Select Committee on the Barnett Formula

1st Report of Session 2008–09

The Barnett Formula

Report with Evidence

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The alternative, and in our view preferable, approach would be based on a clear distinction between the taxes raised in particular nations or regions; and the funds that were allocated to them from central resources according to some kind of needs-based formula. The ultimate outcome in terms of central redistribution of funds might not differ radically from present arrangements, but it is to be hoped it would be more possible to achieve a degree of public understanding and acceptance around it. However, the current unitary UK constitution does not permit such an approach. Within this system, however it is modified, the Formula is likely to bring with it similar problems such as resentment within England that it is subsidising other parts of the UK.

Do the advantages of the Formula as presently constituted outweigh its disadvantages?

The primary political goal of the Formula is to satisfy those nations within the UK that are in practice its beneficiaries that membership of the Union is advantageous to them; while not causing excessive resentment amongst the other nations (or rather, nation). So long as both these conditions are fulfilled by the formula, its advantages could be said to be outweighing its disadvantages. Inevitably, there will be those in both the smaller nations of the UK and in England who will be unhappy with the precise balance established by the Formula. Until now, both these minorities have been politically marginal, but there can be no guarantee that their marginality will continue indefinitely.

Should the Barnett Formula be (a) retained in its current form, (b) amended or (c) replaced entirely?

We believe that, while the status of the UK as a highly centralised, unitary state remains intact, there would little purpose in amending the Formula. Problems associated with the Formula are likely to remain roughly similar in nature while the current framework persists. For it to be “replaced entirely” in a meaningful way would involve alterations to the structural make-up of the UK.

March 2009

Memorandum by Professor David Heald

INTRODUCTION

(1) My evidence takes the form of direct answers to the questions on which the Committee asked for responses. The Committee’s terms of reference, and the clarification of what is thereby excluded, have the effect of removing some of the questions and answers from their operational and political context. The meaning of the first and third “main areas” that are explicitly considered for exclusion is unclear; these could be interpreted in ways which would prevent the Committee from making a balanced assessment of the Barnett Formula.

(2) I have interpreted “Barnett Formula” in a broad way, as referring to the funding system as a whole and not just to the calculation of formula consequentials. The Barnett Formula is often criticised for what it does or does not do, without reference to its ranking against viable alternative methods of funding the UK Devolved Administrations. The Committee should distinguish those criticisms which are specific to the Barnett Formula from those which would apply to all block-grant funding mechanisms.

RESPONSES TO THE COMMITTEE’S QUESTIONS

(3) For readability, each question is reproduced before the answer. Answers appear in bold type. Some of these questions and sub-questions could be answered at great length, but the importance of brevity has been respected. Where amplification is clearly required, I provide references to my published work.

1. APPLICATION OF THE FORMULA IN PRACTICE

(a) Are the present disparities in public expenditure per head of population between the countries of the UK a consequence of the Barnett Formula itself, the historic baseline or of other factors? To what extent are those disparities related to need?

The terminology of “disparities” is loaded. Given the functional composition of UK identifiable public expenditure, and the economic and socio-demographic differences across the nations and regions of the United Kingdom, there is no reason to expect that each nation and region would have equal expenditure per head (ie a per capita index of 100 where UK = 100).24 This point is reinforced by the analyses in Public Expenditure: Statistical Analyses of the regions of England; the choice of the unit of analysis is very important.

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24 Expecting all nations and regions to have an index of 100 (UK = 100) indicates that the only need indicator is population.
The key factors are clearly the pre-Formula baseline (determined about 30 years ago) and operational decisions about how the Formula is applied (eg population updating, changes in scope and formula by-pass).

It is impossible to answer the question as to whether differences in per capita indexes reflect differences in need. First, need would have to be operationally defined in relation to expenditure functions, and there would be value conflicts because the definition of need to spend involves political choices. Second, empirical evidence would have to be accumulated on relative need. Most needs assessments for public services are undertaken separately for England, Scotland, Wales and Northern Ireland, and institutional differences make read-across very difficult.

