

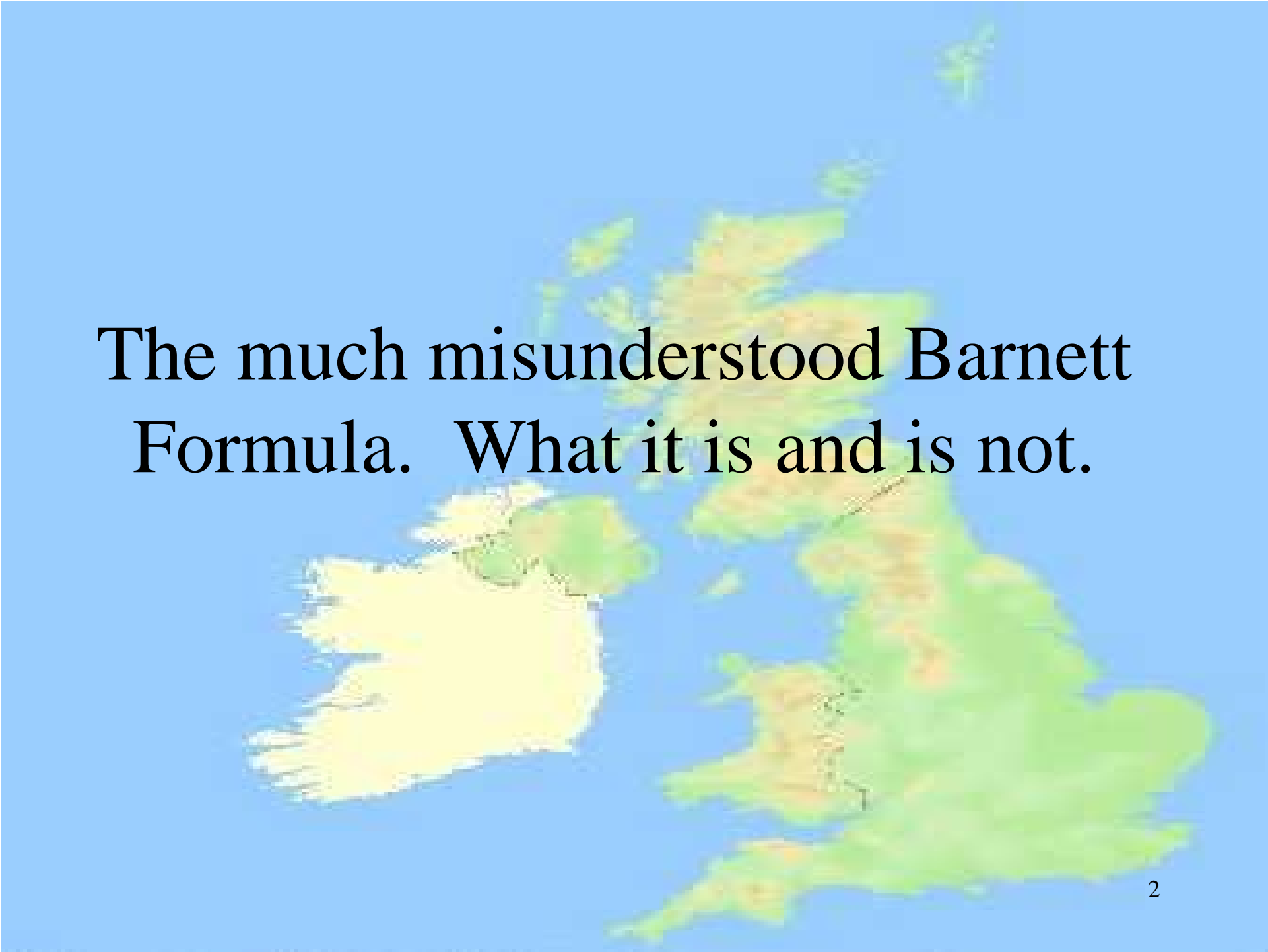


The Barnett Formula and Fiscal Policy - What Lies Ahead

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The much misunderstood Barnett
Formula. What it is and is not.

