be informed by an independent report with recommendations presented to both governments by the end of 2021'.

But which aspects of the fiscal framework should a review cover? Who should lead the independent report, and what sorts of analysis should it include? The 2016 fiscal framework did not explicitly address any of these questions, and there is now tension between the governments about what the scope of both the independent report, and the subsequent review should be.

The UK government's position is that the scope of the review should be narrow, and focus for the most part on the mechanism for adjusting the block grant. Its argument is that this narrow focus is implicitly what is implied by the 2016 fiscal framework. It is indeed the case that the part of the fiscal framework that discusses the review follows on immediately after the section on BGAs; and that later on the fiscal framework refers to 'the independent report on the block grant arrangements' (para 111), implying that BGA issues will be the main focus of the review.

The Scottish Government has consistently argued that the scope of the review should be broader. In its 2021 Medium Term Financial Strategy,[17] the Scottish Government argues that the review of the fiscal framework 'should consider not only how the Fiscal Framework has operated to date, but whether there is an appropriate balance between the risks to which the Scottish Budget is exposed, and the levers that the Scottish Government has to manage those risks, particularly in light of the COVID-19 pandemic' (p.58).

It argues that the review should consider, as a minimum:

- The mechanism for calculating block grant adjustments
- Appropriateness of budget management tools to manage forecast risk
- The sufficiency of capital borrowing powers
- Policy risks that arise when UK government tax or spending decisions affect or constraint the Scottish Government's policy options.
- The range of fiscal responsibilities devolved, and the scope for 'identifying further powers that would make the tax system work more efficiently in Scotland, and serve the people and businesses of Scotland more effectively'. The devolution of VAT, Capital Gains Tax, National Insurance Contributions, and full devolution of income tax are mentioned as possibilities worth of exploration, according to the Scottish Government.

[16] Scottish Fiscal Commission (2021) Economic and Fiscal Forecasts, January 2021

[17] Scottish Government (2021) Scotland's Fiscal Outlook: The Scottish Government's Medium-Term Financial Strategy

The Scottish Government argues that this broader scope is warranted given 'the significant changes in the political and constitutional landscape in the years since the agreement was made, and the recent and ongoing experience of COVID-19' (p.58).

The argument that the scope of the review should cover all aspects of the fiscal framework has also been made by a joint report of the Scottish Government with the Scottish Parliament's Finance and Constitution Committee and Social Security Committee[18]. Their joint report recommended that the fiscal framework review should cover all aspects of the fiscal framework itself, and consider issues including: the mechanism for calculating the BGA mechanism, budget management tools, issues around policy, intergovernmental relations and dispute resolution, and transparency and accountability issues. However, it does not recommend the consideration of further tax devolution as part of the review, given differences in the positions of the political parties represented in the Scottish Parliament's committees.

The point that UK government decisions can affect devolved governments was made in a joint letter from the Finance Secretaries of the Scottish, Welsh and Northern Irish Governments to the Chair of the UK Parliament's Treasury Committee in September 2020.[19] This highlighted several ways in which UK government tax changes could impact on devolved governments, including directly through changes to the block grant adjustments, and indirectly as a result of uncertainty and behavioural change.

One example provided in the letter was the UK government's decision to temporarily, and with immediate effect, raise the zero-rate threshold for Stamp Duty in England with at the Summer Economic Update. The devolved governments were given no advance notice of the policy change, which 'resulted in unhelpful uncertainty for the housing markets in Scotland and Wales at a sensitive time and risked stalling property transaction activity, directly and indirectly, with impacts for tax revenues and the wider economy'.

The finance ministers thus called for 'existing arrangements for developing and implementing tax policy in the UK need to be strengthened and improved, to reflect the devolution of tax powers to the democratically-elected, devolved governments of Wales, Scotland, and Northern Ireland'.

The scope of any independent review has to be jointly agreed by the UK and Scottish governments. But how will the governments agree on its scope, particularly at a time when the UK Government has introduced new spending programmes in the nations that appear not to involve the devolved governments?

It seems hard to deny that there is a strong case for reviewing budget management tools (forecast error borrowing and reserve limits), as well as BGA mechanisms, and there is also a need to reflect on issues of the implications of the timing of UK and Scottish fiscal events. There is a strong case therefore for saying that the framework as a whole should be reviewed. Indeed, the Smith Commission did state that the fiscal framework should be reviewed 'periodically' (para 95), and this was reiterated in the 2016 fiscal framework agreement, which stated that the 'fiscal framework *as a whole* will be reviewed periodically' (para 113 – emphasis added).

However, whether or not a review of the fiscal framework should encompass questions of which fiscal responsibilities should be devolved is more ambiguous. The UK government is likely to argue a

[18] https://archive2021.parliament.scot/S5_Finance/General%20Documents/Report(2).pdf

[19] See letter from the devolved finance ministers to the UK Parliament's Treasury Committee inquiry into Tax after Coronavirus: https://committees.parliament.uk/writtenevidence/11474/html/

review of the fiscal framework should cover the operational aspects of fiscal devolution that were covered by the 2016 fiscal framework document, but that the question of fiscal responsibilities themselves (including discretionary borrowing powers), if they are to be reviewed, should be considered as part of a politically broader and more deliberative process.

