

Impact case study (REF3b)

Institution: University of Oxford
Unit of Assessment: UOA21
Title of case study: Working toward more accurate regional expenditure data and fairer regional funding formulae in the UK (21-03)
<p>1. Summary of the impact</p> <p>Research by Professor Iain McLean and his team has demonstrated that for more than 30 years, the process of distributing public expenditure to the regions of England, Scotland, Northern Ireland, and Wales was hampered by inadequate data and inappropriate policy targets. Since 2008, this work has had two principal impacts: (1) it has informed a change in the Treasury's methods of collecting and calculating regional expenditure data, information which is used to guide policy across all government departments; and (2) it has contributed to the acceptance of needs-based regional funding as an appropriate policy target, and has laid the basis for a fundamental reform of the funding arrangements for Scotland and Wales.</p>
<p>2. Underpinning research</p> <p>The research was carried out at the University of Oxford by Iain McLean (Professor of Politics), who joined the Department of Politics and IR in 1993. He has a long record of research and publication on spatial issues in taxation and public expenditure; he led the <i>Public Expenditure Research Group</i> (19 collaborators and staff) examining regional expenditure data, and has carried out work on the fiscal transfer formulae.</p> <p>Since their introduction in 1888, UK regional funding formulae have relied on poor data and have been hampered by a lack of clear objectives as to whether funding should be distributed <i>per capita</i> or allocated in a needs-sensitive way. McLean's research on the regional funding regime has demonstrated inadequacies in the underlying regional expenditure data, and recommended improvements to the methods used for its collection and calculation. This work has laid the basis for a better and more accurate understanding of the distortive effects of the regional funding formulae, and for McLean's recommendations to reform the formulae in order to achieve fairer and more needs-based outcomes. Work in both of these areas is central to the impacts described below.</p> <p>(a) Developing a methodology to produce reliable expenditure data</p> <p>In the early 2000's the Treasury (and researchers including McLean) expressed concern about the reliability of official data on public expenditure per head in the nine regions of England and in the devolved administrations of Scotland, Wales, and Northern Ireland. Flawed data could undermine the usefulness of the Treasury's <i>Public Expenditure Statistical Analyses</i> (PESA) as a source of information to guide policy affecting the regions across the full range of government departments. As a result of his expertise in this area [R2], the Treasury asked McLean to assess the quality of the data and he assembled a research group to do so. The year-long research programme, launched in 2002, examined the level and form of public expenditure (domestic and European) to the regions. It revealed substantial inadequacies and significant variability in the data, inconsistencies in reporting data between government departments, and conceptual and methodological differences underpinning regional reporting [R4, R6]. It also drew attention to the fact that different definitions of regional expenditure were used not only across government departments, but also by the Treasury and the Office for National Statistics. The research made a number of recommendations to improve data quality in 2003 that were summarized in the <i>McLean Report (Identifying the Flow of Domestic and European Expenditure into the English Regions)</i> [R6]. One of McLean's central recommendations was that departments should use real expenditure data whenever possible, rather than assume that spending per head was equal in each region as had often been done in practice. McLean's <i>Public Expenditure Research Group</i> included several co-researchers at the University of Oxford: A. McMillan (Post-Doctoral fellow 2003 to 2006), C. Wlezien (Reader in Comparative Government 2002-2007), S.N. Soroka (Post-Doctoral</p>

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fellow 2000-2002) and G. Cameron (University Lecturer 2000-2006, University Reader in Macroeconomics, 2006 (deceased 2007)).

(b) Demonstrating the inadequacy of the existing funding formulae

McLean's research then addressed how a more accurate and more incentive-compatible regime of transfers might be introduced to replace the Barnett Formula which has historically been applied to determine the block grant to the three devolved administrations of the UK - Scotland, Wales and Northern Ireland. This work demonstrated that the Barnett Formula, which is population-based and takes no account of relative needs, has benefitted Scotland and disadvantaged Wales. McLean showed equal spending per capita to be an inappropriate policy target [R1, R3], and recommended that fairer and less distortive regimes of territorial transfers should be introduced to replace the Barnett Formula. The research argued that the introduction of a needs-based formula to replace Barnett would not undermine a devolved government's autonomy in making decisions on public spending, and recommended that proposed replacements for the Barnett Formula should increase the options for devolved administrations to raise revenue and enhance fiscal responsibility [R5].

3. References to the research

[R1] McLean, I., *The Fiscal Crisis of the United Kingdom*. Basingstoke: Palgrave Macmillan 2005. ISBN 1-4039-0366-2.

[R2] McLean, I., 'Editorial: Statistics and devolution in the UK', *Journal of the Royal Statistical Society Series A*, vol.162 (2), 1999, pp. 133-6. ISSN 0964-1998.

