

# Barnett reform: Future funding for Wales

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The Holtham Commission found that Wales is currently underfunded by around £300 million per year. Is it time to address the thorny issue of funding devolution via the Barnett formula, what are the alternatives and what would this mean for Wales?

## The Barnett formula

The Barnett formula is a non-statutory mechanism, by which changes to the funding of the devolved administrations are determined, based on changes to spend in UK Government departments and population share.

Barnett has been criticised over the years on the basis of accountability, equity and fairness. These criticisms and calls for review culminated in 2008, with the formation of the Calman and Holtham Commissions in Scotland and Wales, respectively.

## Calls for review

In Scotland, the Commission on Scottish Devolution (Calman) had a wide remit to review the experience of Scottish devolution, including the funding of devolution and alternatives to the current arrangements. The Independent Commission on Funding and Finance for Wales (Holtham) had a somewhat narrower remit and was tasked with reviewing the funding of devolution as it relates to Wales.

## Calman and tax devolution

In relation to funding devolution, the Calman recommendations focused mainly on tax devolution, including:

- the reduction of basic and higher rates of income tax by 10p and using this to form a new Scottish income tax rate;
- devolution of a number of other taxes; and
- a corresponding reduction in the block grant to offset tax revenues.

## Holtham and the 'Barnett floor'

The Holtham Commission found that:

- under current arrangements Wales is underfunded by some £300 million per year;
- fair funding for Wales should be on the basis of relative need; and
- as reform to a needs-based formula would take time, they suggested the immediate implementation of a 'Barnett floor' as an interim measure, to prevent any further underfunding of public services in Wales.

In the longer term, the possibility of tax devolution was proposed, similar to that endorsed by Calman, but tailored to meet the specific requirements of Wales.

## Time for change?

The Third Assembly unanimously endorsed a motion calling for the immediate implementation of a funding floor by the UK Government, followed by wider reform of the funding formula. The issue of tax devolution has been agreed to be a matter for the people of Wales as the First Minister has stated that this would require a further referendum.

*There appears to be no great political appetite for tax devolution in Wales*

Should the issue of tax devolution arise in the future, it is generally agreed that the arrangements would have to be tailored to meet

the specific socio-economic circumstances of Wales. For example, tax revenues likely to be raised in Wales are significantly different from those in Scotland, and the risks inherent in tax devolution would be different from those applicable to Scotland.

### Barnett floor

The Holtham Commission suggested the implementation of a Barnett floor, as a mechanism to place a threshold under the current funding to Wales and prevent further underfunding of public services in Wales.

It was suggested that this could be achieved by multiplying any positive increments allocated to Wales by 114 per cent. This could be simply added to the calculation already in place under the Barnett formula. Thus, any increase in spend to a UK Government department would be multiplied by:

- the comparability factor;
- the population share; and
- 114 per cent.

For example, if there was an increase of £100 million in the planned spend of a UK department, whose activities are 90 per cent devolved, and the latest estimates of the Welsh population as a proportion of the English population are 5.79 per cent. Combining these elements with the implementation of the 114 per cent floor mechanism would give a positive consequential to Wales of £5.9 million, as opposed to £5.2 million without the floor:

**With floor:**  $100 \times 90 \times 5.79 \times 114$

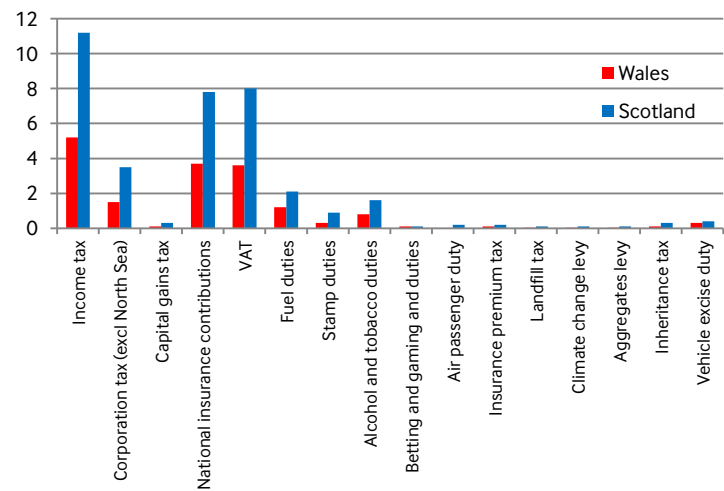
**Without floor:**  $100 \times 90 \times 5.79$

As Wales is already moving to a position where it is underfunded in comparison to what it would receive via English funding formulae, it was considered to be inappropriate to apply the 'floor' in the event of negative funding allocations to Wales.

### Barriers to Barnett reform?

The current UK Government have stated that Barnett reform is not a priority, as their focus is on reducing the deficit.

#### Revenues raised by UK-wide taxes, 2007-08 (£ billions)



Source: GERS and Holtham Commission

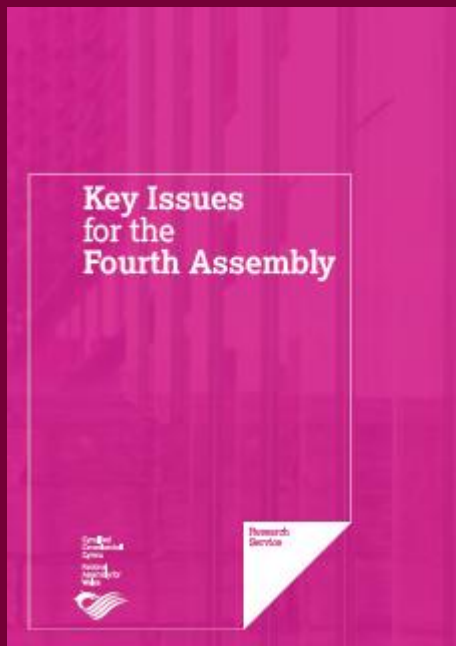
Historically, there have been political reasons for avoiding Barnett reform. Part of this relates to the notion that moving to a needs-based mechanism would potentially have a detrimental effect on the Scottish block. With the introduction of the *Scotland Bill* in November 2010 and the move towards tax devolution in Scotland, this potential barrier may be removed and allow for reform of the formula as it is applied to Wales.

### Recent events and a way forward?

The UK Government stated that in the event of a Yes vote in the recent referendum on legislative powers for Wales that it would 'establish a Calman-like process' for Wales.

The Chief Secretary to the Treasury (Danny Alexander) confirmed that discussions should commence between HM Treasury and the Welsh Government regarding the Holtham proposals. Although he has stated that wider reform of Barnett was not a priority at this time, he also indicated that the proposal for a 'Barnett floor' would be considered.

# Article taken from Research Service publication



## Key Issues for the Fourth Assembly

This document has been specially prepared for Assembly Members by the Research Service. It sets out some of the key issues likely to matter to Members during the Fourth Assembly.

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