

**REVIEW OF PUBLIC ADMINISTRATION  
IN NORTHERN IRELAND**

**BRIEFING PAPER:  
FUNDING ARRANGEMENTS FOR  
LOCAL GOVERNMENT IN THE UK  
JURISDICTIONS AND ELSEWHERE**

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## Executive summary

Local government in the UK receives funding from central government grant and from local taxes and fees. For Northern Ireland, Scotland and Wales, funding flows via their devolved administrations. The overall approach to local government funding is similar for all the nations of the UK, although the Northern Ireland system is the most atypical as local government has fewer functions and local finance is levied by rates rather than council tax.

Central funding of local government in the UK is a component of the overall system of fiscal policy and public expenditure allocation that is determined by the Treasury.

Because central funding flows from the UK government, it is relevant to consider the overall system of UK public expenditure control before looking at the expenditure of the devolved administrations.

The overall system of UK public expenditure takes as its control total an aggregate called Total Managed Expenditure (TME) comprising Departmental Expenditure Limits (DELs) and Annually Managed Expenditure (AME). Under the Spending Review, DELs are set for most UK government departments and also for the devolved administrations, which are treated analogously to UK government departments.

The vast bulk of DELs for devolved administrations are “assigned” which means that how they are spent is decided by the recipient government. Each year the DEL is calculated using the Barnett formula. This formula takes as its base the existing DEL and adds to it increases which are equal per head to increases in comparable UK government services in England.

Spending on the Northern Ireland DEL is allocated according to the devolved administration’s priorities and set out in an annual budget. The budget includes an allocation for local government which appears as part of the DEL for the Department of the Environment.

Properties in Northern Ireland are subject to both a regional rate and district rates. Regional rates are collected to support Northern Ireland government expenditure on such services as education, housing, social services, roads, water and sewerage.

Local government funding comes from the district rates, described above and general and specific government grant. Local authorities also receive income from fees and charges and various capital funding mechanisms.

The question of whether expenditures have been appropriately assigned to levels of government applies at all levels of inter-governmental relations, but is particularly relevant to the case of local government in Northern Ireland because its local authorities are responsible for a much smaller range of services than are local authorities in the rest of the UK.

The main grant local authorities are paid is called the General Grant. This grant provides partial equalisation with respect to needs and is in line with worldwide practice.

Equalisation mechanisms between local governments operate at two levels: firstly there is the equalisation that occurs between the UK nations as a result of the Barnett formula and local revenue contributions to spending. Secondly there is the equalisation that occurs between local governments within each nation.

Accountability requires that those who decide on local spending also pay for it. The central/local balance of funding for Northern Ireland is more towards local finance than the rest of the UK, so this would appear to lead to more local accountability. However this is partly achieved by what might be considered a centralisation of local government functions towards the Northern Ireland administration. This centralisation may not be in line with an ideal level of subsidiarity. The other component of this locally orientated funding balance is local authorities' control of the non-domestic rate, which has some drawbacks in terms of democratic accountability.

## Introduction

Local government in the UK receives funding from central government grant and from local taxes and fees. Central funding for local government comes from taxpayers throughout the UK. For local authorities in England, central funding is from the government ministries concerned. For Northern Ireland, Scotland and Wales, funding to local government flows via the devolved administrations. The devolved administrations receive payments from the United Kingdom government to support their functions, one of which is grants to local government. The overall approach to local government funding is similar for all the nations of the UK, although the Northern Ireland system is the most atypical as local government has fewer functions and local finance is levied by rates rather than council tax.

Central funding of local government in the UK is a component of the overall system of fiscal policy and public expenditure allocation determined by the Treasury. Although the Treasury determines overall budgets, the devolved administrations are free to allocate assigned spending<sup>1</sup> within the totals as they see fit (HM Treasury, 2002, p. 3).

Equalisation mechanisms between local governments operate at two levels<sup>2</sup>: firstly there is the equalisation that occurs between the UK nations as a result of the Barnett formula and local revenue contributions to spending. Secondly there is the equalisation that occurs between local governments within each nation.

Because central funding flows from the UK government, it is relevant to consider the overall system of UK public expenditure control before looking at the expenditure of the devolved administrations.

