



Northern Ireland
Assembly

Committee for Finance and Personnel

OFFICIAL REPORT (Hansard)

Review of the Operation of the Barnett
Formula: Professor Derek Birrell

11 March 2015

NORTHERN IRELAND ASSEMBLY

Committee for Finance and Personnel

Review of the Operation of the Barnett Formula: Professor Derek Birrell

11 March 2015

Members present for all or part of the proceedings:

Mr Daithí McKay (Chairperson)
Ms Michaela Boyle
Mr Leslie Cree
Mr Paul Girvan
Mr John McCallister
Mr Adrian McQuillan
Mr Peter Weir

Witnesses:

Professor Derek Birrell Ulster University

The Chairperson (Mr McKay): Good morning, Professor. You are very welcome. Do you want to give us some opening comments as evidence? Then we will go to questions.

Professor Derek Birrell (Ulster University): Yes. How long am I allowed for my opening comments?

The Chairperson (Mr McKay): How long do you want?

Professor Birrell: Not too long.

The Chairperson (Mr McKay): That is OK. *[Laughter.]*

Professor Birrell: There are seven points that I will address fairly briefly. It will take not more than 10 minutes. First, I apologise for croaking at you; I have had a cold in the last few days.

Mr Cree: Keep your distance. *[Laughter.]*

Professor Birrell: I thought that I should focus on the Barnett formula's relationship with Northern Ireland and largely keep to Northern Ireland issues. I think that you have had quite a lot of evidence about Scotland and Wales. There are seven issues about Barnett and Northern Ireland. I will go through them fairly briefly. You may want not to pick up on all of them but to come back on a few of them. I meet people who think that the Barnett formula was named after the vice chancellor of Ulster University, but that is not the case, of course.

The first issue is the view of the Treasury, which is quite important. The Treasury has been very attached to the Barnett formula and still is. That was very noticeable when David Cameron appeared, immediately after the Scottish referendum, to make his vow. He put in it that they did not see the

Barnett formula changing. There has been a very strong Treasury commitment that it is robust and works well. The Treasury has not seen convincing reasons for changing it. I listed some of those reasons: it is simple to apply — one civil servant can do it each year; it removes the need for direct negotiations; it is a robust mechanism, with room for alteration; and it affects each of the devolved Administrations roughly equally. There has not been a lot of conflict about it, at least, not until fairly recently. It makes the allocations fairly predictable, so that each of the devolved Administrations knows what is coming. As I say, only recently have serious issues arisen about difficulties with it or whether it should be changed.

The second issue is funding outside Barnett. You may already have covered that. There are really two main things outside Barnett, but they are quite important for Northern Ireland. To some extent, the Northern Ireland system has been called "Barnett-plus", rather than just "Barnett". First, there is the role of annually managed expenditure (AME). Only about 50% of Northern Ireland expenditure comes from Barnett; some 40% comes from annually managed expenditure. Of course, the big item in that, which is very topical at the moment, is social security or welfare expenditure. That is annually managed and is therefore outside the Barnett calculation. Secondly, there is the Barnett bypass, as it is called, where other items of funding bypass Barnett and are not part of the calculation, such as special allocations. There was a special allocation for the cost of devolved policing, when that happened; the reinvestment and reform initiative (RRI); and maybe some of the more current funding items. That may be one of the reasons why the convergence argument about devolution has not really happened. I know that that is usually put down to population factors, but that could be another factor.

The third issue is the alternative, which is what people tend to talk about in any current discussion about Barnett. Any academic conference about Barnett nowadays is about how you would replace it with a needs assessment. That is not an immediately simple thing to do. It tends to attract quite a lot of support. I mentioned that a House of Lords inquiry supported it. Politicians tend to support it a lot. The media support it a lot. There is a lot of support. It seems to have an appeal, but, when you drill down into it, it becomes much more difficult to do in terms of producing a need for negotiation, dispute and so on.

There are three points on that. One is that, originally, Barnett was thought to encompass needs; that is why it was set up. It was set up originally to say, "If we look roughly at populations, we will meet need." The intention was for it to be a formula that roughly met need and was equitable throughout the UK. Things moved away from that a bit, but, to actually replace it with a needs assessment system, you would probably have to do that in either one of two ways. It could be done through a broad-brush approach, whereby you take four or five indicators like population, number of elderly people, number of children and number of people on low income; or you could produce dozens of formulae or principles, which becomes very difficult because it would immediately lead to conflict and disputes. One that is sometimes brought up in Wales is about making calculations for the Welsh language and whether that should be counted as a need and so on.

