

# HOUSE OF LORDS

*Thursday 11 Mar 2010*

## **Barnett Formula**

*Motion to Take Note*

12.37 pm

*Moved By Lord Richard*

That this House takes note of the Report of the Committee on the Barnett Formula (First Report, Session 2008-09, HL Paper 139).

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**Lord Richard:** My Lords, the exodus having taken place, perhaps I could say one or two words about the Barnett committee. I had the privilege of chairing your Lordships' ad hoc Committee on the Barnett Formula. It was an interesting committee, whose membership is worth looking at. Not only was the membership good but it produced a unanimous report. We were helped in coming to our conclusion by our special advisers, Mr Alan Trench and Mr Peter Kenway, who gave us invaluable advice. We were extremely well served also by one of your Lordships' Clerks, Ms Audrey Nelson. It is almost de rigueur now to mention Clerks, but she did an extraordinarily good job and I am very grateful to her.

The mandate given to the committee was necessarily limited. It was,

"to examine the purpose, methodology and application of the Barnett Formula as a means of determining funding for the devolved administrations of the United Kingdom, to assess the effectiveness of the calculation mechanism to meet its purpose and to consider alternative mechanisms".

I am delighted that my noble friend Lord Davies of Oldham will reply for the Government to this debate. He has always struck me as the sort of Minister who is essential in any Government. You give him a brief on anything and he gets up, he is persuasive, he is bland, he is pleasant and he is very good at defusing a situation and bringing the temperature down. I pay tribute to him for all those qualities, which I have observed on many occasions in the past, but I am bound to tell him that, in all the briefs that he may have handled from that Dispatch Box, to defend the position of the Government on the Barnett formula is going to prove a very difficult, forensic task indeed. At the outset, he has my deepest sympathy.

Our terms of reference were not only limited but they specifically excluded consideration of three particular areas. One was the overall system of funding the devolved Administrations, particularly tax-raising powers. Secondly, we were not allowed to consider other political aspects of the devolution settlements. Thirdly, we were not allowed to consider the distribution of funds within the different regions of the United Kingdom. Therefore, the scope of the inquiry that the Select Committee undertook was focused tightly on the methodology and the practical application of the Barnett formula.

We asked ourselves four main questions and produced unanimous answers to them all. First, what is the Barnett formula; what is its purpose; how did it come to be introduced; how has it worn with time? Secondly, how does the formula at present operate, particularly the part that the Treasury plays? Thirdly, is the formula still relevant and, if not, what should be done? Fourthly, is it possible to produce a formula for the distribution of moneys from central government to the devolved Administrations that is based on an assessment of need rather than, as at present, only on population?

I cannot resist going into the history of the Barnett formula a little, although I see that my noble friend Lord Barnett is here. The history is interesting and, indeed, instructive. It dates back to 1976, when it was felt by Ministers in the Treasury that a formula was needed to determine the territorial distribution of public spending in the UK. As far back as 1888 the

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Goschen formula-named after the then Chancellor of the Exchequer, the one whom Lord Randolph Churchill forgot-allocated funds based on the population: 80 per cent to England and Wales, 11 per cent to Scotland and 9 per cent to Ireland. Over time the precision of that formula came to be eroded. After World War II successive Scottish Secretaries of State negotiated additional allocations. They argued special needs, such as sparsity of population in the remote areas and density and poor housing in the central belt.

The introduction of what became known as the Barnett formula was part of a wider attempt to constrain public spending in the mid-1970s. The new formula was in essence an update of Goschen, being based on population rather than need. I cannot resist quoting from one or two portions of the evidence given by the noble Lord, Lord Barnett. He made it clear to us that the formula was not designed as a permanent solution. He said:

"I thought it might last a year or two before a Government would decide to change it. It never occurred to me for one moment that it would last this long".

Later, I put it to him:

"You devised a mechanism which helped the Treasury to distribute money. You did not base it on need. It was a straight population index and you did not think it would last".

To this, the noble Lord, Lord Barnett, gave a simple and definite answer: "No". When asked whether he thought that the formula had been successful, he answered in thoughtful terms:

"Successive Governments over 30 years have kept it going. I do not consider it is successful. I do not think it is fair. It cannot be fair with this kind of gap ... At the moment, all one can say is that the figures indicate a huge gap in the expenditure of the different regions".

Right at the outset of this debate, the author of the formula is disclaiming any responsibility for its longevity.

One of the oddities of this part of our inquiry was that it emerged that, at the very time that the Barnett formula was being proposed by the noble Lord, Lord Barnett, the Treasury was engaged in a detailed assessment of need. The noble Lord, Lord Barnett, was asked whether he knew this. He replied:

"If they were, it was not done by me personally. I was not doing any needs assessment".

Summing up his evidence, I put it to him in this way:

"As I understand it, what you have been telling us can probably be summed up in two sentences. You devised a mechanism which you hoped would last for a few years. You did not expect it to last for as long as it has lasted. You are not sure now whether it is based on the right criteria and you lean towards having, among other things, a needs-based assessment. Is that fair?".

He answered: "That is fair".

It is very clear that the formula was devised in a not particularly intricate or sophisticated way to deal with a short-term problem and that it was intended to be temporary. It is perhaps understandable that in those circumstances it was found easier to base it on population rather than on any assessment of comparative need. The formula has been in existence ever since. It has become one of those subjects that most now agree is crude, unsophisticated and ineffective. There is no doubt, based on the totality of the evidence that we have received, that needs and fairness have never been taken into account. They should be and it is high time that they were.

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One of the issues that we considered in detail was the role of the Treasury in administering the formula. It is quite frankly opaque and murky. On many issues the Treasury is judge and jury in its own court. Decisions on Barnett consequentials are taken in secret with no consultations and then presented to the devolved Administrations on a take-it-or-leave-it basis. We were firmly of the opinion that this procedure was unsatisfactory. Decisions on, for example, the extent to which expenditure on the Olympics should attract a Barnett consequential were made by the Treasury and put to the devolved Administrations with little opportunity for them to question those decisions. I think that that is wrong.

Of course, the formula works in the sense that it provides a mechanism for determining mathematically the amounts that should go from central government to the devolved Administrations. The flaw is that the formula itself is based on population criteria going back to the mid-1970s. It is no longer sensible or fair to keep the baseline for payments where it was 35 years ago. The proportions allotted to each nation in the 1970s were based on the situation then. That is no longer appropriate. Things have changed. Populations have moved. Different areas have become more or less prosperous and communications have improved, yet the baseline has remained constant. It is very difficult to justify this on any grounds save perhaps prolonged ministerial torpor.

Furthermore, the way in which the Treasury has dealt with formula bypass problems and Barnett consequentials means that the whole edifice is now distorted. When we questioned Mr Liam Byrne, the Chief Secretary to the Treasury, and specifically asked whether he thought that the Barnett system was fair, the furthest that he would go was to say: "it is fair enough". What "enough" meant in those circumstances was not entirely clear, at least not to me.

One of the committee's main recommendations was to take the administration of the formula out of the hands of the Treasury and transfer it to an independent expert body, which we suggested might be called the United Kingdom funding commission. It is important that the new commission should be independent. The Commonwealth Grants Commission in Australia offers an institutional model of an independent body with responsibility for making recommendations about the allocation of finance. We said in paragraph 73 of our report:

"It should be the role of such a body to recommend the allocation of public monies based on population and through a new needs-based formula".

We accepted that the Treasury would need to retain authority over the overall level of the block grant but not the proportionate allocation of the grant between the devolved Administrations.

The example of the Australian commission is helpful. It is an advisory body to the federal Government with terms of reference framed by the Commonwealth Treasurer after consultation with the states and the territories. Crucial to that operation is the fact that its impartiality is accepted by the states and the territories and the fact that the commission's advice has always been accepted by the federal Government promptly

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and without demur. We therefore agreed that the allocation of the block grant should be determined by such an independent objective body and no longer by the Treasury itself.

If we concluded that the present system was not based on an assessment of what is fair and what is needed, we then had to consider whether it was possible to produce a needs-based formula to replace the present system. In many ways, this was the most important part of our report. It was not for the committee to decide what a fair allocation was or might be. Our function, as we perceived it, was to show that a needs-based system was possible and would be workable without too much angst. Of course, we accepted that it would not be possible to undertake a fully comprehensive needs assessment every year or two. The one in the 1970s took three years to arrive at its final conclusions, which astonishingly do not seem to have been passed to Ministers at the time. Nevertheless, it was a major, comprehensive piece of work.

Instead of that we came to the conclusion that it was possible to arrive at a much fairer allocation of resources by looking at a smaller number of indicators. In the report, there are two illustrative charts, or webs-one with eight indicators and the other with 12. Neither of them was meant to be wholly definitive, but they are wholly indicative of future possibilities.

We tried to take account of the four major aspects of each devolved Administration: the age structure of the population; low income; ill health and disability; and economic weakness. The age structure of the population was easily determined. Low income could be represented fairly by the number of children in poverty, as conventionally defined. Ill health and disability could be represented by the mortality rate and economic weakness by unemployment. It would be possible to argue that our criteria are too few and insufficient-that may or may not be so-but the fact is that you

can get a clear indication of relative needs by using a few major indicators. One would produce a much fairer result on that basis than the operation of the Barnett formula does now.

It is perhaps worth quoting the conclusions that we reached in paragraphs 101 and 102, where we said:

"While we are not in a position to reach a conclusion about precise relative needs in the four countries and regions, on the basis of our initial analysis, we believe that Scotland now has markedly lower overall need than Wales and Northern Ireland in comparison to England. The current allocation of spending does not properly reflect this basic pattern across the devolved administrations ... We recommend that an alternative system on the broad lines suggested above be created to establish a new baseline grant for the devolved administrations and to review needs on a regular basis so that allocations of funds to the devolved administrations reflect the changing patterns of relative need".

Finally, there is the issue of the Government's response to our report. I am bound to say that in all my experience, both here and in the other place and perhaps elsewhere as well, I have rarely if ever seen a response to a Select Committee's report that was weaker intellectually or more politically disingenuous. My noble friend, who is to wind up this debate for the Government, has my deepest sympathy. The essence of the Government's position seems to be that the present situation is fair enough, whatever that means.

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The only people who thought so were the Treasury, the territorial Secretaries of State and Mr Brown. Certainly, there was no sign of any deep analysis or appreciation of the magnitude of the issues involved. It was extraordinarily disappointing to be told that the Government did not agree with our report because they had no intention of implementing it and that they had no intention of implementing it because they did not agree with it. That does not seem to me to take the argument much further. Of course, one can and does understand that the electoral timetable makes it difficult for any Government to commit themselves at this stage, but the government response that all is well when it clearly is not is not good enough.

In our report, we have set out what I believe to be comprehensive and convincing arguments: first, that the present situation is unfair; secondly, that it is possible to arrive at a much fairer mechanism than at present exists; and, thirdly, that the administration of whatever the new formula might be called should be taken away from the Treasury and administered by an independent commission. This is one of those issues that for many years successive Governments have found it easier to live with than to reform. I understand the politics behind the reluctance, but I really cannot condone it. The present system is faulty and quite simply unfair. It needs to be put right and put right soon. I hope that this report may hasten that process.

**12.53 pm**

**Lord Lawson of Blaby:** My Lords, first, I thank the noble Lord, Lord Richard, who chaired in an exemplary manner the committee on which a number of us here sat. It was a very agreeable committee to be a member of. I should like to thank the other members, because we had a very good spirit. We had a range of backgrounds and experience and we reached agreement and unanimity without any difficulty and without even the chairman having to wield a heavy stick. We reached a happy unanimity and produced a result which, I believe, will stand the test of time, unlike the Government's reply, to which I shall come a little later, as did the noble Lord, Lord Richard.

Governments face two kinds of difficulties. There are problems for which the solution is very difficult to discern and problems where the course is clear and it is politically difficult to implement. It is clear where this particular issue fits-in the latter category. However, it matters that we deal with this problem for a number of reasons. The present system is grotesquely unfair, which is leading to an increasing sense of grievance, which could be very damaging for the union. This is not the only important public expenditure issue by any manner of means, but it is one at a time when the need to curb and control public expenditure is the number one challenge facing the next Government, whichever party provides that Government. Therefore, this needs to be addressed. The Government after the election will have to take a whole lot of politically very difficult decisions. If it is going to duck this one, I am afraid that there will be a sense that it will duck everything that is difficult, which would be absolutely disastrous. Indeed, I do not want to attach too much weight to the

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financial markets, but if they were to think that that was the case it would be a grave threat to our country in ways that I do not need to underline.

The problem is a conceptual one. The purpose of public expenditure is to assist not territories but people. That is the point. Over the course of years, as the noble Lord, Lord Richard, said, we have reached a certain point as a result of differing population trends. I leave aside social security payments of all kinds, which are outwith the Barnett formula; those payments, along with the taxation system, which is also outwith the formula, are the ways in which the differing needs of different people in the United Kingdom are primarily addressed. Here, we are talking about the rest of public expenditure quite apart from that. Public expenditure per head in Scotland under the Barnett formula is 27 per cent higher than it is per head in England. There is no rational justification for that whatever. That has arisen because of differing population trends.

