Northern Ireland Fiscal Council
Bringing transparency to NI's public finances

The NI Executive's 2022-25 Draft Budget: an assessment

January 2022

Contents

Foreword

The Northern Ireland (NI) Fiscal Council was established in 2021 to bring greater transparency and independent scrutiny to the region's public finances, focusing in particular on the finances of the NI Executive. In doing so we hope to inform both public debate and policy decisions to everyone's benefit.[1]

Within this overall mission, our Terms of Reference (based on the New Decade New Approach agreement) require us to *"prepare an annual assessment of the Executive's revenue streams and spending proposals and how these allow the Executive to balance their budget"*.[2] After speaking with stakeholders we concluded that the best way to do this was to produce a report on the Executive's Draft Budget, so as to inform public discussion and the deliberations of the Assembly during the consultation period leading up to the Final Budget. As we discuss in the report, the Draft Budget published on 13 December is unprecedented in that it is <u>not</u> an agreed position of the Executive, but simply a starting point for consultation. However, we have decided to use this as the basis for our annual assessment on this occasion.

The members of the Fiscal Council are responsible for the content of the report, but we have relied hugely on the hard work and expertise of our colleagues Jonathan McAdams, Karen Weir, Colin Pidgeon, Tamara Ferguson and Philippa Todd. We are also very grateful for the time and patience of officials from the NI Departments. What follows is our independent assessment. We have come under no pressure from NI Executive or UK Government Ministers, advisers or officials to include, exclude or change any material.

More information on the Executive's finances and the Budget process can be found in *The public finances in Northern Ireland: a comprehensive guide* (henceforth '*the Guide*') published by the Fiscal Council in November 2021.[3]

The assessment is structured as follows:

- Chapter 1 is an **executive summary**.
- Chapter 2 describes the **scope** of the Draft Budget, our interpretation of 'balancing' the Budget and the rest of the Budget process.
- Chapter 3 describes the **context** for the Draft Budget, in particular the outcome of the UK Spending Review, the economic situation and the submissions made to the Department of Finance by other departments.
- Chapter 4 describes the **content** of the Draft Budget, including a summary of spending and financing and the decisions taken to balance the Budget.
- Chapter 5 offers some **concluding reflections**.

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[1] Find out more about the NI Fiscal Council at www.nifiscalcouncil.org
[2] https://www.nifiscalcouncil.org/publications/initial-terms-reference
[3] https://www.nifiscalcouncil.org/publications/public-finances-ni-comprehensive-guide-november-2021

1 Executive summary

Scope and process

The NI Executive published its Draft Budget on 13 December 2021. This set out potential spending allocations for each of the NI Departments for the years 2022-23 to 2024-25, plus an explanation of how they would be financed. This marks a return to multi-year budgeting after seven successive single-year Budgets.

In contrast to previous Draft Budgets, the political parties in the Executive could not agree a set of departmental allocations so they have decided instead to publish the Finance Minister's proposals, but only as a basis for consultation. This will make the task of agreeing a Final Budget before the new financial year more difficult, not least because the parties are positioning themselves for looming Assembly elections.

The Draft Budget sets out separate plans for three categories of spending:

- **Resource** spending, which covers the day-to-day running cost of public services, administration and grants, plus the payment of debt interest.
- Conventional **capital spending**, which covers investment in physical assets like infrastructure and buildings, such as roads and hospitals.
- **Financial transactions capital (FTC)** spending, which can only be used to make loans to or equity investments in the private sector.

The Finance Minister is required by legislation to ensure that the spending plans set out in the Draft Budget 'balance', which in practice means that they can be covered by a combination of agreed UK Government funding, other external funding, income generated by the Executive itself and permitted levels of borrowing. In that context, the key choices the Executive has to make are:

- First, when setting a total spending envelope, **how far to 'top up' the Block Grant** that the Executive receives from Westminster through decisions on the Regional Rate, fees and charges, and capital borrowing?
- Second, **how to balance the competing demands of different departments** within the total spending envelope?

The Block Grant settlement for this Budget is larger than most observers expected. In response, the Finance Minister has put forward a Draft Budget that freezes domestic and non-domestic Regional Rates (rather than using them as a source of extra revenue) and increases capital borrowing to £200 million a year by 2024-25. Within the gross spending envelope that this finances, he has proposed giving just over half the increase in resource spending to the Department of Health.

The public consultation on the Draft Budget runs until 7 March 2022. If and when the Executive manages to agree a Final Budget, the Department of Finance will publish a further document setting out the details. The Finance Minister will make written and oral statements to the Assembly and MLAs will debate them.

If the Executive fails to agree a Budget, departments can continue to spend into the new fiscal year. This would be possible either because the Assembly has passed a 'Vote on Account' (allowing departments to spend 45 per cent of their provision for the previous year) or because of contingency arrangements that allow the top civil servant at the Department of Finance to authorise use of resources. The latter has been done before in years when the Executive and Assembly were not sitting.

Stakeholders across the political spectrum have told us that single-year Budgets have stymied long-term planning and policy action in areas such as health care reform and infrastructure planning and that a return to multi-year budgeting was a golden opportunity to rectify this. This underlines the importance of the current Executive reaching agreement on a Final Budget to support a more strategic approach to government spending over that longer time horizon.

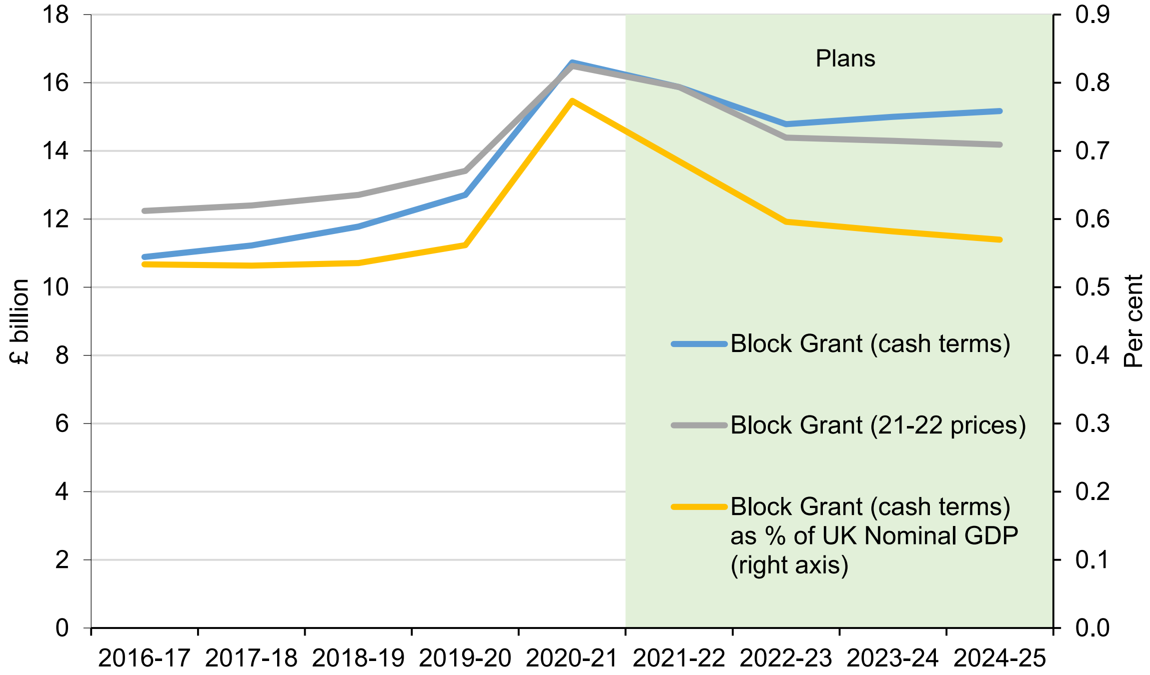
Context

The Chancellor of the Exchequer's willingness to raise taxes to finance higher public spending at the March and October UK Budgets – combined with an improvement in the Office for Budget Responsibility's medium-term revenue forecasts between March and October – mean that UK public spending and tax revenues are expected to be higher as a share of national income coming out of the pandemic than they were going in and higher also than prior to the 2008-09 financial crisis.

Under the Barnett formula – the mechanism used to calculate the change in the Block Grant paid to the devolved administrations – the core component of the Block Grant is adjusted to reflect changes in UK Government spending <u>outside</u> NI in areas that the Executive is responsible for <u>inside</u> NI. So, for this Budget period, the unexpectedly high-spending and high-taxing Budget at the UK level fed through to a higher Block Grant settlement for NI and the other devolved administrations than most observers anticipated. The Block Grant settlement agreed for NI at the Spending Review also included 'non-Barnett additions' for farm and fisheries support and security. Shortly after, funding for past political agreements and City and Growth Deals was added. These had to be confirmed by the Secretary of State.

Not surprisingly, the UK Chancellor and the NI Finance Minister take different views on the generosity of the Block Grant settlement. The Treasury trumpeted a £1.6 billion a year average increase relative to 'baseline' funding of £13.4 billion. The Department of Finance lamented a *"marginal real terms increase"* relative to the Executive's £12.5 billion 2021-22 Budget for resource spending. Both have flaws as a basis for comparison. The longer-term picture is that the Block Grant is higher coming out of the pandemic than going in, although the difference is relatively modest as a share of UK GDP by the end of the three-year Budget period (Chart 1.1).

Chart 1.1 – The Block Grant on different bases of measurement



Note: We express NI DEL as a share of UK GDP becasue the Block Grant reflects an overall judgement on the level of UK spending as a share of UK GDP
Source: HMT PESA 2021 and Spending Review 2021 (DELs) and OBR databank October 2021 (UK Nominal GDP)

The economic backdrop provides further context for the Draft Budget. The performance of the NI economy has little direct impact on the NI public finances or on the Executive's budgetary room for manoeuvre, but it does influence its policy choices. As well as political considerations, the Finance Minister's proposal to freeze domestic and non-domestic rates is presumably in part a response to the impact of higher inflation on household finances and the ongoing impact of Covid-19 and Brexit on potentially vulnerable firms. In both cases, Regional Rates are a relatively blunt instrument – the freezes help firms and households that are in a strong financial position as well as a weak one – but they are one of the few that the Executive has available. In setting its spending plans, the Executive also has to balance the immediate needs of health as we emerge from the pandemic and the need to address longer-term challenges of economic performance through investment in education, skills and infrastructure, which requires careful consideration.

Further context for the Draft Budget comes from what departments have said about the pressures on public services and other spending for which they are responsible in their submissions to the Department of Finance. Having been asked to identify potential savings, most departments have submitted requests for additional resources. Presumably they will give some details in their own consultation documents, which follow that of the Department of Finance.

Content

The Draft Budget shows the Finance Minister's proposed envelope for 'Total Spending', based on planned receipts from the UK Government Block Grant, Regional Rates, capital borrowing (under the Reform and Reinvestment Initiative, RRI) and the Irish Government's contribution to the cost of the A5 road project. Table 1.1 shows how this would break down between resource, capital and FTC spending and between money allocated straight away to departments, money held centrally for later allocation and expected debt interest payments.