Who does this then? Who has the final say? There are ideas about giving it to an independent body, but that would not really make it much simpler and might even lead to us passing it on for more senior politicians, Treasury officials and so on to resolve. Northern Ireland originally had an independent body to adjudicate. A long time ago, before the Barnett formula, it had a body called the Joint Exchequer Board, which had equivalents of the Department of Finance person and the Treasury person and an independent chair, that resolved disputes about Northern Ireland allocations. Something like that has been suggested again. You can also note that the Joint Ministerial Committee (JMC) that now operates occasionally resolves financial disputes; for example, about the Olympic Games moneys.

That is where you go with a needs assessment. The background to that is that, at present, the Barnett formula is more benevolent to Scotland, giving them more than they need; probably gives Wales less than they need; and gives Northern Ireland roughly the right amount — at least that seems to be an academic view of it.

Point 4 is on the Treasury statement of funding policy. It is not statutory, but it is the guidelines to the working of the Barnett formula and the framework of public expenditure control. It shows, of course, that the Treasury is very much in control. There has been quite a lot of speculation that, with the changes in devolved powers in Scotland and Wales that are likely to come, this will have to be radically changed, as you could not have the Treasury laying down all the rules and interpreting those rules. However, that is not necessarily the case. When you look at devolution, you see that macroeconomic policy and fiscal policy is not devolved; it is a responsibility of the UK Government.

Northern Ireland people are probably more aware of that than people in Scotland and Wales. I find that people in Scotland tend to assume that devolution there, with the Smith commission recommendations, will have more powers than Northern Ireland, but that is not really the case. Even with the Smith commission recommendations, the system in Northern Ireland has more devolved powers than Scotland has. In a sense, we are a bit more aware of the nature of non-devolved powers. That position is likely to continue, with the Treasury in control with the Barnett formula.

It is open to interpretation. Of course, there is one topical part of it, which is what it has to say about social security. The statement of funding says specifically, for example, that:

"if the Northern Ireland Executive change social security policy to differ from the rest of the UK, UK ministers will need to take a view on whether and how to adjust this funding."

The issue that has come to some people's attention is the wording "this funding". That would seem to imply that the UK Government could remove the money they give for social security, but it does not necessarily imply that they should alter the whole block grant — you could interpret it like that. That just indicates that the statement of funding policy for the devolved Administrations, which, of course, covers Barnett and the other funding, including departmental expenditure limit (DEL) and AME funding, is quite important but can be open to interpretation. The question then is this: who resolves the matter if there is a dispute? Do you go to a Joint Exchequer Board-type body or the JMC?

I will deal with my fifth, sixth and seventh points very briefly. My fifth point, which tends to be mentioned in the context of Barnett, is about the total subventions to Northern Ireland. It is accepted that Northern Ireland is highly dependent on support through Barnett and other funding, and an argument is often made that it should become less dependent. I could not find more up-to-date statistics in the time that I had, but the statistics I have shown in my submission are fairly up to date because they are from the Silk commission, which was published not so long ago in Wales. They give the regional expenditure for the 12 regions of the UK, and you can see that, in gross terms, Northern Ireland is the lowest, as you might expect.

The fiscal balance, however, is interesting — it is the difference between the income that is raised in a country and the actual expenditure — because London is the only region of the UK that is in a surplus; the other 11 are dependent. Sometimes, the south-east of England also moves into a surplus, but it is the only other one. In this year, it happened to be down, minus £1 billion, but sometimes it is a plus. In terms of the actual balance itself, Northern Ireland is in the middle. The balance is not as great as, say, that in the north-east or the north-west of England. If you work it out per capita, the Northern Ireland position is worse. It is interesting that when you look in detail at the figures, you see that all countries have regions that are dependent on the centre.

I will say something about my sixth point, which is about Barnett consequentials, before briefly noting my seventh point. I tried to look at this a few years ago — I have not been working on it recently — and it was quite difficult to find data on the Barnett consequentials. Therefore, I thought it useful to quote from the work of David Heald from the University of Aberdeen, who tried to investigate this. I do not know whether he is giving evidence at all, but he is probably the top academic on the Barnett formula, and he has done some work relating to Northern Ireland. The Barnett consequential is really the extra money that comes through Barnett during the financial year; the extra, big items of expenditure that the UK Government launch. If the calculation is that that expenditure is England-only expenditure, Northern Ireland, Scotland and Wales get a cut, as it were, through Barnett. That is normally fairly straightforward. There was a row, which you may be familiar with, about the Olympic Games spending.

What tends to happen is that a lot of the information about the Barnett consequentials is not readily open to the public gaze. David Heald did produce figures for Northern Ireland. The figures in my submission are for the formula consequentials to Northern Ireland from the UK Departments. They are a bit out of date, but I imagine that the balance is still somewhat similar. It is worth noting that it tends to be dominated by health and children. Schools, children and health make up most of the Barnett consequentials because that is where extra money is being put in Britain at present. That is what they are protecting — health; social care, to some extent; and education — so all those consequentials are flowing in. There are relatively little consequentials for some other items. You see zeros and so on coming to Northern Ireland.

