



National Audit Office

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## **Report**

by the Comptroller  
and Auditor General

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## **HM Treasury**

# Investigation into devolved funding

# What this investigation is about

**1** The four nations that make up the United Kingdom (England, Scotland, Wales and Northern Ireland) have different powers of self-government. These have been brought about by devolving public services and tax and revenue-raising powers.

**2** HM Treasury, the UK government's economics and finance ministry, has overall responsibility for allocating funding for public services in the UK. At spending reviews, HM Treasury decides how much funding it will allocate to government departments over a three- to five-year period. It allocates a 'block grant' to the devolved administrations in Scotland, Wales and Northern Ireland that they use to provide public services according to their spending priorities. Between spending reviews, HM Treasury allocates funding at annual budgets and authorises in-year adjustments to re-allocate money as priorities change. It may also announce funding for new priorities on an ad hoc basis (**Figure 1**).

**3** Most of the UK government funding allocated to the devolved administrations is determined through the Barnett formula. Before the formula was introduced in the late 1970s, decisions about the funding allocated to the Scottish Office, Welsh Office and Northern Ireland Office were subject to annual negotiations with HM Treasury, as for other government departments.<sup>1</sup> The formula aims to ensure that the devolved administrations receive a population-based share of any changes in what the UK government is spending on public services in England that are devolved in Scotland, Wales and/or Northern Ireland.

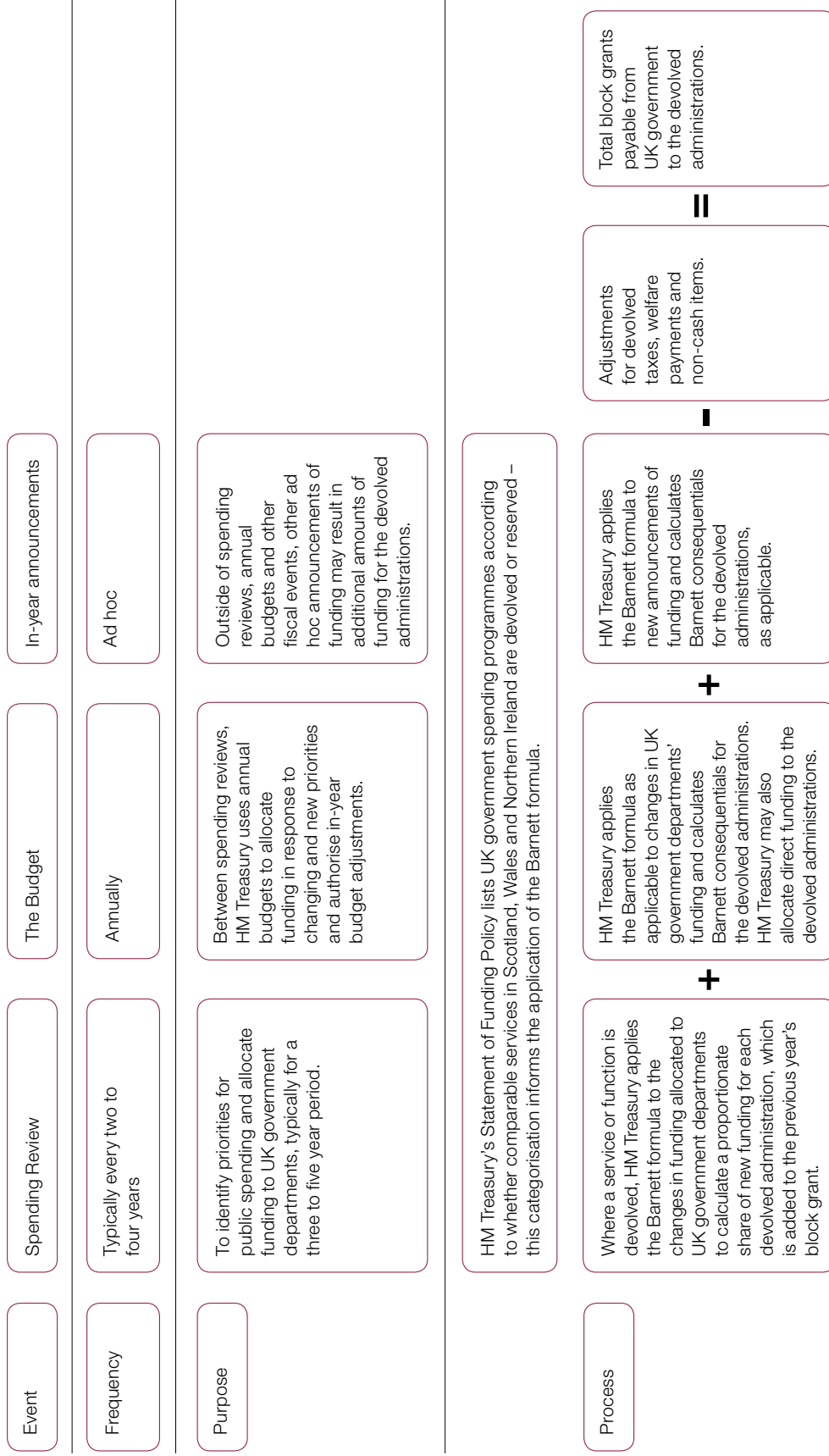
**4** The Barnett formula is not the only funding mechanism available to HM Treasury. It can also decide to allocate funding directly to the devolved administrations. For areas of spending such as public sector pensions, HM Treasury allocates ringfenced funding based on forecasts provided by the devolved administrations.