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<sup>1</sup> For assigned budget items “the devolved administrations will have full discretion over their spending priorities” (HM Treasury, 2002, p. 4)

<sup>2</sup> See Heald and McLeod, 2002, p. 16.

## The overall UK public expenditure system

The current UK system of public expenditure planning was introduced by the Labour Government shortly after they came to power. The new system, based on Spending Reviews is set out in detail in HM Treasury (1998a and 1998b). Spending reviews are carried out every two years and set out plans for public expenditure over the forthcoming three years, with the third year overtaken by the next spending review. Currently Spending Review 2002 is in force, and Spending Review 2004 will be published in July 2004.

The Government emphasises two overall fiscal rules in its spending review system:

- *The Golden Rule*: over the economic cycle the Government will borrow only to invest and not to fund current spending; and
- *The Sustainable Investment Rule*: net public debt as a proportion of GDP will be held over the economic cycle at a stable and prudent level (HM Treasury, 1998a, p. 5)

The system of public expenditure planning takes as its control total an aggregate called Total Managed Expenditure (TME) comprising Departmental Expenditure Limits (DELs) and Annually Managed Expenditure (AME), i.e:

$$\text{TME} = \text{DELs} + \text{AME}.$$

Funding for the devolved administrations consists of both DELs and AME.

## Funding for devolved administrations

Annually Managed Expenditure covers expenditures that cannot be controlled on a multi-year basis but are reviewed and set annually in March. For Northern Ireland, AME comprises Common Agricultural Policy payments, social security benefits, NHS and teachers' pensions, accrual items such as capital charges for roads and water services, district councils' self financed expenditure and regional rates (HM Treasury, 2002, p. 35).

Under the Spending Review, DELs are set for most UK government departments and also for the devolved administrations, which are treated analogously to UK government departments. The UK government departments are largely concerned with expenditure in England only, although other departmental programmes, such as for the Home Office, cover England and Wales and other departmental categories of expenditure relate to Great Britain (HM Treasury, 2002, p. 11).

For Northern Ireland, Scotland and Wales, DELs are set by means of the “Barnett Formula”, which is now discussed.

### The operation of the Barnett Formula

The base level of public spending per head differs quite markedly for the UK nations and has done at least since the 1970s. Table 1 presents some figures. There has been much discussion of these differences in spending per head. Reasons analysts advance for their existence revolve around “historical legacy” and differences in need<sup>3</sup>.

**Table 1: "Needs" and identifiable public expenditure per head indexed to England:**

	Spending 1959-60	Spending 1971-72	Needs 1976-7	Spending 1976-7	Spending 1997-98
England	100	100	100	100	100
Northern Ireland	88	111	131	135	142
Scotland	105	125	116	122	127
Wales	95	104	109	106	120

*Source: Adapted from Mackay (2001) and HM Treasury (1979)*

In 1979, in preparation for prospective devolution, the Treasury carried out a needs analysis of spending of the UK nations (HM Treasury, 1979). The report observed that, “Since the underlying principle of enabling similar policies to be pursued in each country

<sup>3</sup> For discussion see for example Heald (2003), Midwinter (2002), McLean and McMillan (2003).

is not new, it might be presumed that this was reflected in past expenditure allocations.”  
(HM Treasury, 1979, quoted in MacKay, 2001)

At this time, Joel Barnett, the then Chief Secretary to the Treasury, instituted a system of expenditure allocation based on applying equal per capita increases to these differing bases – the so-called Barnett formula.

Under the current operation of Barnett formula, spending DELs for the nations are determined by applying increases to their existing DELs which are equal per head to increases in comparable United Kingdom Government services in England (HM Treasury 2002, p. 1). There are two major points to make about this. Firstly, the system is incremental and the single most important determinant of any year’s DEL will be the previous year’s DEL. Secondly, convergence is built into the Barnett process.

Mathematically, applying equal per head increases to different bases over a number of years will tend to bring overall expenditure per head in each nation towards equality. This is because over time successive equal increases will come to dominate the base<sup>4</sup>.