The other question is what happens to that money, because the discretion to spend Barnett consequentials rests purely with the devolved Administrations. They do not have to spend the money on health and so on. If overall policies are the same, like Transforming Your Care, and if health is in

trouble throughout the UK, is there a view that, if the consequentialists come, they should go to health? That is really the controversial issue. If 60% of the consequentialists are coming into Northern Ireland because of health expenditure in Britain, does it matter where they go? You can interpret it. Is Barnett saying that, all things considered, you should spend it on health, as opposed to, say, roads? I do not think that David Heald could actually find out where the money went in relation to those figures. It may have just disappeared into the pot.

That was the sixth point. Finally, I will not really go through this one, because it is about increased fiscal devolution. Everyone is aware of what is happening on corporation tax and other duties. You probably got evidence explaining what is going to happen in Scotland and Wales and the idea of devolving part of income tax, with the important caveat that, if Scotland changes it — it will apply first of all to Scotland — the change has to be the same for each band. At present, it is 10, 30 and 40. They cannot make it 10, 30 and 50. I think that Holtham was keen that Wales should be able to do that, but the UK Government and Treasury are not keen.

It is probably fair to say, finally, that there is no strong support for partial devolution of income tax to Northern Ireland. It is not really discussed very much. Of course, it is an initiative of this Committee that it probably will be discussed now or at least brought to people's attention, but, obviously, the power to raise income tax is not one that might appeal to a great many people, so I will not say any more about that one. Sorry for croaking a bit.

The Chairperson (Mr McKay): Thanks, professor. On that final point, I was just thinking that, when Alan Trench has made presentations — not only to the Committee but in presentations he has done in the Assembly in the past couple of years — he has always said that the Assembly should go for income tax and not corporation tax. Do you have a view on whether it would be more beneficial for income tax, as opposed to corporation tax, to come to the Assembly?

Professor Birrell: Corporation tax has a set of specific arguments. The main argument for having income tax in Scotland and Wales is to improve electoral accountability so that people in Scotland know that there is a financial cost. Therefore, at elections, they can decide to vote for lower taxes, which might mean poorer services, or they can vote for taxes that are a bit higher and be happy with that because it might mean better health services. They are starting with it in Scotland and Wales as a mechanism, at least in part, to improve, increase and bring in fiscal accountability through the electoral system. I cannot see that working terribly well in Northern Ireland; it is not likely to be a huge issue at elections and so on. I cannot see Northern Ireland having much room for wanting an increase in taxes, and I am not sure that it would benefit greatly from that.

The Barnett formula gives quite a bit of wriggle room for doing things. It is not a kind of lock. Scotland, Wales and Northern Ireland are able to have free prescriptions and so on. They can manoeuvre for that, and they can spend less money on roads. That is what has happened in Scotland. They spent money on social care, free prescriptions and free car parking at hospitals and so on. They have had to cut some things, and they have made some hefty cuts on roads, especially the SNP.

If you had 10% deducted and tried to fill that in with income tax, you are still getting Barnett. However, I am not sure that there is a tremendous advantage to Northern Ireland being able to move the income tax around. There is no great appeal. You could say of the situation at present that the solution is for us to put income tax up by 1%, if we are allowed to. That might be one solution, but I imagine that it would not immediately produce a political consensus.

Mr McQuillan: Thanks for your presentation so far, professor. Further to your point about funding outside Barnett, which has been a factor in explaining why there has not been the expected movement to convergence, to what extent has that been a factor to date, and how likely is it to be one in the future?

Professor Birrell: Convergence is a difficult one. If you want to put professors on the spot, you could ask them why there has not been convergence. It is usually explained in the context of population. Changes in population have been what I think David Heald called a "powerful factor in damping convergence", but it is slightly different, as you note.

When you look at the convergence argument, you see that expenditure per head should converge. Therefore, you are really measuring two slightly different things. You are measuring the input, which is Barnett and which should lead to convergence, but the output you are measuring is Barnett-plus.

So, there are actually all these extra bits of money and payments that block convergence. That is a factor, but you will find that a lot of discussion on convergence ends up saying that it is all very puzzling.

Mr McQuillan: Exactly.

Professor Birrell: Of course, the other issue was the original population basis, which is why it was skewed. I am not sure whether he ever admitted to this, but when the Barnett formula was started, Barnett picked the figures roughly off the top of his head. The figures were 10:5:85 for Scotland, Wales and England. Northern Ireland was not in the original formula in 1978. I am not sure whether that reflected the population terribly accurately even at the time. The original basis was more generous to Scotland, because Scotland did not have 10% of the population. That is how it started. By the time it came to Northern Ireland, the accurate figure, which was 2.7 or 2.8 or something like that, was used.

