

Identifying Need – Devolved Spending in Wales

Ross MacKay, University of Wales, Bangor

Introduction

'It is a long-established principle that all areas of the UK are entitled to the same level of public services and that expenditure on them should be allocated according to relative need' (Treasury, 1979, p.4)

'In its 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" (Edmonds, 2001, p.17).

This brief Essay in Persuasion takes its central argument from the Treasury's continued acceptance of relative need as the correct guide to public expenditure in different countries within the United Kingdom (see quotations above). It argues that the existing financial settlement accepts an arbitrary target, convergence on English spending levels. The arbitrary target ignores relative need.

The Barnett Formula is a divergence reducing mechanism. First, there is an inherited expenditure bias (pre rigorous application of Barnett), with devolved spending per head higher in Northern Ireland, Scotland and Wales than in England. Second, year by year changes in devolved spending are divided equally in line with population. With inherited spending frozen, expenditure per head

in Northern Ireland, Scotland and Wales will, over time, move closer and closer to (without ever quite reaching) English levels. Pace of convergence will depend on rate of growth of relevant public spending. Inflation, as well as real expenditure increases, will reduce divergence.

The yearly increments have a marginal impact in any one year, but over time they become significant. With 8% annual compound growth, the increments would equal the inherited levels within 9 years¹. A week may be a long time in politics, but 9 years is a brief introduction to a financial settlement that decides relative spending in Wales, Scotland, Northern Ireland and England. In any one year the Barnett Squeeze is gentle. However, considered over a number of years, the Barnett embrace would ensure that the Welsh, the Northern Irish and the Scots all lose. Spending on medicine, education and law and order would be confined. Standards of public services would be difficult to maintain and jobs would be lost.

The Barnett Squeeze is not inevitable. The Barnett Formula that pulls spending levels in Wales, Scotland and Northern Ireland progressively closer to England is only in place because there is no accepted agreement on how to measure relative country need. The approaches

and measures of relative country need that have been produced do not point to the desirability of convergence.

Devolved Spending

Needs connect to low opportunity, low incomes and to concentrations of poverty. Low incomes and poverty contribute to ill health, to educational disadvantage, to anti-social behaviour, including crime and drug abuse. Low incomes and poverty add to the pressures on the welfare state and to the cost of providing adequate public services. Figure 1 shows work income per person of working age in different parts of the United Kingdom. Work income combines income from employment and self-employment and includes part-time work. Work income is central to living standards in most households and the key to differences in living standards within the United Kingdom.

Welsh work income per person of working age is only 58% of the Inner Region Core level and 83% of the Scottish level. Wales and Northern Ireland are two of the three low income regions within the UK. Scotland is in the middle income group. The Inner Region Core (the capital and its extensive commuting zone) has substantially higher levels of work income than all other parts of the United Kingdom.

Figure 1: Labour Markets, Work Income by Region, 2001 (Work income per working age person per week, £).



Source: Regional Trends, Labour Market Trends, NOMIS

Figure 2 allows regional per capita devolved spending to be checked against per capita Gross Value Added in each of the 12 UK regions. Gross value added is a broader measure of income than work income (it includes profit and rent, as well as work income). It is close to the measure most often employed when comparing regional living standards within and across countries. For nine regions, relative prosperity (Gross Value Added) is a rough guide to devolved spending levels. There are three clear exceptions². In Northern Ireland, Scotland and London, devolved spending is far higher than their prosperity levels would indicate. London is easily the most prosperous region within the United Kingdom, but devolved spending in London is comfortably above the levels in all other English regions and close to one-fifth higher than the UK average. The differences in devolved spending are substantial. In 2000-01, devolved spending per head was £1600 higher (64%) in Northern Ireland than in South East England. In the same financial year, devolved spending per head was £859 higher (34%) in London than in the East Midlands.

High levels of public expenditure in London are the product of the capital's high cost of living. London is 'jaw-droppingly expensive' (Lonely Planet, 2003, p.92). That horrendous expense applies to public goods and services, as well as those provided by the market. High levels of public expenditure in London do not provide public services that are the envy of the rest of the country. The concentration of political power is critical to the production of

regional inequality within the UK. The centralisation of political and economic power is a problem. The substantial cost of the capital's public services is a burden on the rest of the country and a guide to the economic and social advantages that would flow from decentralisation.

Figure 3 shows Gross Value Added per head and devolved spending per head in the four countries of the United Kingdom. Wales is a less prosperous country than Scotland. GVA per head is only 83% of the Scottish level, but devolved spending is 7% lower. High levels of devolved spending in Scotland flow from the strength of the Scottish Office, the influence of Scottish Secretaries of State and from the delicate union between Scotland and England. In Northern Ireland, devolved spending per head is 29% above the Welsh level, even though the two countries now have similar standards of living.

