

**Northern Ireland Assembly, Committee  
for Finance and Personnel**

**A Submission by:**

**The Chartered Institute of Public  
Finance and Accountancy on '*the  
Review of the Operation of the Barnett  
Formula*'**

**March 2015**

**CIPFA, the Chartered Institute of Public Finance and Accountancy**, is the professional body for people in public finance. CIPFA shows the way in public finance globally, standing up for sound public financial management and good governance around the world as the leading commentator on managing and accounting for public money.

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## **1. Executive Summary**

1.1 CIPFA's position on funding devolved government is as follows:

- a) The temporary population based Barnett Formula in its present format should be withdrawn at a future date and replaced with a mechanism linked with tax devolution that will support equitable and sustainable public services in Northern Ireland.
- b) The vow made to the Scottish electorate by the three UK party leaders, in the run up to the independence referendum,<sup>1</sup> to share 'resources equitably across all four nations' while simultaneously promising 'the continuation of the Barnett Formula' cannot be achieved on both counts if the tax raising powers are devolved across all four nations and English regions.
- c) Future resource allocation across the UK should be principles-based, transparent, accountable and should seek to address relative need as well as the promotion of equity.
- d) The resource allocation process should be depoliticised by being overseen by a commission which is independent of government.<sup>2</sup>
- e) There is scope to move from the traditional piecemeal approach to devolved government by examining the level to which powers should be devolved. CIPFA considers that powers should be devolved to the lowest local level possible within this new framework.

1.2 CIPFA welcomes the fact that the Assembly Committee for Finance and Personnel are looking at the operation of the Barnett Formula. We believe there is an opportunity for the Committee to push their terms of reference further and take the lead on this debate across the UK and be at the forefront of shaping the nature of funding for devolved government.

## **2. The Operation of the Barnett Formula**

2.1 Funding for the devolved administrations is determined within spending reviews, using the Barnett formula alongside that for UK Government departments. This takes the form of a block grant from the relevant Secretary of State which is voted by the UK Parliament. HM Treasury set out arrangements for funding the devolved administrations in their

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<sup>1</sup> Daily Record, [The Vow](#), 16 September 2014

<sup>2</sup> House of Lords Barnett Formula Select Committee, The Barnett Formula, HL Paper 139, July 2009

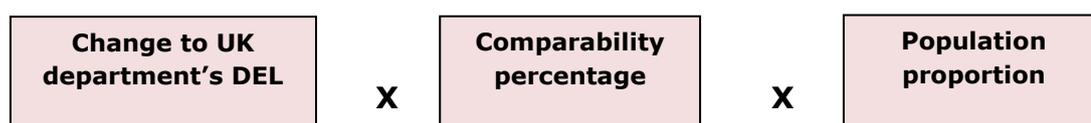
document *Funding the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly: Statement of Funding Policy*, October 2010<sup>3</sup>. The non-statutory Barnett formula determines changes to the devolved administration's block grant but does not determine its overall size.

2.2 When the UK Government reviews its spending plans,<sup>4</sup> the devolved administrations receives a population-based proportion of the changes in planned spending on comparable government services in England.

2.3 Three factors are considered when calculating changes to the devolved administrations grant using the Barnett formula:

- The amount of change in planned spending to UK Government departmental programmes;
- The comparability percentage – this describes the extent to which services delivered by the UK Government departments correspond to services for which the devolved administration has responsibility.<sup>5</sup>
- The population proportion – this the devolved administration's population as a proportion of the population of England. Figures used reflect the annual mid-year estimates of population.

2.4 Thus, the Barnett formula operates an incremental system, in that the allocation in one year is based on that in the previous year. The changes to the block grant are therefore calculated by:



2.5 This calculation would be conducted for each UK Government department with a change to planned spending, and the sum of these represents the net change to the block grant.

2.6 The budgets of the devolved administrations are not exclusively funded by grant from the UK; further elements of financing include local taxation (non-domestic rates and council tax/rates), European funding and

<sup>3</sup> [http://webarchive.nationalarchives.gov.uk/+/http://www.hm-treasury.gov.uk/d/sr2010\\_fundingpolicy.pdf](http://webarchive.nationalarchives.gov.uk/+/http://www.hm-treasury.gov.uk/d/sr2010_fundingpolicy.pdf)

<sup>4</sup> Generally through spending reviews although other spending announcements, such as those made by the Chancellor of the Exchequer in his Budget and Autumn Statement, also impact on allocations to the Welsh block.