Mr McQuillan: Just as a matter of interest, how were we funded before that?

Professor Birrell: It was done by negotiation and a series of agreements. I will just take two minutes on this. I know this because of my age — or I used to know it. When Northern Ireland was set up, income tax, along with all the other taxes, was collected by the British Government of the time, which deducted certain amounts for what they called the imperial contribution. That was for the cost of foreign affairs and defence and so on. They gave the rest back to Northern Ireland to pay for all its services. The initial debate, therefore, was just about the imperial contribution.

Eventually, of course, the money was not enough, and by the 1930s, they said, "We will scrap the imperial contribution". It went on, and then there were specific difficulties. There were a series of what were mainly social security agreements. The 1930s were an era of high unemployment, and Northern Ireland could not meet the unemployment benefit needs. There was therefore a series of social security/National Insurance parity agreements, leading up to, I think — this is where I will stop — the 1938 Simon agreement. Simon was the Chancellor at the time. The agreement was that they would work this out overall and agree it each year with the Treasury. They set up a joint exchequer board to work out how much Northern Ireland should get from the Treasury. Basically, Northern Ireland would get back income tax that was raised there, plus a subvention. Originally, the subvention was not great. It is over only the last 20 years or so that the fiscal deficit has moved ahead. The original idea in the 1920s was that it would work the other way around: the British Government were to make money out of Northern Ireland, rather than having to support it. Some of the agreements are like that. When a fund was in deficit, such as redundancy payments, the Northern Ireland Government or the British Government would come to the other's rescue.

Mr McQuillan: We will move back to the topic that we are here to talk about. We have taken into account the caveats and the considerations that you highlighted in your paper. What would you see as the likely outcome for Northern Ireland of a move to the needs-based system?

Professor Birrell: Looking at it generally, you would think that Northern Ireland would benefit, given that needs are high because of low income, high long-term employment, child poverty figures and costs. If you went through a range of socio-economic indicators, you would see that the needs in Northern Ireland are quite high and that, therefore, it might benefit. If you started to look at detailed items, you would probably see that there are probably other considerations. As I said, there are two ways of doing it. The first is to take a very broad-brush approach. That is based on needs like that and is therefore fairly simple. It is a bit like population plus some socio-economic indicators. Northern Ireland would do reasonably well from that broad-brush approach. Whether it would do much better, I am not so sure. If you are going through a lot of detailed comparisons, which Scotland and Wales or the UK Government might insist on, you start asking Northern Ireland to justify all sorts of things, like the point that is in the recent agreement about the cost of managing a divided society. They might ask about water charges to turn that into a need, and, therefore, Northern Ireland would not do so well. In the other figures, Northern Ireland gets very little in housing consequentials, because practically all housing expenditure in Northern Ireland is seen as unnecessary in Britain. In Britain, they have got rid of all the social housing, so it is not a cost in public expenditure. If you take a very detailed approach to need, you would see that Northern Ireland might actually do worse. If you take a broad-brush approach, looking at population and socio-economic indicators, you would see that Northern Ireland would do a bit better, but it is maybe not going to make a huge difference.

Mr McQuillan: If we move to that, we will end up going back to the 1930s, with the same situation in housing and benefits.

Professor Birrell: The housing issue arises because of what is called stock transfer in Britain. Most of the social housing or local authority housing has been transferred to housing associations, so it is no longer funded directly out of public funds. At the moment, as you know, Northern Ireland is trying to do that. In the future, that might happen anyway, but if it does not, it just means that Northern Ireland has extra housing pressures that it has to meet out of its block grant.

Mr Cree: Good morning, Professor. I found your paper very interesting, particularly when you talked about convergence when we are actually diverging. It seems to be getting worse. My question relates to the implications of devolving fiscal powers. You make the point that the formula really means giving revenue-raising powers to devolved Administrations, which in turn simply control the expenditure. What do you see as the impact of devolving further fiscal powers to Northern Ireland and, indeed, the regions?

Professor Birrell: I will take the last one first. The discussion has got a bit more complex in Britain because of the regional dimension that is being introduced following the Scottish referendum. Barnett has worked fairly successfully in Scotland, Wales and Northern Ireland only; in a sense, it has almost nothing to do with England. Now that we have some discussion about fiscal devolution in Scotland and Wales and their raising and having control of some of their income tax, there has been some demand in the English regions for that. There is not really any demand for devolution, given the disaster in the north-east of England when everyone voted against a north-eastern devolved government. The idea is to somehow import it into local government. That is where it gets complex. You would have groupings of local authorities, a bit like the Boris Johnson London model, that would mean that they could qualify for a Barnett-type allocation.