Neither the pre-devolution Secretaries of State, nor the Devolved Administrations themselves, have asked the UK Government to undertake a needs assessment. Given the convergence property of the Barnett Formula, this would seem to imply that (a) they privately regard the present funding relativities as reasonably generous, and/or (b) they regard the uncertainties attached to a needs assessment and its aftermath as something to be avoided.

(b) What effect does the Barnett Formula have in terms of equity and fairness across the UK as a whole?

A comprehensive answer to this question would be lengthy. This brief response draws attention to a number of important considerations:

— it is very difficult to confer operational meaning on equity and fairness, which in political conversation at least are near synonyms. There is a strong commitment to broadly equal treatment of citizens wherever in the United Kingdom they live. This is given practical expression by the centralised operation of the cash-benefit component of the UK welfare state and by many service-level equalisation formulae. The strength of this commitment—shared by most Western European states, but less so in the United States—is an important feature of UK political life. It necessarily involves large territorial shifts of resources, as reflected by large differences at the “regional” level between tax revenues and public expenditure;

— this generalised commitment to equity is complicated in the United Kingdom by its multinational character. England constitutes 85 per cent of the UK population; only 15 per cent of the population live in Scotland, Wales and Northern Ireland and that proportion seems likely to decline. This population imbalance raises a number of issues about the distribution of political power; do Scotland and Wales have equal status to England (as in the Six Nations Rugby Championship) or does England’s huge population majority give it pre-eminence in terms of democratic authority? Federal systems of government—as in the United States—sometimes qualify majority rule by structuring voting systems and institutions in order to provide protections to smaller jurisdictions;

— majority opinion in Scotland, Wales and Northern Ireland favours a devolved system of government. Where there is genuine policy choice at the devolved level, that brings with it a conflict between interpersonal equity (each UK citizen faces the same treatment wherever they live)25 and territorial equity (each political jurisdiction has the same fiscal capacity in relation to needs). Under territorial equity, each government would have the potential to meet UK standards/norms but devolved political decisions (eg the choice between education and health expenditure) mean that access by individuals to particular services may differ according to the political jurisdictions in which they live;

— it needs to be established whether judgements about equity are made solely with reference to the distribution of public expenditure, or whether the generation of tax revenues is also relevant. Higher tax revenues might flow from higher taxable capacity per head or from higher tax effort (eg on council tax). I make this point but do not develop it in light of the restrictions imposed by the Committee’s terms of reference; and

— the establishment of this ad hoc Select Committee stemmed primarily, in my view, from the Barnett Formula being perceived in England as unfair to England and thereby lacking legitimacy. Paradoxically, some of the criticisms of the Barnett Formula as being unfair use as evidence the distribution of public expenditure across English regions. This distribution is generated by policy decisions within England, taken by UK ministers. Controversy has been stimulated by the way in which devolution has given higher profile in England to institutional and policy differences within the United Kingdom. In particular, certain Scottish policy initiatives (eg free personal care for the elderly, absence of higher education fees paid by students, free hospital parking, abolition of bridge tolls) is taken as evidence that Scotland is over-funded. In fact, such policies entail an opportunity cost, for

25 There is no evidence that a centralised state is, in fact, capable of the uniform provision of service that is implied here.
example in terms of University funding. This sense of grievance in England has been made worse by the way in which the present UK Government closed down debate about the Barnett Formula, rather than either mounting a defence of the devolution financial settlement or debating alternatives.

(c) *What effect does the Barnett Formula have on the aggregate control of public expenditure?*

If it is accepted that the UK Treasury needs to control the aggregate of UK public expenditure, then the Barnett Formula assists that control. The Treasury negotiates directly with UK departments, knowing the size of formula consequentials that will be generated for Scotland, Wales and Northern Ireland by increases in “comparable programmes” in England.