How these differences might be resolved post-election is unclear. Of course, if the SNP win a majority at the May elections, the triggering of a mandate for a subsequent independence referendum may put the issue of the fiscal framework review on the backburner. If this doesn't happen, a compromise on the scope and terms of the review will need to be agreed.

7. Concluding remarks

The devolved governments' fiscal frameworks and settlements were clearly not designed with a fiscal shock like the COVID-19 pandemic in mind.

At the outset of the pandemic there were reasons to be concerned about the ability of the devolution funding frameworks to cope. The funding frameworks link changes in devolved funding to changes in spending in England, and put strict limits and controls on borrowing. They provide no insurance to the devolved budgets against the risk that devolved revenues are hit proportionately harder than those in England.

Had the health or economic impacts of the pandemic disproportionately impacted one or more of the devolved nations, the property of parity inherent in the funding frameworks could potentially have constrained the ability of devolved governments to respond to the pandemic.

As it happens, the devolved governments' funding arrangements have largely coped with the COVID-19 crisis. This is the result of a combination of luck, the huge sums of money provided by the UK government to address the crisis in England, and ad-hoc bypassing of the normal rules of the frameworks.

The 'luck' part of the equation reflects the fact that both the devolved nations have not been disproportionately negatively impacted by the virus in either health or economic terms.

But the shift away from the usual process of allocating funding by Barnett consequentials to the concept of funding 'guarantees' has also been important in providing the devolved governments the resources and flexibility they need to meet the evolving demands of the pandemic. As have the huge sums of money that the UK Government has allocated to the pandemic in England, especially in relation to the NHS. Figures in Honeysett and Brien (2020) and Knight et al (2021) suggest that England-only health spending of around £42 billion has generated £4.1 billion of consequential funding for Scotland, £2.5 billion for Wales, and £1.4 billion for Northern Ireland, for example.[20] Large parts of these consequentials result from the significant cost of purchases of personal protective equipment and the contact tracing programme in England – with per capita spending on these items exceeding the amounts the devolved governments have felt the need to spend. This has allowed the devolved governments to allocate more to other areas – helping address other

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[20] Honeysett, L. and Brien, P. (2020), 'Main Estimates: government spending plans for 2020– 21', House of Commons Library Briefing Paper 08926, Available at: https://commonslibrary.parliament.uk/research-briefings/cbp-8926/, and Knight, A., Broughton, A. and Brien, P. (2021), 'Revised government spending plans for 2020/21', House of Commons Library Briefing Paper 09149, Available at: https://commonslibrary.parliament.uk/research-briefings/cbp-9149/.

pressures that may have arisen – and make use of their flexibility to carry forward funding into 2021/22.

Nonetheless, whilst crises have been avoided, at times this has perhaps only narrowly been the case. Uncertainty around whether the furlough scheme would be available within a devolved nation if a devolved government felt the need to apply tighter restrictions than prevailed in England may have influenced the timing of restrictions in Scotland and Wales in Autumn 2020. But in the end, the UK government's decision to extend lockdown in England averted major crisis around this issue.

Would alternative constitutional arrangements within the UK have improved the response to COVID-19? Germany is cited as an example of a country, with many similar features to the UK, that has managed the pandemic more successfully. This has been partly attributed to allowing its 16 länder to manage the public health response, perhaps facilitating a better-informed local approach. However, lockdown decisions by the länder clearly impose externalities on other parts of the federation.

Lax lockdowns coupled with high infection rates may cause infections to rise in nearby länder. In consequence, the federal government is currently seeking powers to impose lockdowns in high infection-rate länder. Given that Germany has a clearly defined constitution or "Basic Law", this has provoked intense debate as to whether the federal government has the right to override länder decisions in this context.

The UK does not have a written constitution and has been able to "get by" during the pandemic – without a health or economic crisis specific to one or other devolved nation – through a mixture of luck and muddling through. The outcome might have been different had there been a wider dispersion of infection rates among the home nations.

However, the pandemic has exposed some limitations and risks of the devolved funding settlements, and poses a number of questions for their future. For example, do the block grant adjustment mechanisms provide sufficient insurance against the risk of asymmetric shocks? Such shocks have always been thought of as deriving from economic events, such as a financial crash, but recent experience has shown that a health shock can have devastating economic consequences.

Do the devolved governments have enough budgetary flexibility to respond to short-term fluctuations in need, or to vary policy in response to such events? To what extent is there a need for new arrangements for collaborative decision-making or improved communication on 'reserved' policy areas where those affect the ability of devolved governments to implement policy in devolved areas? And will economic development policy function effectively as a shared competency, as envisioned under the Single Market Act, or are co-ordination and de-lineation issues likely?

The aim of this paper has not been to assess or answer these questions, but to lay out the issues that we will consider throughout the remainder of our one-year project. The forthcoming review of the Scottish fiscal framework, the work of the Northern Ireland Fiscal Commission which has just got underway, and changes to funding mechanisms enabled by the Internal Market Act are further reasons why now is an appropriate time to consider these questions and examine the scope for reforms.

Addressing these issues will raise challenging questions around where the responsibility for managing various fiscal risks should lie, and the extent to which the answer to this question depends on the nature of the fiscal powers devolved, and the nature of constitutional arrangements more broadly.

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