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What it is not:

- A device to give more to Wales Scotland and Northern Ireland than to the English regions

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- A needs-based formula

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What it is not:

- A device to give more to Wales Scotland and Northern Ireland than to the English regions
- A needs-based formula
- A formula to equalise resources

The much misunderstood Barnett Formula

What it is:

- A device to bring about convergence in public spending



The much misunderstood Barnett Formula

What it is:

- A device to bring about convergence in public spending
- Target: equal spending per head of population (EPC) in each of the 4 territories of the UK

The much misunderstood Barnett Formula

- The shotgun conversion of Labour to devolution 1974
- Driven by SNP victories in Feb. 74
- The Geordie revolt 1977 led to the defeat of the Scotland & Wales Bill...

Which led to ...

- The Needs Assessment
- The Barnett Formula ...



HM Treasury 'Needs Assessment', 1979 (data for 1976-7).

	England	Scotland	Wales	NI
Relative needs assessment	100	116	109	131
Actual spending levels 1976-7	100	122	106	135

Source: HM Treasury (1979), esp. para 6.5.

The Barnett Formula was designed to:

- Substitute a block for programme-by-programme grants (succeeded)
- Bring about convergence to EPC (Happening SLOWLY)
- Therefore converges on the wrong thing

Scatter-plot of per capita Public Expenditure and GDP, for UK regions and territories
2001-02

