



HM TREASURY

# House of Lords Select Committee on the Barnett Formula: the Government's response

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# House of Lords Select Committee on the Barnett Formula: the Government's response

Presented to Parliament by  
the Chancellor of the Exchequer  
by Command of Her Majesty

December 2009

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# 1

## Introduction

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**1.1** We welcome the Committee's report on the Barnett formula as an important contribution to the debate on the future of devolved funding arrangements in the UK.

**1.2** The Government announced in January 2008 that the Treasury would produce a factual paper on the Barnett formula to inform the debate. Since then the Treasury has provided written and oral evidence to the House of Lords Select Committee (published in the HL Paper 139 in July 2009). It has also provided evidence to the Calman Commission on Scottish devolution. This response to the House of Lords report together with the evidence referred to above meets this remit.

**1.3** In addition the Scotland Office has published the Government's response to the Calman Commission report on 25 November; and the Secretary of State for Wales has presented a Written Ministerial Statement to Parliament on 26 November setting out changes to the arrangements for funding the Welsh Assembly Government following the publication of the Holtham report in July 2009 and the House of Lords report.



# 2

## Response to the Committee's conclusions and recommendations

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**2.1** The Government's response to the conclusions and recommendations in the House of Lords Select Committee report on the Barnett formula are set out below.

**2.2 Recommendation:** The advantages of the Barnett formula - simplicity, stability and the absence of ring-fencing - are important and should be maintained whatever the future methods of allocating funds to the devolved administrations.

**2.3 Response:** The Government welcomes all views on the future of the Barnett formula and particularly welcomes the Committee's report.

**2.4 Recommendation:** The changing populations of the devolved administrations and the failure of the formula to take account of population changes over time within the baseline create a significant problem for the Barnett formula today. In our view the resulting per capita allocations are arbitrary and unfair. In essence the baseline of the grant provides funds for a level of population that has changed.

**2.5 Response:** We note the concerns that have been raised by the Committee. The Barnett formula operates according to long standing principles set out in the Statement of Funding Policy, the latest version of which was published in 2007. The population factors in the Barnett formula are regularly updated to take account of the latest ONS estimates. The Barnett formula determines changes to the baseline, not the baseline itself. The baseline is created by rolling forward existing spending in line with normal public spending practice.

We note the Committee's particular concerns in relation to the perceived levels of relative need in Scotland. The Government has already announced that it will assess, and explore how to implement, the Calman Commission's proposals on funding the Scottish Parliament, which would see a significant proportion of the Scottish Parliament's budget being sourced from taxation decided upon and raised in Scotland. The Government's response to the Calman Commission's proposals was published on 25 November 2009.

We also note that the Holtham Commission has produced its first report on Welsh funding for the Welsh Assembly Government and will be producing its final report in due course. While these are reports to the Welsh Assembly Government, not the UK Government, the UK Government nevertheless welcomes the Commission's substantial work on this important subject and will respond in due course. New arrangements in relation to future funding in Wales were announced by the Secretary of State for Wales on 26 November 2009.

**2.6 Recommendation:** 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 creates a consequential payment there is a clear process and open consultation with the devolved administrations.

**2.7 Response:** Regarding the Committee's views on what spending is within the application of the Barnett formula, for the purposes of the application of the Barnett formula, public spending is divided into comparable and non-comparable spending. Comparability is defined in the

Statement of Funding Policy as the extent to which services delivered by UK Government departments correspond to services within the budgets of the devolved administrations. The devolution settlements and associated legislation determine the extent of devolution in Scotland, Wales and Northern Ireland. Spending which is non-comparable is that which is UK wide and for the benefit of the whole UK. The details of comparable and non-comparable spending are published in Annex C of the Statement of Funding Policy (SFP). The devolved administrations are consulted on this although the Treasury is responsible for the document as it is part of the UK reserved public spending framework.

In advance of publication of new editions of the SFP the Treasury consults with the devolved administrations and agrees the publication with the Territorial Secretaries of State.

The SFP sets out the dispute resolution procedure under which, if all other avenues have been exhausted, disputes may be remitted to the Joint Ministerial Committee (JMC) and then if necessary the Secretary of State can take the dispute to Cabinet for final decision. In practice no disputes have been remitted to the JMC since devolution.

Decisions on how to implement the Barnett formula i.e. additions beyond the Barnett formula are a matter for the Government to decide within the framework of the Statement of Funding Policy, although such decisions are wholly exceptional bearing in mind that the Barnett formula is the normal means for determining changes in devolved funding.

**2.8 Recommendation:** Although we acknowledge that the data on public spending have improved since 1999, we continue to be concerned that clear, thorough and readily accessible data on public spending across the UK are not yet being provided.

We recommend that the Treasury publish their statistics on 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.

