

APPENDIX 2

Funding settlement linked to the lifetime of the Parliament

1. A funding settlement linked to the lifetime of the Parliament is not a radical idea. It is already under active consideration in England¹. In Scotland there is a three year settlement made at the time of the Spending Review².
2. It is well understood that a longer settlement would help financial planning and avoid short-termism; and both enable longer-term investments to promote growth and reform public services. It would remove one of the barriers to local community budget style collaboration.
3. The main obstacle is that the Treasury relies on short-term switches (top-slices) in public spending to maintain public spending control whilst at the same time meeting ministerial policy objectives.

The current arrangements

4. The 2010 Spending Review covered the period up to 2014-15 – the four financial years from 2011-12 to 2014-15. It necessitated the one year Spending Round for 2015-16 to fully cover the term of this Parliament.
5. The 2010 Spending Review did not however give local government the funding clarity it required because:
 - 5.1. There have been a series of in-year reductions, for example the additional 2% made to 2014-15 in the 2012 Autumn Statement followed by a further 1% cut made in the 2013 Budget. These serial cuts mean councils cannot rely on the settlement forecasts provided by government.
 - 5.2. The departmental allocation for local government is translated into authority allocations on an annual basis in the local government finance settlement.
 - 5.3. There have been policy changes, for example the inclusion of £400 million New Homes Bonus funding in the Local Growth Fund.
6. The arrangements for other public services parallel those of local government, for example:
 - 6.1. NHS England makes annual allocations to clinical commissioning groups and local authorities³.

¹ For example see The role and powers of the Prime Minister: the impact of the Fixed-term Parliaments Act 2011 on Government, Political and Constitutional Reform Committee Fourth Report, July 2013

² <http://www.scotland.gov.uk/Topics/Government/local-government/17999>

³ <http://www.england.nhs.uk/wp-content/uploads/2012/12/ccg-allocations-13-141.pdf>

Item 4, Appendix 2

- 6.2. The police are funded through a council tax precept and central government (Home Office Police Grant) on an annual basis⁴. Schools are also funded on annual basis⁵.

What would a settlement for the lifetime of the Parliament imply?

7. In practice, a funding settlement linked to the lifetime of the Parliament would be a four year settlement - for the next government covering the financial years 2016-17 to 2019-20.
8. Taking the next Election as an example, it would however require the Spending Review – including the policy reviews and analytical work - to announce in the autumn of 2015 which allows just 6 months for the review to complete.
9. The price of a longer term settlement could be therefore an accelerated spending review – with less time for considering the case for protections, structural changes to public spending (for example, to consider a significant reform of local government finance) and the efficiencies to be gained from collaborative and cross public sector approaches to public spending. Unless that is government officials are given greater scope to undertake preparatory work on opposition policies.
10. The incoming Labour administration in 1997 chose not to pay this price and stuck to the plans of the previous Conservative administration for 1997-98 and 1998-99 announcing the results of its Comprehensive Spending Review in July 1998. The incoming Coalition Government in 2010, in different economic circumstances, cut the local government settlement for 2010-11 in year.
11. It would also require the Treasury to: relinquish one of its levers for maintaining public spending control by making unilateral in-year reductions; and maintain higher levels of the Reserve to manage changes to circumstance⁶. A new framework would also need to allow for economic shocks.

Rewiring

12. Under the LGA's other Rewiring proposals – the Local Treasury and sector led re-distribution – local government would be self-funded from the revenues of council tax and the full share of business rates (which taken together exceed current local government funding from 2018-19).
13. The a long-term funding settlement can therefore be viewed in two ways – as an alternative proposal to the Local Treasury where current grant arrangements continue or as a proposition that applies across public services, one that enables public sector collaboration, integration and community budget ways of working.

⁴ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/182609/police-funding-announcement.pdf

⁵ <http://www.education.gov.uk/schools/adminandfinance/financialmanagement/schoolsrevenuefunding/a00218077/funding-settlement-2013-14>

⁶ The Treasury sets aside an unallocated amount for unforeseen expenses known as the Reserve (not to be confused with the Official Reserve of gold and international currency) which departments can make claims on.

Item 4, Appendix 2

14. There are different ways of framing a longer settlement with review mechanisms (mid-term) or with different levels of certainty attaching to years 3 and 4, rolling models and so forth.