Although, the Barnett formula should lead to convergence of public expenditure per head across the UK nations, in practice this has not been seen. The reason appears to be that the Barnett approach has not always been fully used as some expenditures have “bypassed” the formula.<sup>5</sup>

We can trace out the precise workings of the Barnett system in more detail for the Northern Ireland case.<sup>6</sup> Under the Barnett approach, increases in expenditure in UK department  $i$ ,  $(\Delta D_i)$  are multiplied by the relevant comparability percentage  $C_i$  and by the population proportion for Northern Ireland ( $P$ ) to give the increase in the Northern Ireland expenditure allocation for that category of expenditure  $(\Delta N_i)$ .

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<sup>4</sup> For a brief explanation and further references, see Heald and McLeod, 2003. Heald (1996) provides a formal discussion.

<sup>5</sup> See Heald, (1998) and references therein for discussion of exceptions to the use of the formula. The Barnett formula is also discussed in McLean and McMillan (2003)

<sup>6</sup> The same system also applies to Scotland and Wales).

Hence for each expenditure category<sup>7</sup> we have:

$$\Delta N_i = \Delta D_i \times (C_i/100) \times P.$$

The increase in the DEL for Northern Ireland,  $\Delta N$  is given by:

$$\Delta N = \sum_i [\Delta D_i \times (C_i/100)] \times P.$$

The comparability percentages  $C_i$  used in the above formulae are specific to each department  $i$ . They are calculated by considering the extent to which spending in each departmental spending area compares with corresponding Northern Ireland expenditure. Thus if a function carried out in England by a government department is also carried out by the public sector in Northern Ireland, the comparability will be 100%

Table 2 below shows the comparability percentages of programme areas. Note that comparability never exceeds 100%. This can be a problem for a devolved administration where there is spending in an area which has no counterpart in England. For example, water is a public sector function in Northern Ireland, but has been privatised in the UK. Hence there is no English departmental expenditure category for this area to which to apply the Barnett formula. This raises a range of issues. Although finance for water would be expected to come under the Northern Ireland DEL aggregate, the Barnett formula would not make provision for it<sup>8</sup> so the effect would be to stretch the Northern Ireland DEL over a wider range of expenditure than the UK equivalent. On the other hand, the UK government might want to argue that water *should* be privatised, so there should be no need to make provision for a publicly provided water service in the DEL. As a temporary expedient, depreciation and capital charges for water are placed in AME

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<sup>7</sup> The categories are agriculture, trade and industry, employment, energy, roads and transport, housing, environment and water, fire, education, health, social security administration, public corporations and other public services, student loans, capital receipts initiative, trust debt remuneration, fossil fuel obligation, bus fuel duty rebate (see HM Treasury, 2002, p. 35)

<sup>8</sup> See Heald (2003, p. 82-83)

as an exceptional item, partly as a result of this non-comparability<sup>9</sup>, and in anticipation of commitments secured to move water to a self financing basis<sup>10</sup>.

As well as the comparability percentages described above, expenditures are multiplied a population proportion (P). The population proportion is based on Northern Ireland's population as a percentage of the population of England.<sup>11</sup> For 2001, Northern Ireland's population as a percentage of the population of England was 3.21. Hence an increase in a 100% comparable programme in England of £100 would lead to an increase in Northern Ireland of £3.21, and these increases would be equal *per capita* for England and Northern Ireland.

**Table 2: Comparability percentages of programme areas**

<b>Programme</b>	<b>Comparability percentage</b>
Education and Employment	99.8
Health	99.7
Transport	87.1
Office of the Deputy Prime Minister	99.5
Local Government	40.7
Home Office	2.6
Legal Departments	1.6
Trade and Industry	26.8
Agriculture	85.5
Forestry	100.0
Culture, Media and Sport	97.1
Work and Pensions	100.0
Chancellor's Departments	3.5
Cabinet Office	18.6

*Source: HM Treasury (2002 pp. 43-63)*

Table 1 above shows that each devolved nation has a higher level of spending per head than England. If the devolved nations seek to preserve this situation, the Barnett formula

<sup>9</sup> See DFPNI (2004, § 90, and NIE (2002, p. 10)

<sup>10</sup> Heald, 2003, p. 83 argues "Notwithstanding the desirability of greater fiscal effort in Northern Ireland, towards which payments (i.e. taxes or charges) for water should play a part, the leverage now enjoyed by the Treasury over the staging of increases may well cause future difficulties on a politically sensitive issue".