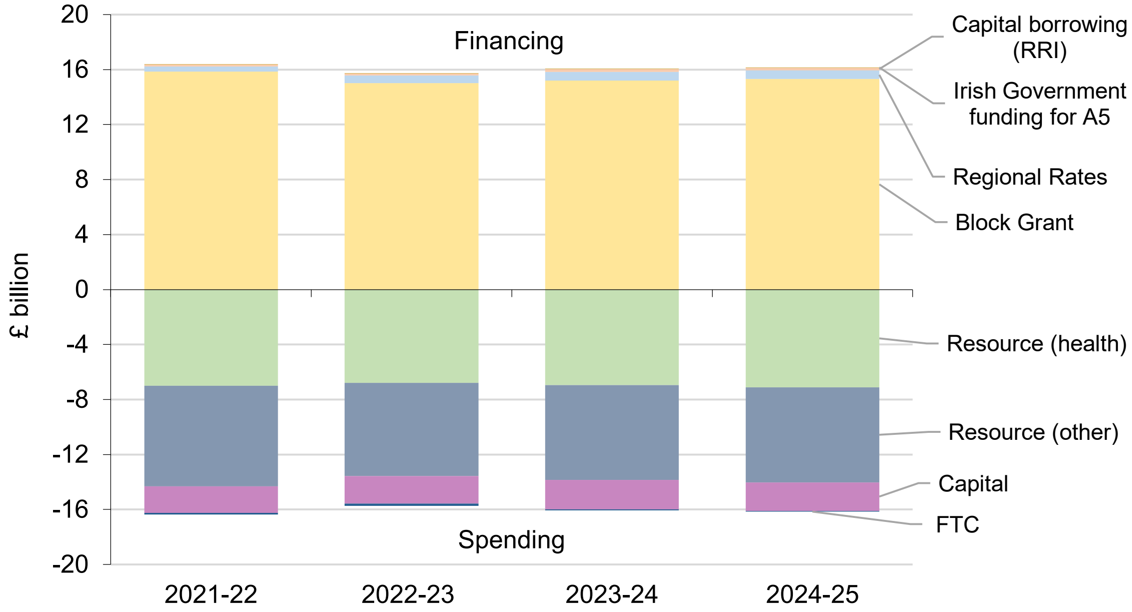
Table 1.1 – Proposed spending and financing by the Executive

	2021-22 (October)	2022-23	2023-24	£ million 2024-25
FINANCING				
Resource				
Block Grant	15,848	15,001	15,207	15,305
Regional Rates	367	577	628	630
Capital borrowing (RRI)	140	140	194	200
Irish Government funding for A5	6	7	25	25
Total financing	**16,361**	**15,725**	**16,054**	**16,160**
pays for				
SPENDING				
Resource	14,301	13,571	13,841	14,035
Capital	1,932	1,991	2,147	2,063
FTC	128	163	66	62
Total spending	**16,361**	**15,725**	**16,054**	**16,160**
Departmental spending	16,245	15,515	15,957	16,077
Held centrally for later allocation	70	164	51	38
Debt interest (RRI)	46	46	46	46
Total spending	**16,361**	**15,725**	**16,054**	**16,160**

Source: Department of Finance

Chart 1.2 shows how proposed financing and spending balance in the Draft Budget, with the former dominated by the Block Grant and the latter by resource spending, around half of which is accounted for by Health.

Chart 1.2 – The composition of total spending and financing



Source: Department of Finance

The Department of Finance does not show fees and charges or EU funding as income for the Executive. It treats both as 'negative spending', thus allowing the departments receiving them to finance additional gross spending within their budget allocations. The Budget also excludes what the Treasury terms 'Annually Managed Expenditure' (AME) by the Executive – notably on state and public service pensions and social security benefits. This is fully covered by additional funding from the UK Government beyond the Block Grant, except if the Executive decides to make the programme more generous than in the rest of the UK (known as 'super-parity'). All these terms are explained and discussed more fully in our Guide.[4]

Rather than using them as a source of additional revenue, the Finance Minister has proposed freezing domestic and non-domestic Regional Rates for the three years of the Budget period and to provide additional relief for some sectors through to the end of June. Land and Property Services estimates that this will cost around £175 million over the next three years, compared to a situation in which poundages were increased in line with inflation and reliefs were not extended. There is also a risk to future Rates revenues from the possibility of appeals against property valuations published in spring 2020 that failed to take any account of the impact of Covid-19. The potential cost has been estimated at between £39 and £255 million.

The Executive has the right to borrow up to £200 million a year and £3 billion in total to finance capital spending under the RRI. The Finance Minister has proposed to borrow £140 million next year (the same as in 2021-22), rising to £200 million

[4] https://www.nifiscalcouncil.org/publications/public-finances-ni-comprehensive-guide-november-2021

by 2024-25. This would take cumulative borrowing to £1,747 million. The gradual increase reflects the difficulty of stepping up capital spending quickly.

Having determined the total amounts of financing for resource, capital and FTC spending, through its decisions on the Rates and capital borrowing, the Executive then has to allocate it between the different NI departments. It may not have agreed yet on all the specific allocations, but: "*Even before the pandemic struck the returning Executive had agreed that health would be its top priority. The focus of this Draft Budget was therefore on providing significant additional resources with a view to transforming the health service and hence improving health outcomes overall.*"

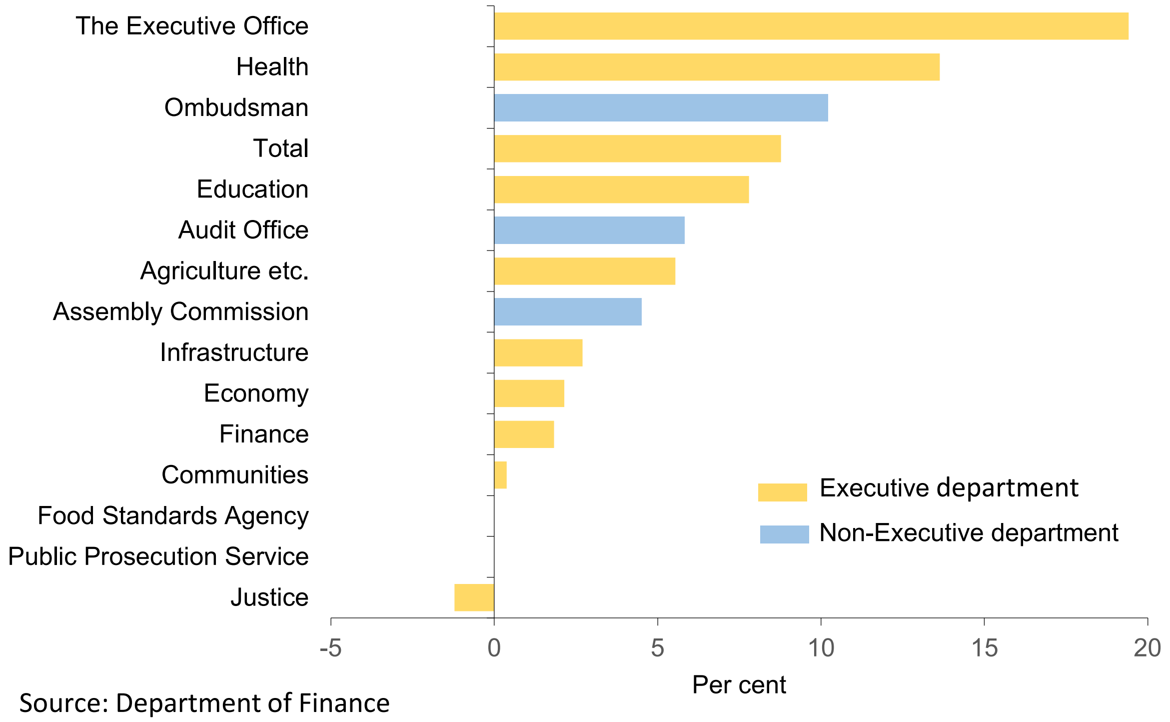
Of the £13,951 million allocated to departments for resource spending in 2024-25, Health has been allocated 51 per cent, Education 18 per cent and Justice 8 per cent. In real terms, adjusting for inflation, the allocation to Health is 10 per cent higher in 2024-25 than the Department of Finance's baseline figure, which excludes temporary Covid-19 support and other one-off and time-limited items. The remaining allocations are 8 per cent higher on average in 2024-25 on the same basis.

When allocating resource spending, the Department of Finance started with the baseline figure it calculated for each department and then reduced all but Health and some small non-Executive departments by 2 per cent, saving around £118 million each year. Departments then received various specific allocations, some of them agreed with the Treasury at the Spending Review (for example farm and fisheries support, allocated to Agriculture) and some made at the Draft Budget (for example funding for pensions to victims of the Troubles, payments to those who suffered historical institutional abuse and an inquiry into Mother and Baby Homes, all allocated to The Executive Office).

Finally, the Department has proposed general allocations to departments *"which along with their baseline funding, may be spent at the discretion of Departmental Ministers"*. These rise from a total of £954 million in 2022-23 to £1,375 million in 2024-25 and are largely the fruits of the increase in the Block Grant. Health receives more than two-thirds of these. Of the £664 million it receives in 2022-23 (which rises to £990 million by 2024-25), the 2 per cent cuts relative to baseline elsewhere contribute less than 20 per cent – most comes from the higher Block Grant.

One might argue that the combined impact of the almost-across-the-board 2 per cent cut and the general allocations is the best indicator of the 'winners and losers' from the Draft Budget proposals. Chart 1.3 shows the average impact over the 3 years 22-23 to 24-25 as a percentage of the baseline for each department.

Chart 1.3 – Change in funding from 2% cut and general allocations



Source: Department of Finance

The conventional capital allocations are significantly smaller than the resource allocations, at £2,063 million in 2024-25. In 2022-23 the largest allocations are to Infrastructure (39 per cent) and Health (18 per cent). Financial Transactions Capital (FTC) allocations are much smaller still and dominated by Communities (for housing) and Economy (for investment projects by Invest NI).

Concluding reflections

The unexpectedly big increase in the Block Grant has enabled the Finance Minister to propose in the Draft Budget to freeze Regional Rates to help vulnerable firms and households as well as to deliver significant increases in health spending. Most other departments were asked to accept 2 per cent cuts in their baseline spending as an initial way to free resources, but in most cases these have been offset or more than offset by general allocations financed from the Block Grant.

But the Draft Budget is also notable for areas where the Department of Finance has asked for suggestions in the consultation but made no proposals yet of its own. These include the possibility of raising more money through fees and charge and making savings in areas of 'super-parity'. The consultation asks in general terms where departments might make efficiency savings and whether they should stop providing some services, but in neither case consults on specific proposals.

One consistent message from stakeholders – and from the budget process report published by the NI Audit Office in June 2021[5] – is that budget allocations should be linked more clearly to plans and targets set out in a Programme for Government

[5] https://www.niauditoffice.gov.uk/sites/niao/files/NIAO_Report_NI%20Budget%20Process%20Report_Combo_4_WEB.pdf

(PfG). But progress on a PfG has advanced little since the close of a public consultation on a Programme for Government draft Outcomes Framework 2021 in March 2021 The incoming Executive will presumably step up efforts to agree one, although it remains to be seen how closely this would resemble the current draft and how effectively it would be linked to departmental spending allocations.

