

Adam Smith Institute
Omega Report

SCOTTISH POLICY



Adam Smith Institute

1983

The Adam Smith Institute's Omega Project has produced a file of 1983-84 of the work of the Institute's research department. This file contains a selection of the work of the Institute's research department, which has been a full-time operation since 1981. The project of this file is to provide a comprehensive and up-to-date record of the work of the Institute's research department.

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London
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FORWORD

The Adam Smith Institute's **Omega Project** was conceived to fill a significant gap in the field of public policy research. Administrations entering office in democratic societies are often aware of the problems which they face, but lack a well-developed range of policy options. The process by which policy innovations are brought forward and examined is often wasteful of time, and uncondusive to creative thought.

The **Omega Project** was designed to create and develop new policy initiatives, to research and analyze these new ideas, and to bring them forward for public discussion in ways which overcame the conventional shortcomings.

Twenty working parties were established more than one year ago to cover each major area of government concern. Each of these groups was structured to include individuals with high academic qualification, those with business experience, those trained in economics, those with an expert knowledge of policy analysis, and those with knowledge of parliamentary or legislative procedures. The project as a whole has thus involved the work of more than one hundred specialists for over a year.

Each working party had secretarial, research and editorial assistance made available to it, and each began its work with a detailed report on the area of its concern. Each group has explored in a systematic way the opportunities for developing choice and enterprise within the particular area of its concern.

The reports of these working parties, containing, as they do, several hundred new policy options, constitute the **Omega File**. All of them are to be made available for public discussion. The **Omega Project** represents the most complete review of the activity of government ever undertaken in Britain. It presents the most comprehensive range of policy initiatives which has ever been researched under one programme.

The Adam Smith Institute hopes that the alternative possible solutions which emerge from this process will enhance the nation's ability to deal with many of the serious problems which face it. The addition of researched initiatives to policy debate could also serve to encourage both innovation and criticism in public policy.

Thanks are owed of all of those who participated in this venture. For this report in particular, thanks are due to Catherine Blight, Michael Fry, Douglas Mason, amongst others. All **Omega Project** reports are the edited summaries of the work of many different individuals, who have made contributions of various sizes over a lengthy period, and as such their contents should not be regarded as the definitive views of any one author.

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1. INTRODUCTION

Economic freedom is the essence of personal freedom. It means giving the power of decision and choice back to individual citizens, taking it away from governments and from vested interests. In Scotland, the way to political reform is blocked by dissensions, but the path to **economic** reform is still open. As a method of improving personal freedom, this economic liberalization is probably more achievable than political restructuring, and its effects would probably be even more profound. Accordingly, it is upon economic freedom in Scotland that we have chosen to concentrate.

The governance of Scotland

Central government is a dominant force in the Scottish economy, but it has still not solved the country's problems. This is despite the fact that it has its own central government, the Scottish Office, which performs the functions carried out in England by half a dozen other ministries.

When the modern Scottish Office was set up in 1938, there were four departments: agriculture, education, health, and home, largely corresponding to their equivalents in England. Since then, further powers have been acquired by government in general and by St Andrew's House in particular, so that the Scottish Office has now come to possess some of the sweeping powers of the Department of the Environment in England, has important functions in industry, and is heavily responsible in other areas - such as energy and employment - which are divided more untidily between Edinburgh and London. Some rationalization is past due.

Though the Scottish Office has generally been ambitious to win these powers, it has rarely used them to produce distinctive policies for Scotland. While, for example, the school system remains separate, and there are significant differences in agriculture and health, over much of the rest of public policy there is scarcely any difference between Scotland and England. The present administrative structure can therefore be seen as only a starting point: its deficiencies and its bureaucratic inertia are plain enough.

Alternatives to devolved powers

In the 1970s, it was thought that the way to open up and democratize Scottish government was through a directly elected assembly. Our alternative is to set about the systematic removal of powers, especially economic powers, from central government. The demand for devolution, after all, arose in part because many Scots resent the all-pervading influence of a distant and insensitive bureaucracy. Cut back that pervasiveness, and it will become obvious that there is enough variety and vitality in

Scottish institutions, and the Scots people, to produce a social and economic renaissance which the present enforcement of a dreary conformity makes impossible.

For a start, the entire structure of grants and other aids to industry could be dismantled: there is no clear evidence that it has done more than a negligible amount of good, and in certain instances it has undoubtedly been harmful. Even if it could be demonstrated that good has been done, there would be no case in equity for continuing the system in Scotland, which is no longer one of the poorest parts of the UK. Scotland is emerging from the recession more quickly than other places not because she receives regional aid, but because she has comparative advantages over others in competing for investors in the latest economic developments. They include an under-used workforce familiar with modern industrial conditions, access to advanced scientific facilities, sophisticated financial services, good communications, and a fine environment.

One would expect these to attract the industries that are in fact being attracted: micro-chips, fibre optics, financial and related services, advanced medical technology, etc. - and that is without even taking into account the windfall of North Sea oil. Already, the industries mentioned employ about four times as many people as the traditional ones of coal, steel, and shipbuilding put together. Yet Scotland continues to delude herself that she depends on those traditional industries.

The delusion can be dangerous, as in the controversy over the Ravenscraig steelworks. In the West of Scotland, there are about fourteen times as many people employed in steel-using industries as in the steel-making industry. The fact that those companies are in effect obliged to buy expensive local steel when (without EEC restrictions) they could buy Korean steel at one-third of the price means that each of them is worse off and less capable of weathering the recession than it might be. No doubt large numbers of companies have failed as a result, while many more have not even been started. We conclude that the maintenance of Ravenscraig without regard to cost is actually destroying more jobs in the West of Scotland than it is preserving.

There is a simple way of testing this thesis that improved prospects for the Scottish economy rest on comparative advantage rather than regional aid: that is to compare it with other economies receiving similar aid. If aid were the decisive factor in their performance, all would be expected to perform roughly similarly. But until a few years ago, Scotland had the highest unemployment rate of any UK region except Northern Ireland. Today, she has lower unemployment than four others - the North of England, the Northwest, Wales and the West Midlands. With the same assistance, the North, the Northwest, and Wales have not done as well as Scotland, because of the comparative advantages which Scotland possesses.

A great psychological benefit would flow from the abolition of

A great psychological benefit would flow from the abolition of automatic subsidies to Scotland. They have fed the delusion that she is a special case, somehow incapable of facing and overcoming economic change - when all experience up to this century pointed to precisely the opposite conclusion. Automatic grants and subsidies make it unnecessary for people to adapt to new circumstances - and hence the restoration of open competition would have beneficial effects in terms of Scotland's adaptation to the facts of the world economy today. And if we strip away further layers of central government, we shall find sound Scottish institutions and traditions, stifled for decades but still capable of being revived. One is the banks' importance as the motor of the the economy. Another is Scots law as a defence for the individual and his environment.

But much of the assumed independence of many Scottish institutions today is illusory. This may be amply demonstrated by reference to the universities, of which the nominal independence is secured by their charters. In fact they have entirely subjected themselves to the state, with disastrous results. During the first half of the last century, the University of Edinburgh was, with the possible exception of Berlin, the finest in Europe. A distinct intellectual tradition, with standards of excellence, continued into the twentieth century. Now the Scottish universities are mere imitations of their English counterparts. It is inconceivable that this could have happened if they had retained their former independence, especially in funding.

All these problems have largely been the consequence of centralized big government, however benevolent its intentions. They have not fulfilled the aspirations of individual Scots.

2. ECONOMY AND INDUSTRY

INTRODUCTION

After the first world war, it became clear that Scotland's economic structure was outdated. She was bound to lose the position of world industrial leader which she had previously enjoyed. The solution to this was to innovate and diversify. But for the first time in her history, a Scotland under threat failed to do so. Instead, she tried to stave off economic change, with ill effects which are still felt today.

The country's prosperity before 1914 was founded on heavy capital industries. If the Scots had chosen, these could have been largely swept away by the 1930s. They would have been replaced (as they were in much of England) by companies making the consumer goods which were the key to future prosperity. Instead, Scotland insisted on preserving them until well into the 1960s. Even now they have not entirely disappeared. They certainly will have done by the end of the twentieth century, except perhaps in a few cases of specialist steels and shipbuilding where comparative advantage may still exist. The vain attempt to maintain them imposes gross distortions and inefficiencies on the Scottish economy.