<sup>11</sup> Unless a particular programme has wider coverage – in which case the divisor would be the population of England and Wales, or Great Britain, as appropriate.

has both an advantage and a disadvantage. The advantage is that the Barnett approach takes existing expenditure levels (which are higher for the devolved nations) as its base. The disadvantage is that equal per head increases will gradually converge spending per head towards equality. Although simple logic would suggest a *prima facie* case for an update to the 1979 needs assessment study, discussion in Heald (2003) and Midwinter (2002) indicates that such an update could easily end up reducing relative expenditure allocations to Northern Ireland. Applying pressure for such an update would therefore be not without some dangers.

We now examine the allocation of spending within the devolved administrations and the funding of local government, with an emphasis on the Northern Ireland case.

## **The allocation of spending within the devolved administrations**

As discussed above, Northern Ireland public expenditure is controlled as Annually Managed Expenditure and the Departmental Expenditure Limit. The Treasury sets out three years of DELs in the Spending Review, whereas it negotiates AME annually (DFPNI, 2004, p. 35).

The vast bulk of the Northern Ireland DEL is *assigned*, meaning that it can be allocated to spending priorities by decision of the devolved administration. This would be the Northern Ireland Executive, but with the present suspension the decision is with the Secretary of State. Non-assigned DEL consists of the EU Special Support Programme for Peace and Reconciliation (DFPNI, 2004, p. 35).

Overall, the DEL for 2004-05 is £7,135.7m. This control total can be supplemented by revenue from the Regional Rate, borrowing under the Reinvestment and Reform initiative, planned over-commitments and asset sales, and other factors, which raises the total amount available for allocation to services to £7927.0m for 2004-5 (DFPNI, 2004, pp. 36-37). The distribution of this overall budget between the Northern Ireland Departments is shown in Table 3. The Department of the Environment's DEL, as determined in consultation by the Secretary of State is £142.9m for 2004-05, of which £54.4m is allocated to local government services (DFPNI, 2004, p. 113).

In England, support for local government appears in the Comprehensive Spending Review, mainly under a separate local government heading for the government department responsible – currently the Office of the Deputy Prime Minister.

In the Northern Ireland budget, there is a link between powers to borrow and the regional rate, as borrowing is conditional on local revenue raising. The 2003-04 budget assumed the introduction of rating of vacant property and the ending of industrial de-rating and rate rises securing increased revenues of 8.8% in 2004-05 and 8.8% and 9.1% in the subsequent two years. A 3.3% annual increase is assumed for the non-domestic rate. (DFPNI, 2004, §§113-114.)

**Table 3: Northern Ireland Public Expenditure Plans: 2004-05 to 2005-06**

DEPARTMENT	2003-04	2004-05		2005-06	
	£m	£m	%	£m	%
Department of Agriculture and Rural Development	253.4	264.7.0	4.5	282.1	6.6
Department of Culture, Arts and Leisure	97.1	103.8	6.8	112.2	8.1
Department of Education	1,529.7	1,650.5	7.9	1,696.0	2.8
Department for Employment and Learning	672.7	680.72	1.2	721.7	6.0
Department of Enterprise, Trade and Investment	248.7	270.6	8.8	257.7	-4.8
Department of Finance and Personnel	165.7	138.8	-16.2	180.8	30.2
Department of Health, Social Services and Public Safety	3,009.7	3,227.6	7.2	3,497.9	8.4
Department of the Environment	133.2	142.9	7.2	137.9	-3.5
Department for Regional Development	611.4	752.5	23.1	705.8	-6.2
Department for Social Development	489.7	537.8	9.8	555.4	3.3
Office of the First Minister and Deputy First Minister	49.2	57.1	16.0	60.8	6.5
Northern Ireland Assembly	49.2	49.2	0.0	49.2	0.0
Other Departments	10.5	11.8	12.0	12.2	4.1
<b>Total Departmental DEL</b>	<b>7,320.3</b>	<b>7,888.0</b>		<b>8,269.8</b>	
Unallocated Executive Programme Funds	26.6	39.0		29.1	
Unallocated Capital	0.0	0.0		50.0	
<b>Total Spend on Services</b>	<b>7,346.9</b>	<b>7,927.0</b>	<b>7.9</b>	<b>8,348.9</b>	<b>5.3</b>
Planned Over commitment	-136.2	-178.3		-186.5	-
Regional Rates	-375.1	-417.1		-453.8	
Other Items	2.0	-57.9		-16.8	
Planned Borrowing	-125.0	-200.0		-200.0	
<b>Total Assigned DEL</b>	<b>6,712.6</b>	<b>7,073.7</b>		<b>7,491.8</b>	
EU Peace II	50.0	62.0		80.0	
<b>Total DEL</b>	<b>6,762</b>	<b>7135.7</b>	<b>5.5</b>	<b>7,571.8</b>	<b>6.1</b>