[R3] McLean, I. and McMillan, A 'The distribution of public expenditure across the UK regions', *Fiscal Studies* 24:1, March 2003, pp. 45-71. ISSN0143-5671.

[R4] Soroka, S., N., Wlezien, C. and McLean, I., 'Public expenditure in the UK: how measures matter', *Journal of the Royal Statistical Society Series A*, vol. 169 (2), 2006, pp. 255-71. ISSN 0964-1998.

[R5] McLean, I., and McMillan, A., *State of the Union: Unionism and the Alternatives in the United Kingdom since 1707*. Oxford: Oxford University Press 2005. ISBN 0 19 924820 1.

[R6] McLean, I., *Identifying the Flow of Domestic and European Expenditure into the English Regions*. Final report. September 2003 DTLR Contract No. LGR 65/12/75
<http://www.nuff.ox.ac.uk/projects/odpm/Identifyingtheflow.pdf> Nuffield College, University of Oxford & ODPM.

The quality of McLean's research is demonstrated by:

- (i) The award of the Political Studies Association's W. J. M. Mackenzie Prize for [R5] as the best book in political science published during 2005.
- (ii) The Publication of [R2] (McLean, 'Editorial: Statistics and devolution in the UK', *Journal of the Royal Statistical Society Series A*) as the invited lead article in the top UK statistical journal.
- (iii) The large competitively awarded research grants that funded the research, including: £56,000 from the Leverhulme Trust 1999 (research started in 2001) for 'Attitudes towards the Union'; £144,000 from the ESRC in 2007 for 'Options for Britain II'; and £106,000 from the Gatsby Foundation, the Gwilym Gibbon Fund, and an internal (peer reviewed) Oxford University research fund (John Fell Fund).

4. Details of the impact

The two central impacts of McLean's research have been (1) to contribute to a change in the Treasury's methods of collecting and calculating regional expenditure data, now used to guide policy and analysis, and (2) to shape acceptance of a needs-based approach to regional funding as an appropriate basis for the reform of funding arrangements for Scotland and Wales.

(1) Contributing to a change in the methods for recording and calculating regional public expenditure across all UK government departments

HM Treasury accepted the recommendations of the *McLean Report* on recording and calculating regional expenditure data in full. Following specific recommendations of the report, HM Treasury and the Office for National Statistics (ONS) developed a joint approach to the calculation of more reliable figures on domestic (and European) regional expenditure to inform the *Public Expenditure*

Statistical Analysis (PESA). In 2008, the Treasury rolled out requirements for all departments to use these methods for collecting and issuing data and provided detailed guidance based on the *McLean Report* on how to attribute various types of spending in the now annually required PESA return. This allows policy debates to be informed increasingly by a more accurate picture of the fiscal position of the UK's twelve regions [C1].

The *McLean Report* also underlined that appropriate data reports should be produced for policy-makers; tailored reports are now used to assess specific outcomes such as the effects of formula funding, demand driven expenditure, and expenditure based on policy decisions. The impact of these changes has been gradual, as departments have increasingly produced better data. Only now, for instance, is the true level of EU farm support across the UK's regions becoming clear, and McLean's methods continue to underpin Treasury initiatives. As the Permanent Secretary at HM Treasury noted in his opening remarks, at recent meeting for academics working on public finance (25.01.2013), "we use the McLean Report all the time here" [C2]. As well as informing PESA, McLean's analysis is also used by the ONS in order to produce their regional Gross Value Added tables and by the Scottish Government for the publication of their annual expenditure and revenue publication [C2].

The beneficiaries of the reforms to the Treasury's *Public Expenditure Statistical Analysis* include not only politicians, civil servants, analysts, and journalists who rely on the PESA statistics to make assessments of the effects of regional spending, but also stakeholders in discussions about the spatial redistribution of public expenditure in the UK. For example, this data is used in the Institute for Public Policy Research's (IPPR) analysis of public funding in the North of England which provides northern stakeholders with a better evidence base and an understanding of the spending review process; the data is also used in current debates about Scottish independence [C3].

(2) Shaping efforts to replace the Barnett Formula by a fairer funding formula responsive to needs

McLean's analysis of the limitations of the Barnett formula has shaped acceptance of the need for a change of the funding formula for Scotland and Wales and the wider policy debate about fiscal devolution.

Scotland: McLean's research on the effects of the Barnett Formula contributed to the launch of a joint initiative by the UK government and Scottish Parliament to replace Barnett as the mechanism to adjust public expenditure for Scotland. McLean was appointed to the Independent Expert Group, which advised the *Calman Commission on Scottish Devolution* in 2008-9 with a view to improving the financial accountability of the Scottish Parliament [C4]. The Expert Group's four reports were adopted by the Commission, including its core recommendation that the UK should vacate 10p in the pound of Income Tax for Scottish taxpayers, and that the Scottish Parliament should be required to set a rate for funding devolved services. This recommendation became part of the Scotland Bill.

