

23. It is widely recognised that the application of the standard Barnett formula leads to essentially arbitrary levels of funding for the devolved governments (House of Lords, 2009; Mellett, 2009; Paun et al., 2021; Bell et al., 2021a). The calculation of block grant as the prior year's block grant plus a population-based share of changes in planned comparable spend by the UK government means there is no link between the relative spending needs of the different devolved governments and the relative levels of funding provided under the Barnett formula.
24. Instead, the *relative* funding levels will depend on historic *relative* funding levels and will change over time based on the *absolute* rate of change in planned comparable spending in England and the *relative* changes in population in the devolved nations compared to England (Boileau and Phillips, 2023). In particular:
 - 24.1. Historic relative funding levels are 'baked in' as the Barnett formula only applies to changes in comparable spending and funding, not existing baseline levels. As of 2019-20, the year prior to the COVID-19 pandemic, it was estimated that block grant funding per person was 129%, 123% and 129% of comparable spending in England, in Scotland, Wales and Northern Ireland respectively. This determined the baseline funding levels for subsequent years, including during the Covid-19 pandemic.
 - 24.2. When planned comparable spending in England is increasing by more, the absolute funding levels for the devolved governments also increase by more, but their relative funding levels tend to fall compared to England. This is because the population-based increase in funding provided by the Barnett formula is a smaller percentage increase in the devolved nations than in England given their higher baseline funding levels. Over time these smaller percentage increases lead to a degree of convergence in funding levels per person in the devolved nations to levels in England - a process known as the 'Barnett squeeze'. For example, if spending was initially £100 per person in England, and £129 per person in Scotland, a £100 per person increase in England and in turn a £100 per person increase for Scotland via the Barnett formula would mean spending would increase to £200 and £229 per person respectively. That represents the same cash difference (£29 per person), but a halving of the percentage difference (from 29% to 14.5%). The faster the increases in comparable spending in England, the more rapid is this relative convergence.
 - 24.3. When spending is being reduced in England though, the same pounds per person reduction in funding for Scotland is a smaller percentage cut, meaning a divergence in relative funding. For example, if spending in England were cut by £50 per person to £50 per person, funding for Scotland would also be reduced by £50 per person to £79 per person by the Barnett formula. Spending per person would remain £29 higher in Scotland as initially, but this would now represent a 58% (not 29%) premium compared to England. Cuts to spending during the early 2010s therefore led to some divergence in funding, and as a result, funding levels relative to England were higher in 2019–10 than 10 years earlier (Phillips, 2021a).
 - 24.4. Another factor that has tended to lead to divergence is differences in the relative population growth rates in the devolved nations compared to England. While the population shares used in the Barnett formula itself are updated to account for

same cash - amount as in England. For example, for non-domestic rates reliefs and associated grants, the number and value of properties means we would expect costs closer to the same cash amount per person as in England, not the same percentage of existing funding. The same percentage increase could have therefore led to significant 'over-funding' of the devolved nations.