**5** Since the introduction of the formula, the devolved administrations have been funded almost entirely by block grants from HM Treasury. However, as additional administrative and legislative powers have been devolved to the nations, the way their funding from the UK government is calculated has also changed. In particular, the devolution of tax-raising powers, whereby the devolved administrations can set taxes and retain the associated revenues, means that adjustments are now made when their funding is calculated.

<sup>1</sup> Prior to devolution, the Scottish Office, Welsh Office and the Northern Ireland Office carried out a range of functions including negotiating funding settlements with HM Treasury.

**Figure 1**  
Calculating the UK government (HM Treasury) funding payable to the devolved administrations

What happens at fiscal events and how this affects the funding allocated to the devolved administrations



**Note**

1 At main and supplementary estimates, the government seeks Parliament's authorisation for its spending plans or changes to budgets.

Source: National Audit Office analysis

**6** The devolved administrations are not funded exclusively by the UK government. Funding comes from other sources, such as local and devolved taxation, other revenue-raising powers, grants from European institutions and borrowing.

**7** Government announcements of funding, such as the £20.5 billion for the NHS announced in summer 2018, led to our interest in devolved funding matters and prompted questions about whether consequential amounts of funding would be made available for health services in the devolved administrations and where this funding would come from. We were also aware of Parliamentary interest in how decisions are made about the UK government funding provided to the devolved administrations. We saw an investigation as an opportunity to present some clear facts about how funding for the devolved administrations is calculated and where it comes from.

**8** Our investigation aimed to establish how decisions on funding are reached and the different mechanisms and formulas that result in funding allocations, covering:

- the way the UK government allocates funding to the devolved administrations and the adjustments that are required, particularly in light of devolution of tax and revenue-raising powers;
- the different UK government funding streams available to the devolved administrations and the mechanisms for calculating and allocating funding; and
- the implications of changes in UK government spending plans and how these impact on the funding allocated to the devolved administrations

**9** The investigation focuses on UK government funding to the devolved administrations. We did not examine any other income sources available to the devolved administrations, their tax and revenue-raising activity, or how spending decisions are made by the devolved administrations or the value for money of their spending decisions. These are all topics that fall within the remit of the respective audit offices of Scotland, Wales and Northern Ireland.

# Summary

## Key findings

HM Treasury's role in allocating funding to the devolved administrations

**1 HM Treasury is responsible for calculating funding allocations to the devolved administrations.** Funding for each devolved administration is calculated based on the previous year's block grant. This funding is rolled forward and adjusted for changes in UK government departmental spending using the Barnett formula. Since the formula was introduced in the late 1970s, HM Treasury has used this method to determine the funding allocated to the devolved administrations (paragraphs 1.1 to 1.3).

**2 The Barnett formula ensures that the devolved administrations receive a share of the changes in planned UK government spending on functions that are devolved in Scotland, Wales and Northern Ireland.** It applies percentage factors (comparability of service, population-based, and 'needs-based' for Wales only) to the planned changes in UK government departmental spending in order to determine how much funding to allocate to the devolved administrations. Outside of spending reviews, funding allocated to UK government departments may result in extra funding for the devolved administrations. Just as HM Treasury calculates block grant allocations at spending reviews, it calculates extra funding or consequential in the same way by using the Barnett formula (paragraphs 1.3, 1.4 and 1.11 and Figure 1).