(d) *What measure of flexibility do the Devolved Administrations (DAs) presently enjoy in allocating funds, between various policy areas, between capital and current spending, and for accounting purposes? Is there any need for reform in this area?*

The great attraction of the Barnett Formula system to pre-devolution territorial Secretaries of State was that it gave them expenditure-switching discretion over the block. This was fed by formula consequentials, but—except for small amounts of expenditure, some connected with Europe—there was independent choice on how to allocate the increments and (over time and subject to obvious political constraints) the base.

This expenditure-switching discretion continued under devolution. However, there has been some subsequent erosion, particularly from Spending Review 2004; these changes occurred without any public announcement. At SR2004, the Treasury became more concerned about meeting the golden rule, and insisted on the distinction between Resource DEL and Capital DEL. There are now two types of Resource DEL: near-cash and non-cash (covering depreciation and cost of capital charges). This partitions the Assigned Budget and qualifies the expenditure-switching power. These public expenditure control mechanisms affect the Devolved Administrations because it is possible to have the “wrong type of DEL” in both new formula consequentials and in stocks of End-Year Flexibility (EYF).

These developments pose two threats to the devolved funding system:

(i) restrictions on the fundibility of the Assigned Budget run counter to the principle that the Devolved Administration should have full expenditure-switching discretion; and

(ii) these changes were made without either public announcement or justification, a situation that undermines transparency. The fact that this attracted minimal attention is perhaps attributable to the large volume of formula consequentials in SR2004 and to the Labour Party’s role as UK Government and in all three Devolved Administrations.

Although the Treasury’s reasons for wishing to control the release of accumulated EYF to UK departments and Devolved Administrations are understandable given the large amounts now involved, the UK Government’s control over such release gives them leverage over the Devolved Administrations that was not foreseen in 1999.

There are expected to be future changes in the UK public spending framework, as a result of the Treasury’s “Clear Line of Sight” project. This is likely to involve the abolition of cost of capital charges and of “non-cash”. However, the Treasury will continue to be interested in the split between Resource DEL and Capital DEL as this affects compliance with UK and EU fiscal rules. In practice, the actual numbers relating to the Devolved Administrations may not be significant in relation to the fiscal aggregates, but the Devolved Administrations are deeply embedded in the UK public expenditure control system.

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26 There are differences between Devolved Administrations in what is comparable and what is not, but that does not affect this point.
27 DEL stands for Departmental Expenditure Limit.
28 EYF stands for End-Year Flexibility and represents accumulated DEL underspends from earlier years, release of which to UK departments and the Devolved Administrations requires the agreement of the Treasury.
29 This issue arose while the Northern Ireland Assembly was suspended and decisions were taken by Direct Rule ministers in the Northern Ireland Office.
2. **Formula By-pass and the Barnett Squeeze**

(e) *Has convergence of levels of public spending in Scotland, Wales and Northern Ireland based on the English level of spending happened, and if not why?*

The mathematical properties of the Barnett Formula will, over time in the context of rising public expenditure, create a movement towards convergence on £100, but there has never been a UK government commitment to arrive there. Full convergence would take place over a long period and would only apply to that part of identifiable public expenditure that falls within the coverage of the Barnett Formula. There would not be convergence on £100 of the indexes of per capita identifiable expenditure.

Inadequate data in the public domain mean that indexes that are calculated are only proxies for the correct aggregate. My own judgement is that, if appropriate data were available, it would provide evidence of some convergence—but not as much as expected. This judgement is heavily influenced by an analysis published in 2002 by Dr Andrew Goudie, Chief Economic Adviser to the Scottish Government.

Although it is not possible to quantify the relative importance of factors that have inhibited convergence, several can be identified:

- in the case of Scotland, population relative to that of England has continued to fall and—even with updated population relatives for the calculation of formula consequentials—the per capita expenditure index is affected by the relative-to-England reduction in the denominator;
- not all public expenditure changes actually go through the formula; by-pass—if more favourable than formula consequentialswould operate against convergence;
- prior to 1992, there was some continuing up-rating for inflation for the horizon year coming into the Public Expenditure Survey period; and
- there is a lot of noise in the data, arising from, *inter alia*, transfers of functions, changes in accounting conventions, and improvements in data collection.

