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Barnett Consequentials

This Briefing Paper explains how changes to Northern Ireland's block grant are determined. Consideration is given to how 'Barnett consequentials' are announced and applied by the Northern Ireland Executive, the Scottish and the Welsh Governments. Some of the difficulties for the Assembly's statutory committees' financial scrutiny processes associated with the Barnett mechanism are also discussed.

1. Introduction

The purpose of this paper is to assist the Assembly's statutory committees' ongoing scrutiny of public finance in Northern Ireland. It highlights some issues that Members and committees will find helpful in understanding the devolution funding settlement. It also provides relevant background material for the Committee of Finance and Personnel's consideration of devolved funding as a potential topic for an Inquiry.

The first section presents background on the Barnett Formula and how it is used to adjust the resources available to the UK's devolved administrations. Then, some of the difficulties associated with the operation of the Barnett Formula are discussed. In particular, the following issues are highlighted:

- Barnett 'boundaries';
- Formula 'bypass'; and,
- The availability of data.

The paper concludes with discussion of some of the considerations for Northern Ireland and possible areas for improvement.

1.1. The Barnett Formula

The Barnett Formula that is used to calculate changes to the devolved administrations' funding is non-statutory. In effect, it is an accepted agreement between the devolved administrations and HM Treasury and is set out in the 'Statement of Funding Policy'.¹ How the Formula works in broad terms is described here and a worked example is attached as Appendix 1.

The Formula determines changes to the assigned budgets of the devolved administrations. *It does not change the inherited levels of spending for each administration.* The Formula concerns the public expenditure that is set over three- or four-year periods through the UK Government's spending reviews: the Departmental Expenditure Levels (DEL). DEL includes those items that are within the assigned budget of the UK Government – i.e. most programme spending (for example health, education, and housing).

The Formula is based upon relative population proportions and *not* upon assessment of need. Population proportions are based upon mid-year estimates by the Office of National Statistics and notified to the devolved administrations by HM Treasury.

There is also a 'comparability percentage' applied. This, in essence, is the extent to which the relevant UK departmental programme (i.e. the programme that is receiving increased or decreased level of funding) is comparable with the services delivered by each devolved administration. So changes to Ministry of Defence DEL, for example,

¹ HM Treasury (2010) 'Funding the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly': available online at: http://cdn.hm-treasury.gov.uk/sr2010_fundingpolicy.pdf (accessed 19 December 2011)

do *not* result in changes to the devolved administrations' assigned budgets because they do not deliver defence functions: they are non-comparable. But an increase in the assigned budget for environmental protection functions, for example, *would* result in an increase because these functions are devolved and comparable.

Net change to the spending allocations for each devolved administrations is calculated as follows:

$$\text{Change to the UK Government department's programme} \times \text{Comparability percentage} \times \text{Appropriate population proportion}$$

The calculation is performed during a spending review for each UK departmental programme in DEL and then added together to give the aggregate net change for the assigned budget for each devolved administration. This is effectively then passed as a lump sum for the devolved administrations to allocate according to their own spending priorities.

1.2. What is a 'Barnett Consequential'?

A Barnett Consequential is the change to a devolved administration's assigned budget as a consequence of changes in spending in England.

As described above, this occurs during the spending review process conducted by HM Treasury. But the Barnett Formula can also be applied to changes in planned spending that are announced *during* the lifetime of the spending review period. Spending Review 2010 covers the four years from 2011-12 to 2014-15, but the initial allocation to the Northern Ireland Executive has already been changed through Barnett Consequentials.

If the UK Government made no further spending announcements until 31 March 2015, there would be no further change to the Northern Ireland Executive's assigned budget until after that point. In practice, however, spending announcements are made from time to time – the most recent example being the UK Chancellor's Autumn Statement.²

The Barnett Consequentials from the spending decisions detailed in the Autumn Statement were announced by the Minister of Finance and Personnel:

£134million of additional capital will be available for Northern Ireland over the next three years.