**2.9 Response:** The Government welcomes the Committee's recognition that the data on public spending has improved since 1999. The Treasury is committed to publishing high quality data and making improvements where necessary. The Treasury's main publication on public spending data is Public Expenditure Statistical Analyses (PESA). The scope of National Statistics in PESA is indicated in the text of each chapter. The Government accepts the Committee's recommendation that the allocations of grant to the devolved administrations, changes from previous years and explanations for any changes made, as provided to the Committee, should be included in PESA supplementary material.

**2.10 Recommendation:** The role of the Commonwealth Grants Commission (CGC) in Australia offers a useful institutional model of an independent body that has responsibility for making recommendations about the allocation of finance. An independent body, similar to the CGC should be established in the UK. It should be the role of such a body to recommend the allocation of public monies based on population and through a needs based formula. Within the new framework the Treasury will need to retain its authority over the overall level of the block grant but not the proportionate allocation of the grant between the devolved administrations. This independent body might perhaps be called the UK Funding Commission. This Commission would carry out an assessment of relative need, undertake periodic reviews, and collect and publish information on an annual basis about the allocation of finance to the devolved administrations.

The Commission should be advisory in nature rather than have the power to make substantive allocation of funds on its own account. Its advice should, however, be published.

The remit of the Commission should be to determine the relative needs of each devolved administration on a regular basis, perhaps every five years. The Commission should also advise on the relative proportions of public spending for the devolved administrations, compared with spending within England, during a transitional period and recommend annual increments based on the latest population figures.

The Commission should be appointed by the UK Government as a non-departmental public body. It should be politically neutral and independent. It should be composed of a small number of members with sufficient expertise to ensure the dispassionate and authoritative nature of its work.

**2.11** Response: The Government notes the Committee's views on the role of the Australian Grants Commission. Under the devolution settlements for Scotland, Wales and Northern Ireland the UK public expenditure framework and allocation methodology is reserved to the Treasury. We note the Committee's views on the desirability of establishing an independent UK Funding Commission, notwithstanding the potentially substantial costs of establishing and running such a system, but currently have no plans to set up such a body.

**2.12** Recommendation: We recommend that future grants be payable directly from the UK Government to the consolidated fund of each devolved administration.

**2.13** Response: The UK Government already pays the block grants to the devolved consolidated funds. The Devolution Acts provide for the Territorial Secretaries of State to make the payments to the devolved consolidated funds. This arrangement has worked well over the period since devolution was introduced and the Government has no plans to change this arrangement. In so far as this recommendation relates to the new funding system recommended by the Committee, the Government currently has no plans to introduce such a system.

**2.14** Recommendation: We find the argument that devolution funding should be based on relative need to be a compelling one. Public spending per head of population should be allocated across the UK on the basis of relative need, so that those parts of the UK which have a greater need receive more public funds to help them pay for the additional levels of public services they require as a result. Those levels of need, and which parts of the UK need them, may well change over time. Historically they have done so.

The new system should be based on the following principles:

- It should consider both the baseline and any increments in funds;
- It should be fair and seen to be fair;
- It should be comprehensible;
- It should respect territorial autonomy; and
- It should be stable and predictable.

Any needs assessment should take these aspects into account:

- The age structure of the population;
- Low income;
- Ill-health and disability; and
- Economic weakness.

While we are not in a position to reach a conclusion about the precise relative needs in the four countries and regions, on the basis of our initial analysis, we believe that Scotland now has a markedly lower need than Wales and Northern Ireland in comparison with England. The current allocation of spending does not properly reflect this basic pattern across the devolved administrations.

We recommend that an alternative system on the broad lines suggested above be created to establish a new baseline grant for the devolved administrations and to review needs on a regular basis so that allocations of funds to the devolved administrations reflect the changing patterns of relative need.

The task for the Commission is to select indicators of the type illustrated above and to combine them in the way suggested. It is a feature of this approach that there can be choice about which, and how many, of the indicators are used to the ultimate formula. All of them will be brought into the analysis.

**2.15** Response: The Government notes the Committee's views on the desirability of their suggested needs-based system. The Government's view is that the Barnett formula has a number of strengths, among them the merit of allowing the devolved administrations to determine their own assessment of needs and priorities in devolved areas.

The Government will continue to keep all aspects of public spending under review, including the operation of the Barnett formula, and welcomes the careful analysis presented in the report.

**2.16** Recommendation: We recognise the need for a carefully handled transition to implement the new arrangements. We anticipate a transitional period of between three and five years, preferably to no more than seven, before the new arrangements are brought wholly into effect. Smoothing mechanisms would need to be put in place to manage the change from present levels of funding to those that the new arrangements would supply.

Both the length of the transition period before the new system is brought wholly into effect and the pace at which the actual levels of grant per head converge with the needs-based levels are issues upon which the new Commission should advise the UK Government.

The new arrangements we propose will need to be embodied in statute, at least in general outline. The legislation should contain provisions to ensure that the quinquennial reviews indeed take place.

**2.17** Response: The Government notes the recommendations for transitional arrangements if the Committee's suggested needs based system were adopted but as noted above the Government has no plans to make such changes.





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