

**Evidence from Cymru Yfory – Tomorrow's Wales
to the
House of Lords Barnett Formula Committee**

1. A Mechanism not fit for Purpose

1.1 Cymru Yfory regards the current method of allocating funding to the devolved governments via the Barnett formula as not fit for purpose in a context where devolved parliaments/ assemblies have now established themselves as key institutions within the wider UK governmental structure.

1.2 It seems clear that Wales suffers significant disadvantage as a result of the way in which the formula works and this is a matter of concern for us, particularly in view of the extremely tight public expenditure framework that will result from the current financial and economic crisis. However we are also aware of wider concerns. Bell and Christie are certainly not alone in their criticism: 'The funding mechanism has been roundly condemned by all shades of public opinion.... Unless this issue can be satisfactorily resolved, the tension caused by the perceived unfairness of the system of allocating resources between the constituent parts of the UK will undermine the legitimacy of devolution' (our underlining). Lord Barnett's characterisation of his own formula as 'terribly unfair' is well known.

1.3 Gillian Bristow points out that Barnett 'is an inherited legacy of the finance arrangements that existed pre-devolution and which operated within the era of territorial arrangements'. When it was devised in 1978 in readiness for the devolution arrangements then being planned the intention was for it to be a temporary arrangement. According to Bristow, it was 'an historical and temporary expedient which became permanent'.

1.4 The assessment of need carried out at that time, according to Alan Trench, 'showed that significantly greater amounts of spending would be justified for all three territories than for England – but that amount would be less than what Scotland and Northern Ireland already received'. It is recognised that the reason those two territories enjoyed a higher level of spending than that provided for Wales was that they, unlike Wales, posed a potential threat to the union and, in any case, had administrative devolution for far longer.

1.5 The disparity was retained in the Barnett formula to avoid shocks and for reasons of political expediency. Thus Wales was disadvantaged in comparison with Scotland and Northern Ireland from the very outset. In addition, the Barnett formula, says Trench, was designed 'to serve as a way of braking growth in Scottish spending' by incorporating a mechanism to bring about convergence in per capita spending levels in the four countries. Ironically, but perhaps not surprisingly, the resultant 'Barnett squeeze' has probably punished Wales more than it has Scotland (McLean and McMillan).

1.6 When democratic devolution was introduced in 1999, a decision was taken behind closed doors, again for reasons of political expediency, to retain Barnett rather than consult on a new funding mechanism that would be appropriate for the new arrangements.

2. A Time for Reform

2.1 We have briefly rehearsed the Barnett story in order to illustrate the way that the current arrangements have evolved in an ad hoc and politically expedient manner rather than being based on any logic or fundamental principles. Such a state of affairs is our view no longer acceptable. It is time for reform, and if there is to be reform, it should be sufficiently radical to tackle head-on the chronic dissatisfaction that exists in so many quarters, specifically in Wales, and which is certain to get worse rather than better.

3. The Deficiencies of the Current Arrangements

3.1 We now list some of the deficiencies, of both process and outcome, of the current arrangements.

(i) Convergence

Our view is that the formula should converge, not on a per capita population basis, but on need (see below 4.1). Eurfyl ap Gwilym claims that the 'Barnett squeeze' arising from the existing convergence principle, cost Wales about £1bn between 1999 and 2006. McLean, Lodge and Schmuecker state that identifiable public spending, which they say 'provide[s] the most accurate picture possible of monies flowing through the Barnett formula', fell between 2002-3 and 2007-8 in Wales from 13% to 8% over the UK average, in Northern Ireland from 31% to 21%, and in Scotland not at all

(ii) Failure to reflect changing circumstances

- Since 1978 the population of Scotland has fallen and that of Wales has risen but this change was not reflected in the allocation of funds until 1997, by which time the baseline for the calculation of increased funding had been adversely affected.
- Over the same period, as a result largely of the decline of heavy industry, which was dominant in the Welsh economy, GDP per capita has declined from 88% of the UK average in 1979 to 77% in 2007. This decline is what led to the EU recognising the West and Valleys, four-fifths of Welsh land area, as being in serious need, having less than 75% of EU average GDP, and thus eligible for Objective 1 status under the Structural Funds. However the Barnett formula remained unaffected by all of this.

(iii) The Formula is not needs-based

Basing the allocation of funding, ever since the initial estimation of needs, on a population basis has been severely disadvantageous to Wales. Two recognised proxy indicators of need are poverty, as measured by social security spending, and average GDP. According to Mackay and Williams, if the first were used, devolved spending per head should be roughly 20% higher in Wales and Northern Ireland and 10% higher in Scotland than in England. In the case of the second (arguably a more objective measure), the devolved spending per head should be 27% higher in Wales and Northern Ireland and 6% higher in Scotland than in England.

McLean, Lodge and Schmuecker state that identifiable public spending ('the most accurate picture of monies flowing through the Barnett formula') are as follows: Northern Ireland 21% over UK average; Scotland 21%; Wales 8%. The same authors consider the relationship between public expenditure and GVA. They state that England has a GVA per head 2% over the UK average, Scotland 5% below and Wales, lowest among the UK regions, at 23% below. They then proceed to calculate that in 2006-7 London received 65% more than it would if public expenditure were allocated on the basis of GVA per head, with Scotland receiving 11% more, and Wales receiving 14% less.

