

**Follow-up written Submission from Prof Holtham – received 26 January 2015**

Contrary to some reports there was no error made in letting Scotland and Northern Ireland off cuts but it is true that the outcome was anomalous. It is caused by the way Barnett is operated and in principle is easy to fix.

It happens because consequentialism is calculated for the departmental level and then applied to changes in the departmental budget. So DCLG distributes business rates receipts and provides grants for local authorities. As the reports say, the grants were slashed and business rates were not. Overall the department's budget fell by some large percentage. The consequential for Northern Ireland would be the consequential for grants = 1 and the consequential for business rates = 0 since rates are fully devolved in Northern Ireland; it keeps the rates collected in the province and does not participate in the England and Wales pool. Its departmental consequential is the weighted average of 1 and 0, with weights given by the shares in the DCLG budget. If that comes out at, say, 0.7, northern Ireland gets the total DCLG cut times 0.7. Because Wales participates in the business rates pool, its consequential there and overall is 1 so it gets the full cut in DCLG budget.

The unfairness of that is that business rates were not cut. The cut came in items where everyone had a consequential of 1. Northern Ireland was shielded by the fact that it did not participate in an activity that was irrelevant to the cuts anyway. The problem is simply the aggregation of consequentialism to a departmental average and then applying that average to the change in the departmental budget. A more sensible procedure would go bottom up, take each expenditure item in the departmental budget, take the consequential applying to that item and calculate the change in the block grant stemming from it. Then add those sums up across all the items in the budget to get the total. The reason that is not done is that the block grant is determined when overall departmental allocations are made and at that point spending on the individual projects within departments is not known for the current year.

It worked your way that time but notice that if the UK government made cuts in an item that was not devolved to you but which reduced a departmental budget, you could get a reduction in the block grant if your average consequential for the department in question was not zero. So this anomaly could hurt you in future. I agree with the IFS conclusion that the anomaly should be sorted out—it is difficult to do that when initial allocations are made but there is no reason why there could not be a retrospective adjustment the following year. It could be subject to a de minimis rule so that trivial changes are not made but there is an adjustment for large discrepancies.