Future work

15. The immediate next step is to develop our case, in doing so we propose to:

15.1. Develop a model settlement or models, drawing on international examples, comparing the new arrangements with the current, and the likely impacts at the level of the council. This could take the form of a published report (subject to the usual clearance).

15.2. Discuss the issue with the Institute for Government, NHS Confederation, Association of Chief Police Officers, National Association of Head Teachers and others with a view to building a coalition for longer term settlements.

16. The intention would be to lay the basis for a campaign for a funding settlement linked to the lifetime of the Parliament in legislation. We would need to consider this alongside the other proposals in Re-wiring and might decide to bring the financial elements together.

17. Members are invited to comment on the report and the actions in paragraph 15. Officers would update the Panel at its next meeting in November on progress.

Item 4, Appendix 2

Replacing the Barnett formula with a needs-based assessment

1. The Barnett formula for allocating funding to the devolved administrations, The funding arrangements for Scotland in particular, have been subject to scrutiny and debate in the media in the past and, more recently, following the publication of 'Rewiring public services'. This debate is likely to become more active as the 2014 referendum on Scottish independence approaches and the taxation and spending in Scotland is subject to greater scrutiny.
2. It is commonly believed that Scotland is the main beneficiary of the current system as its spending per head of population is higher than the other constituent countries of the UK and some research suggests that it receives more resources than a needs-based approach would justify, especially in comparison to identifiable public expenditure in England.
3. However, the Barnett formula is a straightforward and convenient way for the Treasury to exercise control over total UK public expenditure.
4. Research in this area is difficult and ultimately the allocation of resources between countries, regions and areas is a matter of political judgement. The purpose of a funding formula should be to provide rigour and transparency to these judgements.

The Barnett system

5. Introduced in 1979 as a temporary measure before a needs-based settlement could be agreed, the Barnett mechanism locked in the pre-existing devolved budgets and provided a formula that applies to changes in budgets of government departments.
6. The formula works by taking changes in individual department spending and adjusting them based on relative population size and a 'Barnett comparability factor' which reflects how far, by Treasury's estimates, a department's expenditure can be identified as 'England-only' and is on devolved policy areas. Table 1 in Annex A provides an example of a Barnett adjustment calculation for the Department for Transport.
7. The cumulative change in the devolved budget is applied to an existing baseline to arrive at the total funding block for each devolved nation. Devolved administrations are free to spend the total funding on their own preferred policies and do not have to follow policies and preferences of the government that affect England only.
8. There are arguments in support of the current arrangements, for example:
 - 8.1. The formula is a straightforward mechanism which is easy to apply and update. The allocation process is perceived as mostly free of political negotiation.
 - 8.2. Has survived and is convenient for governments of all main political parties.

Item 4, Appendix 2

9. The following are the common criticisms of the formula:
- 9.1. In 1979, the mechanism locked in higher public service funding in Scotland which is not reflective of relative need.
 - 9.2. There is room for manipulation by the government, for example through specifying major projects as 'UK-wide' expenditure which does not trigger a Barnett adjustment. This has happened in the case of London 2012.
 - 9.3. There is a mismatch of accountability for spending public funds and raising revenue in the devolved administrations.
10. In connection with the latter the Treasury has agreed to devolve the power over 10p off of every band of income tax, as well as a few other minor taxes in full, to the Scottish Parliament, with an equivalent reduction in the block grant from April 2016.

What would the benefits of replacing Barnett be to England and local government?

11. While the policies are ultimately under the control of the Scottish administration, a generous funding settlement allows a more extensive public service offer in general. The Scottish government has diverged from English policies in a few key areas and offers free adult social care for the elderly, free prescriptions and free university tuition.
12. Based on internal research, a rebalancing of identifiable expenditure based on need would give England an additional £5bn per year while Scotland would lose £4.4bn. The figures are smaller for devolved-only expenditure, £3.7bn and £2.2bn respectively (please see tables 2 and 3 in Annex A for further information).
13. However, the Treasury would be in control of the distribution of this pot so the benefits to English local government are uncertain. A proportional distribution of the pot would mean a £1.1bn benefit to local government, including expenditure on schools.