The longer they go on, the more painful will it be to remove them. We have missed one industrial revolution, but now we are in danger of missing another. Every pound devoted to meeting the industrial demand of the past is a pound that cannot be devoted to meeting the industrial demand of the future.

We believe it is necessary to get rid of the distortions as quickly as possible. This may be difficult in the short run, but a too cautious approach will make the adjustment even harder in the long run. We estimate that if, between now and 1990, investment goes to those areas in which Scotland excels and cannot be undercut by foreign competition, then she will acquire an economy able to sustain the prosperity of her people till well on into the twenty-first century. It would be an economy based not on steel and coal and shipbuilding, but on high technology, financial services, and on supplying the needs of the worldwide oil industry. These are the industries in which she now has comparative advantage. Unless that is exploited, Scotland will stagger downwards.

We do not believe that such investment can be directed by any government. Government intervention in the 1960s and 1970s stimulated only a series of disastrous schemes: UCS, Invergordon, Lindwood and Ravenscraig. Governments almost invariably opt for ambitious prestige projects which may enhance their own political reputation, but which do nothing to mobilize the creative power of the population. This 'picking winners' policy is always guided by the wildest wishful thinking, and generally the 'winners' have become expensive losers. Despite the number of

apparently worthwhile projects being considered, it is likely that none of them will succeed if undertaken by the cold hand of government bureaucracy. Rebuilding Scotland's economy must be done by the private sector, building on the foundations which the enterprise of talented individuals has laid down in Scotland in the last few years. This entrepreneurial drive can best be helped by the absence of government regulation, rather than by the expenditure of large sums of taxpayers' money on prestigious schemes. Revival comes at the small business end of industry, as thousands of individuals apply their energy to satisfying market demand, and by its nature it must be multiform and responsive to demand changes. Encouragement of new small enterprises through deregulation is therefore likely to be more effective than a major investment in only one direction which may prove to be a mistaken guess.

Scottish Development Agency

The SDA is the embodiment of corporatist thinking that has typified Scottish policy for the last forty years. It does very little, if anything, to harness the energy of voluntary groups or promote the enterprise of small businesses. Its philosophy is that of 1950s regional economics with a contemporary veneer of microchips and ecology. Its industrial function, a sort of merchant banking service, helps those who have difficulty finding support in the commercial market, but is a failure, with a return on investments averaging minus 14 per cent. The Scottish people would have been better off if the money had been put into premium bonds.

Since 1982, the SDA has been instructed to achieve a return equal to the cost of borrowing its money, that is to say, at least to break even. It has failed to meet the 12.45 per cent return this would need: while it invested and lent £8.5 million in 1981/82, it returned a loss of £850,000. The investment criteria are nominally based on 'potential return' but in fact (and a prominent reason for their failure) they hinge on employment creation and the relative unattractiveness of the location.

The SDA is Scotland's leading industrial landlord, and surprisingly, its leading landscaping contractor. Its land renewal and environmental expenditure has passed £100 million. Although hailed by the SDA as a model of achievement that only government can accomplish, most of these projects were in fact taken over from local authorities that had rejected them as being of low priority. More than half the agency's capital expenditure goes on building factories as a subsidy to prospective tenants, although no commercial property owner would erect these structures in the sites picked by the SDA. Many remain vacant. At a present value of £214 million, it seems unacceptable to place the burden of this main investment on the taxpayer.

If government funding, with its present ceiling of £700

million, were to end, the true market value of the SDA's investments in marginal companies and in land and factories would be clear. We believe most of these interventions to be superfluous or harmful - products again of the notion that Scotland is uniquely handicapped, only be nursed back to health by the transfusion of subsidies. In fact, a reduction of taxes, and of regulations on companies and on land development would be infinitely more effective.

We suggest that there could be consultation with the CBI, the Scottish Council and other voluntary bodies to see if they wish to take over particular SDA functions. But these specific conclusions seem justified:

Technology. The Scottish Office cannot know what technologies will flourish in the future and has usually backed the wrong ones. Its work in this area should cease because of its potential for major malinvestment at the expense of higher taxation. Measures to improve relocation (for example, the liberalizing of the Scottish housing market) would probably be more effective in helping the establishment of new industries than any attempts at conscious support of potential 'winners';

Property. Future programmes can be abandoned, although in some cases it might be better to finish projects in progress before they are eventually sold. Private estate agents can be retained to advise on the rate of sales and to place property on the market;

Area development. Regional programmes attract resources wastefully to unpromising locations, and so cannot be justified economically. To prevent hardship, however, the programmes can be phased out over a few years or a once and for all payment can be made to ease the transition to a zero subsidy regimen;

Environment and landscaping. The costs can be imposed on the landowners, or placed on the local authorities concerned. A system of matching funds between owners and local authorities seems a reasonable way to ease into the new regimen. Landscaping can, in certain circumstances, be made a condition of commercial development;

Locate in Scotland. The Scottish Council and the CBI can be encouraged to take back this responsibility. Again, matching funds can help in the interim, but it is questionable whether a campaign of this nature has significant benefits in any event, and it is perhaps best that funding should be phased out in early course.

Enterprise zones and freeports.

Any part of Scotland which can support the status of enterprise zone or freeport should get it. But for enterprise zones to work it is essential to restore the guidelines which Sir Geoffrey Howe

put forward in 1978:

(1) Detailed planning control would not apply. Any building satisfying certain basic health and safety standards would be acceptable. Industrial Development Certificates and Office Development Permits would not be required;

(2) Public authorities would be required to auction off any land they owned in the zone, possibly using estate agents. New developments would be free from rent control;

(3) New firms would be free of development land tax and of all or part of their rates;

(4) Businesses would get a guarantee that tax law would not be changed to their disadvantage. No grants or subsidies would be payable;

(5) Price control, pay policy and restrictive labour legislation would not apply.

Few of these conditions presently prevail. The main benefits enjoyed by firms are rates relief and 100 per cent capital allowance for income and corporation tax purposes on commercial and industrial building. But detailed planning control is still enforced, the full range of grants and subsidies is retained, and there is no exemption from regulations such as the Employment Protection Act. Altogether, the zones have ceased to be an instrument of economic liberalism and have become instead a further refinement of economic interventionism.

This may be illustrated by our experience in Scotland. Clydebank was chosen for a zone simply because, in 1979, it happened to be the Scottish Office's main economic problem, following the closure of the Singer factory. On the same grounds, a zone was established at Invergordon after the aluminium smelter was closed down. The zones are in effect extra aid for the worst unemployment blackspots. Scarcely any pretence remains that they are fulfilling their original purpose of releasing entrepreneurial energy. The Scottish Office's own handout says: 'The boost provided for Clydebank by it being Scotland's Enterprise Zone is only an element in a much broader framework of incentives which exist for all sectors of industry.' If it is thought desirable to subsidize areas of high unemployment (a policy which we think is less effective than subsidizing individuals who want to move to where the new jobs are emerging), it is probably best done openly, and not under the confusing appellation of 'enterprise'.

Other political pressures have been impossible to resist in the establishment of the zones. For example, at Clydebank, planning restrictions have been drawn up, at the insistence of the local authorities, so as to ban hypermarkets. The only shops not requiring planning permission are those not selling food or clothing and of less than 400 square metres in area. Whisky

bonds are also banned. For its corner of the zone, Glasgow lists 60 Acts with which incoming firms have to comply. The government has also given way on the geographical concept of the enterprise zone. Originally it rejected a proposal from Glasgow that a zone should consist of isolated factory sites that the council wanted to see developed. But this is precisely the form in which the new Tayside zone has been set up.

Among others, the following places have requested the status of enterprise zone from the Scottish Office: Dundee, Fort William, Kyle and Carrick (for Prestwick), Wigtownshire and the Isle of Eigg. These requests seem reasonable. But in order to be effective, the enterprise zones must not become subsidy islands; they must be drawn up in such a way as to promote business and employment by the relaxation of restrictions, a strategy which, if it is as successful as we believe it will be, would quickly spread to other areas.

However, the political and geographical limitations of enterprise zones greatly limit their potential for success. More effective unleashing of enterprise is likely to come from the establishment of freeports and the general deregulation of small businesses getting established in Scotland.