There has been a very considerable growth in population in England since the Barnett formula came into effect, whereas there has been virtually no increase in the population in Scotland. The demographic projections say that that will get worse. People talk about there being an inherent convergence, but from the demographics we can see that there will be a divergence. From figure 1 of our report, we can see that the divergence of population of Scotland and England will be far greater in the next 20 years even than it has been in the past 30 years. Of course, the formula, as the noble Lord, Lord Richard, pointed out, is not based on actual population; if it were, there would be a rough and ready justice, but because the baseline is not touched under the formula and only the annual increment is affected by it, the population basis gets progressively more out of date, unrealistic and unjust. That has to be addressed earnestly by the Government of the day, whoever that may be; they must be prepared to take unpopular decisions on public expenditure, if they are right, on the grounds of fairness and justice.

I find the Treasury's response to this an embarrassment. I deeply regret it. During my eight and a half years as a Treasury Minister, I had a great respect for the Treasury; indeed, I am one of the few people who had a great affection for the Treasury. However, this reply is an insult to the House. It is only three and a half pages long, of which more than half is just a regurgitation of things that we said in our report, leaving about one and a half pages of actual Treasury response. All it does is to state what the status quo is and its unwillingness to entertain any possible change. Well, we know what the status quo is. Its only argument-if argument it be called-states:

"The Barnett formula operates according to long standing principles".

That is it. I thought that new Labour was meant to be a reforming Government. Apparently the essence of new Labour now is that if it operates according to long-standing principles, that is the end of the matter. It does not address the population point which, as the noble Lord, Lord Richard, and I have tried to point out, is absolutely central to this. It therefore does not address at all the projected deterioration in the system

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due to the increasing divergence of population trends, nor does it address the outcome so far. None of that is addressed.

We in the committee have produced a solution-which is agreeable to all sides of the committee and to all parties-to a problem that no Government can escape. I hope that we will have a Government who have the courage to adopt the solution that we have put forward.

**1.02 pm**

**Lord Livsey of Talgarth:** My Lords, I hope the House will bear with me, because I am the Welsh affairs spokesperson for the Liberal Democrats and will address most of my remarks in that context. I am sure that my colleague from Scotland, the noble Earl, Lord Mar and Kellie, will address such measures as the Calman report, which is not dissimilar to the Holtham report, which has come out on funding the needs in Wales.

I congratulate the noble Lord, Lord Richard, the chairman of the Select Committee, on this excellent report. The Barnett formula is crucial to us in Wales, where the economy is extremely fragile. It is one of the two key points that have to be resolved in Wales; the other is law-making powers-on which the noble Lord, Lord Richard, also chaired a commission. He and his fellow commission members made recommendations in their report with which I wholly agreed.

Our problem is that, for example, if we get law-making powers in Wales in the referendum which is likely to occur this autumn, we may not have the means adequately to carry out economic policies to regenerate large parts of Wales, because, as has already been said, it is a very unfair formula as regards needs. The Government of Wales Act 2006 opens the door, but if we get law-making powers, we will need to follow it up very rapidly with reform, on a needs basis, of the Barnett formula.

My country, Wales, has large sparsely populated areas. Some parts are as sparse as the highlands of Scotland. Other parts are old, decaying, formerly heavy industrialised areas, for example in the Valleys. We have a low-wage economy. We therefore have a lot of needs. The conclusion of the Select Committee report on the Barnett formula lists quite a number of facets and makes extremely sound recommendations. It says that the advantages of the current formula are,

"simplicity, stability and the absence of ring-fencing".

There is a failure to take account of population changes, as has already been said, and that creates a significant problem. Therefore,

"the resulting per capita allocations are arbitrary and unfair",

and, indeed, they often fall short. The baseline represents a population level that has changed and,

"the Treasury is judge in its own cause".

Much of this has already been stated, so I do not want to go over it in its entirety.

The recommendation for a clear process and open consultation is very important for the devolved Administrations of the UK. This consultation needs to be clear, thorough and accessible. The recommendations on the independent commission which the Select Committee report wants to see in place are of particular

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interest. It has to be a fair resolution, and it has to be seen to be fair. It has to be comprehensible, stable and predictable. It has to respect territorial autonomy. As the report says, and as the noble Lord, Lord Richard, stressed, any needs assessment has to address the questions of age structure, low income, ill health, disability and economic weakness.

Taking those in the context of Wales, for example, we have a higher number of elderly people by a factor of 3 or 4 per cent. We have lower family income by as much as £7,000 per family. Our levels of ill health and disability are a legacy of heavy industry, whether in the coal and steel industries or from working long hours in the countryside. We also have economic weakness. Our GDP seems to have been stuck on 80 per cent of the average. That penalises many of us, and the result is that Wales does not produce a sufficient surplus for investment in a much more resilient economy.

The government response to the needs list-it is undoubtedly a Treasury response-was rightly criticised. It contains words such as "notes" and "concern". The Government say that devolved Administrations should be allowed to determine their own assessment of needs and priorities in devolved areas.

The committee also suggested a transition period to implement the new arrangements, but the Government's response was to say that they have no plans to make such changes. We in Wales find such responses from the Government in Westminster very familiar. The Government's attitude to the report's constructive proposals reminds me of a slightly erring child being patted on the head and told, "There, there; we'll think about it. But please go away now. I have lots of other things on my mind to consider". Well, we in Wales have news for you. We will not stand for this kind of treatment any longer. We are used to it, but we have overcome it. We have now had 10 years of devolution, and we have a lot more confidence than we used to. We have a just cause not only in relation to public services but in relation to building up a new entrepreneurial economy in Wales, which is extremely important to us.

While the Calman commission has considered the funding of initiatives in Scotland through adjustments to the tax system, we in Wales suggested in 2007 that we should have an independent committee to look at the question of the Barnett formula. The Holtham commission was set up and it reported last July. It concluded that Wales was losing out to the tune of £300 million per year. The result-in lower spending on pupils, higher education, the NHS and local government-is evident. Spending on children's education in Wales, for example, is £500 per child less than in England; higher education is less adequately funded per student, and the NHS is constrained by higher demand from the factors that I have already mentioned.

Sparseness of population is another issue where we used to be compensated much more adequately than we are now. There is a lack of affordable housing and quality jobs. Public sector employment is sometimes more dominant than private sector employment, so the impending cuts are bound to be

another factor affecting, for example, the spending of local authorities. In the private sector, we do not have any multinational HQs or bank HQs, but we often have closures-such

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as Burberry in the Rhondda, Bosch industries near Cardiff and Anglesey Aluminium, to name just a few. The situation is therefore one of need. The Holtham investigation made some very constructive proposals, which there is no time to mull over now. None the less, they are rather similar to those in the Select Committee report. The main point is that both reports support a needs-based formula. We should proceed soon to finding a fair replacement for Barnett. We will surely make significant progress there, which will be extremely fair.

**Lord Tunncliffe:** My Lords, this is a timed debate of three hours. The advice on eight minutes-

**Noble Lords:** No!

**Lord Livsey of Talgarth:** My Lords, I was informed, as were we all, that the suggested time for speeches is 10 minutes. I have done that.

**Lord Tunncliffe:** My Lords, I apologise to the House. I was not in the Chamber at that point. I am very sorry to have interrupted.

**1.13 pm**

**Lord Moser:** My Lords, I also speak as a member of the committee which, like the noble Lord, Lord Lawson, I enjoyed enormously. It was agreeable and, thanks to our chairman, we were led with great calmness through this rather complex issue towards total unanimity. Of course, the statistical side interested me particularly. I also want to pay my tribute in retrospect to the ingenuity of the noble Lord, Lord Barnett, in creating the formula in the first place. Its survival over some three decades is a tribute in itself, and it makes it doubly significant that the noble Lord himself has urged the case for reviewing his creation.

Let me say straight away that our deliberations and almost all the evidence-with the notable exception of the rather complacent attitude of the Treasury to the whole thing-left me in no doubt at all that the original formula has now had its time. For all the reasons already expressed by the noble Lord, Lord Richard, it does not lead to a fair and truly equitable funding allocation across the UK, which is what it was all about. The time is then right for a new approach, which has to be a proper needs-based formula.

That approach has been considered many times over the years but not pursued. One argument against it has been that a needs-based approach cannot be done objectively. Judgments are, of course, involved in selecting appropriate measures of needs, but if those are done properly-especially by an independent commission-there is a safeguard in total transparency and good research back-up. Moreover, we need to remember that the Treasury's application of the present formula is not exactly judgment-free either.

It has also been argued that a needs-based formula is too complex to be practicable. As I hope that our report shows, that is just not the case. As the noble Lord, Lord Richard said, we have produced a purely illustrative model with a few key principles involved.

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The formula has to be simple, not only in its construction but so that it can be easily understood, so we suggest limiting it to a small number of broad-brush proxy indicators that, between them, get to the heart of funding needs. They must be based on good up-to-date official statistics, both to produce a new, sound baseline for the formula and for annual increments. Importantly, the formula must lend itself to easy periodic assessment and adjustment. Because relative needs will change, it is important that it is a flexible instrument. To deal with another possible objection, I stress that in my view this sort of approach in no way undermines territorial autonomy for the devolved Administrations in deciding how to spend their money. That is a different issue.

In our model, we chose illustratively to focus on four broad categories of measurement that have a bearing on needs. They are the size and structure of the population; issues of income and poverty; health and disability; and general economic strength. Each of those, and perhaps others, would be represented by proxy indicators that simply measure the number of people with a particular need as a proportion of the population. Obviously, population is the starting point, as it was for the Barnett formula. Conversely, however, it is not only the size, as in the Barnett formula, but the sex and age structure. Age is particularly important because many needs vary substantially between the young and the old, so, illustratively, our indicators distinguish between the under-fives, those aged from perhaps five to 16, and the old-say, the over-65s.

We make suggestions, as the noble Lord, Lord Richard, has said, for low income as a possible indicator. Child poverty is conventionally favoured in that respect. It is certainly a good proxy, but so would be reverse household income, which some of our witnesses proposed. We have our own suggestions for measuring health and disability, and for the general economy, perhaps through employment measures. I stress, as our chairman did, that these examples in the report are purely illustrative; they are not definitive or complete. It would be totally up to the advisory funding body—the proposed independent commission—to propose the choice of suitable proxy indicators. A great deal will depend on the availability of really responsible up-to-date figures. We were hampered in our examples by not including housing, because there are no suitable figures, or population density—a very important measure, but here again there are no national figures. All this can change with time and improve, and that is one reason why we proposed the involvement of the UK Statistics Authority in this whole task, perhaps allied to the proposed commission.

Choices have to be made not only about the proxy indicators, but also about the weights to be attached to each indicator, so that they can be combined into a single, overall measure of needs. We suggested that the weights be based on how much national public expenditure is related to each type of need. Again, there is a choice: there are different kinds of weights that can be considered.

What we have shown, very much with the help of our expert advisers, is how a needs-based formula can be constructed. The age-old objections to going down

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that route may have political backing, but they certainly cannot be justified on statistical or methodological grounds. We emphasised repeatedly that, especially in the hands of an independent body, backed by thorough and on-going research, this was an eminently practical task. It is just not true to say that it is difficult or too time-consuming or too complex—that is not so.

If we are serious about allocating funding in a fair and equitable manner across the UK, the Government's duty now seems clearly to move to an explicit needs-based formula.

1.23 pm

**Lord Barnett:** My Lords, I congratulate my noble friend Lord Richard and the committee on an excellent report. When I persuaded the House to set up an ad hoc Select Committee, I hoped it would be a strong committee, and I was certainly not disappointed. It was a very strong and distinguished committee; it had two Secretaries of State for Scotland and the former Chancellor of the Exchequer, the noble Lord, Lord Lawson, with whom I agree from time to time-and I certainly agree with him and what he said today. It was wonderful to hear the noble Lord, Lord Moser, with his great statistical knowledge and experience, speak in the way he did in support of the committee's report.

The case for a needs-based formula has been set out so clearly in this report and by speakers in this debate that there is no need to repeat it. The reason I have been pressing for change for so long is, as has been pointed out by other speakers, the need for basic fairness in the allocation of expenditure. The worry I have had for some considerable time is that, if we did not do something about it soon, the only people who would benefit from this would be those who wanted to break up the United Kingdom, like the SNP in Scotland-something of which I doubt whether anybody else in this House or in any other House would be in favour. The overwhelming case in this report has been made brilliantly, in my view, as has the case for an independent commission to deal with the job.

I should like to follow the noble Lord, Lord Lawson, on one aspect-this whole question of convergence that we have heard so much about. Like the noble Lord, I have affection for officials in the Treasury; no one who has spent as long as he and I have in the Treasury could not but have affection for officials there. But convergence was referred to in paragraph 53 of the report, and it is worth quoting:

"The most serious criticism of the current basis of funding is that, whilst the core allocation (the baseline) has been built upon since the Formula was first applied, it has never been reviewed".

The only convergence there could conceivably have been, therefore, would be back to that corrupt baseline. But in any case, over the years that have gone by, there has not been any convergence, so how anyone could say that it would bring about convergence I do not know, because we have seen that it has not brought about convergence.

As I indicated in my evidence, from which my noble friend Lord Richard was kind enough to quote, I never expected that the formula would last three years, let alone 30 years. I think it was the noble Lord, Lord Moser, who said that it was a tribute to the formula

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that it lasted 30 years. It was not a tribute to the formula; it was a tribute to the fact that Governments of all persuasions do not like to make the major changes that are needed. As we all know, that is really the case-it is not just new Labour; it is everyone else as well.