It is very complex, because you are then interchanging the whole basis of local government expenditure. The regional issue makes it quite difficult. Scotland sees fiscal devolution as just the start. It would go on and on. There was a 3% tartan tax that it never used, and it is now 10% in the Scotland Bill. Following the Smith commission, it might try to push that up, but it would want to go until Scotland had total control over all its income tax. It is a bit disputed, but the argument with Scotland is that it contributes more in income tax than it gets back. If you add oil revenues to that, Scotland is flying and could be independent. The income tax basis in Scotland means that it is possible that Scotland would have a lot to gain from more control over its income tax and from scrapping Barnett.

That is not the case in Wales and Northern Ireland. Their tax bases are very low, because they are poorer areas, are not heavily industrialised and do not have a big export market and so on. Quite large numbers of children and old people live in Wales and Northern Ireland, and there is an increasing population. Strangely, Scotland has a declining population. Therefore, there is not the tax basis, so giving Northern Ireland 100% income tax-raising powers will probably not make much difference to the income. In Scotland, it would. It is argued that, Northern Ireland and, to a slightly lesser extent, Wales, would not have a lot to benefit from.

Mr Cree: What about sales tax, professor? Has that been considered?

Professor Birrell: Local government usually considers a sales tax, because it is local sales tax. The only place that I ever came across it was in the States.

Mr Cree: I think that it is a county system in the States.

Professor Birrell: It is usually associated with local government. The only place I have ever come across it being discussed is in some of the papers about reforming rates or council tax. It was looked at in Scotland. I think that it is about to have another look at council tax. A few years ago, it looked at a sales tax but thought that it was too complicated, too costly to administer, probably would not make a great deal of difference and might benefit wealthy areas or areas with more shopping more than other local authority areas, so it said no to the sales tax. VAT is linked to sales tax. As far as I understand it, the EU does not allow regions to have different VAT rates. That tends not to be discussed very much. You get it between the North and South of Ireland, of course, but that is because they are separate sovereign jurisdictions. So, I do not think that the VAT idea is regarded as much of a runner.

Mr Cree: Lastly, I have a tricky one: what happens if we come out of Europe?

Professor Birrell: The direct question and the one that you can be a bit clear about is that there are two things in Northern Ireland. It would lose out on the special European funding, because it would obviously just disappear. Of course, EU Peace funding — I forget its full name — has brought in a considerable amount of money, so, in a sense, you would lose that. The rest of Northern Ireland's EU income largely comes through the UK Government and the Treasury; therefore, it would be a matter of seeing what immediately replaced it if there was no European special funding and INTERREG and so on. Would that all just go, or would there be some special UK systems to replace it? There is the wider issue of how to fix the economy and whether there is any benefit from the contributions that the UK make and the argument about whether they are putting in more than they are getting out. People argue about that. Ten years ago or so, some figures showed that, a bit surprisingly, Northern Ireland got less out of it than it puts in. How do you work out what Northern Ireland puts in? It was a mathematical calculation; they just calculated 2.8% of what the UK Treasury was passing over. That must have come from Northern Ireland, but they were not getting 2.8% back.

Mr Cree: Interesting.

The Chairperson (Mr McKay): Professor, section 5 of your paper contains figures on expenditure and fiscal balance. How have those been calculated? Are there different methodologies between here, Scotland and some of the other areas of England and Wales, or is there consistency?

Professor Birrell: I imagine that they are fairly consistent. This came from the Silk commission, which will have been using Treasury figures from that time. Those figures will have been fairly accurate and comparable. People may have done it differently since. I think that Oxford Economics produced some figures on it more recently, but I could not find them. It is just done on a figure for total public expenditure. I imagine that it would be calculated similarly for each region. I also imagine that there probably are Treasury figures on what the income was. It has made a calculation of the balance. I think that the thing about greater London and the south-east is fairly accurate, because it is well known that those are the only regions that ever show a surplus. It is quite well known that the north of England is more dependent.

The other question that was asked was whether Scotland might do quite well out of having independent sources of income because of its strong tax revenue and its big financial services industry in Edinburgh and so on. It is thought that it would do much better than most of England if you had regionalised income tax-revenue powers, as the tax base in Scotland is certainly stronger than that in the north of England.

The Chairperson (Mr McKay): A number of commentators raised concerns about the lack of transparent public finance data or independent public finance data. The data that we largely rely on are Treasury data. How could that be addressed in the future to provide the assurance that, if the Assembly or some of the other institutions decide to devolve further fiscal powers, those processes are fair?