If there were now to be a period of retrenchment of nominal-terms public expenditure in England that is assessed as comparable, then the mathematical properties of the Barnett Formula would—if not offset—lead to divergence rather than convergence.

(f) *To what extent did by-passing of the Formula occur before 1999? Has scope for such “Formula by-passes” changed? What have been the consequences of that change in scope?*

I wrote about formula by-pass in the pre-devolution period, but it was only possible to describe—not quantify—examples. It is my understanding that, after 1992, the general tightening of public expenditure control limited opportunities for by-pass that was favourable to the territorial Secretaries of State.

Devolution in 1999 changed the Barnett Formula from a formula within a single government into an inter-governmental mechanism. With the publication of the funding rules (Statement of Funding Policy), which had never before been in the public domain, there was more transparency about processes but very limited transparency about relevant numbers.

There is a terminological problem about what constitutes by-pass. If this signifies anything that does not go through the Formula, then there has been positive by-pass to Wales (Objective 1 funding) and Northern Ireland (borrowing powers under the Regeneration and Reform Initiative).

By-pass was traditionally seen as beneficial to the territorial Secretaries of State, in the sense that they secured more funds than if the Formula had been strictly applied. Much of the discussion of formula by-pass originated in puzzlement about less-than-predicted convergence. However, there is no reason for this necessarily to be the case: for example, in-year allocations to UK departments for services in England out of the Reserve do not generate formula consequential for the Devolved Administrations. Increases in expenditure in England might be structured in ways that avoid being categorised as comparable expenditure.

31 More precisely, when the cumulative increments that have passed through the Formula have become extremely large in relation to the inherited expenditure base.
33 This important 1992 change to UK-wide practice, which passed a greater proportion of expenditure changes through the Barnett Formula, was not publicly announced until December 1997.
3. Data Quality and Availability

(g) Are sufficient data available to enable a clear understanding of how public spending is distributed across the UK, and to show the working of the Formula as set out in the Statement of Funding Policy?

This constitutes two quite separate questions. On the first, the territorial data in Public Expenditure: Statistical Analyses are much improved, particularly with regard to the pattern of spending within England. However, there is no counterpart in Wales or Northern Ireland to Government Expenditure & Revenues in Scotland. In part this reflects the different nature of political debate from that in Scotland, and also the realisation that such an exercise would show the public finances of both Northern Ireland and Wales to be very weak.

On the second, detailed expositions of how the Formula operates in practice have not been published by the UK Government. For example, the generation of formula consequentials and the evolution of the Assigned Budgets have not been properly documented, with the gaps partially filled by academic analyses. This has contributed to widespread misunderstanding of how the Formula works, and indirectly to the erosion of its legitimacy.

(h) What additional data, or ways of presenting data, would be necessary to undertake a new needs assessment, or otherwise to reform the Formula?

This is a massive question, to which my brief answers appear elsewhere in this memorandum of evidence.

(i) What additional data, or ways of presenting data, should be available to ensure that the Formula is transparent in its application?

Transparency in the application of the Formula, as it now operates, requires important changes, including the following:

- continuous updating of the published Statement of Funding Policy whenever there are changes (for example, in comparability percentages, populations and operating rules). At present the only updates are published at Spending Reviews, which are timed at the convenience of the UK Government, and information in the public domain lags practice;
- publication of time series of comparable spending in England, which requires three sets of tables because of differences in the scope of devolved expenditure in the three Devolved Administrations. This would bring into the public domain the three notional English blocks which generate formula consequences for the Devolved Administrations;
- automatic publication of “generation of formula consequentials” tables whenever the Barnett Formula is applied; and
- automatic publication of the “chain-linking” of one public expenditure announcement to the next, thereby identifying, inter alia, the effect of classification and accounting changes.