I myself thought it would last only a short period time. It began to be recognised as the Barnett formula only after the Thatcher and Major Governments kept it going for another 18 years, followed by the Blair-Brown Administration for another 13 years. So, when I published my book in 1982 called *Inside the Treasury*, which everybody will have read, of course, I never even referred to the formula, because I never dreamt it would last that long.

Now there is the question of pressure for a review. I should indicate that it is not anti-Scottish; it is about fairness. Indeed, when we have a needs-based formula, which I am sure we will have at some time or other, there will need to be a transitional period, as the committee rightly said. It is possible that the review might show that Scotland needs some extra money. There is certainly a case for parts of the north-west of England and the whole of the north-east-if one looks at the figures and sees how badly they have done-to have some more expenditure. I do not know how long the transitional period would have to be, but there may well be a need for a transition if the grant to Scotland were substantially reduced. Why on earth anybody should worry politically about it, I do not know, because after keeping that formula for 18 years-I do not have to tell noble Lords-the Conservative Party lost every single seat in Scotland. So keeping the formula going or turning it into what is called "a recognised formula" did not exactly do it any good. The next Parliament, whoever forms the Government, will, as the noble Lord, Lord Lawson, indicated, need to make major cuts. If it does not do something about this, the people of England will not take kindly to those public expenditure cuts when they see, as the noble Lord, Lord Lawson, said, 27 per cent higher expenditure-approximately £1,600-per head in Scotland. It is very cleverly used by the present SNP Administration in Scotland to the political benefit, it hopes, of that party.

I come now, briefly, to the Government's "response", though it is a disgrace to call it a response. The committee made a carefully drafted case for change, and what did the Government say? I do not mean my noble friend Lord Davies, who, I am sure, would not have said this. In paragraph 2.15 the Government note the committee's views. They go on to welcome "the careful analysis". What will the Government do? We are told that they will,

"keep all aspects of public spending under review".

We do not need another review; we have an excellent review here in this report. There has been no attempt to answer the overwhelming case made. In paragraph 2.17, all we have is that there are,

"no plans to make ... changes".

It must not just end here. There is a need now for whoever is in government after the next election to do something about this report. Public expenditure will

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be a crucial issue. The noble Lord, Lord Lawson, referred to it as the number one challenge for the next Administration. I entirely agree.

In chapter 2 of the report, we are told that spending in devolved Administrations is £62,956 million and the part subject to the formula is £48,976 million. It is not petty cash. I hope the Minister and the Opposition will today make a case. Doing nothing is simply not possible. I hope my noble friend will not, once again, give us some waffle. I know he is very good at it. Perhaps today he will give us a better reply to this excellent report. We have not had it yet but I hope we will by the end of today, whatever my noble friend says and whatever the Opposition say. We should remember that when David Cameron went to Scotland for the first time as leader, he assured the Scots that he would keep the formula. He obviously had not noticed what had happened previously. I hope that whoever is in government after the next election will implement this report. It is vital to the future of this country.

1.33 pm

**Lord Forsyth of Drumlean:** My Lords, it is a pleasure to follow the noble Lord, Lord Barnett, who is responsible for the paternity not just of the formula but of our committee. I recall that he fought pretty hard for it. The first time around there was a view that the committee might not be needed. When I saw the composition of the committee, I thought, "This is going to be an absolute nightmare. Here we have a lot of very strong Members of the House who are coming from completely different directions. There is no way we will be able to get a consensus on something as complex as this". It is a real tribute to the noble Lord, Lord Richard, and his chairmanship of the committee that we did.

I have to say, it was great fun and this House at its best. The path before us was laid out inexorably towards the conclusions we reached. There was no rancour or division in the committee. Some of it was quite amusing. One of the things that amused me most was all the vast academic tomes and theses that have been produced about how the Barnett formula was carefully constructed to achieve convergence and was all very clever. These were blown sky-high out of the water, not least by the evidence which the noble Lord gave to the committee. It turned out that the formula was a short-term political fix. All the attributes that had been ascribed to it were post facto rationalisation.

It is very hard to argue against having a needs-based formula. I cannot think of any such arguments. When I was Secretary of State, I struggled with that. It is something that is on my conscience. The reason why the work to try to develop a needs-based system of funding was being done when the noble Lord, Lord Barnett, was producing his formula in the Treasury was that it was then anticipated that there would be a Scottish Assembly. However, the referendum was lost. The officials in the Treasury knew very well that you could not have a devolved Administration without some kind of objective needs-based system of funding. All the efforts by the Treasury over the years, as set out in the committee's report, to move to a needs-based system were as a result of anticipating devolution.

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If I may be just a little partisan, one of the things which was quite disgraceful was that when the present Government took office in 1997 and decided to set up a Scottish Parliament, the then Chancellor-not the Prime Minister-gave absolute instructions that there was to be no work done on a needs-based system. The Parliament would be funded on the Barnett formula. That was a fundamental strategic mistake. I agree with the noble Lord, Lord Barnett: the sooner that this is dealt with, the better. It is unanswerable. We have the absurd position of people in the devolved Administrations and elsewhere arguing that it would be a very difficult to have a needs-based system. However, when they get their £30 billion, how do they distribute it? It goes to health and local government by using formulae that are based on needs. It is simply intellectually impossible to argue that there is one rule for the determination of the amount and another for its subsequent distribution to devolved authorities within the devolved areas.

I have a confession. When I was Secretary of State for Scotland and negotiating with the Treasury on the Budget, I was briefed by my officials under no circumstances to let the Treasury talk me into moving to a needs-based system of funding. They told me then that it would result in Scotland losing £2.5 billion to £3 billion of funding. I hope the House will forgive me if I saw it as my job to look after Scotland's corner and took that advice. One of the reasons why I was totally opposed to a Scottish Parliament was that I realised it would mean moving to a needs-based system.

For us, as Conservatives, there was political difficulty in moving towards a Parliament when we could not find a system of funding that would not result in a substantial reduction in funding. The noble Lord kindly pointed out that we were not particularly strong in Scotland, and we were even less so after my tenure. With all the other problems, including West Lothian, that was one reason why we opposed devolution. The moment a Scottish Parliament was established, it became inevitable that we had to have some kind of objective system of funding. The noble Lord says that maintaining Barnett did us no good because we lost every seat. We did not take a position on any of these matters because of what we thought was in our party's interest. We did it because of what we thought was in Scotland's interest.

Professor David Bell from Stirling University is one of these academics who has made a great career out of explaining the Barnett formula. He now estimates that the amount Scotland would lose as a result of a needs-based system would be £4.5 billion. I do not know whether that figure is correct but it rings alongside what I was told when I was Secretary of State. On page 41 of the report, the committee produced a diagram which shows broadly the needs of the various parts of the United Kingdom. One of the things that is clear is that the needs of England and Scotland are not very different. We have to accept that if we move to a needs-based system, there will be a substantial reduction in the grant available.

Therefore, what I want to highlight from the report to whoever forms the next Government is that it is absolutely essential that we do this over a long transition period. You cannot do this overnight. This issue is a ticking time bomb at the heart of the union; it is very

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important that it is defused and not allowed to explode. Therefore, the first point is that we need to have a long transition period.

The second point is that we could do with fewer reports which do not address this matter. The Select Committee in the other place has reported on the Calman commission report today, which had no mention at all of funding or Barnett, which I find quite extraordinary. The Calman commission blithely says that Scotland should move to a needs-based system of funding as soon as practicable, and says that the gap in funding can be filled by allowing the Scottish Parliament to raise income tax. A gap of £4.5 billion, assuming no reduction in yield—which is highly unlikely—would mean putting 15p on the basic rate of income tax. That is before you start to deal with the consequences of the reductions in public expenditure which will be required in order to deal with the deficit.

These are very serious matters which could do enormous damage. What we need is not more taxes in Scotland, but a period of time where value for money can be obtained and where the required reductions can be carried out. Incidentally, the Nuffield Foundation produced a report about a month ago which showed that, although Scotland was benefiting by about a quarter more on expenditure for health, England was doing rather better in many respects because of the reforms carried out here but not in Scotland. There are policy implications here and the Scottish Parliament needs time to adjust to it.

Thirdly, I think it is irresponsible of the Government not to address these issues, but I understand the politics. Therefore it is very important that we have this independent body to recommend what the allocation of funds should be, and that the Treasury's arbitrary powers be taken from it. We had the extraordinary evidence from the Secretaries of State that the Scottish Parliament wanted to build a second Forth road crossing. This is very expensive, and the Scottish Parliament is not able to

borrow. There was a bit of a row, and the Treasury decided that the Crossrail scheme was a UK scheme so there were no Barnett consequences. As a result of the row, which happened to coincide with a by-election-I am sure the two are not in any way connected-it was suddenly decided that, after all, there were Barnett formula consequences from Crossrail. The Government turned full circle. I do not know which is right or wrong. Perhaps the Minister could, in his wind-up comments, tell us whether there will be Barnett formula consequences from the high-speed rail link which we heard about this morning. If that will cost £30 billion, then the Barnett consequences will be £3 billion. I can tell you that Alex Salmond will be spending the money even as we speak. We need to have some order, rigour and objectivity about this, because the Treasury is judge and jury in its own court.

I am conscious that I am out of time. I just say to the Government that this is a very important issue for the United Kingdom as a whole, for people in Wales, for the north-east of England and for elsewhere. I accept that devolution is here to stay. The noble Lord, Lord Barnett, does not have paternity of devolution; the Government have. They owe it to the country and

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to the future of the United Kingdom to follow through what they started by having a funding system which is seen to be fair, which is objective, and which everyone can look to as a basis upon which to carry on with this constitutional innovation in the regions and countries of the United Kingdom.

**1.44 pm**

**Lord Morgan:** My Lords, I think there are only two advantages to the Barnett formula. One is that it has given my noble friend Lord Barnett cause for everlasting fame. People forgot Goschen, but they will not forget the noble Lord, Lord Barnett. That is a good thing.

The Barnett formula has also produced for 30 years, I suppose, a stable and seemingly simple way of adjusting expenditure throughout the United Kingdom. However, I agree with all the previous speakers, who said that it is deeply unsatisfactory. We have had a solution that, as the noble Lord, Lord Barnett, explained, was thought to be temporary in 1978. This emergency stop-gap-this political fix, as the noble Lord, Lord Forsyth, said-has become a long-term feature of our constitution in a way that is very characteristic of this country. It has become increasingly unpopular; IPPR research has shown how unpopular it is. The Government's response, as we have heard, is pathetic and intellectually contemptible, and I was deeply sorry to see it.

The judgments of the Barnett formula are now clearly out of date. They are based on a passage of time but things have obviously changed. The calculations for the baseline expenditure should have changed. They are based on population not need, and are therefore crude and unfair-particularly for Wales, where the population growth has been slower and where there have been considerable changes in the economy, as the noble Lord, Lord Livsey, said. Therefore, Wales is directly disadvantaged. We have had asymmetrical devolution, and now we have an asymmetrical formula.

I want to speak briefly about not the financial aspects, on which other noble Lords are far more expert than I am, but the constitutional weaknesses of Barnett. First, it seems a very centralised system, dictated by Treasury control-the noble Lord, Lord Richard, said that the Treasury was judge and jury in its own cause. Treasury decisions are based on the allocations in England. England in this context is another country, like the past. This affects the block grant in Wales and goes against the spirit of devolution, which seems to be a fundamental constitutional contradiction.

Secondly, although Barnett appears to be a transparent system, it is not transparent at all. It does not have accountability written into it, and is not at all a model of open government. The Richard committee evidently found difficulty in discovering the relevant statistics on how it had worked. Indeed, when it was operated, there was evidently much confusion. The committee heard, I think, from witnesses about "Barnett plus" and "the Barnett bypass", where particular kinds of expenditure were taken out of account-notably the expenditure in Wales from Europe under Objective 1.

Another aspect is that the constitutional change so far has not affected England. The Barnett formula seems very unfair to the different regions of England-the

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north-east, the north-west and East Anglia, where, by the test of needs, there should be very different and more substantial allocations. The operation of the Barnett formula, as we have heard, has been very damaging to Wales. The reason for that is historic. It is rooted in the history of Wales, whose political and administrative personality developed later than those of Scotland and Ireland. Administrative devolution only began in Wales at all in 1907 in education. It was much more developed in Scotland and Ireland, and Wales has suffered.

The progress, such as it is, towards convergence has been very unhelpful and very unfair to Wales; it is based on English levels of spending. It has led to the Barnett formula becoming the Barnett squeeze. The Holtham commission's findings are devastating on this. It shows how spending per cap has gone down steadily in Wales from £125 per £100 in England down to £113, and projections show that it could go down to £107 or worse. Wales is in many ways one of the most deprived areas of the United Kingdom and is in danger of becoming the most underfunded part of the United Kingdom. That seems very unsatisfactory and unfair. There is therefore a very strong case, which has been brilliantly made by the Richard committee, for a much more rational system. The committee very helpfully suggested the analogy of the grants commission in Australia. Such a system would be transparent; it would be based on objective criteria; it would show an ability to shift baseline calculations over a period of time; and, above all, it would be based on need.