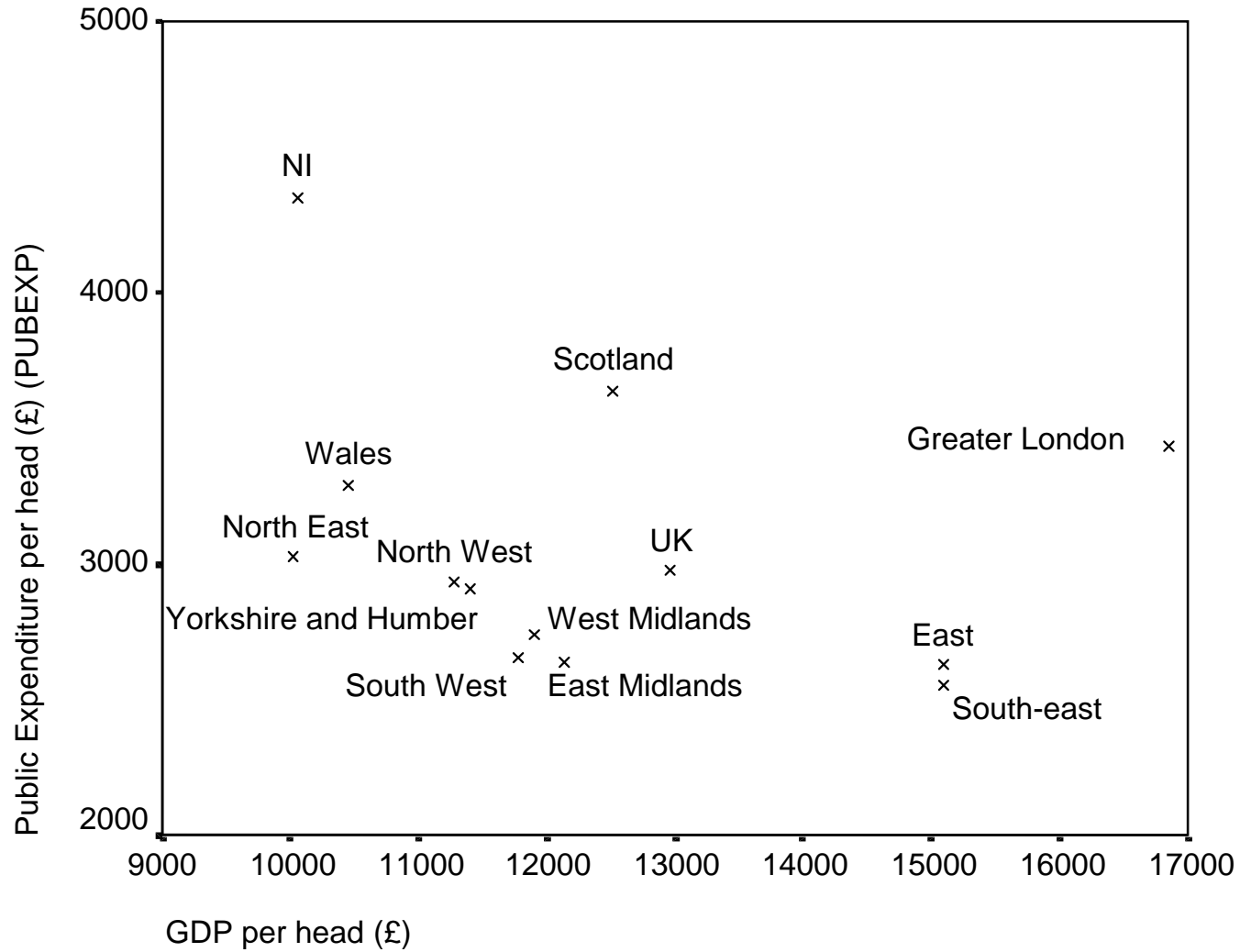
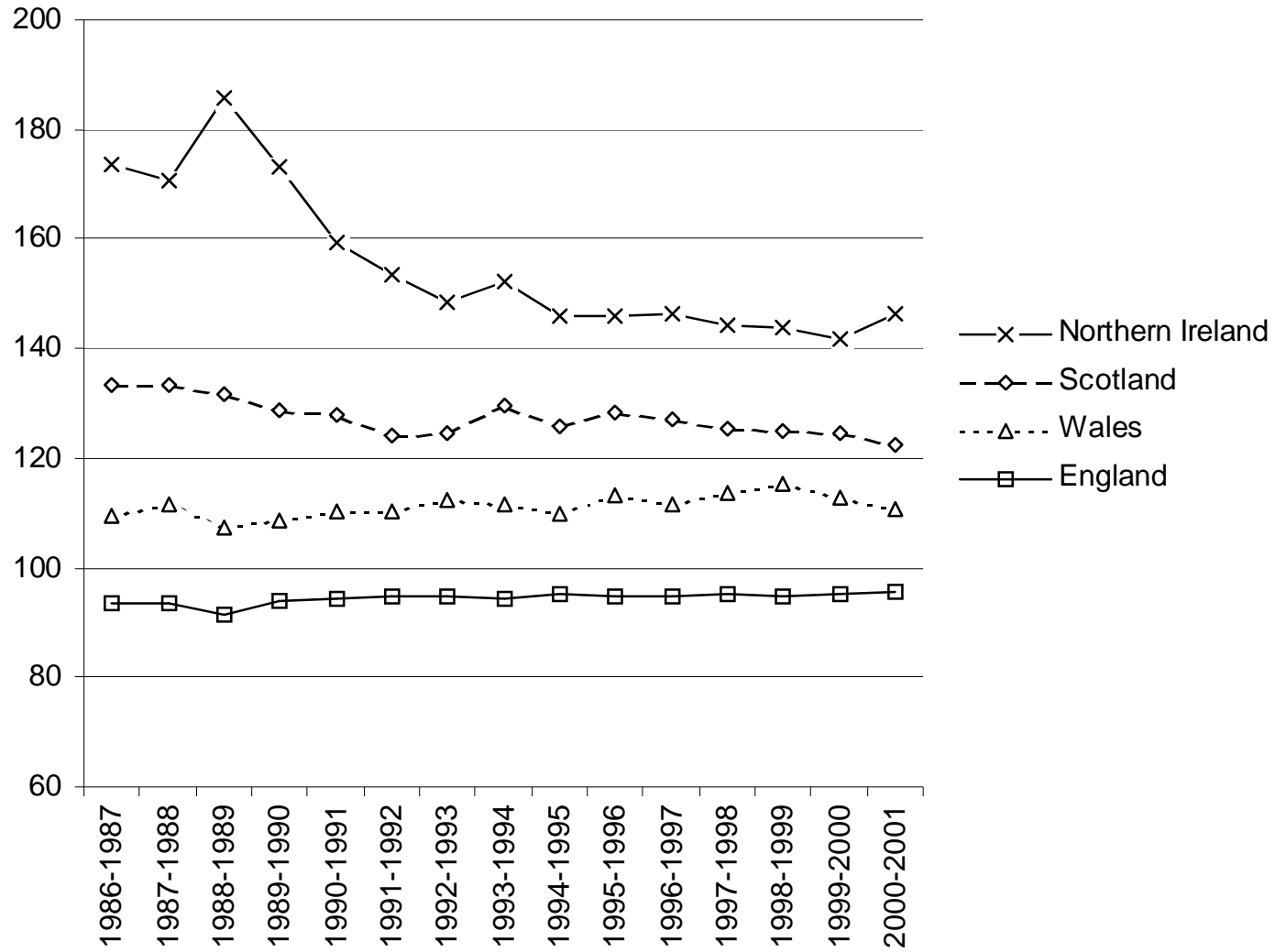