The Executive had an 'Investment Strategy' in place for 2011 to 2021 and a new one is needed. We understand that a draft will soon be published for consultation, although ideally it would have been in place in time to shape the Draft Budget capital allocations. The lack of an Investment Strategy providing Executive-level direction and prioritisation has consequences for capital spending and delivery. In recent years, for example, a number of major projects have been repeatedly delayed – partly because of the planning system and judicial reviews of contract decisions. Additionally, the Executive has struggled to spend the FTC available to it. By implication, much of the capital budget seems either not to have been spent or has not been spent on the originally intended project.

For the first time the Draft Budget contained a statement on pay policy, noting that: *"Departmental pay increase assumptions typically average 2 per cent per year for all pay elements, although for some staff groups these will be higher, particularly those in the Health Service. There is also scope to offer increased awards in support of efficiency and reform."* The policy only applies to a sub-set of public sector workers in NI, but, in an environment of relatively high inflation, upward pressure on pay increases for groups to which the policy applies could represent an additional call on resources for departments during 2022-25 the three year Budget period.

One key goal of the Fiscal Council is to increase the transparency of the NI public finances, both through what we publish and in what we can encourage the Department of Finance and other bodies to do. There have been some useful advances in transparency in this Draft Budget, but there is plenty of scope to do more. For example, the Budget resource and capital plans are still not presented alongside a comparable set of outturn data for recent years or an up-to date forecast for the current year. And no explanation is provided for the distribution of general allocations to departments in the resource budget.

In our response to the UK Government Spending Review, we argued that a return to multi-year budgeting in NI after seven successive single year Budgets was a golden opportunity for greater long-term thinking and policy action, especially in areas like healthcare and infrastructure planning. With the five parties in the Executive failing to reach agreement on the substance of the Draft Budget, this is not a particularly encouraging start. It is also notable that the Budget contains very little earmarked funding for transformation and that there is no specific evidence of systematic and well-explained priority-setting beyond the top spot given to Health.

That said, we must recognise that while the predictability around external financing is there to prepare a reforming multi-year Budget, the politics of agreeing one with a fresh set of Assembly elections relatively near at hand are inevitably complicated. At the end of the day, the challenge will be in hands of the incoming Executive.

2 The Draft Budget: scope and process

The NI Executive published its Draft Budget on 13 December 2022. This set out potential spending allocations for each of the NI Departments for the years 2022-23 to 2024-25, plus an explanation of how they would be financed. In contrast to previous Draft Budgets, the political parties in the Executive could not agree a set of allocations so these have been published solely for consultation. This will make the task of agreeing a Final Budget before the new financial year more difficult, not least because the parties are readying themselves for the Assembly elections in May.

This chapter:

- Describes the **scope** of the Draft Budget.
- Outlines the decisions the Executive needs to take to **'balance'** the Budget.
- Describes the remainder of the Budget **process**.

The scope of the NI Budget

Like the other devolved administrations, in Scotland and Wales, the NI Executive is constrained to manage its spending within the framework that the UK Government has put in place to manage the public finances of the UK as a whole.

For each Whitehall department and devolved administration, the UK Treasury divides public spending responsibilities into two categories – those for which it sets 'Departmental Expenditure Limits' (DELs) and those which it treats as 'Annually Managed Expenditure' (AME). DELs cover spending over which the Treasury believes that departments and administrations have reasonable short-term control and the potential to make meaningful plans over the medium term. AME covers spending that is *"demand-led and volatile in a way that could not adequately be controlled by the devolved administrations; and/or that are so large that the devolved administrations could not be expected to absorb the effects of volatility within DEL"*. [6]

The Executive's Budget focuses on the allocation and financing of spending covered by its DEL (although the Budget documents also contain forecasts for AME). Within its total DEL, the Treasury sets three subsidiary DELs for the Executive (plus a separate 'non-cash' DEL to cover depreciation). The Department of Finance mirrors this in the way it presents the NI Budget, laying out separate sets of plans for:

- **Non-ringfenced resource** spending, which covers the day-to-day running costs of public services, administration and grants, plus the payment of debt interest. This is the largest component and the Department of Finance describes it as the *"focus"* of the Budget. It notes that resource budgets *"are*

[6] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1030043/Statement_of_Funding_Policy_2021_-_FINAL.pdf

set on an incremental basis - that is they are substantially based on the previous year's budget with additions or reductions applied as appropriate".

- **Conventional capital** spending, which largely covers investment in physical assets like infrastructure, buildings and machinery. Rather than an incremental approach, capital budgets are *"determined on a zero-based approach informed by an assessment of the capital requirements of individual departments"*. Some of the funding is earmarked for 'flagship projects' and other specific purposes, but once these have been allocated Ministers are free to allocate the rest of their capital budgets as they wish.

- **Financial transactions capital (FTC)** spending, which can only be used to make loans to or equity investments in the private sector.

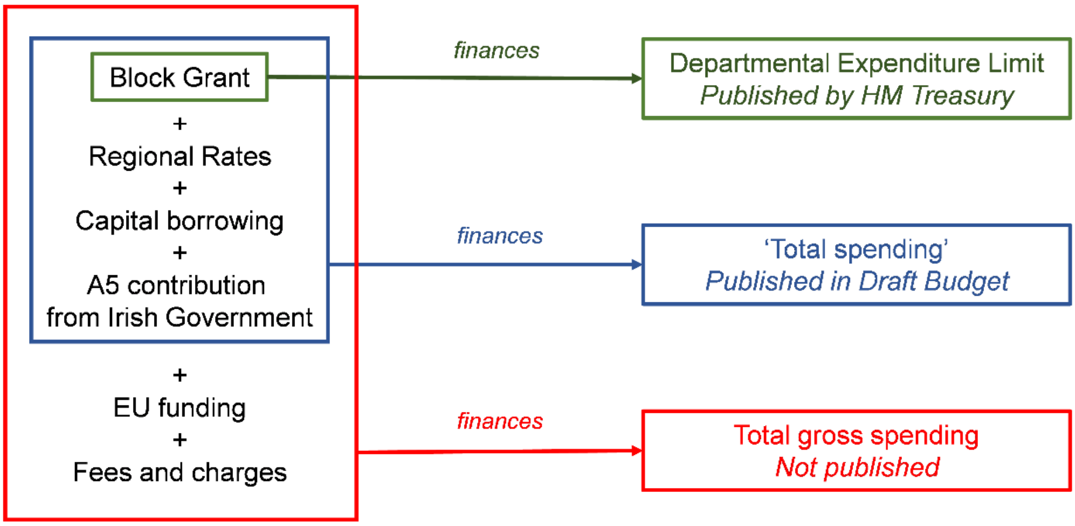
In each category the Executive allocates planned spending department-by-department, with a small proportion of planned resource and capital spending (and a larger proportion of FTC) held centrally for allocation later in the Budget period.

The bulk of this spending is financed by the UK Government 'Block Grant'. Indeed, under the UK spending control framework the Treasury sets the Executive's DEL equal to the Block Grant and treats all other financing as 'negative DEL' that creates room for higher gross spending within this net spending/funding limit.

In its own presentation of the Budget, the Department of Finance publishes a larger measure of 'Total Spending' and 'Total Financing' that, in addition to the Block Grant, includes Regional Rates revenue (which helps finance resource spending) plus borrowing under the Reinvestment and Reform Initiative (RRI) and the Irish Government's contribution to the A5 road project (which both help finance capital spending). But these totals are still net of other sources of finance – mainly income from fees and charges[7] and EU funding – which the Department of Finance treats as negative spending that creates room for additional gross spending within its own totals. The Department of Finance does not publish estimates for these – or a 'Total Gross Spending' figure that includes the spending that would be financed by them (Figure 2.1). (We have estimated broader measures of gross spending and financing by the Executive for past years in our *Guide*, but this remains work in progress.)

[7] 'Sales of goods and services' in the National Accounts, including non-domestic water charges and tuition fees. Some of this income is a transfer within the public sector.

Figure 2.1 – Financing of the NI Executive's DEL spending



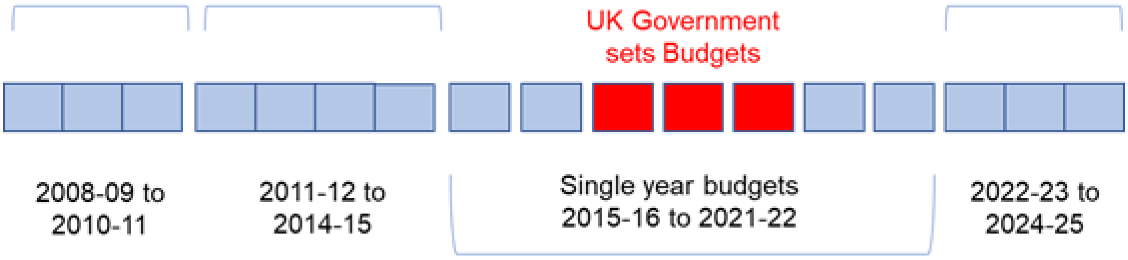
Source: NIFC based on Draft Budget

The AME spending for which the Executive is responsible – primarily state and public sector pensions and social security benefits – is financed fully and automatically by the UK Government, unless the Executive makes an AME programme more generous than in the rest of the UK – which is known as 'super-parity' – in which case it has to meet the additional cost within its DEL. As we discuss in our *Guide*, this means that AME spending in NI gets less attention from the Executive and the UK Government than DEL – even though issues around super-parity in welfare reform and the cost of the Renewable Heat Incentive (RHI) scheme have caused serious political difficulties in the past.

The Treasury sets the Executive's DEL and corresponding Block Grant at the UK Spending Review (most recently on 27 October 2021) and then updates them as necessary. Following the Spending Review, the Secretary of State for Northern Ireland writes formally to the Finance Minister to confirm the funding which will be available. On this occasion, the Secretary of State wrote two days after the Review to confirm the Block Grant agreed at the Review (which included a core element calculated using the Barnett Formula plus much smaller 'specific allocations' for farm and fisheries support, security and 'Tackling Paramilitary Activity'), as well as a small amount of additional funding for past political agreements (including the 2020 New Decade New Approach agreement) and City and Growth Deals. (These require separate approval from the Secretary of State before they can be included in the NI Budget, which leaves the Review settlement itself unhelpfully incomplete.)

The Executive's 2021-22 DEL and Block Grant have been increased slightly further <u>since</u> the publication of the Draft Budget, with the announcement of extra UK funding for vaccine rollouts on 15 and 19 December (see Chapter 4).

Figure 2.2 – Multi- and single-year Budgets in NI since 2007



Source: Northern Ireland Fiscal Council

The Draft Budget covers the three years from 2022-23 to 2024-25, mirroring the years for which the UK Government set out its departmental spending plans (including the devolved administration Block Grants) at the Spending Review. This marks a return to multi-year budgeting in NI after seven successive single-year Budgets, as a result either of single-year Spending Reviews at the UK level or of political difficulties in NI that precluded a multi-year Budget or meant that the UK Government had to set the Budget because the Assembly and Executive were not sitting (Figure 2.2). We noted in our response to the Spending Review that stakeholders across the political spectrum felt that single-year Budgets had stymied long-term planning and policy action in areas such as health care reform and infrastructure planning and that a return to multi-year budgeting was a golden opportunity to rectify this.[8] This underlines the importance of the current Executive reaching agreement on a Final Budget that the next one can build upon.