Freeports. A liberal attitude also seems appropriate for the areas seeking freeport status. At present there are some 400 or more freeports in the world, attracting a large proportion of international trade. Currently, Britain has none.

One advantage of freeports for Scotland is that they create new jobs which would not otherwise exist, rather than merely shifting jobs from one area to another (which enterprise zones currently do). The easier customs restrictions make possible importation, packaging, processing, storing or other processes which would not even occur under the present complicated customs regimen. To work effectively, however, freeports in Scotland will require other attractive features, such as minimal planning restrictions (probably controlled only by the freeport authorities), and the suspension of much industrial and labour legislation. The freeports must, in essence, be thought of as foreign territories implanted on Scottish soil, and the attempt to make them subject to all of the prevailing UK regulation on industry will ensure their failure.

Portable enterprise zones. We suggest that small businesses could be encouraged, with obvious benefits for employment, by applying the enterprise zone concept to all small businesses throughout Scotland. Thus, VAT thresholds would be raised to £100,000, and businesses with less than twenty employees would be subject to more liberal employment conditions for each new worker they took on. Excessive health, safety, and planning regulations would also not apply to these small firms, although minimum standards would be maintained. The growth of small, flexible companies under this new set of arrangements would nevertheless increase the range of employment prospects available and would

encourage small firms to offer attractive working environments and employment conditions.

We anticipate that this strategy will do much to encourage the new, small industries which are particularly suited to the high technology, design, and other industries of the future, which will have particular importance for Scotland.

North Sea Oil

The Scots have not done as well from the oil industry as they expected, largely because of the fickleness of bureaucratic policy concerning it, and the shortcomings of the tax system. Greater benefits can be expected during the remaining life of the oilfields, if these problems are tackled now.

The state has an accepted responsibility in the North Sea in terms of maintaining safety standards, preventing pollution, and so on. But its main interest has been revenue, and the question of exactly what it should receive, and on what grounds, has been tricky. Originally, nobody owned the North Sea: when the question arose, it was assumed that the state owned it. The state undertook the auctioning and licensing of oilfields, granting private companies the privilege of extracting oil and selling it, but insisting on a return. This raised in theory the question of economic rent. The issue was what part of the final proceeds should be regarded as having accounted for the state's original rights and what part should be attributed to the companies' own efforts.

In Britain, the price demanded by the state for the privilege of exploitation has been low from the start. It has instead tried to extract rent by means of the petroleum revenue tax. This was a mistake. For, while the rent which might have been demanded was in almost every case large, the actual financial burden has fallen unequally on particular oilfields because the tax is determined by rates of investment and other factors which may bear no relation to eventual proceeds. Some of the most profitable fields attract relatively little PRT, while exploitation of some smaller ones has been inhibited because they would be liable to relatively high tax. Moreover, PRT can be manipulated by the internal accounts of oil companies to maximize these irrational differences.

The correct strategy. If it is accepted that the state owns the North Sea fields and has a right to some of the proceeds from their exploitation, the correct strategy is - and was - that actual or potential oilfields should be auctioned to the companies wishing to explore or exploit them. (This happened only in the licensing round of 1971). So far, the fields have been allocated by a bureaucratic process, which has many shortcomings, in particular that companies have been able to reduce their tax liabilities by deceiving the bureaucracy about their wish to acquire rights in a particular field, since

government officials tend to be less well informed than those doing the exploitation. But if the fields were auctioned, then the real views and intentions of the companies would become obvious through the market prices which were being bid.

There is nothing for the state to fear in this. The higher the bids go in an auction, the greater is the rent extracted by the state, and the greater is the revenue that can be remitted for national development. Whether the expectations implicit in a bid are correct or not is unpredictable (as is PRT), but that is a risk all companies are prepared to take in other parts of the world. This system would also favour low-cost operators who are able to supply energy to consumers at lower prices. PRT could then be abolished.

In recent years, the Treasury has repeatedly raised the tax, supposedly to take account of higher oil prices. This is another misconception: oil prices rise because demand outruns supply, and the proper response is to increase supply, which can only be done through higher investment in oilfields. Greater taxation of oil company profits works in precisely the opposite direction.

North Sea gas

The performance in reaping the potential benefits from North Sea gas has been even worse than that on oil. The basic reason is the monopsony power of British Gas to buy the exploiting companies's product. Ending the monopsony should make it possible to construct the gas-gathering pipeline, the loss of which has cost so many jobs in Scotland.

The outstanding feature of the UK regime is that companies are not allowed to sell independently to industry or consumers on the mainland, or to export: they must sell to British Gas. This permits the government to regulate gas prices according to its political ends, for example, by insisting on the political principle that they should rise at a lower rate than inflation. This happened all through the 1970s, with serious distortions to the energy market: for optimal allocation, the price of gas, like other commodities, should be free to adjust the supply and demand conditions.

The distortions could once again have been averted by a system of auctioning. Exploiters of gas would have raised their bids as the general cost of energy increased in line with oil prices. That might have raised consumer prices too - but the existing system has not in any case given households and companies value for money, as frequent complaints attest. A proper market system would have kept gas prices competitively low. Instead, the price of gas is today inflated by an inefficient corporation which maintains its own costs at a bloated level - as shown by the network of sales outlets that could easily be run by private operators.

A market system would also produce greater incentives for exploration and exploitation. It would no longer be a matter of indifference that so much gas is flared off. A market price would end the wastage and would make it profitable for the gas companies to construct a gas-gathering pipeline themselves.

Scottish electricity boards

There is further scope for Scottish enterprise in the field of energy. The two electricity boards could be eventually privatized and allowed to sell their output to any consumers wanting it, including those in England.

The South of Scotland Electricity Board already exports part of its output to the CEGB - about 7 per cent in 1982. The SSEB has quite large overcapacity: a theoretical total of 8500MW (to be increased to 9800MW when the Torness power station starts up in the later 1980s), against simultaneous maximum demand of 4700 MW. As a result it can easily oblige if called on when the CEGB has a shortage. SSEB prices are relatively cheap, because of the higher than normal proportion of generation from nuclear plant (more than 20 per cent in 1982), and are expected to get cheaper in real terms. But when the SSEB sells to the CEGB, it does so at a price determined by cost rather than demand.

In our opinion, these arrangements could be reformed in two steps:

- (1) The first step involves the two Scottish electricity boards being made into independent corporations, on the analogy of British Telecom. At some point in the future, they would be required to sell at least half their equity to private investors. We suggest that Scottish people should have the first option on shares;
- (2) They would then be able to sell their capacity to any area board in England wanting to benefit from it, instead of allowing it to lie idle until it suits the CEGB to ask for it.

These steps could be taken ahead of the complex task of privatizing the electricity network in England, and could act as a sort of trial run for it. They would not prejudice the granting of rights to any private manufacturer to generate and sell his own electricity.

Scottish banking reform

Official control often extends to economic institutions which are nominally independent. The most important are the banks. There is a strong case for the complete removal of that control. Under this Scottish banks would no longer be subject to central monetary policy: they would be able to issue as much of their own currency as they judged to be right for the conditions of the Scottish economy. All other restrictions, such as the effective

prohibition on the foundation of new note-issuing banks, would be lifted at the same time.

The present system. The basic law governing the status and operation of the banks is the Banking (Scotland) Act, 1845. Before that, Scottish banks had not been subject to any legislation. The reforms introduced in 1826 for English provincial banks had seemed sensible enough, because those institutions issued notes of only local validity and often failed. The standing and practice of Scottish banks, noted for their sound practice and fierce competition, were quite different: their notes were so widely accepted and trusted that they replaced gold in most banking and commercial transactions.

The 1845 Act had three main effects. Firstly, it preserved the Scots' right to their own notes, but in return it limited the fiduciary issue of notes not backed by gold to its current level of £3 million. That provision is still in force, though in the course of time the fiduciary issue has been drastically eroded by inflation. As a minimum reform, it could be restored to something much nearer its original level in real terms. Secondly, the law stated that any issue beyond the authorized maximum was to be covered by gold. This purported to deal with a problem - excessive creation of paper money - which in Scotland did not exist. There was a fundamental difference between the English and Scottish systems: the former financed the state, while the latter financed industry, and was much less prone to inflation and instability. In fact, the circulation of notes in Scotland had been falling before the Act was passed.