However, the Minister also stated that:

² See http://www.hm-treasury.gov.uk/as2011_index.htm

*I have not yet received details of the impact on our resource budget, however, I remain hopeful that this too will involve additions rather than reductions.*³

This second statement by the Minister indicates one of the difficulties of the Barnett Formula mechanism from the perspective of transparency: when the UK Government makes an announcement that impacts upon the resources of the devolved administrations, it is not immediately clear what that impact will be. This and other issues are discussed in the following section.

³ DFP News Release 'Wilson welcomes additional funds to the Northern Ireland Budget' 29 November 2011 available online at: <http://www.northernireland.gov.uk/index/media-centre/news-departments/news-dfp/news-archives-dfp-nov-2011/news-dfp-291111-wilson-welcomes-additional.htm> (accessed 19 December 2011)

2. Difficulties with the operation of the Barnett Formula

The Barnett Formula is a relatively simple mathematical means of calculating changes to the devolved administrations' assigned budgets; this simplicity is one of the system's greatest strengths. But the operation of the Barnett Formula is not without its problems, nor indeed without some controversy. To some extent, the nature of these complexities depends upon the expenditure announcements made by the UK Government.

2.1. Crossing Barnett 'boundaries'

As described above, if the UK Government increases or decreases funding to a spending programme it can trigger a Barnett Consequential for the devolved administrations. This can also happen if it switches an amount of funding from one programme to another.

Additional funding on a comparable programme will trigger a consequential. Similarly, a spending reduction on a comparable programme will lead to a consequential reduction. If, though, the funding switch crosses boundaries between comparable and non-comparable functions then the picture becomes more complex.

For example, if £100m were switched from defence spending to education, Northern Ireland would usually get a consequential if education spending increases. But if it is not increased *aggregate* expenditure, *should* it do so?

Part of the UK Government's deficit-reduction strategy has been to impose hard spending restraints in most areas of public expenditure. This forces departments to manage their budgetary pressures by switching across areas and reprioritising rather than bidding for greater resources. On the face of it, it might seem somewhat perverse if in so doing it *increased* spending in the devolved administrations.

Of course, the reverse could also be true. If expenditure shifted and crossed a Barnett boundary the other way, Northern Ireland might get a reduction. Because, continuing the example, defence spending is not devolved and therefore not comparable. This situation *can* – and from the Minister of Finance and Personnel's statement cited above, *does* – cause a degree of uncertainty: the devolved administrations do not immediately know whether a spending announcement will trigger a Barnett Consequential or not.

2.2. Formula bypass.

HM Treasury classifies expenditure as "England only" or "UK-wide". If it is England only (i.e. it is deemed to benefit only the population of England) then the devolved administrations will receive a Barnett Consequential. UK-wide spending, however, is deemed to benefit the UK population as a whole. In these cases, the devolved

administrations do *not* get a Barnett Consequential – see Box 1 for a recent example that caused some controversy.

Box 1: Funding for the 2012 London Olympics

Some of the expenditure on the 2012 Olympics relates to urban regeneration (a devolved function) and therefore might have been expected to generate Barnett Consequentials. But HM Treasury classified Olympics expenditure as benefitting the UK as a whole, and therefore no Barnett Consequentials arose.

On 20 October 2010 the devolved administrations issued a joint declaration to the Chancellor stating their shared disappointment that HM Treasury did not apply “fairly” the Barnett funding formula in relation to Olympic Games spending.⁴

The classification led to the accusation that some of the UK’s poorest communities had effectively helped subsidise a UK Government-funded access road to a huge shopping mall in East London.⁵

The devolved administrations argued - rightly in the view of some commentators - that if this spending were on any other regeneration project in England, they would get those consequentials. In Scotland’s case, the figure being used was £165 million, which implies a total ‘lost consequential’ of about £330 million for all three devolved governments (£104 million for Wales and £61 million for Northern Ireland). The UK-wide classification was apparently arrived at because “the amount was clearly too large once the Barnett consequentials were added in. The Chief Secretary [of the Treasury] decided that the easiest way to bring the costs under control was to eliminate the Barnett consequentials.”⁶