'Balancing the Budget'

For any government or sub-national administration, Budget-making involves three interdependent judgements: how much to spend (and on what); how much revenue to raise (and from whom); and whether and how much to borrow or repay debt.

The Executive is much more constrained in these judgements than the UK Government and somewhat more so than the other devolved administrations. Rather than operating under self-imposed (and frequently abandoned) fiscal rules, like the UK Government, the Executive's ability to borrow and carry debt is limited by UK legislation and confined to the financing of capital spending. The Executive's tax-raising powers are particularly limited, with Regional Rates its only significant source of tax revenue (and even then they are expected to pay for only 5 per cent of the Executive's measure of 'Total Spending' over the Budget period).

So, within this context, how are we to interpret the request in our Terms of Reference to assess *"the Executive's revenue streams and spending proposals and how these allow the Executive to balance their budget"*? The simplest interpretation of 'balancing the budget' would be to assess if spending equals revenue over a specified time period, requiring no borrowing to make up the difference. But the Executive does have explicit borrowing powers, so a more logical interpretation is to assess whether its revenue streams and spending proposals are consistent with

[8] https://www.nifiscalcouncil.org/publications/fiscal-council-response-2021-spending-review

the borrowing limits placed upon it in legislation and agreement with the Treasury – namely currently that it should borrow no more than £200 million a year, no more than £3 billion in total at any point in time and only to finance capital spending. (The Executive can undertake some non-capital borrowing to smooth its cash flow through the fiscal year, but in practice never needs to.)

This interpretation is consistent with the requirement placed on the NI Finance Minister by the 1998 Northern Ireland Act[9] to confirm that the Draft Budget can be delivered with the UK Government funding available. Once the Secretary of State has confirmed the funding agreed (as described above), the Finance Minister must in turn confirm these numbers to the Assembly at least 14 days before he publishes the Draft Budget (which he did on 2 November)[10] and undertake to *"demonstrate that the amount of funding required by any draft Budget does not exceed the amount notified by the Secretary of State as set out in this statement"*.

These formalities are a legacy of the NI Budget crisis of 2014, when the Executive could not reach agreement to implement the cost saving welfare reform package announced by the UK Government in 2012 and found itself with unsought 'super-parity' in its largest AME programme. The Executive published a Draft Budget that assumed the NI parties would be able to agree a package of reforms so that the Treasury would not penalise it for failing to implement the UK package by cutting the Block Grant. But the UK Government regarded this as an 'unbalanced' Budget and imposed penalties until the issue was resolved in the Fresh Start Agreement.

Notwithstanding the Executive's relatively limited room for manoeuvre within the Budget, the dictum "To govern is to choose"[11] applies as much at the NI as the UK-wide level. Given the size of the Block Grant (and the much smaller sums of external funding from the EU and Irish Government), the key choices that the Executive has to make in deciding how to 'balance the Budget' (in the sense used here) are:

- First, **how far to 'top up' the Block Grant** when determining the total envelope for gross spending – through the setting of the Regional Rate, the setting of fees and charges, and capital borrowing?

- Second, **how to balance the competing demands of different departments** within the total envelope for gross spending?

As we shall see in Chapter 3, the Block Grant settlement is larger than most observers expected over the three-year Budget period. And in response, as we shall see in Chapter 4, the Finance Minister has put forward a Draft Budget that freezes both domestic and non-domestic rates (rather than using them as a source of extra revenue) and increases capital borrowing from £140 million this year to the maximum permitted £200 million by 2024-25. Within the gross spending envelope that results – where the increase in the Block Grant easily dominates these three

[9] As amended by s.9 of Northern Ireland (Stormont Agreement and Implementation Plan) Act 2016
[10] https://www.finance-ni.gov.uk/sites/default/files/publications/dfp/Statement%20by%20the%20Finance%20Minister%20-%20Budget%202022-25%20Funding%20Available.pdf
[11] Usually attributed to the 1950s French Prime Minister Pierre Mendez-France although also used by JF Kennedy and Nigel Lawson. For a recent example of use see Resolution Foundation 6 September 2021, "To govern is to choose: The choices facing the Chancellor this Autumn".

proposals – the Finance Minister has proposed giving a little over half the increase in resource spending to the Department of Health.

This set of decisions would 'balance the budget' in the sense that we use it here. But, as we noted at the outset of this chapter, this is not the agreed position of the Executive. According to media reports[12], the Finance Minister put the Draft Budget to the Executive on 9 December, supported by other Sinn Féin Ministers, but the DUP voted against it. The smaller parties – the SDLP, the Alliance and the UUP – endorsed the headline proposal to prioritise health spending but said that they would not necessarily support the detailed departmental allocations. On that basis the Executive agreed to publish the draft, but only as a basis for consultation.

Even though the parties have kicked the budgetary can down the road, the publication does at least make the arithmetic constraints confronting them in agreeing a Final Budget explicit. In particular, if the Executive wishes to give a substantial funding increase to Health then other departments have to make sacrifices. If, however, the desire is to avoid pain in the other departments, then a large funding increase cannot be provided to Health. The political appetite to loosen the overall budget constraint significantly through a change of heart on Regional Rates or more decisive action on fees and charges looks very limited.

The remainder of the Budget process

The publication of the Draft Budget on 13 December 2021 marked the beginning of a formal public consultation period that will close on 7 March 2022. MLAs and other stakeholders have complained about the lack of time to debate Budget proposals in recent years, but the 57-working-day consultation period this time compares well with 28 days for the 2021-22 Draft Budget and no Draft Budget at all for 2020-21. The timescale is just short of the 12 weeks the Finance Minister was hoping for but is in excess of the 8 weeks minimum set in the Fresh Start Agreement[13].

The Department of Finance has requested responses to three sets of questions[14]:

- **Funding our Budget**
    - Should we in NI raise more money for public services. If so, how?
    - Is it right to freeze our household and business rates at current levels?
    - Where should we look to save money through better efficiencies?
- **Spending our Budget**

[12] https://www.belfasttelegraph.co.uk/news/northern-ireland/stormont-ministers-approve-draft-budget-going-for-consultation-41137367.html
[13] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/479116/A_Fresh_Start_-_The_Stormont_Agreement_and_Implementation_Plan_-_Final_Version_20_Nov_2015_for_PDF.pdf (The text of the Fresh Start Agreement says that the time limits are maxima rather than minima, but this was unintentional.)
[14] https://www.finance-ni.gov.uk/budget-consultation

- Do you think we have the right balance between health and other priorities?
- Do you agree with the proposal to direct 2% from other departments to health?
- Do we need to reduce or completely stop delivering any services? If so, what are they and why?
- Do we need to re-direct spending? What needs more funding and where would you take it from?

- **What else?**
  - Is there anything else you would wish us to know about the Draft Budget?

In the consultation on the 2021-22 Draft Budget, 177 formal responses were received from a variety of stakeholders, including business groups, trade unions and community and voluntary organisations. It remains to be seen how this consultation process will be affected by the fact that the proposals set out this time are those of the Finance Minister rather than the agreed position of the Executive. On the one hand, people may see more potential to shape the end result differently. On the other, people may be pessimistic about the political parties engaging substantively with outside proposals with an election in the offing.

Judging from past experience, the statutory committees in the Assembly would be expected to take evidence from their departments during the consultation period. The Chair of the Finance Committee also typically tables a 'take note debate' in the Assembly, which allows MLAs to air their views. In the past, the Finance Committee has brought together the conclusions of the take note debate and the fruits of the committees' evidence sessions into a co-ordinated report on the Draft Budget. Once again, it is not clear to what extent the unusual status of this Draft Budget will affect the way in which committees and party groupings in the Assembly will engage.

Under normal circumstances, the Final Budget is an opportunity to tweak the departmental allocations in the Draft Budget in the light of the consultation and other political and technical developments. Changes may be prompted in part by fresh news on UK Government funding at the Spring UK Budget or Statement, should that occur in time. Any changes to spending settlements for UK Government departments can affect the NI DEL and Block Grant via the Barnett Formula.

Once the Executive has agreed the Final Budget, the Department of Finance publishes a document setting out the details. The main presentational difference from the Draft is usually that the Final Budget breaks each departmental allocation down by 'spending area' or 'Unit of Service'. The Finance Minister makes written and oral statements to the Assembly and MLAs debate them. The Assembly typically legislates for the Budget in a Budget Act and 'Main Estimates' in June or July – the twin acts by which the Assembly formally sanctions departmental spending.

But what happens if the Executive fails to agree a Final Budget by the end of the fiscal year or by the time that the Assembly dissolves for the 2022 elections?

Fortunately, neither the Executive nor the Assembly need to agree the Final Budget to provide departments with the legislative authority to spend money into the following fiscal year – indeed, as just noted, the Budget is not normally legislated for until some way into the fiscal year to which it applies. Whether or not the Budget for the coming fiscal year has been agreed, the Assembly normally considers a Budget Act in February or March, alongside the Spring Supplementary Estimates that update within-year spending plans and provide legal authority for them close to the end of the fiscal year. This usually includes a 'Vote on Account' that allows departments to spend up to 45 per cent of their provision for the previous year, which is normally sufficient to get departments through to late summer.

In the event that a Vote on Account is not in place – because a Budget Act was not passed at least three working days before the end of the fiscal year – the NI Civil Service has recourse to contingency arrangements under the Northern Ireland Act 1998 (Section 59) and the Government Resources and Accounts Act (Northern Ireland) 2001 (Section 7). These powers were used in the absence of a functioning Executive in 2017 and allow the Permanent Secretary of the Department of Finance (or an officer nominated by them) to authorise the issue of cash and the use of resources up to 75 per cent of the total amount authorised by the Budget Act for the preceding financial year. If a Budget Act is not passed by the end of July then this is increased to 95 per cent. During periods without a functioning Assembly, the UK Parliament has at times legislated for NI Budget Acts in lieu of the Assembly.

3 The context for the Draft Budget

When putting together and attempting to agree a Draft Budget, the Department of Finance and rest of the Executive are operating in a broader context that affects both the funding available and what they may wish to spend it on.

Three factors providing context for this Draft Budget are:

- The judgements made by the UK Government on its own finances at the UK Spending Review (which largely determined the size of the **Block Grant**)
- The **economic backdrop** – both long-term challenges and the nearer-term outlook for activity and household and business finances.
- Pressures on **public services** (as highlighted by departments in their submissions to the Department of Finance ahead of the Draft Budget)

In this chapter we consider these in turn.

The UK Spending Review and the Block Grant

The core component of the Executive's Block Grant is determined by the Barnett Formula, as explained in Chapter 4 of our *Guide*. Roughly speaking, the Treasury calculates a baseline level of Grant for the Review by removing one-off and time limited items from the level of the Grant for the previous year and then increases or decreases it to reflect planned changes in UK Government spending <u>outside</u> NI on items for which the Executive is responsible <u>inside</u> NI (e.g. health and education). This ensures that when NI taxpayers help finance increases in UK Government spending in England through the UK taxes they pay, the resources available to the Executive to spend in NI are increased by a broadly equivalent amount per head.

