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The Barnett Formula

The Barnett formula is part of the mechanism used to determine the budgets of the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly.

This paper describes the origin and operation of the Barnett formula. It also looks at some of the issues around its use. Data on public spending and tax revenue in Scotland, Wales, Northern Ireland and the English regions are included.

The disparities in public spending per head between the different parts of the UK have led to criticisms that the Barnett formula is unfair and for calls for it to be reviewed. The Government has consistently said that it has no plans for such a review.

This paper updates Library Research Paper 01/108.

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Summary

The non-statutory Barnett formula is part of the mechanism used to determine the budgets of the devolved administrations. It determines the change in these budgets rather than their absolute level. This change is based on increases (or decreases) in spending on programmes in England (where these are comparable to spending by the devolved administrations) and the populations of Scotland, Wales and Northern Ireland relative to England.

Public spending per head is higher than the UK average in Scotland, Wales and Northern Ireland. These figures relate to all public spending which can be identified as benefiting a particular country or region and thus include substantial areas of spending outside the Barnett formula. There is also considerable variation in spending per head between the English regions. The Barnett formula plays no part in the allocation of public spending between the English regions.

There are fewer figures on the amount of tax revenue raised in the different parts of the UK. Scottish Executive figures suggest that Scotland had a fiscal deficit of £11.2 billion in 2004/05 if no North Sea revenues are allocated to Scotland. This falls to £6.0 billion if all North Sea revenue is assumed to go Scotland. These figures are the subject of political controversy: the SNP argue that Scotland is in surplus. Estimates by Oxford Economics suggest that only three areas of the UK – London, the South East and the East – make a positive contribution to the UK's public finances. These estimates also show that Wales, Northern Ireland and a number of English regions have higher deficits than Scotland, measured on a per capita basis.

Strict operation of the Barnett formula could lead to slower increases in public spending for Scotland, Wales and Northern Ireland compared with those for England. This has been called the "Barnett squeeze". It is difficult to verify empirically whether this has occurred.

The disparities in public spending per head between the different parts of the UK have led to criticisms that the Barnett formula is unfair and for calls for it to be reviewed. The Government has consistently said that it has no plans for such a review.

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I Introduction

The Barnett formula plays a key role in determining the budgets of the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly. It has been used since the late 1970s. While the introduction of devolution in the late 1990s was a significant constitutional change, it did not change the financial relationship between the Treasury and the devolved administrations. The pre-devolution system, based on the Barnett formula, has remained in place.

Devolution has allowed different policies to be pursued in the different parts of the UK. This has, arguably, highlighted the different levels of public spending in the four nations of the UK. Some have alleged that England "subsidises" higher spending in other parts of the UK. Others have commented on "[oil] revenues flowing from Scottish waters to the … Treasury."[1] There have been a number of calls for the current system to be reviewed with greater attention paid to the relative public spending needs of the different parts of the UK. A further development is the formation of a minority SNP government in Holyrood in 2007. This is the first time different parties have formed the government in Westminster and Edinburgh and provides a new context in which the Barnett formula must operate.

The (Westminster) Government has consistently said that it has no plans to review the Barnett formula. In Scotland, however, the Labour Party, together with the Conservatives and Liberal Democrats, is supporting the formation a Scottish Constitutional Commission to review the devolution settlement, including financial aspects. For the Conservatives, David Cameron has said "the time will come when we have to look at it [the Barnett formula]", but that it should not be treated "as a big grievance."[2] The Liberal Democrats are in favour of replacing the Barnett formula. In Wales, the Labour-Plaid Cymru coalition is setting up a Commission to look at the funding of the National Assembly for Wales.

This paper is structured as follows. Section II discusses the origins and history of the Barnett formula and Section III describes its operation. Section IV provides data on public spending in the countries and regions of the UK and gives estimates of the amount of tax revenue raised. Section V considers some issues relating to the Barnett formula such as the "Barnett squeeze", needs assessment and fiscal autonomy.

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1 Alex Salmond address to Annual SNP Conference, 28 October 2007.

2 "Cameron is determined to fly the flag for Britain", *Daily Telegraph*, 10 December 2007

II The origins of the Barnett formula

Some type of formula for allocating funds between the countries of the Union can be traced back to arrangements introduced in the 1880s by the then Chancellor, George Goschen. In 1888 he decided to use a formula to allocate probate duties in support of local government.[3]

During the 1960s and early 1970s, public expenditure plans for Scotland, Wales and Northern Ireland were settled collectively and by negotiation within the wider public expenditure framework on much the same basis as other public spending programmes.[4]

The Barnett formula was introduced in relation to Scotland in 1978. The origins are not well documented. In 1980, David Heald, now Professor of Financial Management at the University of Sheffield, commented:

> In 1978 there was a return to a formula [for determining public expenditure in Scotland]. It is an indication of the extent of official secrecy that this was never placed on the public record until the Select Committee on Scottish Affairs elicited this information from Mr Younger. The Labour Government did not reveal the existence of this formula despite its relevance to the debate on the financing of devolved assemblies.
>
> […]
>
> All formulae need a name. In the apparent absence of an official one, I now name this the 'Barnett formula', after Joel Barnett MP, the then Chief Secretary of the Treasury with responsibility for public expenditure. Perhaps, some day, this will make Joel Barnett as famous as Lord Goschen![5]

The Select Committee hearing to which David Heald referred took place on 7 July 1980. The relevant exchange would appear to have been that between the Chairman, Donald Dewar, and George Younger (then Scottish Secretary):

> Mr Dewar**:** […] Could I start by asking you a little about how the figure of almost £4 billion to which you have referred in the White Paper is arrived at as the total of expenditure within the Secretary of State's responsibility? The point that I am interested in is whether in fact the changes each year, recently the decreases which the Government have been anticipating, are worked out on a programme basis specifically for Scotland or whether, as has been suggested to me, the position is that the English comparable programmes are the subject of discussion and argument; and when they have been scaled down, or theoretically increased perhaps in other circumstances, but for the present scaled down, whether those decreases are applied on a purely proportional basis automatically to the Scottish programmes?

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3 HM Treasury, evidence to the Treasury Committee, *The Barnett Formula*, 22 December 1997, HC 341 1997-98, Ev12

4 *Ibid*

5 D. Heald, *Territorial Equity and Public Finances: Concepts and confusion*, University of Strathclyde Centre for the Study of Public Policy, Studies in Public Policy No.75, 1980

> Mr Younger: There are two different sorts of expenditure which come under my control: those sorts of expenditure which have comparable forms of expenditure in England: things like education, health, etc are common to north and south of the border: and other sorts of expenditure which are not strictly comparable; they are dealt with differently. What you have just asked refers to the main block of expenditure which concerns the comparable programmes. The way those are adjusted year by year is that they are argued on a general basis within government as comparable programmes as a whole. I take part in those discussions, of course; and we come to a decision; and it is agreed that the Scottish block expenditure as it relates to those programmes is adjusted by a formula, which is 10/85 in the case of programmes which are comparable between Scotland and England only, and 10/90 for programmes which are comparable between Scotland on the one hand and England and Wales on the other. This is, I should stress, purely for the alteration of the programmes and not for the base line from which it starts.[6]

In fact, the formula had previously been alluded to in an answer to a Parliamentary Question in April 1980, which stated:

> The move [the creation of a separate Scottish programme] also gives formal recognition to arrangements under which, where there are comparable English and Welsh programmes, the Secretary of State has discretion in the allocation of expenditure in Scotland within a total determined by reference to these programmes.[7]

It would appear that the formula had originally been intended to be a temporary measure prior to Scottish devolution.[8] However, it has been used continuously, with some modification, ever since. The formula was extended to Wales in 1980.[9]

In his evidence to the Treasury Committee's 1997 inquiry into the Barnett formula, Lord Barnett described the origins of the formula as follows:

