

## **THE NORTHERN IRELAND BLOCK GRANT AND CALLS TO REFORM THE BARNETT FORMULA**

### **BACKGROUND**

The Barnett Formula has been used for apportioning changes in public expenditure to the devolved administrations since 1979-80. It was originally intended to be a short-term mechanism but remains in operation three decades on. A growing number of voices, however, is calling for Barnett Formula to be scrapped and for the financing of the devolved administrations to be fundamentally changed.

An in-depth discussion of how the Barnett Formula works – and arguments for and against reform - can be found in Assembly Research Paper [49/09](#). The purpose of this Briefing Note is to update that paper by drawing Members' attention to recent developments.

### **1. THE HOUSE OF COMMONS JUSTICE COMMITTEE**

In May 2009, the Justice Committee published its report 'Devolution: A Decade On'.<sup>1</sup> The purpose of the report was to review devolution "in order to consider its impact on the United Kingdom and the development of devolution policy since 1999." The inquiry had two main strands:

*a) what changes (if any) are required to improve the current infrastructure and the procedures and practices of governance in the UK post-devolution. We examined the mechanisms, structures and frameworks that have been put in place at a UK level in order to facilitate the effective and efficient functioning of the asymmetric system of devolution that was introduced to the United Kingdom in 1999, for example, the co-ordination of relationships between administrations and the smooth running of the legislative process.*

*b) what outstanding constitutional and political issues have arisen after 1999 as a result of devolution, which have an impact or a potential impact on the governance of the UK as a whole. We identified two major issues: the "English Question" (or the England outside London question), described by Rt Hon Sir Malcolm Rifkind MP as "the unfinished business of devolution,"<sup>[5]</sup> and the issue of public finance and the continued use of the Barnett Formula as the basis for the allocation of public finance in the UK post-devolution, which excites particular interest in some of the English regions as well as in Wales and Scotland. Professor James Mitchell, Head of the Department of Government, University of Strathclyde, told us that while devolution resolved "one problem of legitimacy" in Scotland and Wales, it "has created a series of others, the English Question, the West Lothian Question, the question of Barnett and*

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<sup>1</sup> The full report is available at:

<http://www.publications.parliament.uk/pa/cm200809/cmselect/cmjust/529/52902.htm>

*Providing research and information services to the Northern Ireland Assembly*

*finance ... in a sense we have shifted the problem around within the UK" (para 8)*

Both of these strands are relevant to Northern Ireland; the continued use of the Barnett Formula is part of the infrastructure of devolution. In this regard, the Committee noted that the funding system "creates controversy in all of the constituent parts of the UK".(para 253) It expressed concern at the lack of transparency in the decision-making process.

The Committee recommended that the Government should publish detailed factual information on how the formula works, including the criteria for whether certain funding decisions in relation to spending in England trigger consequential changes to the block grants of the devolved administrations.

More importantly, perhaps, it recommended that there is an **"urgent need for the Government to undertake a UK-wide review of the Barnett Formula**, and to put forward an alternative system for the allocation between the nations and the regions of the UK". (my emphasis) (para 256)

It further recommended that this alternative system should have "a generally accepted mechanism for reviewing its operation and adjudicating disputes that arise." (para 256) Also that "any new system should be robust and long term – enabling Departments and Agencies of Government to have dependable indicative figures on which to plan". (para 257)

Beyond these recommendations the Committee did not make any comment on what a future system of funding might look like.

## **2. THE HOUSE OF LORDS SELECT COMMITTEE ON THE BARNETT FORMULA**

In June 2009, the Committee on the Barnett Formula published its report 'The Barnett Formula'.<sup>2</sup> The Committee's focus was on the methodology and practical application of the Barnett formula, rather than wider, political aspects of devolution.

The Committee concluded that **"the Barnett Formula should no longer be used to determine annual increases in the block grant for the United Kingdom's devolved administrations."** (my emphasis) (Page 7) It went on to recommend that a new system is required and that this new system must be based upon an assessment of the relative needs of each administration - which the current arrangements are not.

The Committee recommended that a new independent (i.e. politically neutral) expert body (perhaps called the UK Funding Commission) should be established to determine a baseline and perform a needs assessment, using a small number of indicators – such as the age structure of the population; low income; ill-health and disability; and economic weakness.

This Commission should also be responsible for periodically reviewing the needs assessment. The Committee suggested that the Commonwealth Grants Commission in Australia offered "a useful institutional model".(page 8)

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<sup>2</sup> The full report is available at: <http://www.publications.parliament.uk/pa/ld/ldbarnett.htm>

The Committee also made recommendations in relation to the transparency of the system. It stated that the new Commission should be advisory in nature, but that its advice should be published. Further, the Treasury should publish its statistics on the workings of the Barnett Formula - and its successor. This publication should include "all material data on devolved finance, showing the allocations of grant to the devolved administrations, changes from previous years and explanations for any changes made" (page 8). At present, such information is difficult to come by.

The Committee suggested that transitional arrangements will need to be carefully handled, over a recommended period of between three and five years: "smoothing mechanisms would need to be put in place to manage the change from the present levels of funding". (page 10)

Finally, the Committee called for the new arrangements to be statutory – the Barnett Formula is non-statutory – including a requirement to review and update the needs assessment every five years.