In December 2011, the Joint Ministerial Council met and agreed:

...that the Scottish Government, the Welsh Government and the Northern Ireland Executive will receive a one-off sum equivalent to the Barnett formula consequentials of relevant changes to Olympics funding since the present UK Government took office in May 2010. These sums amount to £30.2m, of which the Scottish Government will receive £16m, the Welsh Government £8.9m and the Northern Ireland Executive £5.4m (rounded to the nearest £100,000).⁷

The total settlement, therefore, was about 10% of what the devolved administrations thought they should have been receiving. This was described by one commentator as “a pretty miserly settlement”.⁸ This is particularly the case, it is argued, because if the Olympics funding had been correctly classified at the time of CSR 2007, it would have then formed part of the devolved administrations’ baselines for Spending Review 2010.

But it should be noted that these classification issues can work both ways: there can also be benefit to the devolved administrations. For example, when the UK Department of Culture Media and Sport had to find savings from its Olympics budget, there was no consequential reduction to the devolved administrations.⁹

⁴ See <http://www.scotland.gov.uk/News/Releases/2010/10/20112244> (accessed 21 December 2011)

⁵ See <http://www.walesonline.co.uk/news/wales-news/2011/09/21/wales-has-lost-out-over-200m-olympic-grant-for-london-shopping-mall-91466-29458238/> (accessed 21 December 2011)

⁶ See <http://devolutionmatters.wordpress.com/2010/06/03/the-barnett-formula-and-the-olympics/> (accessed 21 December 2011)

⁷ Cabinet Office (2011) ‘JMC agreement on 2012 Olympics consequential funding’ available online at: <http://www.cabinetoffice.gov.uk/news/jmc-agreement-2012-olympics-consequential-funding> (accessed 2 February 2012)

⁸ See <http://devolutionmatters.wordpress.com/2011/12/23/the-2012-olympics-and-the-barnett-formula-an-end-to-the-row/#more-3102> (accessed 2 February 2012)

⁹ see <http://www.walesoffice.gov.uk/files/2010/10/101005-10FOI-61-Kelly-Davies-Barnett-Consequentials- 2 .pdf> (accessed 21 December 2011)

There have been other examples of Formula bypass. A prominent academic noted in 1994 at least five ways in which the Barnett Formula can be bypassed.¹⁰ In addition to these, the Reinvestment and Reform Initiative that allows the Northern Ireland Executive to borrow (up to a fixed ceiling) is *outside* the Barnett Formula – so-called ‘Barnett-plus’.¹¹

The House of Lords Select Committee on the Barnett Formula in 2009 criticised the decision making relating to Barnett Consequentials for being opaque. In particular it noted that if expenditure is classified as “England only” then a Barnett Consequential is triggered – as highlighted above.

The Select Committee observed that the asymmetric nature of devolution in the UK (i.e. some things are devolved to Scotland and Northern Ireland, but not to Wales, for example) means the system is “*inherently complex*.”¹²

Building on this point, the Select Committee reported that:

*There was general agreement from all our witnesses, except the United Kingdom Government, that the application of the Formula is unclear.*¹³

Ultimately the Select Committee recommended that:

On every funding decision the Treasury is judge in its own cause, including whether to bypass or include any expenditure within the application of the Barnett Formula. We recommend that before decisions are made on whether the system is bypassed or create a ‘consequential’ there is a clear process and open consultation with the devolved administrations.

This point has also been picked up by other informed commentators:

*The decision to have a single ‘UK’ Olympics funding stream saved the Treasury money, helped control some risks and made administering a complex project a bit easier. It wasn’t, in that sense, a bad decision. But it was a bad decision because it illustrated the arbitrary nature of the Treasury’s power over the block grant and formula system, and how it acts as both judge and jury in its own cause.*¹⁴

2.3. The availability of data

Beyond the opacity of decision making, the House of Lords Select Committee on the Barnett Formula was also critical of the publication of data relating to its application:

¹⁰ Heald (1994) ‘Territorial Public Expenditure in the United Kingdom’ available online at:

<http://www.davidheald.com/publications/terra.pdf> (Accessed 21 December 2011) (see section VI)

¹¹ http://www.psa.ac.uk/spgrp/4/2010/Ppr/BaCTPSGC2_HealdDavid%20Heald%20and%20McLeod%20-%20taxes%20and%20borrowing%20-%20Oxford%207-8%20Jan%202010.pdf (accessed 21 December 2011)

¹² <http://www.publications.parliament.uk/pa/ld200809/ldselect/ldbarnett/139/139.pdf> para 57

¹³ <http://www.publications.parliament.uk/pa/ld200809/ldselect/ldbarnett/139/139.pdf> para 58

¹⁴ <http://devolutionmatters.wordpress.com/2010/06/03/the-barnett-formula-and-the-olympics/>

Rather than having a multiplicity of official documents providing some data on devolved finance, we recommend that the Treasury publish their statistics of the workings of the Barnett Formula, or its successor, in a single, coherent and consistent publication. This annual publication should contain 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. We recommend that the statistics be monitored by the UK Statistics Authority.¹⁵

There has been considerable rhetoric from the current UK Government about 'open government' and large sets of previously unavailable spending data have been made available. However, there has not been a publication like that envisaged by the Select Committee to enhance the transparency of the Barnett Formula.

As part of its attempt to increase the availability of data on the application of the Barnett Formula, the Select Committee published a series of tables provided by the Treasury. This are reproduced as Appendix 2 to this paper as an illustration of the nature of the data that can be made available. As part of its consideration of Barnett Formula issues, the Committee may wish to seek this kind of information. DFP has also provided similar information in FOI releases.¹⁶

There is not in Northern Ireland an official publication of Barnett Consequentials after an adjustment. As part of its routine provision of information to the Committee for Finance and Personnel in relation to monitoring rounds, DFP provides data on Barnett Consequentials because they affect the availability of resources for reallocation in-year. However, this can be provided some time after the expenditure announcements of the UK Government that give rise to the funding adjustments.

2.4. Provision of information in Wales and Scotland

Wales

Rather like in Northern Ireland, there is not a clear and transparent mechanism for the Welsh Government to report Barnett Consequentials to the legislature. There is, generally speaking, no formal statement to the National Assembly for Wales, nor is there routine publication of figures.¹⁷

Like in Northern Ireland, adjustments are picked up in supplementary budget revisions during the fiscal year.

Scotland

¹⁵ <http://www.publications.parliament.uk/pa/ld200809/ldselect/ldbarnett/139/139.pdf> para 63

¹⁶ http://www.dfpni.gov.uk/evolution_of_department_expenditure_limit.pdf

¹⁷ Source: National Assembly for Wales official

In Scotland, the picture is rather similar. There isn't usually a detailed release from the Scottish Government to the Parliament.¹⁸ Generally what occurs is that once the Scottish Government knows what Barnett Consequentials it has received it will issue a press release announcing – in the case of additional funding – what it will be spent on.¹⁹

Changes will be visible in Budget Revisions (rather like the Northern Ireland monitoring rounds and Supplementary Estimates). These, however, may be some considerable time after the initial spending announcement for England that triggered the consequential calculation.

¹⁸ Source: Scottish Parliament official

¹⁹ See for example, a release from the Scotland Office: <http://www.scotlandoffice.gov.uk/scotlandoffice/16341.html>

4. Considerations for Northern Ireland

The Assembly and its statutory committees could consider asking for enhanced transparency from UK Government and DFP. This would be in line with the arguments the Committee for Finance and Personnel has been making in relation to the Review of Financial Process for enhanced provision of information to the Assembly. It would also enhance compatibility with international best practice on open budgeting and fiscal transparency.

One consideration for both the Assembly – perhaps more so – for the Executive might be that, if MLAs and statutory committees or the public are aware of *why* Northern Ireland got an additional £Xm, it might undermine the Executive's flexibility on how to spend. For example if it is clear that, say, a £2m addition came as a consequence of changes in funding education in England, it might understandably lead to a demand that the full consequential be spent on education locally – even if that didn't fit with the Executive's priorities.