(iv) Allocations are based on departmental spending levels in English departments

This is inappropriate in a system where the devolved assemblies and parliament exist in their own right as representative bodies of their peoples. Bell and Christie found that 'there is no country in the developed world other than the UK that allocates resources at a subnational level using a formula based on spending changes elsewhere, rather than allocating levels of spending in relation to assessed need'

(v) The way in which decisions on allocations are made is often opaque

- There is no independent audit of the process or of the decisions made.
- Determining what counts as spending for England and what is for the UK as a whole, and therefore may or may not carry a Barnett consequential, may be subjective and arbitrary, as for example with spending on the Olympics and rail infrastructure.
- The extent to which convergence has actually occurred and why, including the various Barnett bypasses engineered, has been extremely difficult to ascertain, even by experts in the field.

Such weaknesses arise from the fact that the Barnett formula has no statutory basis and the way it is applied depends very much on informal practice, conventions and goodwill. We would argue that this is not sufficiently robust in the quasi-federal system that now exists in the UK.

4. Principles for a New System

4.1 We have no doubt that a new system for allocating resources should be based on need. We recognise that determining need is a complex matter and that opinions concerning what factors should be included differ. However the task is achievable, as examples in numerous countries demonstrate. Among the elements to be considered would be: geographical factors such as rurality and population dispersal; age profile; health needs; and average GDP or social security spending as indicators of deprivation.

4.2 The way in which resources are allocated to nations and regions within an union state should reflect the principles of solidarity, mutual dependence and justice. Indeed the very stability of such a state may depend on the application of those principles. This is the philosophical underpinning for basing allocations on need, but it should also lead to a commitment to the elimination (or at least amelioration) of disadvantage as well as compensation for it. The formula should therefore include an element of funding for achieving economic and social cohesion across the UK.

4.3 This is linked with the way in which the UK Government deals with the European Union's Convergence Funds. The UK as an EU member state accepts the criterion of a needs-based approach in order to promote economic and social cohesion across the EU and as a counterbalance to the internal market. As a result a number of UK regions have at various times been allocated structural fund resources. We believe that the same strategic policy approach should apply within the UK, as we argue in 4.2 above. Specifically, resources allocated to regions of the UK by the EU should always be truly additional to existing budgets.

New ground was broken in UK Government policy in 2001 with the famous 'Barnett +' allocation to Wales for the delivery of the Objective 1 programme in the West and the Valleys and this is very welcome. However the failure to provide any resources for match funding this programme has imposed a significant burden on the National Assembly. Among the effects (combined with the impact of the Barnett squeeze) has been the increasing funding gap in education between Wales and England, which is particularly acute in Further and Higher Education. In the spirit of cohesion enshrined in the EU Convergence programmes, funds allocated to Wales should include provision of match funding for those programmes.

4.4 The introduction of a needs based formula should in no way imperil the devolved governments' autonomy in making decisions on public spending. In discussing the introduction of an 'equalisation formula' for funding allocations, McLean and McMillan say that this would mean 'placing each territory in a position to offer the same mean level of service, should it choose to do so' (our underlining). The Welsh Assembly Government may decide for example that investing in appropriate economic development or in housing, or in environmental improvement, is an effective way of tackling long-term health problems. It should be entirely free to do so. Policy divergence is a major justification for devolved government, and one of its advantages is that the countries of the Union can learn from each others' achievements as well as, sometimes, their mistakes.

4.5 Transparency should be a key principle of the new system. This does not mean that the new allocations formula would be readily understandable by the public at large – indeed the degree of complexity necessary to achieve a just allocation would make this difficult. What it does mean is that the principles underlying decisions would be explicit and all the information publicly available.

4.6 The relationship between the countries of the UK in determining a new formula and in negotiating allocations should be established on the basis of equality. Currently the

bargaining position of Wales is weak in comparison with Scotland and Northern Ireland and the position of all three weak in relation to the UK Treasury. This needs to be corrected.

5. The New Arrangements

5.1 We strongly support the proposal made by a number of experts, notably McLean and McMillan, and Bristow, that a new Territorial Grants Commission, on the lines of the Commonwealth Grants Commission of Australia, be set up. It would be established by Act of Parliament and would be independent in status, similar to that of the Electoral Commission.

5.2 We support the following suggestions by Bristow: 'It should be a non-governmental public body staffed by non-partisan public servants (e.g secondees from the devolved administrations and relevant government departments) plus relevant experts in the field of public finance (e.g academics, other professionals). The members of the commission would be appointed on the basis of widespread consultation with the devolved administrations and regional representatives ... The Commission should be charged with making an annual report on regional expenditure needs and the relevant equalisation process with this report being made to a joint ministerial council of the UK and regional governments.'

5.3 The final decisions on funding allocations would have to be unanimous. Failing that, we agree with the suggestion of McLean and McMillan that the default would be the use of average GDP per head as the proxy indicator of need.

5.4 We accept that the move from Barnett to a new needs-based formula will not bring change in one fell swoop. Rather there would be, to use McLean and McMillan's term, a 'convergence on need' which would take a number of years to be completed.

6. Conclusion

6.1 The current arrangements for funding devolved government are flawed and unsustainable. As devolved government becomes embedded in the UK system and as Wales looks forward to the granting of primary legislative powers to its National Assembly, now is the time for a radical overhaul. Whereas we believe that Wales would benefit from the changes that we advocate, we also believe that the UK as an union state would strengthen its credibility by adopting a system designed to meet collective interests and to promote cohesion, equity, stability and transparency.

Bibliography

In drawing up our analysis and recommendations we have drawn heavily upon the work of experts in the field and we wish to acknowledge our indebtedness to them. The relevant works are listed here

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