As other noble Lords, and notably the noble Lord, Lord Livsey, have said, the relative needs of Wales are greater than those of England when measured by unemployment, child poverty, claimants of benefits, housing and education. At present, the system does not reflect this and Wales has suffered most unfairly. However, it should be said that we need a system that is congruent with devolution. Some of the solutions that were proposed to and considered by the Richard committee were in a sense relevant to a quite different system-for example, if the United Kingdom were a federal country, which it is not and nor do I wish it to be. Therefore, we need a solution that is consistent with devolution and it needs to come from a Government who believe in devolution.

Taking that context into account, the Richard committee has done a very great service. As has been said, this is the second great service that my noble friend Lord Richard has performed for the people of Wales. His commission in 2004 on the legislative powers of the Assembly brought about an enormous improvement. It led to improvement through the Government of Wales Act, and there will be more improvement if, as I trust, Wales has a referendum on the legislative aspects later this year.

Therefore, we have had major legislative reform and I hope that, in addition, this committee will produce an important fiscal reform. I hope that it will give new authority to the Welsh Assembly. The Holtham commission has suggested ways in which the powers of the Assembly could be shaped in framing its budget and in moving funds from a capital to a resource budget. Very wisely,

the Holtham commission suggests  
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that funding for Wales per capita should not be changed until a new system is in place. At the moment, it is manifestly unfair and getting more unfair year by year.

I strongly welcome this report as being consistent with an increasingly pluralist United Kingdom based on differentiation and diversity. I hope that, as part of that, the Barnett formula will soon be reversed, as it is doing considerable harm, and that in Wales the Holtham commission's proposals will be taken seriously and enacted. Then, I think we will have a devolution settlement that is made on a durable and rational basis, which I am afraid does not exist today.

1.53 pm

**Lord MacGregor of Pulham Market:** My Lords, as I approached giving evidence to the Select Committee and as I approached this debate, I was tempted to say, "Here we are yet again", for many of us have been critics of the Barnett formula over many years, not least in this House. More recently, we have had the Calman commission, to which my noble friend Lord Forsyth referred, with its recognition of the importance of a needs assessment. Now we have this excellent report. The Government's response has never been argued; it has always been, "Please just shut up and go away". I congratulate the committee on an admirable report and, in particular, I congratulate its chairman, the noble Lord, Lord Richard, on his masterly introduction to this debate.

I well remember 1978 and the period when the noble Lord, Lord Barnett, was formulating what at that time was not recognised as the Barnett formula. He was under enormous pressure on the public expenditure front. We were giving him a terrible time in the Finance Bill Standing Committee in the House of Commons. It was only when I subsequently became Chief Secretary that I realised why he found the Barnett formula to be an easy way out of one particular problem in the public expenditure round. It meant that for three departments he did not have, yet again, to make tortuous arguments through the night in negotiations to reach a public expenditure settlement.

Certainly, when I became Chief Secretary I was anxious to do something about the Barnett formula. In fact, we set up a small committee of officials to look at some quite limited aspects of change that we might have got through by the time of the 1987 election. I would have liked to set up a needs assessment but the problem was that time was running out in that Parliament. I shall come back to that point towards the end of my speech. We have subsequently seen changes. In the 1990s, we saw some modest adjustments to the population formula but nothing fundamental because, of course, it is the baseline that should be challenged.

The flaws are recognised but, as others have said, putting them right has been too difficult politically at various times, as it is now administratively. I was interested to see that the then Chief Secretary, Liam Byrne, who gave evidence to the committee, placed some emphasis on all the administrative difficulties, but he himself recognised that there were major disadvantages to the Barnett formula. In fact, at one point he said that there were three, and he listed them.

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They are the sort of arguments that we have been deploying today. He was then asked by the chairman, the noble Lord, Lord Richard:

"But they could all be corrected, those three disadvantages?",

and he replied:

"I hope you are going to tell me that".

That is precisely what the committee has done. It has told him exactly how the flaws that he himself recognised-I am not sure that he was adhering to a Treasury briefing-could be put right.

I do not want to go over all the arguments that have already been rehearsed but I want to stress that, for me, it is all about fairness and the obvious inequity in having the key baselines-I keep coming back to them-established on assessments that were made well over 30 years ago and were not based on need. Indeed, my noble friend Lord Lang, in his excellent and charming autobiography, recognised this point about fairness. He said:

"When under attack once again from the Treasury in 1994"-

so the issue was clearly arising slightly again-

"if they had asked me to agree to an impartial reassessment of Scotland's relative needs, I would have felt obliged to agree to it and to abide by its outcome".

I do not know why the Treasury did not press him along those lines at that time. My noble friend recognised that the formula,

"makes no attempt to define need".

The point concerning fairness was also acknowledged by Liam Byrne as Chief Secretary.

It is important to stress that it is a question of fairness not just between the territories but also between the regions. The Treasury calculation of identifiable public expenditure per head in 2006-07 showed, with the UK being 100, Scotland at 117-or 122 if expenditure on social security payments was taken out-England at 97 and East Anglia, where I come from, at 83. Therefore, there are inequities within the regions as well. We were told that it was all too difficult. The noble Baroness, Lady Hollis of Heigham, got that absolutely right in the evidence session with the committee when she pointed out that the rate support grant was calculated on the assessment of need. If that can be done, it can certainly be done elsewhere.

There is a new factor, which is well recognised in the Select Committee's report. In the summary, the report refers to,

"increasing scepticism about the fairness of the Barnett Formula which may be exacerbated by any deterioration in the public finances".

That is the point that I, too, want to stress. As my noble friend Lord Lawson said, we are now in that situation and will be for a long time to come. I do not know whether other members of the committee received in their post this morning a briefing for this debate from London Councils. Incidentally, on that assessment of identifiable public expenditure per head based on a figure of 100, London does rather well. In answer to the question,

"Can Barnett survive the challenging financial environment?",

London Councils says:

"The extremely challenging financial environment for public services further highlights the inequities and unfairness inherent in the Barnett Formula, making its continued application unsustainable

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and a potential source of tension. This is inevitable in such a tight financial environment with diminished real-term resources for both central and local government".

It is very interesting that London Councils, of all people, latched on to this and recognised that we were debating the formula today. If London Councils is doing it, you can just imagine the turmoil there will be as we move into the much tougher public expenditure environment if the formula is not tackled now.

The recommendations of the Select Committee will be increasingly relevant as we move into this period of stringent scrutiny of all public expenditure and the fair distribution of it. As I said earlier, I recognise that the fag end of this Parliament is not the time to set up the commission that the Select Committee recommends—that was the problem I faced in 1987. The start of the new Parliament would be the ideal time to set up the commission and let it do its work. However, as speakers before me have pointed out, there is no recognition of this, not even a nod in the right direction, in the Government's response.

The Government start off by saying:

"We welcome the Committee's report".

They do not mean it, and the whole response was a total farce. I hope we get better answers from the Minister today. It is no disrespect to him, and I very much concur with what the noble Lord, Lord Richard, said about him. I admire the way he moves so skilfully and seamlessly from one subject to another, but I have no doubt that in his brief there will be effectively a straight, "Clear off, go away, tell them to shut up". I hope we in this House will not. We now have an authoritative, all-party report, and I am most grateful to the committee for the comprehensive work it has done and the recommendations it has made. The work clearly and conclusively demonstrates that the Barnett formula is no longer relevant, and the committee has given us the way out.

**2.01 pm**

**Lord Sewel:** My Lords, I had better make it clear at the outset to my noble friend on the Front Bench that, like everybody else, I have no words of comfort for him. However, I look across the Chamber to the noble Baroness on the opposition Front Bench: I look forward to hearing her clarify her party's position on the Barnett formula and say whether Mr Cameron's position is still as it was reported earlier in the debate.

I have a couple of things to clear up. The first relates to the fact that the Barnett formula has no impact on the distribution of regional expenditure in England. That is an English matter, which the English will have to address; it is not determined by the Barnett formula at all. Secondly, everybody is agreeing with everybody else in this debate, so an element of disagreement might be appropriate. In that context, one turns to the noble Lord, Lord Forsyth. Following the noble Lord is always a bit of a challenge, because he is a passionate, sometimes persuasive and occasionally partisan

politician. His two great passions are the Conservative Party and the union, for both of which he has done noble duty. He virtually annihilated the Conservative Party in Scotland and from time to time I am concerned that, despite his commitment to the union, he might be in danger of bringing it to an end.

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However, I am sure that his heart is in the right place. That is the tragic irony with some of these debates: the political outcomes and the policy discussion get a little out of joint. I fundamentally disagree with the view expressed by the noble Lord, Lord Forsyth, that it was wrong not to change the funding formula when devolution was introduced. I believe that it was right to maintain what had gone before-the Barnett formula-over that transitional period. With a great deal of political change, there was a strong argument to have the stability, continuity and predictability that the continuation of the formula allowed.

However, I agree with all speakers that the mistake has been in not looking at and reviewing the formula subsequently, once the political institutions had bedded down. There is now an urgent case to make it clear that the funding formula passes the test of fairness and equity. Like everybody else, I have come to the conclusion that it no longer does; not only that, but I believe that it is so structured that it cannot pass that test. Let us look at the two elements of the formula: the base and the annual increment. Neither of them can be convincingly defended. The base, as we know, goes back to 1978. If you look at the amount in the base, about 10 per cent predates 1978. Everything in the base from then on are these annual increments that have been built up and aggregated, with the effect that the money in the base is financing services for a population that no longer exists. It is dealing with a series of fantasy populations: they were historically there, but they are not there now. It is a degraded, degenerate population formula. That is its primary weakness. The increment is effectively just a crudely driven population formula that pays no attention at all to need. That is a great weakness.

One of the great things about the inquiry that we held was that we learnt quite a lot as we went along, sometimes from the academics and sometimes not. One of the revealing things was that the explanation for the disparities between the various territories was not what many of us thought it was likely to be-the differential use of formula bypass. Some of us on the committee had spent some time trying to argue for formula bypass, and quite successfully. But it was not that at all. As some noble Lords have pointed out, it had to do with relative population movement over time. Put simply, if your population is going up and you have that type of base formula, your per capita expenditure will inevitably go down.

Let us look at Wales and Scotland, the two nations that are perhaps most obviously affected by the formula. The population of Wales is going up and, according to the needs analysis that we carried out, its needs are greater than those of anywhere else in the other three territories in the United Kingdom, so Wales gets a double hit. In Scotland the relative population is going down, so per capita expenditure is increasing. It is apparent that its relative needs are not as great as those of other parts of the United Kingdom, particularly Wales. Indeed, Scotland is now the fourth most prosperous part of the United Kingdom. That is a policy success. One of the problems is that we are reluctant to recognise such policy successes. Scotland has come up; it has

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been a success. That does not justify its retention of a high level of public expenditure. Perhaps a readjustment is needed.

If we look forward, the question must be: what is the alternative? The committee came down clearly in favour of a needs-based approach. We did not have to look too far for that because, as the noble Lords, Lord Forsyth and Lord MacGregor, pointed out, you just have to look at what the devolved Administrations are doing themselves. They distribute money to their major spending areas-local government and the health service-on a needs-based system. We have a strange position in Scotland, where Mr Swinney, the Scottish nationalist Finance Minister, wants to retain the Barnett formula to get the money into Scotland but, once it is there, he wants to use a needs-based formula to distribute the money around Scotland. That is not very consistent. The point has been made-and I accept it-that if it is distributed on a needs-based formula, it ought to come in on a needs-based formula.

As the Government are reluctant to embrace the idea of a needs-based system, there is a danger that they might try something else. The obvious thing is to move a percentage out of the base and distribute it according to the incremental formula. If, say, 10 per cent came out every other year, that would over a relatively short period bring about a major change in the territorial distribution of money within the United Kingdom. It would be based purely on population and would not be related to need. That would be a very adverse move indeed.

The greatest argument for moving towards a needs-based system follows on from what my noble friend Lord Morgan said. It is the system that sits most easily with the idea of devolution. Devolution provides for the three territories what I have always considered to be the best of both worlds. They have the ability to make local decisions about local problems according to local priorities, while at the same time, at the macro level, enjoying the benefit and security of being a member of a larger state, which gives that larger state the opportunity and responsibility of dealing with matters such as fairness and equity. That is how I believe you square the circle of devolution. A needs-based approach is the way forward. It is right and proper that you then give those devolved Parliaments and Assemblies the opportunity to make additional adjustments either upwards or downwards through taxation, according to their own values and political priorities.

We are now in a position where virtually no voice is raised in support of the existing system. It is bust; it is broken. I see a finger being pointed, but the noble Lord has said nothing yet; we are waiting for a conversion on the road to somewhere, so he may tear up his speech. The existing system is discredited. We have to move to a needs-based system and it has to be done with a degree of sensitivity. We must recognise that adjustments will be needed and that the long transition period will have to be handled with a degree of sensitivity.

2.13 pm

**Lord Trimble:** My Lords, I, too, had the pleasure of serving on the ad hoc committee on the Barnett formula. I use the word "pleasure" because, as my noble friend

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Lord Forsyth, said, the committee turned out to be great fun. At the outset, I had difficulty conceiving how the committee might result in agreement, let alone a unanimous agreement. It was a very pleasant surprise to find that we all agreed. The key term that has come out of the speeches during the day is "needs-based", and that is what we are suggesting. It is the sensible thing to do.