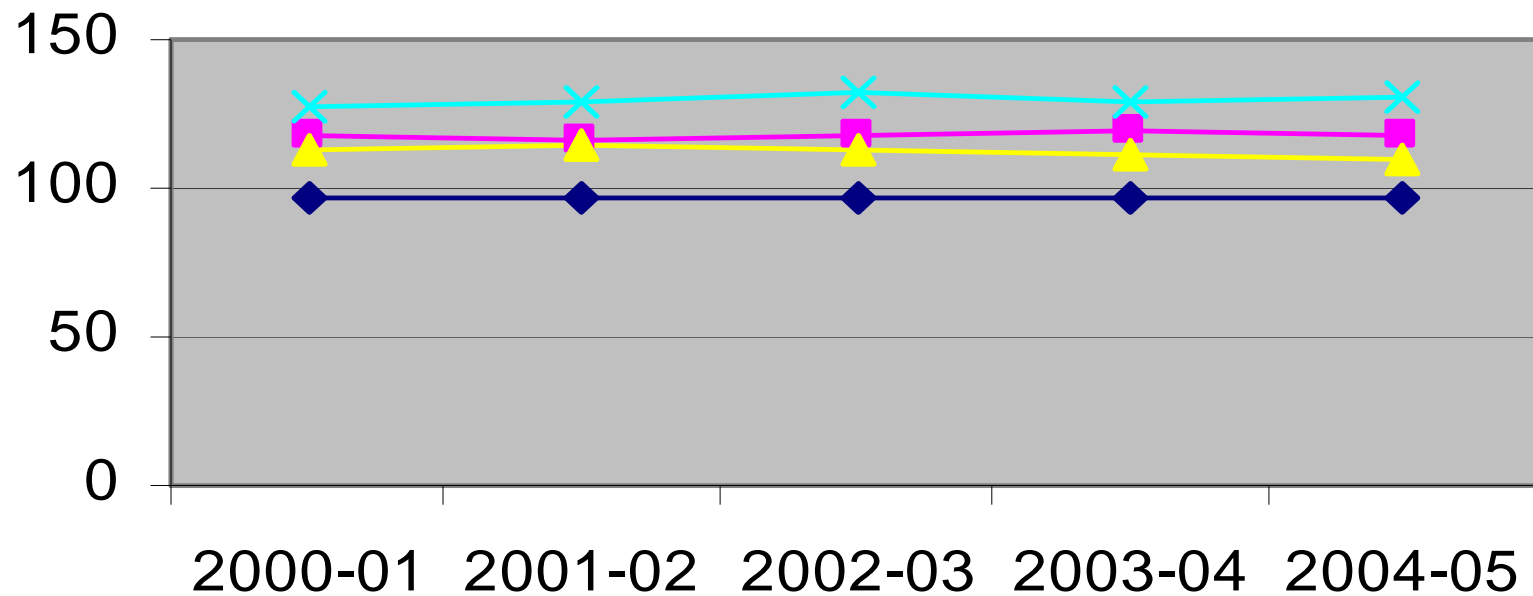