Today, the equivalent requirement is that the issue should be covered by Treasury or Bank of England paper: a system meant to avoid the creation of paper money has in reality become reliant on it. There seems no logic to maintaining the present provision.

Thirdly, the Bank of England was for practical purposes set at the head of the Scottish system, and in particular was to rule on the founding of new banks. It always used its powers to forbid them, so that competition was reduced.

With only three banks left, competition has been reduced so far that it is difficult to get any new ideas, new men, or new capital injected into the system. After the affair of the Royal Bank of Scotland take-over, the government clearly believes it politically unacceptable for this problem to be solved by association with non-Scottish banks. How, then, are stagnation and decline to be halted? The only alternative that we can see available is to lift the effective prohibition on the foundation of new Scottish banks.

Prospects for reform. We suggest that these problems could be overcome, and vitality returned to the Scottish banking system, if the 1845 Act were repealed and the state's monopoly of the currency ended. The practical framework, in the institutions and

in the public's familiarity with different notes, already exists in Scotland, and it is only a small step to making the public familiar with the idea that different notes circulating internally might have different values, and inducing them (and the banks) to behave accordingly.

Considerable academic work has already been done on this concept, notably with F A Hayek's Denationalization of Money (1), where the requirements for such a system to work are clearly worked out. Practical experience comes from many examples such as that of the Suffolk Bank system which operated in Massachusetts between 1825 and 1858, (2), where the notes of many competing banks circulated freely and were accepted by traders and bankers at the relevant discount rates, in what was a very simple and efficient system.

The assumption that it is impossible to have more than one note-issuing authority for a unitary state can be answered with a practical example even closer to hand. Until the monetary union between the UK and the Republic of Ireland was broken in 1979, the latter's notes and coin circulated freely in Northern Ireland without causing disruption - needless to say, the Irish central bank was not under the control of the Bank of England. Indeed, the Scottish fiduciary issue has in the past been much higher in real terms and as a proportion of the total UK issue, without being troublesome. With repeal of the 1845 Act, the Scots banks' wish to maintain confidence in their notes would be at least as strong a disincentive to printing money as the existing restraints. English clearing banks could be given the same privileges once the success of the denationalizing money had been proved in the Scottish experiment.

Working of the system. Until 1979, the Irish central bank usually followed Bank of England policy, though it had a valuable margin of discretion. Under our proposals, the Scots banks might act similarly. At first, especially if monetary conditions remained much as they are now, they would probably continue existing arrangements, even in the absence of a legal obligation to do so. The real test would come if a conscious decision were taken in London to inflate the currency as in the early 1970s. The Scottish banks could have the choice of refusing to join in, and thus render a service not just to Scotland but to the whole UK. Indeed, by allowing competing Scottish banks to issue notes it is (perhaps paradoxically) probable that there would be a stronger pressure on the English monetary authorities **not** to inflate. This is because the creation of independent note-issuing authorities within a unified monetary area, such as the UK, makes it impossible for any of them to issue notes which are

(1) F A Hayek, Denationalization of Money, (London: Institute of Economic Affairs, 1976, second edition 1978).

(2) Dr George Trivoli, The Suffolk Bank, (London: Adam Smith Institute, 1981).

substantially less reliable or useful than another, if they are to avoid the embarrassment of being accepted at a discount. The Scots, accustomed to different notes, would soon learn to distinguish the good from the bad, and deposits and trading would be attracted other sounder currencies. All the authorities would then be forced to keep the value of their currencies reasonably stable, at least so long as all were on an equal legal footing and there was no monopoly power. To bring this position about, it would be necessary to restore clause XV of the Scottish Act of 1845 (itself repealed in 1885), which provides that Bank of England notes should not be legal tender in Scotland: Bank of England notes would be accepted only at a discount if they were less valuable than those of the Scottish banks.

In every other respect, the Bank of England's role would be the same. It would remain the central bank: but this is a term held in too much awe, and it means only that the bank finances the government. The Scots banks have neither the means, nor probably the will, to do so, but they would continue to fulfil their traditional role of financing industry. Free trade in money simply means that each issuing authority has, whatever its particular sphere of operation, to maintain the value of the currency it issues, and a marked change would occur only if the Bank of England started to inflate. Then Scots, and perhaps others, would prefer to hold assets denominated by the Scottish banks rather than assets denominated by the Bank of England. But the latter could counteract this by correcting the policies which had led to such a tendency. The same forces would obviously work in the opposite direction, preventing irresponsibility by the Scots banks.

It would clearly be expedient for the Scots banks to announce in advance at what value they intended to keep their independently issued notes. One may assume that this would initially be parity with the pounds issued by the Bank of England. But the pound sterling itself has no absolute value; it is often valued in terms of its trade-weighted average, or of the dollar, and formerly was valued in terms of gold. All these standards of comparison would still be available. It would be up to Scottish bankers to decide whether they preferred the other standards - or more to the point, to assess whether the public holding their notes would prefer the other standards. The predominant factor would be the expectations of the public rather than the dictation of central government.

Competition, and the need for banks to provide sound currency if they were to compete effectively, would then become the essential constraint, rather than the 'legal tender' obligation to redeem the currency in some other form dictated by the Bank of England. The kind of trust on which the value of Scottish notes would rest would be in practice no different from the trust on which private banking rests today - everyone assumes that a private bank will arrange its affairs so that at any given time it will be able to exchange demand deposits for cash, while knowing also that if all depositors demanded all their balances

at the same time, the bank would assuredly fail. Competition only ever works if there is confidence.

Further advantages. Our scheme holds out the prospect of a further practical benefit in the creation of a Scottish money market, with more jobs arising from the growth of old and new financial institutions. This would present few difficulties, even if the long-established use of the London money market continued. A money market exists to provide the liquidity needed by lenders, at the same time satisfying the short-term requirements of borrowers. If in any respect the behaviour of those holding assets denominated by the Scots banks differed from those holding Bank of England assets, it could be natural for those banks to turn to Scottish sources of finance, especially for short-term borrowing. The machinery could probably be set up with little trouble. There is already a sophisticated monetary community in Edinburgh and Glasgow quite capable of arranging for an inter-bank market to even out positions, for private dealership to ensure the encashment of bills and short-term bonds and for the use of bills of exchange.

To sum up, given the repeal of the 1845 Act, money expected to preserve its purchasing power would be in continuous demand. The banks would then make every effort to preserve the purchasing power, in contrast to the present central bank which runs no risk by depreciating its currency: the banks could achieve this result by controlling the quantity of their issue. Such control would also provide a restraint on the quantity of money issued by the central bank, which would otherwise depreciate.

Nothing in this demands a permanent special status for Scotland, and the Ulster banks, for example, could be treated in the same way. the case for dealing with Scotland first is simply one of convenience. In seeking gradual change, it is obviously sensible to begin where the institutional structure already exists. Assuming the experiment works, it could be extended to all banks - as they would certainly demand themselves.

3. LOCAL GOVERNMENT FUNCTIONS

STRUCTURE AND SERVICES

The reform of local government in 1974 proved neither final, nor satisfactory, nor popular. The local government system has been tinkered with constantly since the reorganization, which left a considerable overlap between the functions of regional and district councils, and gave them more power to undermine the policies of successive governments that the Westminster politicians were prepared to tolerate in the the event. As a result, almost every session of Parliament has one or more acts aimed at rationalizing the duties of local government and controlling the ways in which it discharges them.

Limiting authorities to essential services. Local authorities exist to administer certain services for the benefit of their communities under the control of elected councillors. The two-tier system assumes that different types of service are most efficiently and economically provided over areas of different size, and that the areas presently designated are the best ones. But an economically efficient reform of the services themselves, detailed below, means that only a single tier makes sense, and over most of Scotland, the districts would become that single tier. In the more sparsely populated areas of the Highlands, the Borders, and Dumfries and Galloway, the regions would become that single tier - except that some adjustment of the boundaries might be put to a local referendum, with benefits in terms of efficiency and local popularity. The islands councils would remain all-purpose authorities, as at present. These steps would eliminate costly and wasteful duplication of elected members, officials, and activities, and would do much to make the local government system more intelligible to, and thus nearer to, the ordinary individual.