On a different but related point, updates of the 1979 Needs Assessment that have been prepared by the UK Government should be put in the public domain. These will not have direct policy relevance because circumstances have changed much since 1979: for example, there have been marked changes in the demographic composition of England. The main reason for urging publication now is that they are presently available only to the UK Government and not to the Devolved Administrations or the public. In addition, access to them might inform discussion about whether to have a future needs assessment and, if so, how to conduct it.

(j) What body should undertake the collection and publication of such data?

The answer depends on which data this question refers to. With regard to Question (h), the UK Parliament should establish an independent Territorial Exchequer Board as the Treasury does not have the credibility across the United Kingdom to undertake a needs assessment. The Devolved Administrations should have rights of nomination to this Board. If there is to be a needs assessment, it is unlikely that this can be done in a rough and ready way, and so that implies using Australia’s Commonwealth Grants Commission as a model.

With regard to Question (i), this is a role that is best performed by the Treasury, in consultation with the Finance directorates of the Devolved Administrations. The additional information to be placed in the public domain is mostly generated, or could be generated, from existing databases held by the Treasury.

35 See D A Heald and A McLeod, “The embeddedness of UK devolution finance within the public expenditure system”, Regional Studies, Vol 39(4), pp 495–518. However, such academic analyses are one-offs and retrospective, therefore not meeting the transparency requirement of a timely and continuous flow of information.
36 See Heald and McLeod, op cit, Regional Studies, 2005.
37 See Heald and McLeod, op cit, Regional Studies, 2005.
4. Need for Reform/Alternatives to the Existing Formula

(k) Do the advantages of the Formula as presently constituted outweigh its disadvantages?

The answer depends on how this particular question is interpreted. Does it apply only to the generation of consequentials or to the funding system more generally (ie protected base, formula consequentials dependent on changes in England, and expenditure-switching discretion)? Moreover, advantages and disadvantages have to be evaluated in relation to credible alternative funding models.

A comprehensive answer would stray outside the terms of reference of the Committee. However, it is my view that, though some extension of taxation powers is desirable, there are powerful factors in the United Kingdom that suggest that the Devolved Administrations will continue to be largely funded by grant from the UK Government. In such a context, it is essential to preserve the expenditure-switching discretion that has been a major feature of both pre-devolution and devolution.

(l) Should the Barnett Formula be (a) retained in its current form, (b) amended or (c) replaced entirely?

Option (a) has to be associated with greater transparency about the system, as this is a necessary feature now that it is intergovernmental rather than intra-governmental, and inter-party rather than intra-party. Retention is the default option if there is no agreement on alternatives.

Option (b) is not well-differentiated from (a) because the Barnett Formula system has clearly evolved through time.

Option (c) might be semantic—the name changes but the substance does not—or substantive. On the assumption that neither independence nor the reversal of devolution is being considered, that leaves two substantive funding arrangements:

— the conduct of a needs assessment which, after reporting and agreement, would require a formula mechanism to phase the movement of actual spending towards assessed spending need (on the assumption that sudden adjustment would be both disruptive to public services and politically destabilising); and

— a move to a system in which the spending of a Devolved Administration depends upon its own revenue generation and explicit equalisation payments. This is often described as “fiscal autonomy”, but I would only accept that label if the Devolved Administration had control over tax rates (if not of bases) and extensive borrowing powers.

There has been discussion of modifying the Barnett Formula by using inverse GDP. If this only applied to the increment, it would make relatively little difference to Scotland (whose per capita GDP is not far below UK = 100), but it would significantly benefit Wales and Northern Ireland. Alternatively, it seems to have been suggested that it could apply to the determination of Assigned Budgets. Given the scope of devolved functions, which exclude social security, there is no logic in treating per capita GDP as closely related to the overall need to spend of Devolved Administrations. Other factors are likely to be much more important: for example, socio-demographic characteristics and participation rates in publicly-provided education and health services.

I have briefly discussed in this response how the operation of the Barnett Formula could be improved. If it were to be “replaced entirely”, the replacement scheme would have to be assessed carefully to establish whether it is consistent with the political objectives of devolution.