67. Moreover, UK government departments significantly underspent their final budgets (by £25 billion in total in 2020-21), suggesting that financial constraints did not constrain the response by departments serving England. The devolved governments' funding was based on budgeted (rather than actual) spending in England, and ad hoc changes allowed them to carry forward the final tranche of funding into 2021-22 for use in that year. Thus while their funding was increased by the same cash amount per person as budgeted for in England, it increased by more per person than what was actually spent in England.
68. As a result of this carried-forward funding, the devolved governments were able to provide more generous financial support to businesses and households in 2021-22 than in England. For example, in England non-domestic rates relief for the retail, hospitality and leisure sector was reduced to 66% from July 2021 to March 2022, and capped at £105,000 per business for essential retailers able to remain open during lockdowns (such as supermarkets) and £2 million for business for other retail, hospitality and leisure businesses. However, in Scotland, relief was maintained at 100% for retail, hospitality and leisure properties in Scotland for the full 2021-22 fiscal year. And for Wales, relief was 100% for all retail properties with a rateable value of up to £500,000, and all hospitality and leisure properties.
69. Second, as well as providing more end-year flexibility, **the ad-hoc introduction of funding guarantees provided more certainty for the devolved governments in 2020-21**. Because funding guarantees were set at a level above what would otherwise be implied by the Barnett formula, this helped the devolved governments to plan their spending without waiting for announcements on planned spending in England. Improved communication between the UK and devolved governments also helped in this regard. **However, there remained a degree of financial uncertainty**: the funding guarantees were not in place during the first few months of the pandemic (arguably the most uncertain time); the guarantee levels were increased during the course of the year; and they did not apply in 2021-22.
70. Third, the fact that the Covid-19 pandemic was a relatively **symmetric shock across the nations of the UK meant population-based funding via the Barnett formula was more appropriate** than it would have been if the pandemic significantly disproportionately hit some nations more than others. Reviewing the evidence on health impacts, as summarised by excess mortality and deaths attributed on death certificates to Covid-19, Bell et al (2021b) find similar trends across the UK nations, with Scotland and Northern Ireland seeing, if anything, lower excess mortality and reported deaths than England up until March 2023. Reviewing the evidence on economic outcomes, the same authors highlight similar trends in employment and earnings in England, Scotland and Wales (Northern Ireland fared better in both), broadly similar shares of furloughed employees, similar residential property transaction trends, and for Scotland, similar trends in GDP (high-frequency GDP estimates are not available for Wales and Northern Ireland).
71. **These three factors (significant funding, ad-hoc changes and a reasonably symmetric shock) helped mean that concerns expressed at the outset of the pandemic were not**

- 88.1. As discussed earlier, the UK government agreed to remove reserve drawdown limits for the Scotland Reserve when the Scottish fiscal framework was renegotiated in 2023. Limits currently remain in place for Wales.
 - 88.2. As discussed earlier, the UK government also agreed to increase borrowing and reserves limits in line with inflation, after first increasing the limit for resource borrowing for forecast errors and reconciliation payments to £600 million in all years (by removing the provision that this higher limit only applied during a 'Scotland specific shock'). Limits currently remain frozen for Wales.
 - 88.3. As discussed earlier, the Barnett formula remains in place but a 'needs-based factor' has been introduced for Northern Ireland providing the NI Executive with 1.24 times its population-based share of any change in planned spending in England.
89. Some features of the fiscal frameworks have remained the same, however:
- 89.1. The UK government appears to concur with us that funding guarantees should not be a permanent feature of funding arrangements, having not used them again since 2020-21.
 - 89.2. The UK government has not followed our alternative suggestion of automatically allowing devolved governments to carry over late in-year increases or defer late in-year decreases in funding.
 - 89.3. The UK government has not followed our suggestion of providing the Scottish Government with limited discretionary resource borrowing power when the Scottish fiscal framework was renegotiated. Nor have such powers been provided to the Welsh Government or NI Executive.
 - 89.4. The BGA calculation method for Scotland has remained the same, despite the Scottish Government requesting some form of insurance against idiosyncratic shocks or trends in revenues (Scottish Government, 2022a). No changes have been made to the calculation of BGAs for Wales either.
90. Taking these changes into account, my view is that the most serious remaining issue for the devolved fiscal frameworks in relation to funding certainty and flexibility is the lack of discretionary resource borrowing powers.

Potential temporary changes to rules during future crises

91. Bell et al (2021a), also considers what changes should be considered during future crises with major implications for the devolved governments' finances.
92. We concluded that **some combination of relaxed borrowing rules and funding guarantees should be rapidly introduced in a future major fiscal shock where spending decisions are likely to need to be taken quickly and on a rolling basis.**
 - 92.1. Both would help devolved governments address the short-term effects of the crises, but they are not perfect substitutes and have their own advantages and disadvantages. For example, the funding guarantees allowed the UK government to

continue its direct control over UK borrowing and debt, and also keep devolved government debt relatively low. From the perspective of the devolved governments, the headroom provided by the guarantees comes at no cost to them, whereas the headroom provided by borrowing may require repayment in subsequent years, if additional Barnett consequentialia are not forthcoming allowing them to unwind the borrowing. On the other hand, from a UK-wide equity perspective, granting enhanced borrowing powers instead would have meant that there was no risk that the UK government was providing the devolved governments with a higher-than-population share of the funding to address the shock, whereas such a risk did exist under the funding guarantees. Enhanced borrowing powers would also give the devolved governments greater flexibility to decide how much extra they need to spend, potentially providing greater flexibility to address asymmetric impacts of a shock.