Figure 2: Spending on devolved services in England, Scotland, Wales and Northern Ireland 1986–2000 (UK spending = 100)



Source: PESA various years

Expenditure/head, new series. UK=100



—◆— England —■— Scotland —▲— Wales —×— NI

Some possibilities

1. Continue with Barnett; gentle 'squeeze'
2. Needs-based equalisation
3. Eliminating the fiscal gap
4. Fiscal autonomy within Union
5. Fiscal autonomy (SNP version)

Continue with Barnett?

- Scotland richer than Wales but gets more
- Convergence is hurting NI; Eng regions are regrouping
- Therefore Scotland is on its own
- Current squeeze gentle, but change of govt in Scotland or UK could toughen it
- SNP has unveiled big-spend manifesto

A needs-based system?

- Redo the 1979 exercise
- Not popular in Scotland but might happen
- A neutral referee, as in Australia
- One region, one vote
- ‘Inverse GDP’ default?

Eliminate the fiscal gap?

- He who calls the tune should pay the piper
- SE has trivial tax powers (unused Variable Rate income tax + LA taxation)
- Assignment of tax proceeds or devolution of tax powers would align incentives
- VAT, Income Tax easy to assign but would reduce Scottish black grant

Fiscal autonomy within Union

- Would look a bit like Canada
- Federal govt equalises for resources, but not needs or costs
- Could assign oil revenue to territories (they do in Canada)
- But beware of what you ask for.
- Huge transfers from London and SE would end – probably dwarfing oil

Fiscal autonomy outside Union

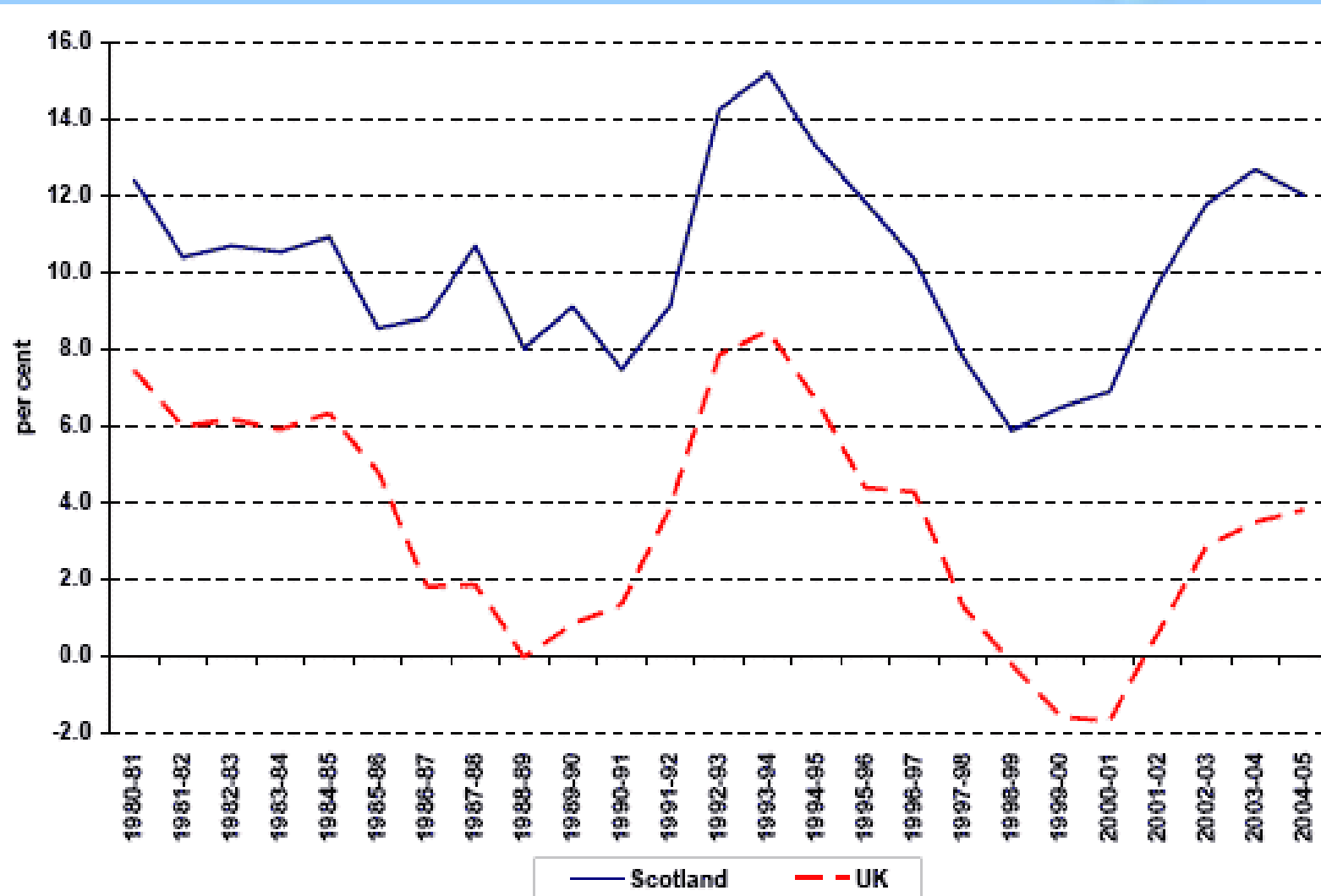
- A logical solution
- Incentives aligned correctly
- But Scotland couldn't join Euro
- Would face sharp adjustment
 - Cut spending, or
 - Increase taxes, or
 - Both