*Source: DFPNI, 2004, p. 34*

Properties in Northern Ireland are subject to both a regional rate and district rates. The regional rate applies across the whole of Northern Ireland and is decided by the Executive.<sup>12</sup> The regional rate is collected in support of Northern Ireland Government Departments' expenditure as listed in Table 3, contributing to such services as education, housing, personal social services, roads water and sewerage (Heald, 2003, p. 60).

Regional rates are shown in Table 4.

**Table 4: Regional and district rate poundages, 2004/05**

	2003/2004	2004/2005	%Change
<b>Regional Rate Poundages</b>			
Non-Domestic Regional Rate	25.56p	<b>26.40p</b>	<b>3.3%</b>
Domestic Regional Rate	140.42p	<b>152.78p</b>	<b>8.8%</b>
<b>Average District Council Rate Poundages</b>			
Average Non-Domestic District Rate	16.50p	<b>17.54p</b>	<b>6.3%</b>
Average Domestic District Rate	132.88p	<b>141.24p</b>	<b>6.3%</b>
<b>Overall Average Rate Poundages</b>			
Overall Average Non-Domestic Rate	42.06p	<b>43.94p</b>	<b>4.5%</b>
Overall Average Domestic Rate (After DRAG)	273.30p	<b>294.02p</b>	<b>7.6%</b>
<i>Source: Department of Finance and personnel, April 2004</i>			

Domestic ratepayers receive a reduction called Domestic Relief Aid Grant (DRAG), amounting to £61.48m in 2003/04. Properties are valued for rates on the basis of a notional rental value – the Net Annual Value (NAV). Non-domestic properties were last revalued as from April 2003. The valuation of domestic properties is unchanged since 1976<sup>13</sup>, but revaluation is planned shortly on the basis of capital value (Heald, 2003,

<sup>12</sup> Or the Secretary of State under suspension.

<sup>13</sup> Revaluations are unpopular as they create gaining and losing ratepayers who cancel out financially but not politically. Because they are unpopular, revaluations tend to be put off to a later date but this is at the cost of increasing the eventual unpopularity. In England the last revaluations were in 1973 and 1993, and the next is introduced in 2007 (Watt, 1996, and Watt, 2002)

p. 51). As the domestic and no-domestic values diverge strongly, a different rate is set for each (CIPFA, 2003, p. 43-44).

As mentioned above, Northern Ireland currently applies industrial de-rating, based on the 1929 UK system but abolished elsewhere. Loss of this income is fully recovered from General Grant (CIPFA, 2003, p. 41-43). There will be a phased removal of industrial de-rating over seven years, beginning in April 2005 (Review of Rating Policy, 2003).

## Local Government Funding

Local government funding comes from the district rates, described above and general and specific government grant. These sources for local government income for 2002/03 are set out in Table 5.

**Table 5: Sources of funds for Northern Ireland local authorities**

Source of funds	£m	%
District Rate	£267m	64%
General Grant	£48m	12%
Specific Grants and Income from Fees and Charges	£102m	24%

*Source: CIPFA 2003, p. 38.*

Local authorities also receive income from fees and charges. Capital financing is from government capital grants, borrowing,<sup>14</sup> use of capital receipts and revenue sources.