- 92.2. Funding guarantees and enhanced borrowing powers therefore differ in the extent to which they provide certainty to the UK and devolved governments, and the degree of both flexibility and responsibility they provide to the devolved governments. Thus, if a similar shock arises in future, the choice or balance between funding guarantees and enhanced borrowing powers should depend on the importance placed on these different objectives. To the extent that certainty over funding and borrowing levels is valued highly by the UK and/or devolved governments, provision of most of the funding headroom deemed necessary via funding guarantees is likely to be more attractive. But if greater flexibility and/or responsibility for the devolved governments is seen as desirable, and/or the risk of the shock impacting asymmetrically across the nations of the UK is considered likely, greater reliance on enhanced borrowing powers will be more attractive.
93. We concluded that **decisions on the fiscal response to a future fiscal shock should be made on an ad hoc basis, rather than on the basis of a pre-defined set of quantitative rules.**
- 93.1. While the IMF and OECD recommend setting out formal criteria for when the economic situation should warrant a relaxation of the rules (as with the definition of a Scotland-specific economic shock, for example), they recognise that this is not possible for all fiscal shocks, including natural disasters and pandemics (see Eyraud et al., (2020)). And similarly, it is infeasible to set out in advance exactly what sort of fiscal response would be most appropriate to any given fiscal shock.
94. We concluded that **it is unlikely to be feasible to rapidly develop bespoke formulas to allocate funding on a needs basis in response to asymmetric shocks. However, the UK government can and should bypass the Barnett formula (or any replacement formula) if, during the course of forecasting and monitoring the impact of a fiscal shock, it becomes clear it is having disproportionate impacts on one or more of the UK nations.**
- 94.1. Assessing spending needs is difficult, and limited data will likely be available for such purposes during the early stages of a crisis. The design of such a formula is likely to be very politically contentious.

Conclusions and recommendations

178. This report has described the funding arrangements for the devolved Northern Irish, Scottish and Welsh governments, and local authorities across the country, both in 'normal' times and during the Covid-19 pandemic, addressing questions 1, 2, 3 and 5a in the terms of reference provided to me. It has assessed the performance of these arrangements, in terms of whether they enabled the devolved and local governments to effectively respond to the Covid-19 pandemic, addressing question 4, 5b and 6. It has also drawn lessons for funding arrangements going forwards, both in normal times (to improve resilience to more modest shocks) and in potential future pandemics and national emergencies, addressing questions 7 and 8.
179. Answers to questions 1 – 6 are summarised in boxes in the main body of the report. These underpin the lessons drawn (questions 7 and 8), which we summarise here.
180. The overarching recommendation I would make for potential future national emergencies would be to maintain a flexible rather than rules-based approach for determining which arrangements to utilise. Bearing this in mind, the general lessons I draw from the Covid-19 pandemic for future national emergency situations are:
- 180.1. Updated contingency plans for potential future pandemics and national emergencies, which the UK and devolved governments have committed to producing in response to Module 1 of the Inquiry, should include options for funding arrangements for devolved and local governments. They should set out the principles for how decisions on the funding arrangements to use in particular circumstances will be made, and guidance for particular funding arrangements that enables their rapid implementation. This is not currently the case and should be rectified.
- 180.2. The UK government is usually best placed to raise funding for a national emergency, given the large and liquid gilt market, and the Bank of England's liquidity and quantitative easing operations. Direct borrowing by the devolved or local governments would likely take longer and be more costly, especially if large amounts were being borrowed for the first time.
- 180.3. The UK government should be ready to bypass the Barnett formula and target funding at particular nations or regions of the UK in the case of a large asymmetric emergency. This approach would provide greater insurance against asymmetric shocks than allowing devolved and local governments to borrow to fund measures themselves (as in that case, those facing bigger shocks would need to borrow and pay back more).
- 180.4. The use of temporary funding guarantees, set at a level somewhat above the level implied by Barnett formula at any given point, mean the devolved governments do not need to wait for announcements of new spending for England before planning and announcing their own measures. The provision of modest discretionary borrowing powers, either during a period of crisis, or more generally (see below) could also provide them with such flexibility.