We recognize that the police and fire services could not be provided efficiently by small authorities. It may, however, be possible to establish associations of two or more authorities to take on these functions jointly. Alternatively, these responsibilities can be returned to central government, although this is a less desirable option because of the deadening effect of the central control of services. In either event, there is scope for some contracting out of related services, such as routine security patrols, traffic management and so on, with the extend of the contracting becoming broadened as its best applications were learned.

The dramatic growth of local government since 1945 has only partly arisen from the meeting of essential local needs. Much of it has instead been due to the elimination of private services by subsidized council competition, often for political motives. In leisure and recreation, for example, an ever-expanding range of facilities is offered with charges, where they exist, bearing little or no relation to the cost of providing or maintaining the

facilities. Poor accounting makes identification of costs almost impossible.

Subsidies to non-essential services are not, in our view, a legitimate application of ratepayers' money. If non-essential services cannot be run without a subsidy they are best put up for sale, possibly to those previously running them or to local interest groups who benefit from them. An attractive proposal is to allow any ratepayer to petition in the courts for the enforced sale of local authority land or property for which no essential service use is identified within five years. If those holdings have existing tenants, these should be given first option on purchase, possibly with a discount on the open market value.

Tendering. The new councils would need to be clear about how their responsibilities are discharged: the obligation to ensure that a service is provided should not require the council to provide the service itself. Competitive tendering is often the best route to achieving value for money. An obligation to put work out to tender has already been introduced for building and maintenance projects, and it would be a small step to extend the same obligation over a wider range of local authority services. Where private enterprise has been allowed to compete, as in cleansing, refuse disposal and street sweeping, large savings have been possible.

A phased programme might be laid down under which an increasing number of local government functions would be opened up each year to fair competition. The Local Government Audit Commission would supervise the transition and would investigate complaints of unfair practices. In particular, it would draw up standard accounting tests to make sure that tenders from the council and tenders from outside contractors were all submitted on equal terms. It seems likely that the stimulus of competition will bring improved methods of service delivery with a corresponding rise in efficiency and reduction in costs.

The rating system itself needs to be reformed: more than sixty per cent of rates are paid by those who have no vote, while most electors in Scotland pay no rates. Industry, trade and commerce have no say in determining policy but must meet most of the bill. So it has been easy for councils to milk them. One relatively painless route to reform is to fix non-domestic rates once and for all at a level commensurate with the services received by those who pay for them, adjusting the level only to reflect inflation or changes in valuation levels. Domestic rates could be replaced by a per capita tax on all electors, reflecting more closely the true incidence of service costs and avoiding the worst effects of property-based taxes.

HOUSING

The essential aim on housing must be to raise the generally poorer standards of Scottish housing to at least the British

average. This can be achieved through reviving and extending the private sector. Scotland differs from the rest of the UK, Europe, the Commonwealth and even the Communist bloc in having so much public sector housing and so few owner-occupied dwellings. Less than forty per cent of Scots own their homes (compared with more than sixty per cent in Britain as a whole). More than half live in publicly rented property (against less than a third in the rest of Britain). Very few now live in the privately rented accommodation that housed ninety per cent of the population until the first world war.

All forms of tenure are subsidized. The home buyer gets tax relief on his mortgage; the council tenant gets the large benefit of a rent based on historic cost and may also get subsidies from his landlord through artificially depressed rents. Yet this well-intentioned system of subsidy is chaotic and clearly fails to meet public demand. Many more people would like to own their own homes than actually do. The numbers in search of privately rented accommodation far exceed the supply. In the public sector, thousands of houses stand empty while thousands of people have their names on housing lists. Despite a crude surplus of houses nearing a quarter of a million in Scotland, we still have a problem of homelessness.

Council housing

It is curious that housing should be singled out for massive intervention in the market while other essential commodities - such as food and clothing - are almost completely free of it. Yet food and clothing are available in enormous variety, and even those receiving welfare payments can shop around to find the best items to suit their needs and preferences. In housing, however, the actual **provision** of housing for the poorer members of the community is assumed by the state: with the result that the individuals have no choice and that there is little or no choice within the monopoly system. A much wiser course, in our view, would be for the government to help poorer people by subsidizing needy individuals, who could then purchase or rent accommodation on an open market that offers variety and flexibility, rather than to take on the roles of housebuilders, estate agents, and landlords. The subsidy to needy individuals can be made through the present welfare system or in the form of housing vouchers redeemable when spent on any housing rent or purchase.

The present system is inefficient, wasteful and costly. It discourages mobility, overrides consumer preferences in the allocation of housing and the planning, designing and building of new homes, and is widely misused for political purposes. Furthermore, council housing is often occupied by individuals who are not in real need. An individual may qualify for a local authority home because of hardship, but is then not required to move if his circumstances change. Hence, individuals who become much better off than the average still find themselves entitled to occupy council housing at low rents subsidized by their less

fortunate ratepaying fellows.

There is a strong argument that because of all these problems, councils should be forbidden to construct further houses, except sheltered accommodation for the elderly and disabled, a point reinforced by the fact that much of the local authority housing built in Scotland recently has proved 'difficult to let', if not uninhabitable. That is a waste of resources the country can ill afford.

Imaginative solutions. Some councils then compound their error by demolishing these undesirable dwellings. Others, with more imagination, have invited private enterprise to improve the property and sell it, often with considerable success. This gives work to the construction industry and helps meet unsatisfied demand for ownership among those who cannot afford to pay a great deal. In Edinburgh, for example, renovation of an unpopular tower block was done on a profit-sharing basis and every unit within it was sold. Other types of 'difficult to let' property has been successfully upgraded and sold in Livingston, and in Glenrothes, where the sale of low-cost, renovated, council properties greatly exceeded expectations. The Scottish Office would be able to accelerate this movement by taking powers to prohibit the demolition of local authority houses unless the ground is required for some essential project or all efforts to find a private buyer or profit-sharing developer have failed demonstrably. Once a property is so unpopular that it is 'difficult to let' and is being considered for demolition, its capital cost is of little concern: it is more important to make it habitable, than to attempt to recover large sums from the developers. Councils can even consider giving away blocks or selling them at large discounts, although some might wish to set conditions on the ultimate terms of sale.

Market information would be improved greatly if councils were required to publish regular lists of all their houses which have been vacant longer than (say) three months. Given the length of the council house waiting lists, it seems reasonable that any individual or company should then be entitled to demand that any such house or houses should be sold at the district valuer's price or by auction, unless the authority can give good reason for the vacancy.

Sales. The sale of council houses has made a great contribution to satisfying unmet demand for housing, and improves mobility, and will have even more profound effects with the sixty per cent discount proposed. But there are many older tenants for whom even that will still not make ownership possible in their remaining working lives. In such cases, the scheme could be extended to give those with tenancies of fifty years a maximum discount of eighty per cent.

The Tenants' Rights Act provides that public sector houses cannot be sold for less than their outstanding debt if first let after 15 May 1975. This seems an arbitrary barrier to sales:

high inflation in the past might have produced rising valuations which minimize its effect. With inflation now below five per cent, it effectively bars many tenants from receiving discounts that others about them enjoy. This is a strange inconsistency in view of the fact that powers already exist under the Act which would allow the progressive exemption of houses first let after 15 May 1975 from this restriction.

Further progress could be made if the responsibility for sales was systematically transferred to other agencies. Experience from England suggests that private estate agents, working under contract, have more immediate market knowledge and are more effective in arranging sales than councils' own housing and valuation departments in most cases. Again, the compulsory contracting out of some or all of this work could speed sales and raise mobility.

Tenants. For those choosing to remain tenants, current allocation systems depress mobility and bring a degree of unfairness into housing. Present policies have the unintended effect of benefiting those who can afford to wait. Those who have to move or require housing in a hurry have little hope of qualifying for the best housing, whereas those who stay put will eventually receive better accommodation. With little difference between the rents to the best and worst housing they have every incentive to do so.