I emphasise one point which is very important in the context of a needs-based system: we must preserve the concept of the block grant. Reference was made to the formulas for funding local authorities in England. We do not want to see that sort of situation obtaining because that would,

effectively, mean detailed Treasury control. It would produce the situation which existed in Northern Ireland under Stormont, when there was detailed Treasury control of all expenditure. We did not have block grants then, but we now have a block grant, which is a considerable advantage to the Administration. As the noble Lord, Lord Moser, said, we are looking for a number of proxy factors which can be taken together to produce a simple formula which is related to needs, but without being a detailed ground-up construction of needs. It is important to make that point.

I do not want to say too much about the needs-based formula itself. Another important term is "transparency", and I urge the Minister who is to wind up to reflect on that. It is crucial that we have a transparent system. We all know that there is much public concern about Barnett. In parts of England, there is a feeling that we have drifted into a financial arrangement which is somewhat unfair. As that feeling is then focused on the Barnett formula, I can well understand why the noble Lord, Lord Barnett, wants to disassociate himself from that. He does not want the public opprobrium which is around at the moment. It is ill focused, as they think the Barnett formula has produced this unfair situation. That comes back to the absence of transparency. If we are to deal with the public concern-in many cases legitimate public concern-we need a system which is transparent, and if the Treasury is not prepared to move immediately in the direction of the sort of commission we are mentioning, at the very least it needs to make the existing process as transparent as possible. Maybe we will be able to go further, but I emphasise that transparency is hugely important.

It is also important to get some balance in the way in which we are looking at this. At the outset, my noble friend Lord Lawson made the point that Barnett covers only part of the expenditure in the regions-a very significant part-but it refers to annually managed expenditure relating to benefit; the welfare system is not part of Barnett. Essentially, Barnett is a population-based formula and, in addition, we have a number of other avenues whereby money can be found. From the point of view of local administration, the annually managed expenditure comes simply as a result of how many people are on benefits, or whatever, and the main Barnett money comes because of the population formula, which it cannot change. Therefore, the other little extras become very significant and you focus on them because that is the only way in which you get some money and have greater flexibility. Those areas are and, inevitably, will continue to be under the

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control of the Treasury. The Treasury does not have to feel too defensive about this. We will not deprive it of its major areas of power.

We note in paragraph 46, on year-end flexibility, how, in the course of one discussion, the Treasury suddenly decided in 2007 to release £900 million from the accumulated underspend in Scotland. I am sure that the Scottish Administration thought that it was Christmas when they received that extra money, which they could do something with. There is also the contingency reserve. We had a very interesting exposition from Mr Liam Byrne about the basis on which the contingency reserve can be accessed, which depends essentially on a wholly exceptional situation. From the point of view of the Administration, that is an important matter.

There is also the Barnett bypass. We deal with that in paragraph 42. Whatever might have happened in previous years, in recent years the Barnett bypass has been comparatively limited and the Government said in evidence to us that only matters which they regard as wholly exceptional come through that route. The example given in paragraph 42 is an arrangement which I had the pleasure of negotiating along with Mark Durkan with the Government for what we called a reform and reinvestment initiative in Northern Ireland. That reminds me of a point made again by my noble

friend Lord Forsyth in his comments when he pointed out that, although there is more money in the Scottish health service per capita, the outputs are not as good as the outputs in England, where they do better with less money.

That is why we were persuaded and why the Treasury was prepared to give us some additional scope with that initiative, because what Mark and I were proposing, or hoping to do, was to try and start reforming public services in Northern Ireland, which have not been reformed. The changes and reforms that have happened in public services in England, limited though they may be, have not been replicated in the regions and that is a huge problem. Instead of people in Scotland and Northern Ireland approaching this issue defensively, saying, "We must cling on to the amount of public expenditure we have at the moment", they would be better served if they approached this issue saying, "We need to use the money better and we will find that we can get by on less". That is important.

I regret to say that, since Mark and I negotiated that nearly nine years ago, nothing has happened. The direct rule Administration that took over after 2002 did nothing about it and the new devolved Administration in Northern Ireland are also doing their best to avoid facing up to the realities which will, inevitably, force their way through.

The fourth extra way in which you can get money is through new projects which generate Barnett consequential. We give examples of those in paragraph 44 and a couple of them have been mentioned-the Forth road bridge in Scotland, Crossrail and the Olympics. We are not trying to take the power away from the Treasury, but endeavouring to put in position a more transparent process.

In paragraph 60, we recommend that before decisions are made as to whether the system is bypassed, or a consequential is created, there is a clear process and

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open consultation with the devolved Administrations. I think that that should obviously be there; it is not there at present. The Administrations simply get told whether they are getting a consequential or not, and whether that will change depends on how much fuss they can create and how much pressure they can put on politically.

We further suggest, in paragraph 77, that the new commission that we have in mind might give advice to the Government as to whether these consequential adjustments should arise. So we are not trying to deprive the Treasury of power in this matter, but to put in place a better process that would be more open, more transparent and more likely, we hope, to defuse some of the public concern that is clearly there at present and needs to be addressed.

Parenthetically, on the question of consequentials, the terminology that we have to use-because it is the terminology that already exists-as to whether a project is a UK-wide one, or an England-only one, is misleading. It may mislead people into thinking that some decisions or matters are England-only. The things that are classified as England-only are the ones that trigger consequentials. What is important for the devolved Administrations is whether or not there is a consequential. If it is said to be UK-wide, there is no consequential and no extra money. If it is deemed to be England-only, then there is extra money, so obviously the England-only decisions are matters of huge importance to the devolved Administrations. If anybody runs around with the quaint notion that these England-only decisions should be taken only on English votes, they will find that there are huge uprisings in all the devolved Administrations and a constitutional crisis. I want to underline that: do not let the terminology mislead noble Lords on that matter.

In conclusion, if we do not have the reforms to Barnett that we are suggesting, and if the Government do not go down the line that we have suggested here, the political pressure to go down other lines will become greater. By other lines, I am thinking partly of Calman. I think that Calman, in concept, is misconceived and is the wrong road to go down-it will be very difficult in practice and very dangerous for the union. I say to the Government that if they want to sustain the union, they should not sit back and do nothing, because then things will drift in the wrong direction.

We want to see these reforms introduced. I hope that, as suggested by my noble friend, the next Government, whoever they may be, will take the opportunity of starting off with these ideas and running with them. I can understand why the Treasury of the present Administration, tired as it is-I shall not say too much more about that-is not going to do anything in the remaining weeks, but I hope that the next Parliament will.

2.24 pm

**The Earl of Mar and Kellie:** My Lords, I am glad that we are debating this report and its conclusions as I believe that it points a way towards a fairer union. It certainly presents difficulties when it comes to implementation in Scotland, but it rectifies underfunding and unfairness for Wales and Northern Ireland and

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of course, it could pave the way to a more systematic funding method for the English regions-not that we were allowed to consider their plight, and nor should they be considered as the equals of Scotland, Wales or Northern Ireland.

I believe there to be a substantial desire in Scotland and elsewhere for increased self-government, allied to a belief that the union should be fair and should evolve to accommodate this desire for greater self-government within the union. Certainly, the union has evolved dramatically since 1603. The treaty that my predecessor signed and promoted in 1706 bears little resemblance to where we are today, and nor should it. Multinational states must evolve or become redundant.

Given my own minority position, as someone seeking political independence for Scotland and a confederal union, this inquiry and report was an interesting exercise in how to develop the current devolution settlement. Leaving aside the problem of altering the block grants, perhaps the biggest problem of the present system, the Barnett formula, is the inevitable fact that, as devolution expands and the years pass, so policy deviation will increase-quite rightly-to the point that the various polities are doing significantly different things. The Barnett formula is, of course, derived from policy in England. That connection may become ever more irrelevant and obscure. This is made worse by the Treasury's control of the decision about consequential funding, or the decision that a new policy is a UK activity or a devolved activity.

These increasing anomalies are replaced by the new formula of identified objective criteria, needs assessment and an independent grants commission. The needs assessment process should be placed on a statutory footing and carried out every so many years. In between these assessments, the agreed percentages will be used by the Treasury to announce the annual block grant. It would be just as easy as it is now. This needs assessment and grants commission formula would be an improvement to the devolution settlement and prolong its life.

However, greater self-government is demanded and is certainly needed. The union has a lot more support than the current settlement deserves. Further development would take us to either the

anomalous "devo max" and the convoluted thoughts of the Calman commission; or to a federal union, which would be very difficult to construct; or to a confederal union, where sovereign states pool some of their sovereignty in limited policy areas.

I hope that the United Kingdom Government will begin to respond more favourably to this report than they have done so far. They should take confidence from the strong support for a fairer union and face up to the alteration to the block grant, in the name of fairness. If that should happen to make the people of Scotland think that taxing themselves and making all their own decisions was simpler and more logical, then the British family is growing up and moving out, back into the world. Scotland may well come to realise that it is the 35-year-old who needs to leave home. This report may provoke such a reaction in the long run. In the short term, it sorts out unfairness and copes with policy deviation.

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**2.29 pm**

**Lord Lang of Monkton:** My Lords, given the relatively short time available, I hope that the House will indulge me if I focus my remarks primarily on the situation of Scotland in the scheme of things in this debate, not least since it was with the then Secretary of State for Scotland, Bruce Millan, that the noble Lord, Lord Barnett, signed his original deal which gained the soubriquet, the Barnett formula. I am delighted that the noble Lord, Lord Barnett, is with us today participating in our proceedings. He is clearly in very robust health. I wish that we could say the same for his formula, but sadly not.

My other reason for wishing to focus on Scotland is that towards the end of my tenure there, I was approached by my special adviser with the news that I was the longest-serving, continuous-serving Minister in the entire history of the Scottish Office. Moving on to another department, I was able to preen myself that at least there was something to show for my nearly 10 years in the job, when my honourable friend Lord James Douglas-Hamilton immediately overtook me, whereupon he celebrated that achievement by moving to this House and changing his name from Douglas-Hamilton to Lord Selkirk of Douglas.

It was in the nature of territorial departments of government that the Secretaries of State for such departments would-indeed, must-fight for cash to deal with the territory's problems. His duty of loyalty was clear and absolute. It was the way to deal with issues of relative need. Indeed, it was the only way. The fruits of victory of such Ministers and their special pleadings became baked into the respective baselines. They can still be seen like sedimentary layers in the geology of their spending blocks. The Barnett formula did not change the size of those blocks in the devolved territories, which is one of the reasons why it was never a long-term solution. But it simply tweaked the annual increases.

In the economic conditions of the late 1970s and the early 1980s, there was perhaps a rough justice in the funding levels that then obtained. But neither the block nor the Barnett formula specifically recognised relative need and that, as many others have pointed out in this debate, is still the case and the core of the problem. In addition, since the late 1970s, a number of things have happened. For example, the relative sizes of populations have varied without always being adjusted into the

funding arrangements. For a time, Scotland's relative economic position in the United Kingdom improved. It has not persisted in the past decade, but in the late 1980s and 1990s it rose quite sharply.

But a significant change in the situation was brought about by devolution. As my noble friend Lord Forsyth has already argued, devolution changed everything. Among its follies was the loss of the role of the Secretary of State for Scotland. All the benefits that such a role had brought Scotland cumulatively over the previous 100 years were simply discarded. Scotland's voice at the centre became more muffled. The Secretary of State no longer has a department to speak of. He has no budget of any size and, therefore, no influence. His role is largely confined now to telling Mr Salmond what he can and cannot do, and to filling a seat at the

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table to pad out the Cabinet. Any idea that the Scottish Secretary can still influence Cabinet colleagues-Crossrail notwithstanding-to grant more money to Mr Salmond to do with it what the Secretary of State's own party in Scotland is probably opposing, defies credibility.

As this and other shortcomings of devolution have emerged, the call for further change and more powers has grown. Some of us used to talk about a slippery slope and were castigated for doing so. But the fact is that the constant call for more powers was built into the DNA of devolution from its very beginnings. That is why there is now so much dissatisfaction with Barnett north and south of the border. As usual, the unhappiness centres around money.

Of course, the system lacks accountability and the Government should explain why they ever thought that devolution without accountability of some kind was sensible. That devolution settlement is becoming increasingly unsettled, with three separate strands of possible turmoil. First, there is the question of independence. Perhaps I may digress for a moment. Of the funding of public expenditure in an independent Scotland, I would simply say that to base a country's future public expenditure plans on revenues from oil-a wasting asset of indeterminate life expectancy, of increasing production costs, of uncertain national ownership and of wildly fluctuating price, and traded in volatile currencies-is irresponsible in the extreme. In the past seven years, the oil price has ranged between \$25 and \$145 a barrel.

Then there is the Calman commission, which proposes that half the income tax revenue raised in Scotland should be kept and spent in Scotland, preferring to rely on a large proportion of the not-very-large, not-very-strong tax base of Scotland, rather than the much larger and, I venture to suggest, more resilient base of the United Kingdom as a whole. That might certainly bring home quite forcefully the meaning of accountability because, after a decade of relative decline in Scotland's economy, its tax base is diminishing and a Manchester University study points out that more than 770,000 Scots-one in three Scottish workers-have jobs paid for by public expenditure. As for those who seek fiscal autonomy in Scotland, I simply wonder if they know what they asking for. Full fiscal autonomy would be independence in all but name.

