Glossary

*Allocative efficiency:* a combination of efficiency in production and efficiency in consumption. ‘Efficiency in production’ means that goods are produced at least possible cost. ‘Efficiency in consumption’ means that consumers are able to obtain the goods that they want in the combinations they prefer. Technically, allocative efficiency is achieved when for any pairs of goods the ratio of marginal cost is equal to the marginal rate of substitution (or ratio marginal utilities).

*Assigned tax:* taxes paid by and returned to the tax jurisdiction in which they were raised.

*Benefit taxes:* taxes that match benefits received by taxpayers. For example, residents of a local school district paying the full cost of its school system. Thus, residents ‘pay for what they get’. See non-benefit taxes.

*Bloc grant:* the annual grant from Westminster to Edinburgh used to finance devolved expenditures.

*Central government:* the government of the UK based in Westminster.

*CG:* see central government.

*Conditional grant:* a grant from central government to sub-central government that is conditional on some action by the latter – very often to encourage sub-central government to spend money for a designated purpose, such as education. One purpose of conditional grants is to take account of spillover benefits from one tax jurisdiction to another. This is known as ‘internalizing an externality’. As the spillover is a benefit not paid for by the receiving region, the sending region will tend to under-invest in it. The condition grant gets around this problem.

*Devolved expenditure:* expenditure classes devolved to Edinburgh under the Scotland Act (1999) – such as spending on Scottish health and education.
Devolved tax: a tax, such as income tax, over which sub-central government has some decision-making responsibility – such as setting the tax rate or the tax base.

Economies of scale occur when the average (or, per unit) cost of production falls with the size, or scale, of operations.

Equity or distributive justice occurs when the distribution of goods between people in a society is thought to be ‘fair’ by the electorate.

Fiscal autonomy: tax revenues raised in Scotland stay in Scotland and are used to finance spending by the Scottish government and parliament. At the highest level of fiscal autonomy no grants would flow to Scotland from the rest of the UK. If Scotland remains in the UK it would possibly have to pay the rest of the UK for public goods supplied by the latter (for example, defence, diplomatic services).

Fiscal equalization: see horizontal equity.

Fiscal federalism: in a strict legal sense fiscal federalism exists when a country’s constitution grants rights to SCG over public spending and taxes. These powers cannot be removed by CG without an amendment of the constitution. Examples of such federal systems include the USA, Canada and Germany. In this sense the UK is not a federalism system, rather it is a unitary state. However, the term ‘fiscal federalism’ is widely used in a looser sense to describe situations where SCG has powers over spending and/or taxing that derives from CG that is not constitutionally protected. In this sense, Scotland is already part of a ‘federal’ system but with rather limited fiscal powers, especially over taxation.

Hard budget constraint: where the financial constraint on spending is binding – a SCG has to live within its means without expecting relief from CG.

Horizontal balance occurs when per head public expenditure is similar between regions at similar per head tax burdens. See also horizontal imbalance.

Horizontal equity what is judged to be ‘fair’ in taxing and spending between regions. See also fiscal equalization.

Horizontal imbalance: when per head regional tax burdens differ markedly for similar levels of per head public spending. Horizontal imbalance is
reduced if some tax revenue raised in high income regions is transferred to a low income region. See also horizontal balance.

*Local public goods and services:* their benefits are enjoyed within a restricted geographic area, for example, schools, hospitals, fire service.

*Macroeconomic stabilization:* see ‘stabilization function of government’.

*Marginal tax rule:* increased spending by the Scottish government in one area is matched by higher taxes to pay for it, and/or by lower spending elsewhere.

*Matching grant:* see conditional grant.

*Moral Hazard:* initially used in relation to the insurance industry. Somebody who is insured then acting differently once they are insured. For example, somebody with property insurance taking less care to secure their property.

*Needs equalization:* money transferred from central government to sub-central government on the basis of ‘need’ – usually to balance the per head supply of public goods at similar local tax burdens. Without needs equalization poorer regions would have a greater tax burden for the same supply of public goods.

*Non-benefit taxes:* taxes not necessarily related to benefits received from public spending in a region – such as taxes raised to redistribute income between high and low income households. See also benefit taxes.

*Public choice theory:* a branch of economics that views government as being run by self-interested agents. Thus, politicians and bureaucrats in acting in their own best interests do not necessarily act in the best interests of the electorate.

*SCG:* see sub-central government.

*Soft budget constraint:* when a SCG is aware that should it breach its spending or borrowing limits it can expect relief from CG.

*Stabilization function of government:* the use of the public finances to even out fluctuations in national production and employment. For example, in a recession increasing public spending and cutting taxes so as to stimulate the economy.
**Sub-central government**: a regional government, for example, the Scottish executive and parliament based in Edinburgh. See also central government and CG.

**Tax assignment problem**: determination of the ideal balance between taxes raised locally and total public expenditure in a region.

**Time consistency**: a commitment made today because it is rational to make it today that is still rational to execute when the time comes to do so. Thus, to constrain possible SCG overspending, CG commits to a ‘no bailout’ clause. The commitment is time consistent if SCG later threatens default on its debts and it is still rational for CG to let it happen. If at this time of a threatened default it is not rational to let the default occur, the original commitment was not time consistent. Commitments that are known not to be time consistent are likely to be ineffective in governing behaviour.

**Unconditional grant**: a grant from CG a SCG that is not conditional on a predefined performance by the latter. See also conditional grant.

**Vertical balance in the tax structure** is the relationship between taxes raised in a region and a region’s public spending. High vertical imbalance means that taxes raised in a region cover only a small part of local public spending.

**Vertical imbalance**: see vertical balance.

**West Lothian question**: the member for West Lothian, Tam Dalyell, in 1977, questioned the sustainability of a devolved parliamentary system whereby Scottish MPs can vote on English only issues, but English MPs cannot vote on Scottish only matters.