This, and other allocation problems, could be solved if councils were required to revise their rent structures to reflect the relative demand for different types of housing and different areas. The Scottish Office could assist this exercise, drawing on the experience of the district valuers' offices and of a few councils which have already introduced such schemes. private agencies, such as conveyancing solicitors, building societies and others with an up-to-date knowledge of the market, could also be used on a contract basis to help the review. Those rents will be based on the pooled historic cost of building the houses, generally less than £3,000 per unit. There can thus be no reason for additional subsidy: the comparison commonly made with mortgage tax relief is invalid, since the capital cost of the property on which most mortgages are based far exceeds the comparable capital debt for council houses. The case against using rate income to subsidize housing is even stronger, since it is often little short of electoral bribery. All tax-borne and rate-borne subsidies to council housing could be stopped without hardship if those truly in need, and not simply all those who live in council housing received welfare provision for their housing needs.

Scottish Special Housing Association and new towns. These bodies, owning 90,000 and 50,000 houses respectively, account for one-seventh of the public sector stock. We envisage that they would be responsive to the same techniques as those described above.

The new town corporations are to be wound up, and their housing handed over to local authorities. In most cases this would mean tenants being placed under less liberal regimes, since both SSHA and the new towns have been willing to sell houses without the deliberate delays and obstructions imposed by many local councils: in fact, nearly one-third of former new town tenants now own their own homes, far above the national average. Allocation policy has also been much more free. If this progressive approach is not to be lost, new town housing would have to be transferred to the SSHA rather than local authorities.

Local authority mortgages. The provision of mortgages is another area in which local authorities are taking on curious responsibilities and so crowding out the private sector. They became involved in mortgages because some building societies were unwilling to lend to certain types of borrowers on certain types of property. Now the biggest area of growth, which is likely to increase, is in financing council house sales, of which building societies are again occasionally cautious. Local authorities probably now have about £200 million in mortgages on their books, along with other sums advanced to housing associations. Because of their large ability to attract market funds, local authority activity in this area makes interest rates generally higher and thus makes it difficult for private people and firms to borrow.

If their mortgage role is deemed necessary, a more effective approach would be to set up a new Scottish financial institution to take over the financing of house purchase from local authorities. The new institution would be a sort of building society established by the government but afterwards independent, possibly formed by public and private agencies together. It would handle all local authority sales that building societies refuse to finance, as well as promoting home ownership in areas traditionally 'red lined'. It would be provided with a government loan sufficient to buy out all existing local authority mortgages. Proceeds would flow back to the government and private investors through the redemption of existing local authority borrowing. A similar arrangement would cover future council house sales not accepted by a conventional building society.

Based on a large long-term loan, the interest rates of the new institution would be more stable than those of the building society movement and would normally differ from them (as do rates charged by the local authorities). If, at a time of falling interest rates, it had to charge more than building societies, it would be able to offer higher rates to investors. As it attracted savings and generated new business, the importance of this initial finance in its total accounts would diminish and its interest rates would come into line with those of competitors.

Private sector renting. The shortage of housing whereby those in search of rented accommodation greatly exceed the number of dwellings available for rent, has been largely or entirely generated by past policies which were well-intentioned but which

have proved to be counterproductive.

Rent controls and generous security of tenure arrangements, for example, have all but killed off the private rented market. They make it imprudent for sitting tenants to move, even where the units they occupy are too big for them and would ideally be rented to larger families; they greatly increase the reluctance of many small property owners to put accommodation on the rental market; they make the search for accommodation more of a lottery than an efficient choice (1).

Naturally, it would be difficult and perhaps undesirable to remove rent controls and security of tenure protection from existing tenants, especially if this were attempted suddenly; but it seems reasonable that those current and future tenants who wish to avoid the economic and other costs of the restrictions should be allowed to do so if they choose. Perhaps the simplest way would be to give tenants the automatic right to exempt themselves from some or all of the range of protections in writing. Potential tenants would no doubt find a sizeable volume of rented property becoming available (with corresponding downward pressure on rents) from new landlords who are deterred by the present restrictions but who would be willing to let out accommodation under a more liberal regimen. Thus, without the security of any of today's tenants being affected, tomorrow's tenants would find a wider range of property available, probably at lower rents.

Private housing for sale

Much can also be done to encourage a more responsive market in housing sales. For example, title registration could be universally enforced and the solicitors' monopoly on conveyancing could be suspended. These steps would increase the market information available to potential purchasers and would lead to the development of new, cheaper, and faster methods of conveyancing. It is curious that in any other commodity market - such as car purchase or buying major pieces of equipment - large and valuable assets can be transferred almost instantly and with the minimum of legal work being necessary. The ease and speed with which expensive items such as cars, tractors, or diamonds can be bought suggests that the conveyancing monopoly - where house purchase procedures can cost hundreds of pounds and can take many months - and poor land registration systems have imposed major constraints on the market. The conveyancing monopoly is easy to remove, however, and land registration itself can even be contracted out if this is likely to produce savings and administrative improvements.

(1) F A Hayek et al., Verdict on Rent Control (London: Institute of Economic Affairs, 1972).

Another curious feature of the housing market is that there are no dealers in housing as there are dealers in cars or diamonds, who buy items of property and hold them for later sale. Again, the time and cost of conveyancing is the prime explanation, but undoubtedly this shortcoming means that individual vendors and purchasers have to deal with each other and not with a recognized agent who may have a stock of many other items on sale, reduces mobility and increases the difficulty of making transfers. We suggest that consultations with private sector groups might lead to the establishment of such a 'secondhand' market in housing with the obvious benefits that it would bring. But it almost certainly presumes the removal of costs and restrictions on property transfer as a first step. Stamp duty, a tax which yields little and increases the costs of housing, is one such cost. It can perhaps be removed in a series of stages if outright abolition caused budgetary problems.

PLANNING

Planning policy has been responsible for most of the environmental disasters in Scotland in recent decades: its outstanding achievement is modern Glasgow. As a philosophy, it is open to changing theories and to political turnabouts, though its results, unfortunately, are permanent.

Planning has been going on through most of the twentieth century, but the major extensions of it came during and immediately after the second world war. The Town and Country Planning (Scotland) Act, 1947, laid the foundations of the present system, and in principle was similar to the corresponding English Act. The only differences were those required by the separate Scottish legal and administrative systems. The law gave the local authorities wide control over the use and development of land.

Further changes were made necessary by the reform of local government in 1974. It was thought a good idea to give each tier a hand in planning. Regions were to draw up 'strategic plans' for themselves (such plans having been previously the responsibility of central government). Consistent with them, 'local plans' were to be drawn up by the districts. There were also to exercise the 'development control' which would ensure that individual planning applications conformed to the plans.

Most regional councils have now produced strategic plans for all or parts of their areas. These have been approved by the Secretary of State for Scotland with only minor amendments. District councils have embarked, with varying degrees of enthusiasm, on the preparation of local plans. Development control has meanwhile continued as it did before reorganization. Individual applications are decided through committees of local politicians.

Planning by feu charters

In all this, there is no sign that planning will serve Scotland better in the future than it has done in the past. In our opinion, the system could be radically improved if it were replaced by a modernized system of feu-charters.

The reform of feudalism in 1974 was a popular and overdue measure which ended the imposition of new feu-duties and started the elimination of existing ones. But it did not get rid of **feu-charters**, which are still being created (generally with the intention of imposing conditions necessary to preserve local amenity). The conditions are usually a matter for the owners conducting a transaction and for their superior. But the charters can and often do enable other parties, such as neighbours, to ensure that conditions are enforced. The feu-charter is a unique Scottish institution, capable of much wider and more flexible application. Normal legal contracts give rights only to the parties to them: a feu-charter also gives rights to third parties, such as neighbours, if they have an interest in its enforcement. Hence its potential application as a planning instrument. To work, this system would require adaptation to the complexities of modern urban society; but it is a unique Scottish institution which does not, like most modern planning legislation, follow inappropriate English analogies and it has many obvious advantages of its own. In the past, it has given us classical Edinburgh - we still owe the absence of buildings in Princes Street Gardens to the fact that in 1770 the feuars on the north side took the town council to court (and eventually to the House of Lords) on the grounds that their charters would be violated by plans to develop the south side.

It is a more democratic system. It not only gives parties to an agreement the right to sue under it but can also confer that right on others with an interest. Instead of matters being settled between the politicians on a council planning committee and the vested interests concerned, any person with a feu-charter containing conditions that would be affected by a proposed development could have a say in the decision. One would expect feu-charters to become more elaborate as a result, but this is all to the good: it would mean that more people would participate directly in the planning process.