My reason for digressing briefly into these areas is to point out that none of these proposals can be sensibly debated and carried forward if the starting point, Barnett, remains unstable and unresolved. Devolution has changed the game with the gradual disaggregation of the United Kingdom, a slow motion landslide now under way. Every action creates a reaction and the English have woken up. They see the unfairness to them of the present arrangements, which our report confirms. They see the Scottish Parliament with its tax-raising powers. They hear its demands for more powers and they now want to have their say. That, in essence, is why the special committee on Barnett was set

up. I believe that our unanimously agreed report has achieved a breakthrough. The key to that is our illustration of the way that the relative-needs assessment issue can be solved. Our proposal is illustrative, but not necessarily the ultimate solution. But it is one of the reasons why I support the report's conclusions.

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We have come up with a way of changing a formula that enshrines unfairness and replacing it with one that will enshrine fairness not just for now but for the longer term. The Government's response to this crucial feature in the report is, to say the least, disappointing. It says that the Barnett formula has,

"the merit of allowing the devolved administrations to determine their own assessment of needs and priorities".

But that is not the point. The issue was one of relative need between the different Administrations, not within them.

We need an outbreak of realism in dealing with this issue. Yes, it may reduce Treasury funds coming to Scotland. If so, that should be done only gradually and I am the first to agree that now is not the ideal time to start that process—the middle of an economic crisis that the Government have not yet begun to solve. However, looked at objectively, I believe that it is impossible to argue against correcting a long-running injustice when a solution is available. But it is vital that that solution is brought in with a long transition. Personally, I would like to see that closer to 10 years, than to five years.

Essentially, it is a moral question, rather than an economic one. If an independent and objective review process of the kind our report recommends finds that Scotland's share is fair, that is well and good. If not, Scotland, which has had and has deserved favourable treatment in the past, will still be able to receive it again in the future, if and when its case is justified.

Can we morally justify a situation where a Scottish Parliament, which has the right to vary income tax in Scotland, continues to receive more than is justified by an impartial, independent appraisal, knowing that other citizens of the United Kingdom are thereby being disadvantaged? I think not. It is not fair to Wales or, to a lesser extent, to England. It probably is not fair to Northern Ireland. It is not even fair to Scotland, because all the high-flown plans for new departures there are being founded on a false prospectus, if the existing arrangements are unfair and unsustainable.

If we can exchange the present atmosphere of mutual suspicion and resentment for a sense of fairness, self-esteem and mutual respect, we might even engender also a shred of national unity.

2.39 pm

**Lord Sheldon:** My Lords, the original decision by my noble friend Lord Barnett, as Chief Secretary to the Treasury, was to simplify the very complicated examination of the expenditure and to avoid the many sessions with those concerned with expenditure in England, Scotland and Wales. I was the Financial Secretary and I agreed fully with what he had to say, which was that England

should have 85 per cent, Scotland should have 10 per cent and Wales should have 5 per cent. That was a sensible reduction of the complicated expenditure system. It was intended to last for a limited time, with perhaps a year or two before it was changed. We did not consider that the decision would be successful after more than a few years. This was not a matter that came before us.

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The formula was substantially based on population, not need. It avoided the negotiations with and pressures from all Secretaries of State, which would have been a major problem for the Chief Secretary to the Treasury. In Question 74 in the evidence, the noble Lord, Lord Lawson, said to the noble Lord, Lord Barnett:

"What has happened since then-it is not your fault because you had no intention in this regard-is that the population trends have diverged and that has not, except to an absolutely minimal extent, been taken into account by your successors in the operation of the true system".

The noble Lord, Lord Barnett, said, "Yes". That was a sensible response.

Although there was no needs assessment at the time, there was one in December 1979, after the noble Lord, Lord Barnett, had left office. A major problem has been the failure to take account of the change in the population in Scotland compared with that in England. At the end of the session, the chairman said to the noble Lord, Lord Barnett:

"You devised a mechanism which you hoped would last for a few years. You did not expect it to last for as long as it has lasted. You are not sure now whether it is based on the right criteria and you lean towards having, among other things, a needs based assessment. Is that fair?".

The noble Lord replied, "That is fair".

In the years that followed, what needed to be the main considerations in assessing the needs of Scotland compared with England were the age of the population, the levels of population with low income, the numbers with ill health and disability, and the levels of unemployment. The change in expenditure over the country over the last 30 years has been enormous. Expenditure in Scotland was £126 per head, in England it was £103 and in the United Kingdom it was £100. This has grown up enormously, far more than anybody ever expected. If they had taken that into account, those 30 years would have been quite a different period.

The noble Lord, Lord Lawson, said in his valuable speech that we need to assist people, not the territories. Although that is opposed by Scotland, it is justified. He further said that the Treasury response to the Barnett formula report is an embarrassment. I look forward to hearing the response from my noble friend Lord Davies to all the questions in the debate that we have had today. The view has been unanimous, so he will have a rather difficult time in dealing with some of these points. The Barnett formula has no legal standing. It can be removed and I believe that it should be.

**2.43 pm**

**Lord Selkirk of Douglas:** My Lords, I am glad to follow the noble Lord. I enjoyed his speeches as a Minister in the House of Commons and I enjoy them in this House as well. All noble Lords will be aware of the Schleswig-Holstein question. Lord Palmerston famously remarked:

"The Schleswig-Holstein question is so complicated, only three men in Europe have ever understood it. One was Prince Albert, who is dead. The second was a German professor who became mad. I am the third and I have forgotten all about it".

Unfortunately, today we are not able to follow the mathematics of the Barnett formula like Lord Palmerston into a state of happy oblivion. The issues are far too important.

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I mention an interest as a former Member of the Scottish Parliament-I was a Member for eight years-and as a member of the Calman commission, which reviewed the working of the present devolution of powers from Westminster to Scotland and made a number of significant recommendations for change. The most important and far-reaching of those was to give the Scottish Parliament more tax-raising powers, which would be proportionate to a reduction in the current block grant from Westminster.

I request of the Government-and whatever Government may follow-that the report from the Select Committee be considered in conjunction with the Calman conclusions, the Holtham commission report to come this summer about funding devolved government in Wales, and the position of Northern Ireland. That is extremely important, as the report that we are debating and the Calman report do not entirely endorse each other. Calman wished to retain the Barnett formula at least for the time being, while the Select Committee wants to see it replaced by a new needs-based funding system. Paragraph 37 of the Calman report states:

"Until such time as a needs assessment is conducted, the Barnett formula, proportionately reduced to take account of devolved taxes, can continue to be used to determine the grant element in the Scottish Budget".

This may indicate a different approach from that taken in the Select Committee report; it certainly does on the issue of a timescale. Interestingly, the response from the Government to getting rid of the Barnett formula was fairly dismissive. The Government defend the present arrangements, saying:

"The Government's view is that the Barnett formula has a number of strengths, among them the merit of allowing the devolved administrations to determine their own assessment of needs and priorities in devolved areas".

They later say that they have "no plans" to make the changes to the funding formula recommended in the Lords report.

The Select Committee chaired by the noble Lord, Lord Richard, contributed a great service in two respects: first, in its recommendation of the example of the Australian commission on grant funding, which takes account of individual needs, and, secondly, in what it says about transitional

arrangements. I agree with the noble Lord, Lord Lang, that the timescale should be considerable and perhaps even longer than the Select Committee recommended. I note that London Councils has come out in support of the Select Committee by stressing the importance of equity. Part of the remit of the Calman commission was to concentrate on accountability, but equity is every bit as important.

**Lord Forsyth of Drumlean:** My Lords, if I may-

**Lord Selkirk of Douglas:** Very briefly, as I do not want to take up too much time.

**Lord Forsyth of Drumlean:** There is no time limit, but this is an important point. My noble friend was on the Calman commission. My understanding is that it acknowledged that we would have to move to a needs-based system. To have a needs-based system, you have to have a needs assessment, which will obviously take time. It was not defending the idea that we should continue with Barnett. Is that not correct?

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**Lord Selkirk of Douglas:** The point that I was making, if my noble friend had followed me closely, was that this is a matter of practicalities and timescale. Until the needs-based assessment is fully conducted throughout Britain-for all parts of the United Kingdom-the Barnett formula can continue in the interim.

I note that, while the Government welcomed the Calman commission's recommendations, the shadow Chancellor of the Exchequer, the honourable Member for Tatton, stated in the *Scotsman* on 26 November:

"We will use the recommendations in the Calman report as a starting point. We believe the Scottish Parliament needs to have greater powers over raising and spending taxes and borrowing".

To sum this up in one sentence for the noble Lord, Lord Forsyth, if there is to be a massive reduction, there should be the opportunity for substitution. That is the essence of the Calman recommendation. The shadow Chancellor also emphasised that the most important aspect of the Calman commission was that it had as its foundation,

"the protection and continuation of the Union".

The Select Committee report does not say by how much funding for devolved responsibilities in Scotland would be cut. As the noble Lord, Lord Forsyth, said, Professor David Bell, who I understand was advising the Welsh commission, has stated that moving down this path could lead to a reduction of £4.5 billion for Scotland. That would have dramatic effects on the Scottish budget. Many experts believe that, while an immediate change in the funding formula would mean a huge loss for Scotland, it would make a relatively small difference in funding per head in England. Indeed, the leader of the Conservative Party has been quoted as saying that there is no crock of gold for English regions. That raises a real difficulty at a time of recession, when public expenditure is likely to be cut and severely restrained throughout the United Kingdom. The question arises: is it wise to make major cuts over and above what is needed to bring the UK's deficit under control? I

urge considerable caution over any swift moves to replace the Barnett formula, while hoping that the Calman proposals will be considered as an overall package of measures to be brought forward.

Constitutional reform has traditionally played itself out over a long timescale. The opinion polls in Scotland show that the voters believe that, on the whole, the Scottish Parliament is working well; in fact, a clear majority favours giving it increased powers and only a much smaller minority wishes to see Scotland torn out of the union. I am not one of those who believe that the form of the union and the partnership should be constrained in a constitutional straitjacket. For those of us who wish to see the union thrive and prosper, I refer to Charles Darwin, who made the claim that the species that survived were not necessarily the cleverest or the strongest but those that could best adapt to changing circumstances. I rest my case.

2.51 pm

**Baroness Hollis of Heigham:** My Lords, like other members of the committee, I enjoyed serving on it enormously, not least because one learnt a lot about the past history of Labour-and, intriguingly, Conservative-discussions, debates, in-fighting and public expenditure bids and how such procedures took place.

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Why does the report matter? It matters because more than 50 per cent of public expenditure to the devolved nations comes via the Barnett formula-a formula that, as every previous speaker has said, is founded on the basis of adjusted 1970s population figures rather than on need. It was meant to be a one-year fit, as the noble Lord, Lord Lawson, said, but it lasted for 30. As a result of predictability and inertia, few of us would now press its virtues on any allocation of moneys. I estimate that between £4 billion and £5 billion a year are misallocated.

We were assured by retrofit statisticians that over time, in almost the words of the noble Lord, Lord Forsyth, the discrepancies would narrow-the Barnett squeeze-but that has not happened. The Barnett squeeze was invented after the event to justify the unjustifiable, but it has not even done that and it simply will not do. Nowhere else in government that I am aware of do we allocate resources not by need but by adjusted 1970s population figures. It would be unthinkable to do this for benefits in DWP, for aid via DfID or for expenditure on education, public health and local government. We certainly would not claim, as the Treasury does in paragraph 2.13 of the report, that "it has worked well"-although, of course, in Treasury-speak that is not about fairness, which most of us would think relevant, but about the simplicity of administrative and arithmetic rollout.

I was especially shocked to read paragraph 2.15, where the Government state that the Barnett formula,

"has the merit of allowing the devolved administrations to determine their own assessment of needs and priorities in devolved areas".

For sophistry, that takes the prize. They are saying that, because we all know that the devolved Administrations allocate resources by need, it does not matter that the original sum received is not allocated by need. To give a non-PC example, that is like saying that because white male teachers

are paid more than other teachers, it is okay that female and black teachers are paid less because they all have equal freedom to spend their salaries.

I know that my noble friend will have to stonewall, but I have news for him: this is not acceptable. Almost every other public body providing services gets its central government finance according to the criteria of need-the RAWP formula in health authorities and local government. Let me spend a moment on how the allocation of need is decided within local government. Typically, a shire county and local authority will receive RSG on a number of headings-children's services, adult personal services, police, fire and rescue, highways maintenance, environmental protection, cultural services and capital finance. Digging down a bit lower, one sees that within children's services, for example, there will be allocation by education and by youth, community and conventional social services. Within the education sector of children's services, there will be an allocation under further criteria-a standard pupil per capita, a pupil deprivation top-up for children such as those on benefits, and sparsity. The system is similar for adult social services, where allocation is determined by age per capita, with an additional increment for the older elderly, for those with disability, for those

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in rented accommodation, for one-person households and for deprivation as measured by being on personal pension credit.