It is not an accident that the financial relationship between Scotland and the United Kingdom has been partly governed by formula (Goschen then Barnett) for about 100 of the last 120 years. This is attributable to both ease of administration, particularly in the context of tight deadlines, and to the desire to minimise political conflict about expenditure that constitutes a small proportion of UK totals. In the context of Scotland’s continuing membership of the United Kingdom, I would predict the continuation of a formula mechanism, whether or not that is called the Barnett Formula.

The viability of such formula mechanisms implicitly depends upon broad agreement across governments within the United Kingdom about the scope and size of the public sector. For example, a move in England to replace publicly-provided/funded provision by private provision would generate large negative formula

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38 I discuss this matter in my evidence to the Calman and Holtham Commissions.


consequentials. Policy decisions about England have first-mover advantage: the resulting expenditure increases or decreases are then transmitted to the Devolved Administrations.

There is a further asymmetry. The funding rules require the devolved administrations to meet any additional costs imposed on the UK Government by their decisions. While there is some symmetry in that the UK government has to meet the additional costs for the Devolved Administrations of any of its decisions (provided they are not met by the operation of the Barnett formula), policy measures taken by Devolved Administrations that reduce the costs of UK departments do not lead to an increase in the Assigned Budget. This was the subject of dispute when Scotland adopted free personal care for the elderly in 2002 without gaining access to UK savings in attendance allowances.

(m) Should the Barnett Formula be replaced by a system more adequately reflecting relative needs, costs of services or a combination of both? If so, what factors should be considered as part of a needs assessment?

The wording of this question assumes that there is a current misalignment between actual spending in the four countries and the spending that would be validated by a needs assessment considering relative needs and costs of services. This might indeed be the case, but it is noticeable that criticism of the Barnett Formula in Scotland, Wales and Northern Ireland focuses on the “Barnett squeeze”, usually portrayed as undesirable if not malignant. In contrast, discussion in England usually focuses on alleged over-funding of Scotland and sometimes of Wales and Northern Ireland. However, comparisons of spending in Scotland, Wales and Northern Ireland with that in a specific English region have nothing directly to do with Barnett Formula, which affects the Scotland: England relative but not the within-England distribution.

Enumeration of factors relevant to a needs assessment is beyond the length of this written evidence. The contested issues are likely to be (a) the model of provision that is regarded as “standard” for costing purposes, and (b) the indicators that are considered valid causes of additional spending. There would be much rhetoric about neglecting genuine need and rewarding failure.

(n) What practical and conceptual difficulties (particularly for defining “need”) would arise in carrying out a needs-based assessment? How can these difficulties be overcome?

There is sufficient UK evidence (eg distribution formulae for health and education) and international evidence (eg the work of the Commonwealth Grants Commission in Australia) to show that it is technically possible to produce quantitative indicators of the relative need to spend of particular jurisdictions. However, such exercises are time-consuming, data-hungry and expensive. They are, and always will be, politically controversial. Needs assessments are heavily driven by weighted population, which is an important characteristic given present controversies about measuring the size of the UK population in the context of high gross rates of emigration and (legal and illegal) immigration.

The major difficulties which would confront a UK-wide needs assessment include the following:

(i) the needs assessment would take place in a context of contradictory expectations of final outcome (eg that the present relatives of Scotland and Northern Ireland would be shown to be underfunded; and that England—and in particular certain regions of England—would be shown to be unfairly treated in relation to the Devolved Administrations, notably Scotland). This context would heavily politicise the environment within which the needs assessment took place;

(ii) the definition of need is, at least in part, values-specific, time-specific and location-specific. For example, the 1979 Needs Assessment\textsuperscript{41} did not consider that the additional costs of bilingualism in Wales was a valid need indicator, a decision that now seems surprising. The need for spending on the elderly depends not only on longer life expectancies but also on changed attitudes about what is socially acceptable, and also the greater proportion of older voters. Prominent issues in a future needs assessment might be whether parallel denominational and non-denominational school systems are a need indicator or a policy choice, and whether English not being the home language is a need indicator for school education;