Professor Birrell: Treasury figures are Treasury figures. Other sources in England are more independent. The Office for Budget Responsibility (OBR) was set up as an independent body. It has sometimes criticised the current Conservative Government's positions on the economy and so on. The Office for National Statistics (ONS) in Britain has a guaranteed degree of independence, more so, I think, than the statistical research unit in Northern Ireland, which does not have the same degree of independence.

I know the background from talking to him, so this is kind of second hand, but for his paper on the consequentials in Northern Ireland, David Heald had to go through a freedom of information request to get the data on the details on the source of the Barnett consequentials. DFP does not normally publish those, but it is published here in my paper. I think that he was just told that the figures for what happened to each of the Barnett consequentials were not available, presumably because they went into the pot. DFP could not trace exactly where the consequential amount went to. As my paper shows, if there was £29 million as a Barnett consequential for transport, when it came into DFP here, it could not account for where the £29 million was passed on to. It was not in its bookkeeping. That is what he said in 2010, but it may have changed. It is worth knowing whether it is possible to do that.

Ms Boyle: Thank you, Professor Birrell, for your very informative presentation. In your paper, you note that there is uncertainty over the DFP allocation of the Barnett consequentials to Departments

here. I do not want you to repeat yourself, but what modifications would be required to clarify the process?

Professor Birrell: I suppose what we are looking for is almost a table. As we are involved in writing, research and so on, we tend to look for issues to be represented in a fairly straightforward, tabular way. The Department, the Minister or politicians might take the view that they need some discretion over what happens to it. They might require some discretion, and they prefer to have the discretion to make general statements about it. They may be quite happy. There was a recent example of it. This comes in all sorts of different ways, and some of it is probably unknown. If culture and sport get £3 million, nobody may know about it, but if there is quite a large amount, it will be in the public arena. The latest increase in health expenditure in England was publicised; I forget the reason why they said they were doing it in England. However, the Minister of Health here made a statement that said that it meant that so many millions were being passed here as a consequential, and he gave an actual figure. I am not sure whether it was about what it was going to be spent on. It is not, as it were, a totally secretive thing; it just helps in your overall calculations if you can trace in the accounts each year what happened to the Barnett consequentials.

Ms Boyle: Chair, will you allow me just one more? Do you have any thoughts on how we could address the limitations in our current finance system in the context of the Westminster reductions here? Do you have any recommendations on how we could enhance the Budget?

Professor Birrell: Yes, there are a lot of suggestions in the media and from commentators and so on. It can be quite difficult. It is easy to pluck things out of the air without considering all the implications. You could look at things like the reductions in Barnett and in funding and reductions by the UK Treasury and so on. Obviously, the approach is to try to renegotiate things. If we go back to the start of this, we will see that the current negotiations are not technically about Barnett; they are about social security. In a sense, the Barnett formula was meant to avoid that kind of situation and having to go into negotiations every year to try to get more funding and so on. Anything that is suggested, you have to consider in detail. Free prescriptions is quite a good one. In fact, cancelling free prescriptions may not save any money in the long run because of the way the system operates. So, you can get unintended consequences.

Either you opt for the very radical thing — I suppose corporation tax just about makes it as a radical thing — or you devolve income tax where you think it will make a difference. Another option would be to borrow more money. Although the devolved Administrations have borrowing powers, compared with a sovereign Government, they are very limited. It is an odd situation in Ireland. The Northern Ireland Government have very tiny borrowing powers, while the Government in Dublin have huge borrowing powers, although they do not always use them wisely. Northern Ireland is very limited. You could just focus on trying to improve difficult areas, which is what happened in Scotland and Wales. The Scottish and Welsh Governments, because they are kind of left-of-centre Governments, are very focused on using their devolved powers to deflect some of the effects of the austerity measures. They can do that through their big local government system and so on. They would have looked at areas such as youth unemployment and so on. Apart from the UK Government setting, there is a range of measures, but there is not really one thing, as such.

Ms Boyle: There is a plethora. Thank you, Professor.

Mr McCallister: Apologies, Professor: I am about to speak to a school group. In your points about the neutral regulator, you talked about the Treasury statement-of-funding policy and how difficult that can be to challenge. You also talked about the Joint Exchequer Board. This is probably a name that most of us have not heard for quite a while now. Do you think that there is a case for an independent arbitrator or regulator? Some of the evidence we have had is that there should be something like the Office for Budget Responsibility that would do that.

Professor Birrell: It has come up as an issue because the smooth working of Barnett, particularly as in the period before the devolution of power to Scotland and Wales, has been disrupted. Devolution has become embedded, and problems have arisen with Barnett in Scotland and Wales, as well as in Northern Ireland. It is not as smooth-running or robust as they thought, given the political complexities of government and so on. Therefore, there have been some disputes, though not, perhaps, major disputes as yet, and there is no great way to settle them.