<sup>5</sup> Details of comparability percentages can be found in Annex B of HM Treasury's [Funding the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly: Statement of Funding Policy](#), October 2010.

borrowing by local authorities for capital investment. Following the passage of the Scotland Act 2012 and the Wales Bill, the Scottish and Welsh Governments will also have control over additional devolved taxes; the revenues received from these taxes will be deducted from the respective block grant. This would also apply to any reductions to Corporation Tax rates implemented by the Northern Ireland Assembly under proposed legislation.

### **3. Is Barnett Fit for Purpose?**

3.1 Despite the advent of devolution and significant constitutional changes in the late 1990s, and again more recently, there have been no changes made to the funding mechanism. During this period there have been a number of reviews of the funding mechanism although no replacement has been satisfactorily identified. Most of the reviews have called for the introduction of funding on the basis of needs.<sup>6</sup> The Holtham Commission went further, providing evidence of how a simple and complete needs-based funding system could operate in a manner fair to all regions of the UK.<sup>7</sup>

3.2 CIPFA has examined the reports from these reviews and has identified the following recurring advantages of the Barnett Formula:

- It is a simple and objective method of assigning funding.
- It provides a degree of stability and certainty.
- It allows the devolved administrations to exercise discretion over their priorities and policies.
- Enough flexibility is retained for negotiation in exceptional circumstances (formula bypass).
- The devolved administrations do not bear revenue risk; the UK government retains responsibility for borrowing to meet shortfalls in tax revenues.

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<sup>6</sup> Including: House of Lords Barnett Formula Select Committee, *The Barnett Formula*, HL Paper 139, July 2009; House of Commons Justice Committee, 5th Report of Session 2008/09 Vol I, *Devolution: a Decade On*, HC 529-I, May 2009; Commission on Scottish Devolution, *Serving Scotland Better: Scotland and the United Kingdom in the 21st Century. An Overview of the Final Report*, June 2009; and both reports of the Holtham Commission: *Independent Commission on Funding and Finance For Wales, First Report, Funding Devolved Government in Wales: Barnett and Beyond*, July 2009 and *Final Report, Fairness and Accountability: a New Funding Settlement for Wales*, July 2010

<sup>7</sup> *Independent Commission on Funding and Finance for Wales, Final Report, Fairness and Accountability: a New Funding Settlement for Wales*, July 2010

### 3.3 However the following adverse comments recur:

- The formula does not promote equalisation and results in differential public spending per head across the nations; for example identifiable spending per head for 2012/13 was £8,529 in England, £10,152 in Scotland, £9,709 in Wales and £10,876 in Northern Ireland.<sup>8</sup>
- The relative spending needs of the respective devolved nations are not accounted for in the formula
- There is no clear relationship between expenditure on the services provided and the taxes raised to pay for them, and thus no direct accountability for spending on services.

3.4 In relation to convergence or the Barnett 'squeeze,' if the Barnett formula is applied stringently, an inherent property of the formula is that it should lead to convergence of public expenditure per head of the nations of the UK. This is also referred to as the 'Barnett squeeze'.<sup>9</sup> It is unclear whether this was the original intention when the formula was introduced. There is an intrinsic problem in determining whether such convergence has actually occurred, because of '*inadequate and inaccessible data*' as recognised in a review by the House of Lords.<sup>10</sup>

3.5 HM Treasury publishes information on public spending on an annual basis in the Public Expenditure Statistical Analysis (PESA);<sup>11</sup> however this shows identifiable expenditure on services<sup>12</sup> for each of the nations of the UK. Problems with using this data to identify convergence include:

- This is a statistical exercise representing total spend on services, including that by the devolved administrations in their areas of responsibility and that by the UK Government in reserved areas.<sup>13</sup> It does not necessarily represent actual levels of spending.

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<sup>8</sup> HM Treasury, Public Expenditure Statistical Analysis 2014 (Chapter 9)

<sup>9</sup> Treasury Committee, [The Barnett Formula](#), HC 341, 22 December 1997

<sup>10</sup> House of Lords Barnett Formula Select Committee, [The Barnett Formula](#), HL Paper 139, July 2009 page 30

<sup>11</sup> HM Treasury, [Public Expenditure Statistical Analyses](#) (PESA)

<sup>12</sup> 'Identifiable expenditure on services' – that which can be recognised as having been incurred for the benefit of individuals, enterprises or communities within a particular region. This covers expenditure by the UK Government, the devolved administrations, local government and public corporations.