> …I am flattered that the Barnett Formula has lasted twenty years. I hope it will last much longer. At the time, I must confess, I did not think it would last a year or even twenty minutes. I was not sure. Can I also make clear, as you also refer to the question of devolution, that the Barnett Formula, either then or now although I know somebody said it at the time, has nothing whatsoever to do with devolution. In my view, any Government would be bound to consider the facts as they now are in relation to income and expenditure between various regions of the UK. What is it? Put simply, the Barnett Formula set percentages of changes in comparable expenditure in Great Britain. That is to say, it would be 85 per cent for England, 10 percent of expenditure for Scotland and 5 percent for Wales. That is exactly what the Barnett Formula is. It was set up for a variety of reasons. First of all, for the need to recognise the spending levels between the various parts of the UK - population sparsity in Scotland, transport needs, needs because of relative ill health, rural needs for education and so on and industrial needs - but

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6 *Scottish Aspects of the 1980-84 PEWP: Minutes of Evidence*, HC 689 1979-80 Q.2

7 HC Deb 14 April 1980 c458W

8 Treasury Committee, HM Treasury, evidence to the Treasury Committee, *The Barnett Formula*, 22 December 1997, HC 341 1997-98, Q.192

9 *Ibid* Q.195

> above all, of course, although I know some distinguished people have suggested it had nothing to do with it, with income per head. I am bound to say they simply did not understand how the whole allocation of public expenditure worked at the time and I can only speak for myself. I do not know what is happening today - I do not know who does but, as far as I am concerned, what happened then was that I first of all had to persuade Cabinet to agree a total level of public expenditure. Having got that agreement, to make life a trifle easier and have to handle only English departments, I then got Cabinet approval for what is now (not then) called a Barnett Formula - the way public expenditure should be allocated and the changes in public expenditure should be allocated between England, Scotland and Wales - and they agreed that. Then I had a much tougher job of persuading departmental ministers to accept their budgets as I had allocated them. It was a bit easier, I could play one off against the other by saying "You cannot have any more because it would mean taking it away from somebody else", and they could not say anything about the allocation to Scotland and Wales because they, in Cabinet, had agreed it. So all those factors were taken into account in deciding what should be the allocation of public expenditure. [10]

Although Lord Barnett placed emphasis on the relative public expenditure needs of England and Scotland, the Barnett formula - as will be seen from the following section – does not directly reflect need beyond population.

[10] *Ibid* Q.1

III Operation of the Barnett formula

The Barnett formula is part of the mechanism which determines changes to the budgets of the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly. It is important to note that the Barnett formula determines *changes* to these budgets rather than the overall total.

A. Planning and control of public spending in the UK

Before explaining how the Barnett formula works, it is helpful to give a brief overview of how public spending in the UK is planned and controlled. Public spending is divided between Departmental Expenditure Limits (DEL) and Annually Managed Expenditure (AME). DELs are firm three year spending limits for government departments. DELs are usually announced for each government department and the devolved administrations in spending reviews. These take place every two or three years. The most recent spending review was in October 2007. AME covers those areas of spending for which firm three year limits are not appropriate. The largest element of AME at the UK level is social security benefits.

The devolved administrations' budgets have both DEL and AME elements. The "assigned budget" falls within DEL and this is the part of the devolved assemblies' budgets to which the Barnett formula is relevant.[11] The assigned budget was previously known as the Scottish, Welsh or Northern Ireland "Block". It is by far the largest part of the devolved administrations' budgets.

Some budget areas are outside the Barnett formula. These include all items in Annually Managed Expenditure such as housing support provision in Scotland and NHS and teachers' pensions in Scotland and Northern Ireland.[12] Furthermore, some public spending in Scotland, Wales and Northern Ireland is the responsibility of the UK government rather than the devolved administrations. For example, social security in Great Britain is the responsibility of the Department for Work and Pensions (DWP). Public spending on social security in Scotland and Wales is, therefore, not the responsibility of the Scottish Parliament or National Assembly for Wales.

B. How the Barnett formula works

There are three elements to the Barnett formula calculation:

- the change in planned spending by UK government departments;
- the comparability percentage; and

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[11] David Heald and Alastair McLeod, "Embeddedness of UK Devolution Finance within the Public Expenditure System", *Regional Studies*, June 2005

[12] Further detail is in HM Treasury, *Funding the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly: Statement of Funding Policy*, October 2007. See Chapters 4, 5, 13, 14 and 15

- the population proportion in each country.

Each of these three factors is considered below.

Spending by UK government departments is now planned in spending reviews which generally take place every two years, although the 2007 Comprehensive Spending Review reported three years after the previous Spending Review in 2004.[13] There may also be changes to spending plans between spending reviews.

The second factor is the comparability percentage. In effect, this captures the extent to which spending by a UK government department is comparable with the equivalent services carried out by the devolved administration. For example, nearly all of the Department of Health's spending is in England. Health is an area which is devolved. Health therefore has a comparability factor of nearly 100%. By contrast, the Chancellor's Departments, whose functions are mainly reserved, have comparability percentages close to zero. The comparability percentages used in the 2007 Comprehensive Spending Review are published in Annex C of the Treasury's Statement of Funding Policy.

The third factor is the population percentage. The latest available mid-year population estimates published by the ONS are used. In the 2007 Comprehensive Spending Review, mid-year 2007 estimates were used. The population proportions used depend on the coverage of the UK government department concerned. In most cases, this is England only, so the proportion of the English population is used.[14] Scotland, Wales and Northern Ireland's populations as a proportion of England's population were 10.08%, 5.84% and 3.43% respectively.[15] The latest available mid-year estimates are used for in-year spending changes.[16]

The Barnett formula works by multiplying these three factors together. For example, if the change to health spending in England was £100 million, the increase for Wales would be:

> £100m x 99.3% [health comparability percentage for Wales] x 5.84% [Wales population percentage] = £5.8 m.

This £5.8 million (and figures calculated in an analogous way) is sometimes referred to as "Barnett consequentials."

This calculation is carried out for each department and the sum of these results is the net increase in the devolved administration's budget. The devolved administrations have discretion over how to spend the funds that are allocated to them under the Barnett

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13 When the Spending Review is announced, the Treasury usually publishes an updated version of its guide to the Barnett formula. The 2007 version is HM Treasury, *Funding the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly: A Statement of Funding Policy*

14 There are, however, some exceptions to this such as the Home Office and legal departments which cover England and Wales in which case the population as a proportion of England and Wales is used.

15 HM Treasury, *Funding the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly: A Statement of Funding Policy*, pp10-11

16 *Ibid*

formula. There is no requirement that they spend the Barnett consequentials from increased education spending in England on education.

The Scottish Parliament may also vary the basic rate of income tax by up to three percentage points either upwards or downwards (the "tartan tax"). These powers have not been used so far. If the rate of tax were increased, the Scottish Consolidated Fund (SCF) would receive an amount equal to the estimated yield of any increase in income tax. Conversely, the SCF would pay HM Revenue and Customs any shortfall from a cut income tax.[17] [18] This means that the Scottish Budget would fully reflect, upwards or downwards, any use of the tax-varying power.

There are some special arrangements in place relating to Northern Ireland. Changes to Northern Ireland's budget determined by the Barnett formula are abated (reduced) by 2.5%. This is because, under Section 99 of the Value Added Tax Act 1994, the Northern Ireland Executive does not require provision to meet VAT expenditure as any VAT paid is refunded by Customs and Excise.[19] The Treasury's Statement of Funding Policy also describes some features of the regime which are specific to Northern Ireland:

> Provision for law, order and protective services and the Northern Ireland Courts Service is not included in the public expenditure budget for the Northern Ireland Executive but are determined separately through direct negotiations between the Treasury, the Secretary of State for Northern Ireland and Lord Chancellor as appropriate. As areas of responsibility are transferred to the Northern Ireland Executive, their provision will also transfer into the Northern Ireland Assigned Budget.
>
> The United Kingdom Government may adjust provision to Northern Ireland to take account of revenue receipts from taxes and from fines and charges which are analogous to taxes (with the exception of local authority fines and charges) flowing into the Northern Ireland Consolidated Fund. This will not apply to revenue from the Regional Rate which will be available to finance spending in Northern Ireland.[20]

Although the Barnett formula represents the normal procedure, changes to the "block" can be made outside it. This is sometimes referred to as "formula bypass". Some have argued that there is now less scope for formula bypass than in previous years.[21]

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[17] HM Treasury, *Funding the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly: A Statement of Funding Policy* para 13.1

[18] The Treasury estimate that a one penny change in the Scottish variable rate in 2007/08 could be worth approximately £300 million. After the changes announced in the 2007 Budget, a one penny change in 2008/9 could be worth approximately £370 million. These figures do not take account of any behavioural changes following any use of the "tartan tax". Source: HM Treasury, *Budget 2007,* para A.8

[19] HM Treasury, *Funding the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly: A Statement of Funding Policy* para 4.15

[20] *Ibid,* paras 15.1 and 15.2

[21] David Heald and Alastair McLeod, "Embeddedness of UK Devolution Finance within the Public Expenditure System", *Regional Studies*, June 2005

The devolved administrations' budgets are funded largely, but not exclusively, by a grant from the UK Parliament. This grant is paid to the relevant Secretary of State who, in turn, makes a grant to the devolved administration.