### **3. THE COMMISSION ON SCOTTISH DEVOLUTION**

In July 2009, the Commission on Scottish Devolution (also known as "the Calman Commission") published its report 'Serving Scotland Better: Scotland and the United Kingdom in the 21<sup>st</sup> Century'.<sup>3</sup>

The Calman Commission was established to review the provisions of the Scotland Act 1998, and, therefore, the whole of the devolution settlement. Its remit was:

*To review the provisions of the Scotland Act 1998 in the light of experience and to recommend any changes to the present constitutional arrangements that would enable the Scottish Parliament to serve the people of Scotland better, improve the financial accountability of the Scottish Parliament, and continue to secure the position of Scotland within the United Kingdom.*

Obviously this remit was wider than simply the investigation of the arrangements for the block grant, but the phrase 'improve the financial accountability' meant that the Commission would have to consider how the Scottish Parliament is funded.

The Commission recommended that the system of funding Scotland should change. It argued for some devolved taxation and stated: "the main means of achieving this should be by the UK and Scottish Parliaments sharing the yield of income tax." (Page 10) It recommended that the overall structure of the income tax system (including bands, allowances and thresholds) should remain the responsibility of the UK Government but that there should be a new Scottish rate of income tax.

This would be achieved by the UK Government reducing its rates in Scotland by 10p in the pound. It would then be the responsibility of the Scottish Parliament to decide what additional taxation to levy. "The block grant from the UK to the Scottish Parliament should be reduced accordingly." (Page 10)

The Commission also recommended that various other taxes (such as Stamp Duty, Landfill Tax and Air Passenger Duty) should be devolved. In addition, the Scottish

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<sup>3</sup> The full report is available at: <http://www.commissiononscottishdevolution.org.uk/uploads/2009-06-12-csd-final-report-2009bookmarked.pdf>

Parliament should be empowered – with UK Government agreement – to introduce specified new taxes to Scotland.

The Commission suggested that a phased approach to introduce the changes would be required. It also recommended that “**Until such times as a proper assessment of relative spending need across the UK is carried out, the Barnett formula, should continue to be used as the basis for calculating the proportionately reduced block grant.**” (Page 10) Despite this statement, the Commission noted, however, that “we do not [...] consider that our remit extends to our assessing whether the current means of calculating block grants to the devolved administrations across the UK correctly addresses need.” (Page 89)

Finally, the Commission recommended that the Scottish Ministers should be given additional borrowing powers to manage cash flow when devolved taxes are used and also to increase capital expenditure.

#### **4. THE INDEPENDENT COMMISSION ON FUNDING AND FINANCE FOR WALES**

Also in July 2009, the Independent Commission on Funding and Finance for Wales (also known as “the Holtham Commission”) published its first report ‘Funding devolved government in Wales: Barnett and beyond’.<sup>4</sup> The Holtham Commission’s terms of reference were to:

- *look at the pros and cons of the present formula-based approach to the distribution of public expenditure resources to the Welsh Assembly Government; and*
- *identify possible alternative funding mechanisms including the scope for the Welsh Assembly Government to have tax varying powers as well as greater powers to borrow.*

In its report the Commission argued that the current arrangements work as if “the devolved administrations were mere departments of the UK Government, without a democratic locus of their own.” (page 55) It goes on to state that “**in the medium term the funding arrangements for Wales should be based on relative needs.**”(page 33)

The Holtham Commission intends to undertake further work on how future arrangements should work which will be published in its final report, while noting that ultimately the decisions will rest with the UK Government in agreement with the devolved administrations at a political level.

The Commission made a number of recommendations aimed at improving the flexibility of the current system - allowing the re-profiling of capital expenditure, for example.

The Commission made two recommendations in relation to dispute resolution. It recommended that the operation of the Barnett Formula be administered by an advisory body independent of both the Treasury and the Welsh Assembly Government. This body would have the following responsibilities:

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<sup>4</sup> The full report is available at: <http://wales.gov.uk/docs/icffw/report/090708barnettfullen.pdf>

- i) assessment of whether spending programmes should have consequentials, and if so what these consequentials should be;*
- ii) calculation of amounts to be transferred as a result of transfers of additional responsibilities to the devolved administrations (so-called “machinery of government” changes);*
- iii) publication of an annual report on the financing of devolved administrations, giving an explanation for all its decisions over the previous year; and*
- iv) in the event that a needs-based component is incorporated in the funding mechanism in future, responsibility for technical aspects of the operation of this formula.(page 72)*

Further, the Commission argued that the detailed arrangements should not be contained in a unilateral statement of policy published by the Treasury but instead the subject of an agreement (in the form of a concordat) between the UK and Assembly Governments.

Finally, the Holtham Commission echoed other Committees’ calls for greater transparency. It recommended that the UK Government should annually publish data to allow direct comparisons between Welsh Assembly Government expenditure on areas covered by the Barnett Formula and similar expenditure in England. Such a document should also detail changes to the devolved budget arising from policy, transfer and classification changes – currently this information is difficult to find.

Transparency would also be enhanced if a Treasury Minister were invited to meet the Welsh Assembly’s Finance Committee at least once in each spending review period. This would enable public discussion of the funds made available to Wales.

## **5. CONCLUSIONS**

None of the recommendations is addressing exactly the same question, nor are any considering the issues from precisely the same angle. Nevertheless there are a number of themes that are noticeable which may be of interest from the Northern Ireland perspective:

1. None of the Committees considered the current arrangements to be satisfactory.
2. All of the Committees recommended change to the system in the medium to long term.
3. in the shorter term a number of recommendations are aimed at improving the transparency of the present system and building it in to any replacement.

Ultimately, it is for the UK Government to decide if and when the system of block grants will formally be reviewed at the UK level – and by whom. But to confer legitimacy on any review – and any subsequent proposals – it is likely that a level of agreement will be needed with, and between, the devolved administrations.

**1 Sept 2009**