Provisions would be needed corresponding to the Secretary of State's present powers to call in applications of national importance and, if necessary, to conduct a public inquiry. A proper system of recording changes in ownership would also be necessary. But beyond these, the basis already exists for the successful revival of a system with a record better than anything state planning has been able to produce.

It would still be possible to relax parts of the present planning system in advance of any more comprehensive reform. In modern industrial estates, for example, there is no need for the same detailed controls that may be required in residential or

conservation areas. There can be no merit in imposing idealistic conditions which simply inhibit building in areas of dereliction where any development would be an improvement.

INDUSTRIAL DEVELOPMENT

There has been an increasing tendency for local authorities to interest themselves in industrial development, notably under Section 83 of the 1973 Act, which gives them the power to use the product of a 2p rate for any purpose they deem beneficial to their communities.

These activities have not been generally successful. For example, a number of councils have duplicated the role of central government and the SDA in giving loans (sometimes interest-free), grants, and other forms of aid. This triplication is confusing and wasteful. There is no evidence that councils have the expertise to operate as local merchant banks, or any deeper competence in industrial matters. Those who are best at handling them, the financial institutions, seem to be better equipped.

A further problem is the preference in many councils for leasing industrial and commercial properties, rather than selling them: Glasgow for instance, actually refuses to sell under any circumstances. This hinders long-term stability in industry. A firm owning its premises has an asset which ties it to the community, an asset against which it can borrow in times of need. If it moves, it will make more strenuous efforts to find a new buyer than councils would, because it has a financial stake in the matter. It would extend the advantages of private ownership if industrial and commercial tenants of public sector property were to have a legal right to buy it at the market value, if necessary determined by the district valuer.

When the authorities in new towns are wound up, any industrial premises they own could be disposed of by transferring it to the SDA. When the SDA's assets are subsequently sold, the responsibility for financial help to industry will eventually be passed on to banks or other private organizations.

HIGHLAND POLICY

For local government in the highlands, we have already outlined the benefits of a one-tier system. In the highlands, the regional tier (rather than the districts) would be the most appropriate one to retain. The population of the whole highland region is anyway smaller than that of some lowland districts, and its scattered communities would probably benefit from having one authority covering them all. And, as the Wheatley Commission recognized, there is no reason at all why Scotland, with greater extremes of diversity than England, should have a uniform system of local government.

The Highlands and Islands Development Board

A one-tier system would allow the absorption of the functions of the Highlands and Islands Development Board into the new local authorities. This was set up in part to deal with problems arising under the old local government system, which was too fragmented to be efficient. In a reformed system, HIDB functions should be handed over to the highlands council or the islands councils. That would produce authorities with more than the usual range of powers: but there is already a precedent for this in the Zetland County Council Act (1974), which makes special provision for the council to deal with oil developments.

It would then be a matter for the local government, as the HIDB does now, to prepare and promote measures for the economic and social development of the highlands and islands, with specific powers to make grants or loans to industry, commerce or any other relevant activity. As at present, funds for these purposes would be voted by Parliament, and their annual disbursement would be settled with the Secretary of State. His approval would still be needed for any proposals of expenditure on particular projects. Aid to industry would continue to be governed by guidelines drawn up in agreement with him and the Treasury.

Thus, though the HIDB would go, its activities would be carried on under a more efficient system. The highlands would lose nothing that exists now. But there would be a gain to the community as a whole in the abolition of a quango containing several full-time members on large salaries, of the replacement of a duplicated system of administration, and of the transfer of the decision-making process down to a more local and personal level.

Crofting reform

The separate development authority for the highlands has not solved the problem of its economic inertia. This is reinforced by the system of land tenure, established by the Crofters Act (1886), which guaranteed both low rents and security of tenure. The last crofting reform, in 1976, failed in its objective to turn the crofting community into one of owner-occupiers who could then have taken advantage of developments in the oil industry and in tourism by going into business themselves or by selling to others willing to undertake development on their land. But the take-up of the option to buy has been extremely low.

Most remain tenants because of the great incentives to do so under the first Crofters Act. Entirely different incentives are needed to introduce the disciplines and benefits of the market to the highland economy. Similar incentives to those now available to council house tenants in the rest of Scotland would seem to be an effective strategy. The main one would be a discount on the valuation price of crofting property. It could be made a once-and-for-all discount financed by the government and not repayable

even if the property is resold immediately. Since most crofts are cheap, the burden on the Exchequer would be small.

SCOTTISH FERRY SERVICES

The shipping services that run between the islands of Scotland might seem a perfect example of where the state has to offer a subsidy just to retain these marginal territories within the day-to-day economy. It is argued that there is no way that a private concern could provide ferry services without subvention.

Nonetheless we believe that radical deregulation might provide some surprises. The assumption that ferries have to carry both passengers and freight could prove wrong. Smaller, more numerous, and cheaper vessels might better provide the passenger service, while fewer but larger vessels could supply the freight, fuel, traffic, and other business. Deregulation may provide a chance for helicopters, hovercraft, or light aircraft to provide an inter-island service that at the moment would be fought by Caledonian-MacBrayne.

Although Cal-Mac's 1983-84 subsidy of £6.6 million is modest even by Scottish Office standards, it does represent a generous per capita subsidy in relation to the island populations. Cal-Mac, somewhat like British Airways, argue that they must continue service the unprofitable routes for 'social reasons', although these are undefined and therefore difficult to accept without qualification. And certainly it is not clear that a blanket subsidy is the best way of accomplishing these 'social' objectives.

Even Gourock-Dunoon, the busiest route, shows no profit at present, but it is possible that small operators could do a Laker on the island services, especially if Cal-Mac lost its monopoly of the mail carriage. But the best help to competition would be in freeing small boat owners from the very exacting and expensive 'safety' regulations imposed by the Department of Trade. The responsibility for safety could be discharged effectively between owner and insurer and customer, with the state insisting only that the vessels are properly insured.

Although Western Ferries, Cal-Mac, and P & O are apparently independent contractors, they are substantially controlled by the state because they are operating licensed monopolies with prices agreed with the Scottish Office. Competition can return only if the right to run any such service or to ply any route is open to all or at least is auctioned every four or five years. The island councils provide as much of a potential regulatory hazard to the ferry operators as central authority, but if local government in the highlands and islands is simplified as we have suggested, these impediments would tend to disappear.

The idea of a 'road equivalent tariff' is a favourite notion for island transport. It pretends that, for costs, the sea does

not exist. As the purpose of pricing is to reflect how alternative costs can be distinguished, RET is a misleading and foolish notion. If transport expenses are greater to island communities, then groceries may be marginally more costly, but other prices, especially property, will be reduced. Only if prices truly reflect the supply and demand conditions which prevail, including the actual costs of transporting people, raw materials, and finished goods, can anything like efficient resource allocation be approached. Otherwise, resources will continue to be attracted to places they would not normally find themselves, which imposes costs and the burden of lost opportunities on the whole community.

In short, there seems very little case for a subsidized ferry service which, when compounded with excessive regulations, makes it unprofitable or impossible for other potential operators to explore new ways of serving the islands' transport needs. Nevertheless, if it is thought necessary to provide transport so that the poorer members of the islands' communities can travel, this is perhaps best done openly by giving those individuals transport tokens, which can be spent on any form of transport provided through the free market, and then are redeemed by the government later.

4. EDUCATION

Schools

Scotland's education system was once the pride of her people, a pride which is no longer justified. Though O-grades are of a basic standard, one-third of pupils leave Scottish schools without passing even one of them. Among those who carry on to highers and to university, the standard is again not good enough to ensure ready acceptance to English universities, or even (in some subjects) to ensure a reasonable chance of the successful completion of a Scottish university course. Many more Scottish students fail than do English ones.

The fall has come through three main channels: the general intellectual downgrading of the idea of excellence; a failure to keep up with the expansion of knowledge and the changing needs of the economy, reflected in outdated curricula; and incessant political interference and changes of aim. Each of these can have effect only because of the large extent to which control of the education system is not vested with those who have most interest in the standards and successes of schools: parents, teachers, pupils, and employers. Control today is almost wholly vested with national politicians, local authorities, and their respective officials. This control at a distance means that education can be quite unresponsive to the needs of pupils, parents, and employers.