You can say, as [*Inaudible.*] have been saying, that the existing system gives final power and control, more or less, to the Treasury, or to the Treasury and the Secretary of State. When financial issues

have come up in Scotland, Scottish Secretaries of State have been quite helpful, as far as I can see, with the Scottish Finance Minister and so on, in resolving them. The Welsh Secretary of State — not the current one, but the previous one — was very unhelpful, and that is probably why he was moved eventually. He got into quite a few disputes with the Welsh Administration because he kept insisting that he would decide and that they did not really matter. I had better not say anything about current Northern Ireland Secretary of State. *[Laughter.]* She has probably been, to begin with, fairly non-interventionist, though she has had to intervene lately, of course.

Then you move to the argument that this is unfair, or not right, and it is not treating the devolved Administrations equitably with respect or whatever, and you are then looking at some intergovernmental mechanism, as you were saying. There is one already, of course: the Joint Ministerial Committee (JMC), which meets three or four times a year and on which the four Administrations are represented. There are also the quadrilateral meetings, as they are called, of the four Finance Ministers once or twice a year, where they could iron out a dispute or problem. If it is a difficult dispute, the only place to go is to the JMC; and it resolved the Olympics consequential row. However, the JMC is not really organised to do that, though it can have a dispute resolution role.

You are then asking whether there should be a special mechanism, who would be on it and who would do it. It could be composed of the following: representatives of the four Governments or whoever is in dispute; representatives plus an independent Chair, which is a bit like the joint executive thing; or a totally independent panel. Once you have a totally independent panel, particularly when you are dealing with key elements of public finance, you get into issues of accountability, democratic control and so on. I do not think that that would be too popular in the UK. If they did set up such a body, it might be given an advisory function to make a recommendation to the Treasury, which would just add another decision-making line or hurdle.

It is a long time since I have looked at it, but I imagine that federal systems may have some mechanisms like that. I am not quite sure. The three big federal systems are the States, Canada and Australia, but I do not quite know if they get into that. The UK Government could argue that this is not federalism — it is devolution, and the devolved Administrations are subordinate.

Mr McCallister: Of course, at times in places like the US and Canada they refer to the powers and rights of states and those of the federal Government and maybe end up in somewhere like the US Supreme Court in order to resolve issues. Is this something we could end up doing? Could we refer a decision to the UK Supreme Court?

Professor Birrell: If there is a legal point, it could be referred. Everything connected with the Northern Ireland, Wales or Scotland Acts is subject to judicial review. You could just pick a legal case.

Mr McCallister: Would some type of body not be more desirable than ending up letting —

Professor Birrell: Yes, but I doubt whether it could have decision-making powers. It could be advisory. Always in the background, as it is with devolution, the UK Government is always in a more powerful position. The House of Commons — Parliament — is the sovereign authority and can, as you know, act over the heads of the Northern Ireland Assembly, Wales or Scotland at any time and could pass —

Mr McCallister: It might have to do that soon.

Professor Birrell: It could pass any law it wishes to pass, and that would be binding on Scotland, Wales and Northern Ireland.

I am not sure whether Treasury Ministers and officials would, with ease, set up a body and fly in somebody from Canada or somewhere who would tell us how much money to allocate to Scotland. I do not think that they would find that terribly acceptable. The Treasury view is always to look for a statement of policy and guidance. The solution might be to beef up the Treasury statement of funding to the devolved Administrations, which is the guidance. If that is not working, it might need to revisit those rules and so on.

Mr McCallister: I want to bring you back to some of your opening comments about a needs-based assessment. The House of Lords also looked at that. A theme in a lot of the evidence that we have received is that replacing Barnett would almost pose more questions and problems than it is perhaps

worth, not that we in the Northern Ireland Assembly are likely to advocate replacing it given that we do relatively well out of it. Will you make some comments on that?

You also talked about the Barnett consequentials. Some 60% of our spending is on health and education. When those have been protected by the national Government, we have done relatively well, hence we have not maybe had as much of the pain of austerity that we might otherwise have had. Even when the national Government decided to provide free school meals in England, we got something in the region of £20 million. We did not adopt free school meals, and that money maybe just went into the pot. It is that idea that we have been largely protected because of decisions that have been made by the UK Government.

Professor Birrell: The bodies that have looked at it, like the House of Lords, as well as other studies, tend to focus a lot on Wales. There is a lot of Welsh influence. They seem to be able to produce an analysis showing that Wales has not done so well out of Barnett in meeting its needs.

Mr McCallister: It is because they have reached the convergence level, effectively.

Professor Birrell: Yes. There are special problems in Wales in that because a lot of things are so integrated with England it is difficult to separate them out. Justice is still not devolved to Wales.

