

# Quick guide

## Barnett formula

September 2008

### Funding the devolved administrations

The responsibility for fiscal policy, macroeconomic policy and public expenditure allocation across the UK lies with HM Treasury. Funding for the devolved administrations is determined within spending reviews alongside that for the UK Government departments.<sup>1</sup> Once the overall budgets have been decided, the devolved administrations have the freedom to allocate spending within these totals; however they must ensure that their plans comply with the UK Government's fiscal policy.

The devolved administrations budget is not exclusively funded by grant from the UK Parliament. Further elements are covered from local taxation (including non-domestic rates and council tax) and through borrowing by local authorities and other public bodies to finance their capital spending.

### The block grant and the Barnett formula

The 'assigned' element of the departmental expenditure limits (DEL)<sup>2</sup> is commonly known as the 'block grant'. This is the portion of the total budget over which the devolved administrations have complete discretion regarding its allocation across departments and programmes.<sup>3</sup> Changes to these budgets are generally determined by the Barnett formula,<sup>4</sup> thereby removing the need to negotiate the allocation with HM Treasury.

**The non-statutory Barnett formula determines changes to expenditure within the assigned budgets of the devolved administrations, but does not determine the absolute**

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<sup>1</sup> HM Treasury set out the arrangements for funding the devolved administrations in [Funding the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly: Statement of Funding Policy \(October 2007\)](#). [on 16 February 2009]

<sup>2</sup> **Departmental Expenditure Limits (DEL)** – normally set over three years as part of the UK Government's Spending Review process. Most of the DEL is unhypothecated and allows the devolved administration full discretion over its spending priorities (known as 'assigned budget' items). Changes in provision for these items are determined through the Barnett formula. Some elements of DEL, however are ring-fenced ('non-assigned budget') and can only be used for specified purposes.

<sup>3</sup> The devolved administrations have **no** discretion over the total level of the assigned DEL.

<sup>4</sup> Note that the Barnett formula is not applied to annually managed expenditure (AME).

level of the assigned DEL. When the UK Government reviews its spending plans,<sup>5</sup> changes in the allocation to the devolved administration are determined by changes in planned spending on comparable services in UK Government departments. The actual change is calculated using the population-based Barnett formula. Thus, the Barnett formula operates an incremental system, in that the **allocation in one year is based on that in the previous year, plus or minus a population based share of changes to comparable UK Government spending for England.**

The change in spending for each devolved administration is therefore calculated by:

Change to UK Government department's DEL

X

Comparability percentage

X

Population proportion

The majority of the devolved administrations allocation is determined via the Barnett formula; however there are a **number of exceptions** where the population-based approach is not considered to be appropriate – sometimes termed '**formula by-pass**'. These include some programmes within DEL, all AME, and other expenditure outside DEL. DEL items in the non-assigned budget will be determined separately between the devolved administration, the Secretary of State, HM Treasury and the relevant UK Government department.

## Barnett 'squeeze' and expenditure per head

Chapter 9 of HM Treasury's Public Expenditure Statistical Analysis (PESA) 2008,<sup>6</sup> presents public expenditure by region and country. Table 9.2 of this document shows that total identifiable expenditure<sup>7</sup> per head is higher in the devolved administrations than England. The term 'Barnett squeeze' refers to the fact the Barnett formula should, over time, lead to a convergence of public expenditure per head in the countries of the UK. In theory over the years, each country receives an equal increase in funding per head, so the higher levels of public spending prevalent in the devolved administrations should eventually become level to that in England.

<sup>5</sup> In the main, through the UK Government's spending reviews though other spending announcements, such as those made by the Chancellor in his Spring and Autumn Budgets, also impact on allocations to the devolved administrations DEL.

<sup>6</sup> [HM Treasury, Public Expenditure Statistical Analysis \(PESA\) 2008](#) [on 16 February 2009]

<sup>7</sup> **Total identifiable expenditure**- that which can be recognised as having been incurred for the benefit of individuals, enterprises or communities within particular regions. This covers expenditure by the UK government, the devolved administrations, local government and public corporations. Therefore it does not wholly represent allocations via the Barnett formula.

However, it has been suggested that there is little evidence that convergence is occurring.<sup>8,9</sup> There are a number of reasons why this may be the case, including:

- **Transparency** - the lack of comparable data on Barnett-funded services in the devolved administrations and equivalent English data makes it difficult to verify whether convergence is occurring in practice. A 2005 report by the Centre for Public Policy Research (CPPR)<sup>10</sup> stated that one of the main issues around the Barnett formula was the lack of transparency and hence the potential for scrutiny.
- **Population** - convergence assumes constant populations levels, however if population levels in the devolved administrations decrease, then convergence does not hold. Until 1992, the 1976 population estimates were used for the Barnett formula; although Scotland's population was declining relative to that of England – this would have worked against convergence. Even with the use of the most recent population estimates, if the devolved administrations population is in decline, this results in increased spending per head – as the inherited spending base will be divided amongst a lower population.
- **Formula by-pass** - a further possible reason why convergence may not have occurred is formula by-pass. The model producing convergence assumes that the formula is strictly applied. However, if payments are made outside the Barnett formula, convergence would be reduced. For example, the transfer of funding for new functions acquired by the Welsh Assembly Government, such as student finance, complicate the picture.