The operation of the Barnett Formula means the Executive's Block Grant depends crucially on the UK Government's assessment of the medium-term outlook for the public finances and the overall level of public spending that it thinks it can support consistent with its objectives for taxation and public sector borrowing and debt.

Key judgements at the Spending Review

At the UK Budget in March 2021, the Chancellor extended the short-term support he had made available for individuals and businesses through the earlier period of the pandemic but announced a number of measures to strengthen the public finances in the longer term – notably an increase in corporation tax rates, a freeze in income tax thresholds and allowances and a cut in planned public spending totals. This was sufficient to deliver a falling ratio of public sector debt-to-GDP at the end of the Office for Budget Responsibility (OBR)'s five-year forecast. But many commentators questioned whether the public spending cuts could be delivered.

The fiscal outlook then improved materially in the run-up to the October Budget and Spending Review. Public sector borrowing came in lower than expected, largely because the vaccine programme and greater opening of the economy saw tax revenues outperform while restraining the cost of government support for individuals and businesses. Looking ahead, the OBR reduced its estimate of the long-term 'scarring' of the real economy by the pandemic (from lower investment, business failures and reduced labour supply) from 3 to 2 per cent. And, thanks to an unexpectedly big temporary increase in inflation, which pushes the price level permanently higher, the cash size of the economy was forecast to return to its pre-pandemic path with no scarring at all. This meant that the outlook for tax revenues was significantly stronger than expected in March 2021. The rise in cash incomes and spending was also expected to be more 'tax rich', in part because the freezing of income tax allowances and thresholds increases the potency of 'fiscal drag' by pulling more people into tax and more income into higher tax brackets as wages rise. So the OBR revised expected revenues higher not just in cash terms but also as a share of GDP. These positive revisions outweighed higher expected debt interest bills because of higher inflation and higher expected interest rates.

Presented with this windfall, the Chancellor chose in the Spending Review to reverse the provisional spending cuts that he had pencilled in outside health. And the Review also incorporated the decision in September 2021 to increase spending on health (initially) and social care (subsequently), ultimately paid for by a new Health and Social Care Levy (in effect additional National Insurance Contributions with a widened base). With revenue rising more than spending, the Chancellor put the budget deficit on an even lower prospective path than prior to the pandemic and kept the debt-to-GDP ratio falling at the OBR's five-year forecast horizon.

Once the temporary damage to the public finances from Covid-19 and the immediate policy response have passed, the aggregate impact of the Chancellor's decisions and the changes to the OBR's forecasts will be to make the UK a noticeably higher government spending and higher taxing economy coming out of the pandemic than it was going in. The ratio of tax receipts to UK GDP is forecast to rise to its highest since the early 1950s and public spending is forecast to settle at around 41.5 per cent of GDP compared to less than 40 per cent prior both to the pandemic and the 2008-09 financial crisis.

This is of critical importance in setting the parameters for NI's own Budget position. The Barnett formula means that the 'tax and spend' decisions taken by the UK Government over the period between its March and October Budgets translate into a rather higher Block Grant for the Executive over the next three years than most commentators and stakeholders expected. The Chancellor has said that he hopes to have the tax-to-GDP ratio falling by the end of the Parliament, which implies that future positive forecast surprises may be more likely to translate into tax cuts than further spending increases and negative forecast surprises more likely to translate into spending cuts than further tax increases. But experience also suggests that the planned redirecting of the 'temporary' increase in NHS spending (to clear backlogs) to the financing of social care may prove easier said than done, which could create pressure for further increases in overall spending plans for any given forecast.

The Block Grant settlement

Table 3.1 shows the Block Grant / DEL plans announced for the Executive at the Spending Review, broken down into the Barnett formula baseline, the Barnett 'consequentials' of changes in UK Government spending relative to the baseline and the 'non-Barnett additions' or 'specific allocations' confirmed at the Review. (The baseline for 2021-22 is the one set at the 2020 Spending Review and the Barnett consequentials shown for that year are relative to that baseline.)

The table then shows the Block Grant figures cited in the Draft Budget, which also included the additional funding for political agreements and City and Growth Deals that were confirmed by the Secretary of State for Northern Ireland in his letter to the Finance Minister on 29 October, as well as some small modifications to the figures published at the Spending Review after the reduction in the Block Grant to reflect the devolution of Long-Haul Air Passenger Duty was updated to reflect new forecasts for air passenger numbers (this adjustment to the Block Grant is explained further in our Guide). [15] For comparison the bottom memo item shows the Final Budget plans for 2021-22 that were published by the Executive in April 2021

[15] https://www.nifiscalcouncil.org/publications/public-finances-ni-comprehensive-guide-november-2021

Table 3.1 – The Executive's Block Grant settlement

				£ million
	2021-22	**2022-23**	**2023-24**	**2024-25**
Barnett baseline	**12,871**	**13,025**	**13,025**	**13,025**
of which: Resource	*11,180*	*11,365*	*11,365*	*11,365*
Capital	*1,510*	*1,524*	*1,524*	*1,524*
FTC	*181*	*136*	*136*	*136*
Barnett consequentials	**2,256**	**1,409**	**1,616**	**1,781**
of which: Resource	*2,126*	*1,220*	*1,425*	*1,619*
Capital	*218*	*162*	*260*	*235*
FTC	*-88*	*27*	*-69*	*-73*
Non-Barnett additions	**747**	**351**	**365**	**366**
of which: Resource	*640*	*351*	*365*	*366*
Capital	*107*	*0*	*0*	*0*
FTC	*0*	*0*	*0*	*0*
Plans/ Block Grant at SR21	**15,874**	**14,785**	**15,006**	**15,172**
of which: Resource	*13,946*	*12,936*	*13,155*	*13,351*
Capital	*1,835*	*1,686*	*1,785*	*1,759*
FTC	*93*	*163*	*66*	*62*
Additional Financial Packages confirmed after SR21		**216**	**201**	**133**
of which: Resource		*58*	*57*	*54*
Capital		*157*	*143*	*79*
FTC				
UK Government Control Total in Draft Budget		**15,001**	**15,207**	**15,305**
of which: Resource		*12,994*	*13,213*	*13,405*
Capital		*1,844*	*1,928*	*1,838*
FTC		*163*	*66*	*62*
Memo: Final Budget (April 2021)[1]	**14,169**			
of which: Resource	*12,485*			
Capital	*1,611*			
FTC	*74*			

Note: The 2021-22 Barnett baseline is that set at SR20 baseline. From 2022-23 onw ards the baselines w ere set at SR21.

Source: HM Treasury

[1] Source: Final Budget 2021-22, Department of Finance

The table shows that:

- The Executive's **Block Grant for the current financial year** was raised to £15,874 million at the Spending Review – or around £8,400 per head of the NI population. This is £1,705 million higher than at the time of the Executive's Final Budget in April 2021, which largely reflects the Barnett consequentials of additional UK Government spending in response to Covid-19 announced at Spring Budget 2021 (£408 million) and Main Estimates 2021 (£343m), plus funding carried forward from 2020-21 (£327m) and non-Barnett funding confirmed at Main Estimates 2021 (£379m) largely in relation to various NI-specific agreements. Most of this had already been incorporated at Main Estimates in June 2021, but the Spending Review announced an additional £175 million of resource consequentials and £61 million of capital consequentials.

- The Treasury set a **baseline for the calculation of Barnett consequentials** in each of the three years covered by the Spending Review of £13,025 million. This was based on planned spending in the current year, 2021-22, but reflecting the exclusion of the Barnett consequentials of temporary Covid-19 support and the various one-off or time-limited ‘non-Barnett additions’ (including farm and fisheries support and funding for political agreements). (The £12,871 million baseline for calculating Barnett consequentials for 2021-22 was set in similar fashion at the 2020 Spending Review, based on plans for 2020-21.)

- The **Barnett consequentials** of the increases in UK Government spending outside NI announced at the Spending Review increase the Block Grant (relative to the baseline) by £1,409 million in 2022-23, £1,616 million in 2023-24 and £1,781 million in 2024-25. These consequentials derive mainly from higher planned UK Government spending on health, education and transport outside NI, all of which are the responsibility of the Executive in NI. (The Barnett consequentials shown in the table for 2021-22 are calculated on the basis of the £12,871 million Treasury baseline set at the 2020 Spending Review.)

- The Spending Review confirmed resource **non-Barnett additions** of £351 million in 2022-23, rising to £365 million in 2023-24 and £366 million in 2024-25. These are dominated by UK Government support for farming and fisheries to replace payments from the European Union’s Common Agricultural and Fisheries Policies that are being foregone as a result of Brexit – £316 million in 2022-23, rising to £332 million in 2024-25. The remaining additions are £31 million a year of security funding and £5 million a year for the ‘Tackling Paramilitary Activity’ programme. The Review did not include any funding for City and Growth Deals or political agreements, which explains some of the drop in non-Barnett additions from the 2021-22 plans. But, as noted above and in the table, these items of funding are included in the Draft Budget figures[16] following confirmation by the Secretary of State shortly after the Review.

As we have noted, the Block Grant is larger than most commentators expected but the Draft Budget argues that there is *“… not enough [money] to cover all the Executive aspires to do…”* and that *“in simple language it represents a breakeven budget after factoring in inflation by 2024-25”*. As one might expect, the UK Chancellor and NI Finance Minister have different interpretations of the generosity or otherwise of the Spending Review settlement:

- In its Budget Red Book, the **Treasury** trumpeted the fact that: *“The government is providing the Northern Ireland Executive with an additional £1.6 billion per year on average through the Barnett formula over the SR21 period, on top of its annual baseline funding of £13.4 billion.”*[17] The £1.6 billion is the average of the Barnett differentials shown in the table above (£1,409 million, £1,616 million and £1,781 million), while the £13.4 billion is the sum of the Barnett baseline of £13,025 (shown in the table above), plus a non-Barnett additions ‘baseline’ of

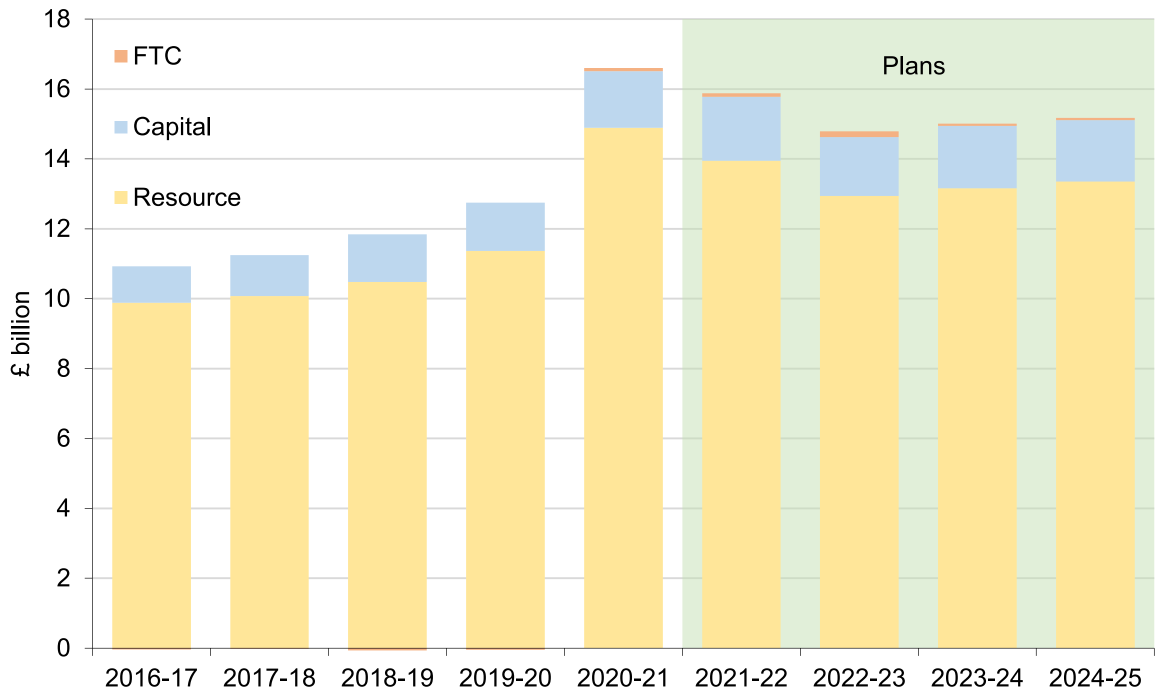
[16] https://www.finance-ni.gov.uk/sites/default/files/publications/dfp/Draft%20Budget%20document%202022-25%20accessible.pdf tables 3.4 and 3.5
[17] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1029973/Budget_AB2021_Print.pdf

£351 million for 2021-22, which (consistent with the presentation described above) excludes the funding in plans for City Deals and political agreements.