IV Data on public spending and taxation by country and region of the UK

A. Public spending

Data showing public expenditure by country and region are published annually in the Treasury's *Public Expenditure Statistical Analyses (PESA)*.[22] The 2007 edition of PESA explains the system for planning and controlling public expenditure:

> Most public spending is planned to benefit categories of individuals and enterprises irrespective of location, or where locations are prioritised using national criteria. The regional analyses presented in this chapter show where the individuals and enterprises that benefited from public spending were located. It does not mean that all such spending was planned to benefit a particular region, though a proportion of public spending is planned on a regional basis.[23]
>
> […]
>
> Public expenditure is planned and controlled on a departmental basis, except where devolved responsibility lies with the Scottish Parliament, National Assembly for Wales and the Northern Ireland Assembly, or with local authorities. Departmental expenditure management means that in several areas expenditure is planned on a UK-wide or GB-wide basis rather than by reference to a single country. For example, the Department for Work and Pensions is responsible for the operation of the social security benefit system throughout Great Britain.[24]

In the PESA data presented here, expenditure is allocated on the basis of the region that benefited from the expenditure or for whom the expenditure was intended. This is referred to as "identifiable expenditure". This covers around 83% of total public expenditure. "Non-identifiable expenditure" is that which cannot be allocated in this way and includes defence, overseas representation and tax collection. The data cover expenditure by central government, local government and public corporations.

The data include expenditure by the devolved administrations but also cover other areas of expenditure. For example, the DWP is responsible for social security expenditure throughout Great Britain. Hence, DWP expenditure on social security in Scotland is included in the tables below, for example.

Table 1 below shows public expenditure per head for each country and region (data for a number of years are in Appendix 1). The table shows that public expenditure per head in Northern Ireland is 27% higher than the UK average, in Scotland it is 17% higher and in Wales 11% higher. Of the English regions, public expenditure per head is higher than the UK average in London, the North West and the North East. In all the other English

[22] HM Treasury, Public Expenditure Statistical Analyses 2007, April 2007, Cm 7091. Since 2004, PESA has contained improved data on public spending by country and region following the McLean Report, *Identifying the Flow of Domestic and European Expenditure into the English Regions.* September 2003.

[23] *Ibid*, para 9.1

[24] *Ibid*, para 9.5

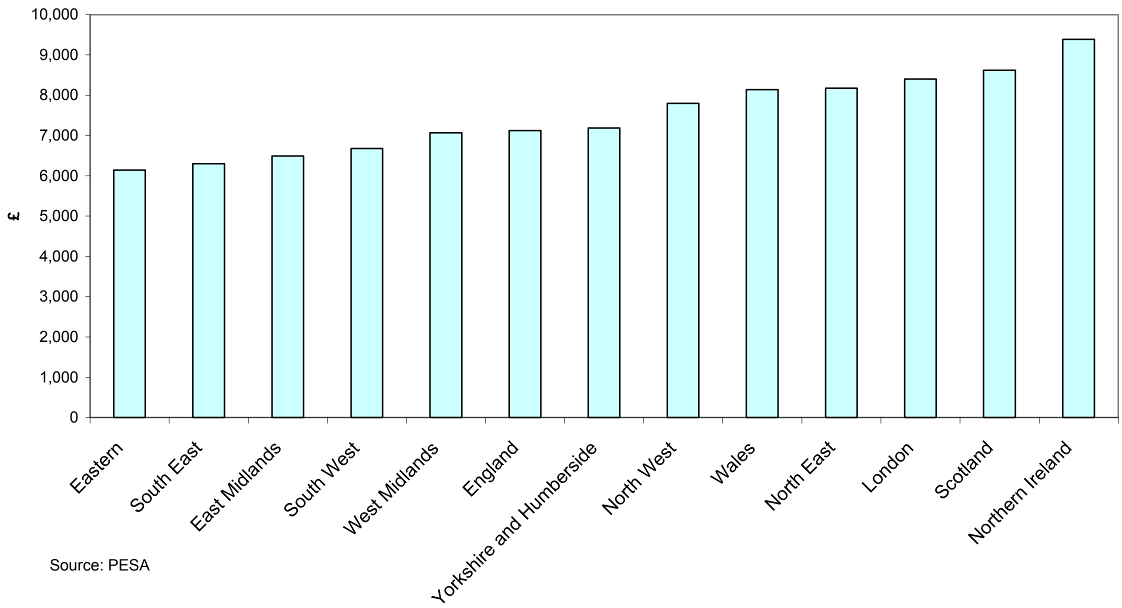
regions, it is lower than the UK average. The South East and Eastern regions have the lowest public expenditure per head.[25]

Table 1
Identifiable public expenditure per head, 2006/07

	£	Index, UK =100
North East	8,177	111
North West	7,798	106
Yorkshire and Humberside	7,188	98
East Midlands	6,491	88
West Midlands	7,065	96
Eastern	6,144	83
London	8,404	114
South East	6,304	86
South West	6,677	91
England	7,121	97
Scotland	8,623	117
Wales	8,139	111
Northern Ireland	9,385	127
UK identifiable expenditure	7,362	100

Source: HM Treasury, PESA 2007, Table 9.2
Notes: data are on an accruals basis; 2006-07 figures are for planned expenditure

Chart 1: Identifiable public expenditure per head 2006/07



Source: PESA

25 See also Library Standard Note, *Public expenditure by country and region*, (SN/EP/4033)

In interpreting the data, it is necessary to bear two points in mind. First, the scope of the public sector varies between countries. For example, water supply is in the public sector in Scotland and Northern Ireland but in the private sector in England and Wales. Second, the figures are intended to give a broad overview and cannot be regarded as a precise measure. This is because it is not always easy to decide who benefits from particular expenditure and simplifying assumptions are made in deriving the data. Small differences in expenditure between regions should not, therefore, be regarded as significant.

It is important to emphasise that the data shown in the tables above do not correspond directly to those areas of public spending which are financed via the Barnett formula. For example, social security spending, which is the responsibility of DWP in Great Britain, is included in these figures. Some authors have suggested that social security and agriculture spending should be excluded to give a better picture of spending covered by the devolved administrations. Using PESA data for 2006/07 shows that Scotland's per capita spending advantage is 21% using this approach compared with 17% on the unadjusted figures. The figures for relative public spending per head in England, Wales and Northern Ireland are similar whether this adjustment is made or not.

These differences in the level of public spending are not new. For example, in 1987/88, spending per head in Scotland was 22% higher than the UK average and in Wales it was 9% higher. In Northern Ireland it was 46% higher than the UK average and spending in England was 4% lower than the UK average.

It is also worth noting that there is considerable variation in spending between the English regions. The latest figures show public spending per head in London is 14% higher than the UK average while in the Eastern region it is 17% lower. The Barnett formula plays no role in allocating spending between different parts of England. These English regional differences are, therefore, entirely unrelated to the Barnett formula.

There is also considerable variation in public spending broken down by category. Per capita spending on health in Scotland is 14% higher than the UK average but spending on public order and safety is 11% lower. In Wales, spending on public order is 5% higher than the UK average but spending on housing is 13% lower (see tables in Appendix 1).