Rewiring

14. The proposal to replace the Barnett formula should be viewed in conjunction with several other proposals for rewiring local government finance.
15. A softer line of argument against Barnett could ask for a reassessment of the funding baselines for devolved nations and a change in the parameters of the formula so that subsequent 'post-Barnett' allocations are reflective of relative needs.
16. A more radical approach could lead to a separate and identifiable English 'pot' of funding, which could nominally be held by the English office. The local treasuries could hold some of the tax and spend powers associated with Scotland.

Item 4, Appendix 2

Issues

17. Taking English regions as independent units, on the same criteria London is funded almost as generously as Scotland. This implies that a more radical approach would need to address the issue of intra-England redistribution as well.
18. The Scottish referendum is the main context for our proposals around the Barnett mechanism. It is unlikely however that the government would wish to propose a reform that is likely to encourage a “yes” vote.
19. The main reason why public spending in Scotland appears to have been shielded from cuts that some departments and local government in England have been experiencing is that health and education policies are devolved, and the protection of those budgets in England has reduced the cut to the Scottish block as well. The difference in Scotland is that the Scottish Parliament is not obliged to ‘ringfence’ spending for schools and hospitals as under the English settlement although the belief is that they largely have. Perhaps in this light, the true prize for England would be a greater degree of devolved responsibility to parts of the country.
20. Any arguments and comparisons we make contain an inherent comparability problem. England is not perceived or funded as a separate entity, and the devolved administrations can follow different policies from those implemented in other countries. This means that even a comparison of Scottish local government and English local government finance is not fully robust as the two sectors operate in very different political circumstances, even if the functions performed are broadly the same.

Future work

21. The immediate next step is to develop our case and broaden the research base. In doing so we propose to:
 - 21.1. Develop our proposals on the post-Barnett system. This could range from a basic restatement of the current funding formula to a radical overhaul of how devolved nations are funded, and England’s place in the post-Barnett system.
 - 21.2. Broaden our research, concentrating on the difference in public service provision between England and Scotland and the reasons for this. One strand of this research could consider the different experiences and status of local authorities in England and Scotland, while another could concentrate on the effect on areas on the Scottish and English borders to stress the ‘postcode lottery’. This research could be commissioned externally.
22. 2014 marks the 35th anniversary of the formula, and it is also the year of the independence referendum. The early months of next year could prove to be an appropriate time to launch our campaign. An alternative would be to wait until the official independence referendum campaign starts in the summer of 2014.
23. Elements of this campaign could include hosting a Smith Square debate, publishing a report using the research base to set out our arguments and providing an online ‘build

Item 4, Appendix 2

your own settlement' tool to illustrate the working of the Barnett formula and how devolved nations benefit from it.

24. Members are invited to comments on the report and the actions in paragraphs 21-23. Officers would update the Panel at its next meeting in November on progress.

Additional information on the Barnett Formula

Table 1. Barnett formula comparability percentages (Department for Transport)

	Scotland	Wales	Northern Ireland
(a) Population as % of England total	10.03%	5.79%	3.45%
(b) Devolution factor	98%	73.1%	100%
(axb) 'Barnett consequential' percentage, transport	9.83%	4.23%	3.45%
A £100 increase in English expenditure on transport results in an increase to devolved funding of..	£9.83	£4.23	£3.45

Table 2. Identifiable public sector expenditure, 2011-12 (excluding social protection)

	England	Scotland	Wales	Northern Ireland	United Kingdom
Identifiable expenditure per head, £	4,795	6,025	5,504	6,413	4,977
Indexed identifiable expenditure (UK = 100)	96	121	111	129	100
Holtham Needs Index* (UK = 100)	98	104	113	118	100
Impact of equalisation to relative need, £bn	5.0	-4.4	0.3	-0.9	

Source: Public Expenditure Statistical Analyses, 2013 (HM Treasury)

**Needs indices are based on the report of the Holtham Commission into Welsh funding*

Table 3. Expenditure by the devolved administrations, 2011-12

	England*	Scotland	Wales	Northern Ireland	United Kingdom
Devolved expenditure per head, £	5,951	6,791	5,943	9,744	6,129
Indexed devolved expenditure per head	97	111	97	159	100
Holtham needs index	98	104	113	118	100
Impact of equalisation to needs, £bn	3.7	-2.2	2.9	-4.5	

Source: Public Expenditure Statistical Analyses, 2013 (HM Treasury)

**As England does not have a devolved budget, it was estimated through internal modelling.*