- The **Department of Finance**, by contrast, lamented that the Review only *"provides a marginal real terms increase in funding next year which will be far outweighed by increased demands on public services"*.[18] This was derived by comparing the Resource DEL (RDEL) settlement adjusted for inflation (using the GDP deflator) to the Executive's April 2021 RDEL Budget for 2021-22, giving real increases of 0.9 per cent, 0.4 per cent and zero across the three years.

Each calculation has its flaws: the first because spending in the private and public sector both tend to rise over time as the economy grows and prices rise; the second because the Executive's Budget for 2021-22 was still being inflated by the Barnett consequentials of temporary spending in response to Covid-19. There is no definitive way to judge the generosity of the Block Grant settlement but putting it into slightly longer-term perspective rather than focussing too much on comparisons with 2021-22 (still a relatively unusual year) can be informative. Chart 3.1 shows the composition of the Block Grant/ DEL set at the Spending Review along with outturn figures back to 2016-17. (These figures are in cash or nominal terms i.e. they have not been adjusted for inflation.) On this basis total Block Grant / DEL is expected to be 19 per cent higher in 2024-25 than 2019-20 (pre-Covid).

Chart 3.1 – Executive Block Grant / DEL outturns and plans



Source: HM Treasury PESA 2021 (outturn) and SR 2021 (plans)

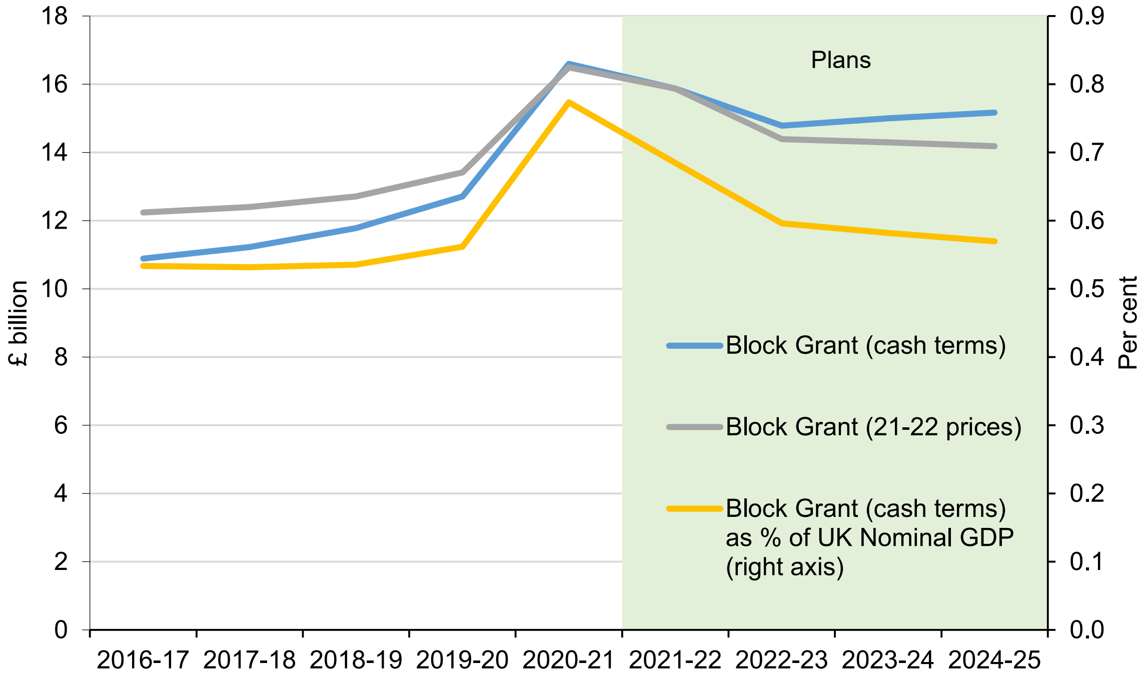
Chart 3.2 below shows the path of DEL outturns and the plans set at the Spending Review on three bases – in nominal or cash terms, real terms and as a share of UK nominal GDP (based on the OBR's economic forecasts). In each case, the picture is dominated by the jump in the DEL outturn in 2020-21 as a result of pandemic-

[18] https://www.finance-ni.gov.uk/news/spending-review-leaves-public-services-under-pressure-murphy

response spending (partially reversed in 2021-22). In each case, the Block Grant moves to a higher level coming out of the pandemic than going into it, although the difference is relatively modest by the end of the Review period as a share of GDP.

It could be argued that, in cash terms, the Review simply returns the Block Grant to the rising path it was on prior to the pandemic. But that path reflected unfunded spending increases and the jettisoning of fiscal objectives at the UK level in the years preceding the pandemic, suggesting that 'more of the same' would not have been sustainable. The latest settlement, that of Spending Review 2021, looks more firmly founded as the UK spending increases underpinning it reflect both tax increases and a better underlying forecast outlook. But future reversals affecting the Block Grant cannot of course be ruled out.

Chart 3.2 – The Block Grant on different bases of measurement



Note: We express NI DEL as a share of UK GDP becasue the Block Grant reflects an overall judgement on the level of UK spending as a share of UK GDP
Source: HMT PESA 2021 and Spending Rreview 2021 (DELs) and OBR databank October 2021 (UK Nominal GDP)

Since the Spending Review, there have been additional funding announcements from the UK Government in relation to its Covid-19 response, which generated in-year Barnett consequentials for the current financial year. The Treasury announced on 20 December[19] that while the Executive has access to up to £150 million of Covid-19 funding in 2021-22 (£50 million of which had already been announced in March) [20] it may have to pay some of this back during the SR period:

"If the amount of funding provided up front to each Devolved Administration is more than the Barnett consequentials confirmed at Supplementary Estimates then the

[19] https://www.gov.uk/government/news/uk-government-doubles-funding-for-devolved-administrations-to-tackle-covid
[20] https://www.gov.uk/government/news/budget-2021-what-you-need-to-know

difference will be repaid in 2022-23, or over the Spending Review period if necessary."

This means that if the Executive uses more of the £150 million than its 'Barnett share' transpires to be, when calculated towards the end of this financial year, the Executive will owe the Treasury the difference, to be repaid before the end of the Spending Review period. This is in contrast to the Covid-19 'Barnett Guarantee' offered by the Treasury through 2020-21, which did not include this potential clawback.

The economic backdrop

At the UK level, there is a close relationship between the performance of the economy, the performance of the public finances and some of the decisions that the Chancellor takes in regard to taxation, spending and public borrowing. For example, economic activity is an important driver of tax revenues (because most taxes are levied on some portion of national income or expenditure) and some parts of public spending (notably working-age social security payments). And tax and spending policy is sometimes used actively to stimulate or dampen overall spending power in the economy, especially when the Bank of England's ability to use interest rates to do so is constrained. Tax and spending policy has also been used actively to respond to the economic, public health and social implications of the Covid-19 pandemic.

The relationship between the NI economy, public finances and Budget decisions is somewhat different. The performance of the NI economy has very little impact on the funding available for the Executive to spend as most of it comes from the Block Grant and the only significant source of tax revenue – Regional Rates – is based on property valuations that do not reflect year-by-year developments in the economy at all closely. That said, the economic backdrop does affect the Executive's DEL spending priorities and the decisions it takes when setting the levels for the Regional Rates. (Developments in the NI economy – notably as regards employment and earnings growth – also affect required spending on social security benefits, but any changes are offset by changes in the UK Government funding for AME.)

The Draft Budget always contains a chapter on the economic context and on this occasion the Department of Finance highlighted the following:

- *"Research from the Department for the Economy*[21] *estimates that from March 2020 to March 2021, the lost economic activity due to Covid-19 in NI amounted to £6.1 billion in Gross Value Added (GVA)*[22] *terms."*
- NI is seeing robust economic growth and rising employment as it emerges from the pandemic, but *"the effects of Covid-19 are still being felt and many businesses and families continue to face significant pressures"*.
- *"Local forecasters expect the local economy to recover to 5.8 per cent growth in 2021 and 4.1 per cent in 2022*[23] *which is in line with the growth expected in*

[21] DfE: Economic recovery from Covid-19 and restrictions – 12 August 2021
[22] Gross Value Added (GVA) is the measure of the value of goods and services produced in an area, industry or sector of an economy.
[23] Ulster University Economic Policy Centre – Summer 2021 Outlook

Britain and Republic of Ireland." (Table 3.2) (The Ulster University Economic Policy Centre forecast to which this refers was published in June 2021)

- Some long-standing structural problems have been compounded by Covid-19 *"such as relatively low productivity and competitiveness, low pay, regional imbalances, economic activity and deprivation"*.

- *"A cost of living crisis is emerging, with CPI inflation having risen sharply over the past number of months."*

- *"The economic support packages… prevented what would otherwise have been a devastating impact on the local labour market. Nevertheless, the claimant count still saw significant increases."* In November 2021 4.5 per cent of the workforce were on the claimant count compared to 3.1 per cent for February 2020 (pre Covid)[24].

- *"The local economy will continue to face some significant headwinds during its recovery phase following the pandemic. Investment in skills and supporting those who lose their jobs or face reduced hours will therefore be vital."*

Table 3.2 – Economic growth forecasts cited in the Draft Budget[25]

Per cent per annum	2020	2021	2022	2023	2024	2025
Northern Ireland	-10.4	5.8	4.1	2.2	1.8	-
UK	-9.4	6.5	6.0	2.1	1.3	1.6
Republic of Ireland	-3.5	4.7	5.2	3.5	3.3	3.2

Sources: NI forecasts: UUEPC Summer Outlook 2021 - June 2021; UK forecasts: OBR Economic and fiscal outlook – October 2021; RoI forecasts: Irish Budget 2022 – Economic and fiscal outlook - October 2021 .