Measuring Need

The Barnett Formula has 'become a mechanism for transferring money between tiers of government, not a mechanism internal to one government.' (Heald, 1998, p.76, emphasis in original).

Resource allocation is a sensitive political issue. Decisions have to be made on the basis of imperfect knowledge. The Barnett Formula corrects an unequal and inequitable distribution of public expenditure. By moving towards equality in devolved spending levels, it overcompensates.

There is a need for an approach that is based on some notion of equity.

Dividing public money between governments requires a system that is transparent, clear, specific, open and reasonably acceptable to all. Within England, relative need is an important guide to spending levels in different parts of England. Three relevant examples include:

1. A recent policy announcement suggested that it might be desirable to encourage young adults aged 17-18 to remain in school. This could involve cash incentives and these would be means tested.
2. Standardised Mortality Ratios are used to represent and identify regional differentials in need for medical services. The higher the mortality rate³, the higher the regional expenditure on health services.
3. The Acheson Inquiry into inequality in health concluded 'those with low levels of educational achievement have poor adult health. Logic and Equity argue that children in need should receive increased resources for their education' (Acheson, 1997, p.37-38). The Inquiry recommended that the Revenue Support Grant Formula should be more generously weighted to reflect need and socio-economic advantage. Education is relevant to health. The Acheson Inquiry argued for a health policy designed to 'favour the less well off' and, wherever possible, reduce health inequalities.

The key point (and there are many other relevant examples) is that needs

Figure 2: Devolved Expenditure, Prosperity Related, 3 Clear Exceptions.

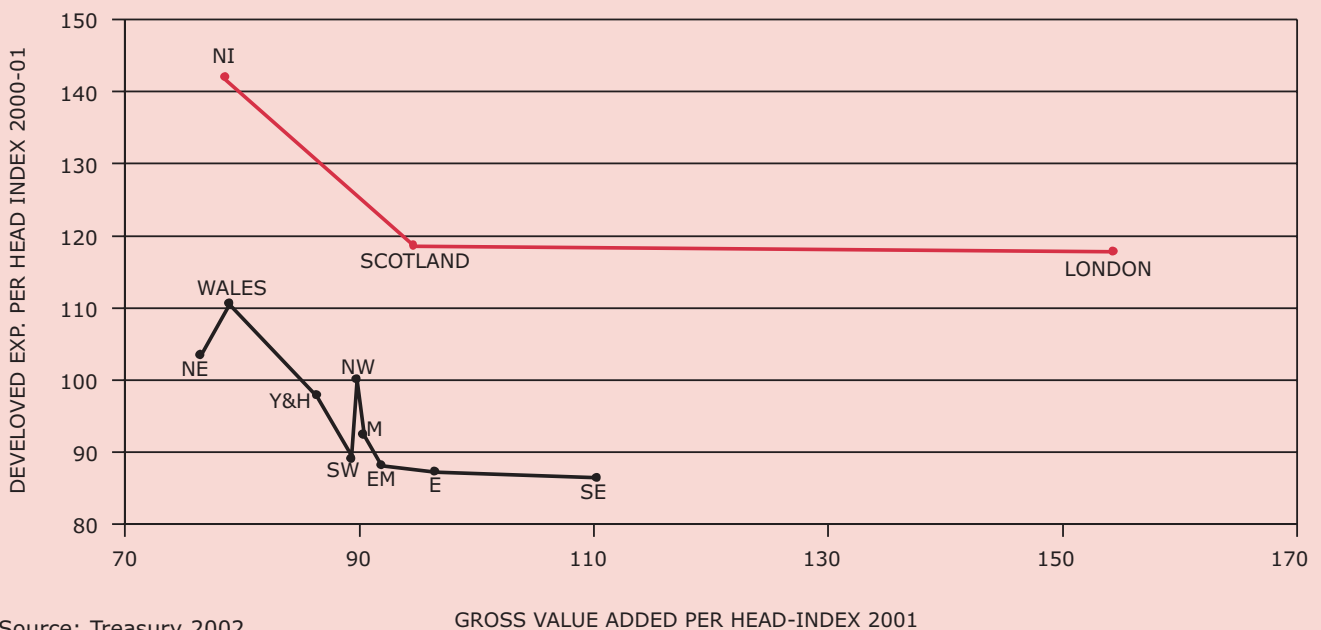
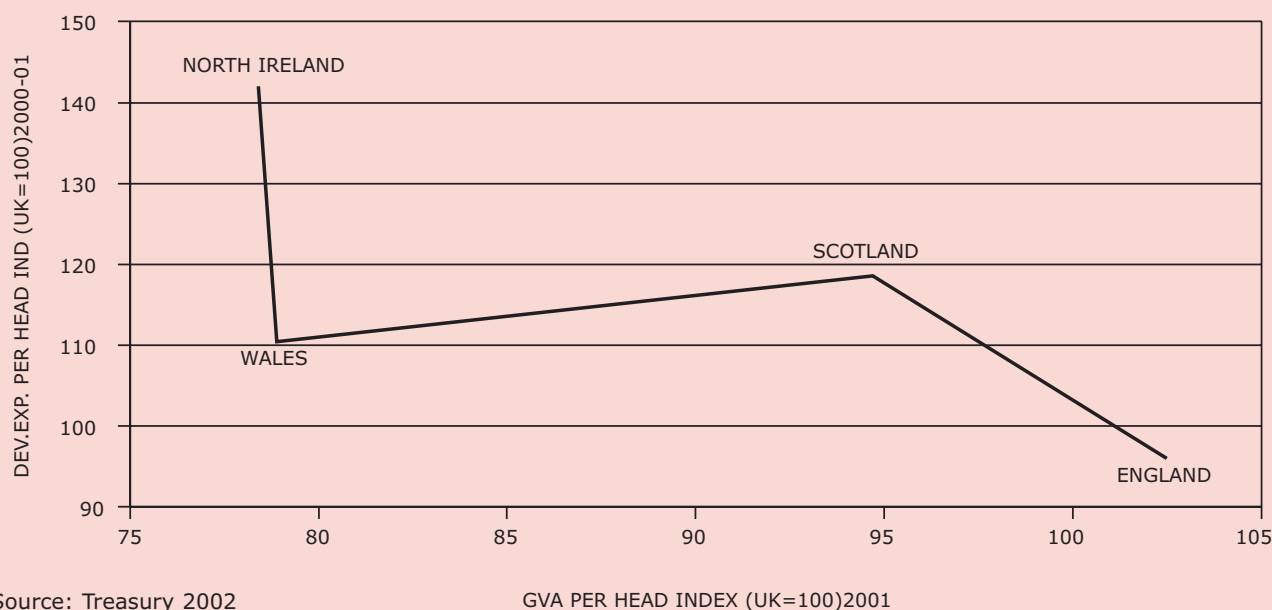


