

The Barnett Formula

Purpose of report

For discussion.

Summary

This paper responds to the Executive's request for an analysis of how the Barnett Funding Formula works.

It also exemplifies two alternative models for allocating funding between the nations of the United Kingdom.

Recommendation

Members are invited to consider the analysis in this report.

Action

Officers to take account of any comments and actions arising out of the discussion.

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The Barnett Formula

Background

1. The Executive has asked for a report on the Barnett Formula.
2. Figures to allow a proper comparison of public expenditure in the devolved administrations with England are, unsurprisingly, debatable. The most authoritative series, which is published by the Treasury, suggests that spending per head of population is about 20 per cent above the UK average in Scotland and Northern Ireland, about 10 per cent above in Wales, and about 3 per cent lower than the average in England.

Table 1: Identifiable Expenditure in the devolved nations¹

2010-11	England	Scotland	Wales	N. Ireland
Net identifiable expenditure on services per capita	£5,493	£6,872	£6,265	£6,821
Net identifiable on services per capita as % of UK average	97%	121%	110%	120%

3. The Barnett formula is the major factor in the way those figures evolve from one year to another. This report:
 - 3.1. explains how the Barnett formula works;
 - 3.2. explores the potential implications of changing the way that public spending is distributed between England and the devolved administrations in the context of the current Spending Review period.

How the Barnett formula works

4. The Barnett formula is a convention that has been used since 1978 to adjust the allocation of public expenditure to Scotland, Wales and Northern Ireland in relation to changes to public spending in England. Although the formula has no basis in statute, all successive administrations, including the current government, have used it to allocate spending to the devolved administrations².

¹ Sources: HM Treasury, *Public Expenditure Statistical Analyses 2011*.

² Full details of the formula and how it works are published by the Treasury in *Funding the Scottish Parliament, National Assembly for Wales, and Northern Ireland assembly: Statement of Funding Policy*: http://cdn.hm-treasury.gov.uk/sr2010_fundingpolicy.pdf

Item 1

5. The Barnett mechanism is this. Scotland, Wales and Northern Ireland each has a “Block” of funding that is mapped onto English programmes. The devolved Blocks receive a fixed percentage of any cash change in the related English spending – a “Barnett consequential” - automatically, without negotiation with the Treasury or any requirement to evidence need. The percentages are based on the different territories’ shares of total UK population.

Table 2: the Barnett formula comparability percentages

England	Scotland	Wales	Northern Ireland
100	10.03	5.79	3.45

6. The percentages apply to all changes to the relevant English spending lines, not just in the Spending Review. A recent example is the council tax freeze grant, where the application of the formula to the £675 million offered to English local authorities automatically resulted in Scotland – which already had a council tax freeze in place - being allocated an extra £67.5 million, Wales £38.9 million and Northern Ireland £22.6 million for 2012-13. The devolved administrations can spend their consequentials on whatever they choose: their spending priorities do not have to reflect England’s.
7. The Barnett Formula applies only to some types of expenditure: expenditure such as welfare payments and tax credits is outside the formula’s remit. Spending by Whitehall departments that is deemed to apply to the United Kingdom as a whole, rather than just England, also does not trigger a Barnett consequential.

How Barnett affects total spending in the different territories

8. The Barnett formula does not measure relative need and was never intended to be about fairness. Nor is it responsible for the higher levels of spending per head in the devolved administrations. These basic higher levels of spending are a historic legacy: what Barnett does is maintain them in a system that does not measure need. (In fact, at times when spending is growing, the formula has gradually brought the relative levels of spending per head a little closer together³.)
9. This section of the paper exemplifies for illustrative purposes two alternatives to the Barnett mechanism: equalising funding in each territory on a common per head basis; and one sample model of a needs-based allocation. This analysis has been produced with the help of Dr Peter Kenway who acted as the

³ This is because it is based on population: if Scotland or Wales only receive the same extra pound per head that England does in each extra year, their starting advantage in terms of pounds per head will gradually be eroded as a proportion of the total. But this is a very slow process: it has taken over thirty years of the operation of this Barnett convergence effect to produce the figures in paragraph 2 above.

Item 1

independent specialist adviser to the House of Lords Select Committee on Barnett.

10. Table 3 below shows the impact of equalising spending per head in the devolved administrations at the current UK average per head. On such a model, aggregate spending across the three devolved countries would be £7.8 billion lower in 2011-12.

Table 3⁴: equalising spending in the devolved nations at the current UK average

2011-12	Scotland	Wales	N Ireland
Total DEL	£27.4bn	£14.6bn	£10.4bn
Net identifiable expenditure per capita 2010-11 (% of UK)	121%	110%	120%
Impact of reducing spending to UK average	-£4.8bn	-£1.3bn	-£1.7bn

11. This equalisation approach would, however, be entirely at odds with the way most public spending on education, the NHS and local government – the vast bulk of the spending concerned – is allocated in England. In the absence of the Barnett formula, it would almost certainly be necessary to allocate spending to the devolved administrations on the basis of measured need.