Table 6 shows sources of capital funding for 2002/03.

**Table 6: Capital funding for Northern Ireland local authorities 2002/03**

Source of funds	£	%
Borrowing	22,429,377	50%
Grants	4,127,027	9 %
Sale of Assets	1,203,519	3%
Capital Receipts	1,524,434	3 %
Revenue Contributions	14,851,904	33%
Other	477,821	1 %

*Source: Department of the Environment.*

<sup>14</sup> As approved by the Department of the Environment in Northern Ireland

The question of funding of local government is inextricably linked with the issue of the assignment of functions to levels of government<sup>15</sup>. In the local public finance literature, the question of the assignment of functions is approached by considering the geographical spread or *benefit area* of publicly provided goods and services. Decentralising decision-making about services down to the level of jurisdiction that most closely matches their benefit area is seen by theorists as generating welfare gains for residents by enabling their preferences to be taken account of most accurately in the tailoring of provision. This argument has its formal expression in Oates's decentralisation theorem (Oates, 1972, p. 35) and also has resonance with discussions of subsidiarity (Warleigh, 2002). A further important principle is that of "fiscal equivalence" – that there should be "a match between those who receive the benefits of [local spending] and those who pay for it" (Olson, 1969, p. 483). Linking these principles together means that decisions are made in local elections by local voters who not only receive the benefits of local goods and services but also pay for them.

The issue of assignment of spending responsibilities applies at all levels of inter-governmental relations, but is particularly relevant to the case of local government in Northern Ireland because its local authorities are responsible for a much smaller range of services than are local authorities in the rest of the UK.<sup>16</sup> They principally provide leisure and recreation facilities, environmental services and promote economic development. Consequently local government expenditure is much lower than in other parts of the UK, with a greater balance of services provided by Northern Ireland central departments. Yet, the UK as a whole is more centralised than on average in Europe<sup>17</sup>. Though they have few functions, Northern Ireland's councils are, along with councils in the rest of the UK the largest in Europe for population size<sup>18</sup>. An important question is therefore whether there is a sufficient degree of subsidiarity in decision making in Northern Ireland. Subsidiarity could be strengthened by decentralising more functions to local authorities, along with adequate revenue raising powers.

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<sup>15</sup> "Finance follows function" Bahl (1999, p. 7))

<sup>16</sup> Knox calls it an "emasculated form of local government" (Knox, 2002, p.3)

<sup>17</sup> Darby et al (2002, p.30)

<sup>18</sup> Knox (2002)

Given the current assignment of expenditure responsibility, accountability for those local services that are provided by local authorities is better than in other parts of the UK. Thus Table 5 shows that 64% of current expenditure is financed by local rates. Although part of this local funding comprises non-domestic rate, whose effective incidence does not lie with local voters, local voters nevertheless are responsible for a much higher proportion of local government funding than in the rest of the UK where in England, on average they pay for only 25 of local current expenditure, and in Scotland and Wales, where they pay for an even lower percentage.

In 2002/03 the total expenditure of local authorities was £417m, which is 6.5% of total Departmental DEL for Northern Ireland, equal to £250 of gross expenditure per head of population, compared to about £1,300 for England and Wales (CIPFA, 2003). Northern Ireland Regional and District rate poundages are shown in Table 4 above. Table 7 below shows the main categories of local government spending.

**Table 7: Northern Ireland District Councils Expenditure 2002/03**

		%
Tourism	£20,112,795	6.32%
Community Services	£19,098,731	6.00%
Refuse Collection	£36,908,816	11.60%
Street Cleansing	£24,067,894	7.56%
Economic Development	£7,679,064	2.41%
Other Services	£210,420,516	66.11%

*Source: Department of the Environment.*

## Local government grants and equalisation

In Northern Ireland, local authorities are paid both specific and general grant, as shown in Table 4 above. The main grant paid to local authorities is called the General Grant. This grant comprises a derating element to compensate for industrial derating, and a resources element, which provides partial equalisation on the basis of needs versus wealth<sup>19</sup>. Needs are calculated on a population basis on the principle that the greater the authority's population, the greater its needs. However, population is adjusted to take account of