(iii) needs assessments usually take place in the context of a large number of jurisdictions, in which no one jurisdiction dominates the picture. With England constituting 85 per cent of the UK population (and likely to increase in future owing to demographic trends), any weighted average is much closer to England than to the Devolved Administrations. Where policies diverge, the issue would arise as to which policy should be costed: for example, the Scottish model of free personal care for the elderly or the English model. The calculated relative needs indexes might be quite sensitive to that choice. The Devolved Administrations would be fearful of a needs assessment becoming an extension of existing

English funding models, thereby institutionalising policy leadership by UK departments with responsibilities for England. Such an extension would also have implications for England: some of the criticisms from English regions that the Barnett Formula is unfair to them appear to be rooted in discontent with the within-England formulae. To the extent that there is substantial periodic reallocation between regions and the UK Reserve, the Committee should seek evidence about the extent of political influence on formulae to the Devolved Administrations would import irrelevant considerations into the assessment of their need-to-spend:

(iv) the “inherited base plus formula-based increment” model has protected the expenditure-switching discretion of the territorial Secretaries of State and of the Devolved Administrations. There is some public pressure for the Devolved Administrations to spend formula consequentials generated by changes in, for example, health expenditure in England on their own health programmes, but this is manageable and relates only to the increment. A needs assessment that explicitly stated how much a Devolved Administration “needed to spend” on individual programmes might strengthen sector-specific lobbies and pressurise conformity of actual spending with centrally-assessed need to spend; and

(v) before agreeing to participate in a needs assessment, the Devolved Administrations would be well advised to secure an agreement on the processes to be adopted in the case of assessed need to spend being calculated as less than actual spending. A sudden reduction in spending after a needs assessment would be seriously disruptive of service provision, and a sudden increase might be difficult to spend wisely. The adjustments—especially downward—would have to be phased over a number of years, probably by a formula.32

(o) Should a needs-based assessment seek to encompass a wide-range of factors or be limited to a smaller number of indicators of “need”?

If there is to be a needs assessment which then directly influences funding, it is difficult to envisage this not being a comprehensive exercise that encompasses a wide range of factors. Otherwise, there would be endless arguments about the hypothetical effects of excluded factors, including those used in distribution formulae within the devolved jurisdiction.

There is a different possible use of a needs assessment, one for which a more broad-brush approach might be acceptable. The purpose would be a pilot exercise to check on how needs relatives relate to existing expenditure relatives; for example, a Devolved Administration might believe that convergence has gone too far or the Treasury might believe that convergence has not gone far enough.

It is known from media reports and memoirs that the Treasury has, at various dates, updated the 1979 Needs Assessment, but nothing has ever been published. Two significant changes to the Formula have related to the population measure (the 1992 one-off updating of population relatives and the 1999 move to annual updating) and the several extensions of scope (expenditure previously outside the Formula has been brought within). The Committee might ask the Treasury to provide at least a summary of these updates to the 1979 Needs Assessment study, and what, if any, changes were subsequently made to the operation of the Formula.

(p) Who should carry out a needs-based assessment, if one were to take place?

The credibility and legitimacy of a needs assessment require that it be undertaken by an independent body. A Territorial Exchequer Board might have a governing body, on which the Devolved Administrations and the UK Government had representation, with the needs assessment undertaken by its operational arm. Results of a needs assessment undertaken by the UK Government would not be accepted, particularly if they led to a reduction in funding to one/all of the Devolved Administrations.

5. Decision Making and Dispute Resolution

(q) How effective, appropriate and fair are the processes and criteria by which HM Treasury determines matters relating to the Barnett Formula? In particular, is the way HM Treasury determines whether items of spending in England do or do not attract consequential payments under the formula, and claims by the DAs on the UK Reserve, appropriate and fair?

