Northern Ireland Assembly, Committee for Finance and Personnel

Review of the operation of the Barnett Formula for allocating public expenditure to Northern Ireland

Evidence from Iain McLean

Introduction

1. I welcome the opportunity to give further evidence, building on the evidence from Alan Trench, Gerald Holtham, and myself given on 08 February 2012, at http://www.niassembly.gov.uk/Documents/Official-Reports/Finance_Personnel/2011-2012/Barnett%20Formula.pdf.
2. This note does not revisit the evidence we gave then. However, that evidence, and the background papers supplied to Members on which that evidence commented, remain relevant to the present situation.
3. The remainder of this note addresses the key objectives of your Review.

Barnett and resources in NI, including extent of convergence to average public spending per head

4. In 2012 we concluded that the block grant to NI under Barnett was approximately what it would have been under a needs formula like those used in England to allocate health and local government expenditure, but that there was a risk that in future years the grant would fall below this relative needs line. Your officials' notes for that session had come to the same conclusion.
5. I have assembled the latest available official data to see whether things have changed since then (Table 1).
6. In the top block of Table 1, the even-numbered columns contain data from the Office for National Statistics (ONS). The odd-numbered columns contain data from HM Treasury (HMT). All these data are classed as National Statistics: in other words, they are warranted to be produced to high professional standards and not subject to improper influence. All data are expressed in per head terms, and are indexed to an average for the UK of 100.
7. The ONS tables record Gross Value Added (GVA) per head, and are produced annually for December. For practical purposes, GVA is the same as the better-known quantity, GDP (Gross Domestic Product). They exclude what statisticians call *Extra Regio*, i.e., income not attributable to any region of the UK. The main component of *Extra Regio* is income from North Sea oil and gas.
8. The HMT tables record identifiable public expenditure per head, and are produced annually, each year with data for the last five financial years. They exclude non-identifiable expenditure, such as that on overseas affairs, defence, and debt interest. To calculate total public expenditure per head in each region, the non-identifiable items are simply assigned on an equal per head basis. They are therefore not relevant to the questions in your Review.
9. As Members know, the theoretical effect of Barnett, in the long run, is to bring expenditure in all the territories it covers to the same level per head as expenditure in England. Less

'Barnett convergence' has been observed in practice than would have occurred if the formula had governed the entire block grant to Scotland, Wales, and Northern Ireland.

10. Table 1 is designed to help answer two questions. The first is: **has there been a consistent trend towards Barnett convergence in Northern Ireland?** Relative public spending per head has actually gone up slightly in the last two years for which we have data, so at the moment the answer is '**No**'.
11. But non-convergence may arise for many reasons. These include:
    a. a reduction in comparable expenditure in England;
    b. a different population structure in NI;
    c. time-lags in updating population data;
    d. expenditure on social protection (most of which does not come through the Barnett arrangements) following a different path to expenditure funded by the block grant.
12. Therefore, a further aim of Table 1 is to evaluate **whether the relative level of public spending in NI is 'fair'**. The second block of figures aims to address that question. These figures are my own calculations, and are therefore not National Statistics.
13. The figures implement the following model. *What if the only purpose of public expenditure were to relieve poverty? In that case, the poorer a region, the more public expenditure per head it should get.* They compare relative public spending with relative GVA per head, and index them to 1. (The formula is index GVA*index expenditure/10000).
14. It is not suggested that the only purpose of public expenditure is actually to relieve poverty. But if it were, and were 100% efficient in that aim, the relative index (lower block of Table 1) would be 1 for all regions in all years. A number above 1 means that a region receives more public expenditure than this model would predict. A number below 1 means that it receives less.
15. These figures suggest that, by this crude measure, Scotland consistently gets more public spending per head than would be expected. Wales gets consistently less than would be expected (a conclusion which is consistent with the work of the Holtham Commission reported to you in 2012). Northern Ireland gets roughly what this model would predict.
16. As with the figures showing non-convergence, there is no clear trend in these numbers. It is **not possible to say that in recent years the amount available to spend on public services in Northern Ireland is becoming either more or less 'fair'** in relation to the average income in NI.

The pace and extent of predictable further convergence

17. It is therefore not clear whether convergence is happening. Various factors would make convergence more or less likely, on the assumption that the Barnett mechanism remains unchanged.
18. The following make convergence more likely:
    a. a large increase in spending in England on comparable services, e.g., the NHS;
    b. an increase in inflation (because the Barnett mechanism works on nominal public expenditure, not adjusted for inflation);
    c. faster population growth in NI in any period before population numbers are re-calculated in the funding formula

19. Accordingly, the opposites of these factors (no large increases in English spending; low or negative inflation; slower population growth in NI before rebasing) make convergence less likely.