Figure 3: Devolved Spending by Country and Prosperity.



Source: Treasury 2002

(usually connected to low incomes and poverty) are used to guide relative spending and changes to relative spending within England. But needs and changes in needs are not reflected in the Barnett approach. The implicit assumption of the Barnett Formula is that expenditure levels in Wales, Scotland and Northern Ireland should move ever closer to those in England. This implicit assumption ignores differences in prosperity and differences in need.

Health, education and law and order dominate devolved spending, and this fact is important when considering need. These three categories account for 8 out of every 10 pounds of devolved spending. Health is the major component, representing 4 out of 10 pounds, with education the second most important with 2.5 out of 10 pounds. Needs connect to low opportunity, low incomes and to concentrations of

poverty. Low incomes and poverty contribute to ill health, to educational disadvantage, to anti-social behaviour, including crime and drug abuse.

Relative levels of need should determine devolved expenditure. Unfortunately, the need of need has no practical impact without an agreement on how to identify and measure need. In considering general measures of need, we have to go back to first principles. Relative need for devolved spending on health, education and law and order will change over time. An acceptable approach should be sensitive to change of need and change in need connects to shifts in economic circumstance. In going back to first principles, we can perhaps accept that need connects to some measure of command over goods and services.

Relative prosperity and relative poverty are sensitive to shifts in productive

capacity, to the turmoil and dislocations that are part and parcel of capitalism. Both relative prosperity and relative poverty are sensitive to change in economic conditions. McLean and McMillan (2003) use inverse Gross Domestic Product (or inverse Gross Value Added) as their measure of relative country need. Bell and Christie (2001) and MacKay and Williams (forthcoming) prefer a poverty based approach. The particular poverty measure used by both sets of authors takes country social security expenditure as the guide to relative country need.

The case for a poverty based measure is strengthened if one accepts the basic theme of Rawls' Theory of Justice (1971). A Just Society, Rawls claims, would have particular regard for the welfare of the most disadvantaged and vulnerable. The poor have limited choice; their needs are greater. Social

Table 1: Devolved Spending - Different Forms of Convergence Avoiding the Barnett Squeeze.