There are other estimates of public spending by region. For example, the Scottish Executive estimates public spending in Scotland including an estimate of non-identifiable expenditure which can be allocated to Scotland.[26] For 2004/05, this adjustment makes little difference to Scotland's share of UK public spending: taking identifiable spending only, Scotland accounts for 9.8% of the UK total whereas the Scottish Executive's estimate, which includes non-identifiable expenditure, is 9.7%.[27] These figures compare with Scotland's share of the UK population which was 8.5% in 2004. Scotland's public

[26] The non-identifiable spending is allocated to Scotland primarily on a population basis. An adjustment is also made to take account of accounting adjustments. See Scottish Executive, *Government Expenditure and Revenue in Scotland 2004-05* pp14-20 for details.

[27] Scottish Executive, *Government Expenditure and Revenue in Scotland 2004-05* p20

spending per head is thus still above the UK average on the basis of the Scottish Executive's estimates.

Oxford Economics have produced a range of estimates of public spending per head by making some adjustments to PESA data.[28] These figures include non-identifiable spending and are therefore higher than the PESA figures. They are shown in the table below. They give generally similar rankings to those in PESA: public spending per head was highest in Northern Ireland, London and Scotland and lowest in the East Midlands and Eastern regions. On the Oxford Economics figures, public spending per head in London is slightly higher than in Scotland.

Table 2
Public spending per head, 2005/06, £ (a)

North East	9,100	112
North West	8,550	105
Yorkshire & The Humber	8,150	100
East Midlands	7,400	91
West Midlands	7,850	96
Eastern	7,250	89
Greater London	9,850	121
South East	7,700	95
South West	8,700	107
Wales	8,950	110
Scotland	9,700	119
Northern Ireland	10,350	127
United Kingdom (b)	8,137	100

Sources: PESA 2007 and Oxford Economics calculations
Note: (a) mid point of Oxford Economics minimum and maximum estimates
(b) UK includes expenditure outside UK

B. Revenue and fiscal balances

In contrast to expenditure, there is relatively little information on the amount of tax revenue raised in England, Scotland, Wales, Northern Ireland and the English regions. For a number of years, the Scottish Executive has produced estimates of tax revenue raised in Scotland (see below). There are no such regular official estimates for other parts of the UK. Allocating public sector revenues to the different parts of the UK is not straightforward. Most tax revenue is collected centrally and regional breakdowns are not published. Some unofficial estimates have been made such as those produced by Oxford Economics (see below). Another issue is revenues from the North Sea. These revenues currently go to the UK Treasury but some in Scotland have argued that they should be devolved.

[28] Oxford Economics, London's place in the UK economy, 2007-08, [A report for the City of London], October 2007

For a number of years, the Scottish Executive has published estimates of public spending and revenue in Scotland in successive editions of *Government Expenditure and Revenue in Scotland* (GERS).[29] The table below shows that government revenue in Scotland in 2004/05 is estimated to be £36.4 billion, excluding North Sea revenues. This is equivalent to 8.1% of UK non-oil revenues.[30] This is very similar to Scotland's share of UK (non-oil) output in 2005.[31] Scotland's share of UK revenues has remained constant at around 8% over the last few years.

Table 3
Estimated public sector revenue, Scotland

	2000/01	2001/02	2002/03	2003/04	2004/05
£ billion	30.4	31.2	31.6	34.0	36.4
% of UK	8.0%	8.1%	8.1%	8.1%	8.1%

Source: Scottish Executive, GERS 2004-05, Table 6.8
Note: excludes North Sea revenues

These figures exclude revenues from the North Sea which are paid to the UK government. These revenues are significant: in 2005/06 they were £9.6 billion. The 2007 Pre-Budget Report forecast revenues of £7.5 billion in 2007/08 and £9.0 billion in 2008/09.[32] North Sea revenues are volatile, however. In 2003/04, they were £4.3 billion.

The SNP has argued that Scotland should receive most of the North Sea oil and gas revenues which currently go to the Treasury.[33] Press reports in September 2007 indicated that control of oil revenues could be an area which brings the Scottish Executive into conflict with the UK Government.[34] GERS contains an analysis of Scotland's fiscal position making various assumptions about the proportion of North Sea revenues allocated to Scotland.

29 In recent years, GERS has been published in December each year. The Scottish Executive announced on 16 November 2007 that the next edition will be published in June 2008 covering 2005/06 and 2006/07. This follows a review of GERS.
30 Scottish Executive, *Government Expenditure and Revenue in Scotland 2004-05* p22
31 National Statistics First Release, *Regional, sub-regional and local gross value added*, 14 December 2007
32 HM Treasury, *2007 Pre-Budget Report and Comprehensive Spending Review*, October 2007, Cm 7227, Table B8
33 SNP, *Let Scotland Flourish*. See also "Union blues", *Financial Times*, 30 April 2007
34 "Minister to spurn SNP call to secure oil powers", *Financial Times*, 4 September 2007

Table 4
Scotland's fiscal position, 2004/05, £ billion

	Allocation of North Sea revenues					
	wholly excluded	66% included	75% included	90% included	100% included	allocated by GDP share
Aggregate expenditure (a)	47.7	47.7	47.7	47.7	47.7	47.7
Aggregate receipts	36.4	39.9	40.3	41.1	41.6	36.9
Net borrowing	11.2	7.8	7.3	6.5	6.0	10.8
Net borrowing as % of GDP (b)	12.0%	6.8%	6.3%	5.4%	4.8%	11.3%

Source: Scottish Executive, GERS 2004-05, Table 5.2
Note: (a) the GERS estimate of public spending in Scotland is higher than the PESA estimate as it includes an estimate of Scotland's share of non-identifiable spending
(b) Scottish GDP including relevant proportion of oil output

On the basis of this analysis, revenue in Scotland would have been £5.2 billion higher in 2004/05 if Scotland had received all North Sea revenues. On the GERS figures, however, even if Scotland did receive all North Sea revenues, it would still run a deficit of £6 billion, equivalent to nearly 5% of Scottish GDP.[35] If Scotland is assumed to receive no North Sea revenues, these estimates suggest its deficit would have been £11.2 billion in 2004/05 or 12% of Scottish GDP. It should be pointed out that the SNP do not agree with the GERS analysis. According to an article in the *Guardian*, "nationalists dispute the GERS figures, but few fiscal experts do."[36] The SNP have argued that Scotland runs a budget surplus. This analysis allocates 95% of North Sea revenues to Scotland.[37]

Oxford Economics have produced estimates of the balance between public spending and taxation in each country and region of the UK.[38] North Sea revenues are allocated to Scotland.[39] They draw a distinction between residence-based and workplace-based revenue figures. The former looks at taxes paid by people living in a region while the latter consider taxes paid where people work. The figures will differ to the extent that there is net commuting between regions. Looking at figures by residence, revenue per head in Wales is £6,000, around 25% less than the UK average. In Scotland and Northern Ireland the figures are £9,600 and £6,100 respectively (19% above and 24% below the UK average).

35 In 2004-05, the UK budget deficit was 3.3% of GDP
36 "Where there's oil …" *Guardian,* 8 February 2007
37 SNP, *Scotland in Surplus – Past, Present and Future*, December 2006
38 Oxford Economics, London's place in the UK economy, 2007-08, [A report for the City of London], October 2007
39 Oxford Economics note that "this does not necessarily represent the fiscal position for Scotland that could be expected in the event of greater independence from the rest of the UK." (p94)

Table 5
Oxford Economics estimates of tax revenue: 2005/06

	Residence-based		Workplace-based	
	Total £ billion	Per capita (£) (a)	Total £ billion	Per capita (£) (a)
North East	15.4	6,000	15.5	6,100
North West	47.5	6,900	48.1	7,000
Yorkshire & The Humber	33.3	6,500	33.5	6,600
East Midlands	31.1	7,200	29.8	6,900
West Midlands	37.6	7,000	37.3	7,000
Eastern	45.5	8,200	43.6	7,800
Greater London	83.1	11,100	90.1	12,100
South East	77.1	9,400	74.0	9,000
South West	37.7	7,400	37.7	7,400
Wales	17.8	6,000	17.6	6,000
Scotland	49.0	9,600	48.3	9,500
Northern Ireland	10.5	6,100	10.8	6,300
United Kingdom	485.7	8,100	485.7	8,100

Sources: Oxford Economics and House of Commons Library calculations
Note: (a) rounded to nearest 100

Oxford Economics have also estimated each country and region's contribution to the UK public finances by subtracting their estimates of spending in each region from their estimates of revenue. Oxford Economics produce a range of estimates. In the table and chart below, the mid-point is used and converted into a per capita basis. The figures show that Northern Ireland, the North East and Wales have the largest deficits. London, the South East and the Eastern region made positive net contributions to the UK's public finances. Scotland has a small deficit. This is in contrast to the GERS figures above which show a larger deficit for Scotland. The Oxford Economics figures are for 2005/06 when North Sea revenues were higher than 2004/05 which is the year of the latest GERS estimates.[40]

The table also shows gross value added (GVA) per head for each country and region of the UK.[41] This is a measure of economic output. The three regions which have surpluses are the regions with the highest GVA per head.