The point is that this is done year in, year out for more than 400 authorities. It is not rocket science. All that information is collected now as part of the National Statistics service on which departments plan their policy, as the report makes clear on page 55. Any of us can access almost all that disaggregated material on government websites. In figures 2 and 3-our spider webs on pages 41 and 42-we show what a similar approach might look like, simplified and for four nations only as opposed to the 400 or so local authorities that currently benefit from RSG. What do we find? We find that Scotland has greater need because of its poor mortality and morbidity figures, but that on child and adult poverty and unemployment it is either at the national average or better. While Northern Ireland does well on mortality and morbidity, it does poorly on children's needs. Wales does poorly on almost all of it. Our estimates have been confirmed in the past month or two by John Hills's report *An Anatomy of Economic Inequality in the UK*, which shows that Scotland has more people in higher education and in employment and that, although the median wage in England is 2 per cent higher, the cost of living in Scotland is more than 4 per cent lower.

By a formula similar to the one with which local authorities allocate moneys in England, the devolved nations distribute their own resources downwards. I return to the question asked by the noble Lord, Lord Forsyth: if they can disaggregate downwards, why cannot we aggregate upwards? If they can so easily distribute money downwards on the basis of need, why cannot we distribute it to them in the first place on the basis of their aggregated need? What could be more unfair-the noble Lord, Lord MacGregor, is right about this-than an elderly, frail person in East Anglia receiving perhaps only two-thirds, in public expenditure terms, of what an equally elderly, frail person in Scotland receives, even though the person in East Anglia is poorer, because we are hanging on to an unfair population basis of estimating subsidy?

It has been estimated by the Society of County Treasurers-I do not always agree with county treasurers, but I think that they are spot on here-that people in Scotland received more than £1,600 per head in 2007-08 than people in England. No wonder Scotland can afford free personal care; it is being subsidised by the elderly of East Anglia, who have lower incomes and greater need and enjoy no such benefit. It is regressive and bad value for money.

Our report says that we should set out not a formula but merely the pathway-the journey, the route to take-of an independent commission to establish criteria of need. We give examples based on a local authority RSG, greatly simplified, in our proposals for the four main categories identified by the noble Lord, Lord Moser, and we recommend a long transitional period.

As the noble Lords, Lord Forsyth and Lord Lawson, have said, the tighter the finances, the more essential it is to establish value for money along with fairness. Otherwise, disparities grow. The present funding mechanism misallocating £4 billion to £5 billion a year

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is indefensible. The only people who defend it are the Treasury and some politicians from places that gain unfairly. However, to coin a cliché, they would, wouldn't they? That does not mean that we have to.

**3 pm**

**The Duke of Montrose:** My Lords, it is a daunting task to follow the noble Baroness, Lady Hollis of Heigham, and her tour round the whole of government finance. The Barnett formula keeps coming up in discussions on finance and it is over 12 years since the last time the operation was considered in as much detail. The House owes a debt of gratitude to the noble Lord, Lord Richard, and his committee for the width of evidence that was collected and the way the committee has presented its conclusions. It has been drawn to our attention that, in the intervening years, devolution has come to three regions of the UK, which makes this study all the more appropriate.

Having sat through the arguments on the passage of the then Scotland Bill, it is interesting to look back now and see what areas of administration were envisaged and the criteria that we now have to apply to things such as climate change or the marine environment. In many ways what was contained in the Scotland Act gives Scotland the opportunity to act more independently of the UK if it wishes to do so. My noble friend Lord Forsyth raised the strange anomalies in the question of the replacement of the Forth road bridge with a second bridge. But if the concept of the definition of "national infrastructure" had been foreseen, as has now occurred with the Infrastructure Planning Commission, it would have been easier to argue that something like the new Forth road bridge was an investment with implications for the whole UK economy and not just for the Scottish block grant. As it is, the Infrastructure Planning Commission projects are for England only, but their financial implications will mostly trigger adjustments under the Barnett formula.

Reading the report, one can only be struck by the number of arguments put forward for greater transparency and a definition of criteria by almost all respondents except the Government. The House of Commons Select Committee even called for the publication of the criteria governing the inclusion or exclusion of spending in the statement of funding. Perhaps it is a step too far to ask the Minister to say when they plan to do this. There is obviously a tension between a totally defined transparency and a pragmatic approach. The contribution in the report provided by Dr Gillian Bristow merits much consideration, with her proposal that what was needed was what she termed territorial justice provided by,

"broadly equal levels of public service at a similar tax burden".

She then offered three yardsticks. One was to use needs assessments-which we have all been talking about-that presume some sense of merit or desert linked to GDP per capita. The second was perhaps

more narrowly linked to merit alone. The third was our current welfare state, where distribution is linked to contributions.

There is a great challenge before us. We are faced with a loosening of the ties and administration that have bound the UK together. There is no doubt that

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different countries in our union have all maintained their cultural differences with unabated enthusiasm over the years, even though we have operated under one Administration. On a point alluded to by the noble Earl, Lord Mar and Kellie, I like to think that I have ancestors who played their part in the pride that the Scots maintain, fighting at the right hand of the original William Wallace, although not the Hollywood one.

The suggestions which seem to find favour with the Government at present of seeking a measure of greater fiscal autonomy for Scotland will present new and greater challenges as to how anything like the Barnett formula should be calculated. As the noble Lord, Lord Barnett, himself pointed out, those involved need to think clearly about whether the path chosen is one which helps us to celebrate our unity and diversity or whether it merely drives a wedge more firmly between us.

**3.04 pm**

**Lord Newby:** My Lords, like all other noble Lords who have spoken, I begin by congratulating the noble Lord, Lord Richard, on producing this report, and not just on its content. The way he led his committee has meant that those who were on it have an unusual desire to have a final committee meeting. Three-quarters of the members of the committee have spoken in today's debate, which I suspect is a record for any Select Committee debate in your Lordships' House. It has seemed at times as though those of us who were not on the committee are intruding into this final wind-up session. I also congratulate the committee on the report. The conclusions that it reached had unanimous support in your Lordships' House. The Liberal Democrats accepted those conclusions some time ago. In terms of gaining public acceptance for a conclusion which will inevitably mean funds being taken away from Scotland, it is interesting to note that within the Lib Dems we had quite a spirited discussion with our colleagues in Scotland when we first proposed this, as you can imagine. In the end, the argument that fairness is the only long-term sustainable basis for allocating expenditure won the day, as I am sure it will in future as this case is made more widely.

I will not detain the House too long because I know all Members are agog to discover whether the noble Lord, Lord Davies, is going to be able to do a better job than the Treasury in defending the Government's refusal to look at this issue. Without repeating everything that has been said, looking at the strengths and weaknesses of the system tells us a lot about the way in which we run Britain today. In terms of the strengths, it is easy to say that this is a short-term fix and does not deserve to continue, but it has continued. Surely its apparent simplicity is one of the reasons why it has survived. It is interesting that over two-thirds of the speakers in today's debate were Ministers. A significant number of them had at least some ability to change the formula during their period of office, but none of them did so, so clearly the formula has some strength or else surely it would have been changed. Bizarrely, the apparent simplicity which is probably its greatest strength turns out to be a chimera, as the noble Lord, Lord Selkirk of Douglas, pointed out. It is not simple at all. It has, like

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the Forth road bridge, been repainted to such an extent that it is an extremely complicated system and one which, outside your Lordships' House and the few cognoscenti of public finances, is barely understood.

The example in the report which surprised me-and I thought I knew a small amount about this-was that of Crossrail. How many people, given the ongoing arguments about the cost of Crossrail, realise that one of the hidden costs is £0.5 billion allocated to Scotland which would not otherwise have been allocated? Extraordinary amounts of money are sloshing backwards and forwards north and south of the border, depending on a more or less arbitrary decision by the Treasury on how to allocate funding. While the original formula was a political expedient, it is clear that the way it is implemented still involves considerable political expediency rather than it being a straightforward matter.

The principal argument as to why the formula deserves to be changed is simply that of fairness, and there is virtually nothing new to be said on that. The other argument that was advanced by the noble Lords, Lord Forsyth, Lord Lawson and Lord MacGregor, and others relates to the effect on the union if you do not change the Barnett formula, and the relationship between the formula and the devolved settlement in Scotland at the moment. The noble Lord, Lord Forsyth, said that a revision was inevitable now that there is a Scottish Parliament. I am surprised by this issue's lack of resonance up and down the United Kingdom. Every now and then, there are some rumbles in the north-east of England about the clear disparity between provision there and in Scotland. It is at its starkest simply because they can see it-it is just up the road. However, as the noble Lord, Lord MacGregor, pointed out, East Anglia does extremely badly under the current system, but I do not believe that the Barnett formula has ever been an issue in politics in East Anglia-perhaps it should have been. When we had the great arguments about devolution to the English regions-I cannot agree, I am afraid, with my noble friend Lord Mar and Kellie about the de minimis nature of regionalism in England-the Barnett formula component was small compared to issues such as the cost of establishing provision across the English regions. The political arguments for changing the formula to protect the union are very strong and have been made extremely well today.

The noble Lord, Lord Sewel, spoke about Scotland being a policy success on the back of the high levels of public expenditure that have been extended to it. He is right, but that is an argument for higher rather than lower levels of public expenditure. If Wales had had the same level of public expenditure as Scotland, I suspect that it too would have been a greater economic success than it has been.

**Lord Sewel:** My argument was that because Scotland is now an economic success does not automatically justify continuing high levels of public expenditure.

**Lord Newby:** I thought that the noble Lord also said that one of the contributory factors to making it an economic success was that it had been the beneficiary of very high levels of public expenditure.

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If we agree that the formula should be changed on fairness grounds, how difficult is it? The Government have implied that it is really rather complicated. A number of noble Lords referred to

the Independent Commission on Funding and Finance for Wales. Its report, published in December last year, looked specifically at the technical basis on which one could recast public expenditure on a fair basis. Unlike the Select Committee, which looked at four measures, the Holtham commission looked at six, sparsity being one and ethnicity the other of the two additions. Its conclusion was:

"A formula for calculating relative needs across the devolved administrations that combines simplicity with a high degree of completeness and is based on real world funding allocations by the UK Government and the devolved administrations finds that Wales should receive some £115 for every £100 of funding spent on comparable activities in England. At present, Wales receives only £112 for such activities. For Scotland and Northern Ireland, the figures generated by the formula are £105 and £121 respectively".

This report, along with the report by the Select Committee, proves that it can be done.

A number of noble Lords spoke about the need for a long transition. Given the current public expenditure climate, the arguments for a very long transition are extremely strong. It is clear that to try to make substantial reductions to expenditure in Scotland when one is already making some reductions is politically impossible and undesirable. A 10-year transition, particularly given the current situation in terms of public expenditure, would be entirely sensible.

I mentioned the expectations of your Lordships' House for the speech to be given by the noble Lord, Lord Davies, but the noble Lord, Lord Sewel, challenged the Conservatives to explain what they were going to do. Unless I was mistaken, I thought that I saw a hollow laugh and a shake of the head from the noble Baroness, Lady Noakes, as he made that point. Given the immense steam of enthusiasm on the Conservative Benches for a change of the formula towards a fair system, I hope that she will be able to go beyond the point to which we expect the noble Lord, Lord Davies, to be able to go and tell us that, were there to be an incoming Conservative Government, one of their first changes would be to move in the direction of this excellent report.

**3.15 pm**

**Baroness Noakes:** My Lords, I congratulate the noble Lord, Lord Richard, and the Select Committee on their thorough and sensible report on the Barnett formula. Perhaps even more congratulation should go to the noble Lord, Lord Barnett-who I see is returning to his place-on his persistence in getting a Select Committee set up to study the formula which bears his name. It was good to see that the committee had the noble Lord, Lord Barnett, as its first witness.

The Select Committee's report makes the issues seem beguilingly simple, but the allocation of resources, whether it is between countries and regions, between government departments or between or within public bodies, is always fraught with difficulties. However much people search for reason and science to inform decisions, judgments have ultimately to be made which are always subjective and often political. Even more subjective judgments have to be made if any form of

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transition is involved. Change is rarely accomplished without winners and losers, and the winners always want to benefit today while the users want to defer the impact of any loss.

The Select Committee has been quite clear and united in its recommendation on the need to move to a needs-based assessment for the allocation of devolution funding. In principle, this is something

which my party supports. We also support the transparency advocated by my noble friend Lord Trimble. The Government have been rightly criticised for their response. They say only that they,

"will continue to keep all aspects of public spending under review",

as if that was a proper response. This is code for never moving towards a needs-based assessment and not making moves towards more transparency.

The committee's report demonstrates that there have long been concerns about whether the allocations of resources to Scotland, Wales and Northern Ireland were fair. These concerns existed before the Barnett formula was introduced and the Barnett formula was never going to provide an answer to them. The Barnett formula might, I suppose, have produced a result that converged with an assessment based on what each country needed, but I think that would have been accidental and was probably highly unlikely. This leads to an inevitable conclusion that change is necessary. That is where the problems start. We believe that we have to start with what a needs-based assessment actually includes. There has to be much more thorough study of that accompanied by an open debate about the issues and the options. There is just as much controversy about what is included in a needs-based assessment as what is excluded.

We are not sure that the committee's solution of an independent commission is the correct one. There are clearly attractions in putting complex problems in the hands of experts. As the report acknowledges, decisions would have to be made by the Government, and any such body would only be advisory. Do we really want to create another quango?