The needs issue

12. Relative need between the territories has been studied. For example, the 2009 Lords Select Committee analysed relative need in the countries of the union and recommended a shift to a needs-based distribution system. The argument for needs-based funding was also conceded in 2009 by the Calman Commission on the future funding of the Scottish government, and a needs-based formula was recommended by the 2010 Holtham Commission on Welsh funding.
13. The Holtham estimates suggested needs-based spending levels should be £105, £115 and £121 for Scotland, Wales and Northern Ireland for every £100 in England. These relativities were broadly in line with the House of Lords conclusion, although that report did not publish estimates of needs. Clearly if Barnett were to be replaced, the debate about an assessment of need would be critical.

⁴ HM Treasury, *Public Expenditure Statistical Analyses 2011*.

Item 1

14. If the needs-based formula recommended by the 2010 Holtham Commission in Wales were to be applied to the distribution of public spending in 2011-12, there would be a net reduction on expenditure across the three devolved nations of £2.6 billion (made up of a £3.6 billion reduction on the Scottish block and an increase in the Welsh block).
15. The House of Lords Select Committee on Barnett recommended that any shift to a needs-based funding model should be phased in over five years.

Table 4⁵: needs based analysis using Holtham index

2011-12	Scotland	Wales	N Ireland
Holtham needs index	105	115	121
Impact of equalising spending to Holtham needs index	-£3.6bn	+£1.0bn	0

16. More detailed versions of tables 1, 3 and 4 are included at **Appendix A**.

Financial Implications

17. The analysis in this paper has been undertaken within the LGA's existing programme resources.

⁵ Source: HM Treasury, *Public Expenditure Statistical Analyses 2011*

Table 1: Identifiable Expenditure in the devolved nations⁶

2010-11	England	Scotland	Wales	N. Ireland
1. Total identifiable expenditure on services	£448bn	£53.2bn	£29.6bn	£19.3bn
2. less social security and tax credits	£162bn	£17.4bn	£10.7bn	£7.0bn
3. Net identifiable expenditure on services (1) – (2)	£287bn	£35.8bn	£18.9bn	£12.3bn
4. Total Departmental Expenditure Limits		£28.5bn	£15.1bn	£10.8bn
5. Net identifiable (3) as % of total DEL (4)		126%	125%	113%
6. Net identifiable expenditure on services (3) per capita	£5,493	£6,872	£6,265	£6,821
7. Net identifiable on services per capita as % of UK	97%	121%	110%	120%

⁶ Sources: HM Treasury, *Public Expenditure Statistical Analyses 2011*.

Table 3⁷: equalising spending in the devolved nations at the current UK average

2011-12	Scotland	Wales	N Ireland
1. Total resource DEL less depreciation	£24.8bn	£13.4bn	£9.5bn
2. Capital DEL	£2.5bn	£1.3bn	£0.9bn
3. Total DEL (1+2)	£27.4bn	£14.6bn	£10.4bn
4. Net identifiable expenditure per capita 2010-11 (% of UK)	121%	110%	120%
5. Impact of reducing spending to UK average	-£4.8bn	-£1.3bn	-£1.7bn
6. Local government current and capital finance in DEL	£9.3bn	£5.7bn	£0.1bn
7. Local government as % of total DEL (6/3)	34%	39%	1%
8. Impact on Local Government spend (7*5)	-£1.6bn	-£0.5bn	
9. Non-education local government spend as proportion of total local government spend (2010-11)	65%	66%	
10. Impact on non-education local government spend (9*8)	-£1.1bn	-£0.3bn	

⁷ Source: HM Treasury, *Public Expenditure Statistical Analyses 2011*.

Table 4⁸: needs based analysis using Holtham index

2011-12	Scotland	Wales	N Ireland
1. Total resource DEL less depreciation	£24.8bn	£13.4bn	£9.5bn
2. Capital DEL	£2.5bn	£1.3bn	£0.9bn
3. Total DEL (1+2)	£27.4bn	£14.6bn	£10.4bn
4. Net identifiable expenditure per capita 2010-11 (% of UK)	121%	110%	120%
5. Impact of reducing spending to UK average	-£4.8bn	-£1.3bn	-£1.7bn
6. Holtham needs index	105	115	121
7. Impact of reducing spending to Holtham needs	-£3.6	+£1.0	0
8. Local government as % of total DEL	34%	39%	1%
9. Impact on Local Government spend	-£1.2bn	£0.4bn	
10. Non-education local government spend as proportion of total local government spend (2010-11)	65%	66%	

⁸ Source: HM Treasury, *Public Expenditure Statistical Analyses 2011*.