40 Other estimates of fiscal balances have been made. For example, on 13 November 2007, Channel 4 news reported research showing that London, the South East and the East of England all had significant surpluses in 2004/05. The East Midlands and West Midlands and the South West also had surpluses. All other areas were in deficit.

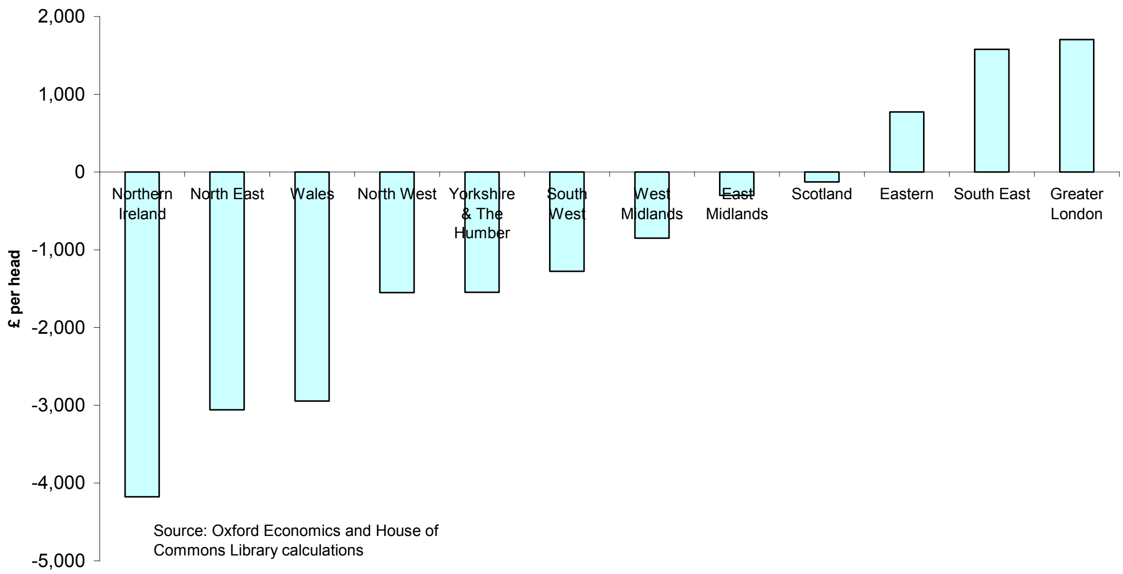
41 Figures are on a residence basis

Table 6
Regional contribution to UK public finances, 2005/06

	Per head, £ (a)	Gross Value Added per head £, 2006 (b)
North East	-3,100	15,200
North West	-1,500	16,200
Yorkshire & The Humber	-1,500	16,000
East Midlands	-300	17,000
West Midlands	-900	16,600
Eastern	800	19,600
Greater London	1,700	26,200
South East	1,600	21,500
South West	-1,300	17,500
Wales	-2,900	14,400
Scotland	-100	17,800
Northern Ireland	-4,200	15,200
United Kingdom	-600	18,600

Sources: Oxford Economics, ONS and House of Commons Library calculations
Note: (a) mid-point of Oxford Economics minimum and maximum estimate, rounded to nearest 100.
(b) Residence basis, rounded to nearest 100 UK figures excludes North Sea income

Chart 2: Regional contribution to public finances



These estimates need to be treated with caution given the simplifying assumptions which underlie them. Nevertheless, they suggest that the argument that the English taxpayer is subsidising public spending elsewhere in the UK may mask a more complex picture. There are considerable variations in public spending and revenue between the English regions.[42] Oxford Economics suggest that most English regions are in deficit with only London, the South East and the East making a positive net contribution.

[42] It is probable that there are also considerable variations in public spending and revenue *within* regions.

V Barnett formula issues

A. The "Barnett squeeze"

The "Barnett squeeze" refers to the fact that the Barnett formula, under certain assumptions, would over time lead to a convergence of public spending per head in the four nations of the UK.[43] In its 1997 report on the Barnett formula, the Treasury Committee said:

> The Treasury agreed that one of the properties of the formula, "all other things being equal", was that it would produce convergence in levels of funding per head. "It will depend on the rate of growth of comparable spending in England.... It also depends on relative stability of the population relativities within the UK. For example, if Scotland's population declines relatively that will tend to offset the convergent effect of the Barnett Formula."[44]

The following example illustrates this feature of the Barnett formula. This uses Scotland for illustrative purposes but exactly the same argument applies to Wales and Northern Ireland. It assumes public spending in England increases by 5% a year. It also assumes that Scotland's population is 10% of England's and that this proportion remains constant over time. Scotland is assumed to have 25% higher public spending per head than England in year 1.

Table 7
The "Barnett squeeze": Constant population model

		Public spending £m	Public spending per head, £	% increase in public spending per head	Scotland spending per head as % of England
Year 1	Scotland	125.00	31.25		125%
	England	1,000.00	25.00		
Year 2	Scotland	130.00	32.50	4.0%	124%
	England	1,050.00	26.25	5.0%	
Year 3	Scotland	135.25	33.81	4.0%	123%
	England	1,102.50	27.56	5.0%	
Year 4	Scotland	140.76	35.19	4.1%	122%
	England	1,157.63	28.94	5.0%	
Year 5	Scotland	146.55	36.64	4.1%	121%
	England	1,215.51	30.39	5.0%	

The table shows that under these assumptions, Scotland's public spending per head falls from being 25% higher than England's in year 1 to only 21% higher by year 5. The reason for this is as follows. If the Barnett formula is followed strictly, the increase in public spending per head is the same in all countries of the UK. Over time, as each country receives the same increase, the advantage that Scotland, Wales and Northern Ireland enjoy should be progressively eroded. Put another way, the percentage increase

[43] See David Bell, *The Barnett Formula*, Department of Economics, University of Stirling, January 2001
[44] Treasury Committee, *The Barnett Formula*, 22 December 1997, HC 341 1997-98, para 6

in spending per head in Scotland, Wales and Northern Ireland is lower than in England as the base from which they start is higher. As the table above shows, per capita spending in Scotland grows at around 4% a year compared to 5% in England.

It is hard to verify empirically the extent to which the Barnett squeeze is happening in practice. This in part reflects the lack of comparable data on Barnett-funded services in the devolved administrations on the one hand and equivalent English data on the other (see section IV.A above). One possible reason why the Barnett squeeze might not have occurred is formula by-pass. The model above assumes that the formula is applied strictly. However, if payments are made outside the Barnett formula, convergence in spending levels may be slowed.

A second reason relates to population levels.[45] The example above assumed these were constant but if Scotland's population were to fall the convergence result does not necessarily hold. Until 1992, the 1976 population estimates were used for the Barnett formula, even though Scotland's population was falling relative to England's (see Appendix 2) . This would have worked against the convergence property of the Barnett formula. In addition, even with up-to-date population figures being used, if a country's population is falling in absolute terms, this will push up its spending per head. This is because although the increase in spending determined by the Barnett formula will reflect the current population, the inherited spending base will now be divided among a lower population. The example below illustrates the effect of a declining population. It is based on the same assumptions as the previous example, except that Scotland's population is assumed to decline by 1% a year.

Table 8
The "Barnett squeeze": Declining population model

		Public spending £m	Public spending per head, £	% increase in public spending per head	Scotland spending per head as % of England
Year 1	Scotland	125.00	31.25		125%
	England	1,000.00	25.00		
Year 2	Scotland	130.00	32.83	5.1%	125%
	England	1,050.00	26.25	5.0%	
Year 3	Scotland	135.20	34.49	5.0%	125%
	England	1,102.50	27.56	5.0%	
Year 4	Scotland	140.60	36.23	5.0%	125%
	England	1,157.63	28.94	5.0%	
Year 5	Scotland	146.22	38.05	5.0%	125%
	England	1,215.51	30.39	5.0%	

In this example, Scotland's public spending per head remains 25% above the level for England throughout the whole period. There is no "squeeze" on Scottish spending.