Net Borrowing for Scotland 2000-01 to 2004-05

	2000-01	2001-02	2002-03	2003-04	2004-05
Aggregate expenditure, £m	35641	38868	41436	45226	47662
Aggregate receipts, £m (with no NS oil)	30386	31186	31601	33972	36439
Net borrowing: £m	5255	7682	9835	11254	11223
as % of GDP	6.9	9.7	11.8	12.7	12.0
Add: 90% of NS oil receipts, £m	3870	4680	4419	3894	4683
Aggregate receipts, £m (with 90% of NS oil rev.)	34256	35866	36020	37866	41122
Net borrowing assuming it's 90% Scotland's oil: £m	1385	3002	5416	7360	6540
as % of GDP	1.6	3.4	4.8	6.8	5.4

Source: GERS, various years. NB, totals subject to correction in later years - may lead to minor data inconsistencies

Chart 7.6 Net Borrowing as a percentage of GDP

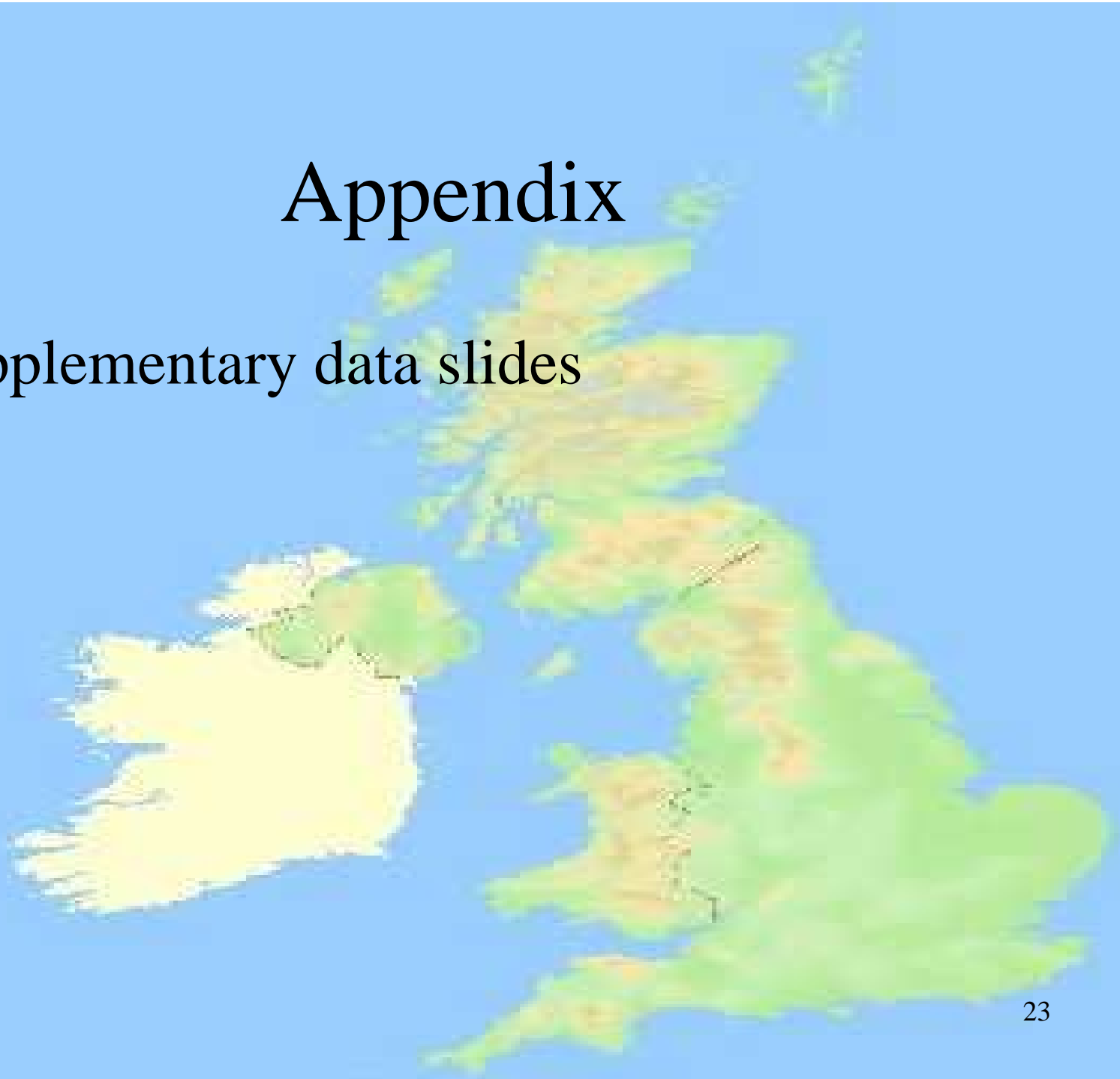


So why are the SNP numbers so different?