The latest regional analysis from the National Institute for Economic and Social Research on 9 November points to challenges for NI relative to the other regions.[26] Among its conclusions:

- *"A marked slowdown in economic growth to less than 1.5 per cent on average per year in 2023-26, combined with continued supply chain disruptions and uncertainty over the Brexit deal, will exacerbate interregional inequalities, notably in Northern Ireland and parts of the South East (e.g. Dover port) and the Midlands (e.g. haulage and warehouses)."*

- *"The sharp rise in prices (food, petrol and energy) will disproportionately affect low-income households concentrated in some of the most deprived parts of the country, such as the North West and Northern Ireland."*

[24] https://www.nisra.gov.uk/statistics/labour-market-and-social-welfare/claimant-count
[25] UUEPC-Summer-2021-Economic-Outlook.pdf (ulster.ac.uk) ; Economic and fiscal outlook - October 2021 - Office for Budget Responsibility (obr.uk) ; gov.ie - Budget Publications (www.gov.ie)
[26] https://www.niesr.ac.uk/publications/recovery-stalling-not-soaring?type=uk-economic-outlook

- *"We also forecast a squeeze on the income of the poorest households in some of the most economically deprived parts of the country (e.g. North West and Northern Ireland), which will result in higher levels of destitution."*

- *"Backed by a boost to travel and hospitality…, all nations of the UK and English regions are expected to return to pre-pandemic employment levels by the end of 2021 or the beginning of 2022 (Figure 2.2). The only exception is Northern Ireland, subject as it were to uneven progress on the Brexit deal, which will return to 2019Q4 employment levels only in 2023."*

The NI Composite Economic Index released by NISRA on 13 January[27] notes the volatility introduced by Covid-19, but reflects some positive signs:

- *"…the NICEI and Private Sector Component Indices have recovered from their respective series lows in Q2 2020, reaching a 13 year high in Q3 2021 and returning to levels of economic output last exceeded in Q3 2008."*

- *"As a result, the NICEI is currently 2.5 per cent below the maximum value recorded in Quarter 2 2007, UK GDP in Quarter 2 2021 is estimated to be 13.7 per cent higher than its pre-economic downturn peak of Quarter 1 2008."*

Various features of the economic outlook might seem to have shaped the decisions taken in the Draft Budget and could further shape those taken in the Final Budget. For example, the fragility of the economic outlook emerging from the pandemic and as the economy continues to adjust to Brexit presumably helped make the case for proposing to freeze non-domestic rates to help potentially vulnerable firms. Similarly, the squeeze on real household incomes from higher energy, fuel, food and transport prices and the uncertain outlook for the labour market may have helped make the case for freezing domestic rates[28]. In both cases, Regional Rates are a relatively blunt instrument – the freezes help firms and households that are in a strong financial position as well as a weak one – but they are one of the few that the Executive has available. At the margin, freezing rates bills means forgoing some resources that could be spent on public services. Within the resources that are available for public services, there is then a trade-off between the obvious demands of healthcare coming out of the pandemic and the desire to address some of the long-term economic challenges facing NI, for example through higher spending on and reform in education, skills and infrastructure.

Pressures on public services and other priorities

Well before the Block Grant settlement is known, the Department of Finance begins preparing the Draft Budget by asking the other departments to make submissions that identify priorities, pressures and potential savings over the Budget period. This is a ritual engaged in by finance ministries and spending departments across the globe – the finance ministry typically asks spending departments to identify

[27] https://www.nisra.gov.uk/system/files/statistics/NI-Composite-Economic-Index-Q3-2021.pdf
[28] The Fiscal Commission is currently consulting on its interim report which considers whether the fiscal powers of the Assembly and Executive should be extended.

potential cuts greater than it thinks it will need to impose and the spending ministries respond by saying that any cuts would have disastrous consequences (sometimes referred to as the parading of 'bleeding stumps'). One variant is to offer up proposed savings that the department knows will be extremely unpalatable to the Finance Minister and/or the Prime Minister or equivalent.

But, taken with an appropriate pinch of salt, departmental budget submissions to the Department of Finance remain a useful lens through which to view the pressures on public services and other areas of spending and the trade-offs required to agree a Budget. When departments submitted details of requirements to the Department of Finance they were asked to:

- Assign **priority ratings and rankings** to resource and conventional capital requirements.
- Identify **conventional capital bids to be funded from ringfenced sources** (such as Confidence and Supply, City and Growth Deals and EU funding).
- Identify **capital receipts.**
- **FTC requirements and receipts**.

Table 3.3 below shows the total requests for additional resource spending made by each department (other than The Executive Office, which did not make a submission). Table 3.4 shows each department's highest priority request (other than for Health and Justice, which did not assign priority ratings).

Table 3.3: Additional resource spending requested by departments

Department	2022-23	2023-24	£ million 2024-25	Average requested as % of baseline
Health	1,801	2,267	2,718	37
Education	435	510	599	23
Communities	315	397	420	48
Justice	275	171	200	20
Economy	157	217	256	26
Infrastructure	148	131	162	35
Agriculture etc	63	76	91	34
Finance	6	11	11	6
Total	**3,199**	**3,782**	**4,456**	**32**

Source: Departmental submissions to the Department of Finance

Table 3.4: Departments' highest priority resource requests

Department	Priority
Agriculture etc	Green Growth
Communities	Covid 19 Benefit Delivery Response
Economy	Loss of EU Structural Funding for Core DfE Services
Education	Non-teaching Pay Awards
Finance	Rates Revaluation 2023
Infrastructure	NI Water

Note: Based on highest rated priority. Economy also noted a requirement for previous Executive Commitments, not included above.
Source: Departmental submissions to the Department of Finance

Table 3.5 shows the total conventional capital gross spending requests submitted by departments (other than Agriculture and The Executive Office, which did not make any submissions). As is clear from Table 4.7, the total requests submitted by departments comfortably exceed the allocations eventually proposed.

Table 3.5: Total conventional capital spend requested by departments

			£ million
Department	**2022-23**	**2023-24**	**2024-25**
Infrastructure	788	1,037	1,444
Communities	389	428	431
Health	385	544	599
Economy	306	404	479
Education	298	426	467
Justice	150	271	387
Finance	39	46	40
Total	**2,355**	**3,155**	**3,847**

Note: Includes all conventional capital spending requests, including ringfenced and EU. Does not include capital receipts.
Source: Departmental submissions to the Department of Finance

Ahead of the Draft Budget the Department of Finance asked the Executive departments other than Health to identify potential savings worth 2, 4 and 8 per cent of their baseline budgets in each year of the Budget period. Less specifically, the Department of Health was asked to identify *"options to generate savings by increasing efficiency and productivity"*. As we show in Chapter 4, the Budget allocations are based on an initial 2 per cent reduction in spending relative to baselines for Executive departments other than health. But for most departments other allocations (mostly financed from the increase in the Block Grant) outweigh this. The Draft Budget does not address whether any department will need to make cuts to live within or balance their budget. We expect in due course to see consultations from each Executive department with more detail in this respect.

4 The content of the Draft Budget

The Draft Budget sets out the Executive's (or, in this case, the Finance Minister's) DEL spending plans for the next three fiscal years and how they are to be financed. It also presents forecasts for AME spending over the same period.

This chapter begins by:

- Summarising the **spending and financing** plans in the Draft Budget

It then looks in more detail at the three main proposals that the Finance Minister is making that together would deliver a 'balanced budget':

- The freezing of domestic and non-domestic **Regional Rates**
- The proposed increase in **capital borrowing**
- The allocation of **departmental spending** to prioritise Health

Spending and financing in summary

As we explained in Chapter 2, the Department of Finance presents its Budget figures for DEL spending by showing a figure for Total Financing (and a matching sum for Total Spending) that includes the Block Grant from the UK Government, Regional Rates revenue, capital borrowing (through the Reform and Reinvestment Initiative, RRI) and Irish Government funding for the A5 road project, but where EU funding and income from fees and charges are treated as 'negative spending' that permits higher gross spending within the Department's Total Spending envelope.

Tables 4.1 summarises the composition of Total Financing and Total Spending and shows how the Budget 'balances' on this basis (i.e. including some borrowing, but within the limits set in legislation and agreed with the Treasury).

Along with the summary of the same data in Table 1.1, it shows that:

- The vast bulk of the Executive's proposed DEL spending is financed from the **Block Grant**, around 95 per cent in 2024-25. Around 95 per cent of the Block Grant is the core element determined through the Barnett formula, with smaller contributions to pay for specific allocations made at the Spending Review (farm and fisheries support, security and tackling paramilitarism) or confirmed by the Secretary of State for NI shortly afterwards (for UK Government funding packages related to political agreements and City & Growth Deals).

- The main **non-Block Grant sources of financing** – over which the Executive has control – are the Regional Rates (which pay for 4 per cent of resource spending in 2024-25) and capital borrowing under the Reform and Reinvestment Initiative (which pays for 10 per cent of conventional capital spending in 2024-25). The Regional Rates revenue is shown after deducting around £120 million each year of RRI debt principal repayment, which formally has first call on that revenue. The Irish Government funding for the A5 is part of the New Decade New Approach agreement.

- The **vast bulk of planned spending has been allocated to departments** (99 per cent in 2023-24), with very small sums earmarked for debt interest or held centrally for later allocation *"pending decisions on timing of allocations or decisions on specific projects or programmes [or where] further negotiations with Treasury are required on the precise profile of the funding"*.

- Treating **EU funding and income from fees and charges** as 'negative spending' and choosing not to identify them separately in the Draft Budget makes a modest but not insignificant difference to the figures. We showed in our *Guide* that EU funding was expected to be almost £200 million in 2021-22 (around half its pre-Brexit level) and income from fees and charges had contributed around £700-£800 million a year over the past five years (albeit partly through transfers within the public sector). The largest were non-domestic water charges, health trust receipts and tuition fees.

Table 4.1 – The financing of the Executive's DEL spending

	2021-22 (October)	2022-23	2023-24	£ million 2024-25
FINANCING				
Resource				
Block grant: core Barnett	12,681	12,584	12,789	12,982
Block Grant: specific allocations	350	352	367	369
Block Grant: political agreements	903	58	57	54
Regional Rates (post debt repayment)	367	577	628	630
Capital				
Block Grant: core Barnett	1,633	1,686	1,785	1,759
Block Grant: agreements and City deals	153	157	143	79
Capital borrowing (RRI)	140	140	194	200
Irish Government funding for A5	6	7	25	25
FTC				
Block Grant: core Barnett	128	163	66	62
TOTAL	**16,361**	**15,725**	**16,054**	**16,160**
pays for				
SPENDING				
Resource				
Departmental spending	14,255	13,484	13,754	13,952
Held centrally for later allocation		42	41	38
Debt interest (RRI)	46	46	46	46
Capital				
Departmental spending	1,929	1,976	2,137	2,063
Held centrally for later allocation	3	15	10	
FTC				
Departmental spending		56	66	62
Held centrally for later allocation	67	107		
TOTAL	**16,361**	**15,725**	**16,054**	**16,160**

Note: The additions to the Block Grant for political agreements include some Covid support beyond Barnett consequentials
Source: Draft Budget, Department of Finance

Outside the Block Grant and beyond the control of the Executive, the UK Government is proposing to finance projects in NI directly through the Levelling Up, Shared Prosperity, Community Renewal and Community Ownership Funds. There is also the potential for additional spending by the Irish Government in NI over the next decade, via the Shared Island Fund. This is set to spend €500 million during 2021-2025 on North-South collaborative cross-border projects. The Irish Government has indicated its intention to maintain this level of funding to 2030.