On the other hand, this might help enhance the transparency of decision making by the Executive and lead to increased accountability. It would be incumbent on the Executive to demonstrate how much has come from what source and where the Executive has chosen to prioritise the spend; the Executive would be required to justify its allocation decisions openly, just as in the usual budgetary process.

Whether or not the Committee for Finance and Personnel decides to pursue a formal Inquiry into the Barnett Formula, it is fairly evident that improvements could be made in the current system. These could assist the Assembly in its effective scrutiny of the Executive.

Appendix 1: The Barnett Formula: a worked example²⁰

The following is based on a worked example of how the Barnett formula operates provided in the HM Treasury evidence to the Commission.¹³⁶

If for example:

- the Government decides to increase the DEL budget of the Department of Innovation, Universities and Skills by £100 million; and
- the comparability percentage for that particular department for each devolved administration is 79 per cent (because that Government department carries out some expenditure at an all United Kingdom level); and
- the population proportions are 10.08 per cent for Scotland, 5.84 per cent for Wales and 3.43 per cent for Northern Ireland of England's population;

then the following changes are added to each Devolved Administration's overall budget:

- for Scotland, £100 million (change in Government department's budget) x 79 per cent (comparability percentage) x 10.08 per cent (population proportion as a percentage of England's) giving a net change of £7.96 million;
- for Wales, £100 million (change in Government department's budget) x 79 per cent (comparability percentage) x 5.84 per cent (population proportion as a percentage of England's) giving a net change of £4.61 million; and
- for Northern Ireland, £100 million (change in Government department's budget) x 79 per cent (comparability percentage) x 3.43 per cent (population proportion as a percentage of England's) giving a change of £2.71 million. This amount is then abated by 2.5 per cent to reflect the fact the Northern Ireland Executive do not require funding to meet Value Added Tax costs incurred as these are refunded by HM Customs and Excise. The net change for Northern Ireland is therefore £2.64 million.

²⁰ Evidence provided by HM Treasury to the Calman Commission (2008) presented as Annexe C of the Commission's 1st Report (2nd Dec 2008 Vol 1) <http://www.commissiononscottishdevolution.org.uk/papers.php>

Appendix 2: extract from House of Lords Select Committee on the Barnett Formula's report

NORTHERN IRELAND - SR 2002

	2003-04 £m	2004-05 £m	2005-06 £m
SR 2002 settlement	6,927.0	7,279.4	7,731.1
Budgeting & classification changes	-57.5	-57.5	-57.5
Interdepartmental transfers	-3.3	-3.3	-3.2
Spending Policy:			
Pre Budget Report 2002 - Employer Training Pilots	3.6	0.0	0.0
Invest to Save Budget	0.4	0.2	0.1
TOTAL changes SR 2002 to PESA 2003	-56.8	-60.6	-60.6
PESA 2003 (tables 1.7 & 1.8)/ Main Estimates 2003-04	6,870.2	7,218.9	7,670.5
Budgeting & classification changes	-111.8	-107.2	-112.5
Interdepartmental transfers	-4.6	1.9	0.1
End Year Flexibility	434.3	0.0	0.0
Spending Policy:			
Budget 2003 - Futurebuilders	0.3	1.7	2.2
Budget 2003 - Parenting Fund	0.2	0.3	0.3
Budget 2003 - Capital Modernisation Fund	0.7	1.8	1.6
Budget 2003 - Landfill Tax Credit Scheme	2.8	3.1	3.1
Budget 2003 - SR 2002 corrections	1.2	1.8	2.4
Pre Budget Report 2003 - Local Authorities	0.0	12.7	2.7
Invest to Save Budget	0.0	0.1	0.1
TOTAL changes PESA 2003 to PESA 2004	323.2	-83.9	-100.0
PESA 2004 (tables 1.7 & 1.8)/ Main Estimates 2004-05	7,193.5	7,135.0	7,570.5
(for further changes to 2005-06, see CSR 2004 table)			
Budgeting & classification changes	0.0	40.8	
Interdepartmental transfers	0.0	1.6	
End Year Flexibility	0.0	340.7	
Outturn adjustments	-412.0	-120.0	
TOTAL changes PESA 2004 to PESA 2005	-412.0	263.1	
PESA 2005 (tables 1.5 & 1.9)/ Main Estimates 2005-06	6,781.5	7,398.1	