- Latest SNP projections Dec 06 assume:
 - it's ~**all** (95%) Scotland's oil
 - Price will stay high
 - So will production
 - Scotland spends < popn share on defence & debt interest
 - Sc could *cut* Corp Tax rate + *raise* proceeds
- Sharp drop in NS Oil revenue invalidates SNP projections
- In reality, indep Sc would have to spend on pub goods
- It could not join €(too much deficit to meet Maastricht criteria)

Appendix

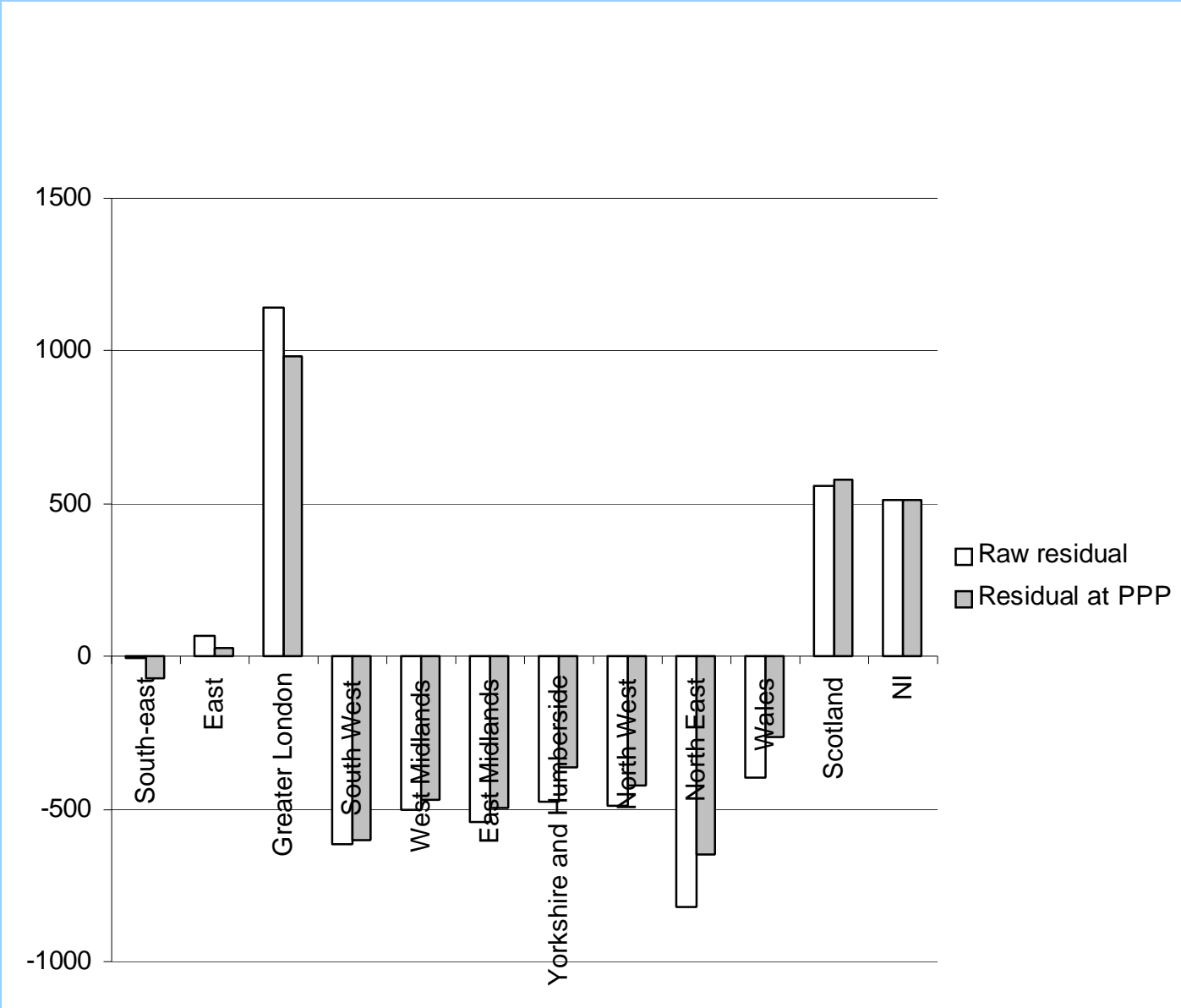
- Supplementary data slides



Barnett converges by:

- Allows 1978 baseline to stand
- Operates on each *increase* in public spending
 - *Every time spending in England on a devolved programme increases, Scotland, Wales, and NI get their population share of that increase*
- If English health spending goes up by 5%, money for health spending in Scotland goes up by $< 5\%$

Raw and PPP-adjusted residuals: actual regional government expenditure per head minus simulated expenditure under inverse GDP formula, £, 2001-02



Scotland's balance 06/07 (SNP)

(Source: SNP)

Receipts (£bn) - 2006/7

Inland Revenue

	UK	Scotland	Allocation
	£	£	%
Income tax (gross of tax credits)	146.1	12.05	8.25%
Income tax credits	-4.6	-0.39	8.50%
National Insurance Contributions	88.5	7.48	8.45%
Corporation Tax	39.9	3.79	9.50%
Corporation Tax Credits	-0.6	-0.06	9.50%
North Sea Corporation Tax	8.1	7.7	95.00%
Petroleum Revenue Tax	2.3	2.19	95.00%
Other Taxes and Duties	20.3	1.46	7.19%
Total Inland Revenue (Net of tax credits)	300	34.21	11.4
Total Customs and Excise	124.8	11.08	8.88
Net Taxes and NI Contributions	487.2	50.33	10.33
CURRENT RECEIPTS	517.9	52.94	10.22

Expenditure (£bn)

	UK	Scotland	Allocation
	554.6	52.33	9.44
Surplus	-36.7	0.61	26

Scotland's balance 06/07 (updated)

(Source: SNP, numbers updated from Budget Red Book 2007)

Receipts (£bn) - 2006/7	UK	Scotland	Allocation
Inland Revenue	£	£	%
Income tax (gross of tax credits)	146.9	12.1	8.25%
Income tax credits	-4.7	-0.4	8.50%
National Insurance Contributions	88.0	7.4	8.45%
Corporation Tax	38.0	3.6	9.50%
Corporation Tax Credits	-0.6	-0.1	9.50%
North Sea Corporation Tax	6.9	6.6	95.00%
Petroleum Revenue Tax	2.2	2.1	95.00%
Other Taxes and Duties	20.3	1.5	7.19%
Total Inland Revenue (Net of tax credits)	297.0	32.8	11.05
Total Customs and Excise	124.8	11.1	8.88
Net Taxes and NI Contributions	487.2	48.9	10.04
CURRENT RECEIPTS	517.9	51.5	9.95
Expenditure (£bn)	UK	Scotland	Allocation
	554.6	52.33	9.44
Surplus	-36.7	-0.8	

Forecast (SNP)

Gordon Brown's oil revenue forecasts from the 2006 Pre-Budget Report (£billion)

	2005/6	2006/7	2007/8	2008/9	2009/10	2010/11	2011/12
GDP	1238	1305	1378	1449	1524	1603	1685
Oil Revenue as % ¹⁰	0.80%	0.80%	0.80%	0.80%	0.80%	0.70%	0.70%
Oil Revenues	9.6	10.4	10.7	11.6	12.2	11.2	11.8
Scotland's share	9.1	9.9	10.2	11	11.6	10.6	11.2

Source: SNP

Total 64.5

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Forecast (corrected)

Gordon Brown's oil revenue forecasts from the 2007 Budget (£billion)

	2005/6	2006/7	2007/8	2008/9	2009/10	2010/11	2011/12
GDP	1238	1305	1378	1449	1524	1603	1685
Oil Revenue as % ¹⁰	0.80%	0.70%	0.60%	0.60%	0.60%	0.60%	0.60%
Oil Revenues	9.7	9.1	8.3	8.7	9.1	9.6	10.1
Scotland's share	9.2	8.6	7.9	8.3	8.7	9.1	9.6

Source: SNP, numbers updated from Budget Red Book 2007

Total 52.2
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