<sup>19</sup> The following section draws heavily on CIPFA (2003)

factors such as a deprivation index, sparsity of population and tourist and commuter influx. Need for local authority  $i$ : ( $N_i$ ) is then expressed as a percentage as follows:

$$N_i = \frac{\text{Council } i \text{ adjusted population} \times 100}{\text{Total adjusted population for Northern Ireland}}$$

A percentage figure for “wealth” is also calculated for each authority by expressing each local authority’s gross penny rate product as a percentage of the penny rate product for the whole of Northern Ireland. Thus wealth for Local authority  $i$ : ( $W_i$ ) is expressed as:

$$W_i = \frac{\text{Council } i \text{ gross penny rate product} \times 100}{\text{Total gross penny rate product for Northern Ireland}}$$

If need is less than wealth for an authority no resources element is paid. If need is greater than wealth, resources grant is payable. In these cases ( $N_i - W_i$ ) will be positive and this is called shortfall  $s_i$  for local authority  $i$ . To calculate resources element, these shortfalls are totalled for all such authorities as  $S = \sum_i s_i$ , subject to  $(N_i - W_i) > 0$ . Lastly, resources grant payable to authority  $i$  ( $R_i$ ) is calculated as pro rata to the local authority’s share of total shortfall – i.e:

$$R_i = (\text{Total resources grant available for distribution}) \times s_i/S$$

This system does not provide full equalisation, as to do so would either necessitate negative grant to set all authorities to a position where needs equals wealth, or else a much larger grant that could bring all authorities up to the position of the authority with the greatest excess of wealth over needs. However, in stopping short of full equalisation the Northern Ireland system is more in line with international practice than the rest of the UK, which is “second to none in pursuing equalisation” (King, 1999, p. 177).

Equalisation grants are paid to local authorities in the rest of the UK on a similar basis, in that the process is formula driven and is based upon measures of need and wealth. Given that, the systems for England, Scotland and Wales are more similar to each other than they are to the Northern Ireland system. In each of these countries, equalisation is across all authorities, rather than just being a top up to the subset of authorities that have a shortage of resources in relation to their needs. Wealth is measured by how much a

standard level of council tax will raise from the local authority's tax base and needs are measured by a formula structured around spending headings and client groups<sup>20</sup>.

The equalisation grant in England, Scotland and Wales is called Revenue Support Grant (RSG) and in each country RSG is set so that if the authority spends at its centrally assessed level of spending need, it will be able to levy a national standard level of council tax<sup>21</sup>. This broad system of equalisation relating to needs and wealth is generally found in most developed nations and is also prescribed by article 9 (5) of the European Charter of Local Self-Government:

“The protection of financially weaker local authorities calls for the institution of financial equalisation procedures or equivalent measures which are designed to correct the effects of the unequal distribution of potential sources of finance and of the financial burden they must support. Such procedures or measures shall not diminish the discretion local authorities may exercise within their own sphere of responsibility.” (Council of Europe, 1985)

An interesting example of extensive equalisation is the case of Australia, where the Commonwealth Grants Commission equalises for both wealth and needs between states. Because equalisation leads to gains and losses for sub units of government<sup>22</sup> the form and extent of equalisation, wherever practised, is usually the subject of strong political controversy. The Commonwealth Grants Commission is an arms' length and independent body which may be able to take a relatively long term and non-partisan view. Appointing such an independent body to determine intergovernmental transfers has been seen as a possible improvement to the administration of design of mechanisms both for the distributions of grants to devolved nations, and for the payment of equalisation grants to UK local governments (Heald, 2003, p. 90, McLean, 2004).

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<sup>20</sup> These formulas are called Formula Spending Share (FSS) in England, Grant Aided Expenditure (GAE) in Scotland and Standard Spending Assessments (SSAs) in Wales.

<sup>21</sup> See for example ODPM (undated)

<sup>22</sup> Either explicitly or implicitly.

Lastly, although equalisation mechanisms between sub units of government are found in most developed nations, an exception is New Zealand, where there are no arrangements for equalisation (RPA, 2003).