## Criticisms of Barnett and calls for review

The Barnett formula has often been criticised because it does not take account of 'needs'. Such criticism of the current arrangements has led to calls for an updated needs assessment. The last official assessment of need was conducted by HM Treasury<sup>11</sup> in the late 1970s, when legislation for devolution was being considered. However, there are significant problems associated with conducting an objective needs assessment. The process of deciding upon and weighing together a number of measures would be inherently subjective.

There have also been a number of criticisms of the Barnett formula for its perceived lack of

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<sup>8</sup> [Institute for Public Policy Research \(IPPR\) North, \*Fair Shares? Barnett and the politics of public expenditure\* \(July 2008\)](#) [on 12 February 2009]

<sup>9</sup> [Centre for Public Policy for Regions \(CPPR\), Discussion Paper 10, \*The Barnett Allocation Mechanism: Formula plus Influence?\* \(December 2005\)](#) [on 12 February 2009]

<sup>10</sup> *ibid*

<sup>11</sup> HM Treasury, *Needs Assessment Study – Report*, 1979

equity. This has particularly been the case since devolution as the devolved administrations can pursue different policies from that of the UK Government. Some have alleged that the current system produces public spending outcomes which are unfair. The view seems to be that higher public spending, particularly in Scotland, enables funding of more generous social policies than those available in England.

Due, to the criticisms discussed in the previous section, there have been many calls for the Barnett formula to be reviewed. Lord Barnett himself has stated that '*the Barnett formula has to go*'.<sup>12</sup> However, the UK Government have consistently stated that they have no plans to review the formula.<sup>13</sup> Despite this, a number of bodies are reviewing the Barnett formula and mechanisms of funding the devolved administrations.

In Scotland, the **Commission on Scottish Devolution** (Calman Commission) is conducting an independent review of the experience of Scottish devolution, including the financing of devolved expenditure and alternative fiscal options. The Calman Commission produced its first report in December 2008.<sup>14</sup> With regard to improving the financial accountability of the Scottish Parliament, the Commission has come to no conclusions as yet and are seeking further evidence. The Commission aims to publish its final report during 2009.

In Wales it was announced last year that Gerald Holtham is to Chair the **Independent Commission on Funding and Finance for Wales**.<sup>15</sup> The remit of the Commission is as follows:

- Look at the pros and cons of the present formula-based approach to the distribution of public expenditure resources to the Welsh Assembly Government; and
- Identify possible alternative funding mechanisms including the scope for the Welsh Assembly Government to have tax varying powers as well as greater powers to borrow.

Initially the Commission is intending to review the Barnett formula, before broadening its work to take into account issues such as tax-varying and borrowing powers. The Commission has stated that it intends to publish an interim report in the summer of 2009, which will be published and debated in the National Assembly, prior to undertaking more detailed work towards the end of 2009.

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<sup>12</sup> **Lord Barnett, I only meant the Barnett formula to last a year, not 30.** Times Online, 11 January 2009 [on 16 February 2009]

<sup>13</sup> **HC Deb 18 July 2007 c443W** [on 16 February 2009]

<sup>14</sup> **Commission on Scottish Devolution, The Future of Scottish Devolution within the Union: A First Report. December 2008.** [on 16 February 2009]

<sup>15</sup> **Welsh Assembly Government Press Release, Chair of Commission on Funding and Finance announced, 8 July 2008.** [on 16 February 2009]

The [House of Lords Barnett Formula Select Committee](#) was appointed on 10 December 2008. The remit of the Committee is to examine the purpose, methodology and application of the Barnett formula as a means of determining funding for the devolved administrations of the United Kingdom, to assess the effectiveness of the calculation mechanism to meet its purpose, and to consider alternative mechanisms. The Committee are currently taking evidence and will report once all evidence has been considered.

## Further information

For further information on the Barnett Formula, please contact **Eleanor Roy**, Members' Research Service ([Eleanor.Roy@Wales.GSI.Gov.UK](mailto:Eleanor.Roy@Wales.GSI.Gov.UK))

For further information on the topics below, double click on the links.

- [HM Treasury, Statement of Funding Policy](#)
- [HM Treasury, Public Expenditure Statistical Analyses \(PESA\)](#)
- [Commission on Scottish Devolution](#)
- [Independent Commission on Funding and Finance for Wales](#)
- [House of Lords Barnett Formula Select Committee](#)

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