Independently of the Expert Group's work McLean also contributed to the wider policy debate about the funding regime for Scotland by giving evidence to the Scotland Bill Committee of the Scottish Parliament [C5], and by publishing in the media on the Calman proposal to make the Scottish Parliament responsible for decisions at the margin between taxing less and spending more [C6].

The Scotland Bill was endorsed by both the Scottish and UK Parliaments and now forms the Scotland Act 2012 [C7], which is set to create a democratically elected and fiscally responsible Parliament for the first time since 1707. If the Scottish people reject independence, the Scotland Act will come into operation immediately. If they accept independence, the scheme will remain available to both governments – Scotland and UK – as a model for reforming fiscal transfers. In either case, the Barnett Formula is now likely to expire and to be replaced a more needs-guided approach.

Wales: McLean's research insights on the Barnett formula [R1] also played a role in informing the proposal by the *Independent Commission on Funding and Finance for Wales* (the *Holtham*

Commission) to replace Barnett with a needs-based funding regime for Wales. The Commission was established by the Welsh Assembly Government to consider the benefits and drawbacks of the Barnett Formula, and to identify possible alternative funding mechanisms including tax-raising and borrowing powers. McLean was invited twice to speak at the *Holtham Commission* in 2009-10, and presented evidence on the effects of the Barnett Formula and arguments for a more needs-based funding regime [C8]. His analysis that the Barnett Formula failed to give Wales a block grant that was commensurate for its needs was accepted by the Commission. In its final report, published in July 2010, the Commission recommended that the Assembly Government should pursue the introduction of a needs-based formula for determining the Welsh block grant instead of the Barnett Formula, a recommendation that is entirely consistent with McLean's arguments and findings [C9]. The *Holtham Commission's* final report was welcomed by Labour, Conservative and Plaid Cymru politicians and is contributing to the growing weight of evidence against the Barnett Formula in the debate about the funding regime for Wales.

In sum, McLean's research has generated impacts of UK-wide reach and lasting significance: the *McLean Report* informed the Treasury's reforms of the PESA-regime which has resulted in more accurate regional expenditure data across the United Kingdom. This change allows policy and debate to be informed increasingly by the true fiscal position of the twelve UK regions. The revised data has also helped McLean to demonstrate the need to reform the Barnett Formula, which influenced the conclusions of the *Calman* and *Holtham Commissions*, as well as the fiscal structure for Scotland envisaged in the Scotland Act 2012, and contributed to the growing acceptance of a needs-based formula for determining the block grant for Wales.

5. Sources to corroborate the impact

- [C1] The Treasury report, *Public Expenditure Statistical Analysis* (2008), includes reference to the McLean report and the detailed guidance that has been developed since (Chapter 9.23.)
<http://www.official-documents.gov.uk/document/hc0708/hc04/0489/0489.pdf>
- [C2] Senior Treasury Official confirms use of the McLean report and the long-term effects of PESA reform, use by ONS and contribution to devolution debates.
- [C3] Use of HM Treasury, *Public Expenditure: Statistical Analyses 2012* (the revised PESA data) by IPPR North's analysis of regional spending and the spending review, for example in
<http://tinyurl.com/IPPR-north>
- [C4] Confirmation of McLean's appointment and role on the IEG from the Secretary to the Calman Commission.
- [C5] Full transcript of the evidence given by Iain McLean to The Scottish Parliament, Scotland Bill Committee
<http://www.scottish.parliament.uk/parliamentarybusiness/28862.aspx?r=6054&mode=html>
- [C6] The Scotsman article: Calman puts good deal on the table 9 January 2011
<http://www.scotsman.com/news/iain-mclean-calman-puts-good-deal-on-the-table-1-1496109>
- [C7] The Scottish Parliament gave its unanimous consent to the Scotland Bill on April 18, 2012 and the House of Commons approved the Bill on April 26. It received Royal Assent on May 1 to become the Scotland Act 2012. <http://www.scotland.gov.uk/Topics/constitution/Scotland-Bill>
- [C8] First report. Funding devolved government in Wales: Barnett & beyond July 2009
<http://wales.gov.uk/docs/icffw/report/090708barnettfullen.pdf> includes reference to McLean's evidence p.39 & 61).
- [C9] The Final Report of the Holtham Commission. Fairness and accountability: a new funding settlement for Wales July 2010. See p.178 for reference to McLean's evidence
<http://wales.gov.uk/docs/icffw/report/100705fundingsettlementfullen.pdf>