### **Accountability and the balance of funding**

The proportion of local authority funding that stems from local taxes, as against the proportion of funding that stems from central grant, is often called the balance of funding. If the sources of taxation for each level of government match their spending responsibilities, a state of vertical fiscal balance is said to obtain (King, 1984, p. 137).

Where local government spending responsibilities exceed their sources of taxation, as is almost invariably the case, there will be vertical fiscal imbalance. In England there is a high degree of vertical fiscal imbalance as local authorities receive 75% of their revenue funding from central grant and distributed business rate and in Scotland and Wales the proportion is slightly higher.

This contrasts strongly with local authorities in Northern Ireland, whose funding is predominantly local, as is shown in Table 5. The balance of funding has important implications for accountability. Accountability requires that those who decide on local spending also pay for it. If funding is predominantly from the centre, the centre will seek an account of the spending and wish to control it. If funding is predominantly from local residents, this function can be performed locally and this arrangement will have advantages in that information flows are shorter and control will be based on better knowledge (Watt and Fender, 1999).

Looking in more detail, the question of accountability can be analysed in terms of two concepts: marginal accountability, and overall or total accountability.<sup>23</sup> Overall accountability is the effect, described above, of a high proportion of central funding leading to central scrutiny and control.

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<sup>23</sup> See Watt and Fender, 1999; and Mintz and Wilson (1991) cited in Barnett and Hutchinson (?)

In contrast, marginal accountability looks at the source of funding for *increases* (or decreases) in expenditure at the margin. In Britain local government has full marginal accountability because, once the grant has been announced, it is fixed, regardless of the expenditure decisions local authorities subsequently make (Watt and Fender, 1999, p. 17). Local authorities cannot therefore increase their central grant by increasing spending and local residents are therefore 100% accountable at the margin. It can be argued that marginal accountability makes expenditure capping unjustified (Fender and Watt, 2002).

Full marginal accountability for local spending was introduced in Britain at the time of the poll tax, and continued under the move to council tax. Northern Ireland does not have full marginal accountability, although a move in that direction was made in April 2003. Before that, grant payment was determined by the Local Government (Northern Ireland) Order 1972, and the resources element acted to the effect placing the Executive in the position of a supplementary ratepayer to councils with a low local tax base<sup>24</sup>. The reason that the current system still does not offer full marginal accountability is that non-domestic ratepayers, who do not have a vote, also contribute to funding at the margin when rates are increased. In the rest of the UK, non-domestic rates are collected at a uniform rate and distributed to local government as a fixed per capita sum that does not vary with an authority's expenditure.

## Conclusions

Local government in Northern Ireland is funded by local ratepayers, fees and charges, borrowing and by grants that are funded ultimately by the UK government. Funding from the UK government comes through the Northern Ireland DEL, which is determined by the Barnett formula. Whilst the Barnett formula can be criticised, it is probably an advantageous system from the point of view of each of the devolved nations.

Grant is used to equalise between local authorities, both to reduce disparities in wealth and to even up their ability to meet need. Unlike the rest of the UK, grant does not fully

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<sup>24</sup> This system was the same as the old resources element of the Rate Support Grant in Britain, prior to the changes introduced at the same time as poll tax.

equalise in Northern Ireland, but in this respect the system is more in line with worldwide practice than the rest of the UK.

The central/local balance of funding for local authorities in Northern Ireland is orientated more towards local finance than the rest of the UK, and it has been argued above that this is a desirable characteristic, as local government works best when local residents not only vote on but also pay for local spending decisions whose benefits they receive<sup>25</sup>.

This desirable balance of funding is however, partly achieved as a result of the relatively small number of functions assigned to local government in Northern Ireland compared to the rest of the UK. There is therefore what might be considered a centralisation of what, elsewhere in the UK, would be local government functions towards the Northern Ireland administration. This centralisation may not be in line with an ideal level of subsidiarity. The other component of this locally-orientated funding balance is local authorities' control of the non-domestic rate, which has some drawbacks in terms of democratic accountability.

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<sup>25</sup> This point is based on a conclusion drawn by Bird (1999, especially p. 11) based on his extensive discussion of the literature.

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