**Lord Lawson of Blaby:** If my noble friend will allow me, I am slightly puzzled. As I understand it, our party wants an independent commission to advise on the whole of fiscal policy, so why is it outrageous to have one advising on this small and defined corner of it?

**Baroness Noakes:** My Lords, the Office for Budget Responsibility, which I think my noble friend is referring to, is of a different kind. Perhaps I can discuss what is involved in that with my noble friend outside the Chamber. I was challenging whether we need another quango, and the Office for Budget Responsibility is not one of those.

The TaxPayers' Alliance has estimated that there are currently more than 1,100 quangos spending a total of £64 billion a year. I know the Government produce slightly different figures, but nevertheless there is an agreement that there are a lot of quangos and they spend a lot of money. My party's policies are to reduce the money spent on quangos and indeed on Whitehall by one-third over the next Parliament. Even the Government have said that they would abolish or

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merge 120 quangos to save £500 million. That makes it very difficult to sign up to creating another quango, because it would make the job of controlling the costs of them even harder. Furthermore, against the background of reducing the cost of Whitehall, it would also be hard to find the resources to do the work within the budgets of Whitehall departments. We are committed to cutting the cost of bureaucracy while protecting front-line services, but the review of a funding formula would not be a front-line service. The cost would have to compete with all the other priorities within Whitehall. The noble Lord, Lord Richard, wishes to-

**Lord Richard:** I want to put one point to the noble Baroness. Is she really saying that the consideration of the Barnett formula should come down to an analysis of whether you are going to

create one more quango, what sort of quango it is and how much it is going to cost? Is that really what the Conservative Party is saying?

**Baroness Noakes:** I am saying that this is a very difficult background against which to move towards the proposals made in the report from the noble Lord's committee. I am not saying that the money could not be found. I am simply saying that it is more difficult to find it against the background of a need to cut the costs of Whitehall while protecting front-line services and trying to deal with the huge number of quangos that already exist.

One of the greatest problems will be making any change to a funding formula—the cost of transition. We all assume that a needs-based assessment will produce a significantly different result from the application of the Barnett formula: a figure of £4.5 billion was referred to today. We cannot be sure of that until we have been through of a lot of prior work, but any transition would be hard and the report acknowledges that. The report suggests a transition period of between three and five years and no longer than seven years. It is very difficult to say how long a transition period would be without actually seeing what an agreed needs-based assessment produced. The judgment then has to be pragmatic. My noble friend Lord Lang has already indicated that 10 years may be nearer the mark. That may well be true. But I do not think that we can be clear about what sort of transitional period would be involved until we see the overall fiscal context in which any moves take place.

I have referred to my own party's concern to cut the cost of Whitehall and quangos, but that is only the tip of the iceberg. We have a deficit of 12.5 per cent forecast for this year and next, and debt is forecast to rise to nearly 80 per cent of GDP. This is the worst public expenditure background for any major changes to resource allocation that could possibly be imagined. We do not believe that the Government have yet set out a credible path to reduce the deficit. We share that view with the Governor of the Bank of England. It remains to be seen whether the Budget in two weeks' time will be any more forthcoming on whether that credible path will be demonstrated.

At the time of the PBR last December, the analysis of the Institute for Fiscal Studies showed that the hidden story of the Pre-Budget Report was that expenditure in departments that were not protected by

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some kind of spending promise would have to fall by up to 19 per cent. That was after allowing for some pretty heroic assumptions on efficiency and growth. A document published last month under the Freedom of Information Act shows that Treasury officials acknowledged the need for very significant cuts, but the Government have not yet even commissioned a comprehensive spending review and are hiding behind some excuse of uncertainty. Perhaps they will announce one in the Budget, but they have lost valuable planning time.

There is one certainty—that there will be significant public expenditure cuts over the medium term, whichever party is in power. We do not need to get into the issue of when those cuts start for the purposes of this debate; it is a fact that those cuts will have to be made, and that will inevitably have an impact on the resources available for Scotland, Wales and Northern Ireland. My noble friend Lord Selkirk recognised the difficulties here.

**Lord Forsyth of Drumlean:** I am most grateful to my noble friend. We had a debate about the impact of Barnett and the post facto rationalisation that said that Barnett would produce convergence over time. Does she agree that in a period when cuts are being made in public

expenditure, the effect of Barnett is to produce divergence and more unfairness? Surely, if resources are scarce, that is all the more reason to be able to demonstrate that they are allocated fairly?

**Baroness Noakes:** I understand the point that my noble friend makes, but it is very difficult to make any transition from one formula to another at a time when significant cuts have to be made. It just overloads the system.

I join the Select Committee in wanting to move to a needs-based assessment. That is the position of my party; but the timing is far from ideal. I apologise to my noble friend Lord Lawson if he thinks that I am being insufficiently courageous at the Dispatch Box today. I can see by the look on his face that he does think that.

The Government have issued their White Paper on devolution and said that they wished Scotland to move towards raising some of its income by way of taxation, but that, as other noble Lords have pointed out, is not an answer to the Select Committee's report, because money still needs to be allocated to Scotland. That leaves the Barnett formula still needing to be dealt with. My noble friend Lord Forsyth pointed out that it will not be possible for a Scottish income tax to pick up the strain of any gap that would open up between a needs-based assessment and the current basis. Indeed, whatever the Government plan for the position in Scotland, the position in Wales and Northern Ireland remains to be dealt with under the Barnett formula.

This is not an issue that we will settle today. I am sure that we will return to it, one way or another, in the next Parliament. It may grieve the noble Lord, Lord Barnett, but I think that he will have to put up with the formula bearing his name for quite a little while longer.

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3.28 pm

**Lord Davies of Oldham:** My Lords, like all noble Lords I am grateful to the noble Lord, Lord Richard, for having chaired the committee and produced this report and to all members of the committee, who have worked so hard on this important topic. My noble friend indicated that he thought that I might have a difficult task at the Dispatch Box responding to the report. I always have a difficult time at the Dispatch Box, but particularly when dealing with Select Committee reports. The great advantage of the operation of Select Committees is that a cross-examination has already gone on during the process, so the Government line has been well identified long before the committee concludes its report. Furthermore, the Government's response in formal terms-prosaic, perhaps, and a little limited for some tastes-is always published before we have the advantage of the debate. The great danger from this Dispatch Box is that I might mechanically read out and reflect on the paragraphs already submitted in the Government's response.

If I am to retain any reputation at all for responding to a debate, I propose not to follow either of those formulae but to respond to the actual points made in the debate and deal with the issues that have been raised rather than spend a great deal of time advocating a Government position that is all too clear and is well known from the documents already presented.

Noble Lords have quite clearly cohered around certain significant positions. In looking at those positions, I hope to be able to throw some light upon the situation and perhaps give a greater note of optimism about the position than has been reflected in the course of this debate. Divergences among the Members of the Opposition about their economic policies has stood out-divergences that are reflected in approaches to this issue as well. When David Cameron went to Scotland he indicated that he did not foresee-I concede that this was a couple of years ago-any real changes with regard to the Barnett formula. I wonder why that speech was made in Scotland. His speech on his most recent visit to Wales was full of suggestions that, in fact, the Barnett formula was out of time and that there was a need for significant reform. I wonder why that speech was made in Wales-I give way to the noble Lord.

**Lord Forsyth of Drumlean:** Is it not conceivable that the Leader of the Opposition may have read our report and accepted it?

**Lord Davies of Oldham:** Unfortunately, my Lords, I am not so sure that the Leader of the Opposition quoted liberally from this excellent report. He might do well to study it with greater care.

The noble Lord, Lord Lawson, was scathing about the Government's response; partly because of that I will reply to the debate in slightly different terms. He did not join in with the position that was generally taken up by former members of Conservative Administrations in the past, which recognised the difficulties that the Barnett formula throws up-and threw up-and the difficulties of how to present an alternative position. The noble Lord, Lord MacGregor, reflected on this position in 1987. The noble Lord,

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Lord Forsyth, reflected on this position with even greater candour nearly a decade later. The noble Lord, Lord Lang, reinforced this position. All of them-one or two decades after the Barnett formula had been established-reflected that the Barnett formula has difficulties attendant upon it, which have been rightly identified in this debate, including the fact that it is based upon a population base that is a considerable 30 years old.

However, in all those cases, Ministers with administrative and political responsibility shied away from producing a solution to it. That is because the solution is not easy. I understand entirely the points that have been made in the report. After all, this report also had the advantage of having looked at what the Holtham inquiry had done for Wales and the Calman commission for Scotland. This report had the benefit of identifying many of the problems attendant upon the Barnett formula. There is no doubt that this position is felt particularly strongly in Wales. As has also been hinted at, but not developed quite as strongly as might have been the case, some regions in England think that they are disfavoured under this arrangement. My noble friend Lord Barnett himself commented on the regional dimension. Why is it, then, difficult to produce a radical solution when, as has been indicated-I think it was by the noble Lord, Lord Forsyth-this Government are based upon both principle and radicalism, and would therefore be eager to right wrongs if that could be done easily, clearly and in a radical fashion?

The answer is quite straightforward. It is very easy to say that it should be based upon needs rather than the dated formula on which the Barnett position is established, but the problem is: what would be the definition of the needs? I know that the Select Committee gave an example of a formula that might be developed for illustrative purposes, but government is not about illustrative purposes. It is about impact upon a population and distributing resources within it, so illustration will not do. I

appreciate the point that the committee had the enormous benefit of having the noble Lord, Lord Moser, helping with regard to statistics, but I am quite sure that he will also recognise the Government's difficulty when it is not just a question of that.

Among others, my noble friend Lady Hollis again emphasised, as she has done in previous debates on this issue, the importance of our shifting the formula to needs. Yet she also knows that the formulas we have in other contexts vary enormously. There are different methods for allocating RSG in each of the four countries involved. There is no agreement across the UK on a single best method of allocating that element of spending, and the same is true of any of our other big spending programmes, such as health. The actual concept of the allocation of need, and how one can be precise about it, is fraught with difficulties. Consequently, noble Lords opposite have recognised—and I think this is also true across the House—that the shift from the Barnett formula to any other would, first, create a significant administrative problem.

I recognise frankly that it is a difficult political problem as well, and as open as this House always is, that has been frankly recognised on many Benches. It is also one that has no chance whatever of being

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solved overnight. If one plea has come strongly on all sides regarding the challenge for reform, it is that there would have to be a long interim period of adjustment. I know what noble Lords will say: that it may of course be a long journey, but somebody has to take the first step. I want to be a little optimistic about that first step.

I emphasise the fact that the moment that the Calman commission produced its report and the Holtham report came from Wales, Government Ministers immediately took a very real interest in what those reports said, and they have been active in those areas. The Secretary of State for Wales indicated on 26 November that he was very concerned about the identification of the problems in Wales—and he derived benefit too from this House's work in that area—and immediately addressed himself to the issue. He is meeting the Chancellor of the Exchequer on those points to emphasise that the Barnett formula brings very significant disadvantages to Wales, which are not acceptable and need to be addressed.

**Baroness Hollis of Heigham:** I have followed the Minister's argument closely. If it is the case that it can be accepted that the Barnett formula brings real disadvantages to Wales that should be corrected, why does the obverse not equally apply: that if there are very real advantages to another nation of this country, those, too, should be adjusted?

**Lord Davies of Oldham:** Remedying abuses, of course, is a good deal easier than correcting advantages. The noble Baroness has been in politics long enough to know that that which people have they are most reluctant to yield. She is merely reflecting the general difficulties we have in this area. However, I emphasise that when the Secretary of State for Wales was talking about this point, he was aided by the fact that the Chief Secretary to the Treasury had also indicated that he appreciated significant criticisms with regard to the Barnett formula. As he said, the Barnett formula was not exactly constructed in stone. I know my noble friend has created a significant piece of practical history over the last 30 years, but he has been one of the keenest advocates of looking at the issue again because of some of the difficulties, and the Chief Secretary to the Treasury agrees with him.

This is not an issue that can be resolved in the short term: it requires a great deal of consideration and a Government with a significant mandate for reform-one who have the power to look at issues over the long term. That is a Government who will be returned in June, or maybe a little earlier, when this Administration are returned, and we will be able to look at the Barnett formula against a background of what the committee and this House have done, allied to those very important reports which have been presented against this background. They have created a framework within which the disadvantages of the Barnett formula are such that a reforming Government would need to look at them.

At this stage, I can go no further than that. I agree with the noble Lord's comments about the block grant. It is important that any change to the Barnett formula

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does not create micro-management of economies which have been used to this degree of discretion. This is one of the virtues of the Barnett formula, and we will need to protect that. I recognise the value of this report, and of all noble Lords who contributed so fully to this debate, but I cannot go any further than that at this stage. If we renewed this debate in a couple of months' time, however, I have no doubt that, from this Dispatch Box, I would be a good deal more optimistic.

**3.43 pm**

**Lord Richard:** My Lords, I thank all those of have taken part in this debate; it has been interesting, though somewhat brisk, and we covered a lot of ground. I am bound to say that the breathtaking, almost brazen irrelevance of the Front-Bench collective in the course of what they had to say I found a little strange. I started off this debate by expressing sympathy for my noble friend who had to reply to it, but I think I should now express my condolences and call for two minutes' silence.

*Motion agreed.*