Extending consumer choice. In recent years only, slightly more consumer choice has been introduced into the education system. Parents now have the right to challenge the rigidity of zoning schemes and should have had the right, under the Local Government (Scotland) Act, 1973, to elect representatives to schools councils. But the councils have gained little power. In most cases, their impotence is assured by their preponderance of councillors, education authority employees, and political appointees. Most also cover more than one school, so that the system of electing parent representatives is tortuous: this has the effect of discouraging many good potential candidates.

The simplest way to restore the responsiveness of Scottish schools to consumer pressure is through adaptation and upgrading of the schools councils, which would entail amendment of section 125 of the 1973 Act. Possible reforms would be:

- (1) to make each council responsible for one school or, at most, one secondary school and the primary schools which provide most of its pupils;
- (2) to extend the remit of the councils to cover the broad policy of school and personnel management and supervision;
- (3) to make the parents the majority group of each council, with each group entitled to representation by direct election.

Another extension which could lead to exciting developments would be for the councils to be granted the power to take their schools out of the state system, to become voluntary, self-financing bodies, free of all official control. This might be a very attractive option in times of budgetary stringency, and could lead to the saving of many small schools in times of recession. It is likely that effective schools councils will in any event move to contain costs, and attract private endowment funds. Thus, **many** schools might find themselves becoming self-financing and would then see the transition as attractive. A useful boost would be for the official control over a school's personnel policy, curriculum, finances, and so on to decline progressively as more of the school's budget was raised from private subscriptions, endowments and other sources. There would then be an incentive for schools councils to make lower demands on government funds in return for greater control and school management. Considerable liberalization of schools and greater parent control could thus be achieved at lower costs to taxpayers and without the need for any pupils to be charged fees. Those schools remaining within the state system would of course continue to be funded according to a fixed sum per head of pupils.

Another enterprising idea, stemming from the Social Affairs unit and designed to help employers to help employers exert some influence to raise the educational standards of the students who will become their 'raw material', to give businesses an education voucher which they can donate to schools of their choice. In competing for this section of their budget, schools would be prompted to raise standards in order to convince employers that they were truly interested in the employability of their pupils after school leaving age. At present there is no systematic follow-up of the employment success of pupils in later life, so it is not surprising that schools are unaware of what steps they need to take to improve it (1).

More effective schools councils would probably exert strong pressure for the standard of the Scottish examinations, especially in scientific subjects, to be raised to a level which allows Scottish students to compete with their English fellows at university, or for other examination boards to be adopted if the Scottish examination system is irresponsive to change.

Analogous reforms could also be devised for all colleges of further education, whether they are presently under the control of the local authorities or of the Scottish Education Department. Again, the basic idea would be to improve the control admitted to students, teachers, and employers.

Universities. Scottish universities remain in some respects distinct from those in other parts of Britain. But they have

(1) See Digby Anderson (ed.), Educated for Employment? (London: Social Affairs Unit, 1982).

lost much of their character and nearly all their independence through their total subjection to the government in their funding. It is the University Grants Committee that, to all intents and purposes, dictates which universities, and even which particular departments of them, are to develop or to decline. The many competing claims on UGC resources means that departments with a fine past record, with present excellence, or with future potential suffer as resources are pre-empted by more powerful universities. The wishes of staff and students carry little or no weight. This has been to the detriment of the universities and of Scotland.

A way out of this unresponsive and inefficient allocation system would be to move the funding route away from the universities and towards the students. Thus, the UGC's budget would be transferred entirely onto the student grant, and the universities would have to charge economic fees and to compete for student customers.

The removal of the universities from the control of the UGC would bring no increase in total government expenditure. The existing (nominal) fees are paid through the Scottish Education Department; the balance is paid from central government funds through the the UGC. The transfer to the SED of that part of UGC expenditure relating to the Scottish universities would allow the same number of students to be financed, but it would leave them free to choose what and where they wished to study and would leave the universities free to choose how to respond to the demand thus revealed by students' wishes, building up those courses in demand and phasing out less popular ones.

In the absence of a similar reform in the rest of the UK, special arrangements would have to be made to top up the grants currently paid to students domiciled outwith Scotland. But this need present no great difficulty.

These changes do not in themselves imply any alteration in the system of financing students (for example, through loans rather than grants). The move to loans could be made only for the whole UK, or there would be a potential disincentive for students to attend Scottish universities. However, when loans are introduced, the Scottish banks are likely to be particularly well disposed to offering them, although liberal bursaries for especially able or poor students would still be desirable. At the same time, the universities could expand freely, since there would no longer be any need for controls on student numbers.

5. SUMMARY AND CONCLUSIONS

- (1) The economic prosperity of Scotland rests not on costly support for outdated industries, but on encouraging the industries of the future.
- (2) The policy of 'picking winners', however, has not been successful and encouragement to new industry should take the form of creating the conditions for success rather than direct subsidy to particular firms or sectors.
- (3) The functions of the Scottish Development Agency require review. To date, millions of pounds have been wasted on investments in marginal companies and on building industrial premises that remain vacant.
- (4) The CBI and Scottish Council could be expected to undertake the valuable functions of the SDA.
- (5) The SDA's property programmes should be phased out. Private estate agents can be retained to advise.
- (6) Area development programmes can be phased out. Alternatively, a once and for all payment can be made to ease the transition to a zero subsidy regimen.
- (7) Costs of required landscaping should fall on the landowners or local authorities concerned.
- (8) Further deregulation is required on Scottish enterprise zones. This includes the suspension of development land tax, restrictive labour legislation, and wage or price policy.
- (9) Government and local government bodies should be required to sell their land holdings in enterprise zones.
- (10) The establishment of freeports is a promising source of new business and employment, but only where they are associated with the suspension of much industrial and labour legislation, planning controls, and so on.
- (11) All small businesses in Scotland should be treated as part of a 'portable enterprise zone', with growth being encouraged by a more liberal operating environment.
- (12) North Sea oil fields should be allocated by auctioning the development rights.
- (13) Following this auctioning, the petroleum revenue tax should be abolished.
- (14) Higher investment in oil should be encouraged by resisting any further taxation of oil company operations. However, higher investment will generate higher returns to the state under the

field allocation process suggested.

(15) The monopsony power of British Gas should be ended.

(16) Gas fields should be allocated by an auction system similar to oil.

(17) The Scottish electricity boards should be made into independent corporations, with shares being sold to Scots and then to the rest of the British public.

(18) The reformed boards would be able to sell their surplus capacity and operate as they saw fit.

(19) Scottish banks should be free to circulate their own currency without direction from the Bank of England. This will secure the stability of Scottish currency and will help the banks to promote Scottish trade and industry.

(20) An entire tier of local government should be removed, mostly at the regional level.

(21) Local authorities would be required to submit services to tender and to justify their decisions on whether tenders are taken up. The Audit Commission should lay down comprehensive guidelines and accounting requirements.

(22) Council-owned accommodation that is difficult to let should be sold for private development or for development by a partnership of public and private interests.

(23) Councils would be required to publish lists of their empty properties, and the public should be given the right to force their sale.

(24) Responsibility for conducting sales of local authority housing should be transferred to other agencies, including commercial estate agents. Reforms should be introduced to remove the inconsistencies in the present system.

(25) Rent structures should reflect the relative demand of different kinds of housing.

(26) New town housing responsibilities and sales should be transferred to the SSHA rather than to the local authorities.

(27) A new institution, including private sector support, should be set up to undertake local authority mortgage functions.

(28) Potential private sector tenants should be helped by allowing new tenants to opt out of rent control and tenure restrictions if they choose to do so.

(29) An improved system of land registration should be developed, and the solicitors' monopoly on conveyancing ended.

(30) The development of a secondhand market for housing should be encouraged.

(31) The Scottish institution of feu charters should be developed as a method of planning control.

(32) The functions of the Highlands and Islands Development Board should be transferred to the local authority.

(33) Crofting property should be sold to tenants at a discounted rate.

(34) Monopolies, especially monopolies of mail carriage, and blanket subsidies to the island ferries should be ended, and deregulation strategies should be pursued in order to encourage innovative alternatives to present ferry systems.

(35) Schools councils should be upgraded, and given greater say over school management and supervision. Direct election to the councils would be extended.

(36) The reconstituted councils should also have the power to take their schools out of the state system and into the independent sector.