On the detail of comparability decisions and of claims on the UK Reserve, the Committee should seek evidence from the Devolved Administrations and the Treasury. However, two issues have reached the public domain:

— the Devolved Administrations have been dissatisfied with the classification of Olympics expenditure

as non-comparable, even that expenditure openly declared to be motivated by the economic regeneration of East London; and

— because claims on the Reserve do not generate formula consequentials, this affords a mechanism whereby some additional expenditure in England (e.g., on prisons) can be financed through a claim on the Reserve rather than as a programme increase triggering formula consequentials.

These examples confirm the importance of developing more formal rules that govern Treasury decisions on such operational matters, together with an appeals procedure. On 4 March 2009, the Scottish Government’s Finance and Sustainable Growth Secretary (John Swinney) met the Chief Secretary to the Treasury (Yvette Cooper) and the Secretary of State for Scotland (James Murphy), in connection with the funding of the second Forth Road Bridge. The results of that meeting were loudly proclaimed by the UK Government as an “unprecedented package” for Scotland. In fact, there was little new in the announcement, other than the quantification of the formula consequentials from the London Crossrail project and announcements on access to End-Year Flexibility and retention of the proceeds of asset sales. The UK Government made it sound as if this was special funding for the second Forth Bridge, as well as promoting Public-Private Partnerships as a funding model. This episode illustrated the unacceptable level of discretion currently held by the Treasury and the willingness of the UK Government to use this for partisan purposes.

(r) Are the existing procedures for resolving disputes between HM Treasury Ministers, territorial Secretaries of State and the Devolved Administrations about funding issues adequate?

I have no experience of these procedures. However, I would stress the importance of funding mechanisms being fully documented in the public domain. This is particularly important in the context of Devolved Administrations predominantly funded by grant from the UK Exchequer. There is the potential to discredit the funding mechanism without there being alternative mechanisms commanding sufficient support for successful implementation.

I mentioned above the Forth Bridge funding announcement on 4 March 2009. Another example is the fact that the Scottish Government reportedly does not yet know the size of the negative formula consequentials for 2010–11 arising from the £5 billion “value for money savings” in UK spending announced in November 2008’s Pre-Budget 2008. Although the figure of £.500 million has been much quoted in the Scottish media, the actual number depends on the extent to which the UK expenditure reductions fall on comparable programmes. I would have expected at least a provisional figure for negative consequentials to have been notified by March 2009. This uncertainty hampers decision-making in the Devolved Administrations at a time when it is important to avoid unnecessarily aggravating the recession.

(s) How could dispute resolution procedures be improved?

I have no comment to make.

March 2009

Memorandum by The Independent Expert Group to the Commission on Scottish Devolution
[from Page 10 Paragraphs 5.7.1 to 5.7.2 of the Independent Expert Group’s First Report]

1. Constitutional Design and Financing Devolution

1.1 Systems of financing subnational governments inevitably involve trade-offs. The choices made between these trade-offs require the philosophy (if there is one), or at least, the structure (as implied by the division of powers and the extent of their asymmetry) of the state to be established first. Finance is not the first link in a chain of constitutional design, but once the constitutional model is chosen, systems of territorial finance can

43 This point is symmetrical in that access by the Devolved Administrations to the Reserve does not feedback to the UK departments responsible for programmes in England. However, it would appear that the main issue does relate to UK departments having access to the Reserve.

44 Recourse to a Public-Private Partnership (PPP) would not resolve the budgetary problem faced by the Scottish Government in connection with Forth Road Bridge funding. From 2009–10, the UK Government and Devolved Administrations are moving from accounting on the basis of UK Generally Accepted Accounting Practice to International Financial Reporting Standards. This reflects the UK Government’s commitment to use best private sector accounting practice. It is widely expected that almost all PPP projects not already on the public sector balance sheet will move on-balance sheet. Accordingly, a PPP-financed Forth Road Bridge would score against the Assigned Budget in the same way as would a publicly financed Bridge. As well as attacking the SNP Scottish Government’s “ideological hostility to PPPs”, the UK Government might have been signalling that more favourable treatment would be available if the PPP option were followed.