<sup>13</sup> It has been suggested that 50 to 55 per cent of identifiable expenditure in the territories is incurred by the devolved administrations. In Research Commissioned by the Independent Commission on Funding and Finance for Wales, [The Barnett Formula and its consequences for Wales: a literature review](#), Dr Gillian Bristow, Cardiff

- The PESA publication does show spend in the devolved administrations broken down into that incurred by the devolved government, local government, and central government. However, as comparable figures cannot be shown for England, it cannot be clearly demonstrated whether spend per head in devolved areas is converging with that in England.<sup>14</sup>
- Figures shown for the devolved administrations spend include that which is not determined by the Barnett formula, such as AME and the non-assigned elements, further muddying the waters as to whether the formula is producing convergence.
- As these figures are based on total identifiable expenditure, they include spend in the devolved nations by the UK Government on reserved areas such as defence and social security. Therefore, this cannot strictly be taken as a measure of convergence of allocations determined by the Barnett formula.

3.6 The Holtham Commission, examined convergence on the basis of the Welsh Government's DEL,<sup>15</sup> and suggested that there has been significant convergence in Wales since the 1990s. They found that Welsh spend per head was 25 per cent higher than that on comparable services in England in 1999-2000, and by 2009-10 this was reduced to 13 per cent higher, suggesting that, 'the gap in spending per head between Wales and England has roughly halved since the introduction of devolved elected government'.<sup>16</sup>

#### **4. Towards a Principles Based Approach**

4.1 As noted in our Executive Summary, we believe that continuation of the use of the Barnett Formula to deal with further devolution is not feasible. Further, we believe that the Barnett Formula in its current form should be withdrawn.

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<sup>14</sup> Figures for the assigned DEL elements of the devolved administrations can be obtained from their annual budget publications. However, as comparable figures are not available for England, these similarly cannot be used to examine the issue of convergence.

<sup>15</sup> This was calculated from HM Treasury's PESA data using Barnett comparability factors to estimate comparable spend in England. This comparison relates only to near-cash DEL; total resource and capital budgets excluding notional transactions such as depreciation, cost of capital charges and the taking and release of provisions. It is also complicated by the accumulation of end year flexibility (due to underspend) and the drawdown of end year flexibility, thus causing year to year variations. As detailed in Chapter 2 of the Independent Commission on Funding and Finance For Wales, [First Report, Funding devolved government in Wales: Barnett and beyond](#), July 2009

<sup>16</sup> Independent Commission on Funding and Finance For Wales, [First Report, Funding devolved government in Wales: Barnett and beyond](#), July 2009, Chapter 2

- 4.2 A way forward was outlined by the Steele Commission<sup>17</sup> which drew attention to the arrangements put in place when Australia introduced a major package of reform to its fiscal system in 1999. The changes came with a guarantee that each state would not be worse off during the transitional period than it would have been had the changes not been implemented. The transition period was approximately 8 years and during this time states whose income fell below the guaranteed level were given non ring fenced grants to maintain overall revenue levels.
- 4.3 CIPFA believes that any future funding solution would have to consider relative public service needs. For example, a recent report on fiscal devolution concluded: 'for a system of fiscal devolution to balance equalisation and incentives it has to start with an assessment of need and resources; have a mechanism for reallocating disproportionate tax yield growth and include periodic reassessments'.<sup>18</sup> Any solution would also need to factor in the extent of local control over taxation including for example over non-domestic and domestic rates.
- 4.4 A clear case for a principles based approach to funding devolved government across the UK emerges from CIPFA's assessment of reviews of the Barnett Formula and consideration of International evidence. CIPFA has proposed four simple principles which would underpin the funding for all devolved government across the UK:
- **Need** – the relative need and assessment of the socio-economic circumstances of each of the devolved government areas should be assessed;
  - **Equity** – this would be the cornerstone principle promoting equalisation across the nations of the UK.
  - **Accountability** – the devolved administrations should have some powers over taxation to provide a direct relationship between services provided and taxes paid, this making them more directly accountable, and
  - **Transparency** – any funding mechanism should be transparent in its operation and should be the responsibility of a body independent of government.

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<sup>17</sup> Moving to federalism – A New settlement for Scotland March 2006

<sup>18</sup> House of Commons, Communities and Local Government Committee Report, Devolution in England: the case for Local Government, June 2014