**3 Devolved administrations receive additional funding when new, additional funding is provided to UK government departments for comparable services or functions.** Whether the devolved administrations receive additional funding from changes in UK government spending depends on whether the changes are financed from existing departmental budgets or from new, additional funding. In the example of the £20.5 billion of additional funding announced for NHS England in June 2018, the actual amount of funding the devolved administrations received was less than they had expected because the Department of Health & Social Care part-funded the increase from ongoing transfers within its existing budgets. Only new money has the effect of increasing the funding allocated to the devolved administrations (paragraphs 2.15 and 2.16).

**4 The Barnett formula has no legislative basis.** HM Treasury's Statement of Funding Policy (SFP) sets out how UK government funding for the devolved administrations should be determined. HM Treasury seeks to ensure that the UK government's decisions on funding allocations are made in accordance with these rules and principles. It categorises services or UK government spending programmes according to whether they are 'reserved' (that is, the UK government retains responsibility for providing them in that nation) or 'devolved' (that is, the devolved administration is responsible for providing services comparable with those provided by UK government departments). Transport and railways infrastructure is one of the more complicated areas of funding. HM Treasury's categorisation of Crossrail as a 'local' transport project in England has triggered consequential payments for the devolved administrations of around £500 million to Scotland, along with additional funding for Wales and Northern Ireland.<sup>2</sup> But the High Speed Two project, rail infrastructure again to be located in England, is categorised as a 'national' project, with the result that Barnett consequentials are payable to Scotland and Northern Ireland but not to Wales (paragraphs 2.4 to 2.7, Figure 7).

**5 It can be unclear whether consequential amounts of funding are due to the devolved administrations for funding allocated to new services or functions established since the Spending Review 2015.** For example, funding allocated to the Home Office for EU exit-related activity carried out by Border Force is a function reserved to the UK government and therefore does not result in Barnett consequentials for the devolved administrations. However, other activity related to EU exit may be of a more general nature, so it may be more complicated to decide whether consequential amounts of funding should be paid to the devolved administrations. All of the devolved administrations have received Barnett consequentials as a result of funding allocated to UK government departments for activity related to EU exit but a lack of up to date information on spending programmes can make it difficult to ascertain how HM Treasury has calculated the consequential amounts (paragraphs 2.5 and 2.13).

**6 HM Treasury may allocate direct, special or ad hoc funding without consequential amounts of funding for other nations.** This funding is sometimes referred to as 'non-Barnett additions'. For example, England, Scotland and Wales have not received any additional funding as a result of the £410 million in funding allocated to Northern Ireland for 2018-19 as part of the agreement reached between the Conservative party and the Democratic Unionist Party.<sup>3</sup> In other examples, the devolved administrations have each received direct funding for city deals or growth deals in their localities (totalling more than £0.3 billion).<sup>4</sup> And, because of the way the Barnett formula works, the devolved administrations will have benefited from consequential amounts of funding from UK government spending on city deals in England. But England does not receive consequential amounts of funding from the UK government as a result of direct funding allocated to the devolved administrations (paragraphs 2.8 and 2.11, Figures 9 and 10).

<sup>2</sup> House of Lords Select Committee on the Barnett Formula, *The Barnett Formula*, First Report of Session 2008-09, HL 139, July 2009.

<sup>3</sup> Available at: [www.gov.uk/government/publications/conservative-and-dup-agreement-and-uk-government-financial-support-for-northern-ireland/uk-government-financial-support-for-northern-ireland](http://www.gov.uk/government/publications/conservative-and-dup-agreement-and-uk-government-financial-support-for-northern-ireland/uk-government-financial-support-for-northern-ireland)

<sup>4</sup> Refers to funding allocated to the devolved administrations up to 2021 and does not include UK government funding commitments beyond this period.