45 There is a discussion of the effect of different assumptions about relative population growth and the growth of public spending in England on the Barnett squeeze in "The effect of relative population growth on the Barnett squeeze", *Fraser of Allender Quarterly Economic Commentary*, May 2001, Vol 26 No. 2 pp34-7

B. Equity and needs assessment

Section IV.A above showed that public spending per head differs considerably between England, Scotland, Wales and Northern Ireland and between the English regions. This has led some to criticise the Barnett formula for its lack of equity. This is especially the case since devolution as the devolved administrations have been able to pursue different policies from the UK government. There is a perception that they have been able to afford better public services as a result of a "subsidy" from England. For example, in Scotland, there is a government commitment for prescription charges for the chronically ill to be abolished and a Bill has been introduced into the Scottish Parliament to scrap the "graduate endowment" fee for higher education. The SNP Spending Review proposes a freeze in council tax in the first year of the spending review period (2008-09). The council tax proposal was described by the *Daily Telegraph* as "a move that will effectively be subsidised by English taxpayers."[46] This view has been countered in the Scottish press which has attacked various "myths" surrounding the Barnett formula. For example, an article in *The Herald* argued that London has higher public spending per head than Scotland, that Scotland's public spending and tax are broadly in balance, unlike some regions in England, and pointed to large projects in London such as the Olympics and the Millennium Dome.[47]

Lord Barnett himself has called for a review of the formula and has described the difference in per capita spending between Scotland and England as unacceptable:

> My noble friend will be aware that recently I quoted the latest Treasury figures, which showed that expenditure per head is £1,500 less in England than in Scotland. Clearly, that is unacceptable. However, as both major parties are opposed to change, I am asking only for support for a review, which I am sure she will accept. Is she aware that she has a unique opportunity—indeed, the House of Lords has a unique opportunity—to review this whole question by agreeing to set up an ad hoc Select Committee, especially as the Government, following yesterday's important announcement, now agree to a great deal more parliamentary democracy? Now that she is a member of the Liaison Committee, will she give me an assurance that she will not oppose but support my request? She will note that I put my Question not to the Government, but to her personally, although I did not know at the time that she would be a member of the committee.[48]

English MPs have expressed their dissatisfaction with the current distribution of spending. For example:

> Mr. Bone: Public expenditure in Scotland is £8,414 per head, yet in the east midlands it is a quarter less at £6,334. In Wellingborough, a secondary school has been demolished, there have been cuts in the police force and we do not have a local hospital. Why should the population of Wellingborough and the rest of the east midlands subsidise the population of Scotland by the massive amount

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46 "Scotland freezes council tax – with English subsidy", *Daily Telegraph*, 15 November 2007
47 "Why the figures being peddled by Scotland's critics just don't add up", *The Herald*, 2 November 2007
48 HL Deb 4 July 2007 c1017

> of £2,080 a year? What is the justification for that huge difference in public expenditure?
>
> David Cairns: In every constituency, in every part of every region and nation of this country, there has been a massive increase in public services: more schools, more doctors, more nurses. As it happens, investment in public spending in Scotland has increased in the past five years by 18 per cent., but in England it increased by 21 per cent., so there are higher rates of increase in England. As the hon. Gentleman has brought it up, I should point out that in his area there are 420 more teachers than in 1998, 163 more police officers and 62 police community support officers. In his NHS area, there are 6,886 more nurses, 725 more consultants, 353 more GPs and 548 more dentists—all on account of strong economic management by the Government—[49]

These concerns were raised in a Westminster Hall debate on the Barnett formula on 21 November 2007. For example, Hugh Bayley MP said:

> [The Union] is challenged indirectly by a groundswell of English resentment, because we in England pay the same taxes as those in others part of the United Kingdom but get a smaller share of public expenditure per person. As a consequence we in England pay for some public services—residential care, prescriptions, university student fees—that cost less or are free in others parts of the United Kingdom.[50]

He argued:

> We should use the same criteria to assess need and the same basis for apportioning public expenditure in all parts of the United Kingdom; if we do not, we will undermine the basis of the Union. I therefore support the proposal by my hon. Friend the Member for Manchester, Blackley that there should be a transparent needs-based review of the Barnett formula.[51]

Adam Price MP said:

> The Barnett formula is anomalous; it is an anachronism; it is unfair; and it lacks transparency. That is the case across these islands, including for the English regions, such as the south-west, that suffer from it. It is not fit for the era of democratic devolution. We are being treated as branch offices of Whitehall. What of the language that is used—"consequentials"? Decisions are made about English expenditure, which then bind our democratic institutions in Wales and Scotland. That is no way to reflect the era of democratic devolution. We need real accountability. We need a needs-based formula and, yes, we need elements of fiscal federalism as well.[52]

A number of arguments have been put forward as to why Scotland, Wales and Northern Ireland need higher levels of public spending per head. For example, the population is more sparsely distributed in these countries and this makes provision of a standard level

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49 HC Deb 12 June 2007 c636
50 HC Deb 21 November 2007 c154WH
51 HC Deb 21 November 2007 c156WH
52 HC Deb 21 November 2007 c158WH

of service more expensive. In the past, commentators have also referred to higher morbidity rates and poverty in Scotland.[53] On the other hand, others point out that Scotland's per capita income is greater than a number of English regions which receive less public money.

These criticisms of the current arrangements have led some to call for an updated needs assessment. The last such official assessment of needs was conducted in the late 1970s when legislation for devolution was first being considered. An inter-departmental study (co-ordinated by the Treasury) tried to assess the extent to which per capita expenditure in Scotland, Wales and Northern Ireland would need to be higher than in England in order to provide a comparable level of services.[54] That exercise - which was based on data for 1976/77 - looked at the six main services which were to have been devolved under the Scotland Act 1978 and the Wales Act 1978. The exercise used a range of 'objective factors' including the age distribution of the population, road lengths, recorded crimes and numbers of sub-standard dwellings to determine need.

The overall results (albeit heavily qualified by considerations about the methodology) were that per capita spending in Scotland would need to be some 16% higher than in England, spending in Wales 9% higher and spending in Northern Ireland 31% higher in order to provide comparable service levels. The actual per capita expenditure levels on these services in 1976/77 were: Scotland some 22% higher than England, in Wales around 6% higher and in Northern Ireland some 35% higher. While the report itself made no explicit comparison of assessed needs and actual spending, the two would appear – given the methodological concerns – to have been broadly in line. It is important to remember that the needs assessment was limited to expenditure on services that were to have been devolved. Spending on national programmes such as social security – which are usually included in comparisons of spending levels - were not considered. Also the definition of public expenditure itself has evolved considerably since the late 1970s and applying the conclusions to the current situation is problematic.[55]

A number of Parliamentary committees have called for an updated needs assessment. For example, in its 2002 report on devolution, the House of Lords Constitution Committee said that "there are serious difficulties presented by the long-term continuation of the Barnett formula".[56] The Committee said that while it did not have any ready-made replacement, it envisaged that any alternative would incorporate "an assessment of the needs of the devolved administrations and the different regions of

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53 Professor Arthur Midwinter, *The Barnett Formula and Scotland's Public Expenditure Needs*, in Treasury Committee, *The Barnett Formula,* December 1997, HC 341 1997-98, Appendix 1 to the Minutes of Evidence, Ev 30

54 HM Treasury, *Needs Assessment Study – Report*, 1979

55 In November 2007, Channel 4 news reported research comparing regional spending with need. This analysis argued that London receives more public money than it needs. Scotland also receives more that its need would indicate, although by a much smaller margin than London. England as a whole, Northern Ireland and the South East were broadly in balance but the other English regions and Wales received less than their needs would indicate.

