

# CIPFA BRIEFING

November 2014

## funding devolved government

across the United Kingdom

The Command Paper issued by HM Government in October 2014<sup>1</sup>, clarified the approach to further devolution in Scotland. The paper recognised that “...any changes to the relationship between the UK and Scottish Parliaments will have wider implications for the constitutional settlement across the UK, and that these will need to be considered in the round”.

CIPFA agrees with that view. However it considers that ‘the continuation of the Barnett allocation for resources’ in its current form as promised in the ‘vow’ by the leaders of the three UK parties ahead of the referendum on independence, will not achieve this in the longer term as the formula takes no account of relative needs or will be as practicable when different parts of the UK all have tax raising powers. We recognise the attraction of retaining Barnett in the short term, but at some point in the future equitable resource allocation will require a transparent needs-based funding system covering all regions of the UK, operated under the supervision of an independent commission of experts, designed to handle the tax decisions made by the governments within the UK.

## The Barnett Formula

The block grant for each of the devolved administrations is set as part of spending reviews, alongside that for UK government departments, using the non-statutory Barnett Formula, as set out in the *Statement of Funding Policy*.<sup>2</sup> The Barnett Formula was introduced in 1979. The 'Barnett' descriptor is a reference to the late Joel Barnett MP who was then Chief Secretary to the Treasury at the time of its inception.

When the UK government changes its spending plans<sup>3</sup>, the devolved administrations receive a population-based proportion of the changes in planned spending on comparable government services in England. Thus, Barnett is an incremental system, with the formula determining changes in the block grant relative to the previous year, but not the overall amount. Changes to the block grant are calculated as follows:



This calculation is 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.

Although the majority of funding for the devolved administrations is determined by the Barnett Formula, there are a number of exceptions where the population-based approach is not appropriate. This is often referred to as formula bypass.<sup>4</sup>

## Is Barnett Fit for Purpose?

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>5</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>6</sup>

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.

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>7</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.
- Concerns about the operation of the formula itself,<sup>8</sup> and what constitutes "comparable spend" were identified. (eg the decision to regard spend on the 2012 Olympics as benefitting the UK).<sup>9</sup>
- The formula is supposed to lead to convergence of the levels of spending per head across the nations over time, but identifying whether this has actually occurred is problematic.<sup>10</sup>

## Comparison with other Funding Mechanisms Internationally

Comparison with other countries demonstrates a low level of tax autonomy in the UK. Federal countries, such as Canada and Switzerland, tend to have the highest levels of tax autonomy, while unitary nations like France have the lowest.<sup>11</sup> The UK retains a unitary system despite devolution, but only 5% of total revenues are raised at local level – well below the average of OECD countries of around 16%.<sup>12</sup> This will change with the devolution of tax raising powers via the Scotland Act 2012 and the Wales Bill, where powers to raise taxes will be accompanied by a corresponding reduction in block grant.

Tax autonomy does not remove the need for some form of transfer from central government to address different funding needs. Internationally, a wide range of inter-governmental grants are used. However, there is a general consensus that the success of tax devolution is dependent on the existence of a well-functioning equalisation system to distribute the balance of funding to devolved governments.<sup>13</sup>

In some nations, the distribution of resources amongst the different tiers of government is overseen by a body independent of government. For example, in Australia, there is a separate Commission<sup>14</sup> which determines the annual allocation of general revenue assistance to the states and territories.

## Towards a Principles-Based Approach

A clear case of 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 proposes 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, thus 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.

## Devolved Government in England?

Of the four nations in the UK, only three have formal devolved government. Yet, the current public service funding mechanism is linked directly to the levels of expenditure in the one nation which does not have devolved government.

This was recognised by the independent commission on local government finance which stated that “...the debate over more powers for Scotland, and the near universal acceptance that decisions are best taken as close to the citizen as possible, has created a rare opportunity to secure devolution within England”. Notably, while the focus for the Commission was local government in England it also concluded that “...giving local communities the power and autonomy to manage their own affairs should be embraced everywhere — devolution must not stop at the Scottish Parliament or the assemblies for Wales and Northern Ireland”.

CIPFA agrees. Any 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>15</sup>

Any solution would also need to factor in, the extent of local control over taxation including for example over non-domestic rates and council tax.

## CIPFA's Position on Funding Devolved Government

- 1 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 across the UK.
- 2 The vow made to the Scottish electorate by the three UK party leaders, in the run up to the independence referendum<sup>16</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 tax raising powers are devolved across all four nations and English regions.
- 3 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.
- 4 The resource allocation process should be depoliticised by being overseen by a commission which is independent of government.<sup>17</sup>
- 5 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.

## References

- 1 <https://www.gov.uk/government/publications/proposals-for-further-devolution-of-powers-to-scottish-parliament>
- 2 HM Treasury, [Funding the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly: Statement of Funding Policy](#), October 2010
- 3 Such changes are generally through spending reviews but also other spending announcements, such as those made by the Chancellor of the Exchequer in his Budget and Autumn Statement.
- 4 Further details can be found in HM Treasury's [Funding the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly: Statement of Funding Policy](#), October 2010
- 5 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
- 6 Independent Commission on Funding and Finance for Wales, [Final Report, Fairness and Accountability: a New Funding Settlement for Wales](#), July 2010
- 7 HM Treasury, [Public Expenditure Statistical Analysis 2014](#) (Chapter 9)
- 8 House of Lords Barnett Formula Select Committee, [The Barnett Formula](#), HL Paper 139, July 2009
- 9 Western Mail, [Shocking Cost to Wales of Olympics](#), 6 October 2007
- 10 As identified in House of Lords Barnett Formula Select Committee, [The Barnett Formula](#), HL Paper 139, July 2009
- 11 Commission on Devolution in Wales, [International Fiscal Systems](#)
- 12 OECD, Fiscal Federalism Network, [Tax revenue as percentage of total general government tax revenue](#)
- 13 Blöchliger, H. and J. Rabesona (2009) The Fiscal Autonomy of Sub Central Governments: An Update, OECD Network on Fiscal Relationships Across Levels of Government
- 14 [Commonwealth Grants Commission](#)
- 15 House of Commons, Communities and Local Government Committee Report, [Devolution in England: the Case for Local Government](#), June 2014
- 16 Daily Record, [The Vow](#), 16 September 2014
- 17 House of Lords Barnett Formula Select Committee, [The Barnett Formula](#), HL Paper 139, July 2009



Registered office: 3 Robert Street, London WC2N 6RL  
T: 020 7543 5600 F: 020 7543 5700 [www.cipfa.org](http://www.cipfa.org)

The Chartered Institute of Public Finance and Accountancy.  
Registered with the Charity Commissioners of England and Wales No 231060.