## Recent funding allocations

### **7 A large part of the block grant funding allocated to the devolved administrations is rolled forward and unaffected by population changes.**

Changes in population only affect the calculation of the annual change in block grant funding. As the populations of Scotland, Wales and Northern Ireland are falling relative to England's population, their corresponding block grant funding per head is therefore increasing. Populations in all countries of the UK have been increasing for several years but the rate of increase in Scotland, Wales and Northern Ireland is consistently lower than the rate of increase in England and the UK as a whole (paragraph 1.5, Figures 2 and 3).

**8 HM Treasury data shows that the highest actual spend on public services per head in the UK is in Northern Ireland at £11,190.** This is followed by Scotland at £10,881, Wales at £10,397 and then England at £9,080 and compares with a UK average spend per head of £9,350.<sup>5</sup> From total UK-wide spending of £617 billion in 2017-18, HM Treasury estimates that England accounts for £505 billion, Scotland £59 billion, Wales £32 billion and Northern Ireland £21 billion (paragraph 3.2 and Figure 11).

**9 In the 2015 Spending Review, HM Treasury allocated £287 billion of funding to the devolved administrations to spend for the five years to 2020-21.** Scotland was allocated indicative annual funding of around £30 billion; Wales was allocated £15 billion; and Northern Ireland was allocated £11 billion. This funding formed part of total funding of almost £4 trillion allocated to UK government departments and the devolved administrations for spending on all public services (reserved and devolved) across the UK (paragraph 1.14).

**10 The Autumn Budget 2018 resulted in consequential amounts of funding totalling £960 million for Scotland, £554 million for Wales and £325 million for Northern Ireland.** Additional funding stemmed from a variety of UK government spending decisions that resulted in increased funding for the devolved administrations. More than 50% of these consequential amounts for each devolved administration were triggered by additional funding allocated to NHS England.<sup>6</sup> Other consequential amounts included £1.6 million for the devolved administrations as a result of Coventry being chosen and awarded £8.5 million as the winner of the UK City of Culture 2021, in a competition organised by the Department for Digital, Culture, Media & Sport (paragraphs 2.9 and 2.10, Figure 8).

<sup>5</sup> Based on spending by devolved administrations and UK government departments that can be identified as benefiting the population of individual regions. HM Treasury guidance asks UK government departments and devolved administrations to apportion their spending between countries and regions.

<sup>6</sup> Department of Health & Social Care and HM Treasury, 'Prime Minister sets out 5-year NHS funding plan', press release, 18 June 2018, available at: [www.gov.uk/government/news/prime-minister-sets-out-5-year-nhs-funding-plan](http://www.gov.uk/government/news/prime-minister-sets-out-5-year-nhs-funding-plan).

**11 The devolved administrations are free to spend their allocated funding**

**(including Barnett consequentials) according to their own priorities.** They are not required to spend the additional funding on the same service or area of spending as the UK government. For example, Barnett consequentials allocated to the devolved administrations because of funding allocated to NHS England do not have to be spent on health services. Similarly, the devolved administrations are free to spend Barnett consequentials arising from funding allocated to UK government departments for EU exit-related activity as they like (paragraphs 2.9 and 2.12).

The impact of devolution on UK government funding to the devolved administrations

**12 Devolution has changed the way that the block grants for Scotland,**

**Wales and Northern Ireland are calculated.** There are specific adjustments that vary depending on the extent of devolution. While the Barnett formula continues to be used to calculate the block grants for all devolved administrations, the UK government makes nation-specific adjustments that have been agreed with the devolved administrations (paragraphs 1.6 and 1.7, Figure 4).

**13 The Scottish block grant is subject to more adjustments than that of the other devolved administrations.**

This reflects the Scottish Government's additional powers and responsibilities for setting its own income tax rates and bands and retaining associated revenues. Among other adjustments, HM Treasury must reduce Scotland's block grant to reflect the income tax revenues that the UK government has foregone. Greater tax and revenue-raising powers have also been extended to Wales and Northern Ireland, but they have yet to exercise these powers to the same degree as Scotland. From 2018-19, the Barnett formula for Wales has included a 'needs-based' factor, which has increased its funding in response to calls to recognise its more dispersed population and greater prevalence of poverty. Adjustments to Northern Ireland's block grant are minimal. The principal adjustments are to reduce funding allocations to reflect different VAT rules and the revenues the UK government has foregone in respect of long-haul air passenger duty tax, which is devolved to the Northern Ireland Executive (paragraphs 1.7 to 1.13).