	Convergence Targets			
	1	2	3	4
	Actual Spending Levels per Head*	Barnett Formula	Dependency Level**	Inverse GVA***
England	100	100	100	100
Northern Ireland	148	100	123	128
Scotland	124	100	113	106
Wales	115	100	119	127

* calculation based on financial year 2000-01 ** calculation based on 2000-01 *** calculation based on 2001.
 Source: *Regional Trends, Treasury 2002, Economic Trends*

and economic inequalities are to some extent inevitable, but they should be so arranged that they be to the benefit of the least advantaged. Inequalities that add to the wellbeing of the least advantaged are acceptable; inequalities that are stronger and lie deeper are a problem. The Rawls approach places particular emphasis on those in poverty. It is they who are often divorced from society, it is they who have limited opportunity to realise their potential (see also Acheson, 1998). Moreover, it is concentrations of the seriously disadvantaged that are a particular challenge to public policy.

Table 1 indicates the implications of substituting either a poverty or income measure of need for the Barnett Formula. Column 1 shows recent relative spending levels. With a strict application of the Barnett Formula, devolved spending per head in Wales, Northern Ireland and Scotland would move towards English levels (Column 2). Taking dependency (social security) levels as a measure of relative need (Column 3), devolved spending per head should be roughly one-fifth higher in Wales and Northern Ireland than in England and more than one-tenth higher in Scotland than in England. Taking inverse GVA as the guide (Column 4), devolved expenditure per head in Wales and Northern Ireland should be about 27% higher than in England: devolved expenditure in Scotland should be 6% higher than in England. *According to both approaches to identifying relative need, devolved expenditure in Wales is already too low.*

The convergence targets would adjust year by year with change in relative need – as measured by relative poverty, or relative income. The sums involved are substantial. They are far more impressive than the levels of additional expenditure that could be realised by the use of the Tartan Tax (or its hypothetical equivalents in Wales and Northern Ireland). Taking recent expenditure levels as a rough guide, the strict application of the Barnett Formula would (in the fullness of time) reduce devolved spending in Wales by almost 15% and would mean a reduction of over £400 per head in Welsh devolved spending. The use of a dependency based approach could (over time) raise devolved spending in Wales by close to 19%. Taking 2000-01 expenditure figures as a guide, this would imply an extra £500 per year⁴, per capita devolved spending in Wales.

Conclusion

'The test [assessing relative need] involves judgments of great complexity and political sensitivity' (White Paper

that foreshadowed The Treasury Study of Relative Need, Treasury, 1979, p.3).

'People in equal positions [but located in different parts of the Nation State] should be treated equally' (Musgrave, 1959, p.160).

Equal treatment of equal citizens, no matter where located within the nation state, is an Enlightenment ideal. Each citizen has the right to potential dignity and to potential self-realisation. Each citizen is equally important. A unified tax system (equal treatment of equal citizens, no matter where located in the UK) ensures that tax revenues are notably uneven. Need is accepted as an appropriate guide to relative expenditure in different parts of the United Kingdom. Since need increases as incomes decline and poverty increases, devolved spending in Wales, Scotland and Northern Ireland should remain above the level in England.

Equal treatment of equal people implies transfers from rich to poorer parts of the United Kingdom. A progressive tax system automatically works in that direction, as does social security that is uniformly applied to rich and poor regions. If devolved spending is to contribute to this process, then some attempt must be made to allocate devolved expenditure according to relative need.

Compensation systems (transfers from richer to poorer regions) have been described as both a product and source of national solidarity. Transfers are economic; they can improve regional opportunity and add to regional resource quality (particularly to human capital). They are also political; they keep the Kingdom United. Bogdanor (1999, p.235) has described finance as the *'spinal cord of devolution'*. Achilles heel may be even more appropriate. The Barnett Formula is a problem, and the difficulties that flow from a strict application of Barnett will become increasingly evident over time. In developing an appropriate guide to relative country need and relative country spending, we should explore the possibility of better measures. But we should not let the absence of an ideal, precise measure, be the enemy of a reasonable working compromise.

Endnotes

- 1 The increase in UK Block spending in the financial year 2000-01 was about 8.3% (Treasury, 2002).
- 2 For the 9 non-exception regions, the correlation coefficient between relative income (GVA per head) and devolved spending is 0.81. For the same 9 regions, the correlation

coefficient between relative poverty (social security spending) and devolved spending is 0.91. For those 9 regions relative need is a good, if rough guide to public spending.

- 3 Standardised Mortality Ratios are higher in regions of low income and particularly in areas with concentrations of poverty.
- 4 The comparable figure for Scotland is £300 per head and for Northern Ireland over £600 per head.

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