56 House of Lords Select Committee on the Constitution, *Devolution: Inter-Institutional Relations in the United Kingdom*, 16 January 2003, HL 28 2002-03, para 103

England".[57] The Committee noted that such an assessment would not be easy and recommended that it be carried out by an independent and impartial body.[58]

In its 1997 report on the Barnett formula, the Treasury Committee agreed with Treasury officials that "…all governments would subscribe to the fact that spending should broadly reflect needs."[59] The report concluded that the needs assessment should be brought up to date:

> The Committee was disappointed that no Government studies have been made in relation to the appropriateness of the Barnett formula and how it relates to needs. The Committee only took evidence relating to the formula. We believe, however, that it is time to bring the needs assessment up to date; this would help to show whether the Barnett formula remains the appropriate method of allocating annual expenditure increases (or savings) to the four nations of the Union. There may be good reasons why this formula should continue to be used in the future as it has for the last 20 years, but it is an argument that cannot finally be settled until it is clear that total expenditure, not just the increase, is still being allocated according to relative need. It is important there should be maximum possible agreement on this in all parts of the UK.[60]

A review of the Barnett formula has been announced in Wales.[61] Jane Hutt, the Minister for Budget and Business Management in the Welsh Assembly Government, said on 20 June 2007:

> The Government has reflected on the call to set up an independent commission to investigate issues relating to our funding and financial powers. As the new Minister for Budget and Business Management, I am pleased to say that we have concluded that the time has now come to put in place such an independent commission. The commission that we intend to appoint will review not only Assembly funding and finance, including an important study of the Barnett formula, but, going further than that, it will also consider tax-varying powers, including corporation tax. Of course, it will have to take account of the recent European Court of Justice rulings in this area, but it will also look at the important issue of borrowing powers …[62]

On 6 November 2007, the First Minister said that "work to establish the Commission is in its early stages."[63]

There are problems associated with a needs assessment.[64] It is very difficult for needs assessments to be precise. The Treasury's 1979 assessment contained many caveats. It is far from easy to measure needs objectively and weighting together a number of

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57 *Ibid*, para 105
58 *Ibid*, para 107
59 Treasury Committee, *The Barnett Formula*, 22 December 1997, HC 341 1997-98, para 11
60 *Ibid,* para 12
61 "Assembly considers if it's time to bury the Barnett formula", *The Western Mail*, 26 July 2007
62 National Assembly for Wales, The Record of Proceedings, 20 June 2007, p106
63 National Assembly for Wales, The Record of Proceedings, 6 November 2007, p35
64 These arguments are based on Arthur Midwinter, "The Barnett Formula and its critics revisited: Evidence from the post-devolution period", *Scottish Affairs,* No. 55, Spring 2006, pp64-86

different measures is inevitably subjective. As a result, Professor Arthur Midwinter has argued that a needs assessment can only offer “broad orders of magnitude rather than exact measures” thereby greatly reducing their attractiveness.[65] As a result, it is argued, the question of relative need cannot be settled by a technical assessment: there will always be a need for political judgement. Midwinter has also argued that moving to a needs assessment would not solve the alleged problem of unfairness. It would simply switch the debate away from the “unfairness” of the Barnett formula to the unfairness of the needs formula.

The Government has consistently said that it has no plans to review the Barnett formula:

> Mr. Paul Murphy: To ask the Chancellor of the Exchequer whether he plans to review the Barnett formula for allocating the block grant for Wales. [150229]
>
> Andy Burnham: The Government have no plans to review the Barnett formula.[66]

C. Fiscal autonomy

There has been some debate about whether greater “fiscal autonomy” for the devolved administrations would be desirable. Under fiscal autonomy, they would have greater responsibility for raising revenue. This is very limited at present. For example, only about 15% of the Scottish Parliament’s spending is financed by taxes it controls.[67] This proportion would be higher if the Parliament exercised its tax-varying powers. Fiscal autonomy for Scotland has received considerable attention. In Wales, the independent commission which will examine the Assembly’s funding and finance will consider tax-varying powers.

There does not seem to be a single, widely accepted definition, of fiscal autonomy. At one extreme, it can mean complete fiscal separation. Under such an arrangement, Scotland, for example, would be responsible for its own public spending and taxation decisions and there would be no fiscal transfers between the UK Government and Scotland, except perhaps for a payment from Scotland to the UK Government to cover UK-wide services such as defence. The term is sometimes used to describe a situation where the devolved administrations would have greater responsibility for raising their own revenue, while stopping short of complete fiscal separation from the rest of the UK. For example, a Liberal Democrat Commission under the chairmanship of Lord Steel of Aikwood said:

> We recognise that, in its academic sense, fiscal autonomy is essentially a sliding scale ranging from full fiscal autonomy to the current position of limited autonomy through limited tax varying powers.[68]

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65 *Ibid*
66 HC Deb 18 July 2007 c443W
67 David Heald and Alasdair McLeod, *Fiscal Autonomy under Devolution: Introduction to Symposium*, Scottish Affairs, No. 41 Autumn 2002
68 *The Steel Commission: Moving to Federalism – A New Settlement for Scotland*, March 2006, p91

A number of arguments have been made in favour of greater fiscal autonomy.[69] Lord Steel has argued that "no self-respecting parliament could exist permanently on a grant from another parliament."[70] There is a view that Parliamentary accountability will be enhanced if politicians have responsibility for raising revenue as well as public spending. It has been argued that fiscal autonomy would provide a greater incentive for the devolved administrations to pursue policies to boost economic growth. This is because under fiscal autonomy they would keep the higher tax receipts arising from faster economic growth. This contrasts with the current arrangements where there is no clear link between tax revenues raised in Scotland, Wales or Northern Ireland and public spending in those countries. Furthermore, allowing Scotland, Wales or Northern Ireland control of tax policy would give those countries an instrument of economic policy to boost the performance of their economies. Finally, greater fiscal autonomy would allow the devolved administrations to choose the level of public spending they wish to have rather than this being constrained by the grant from the UK government.

There are, however, a number of potential problems with a move to fiscal autonomy. Under full fiscal autonomy, taxes might have to rise to allow the current level of public spending to continue. Alternatively, spending might need to fall to bring it into line with tax revenues. The level and distribution of North Sea revenues would clearly influence the likelihood of this. Would a fiscally autonomous Scotland, Wales or Northern Ireland be granted powers to borrow? Such powers would help protect them from fluctuations in revenue over the economic cycle but it is far from clear that the Treasury would consent to this. Under full fiscal autonomy, the devolved administrations might need to pay the UK government for UK-wide services such as defence. How would this figure be determined and disputes about it settled? Opponents of fiscal autonomy argue that the economic arguments in its favour are flawed. They argue that there are already strong incentives for governments to pursue policies which promote economic growth and that Scotland, Wales and Northern Ireland gain through their close integration with the rest of the UK economy.

Fiscal autonomy was discussed in the Scottish Executive's August 2007 document on the future constitutional arrangements for Scotland. This said:

> 2.11 Devolution of taxation and spending responsibilities as a whole – commonly known as "fiscal autonomy" – would allow the Scottish Parliament and Scottish Government to tailor the overall taxation regime to the levels of public expenditure considered appropriate to the needs of Scotland. The Scottish Government would become accountable to the Scottish Parliament and people for the overall level of taxation, rather than for the exercise of the current, very limited tax-varying powers.
>
> 2.12 There could be different levels of fiscal autonomy. The more extensive the tax-raising power, and the less significant the contribution of a block grant from

69 Arguments for and against fiscal autonomy are set out in P Hallwood and R MacDonald "The Economic Case for Fiscal Federalism" in D Coyle, W Alexander and B Ashcroft (eds) *New Wealth for Old Nations*, Princeton University Press 2005 and B Ashcroft, A Christie and K Swales, "Flaws and Myths in the Case for Scottish Fiscal Autonomy", *Fraser of Allender Quarterly Economic Commentary,* June 2006, Vol 31 No. 1.