NORTHERN IRELAND - SR 2004

	2005-06 £m	2006-07 £m	2007-08 £m
SR 2004 settlement	7,570.5	8,029.2	8,395.3
Budgeting & classification changes	120.4	125.2	130.2
Interdepartmental transfers	-1.9	-7.9	-7.9
Spending Policy:			
Counter Terrorism	0.3	0.0	0.0
Pre Budget Report 2004 - Bookstart	0.3	0.3	0.3
Pre Budget Report 2004 - Early Education	0.0	0.3	0.3
Pre Budget Report 2004 - Employer Training Pilots	0.0	2.2	4.4
Pre Budget Report 2004 - Childcare	0.0	6.7	4.3
Pre Budget Report 2004 - Council Tax	4.2	0.0	0.0
Pre Budget Report 2004 - Landfill Tax	2.2	0.0	0.0
Pre Budget Report 2004 - Financial Inclusion Fund	0.5	1.1	1.7
Pre Budget Report 2004 - Learning Allowance	0.0	0.1	0.1
Pre Budget Report 2004 - Pathways to Work	0.0	1.7	1.9
Pre Budget Report 2004 - Admin of payments to pensioners	0.1	0.0	0.0
Budget 2005 - LAGBI	0.4	1.7	3.4
Budget 2005 - Russell Commission	0.3	0.8	2.2
Budget 2005 - Free Bus Travel	0.0	11.7	12.3
Budget 2005 - Education	0.0	8.3	10.4
Budget 2005 - Arts Council	0.0	0.2	0.2
Budget 2005 - Employer Training Pilots	1.3	0.0	0.0
Budget 2005 - Admin for Incapacity Benefit	0.0	0.0	0.0
Invest to Save	0.0	0.2	0.0
TOTAL changes SR 2004 to PESA 2005	128.1	152.7	163.9
PESA 2005 (tables 1.5 & 1.9)/ Main Estimates 2005-06	7,698.6	8,181.9	8,559.1
Budgeting & classification changes	-200.3	-122.4	-20.5
Interdepartmental transfers	-1.8	0.0	0.0
End Year Flexibility	273.6	0.0	0.0
Spending Policy:			
Pre Budget Report 2005 - Warm Front	0.7	4.2	3.1
Pre Budget Report 2005 - Holocaust Education Trust	0.0	0.1	0.0
Pre Budget Report 2005 - Education Exports	0.0	0.1	0.0
Pre Budget Report 2005 - Enterprise Education	0.0	0.1	0.0
Pre Budget Report 2005 - Youth Service Grant	0.0	0.9	0.2
Pre Budget Report 2005 - Carbon Trust Loans	0.0	0.5	0.7
Pre Budget Report 2005 - Employer Training Pilot	0.0	1.3	0.0
Pre Budget Report 2005 - Children's Document	0.0	0.9	0.0
Pre Budget Report 2005 - Financial Inclusion Fund	0.0	0.5	0.2
Budget 2006 - Education	0.0	7.3	12.1
Budget 2006 - Lone Parents	0.0	0.0	0.7
Budget 2006 - Grass Roots Sport	0.0	0.3	0.0
Budget 2006 - Education & Science	0.0	0.3	0.3
Budget 2006 - Further Education	0.0	0.0	1.6
Budget 2006 - Women in Work Comm	0.0	0.7	0.7
Budget 2006 - Energy Efficiency	0.0	0.2	0.0
Budget 2006 - Smart Metering	0.0	0.1	0.0
Budget 2006 - Football Foundation	0.0	0.0	0.0
Budget 2006 - Youth Opportunities Fund	0.0	0.1	0.0