Investigations in Wales have tended to argue that Barnett does not meet identifiable needs in Wales. That tends to push the argument for saying that we must look at some alternative. This is not helped by the fact that Joel Barnett himself, who invented the formula some years ago, thought that it should be replaced by a needs assessment.

Mr McCallister: Different commissions have looked at tax-varying powers for Scotland and Wales. There is, I suppose, an ongoing debate here, although I do not feel that we are as far down the road. If you go down the road of tax-varying powers, whatever those might be, more than just corporation tax or a level of income tax, does that drive devolved Administrations into being more policy-driven or more responsible about what they spend because they raise some of that money directly from the people who suffer the consequences?

Professor Birrell: That is very much where this debate started in Scotland and Wales: that it would make the Governments more responsible and accountable to the electorate. They had all the responsibilities for spending the money but none, or very little, for raising it, which was mainly through local council tax and rates. That was the original argument.

Devolving some minor taxes would not bring in huge amounts of money but it would probably mean people broadly linking that to what the Assembly, Executive or Ministers were doing, so it might generate more debate and discussion on the proper use of money. Air passenger duty is a bit like that.

Usually the same three or four minor taxes are discussed. Some of the other possibilities are not discussed much. If you go back to the old Stormont system, other taxes were devolved, like motor vehicle tax and road tax. You might say that they were localised, so there was a discussion about whether you should raise rates and improve roads. There might be arguments for making all those other items of taxation more locally accountable. In the long run, that might improve aspects of government.

Mr Weir: Thank you, Professor, for an extensive consideration. I want to touch on two issues that you have gone into to some extent. In the context of wider UK considerations of changing the Barnett formula, particularly arising from the Scottish situation, there has been the start of a debate on English votes for English legislation, potential devolution and that type of thing.

What impact do you see that debate having on the wider future of the Barnett formula? You caveated various things in the way forward but, as to what you see suiting Northern Ireland, or likely to be achieved by Northern Ireland, what would be your recommendation? What direction of travel should we be going in?

Professor Birrell: Well, it will be possible to see how the 10% reduction works in Scotland. It is meant to start this year. It has already been passed in 2012 legislation. It is not part of the Smith commission outcome. It would be worth monitoring how that works in Scotland and how they use it. It could be a total damp squib. It could be like the 3% tartan tax, which they do not use at all. It could be that there was a lot of discussion about nothing. It may be followed by Wales. There is a little bit of uncertainty about how it works. Then, you could check that for Northern Ireland.

In England, there is the general issue, as you said, about English votes and so on and the general, wider perception that England is subsidising Scotland. Of course, that will be increased now with the election; the position of the SNP and the Labour Party, and so on. It is a kind of general sense that the Scots are doing well out of us. That is seen through the Barnett formula and the per capita expenditure, which is still higher in Scotland. The Scots reply that, "Well, we are not actually getting back through the formula the total income tax raised in Scotland and we are not getting our full whack out of oil revenues". There is that kind of Scottish dimension. You have a bit of conflict. As you are kind of indicating; rather than dampening down, the conflict may get worse between, as it were, Scotland and England over who is financing who, and so on.

As regards what Northern Ireland could ask for; in a sense, it is maybe this Committee starting it. There has not always been a debate about 10% income tax or changing it. The debate has been dominated really by corporation tax in the past two or three years, which is a kind of specific item. I think that the best thing to do is probably to monitor the Scottish and Welsh systems and see what happens and whether it might be of any benefit. If Barnett is scrapped, of course, Northern Ireland would have to move quickly to produce alternative mechanisms. In the meantime, it could look again at devolution of some other taxes. I think that the aggregates one was meant to come, but there was some EU hold-up or something. There could be other areas. The whole borrowing powers thing is a bit messy, and then we have the new arrangements and so on. It could do with more clarification about borrowing powers.

Mr McCallister: Is borrowing not essential if tax is to be devolved in order to cope with fluctuations in the tax take?

Professor Birrell: Yes. There are about three or four different items in the current borrowing powers; it is a bit confusing to follow. Of course, Scotland is being given the power to issue bonds. That is the other alternative. I think that, again, it used to be the case in Northern Ireland. There used to be Northern Ireland savings bonds, which the Government ran. It is up to Governments to make money through giving people loans. A way to raise government money is to act like a bank. I think that Scotland will have the power to do that. The other side of borrowing is public-private partnerships and private finance initiatives. They have had quite a bad press. It is another way of doing it. Again, Scotland has stopped it more or less because of that. You have to look at the whole outcome. It kind of fits into that area of increased borrowing.

The Chairperson (Mr McKay): OK, Professor Birrell. Thank you very much for your evidence.