Supplementing Barnett to take account of need

20. There is political pressure from Wales and the poorer parts of England to substitute a needs assessment for the Barnett arrangements. Proposals for Wales were made by the Holtham and Silk Commissions.
21. There is no organised pressure in that direction from Scotland. The Independent Expert Group advising the Calman Commission in 2008-9 considered a needs assessment, but instead recommended the scheme that has now been enacted in the Scotland Act 2012, whereby the UK vacates 10p in the pound of each band of Income Tax for Scottish taxpayers, leaving it to the Scottish Parliament to set a Scottish rate.
22. The 'vow' of September 2014 promises Scotland more fiscal autonomy. Similar pressure comes from London and the south-east of England, where politicians call to keep more of the taxes that are raised in their region.
23. At the same time, puzzlingly and apparently inconsistently, the 'vow' states that the Barnett regime will continue.
24. The inconsistency may arise from a misconception that Barnett actually is a needs formula. The promise may therefore have been read as a promise to protect expenditure in Scotland. This would be a double inconsistency (Barnett is not a needs formula; and, if it were, block grant to Scotland would be sharply reduced); but the level of Barnett literacy among Scottish media commentators is low.
25. Historical evidence suggests that the intention of the late Lord Barnett and his advisers in the 1974-9 government was to allow 'his' formula to run until such time as expenditure in Scotland had been reduced to a level that could have been justified under a needs assessment, and then switch to something like the Needs Assessment that HMT started preparing in 1976-7.
26. In the event, the government elected in 1979 did not take the needs assessment forward, and so Barnett continued by default.
27. As Holtham and his colleagues have pointed out in their reports, and in their evidence to you, needs assessments are used in England to distribute funds for NHS and local authority spending around the local authorities and health spending bodies in England. I support the ideas in the Holtham reports for extending this idea to Wales and Northern Ireland, while ensuring that the data on which the assessment is based are not captured and distorted by anybody who wishes to use them to get more money for a particular region.
28. The fiscal autonomy promised to Scotland in the Vow, and now being considered by the Smith Commission, makes transition to a needs assessment for Wales and Northern Ireland easier. Put bluntly, the territory with most to lose from any switch to a needs assessment is now out of the game.

Concerns relating to the administration of Barnett

29. The concern most frequently expressed (including at our last evidence session with you) is that the administration of Barnett is wholly under the control of a single UK government department, namely HMT, which operates its *Statement of Funding Policy* in a non-statutory and non-consultative way..

30. It is often stated that it would be fairer if the mechanism was operated by a neutral regulator, rather than one of the players in the territorial distribution game. Examples are frequently cited in which the classification of an activity in England varies arbitrarily in whether it is deemed to be UK-wide in its benefits (and hence not attracting a Barnett consequential) or England-only (in which case it attracts a Barnett consequential.
31. Well-known examples of this arbitrariness have been infrastructure for the 2012 Olympics; Crossrail; and Kew Gardens.
32. There have also been complaints about the quality and availability of the public finance data that underpins the Barnett calculations. However, the main data series, *Public Expenditure Statistical Analyses*, have improved significantly in recent years. They are the Treasury data series used in my Table 1.
33. As devolution progresses, the operation of the *Statement of Funding Policy* or any successor becomes more complex. The policy must attribute not only spending but also tax revenues to the appropriate territory, and within that the appropriate department.
34. An instance of this complexity has recently been pointed out by the Institute for Fiscal Studies, at http://www.ifs.org.uk/uploads/publications/pr/barnett_formula_pr.pdf. Business Rate income in England has been assigned to the Department for Communities and Local Government. This reduces the amount of DCLG spending that attracts a Barnett consequential. But, DCLG spending has been cut more heavily than that of other domestic English departments. The effect of assigning Business Rate revenue wholly to DCLG is to shield NI, and the other territories, from the consequential cut that they would otherwise suffer. IFS estimates the benefit of this 'flaw' to NI at £200m a year- i.e., the block grant is greater by that amount than it would have been if Business Rates in England were not assigned to a single departmental budget.
35. As tax devolution progresses, further such complications will arise from the devolution of other taxes, e.g., property transaction and landfill taxes.

Improving the future operation and administration of Barnett

36. The responsibility for the 'Statement of Funding Policy' and the assignment of spending programmes between reserved and devolved functions could be moved from HMT to a neutral regulator.
37. Two potential regulators have been suggested: the Statistics Authority and the Office for Budget Responsibility. Either would have to be given more money and more staff if requested to take on this function.
38. More elaborately, a neutral agency could take over the entire process. A model that has been suggested is the Commonwealth Grants Commission (Australia), which is a creature jointly of the Commonwealth (i.e., federal) Government and all eight of the states.

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v2 19.11.2014

Table 1

Identifiable expenditure and relative GVA per head for the UK and its four components, indexed

	Regional GVA/head excl Extra regio 2008	Indentifiable exp/head, index 2008-9	Regional GVA/head excl Extra regio 2009	Indentifiable exp/head, index 2009-10	Regional GVA/head excl Extra regio 2010	Indentifiable exp/head, index 2010-11	Regional GVA/head excl Extra regio 2011	Indentifiable exp/head, index 2011-12	Regional GVA/head excl Extra regio 2012	Indentifiable exp/head, index 2012-13
England	102.4	97	102.2	97	102.4	97	102.3	97	103	97
Scotland	97.8	115	98.8	113	98.7	113	98.6	115	94	116
Wales	74.3	110	74.3	109	74	110	75.2	113	72.3	110
Northern Ireland	78.9	123	79.1	121	76.4	121	79.2	124	75.7	124
United Kingdom	100	100	100	100	100	100	100	100	100	100

Relative index	2008	2009	2010	2011	2012
England	0.99	0.99	0.99	0.99	1.00
Scotland	1.12	1.12	1.12	1.13	1.09
Wales	0.82	0.81	0.81	0.85	0.80
Northern Ireland	0.97	0.96	0.92	0.98	0.94
United Kingdom	1.00	1.00	1.00	1.00	1.00

Sources

Even-numbered columns: Office for National Statistics, *Regional GVA: Income Approach* annual (title varies), Table 1. National Statistics

Odd-numbered columns: HM Treasury, *Public Expenditure Statistical Analyses 2014* , Table 9.16. National Statistics

Relative index: author's calculations