70 *The Steel Commission: Moving to Federalism – A New Settlement for Scotland*, March 2006, p4

> the United Kingdom Government, the greater the degree of fiscal autonomy enjoyed by the Scottish Parliament and Scottish Government. Full fiscal autonomy would involve complete responsibility for every form of taxation in Scotland, and, within the United Kingdom, would need to be complemented by a mechanism for Scotland to contribute from its total tax revenues an equitable charge towards the provision of common United Kingdom services.
>
> 2.13 The effect of increasing Scotland's responsibility for its own economic and fiscal policies remains a matter of debate. The Scottish National Party estimates indicate that matching the growth rates of other small European nations could mean an additional £19 billion in the economy by 2015, or £4000 per person resident in Scotland. Extended devolution could give the Scottish Parliament and Scottish Government economic tools similar to those available to comparable independent nations in Europe, and provide the opportunity to improve Scotland's economic position in line with these countries.[71]

Plaid Cymru MP Adam Price also argued in favour of fiscal federalism in the Westminster Hall debate on the Barnett formula in November 2007:

> We need a needs-based formula and, yes, we need elements of fiscal federalism as well.[72]

In a speech on 30 November 2007, Wendy Alexander MSP, leader of the Labour Party in the Scottish Parliament, called for the establishment of an independent Scottish Constitutional Commission to review devolution in Scotland. She said:

> One key issue, which must be part of these efforts, is to strengthen the financial accountability of the Scottish Parliament. In short the financing of the Parliament almost wholly through grant funding does not provide the proper incentives to make the right decisions. Hence strengthening the financial accountability of the Scottish Parliament by moving to a mixture of assigned and devolved taxes and grant is something the Commission should consider. [73]

On 6 December 2007, Labour, Conservative and Liberal Democrat MSPs voted for the formation of a Scottish Constitutional Commission to review the devolution settlement, including the financial accountability of the Scottish Parliament.

Some commentators, such as Peter Riddell of *The Times*, and the *Economist* have argued in favour of greater tax-raising powers for Scotland.[74]

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71 Scottish Executive, *Choosing Scotland's Future: A National Conversation*, August 2007.
72 HC Deb 21 November 2007 c158WH
73 http://www.wendyalexandermsp.org.uk/ [on 7 December 2007]
74 "West Lothian answer is more tax for Scots", *The Times*, 8 November 2007. "Tax and mend – Scotland" [leader], *The Economist*, 3 November 2007

VI Concluding comments

The Barnett formula has operated for nearly thirty years. The financial arrangements between the four countries of the UK, based on the Barnett formula, were not changed by the introduction of devolved government. A number of arguments can be made in favour of the current system. It has been described as “a simple and objective way of allocating resources”.[75] It removes the need for the devolved administrations to negotiate with the Treasury at the time of each spending review, thereby giving their budgets a degree of protection. The devolved administrations are free to allocate their budgets between programmes as they wish.

There have, however, been a number of calls for reform. Devolution has arguably highlighted the differences in public spending in the four nations of the UK. Some have alleged that the current system produces public spending outcomes which are unfair. Others point to the “Barnett squeeze”. Moreover, the formation of a minority SNP administration in Scotland in 2007 means that, for the first time since devolution was introduced, different parties are in power in Westminster and Holyrood. This provides a different context in which the arrangements for devolution finance must operate.

[75] Arthur Midwinter, “The Barnett Formula and its critics revisited: Evidence from the post-devolution period”, *Scottish Affairs,* No. 55, Spring 2006, pp64-86

VII Appendix 1: Public spending by country and region

Table A.1
Identifiable public expenditure per head, £

	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07
North East	6,125	6,471	7,059	7,424	7,814	8,177
North West	5,716	6,085	6,635	7,087	7,481	7,798
Yorkshire and Humberside	5,346	5,672	6,136	6,577	6,949	7,188
East Midlands	4,817	5,025	5,484	5,938	6,205	6,491
West Midlands	5,111	5,410	5,938	6,385	6,757	7,065
Eastern	4,427	4,767	5,252	5,604	5,928	6,144
London	5,942	6,423	7,259	7,629	8,164	8,404
South East	4,450	4,749	5,243	5,711	5,960	6,304
South West	4,960	5,130	5,659	6,079	6,398	6,677
England	5,171	5,495	6,051	6,474	6,835	7,121
Scotland	6,273	6,627	7,280	7,578	8,179	8,623
Wales	6,000	6,504	6,982	7,367	7,784	8,139
Northern Ireland	7,003	7,428	7,862	8,286	8,713	9,385
UK identifiable expenditure	5,358	5,697	6,253	6,663	7,049	7,362

Source: HM Treasury, PESA 2007, Table 9.2
Notes: data are on an accruals basis; 2006-07 figures are for planned expenditure

Table A.2
Identifiable public expenditure per head, Index UK identifiable expenditure = 100

	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07
North East	114	114	113	111	111	111
North West	107	107	106	106	106	106
Yorkshire and Humberside	100	100	98	99	99	98
East Midlands	90	88	88	89	88	88
West Midlands	95	95	95	96	96	96
Eastern	83	84	84	84	84	83
London	111	113	116	114	116	114
South East	83	83	84	86	85	86
South West	93	90	90	91	91	91
England	96	96	97	97	97	97
Scotland	117	116	116	114	116	117
Wales	112	114	112	111	110	111
Northern Ireland	131	130	126	124	124	127
UK identifiable expenditure	100	100	100	100	100	100

Source: HM Treasury, PESA 2007, Table 9.2
Notes: data are on an accruals basis; 2006-07 figures are for planned expenditure

Table A.3
Identifiable public spending per head by function 2006/07, £

	England	Wales	Scotland	Northern Ireland	UK
Public order and safety	467	496	424	772	473
Transport	305	309	489	226	319
Housing and community amenities	165	163	303	537	187
Health	1,547	1,639	1,788	1,662	1,575
Education and training	1,172	1,226	1,319	1,403	1,194

Source: HM Treasury, PESA 2007, Table 9.11

Table A.4
Identifiable public spending per head by function, Index UK = 100, 2006/07

	England	Wales	Scotland	Northern Ireland	UK
Public order and safety	99	105	89	163	100
Transport	96	97	154	71	100
Housing and community amenities	88	87	162	287	100
Health	98	104	114	106	100
Education and training	98	103	110	118	100

Source: HM Treasury, PESA 2007, Table 9.12

VIII Appendix 2: Population data

Table A.5
Population , 1971-2005

	England		Wales		Scotland		Northern Ireland	
	Pop'n thousands	Index 1971 = 100	Pop'n thousands	Index 1971 = 100	Pop'n thousands	Index 1971 = 100	Pop'n thousands	Index 1971 = 100
1971	46,412	100	2,740	100	5,236	100	1,540	100
1976	46,660	101	2,799	102	5,233	100	1,524	99
1981	46,821	101	2,813	103	5,180	99	1,543	100
1986	47,188	102	2,811	103	5,112	98	1,574	102
1991	47,875	103	2,873	105	5,083	97	1,607	104
1993	48,102	104	2,884	105	5,092	97	1,636	106
1994	48,229	104	2,887	105	5,102	97	1,644	107
1995	48,383	104	2,889	105	5,104	97	1,649	107
1996	48,519	105	2,891	106	5,092	97	1,662	108
1997	48,665	105	2,895	106	5,083	97	1,671	109
1998	48,821	105	2,900	106	5,077	97	1,678	109
1999	49,033	106	2,901	106	5,072	97	1,679	109
2000	49,233	106	2,907	106	5,063	97	1,683	109
2001	49,450	107	2,910	106	5,064	97	1,689	110
2002	49,652	107	2,920	107	5,055	97	1,697	110
2003	49,866	107	2,931	107	5,057	97	1,703	111
2004	50,111	108	2,946	108	5,078	97	1,710	111
2005	50,466	109	2,954	108	5,095	97	1,724	112
2006	50,763	109	2,966	108	5,117	98	1,742	113

Source: ONS, Population Trends, No. 130, Winter 2007, Table 1.2

IX Appendix 3: Links to further information

HM Treasury, Funding the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly: Statement of Funding Policy, October 2007

HM Treasury, Public Expenditure Statistical Analyses 2007, April 2007, Cm 7091

Scottish Executive, Government Expenditure and Revenue in Scotland 2004-05

Treasury Committee, The Barnett Formula, 22 December 1997, HC 341 1997-98,

Government's response, 12 March 1998, HC 619 1997-98,

Oxford Economics, London's place in the UK economy, 2007-08, [A report for the City of London], October 2007

Westminster Hall debate on Barnett formula 21 November 2007 cc145-168WH