Regional Rates

The Regional Rates are the Executive's only significant source of tax revenue and could therefore provide additional financing for spending. But the Draft Budget:

- **Freezes both the domestic and non-domestic Regional Rate** over the three years of the Budget period at the same cash level as in 2021-22.

- Provides **further relief** until the end of April 2022 for all businesses except utilities and larger food stores.

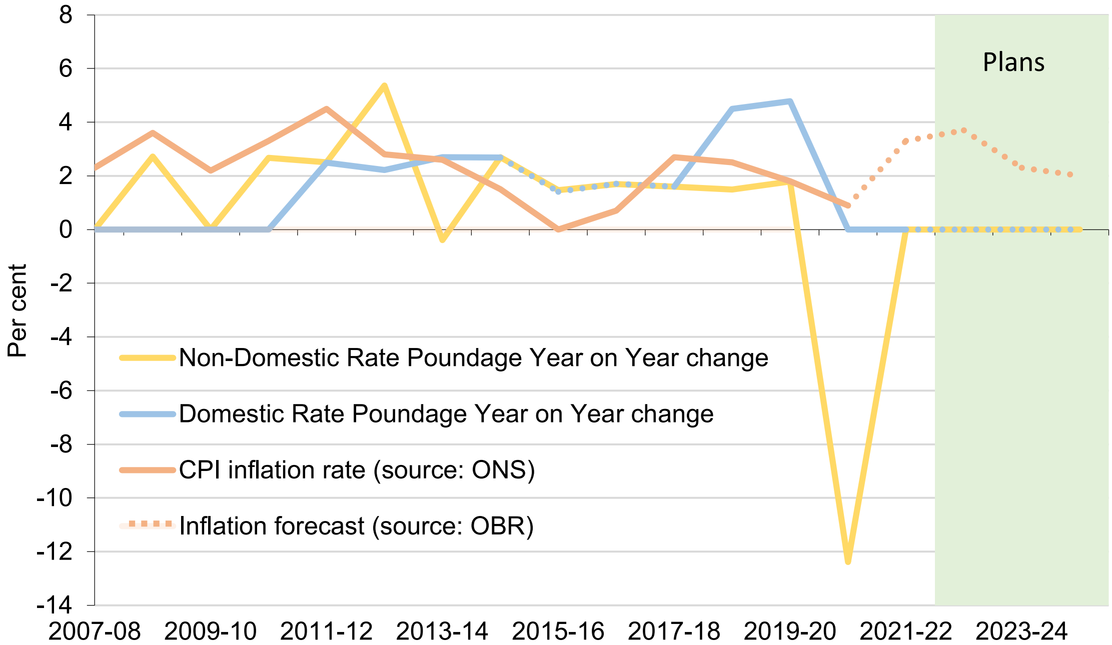
- Provides **targeted relief** until the end of June 2022 for the retail, tourism, hospitality, leisure, childcare and airport sectors.

As discussed in Chapter 3, these decisions are no doubt motivated in large part by the economic backdrop to the Draft Budget – providing support to potentially vulnerable firms coping with the ongoing impact of Covid-19 and the adjustment to Brexit and supporting household budgets at a time of relatively high inflation and uncertainty around the outlook for the labour market. (Although in both cases Regional Rates are a relatively blunt instrument that does not provide targeted support.) The Finance Minister will also have had an eye to the *"£7 billion of support over the next five years"* for business rate payers in England that the Chancellor trumpeted in the UK Spending Review.[29]

Chart 4.1 shows the changes in the domestic and non-domestic rate poundages since 2007-08, plus the planned freezes and the OBR's forecasts for inflation over the Budget period. The Executive froze the domestic poundage or increased it only modestly between 2007 and 2017, while increasing the non-domestic poundage more sharply. But during the three years in which the Executive was not sitting, the UK Government increased the non-domestic poundage with inflation and the domestic poundage more sharply. During the pandemic, the domestic poundage has been frozen and the non-domestic poundage cut by 12.5 per cent in 2020-21. In addition, businesses in sector most affected by Covid-19 were granted rates holidays in 2020-21 and2021-22. Domestic rates bills tend to be lower per household than the equivalent taxes elsewhere in the UK, but non-domestic rates are among the highest in the UK and Ireland even after the reduction in 2020.

[29] Treasury October 2021, Business Rates Review: Final Report.

Chart 4.1 – Annual change in Regional Rate poundages



Note: Non-domestic rate poundage adjusted for effect of revaluations in 2015 and 2020
Source: Department of Finance

As shown in Table 4.2, Land and Property Services (LPS) estimates that if inflation moves in line with the OBR's October forecasts – a big 'if' – the Executive will be forgoing almost £60 million annually in revenue by 2024-25 compared to a scenario in which it linked poundages to changes in the consumer prices index (CPI). But this is equivalent to only one-third of 1 per cent of total planned resource spending.

Table 4.2 – Projected cost of freezes and reliefs

			£ million
	2022-23	**2023-24**	**2024-25**
Non-domestic	12.2	20.1	27.3
Domestic	13.5	22.1	30.6
Non-domestic rates holiday (1-3 months)	50.0		
Total	**75.7**	**42.2**	**57.9**
Memo:			
OBR CPI inflation forecast %	*3.67*	*2.32*	*2.05*

Source: Land and Property Services

In addition to the revenue losses from the rates freezes, LPS estimates that the cost of the non-domestic rates holidays for different sectors will be around £50 million. This is provided automatically by LPS in most cases, applying the holiday to the property's rates bill. As a temporary relief, this does not affect the revenues lost set out in Table 4.2 beyond 2022-23.

It is worth noting that there is a pandemic-related risk to non-domestic Rates revenues, arising from the possibility of appeals against property valuations published in spring 2020 that failed to take account any impact from Covid-19. Depending on the assumptions made about the behaviour of the Lands Tribunal and of landlords and tenants, LPS estimate the risk to revenue as being between £39 million and £255 million over the three years of the Budget. (The wide range reflects the fact that it is hard to predict how a court will interpret the relevant statutes, and there is inherent uncertainty around some of the variables it has modelled.) Of the total sum, 55 per cent would potentially be lost to the Executive and 45 per cent to the District Councils. But the councils could of course call on the Executive to meet some or all of their costs for them.

Capital borrowing

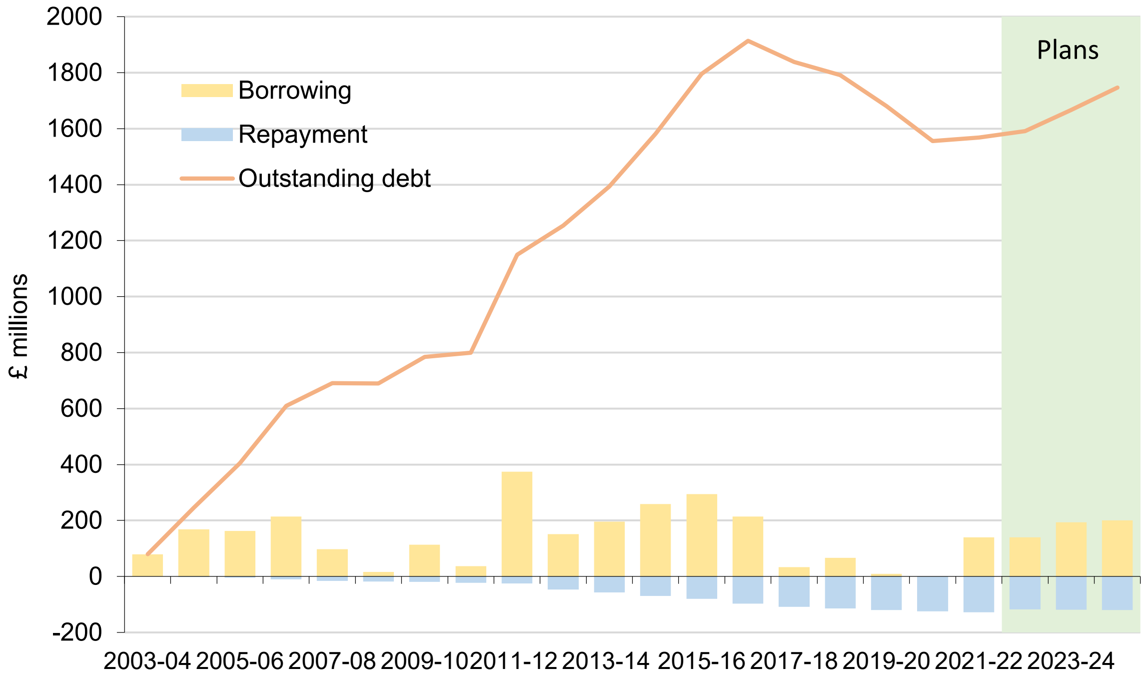
The Executive has the right to borrow for capital investment under the Northern Ireland (Loans) Act 1975. This set a limit on outstanding debt of £2 billion, which was raised to £3 billion in the Northern Ireland (Miscellaneous Provisions) Act 2006. The Executive's capital borrowing takes place under the Reinvestment and Reform Initiative (RRI), which was agreed with the UK Government in 2002 and meant that borrowing was no longer at the cost of funding for capital investment through the Block Grant. The Executive and the Treasury agreed an annual limit on borrowing of £125 million in 2003-04 and £200 million a year thereafter. This was lifted for specific purposes between 2015-16 and 2018-19, under the Fresh Start Agreement, but is now back to £200 million a year.

Despite the fact that the Draft Budget says that UK funding is insufficient for the Executive's needs, the Finance Minister does not propose to borrow up to the full limit in each year of the Budget period – but rather to borrow £140 million in 2022-23 (the same figure as planned in 2021-22), rising to £194 million in 2023-24 and to the full £200 million in 2024-25. This reflects caution as to how quickly it will be possible to increase capital spending now that longer-term budgeting is again possible, given continued disruption from the pandemic.

With principal repayments against this proposed level of borrowing projected at £118 million, £118 million and £120 million (see Draft Budget Table 7), this implies an increase in outstanding debt of around £178 million over the three years to £1,747 million, well short of the £3 billion overall limit. The interest bill on the debt is projected at £43.4 million, £41.8 million and £40.4 million, with £45.5 million allocated each year from the resource envelope to cover this.

Chart 4.2 shows the fresh borrowing and principal prepayments each year since 2003-04 and projected through the Budget period and the level of outstanding debt.

Chart 4.2 – Capital borrowing and outstanding debt



Source: Department of Finance

The allocation of departmental spending

Once the total sum of money available to finance DEL spending has been determined by the Executive's decisions on Regional Rates and capital borrowing (given the external funding available from the UK and Irish Governments), the main decision the Executive has to take to deliver a balanced Budget is the allocation of departmental spending to remain within that overall envelope.

Even in the absence of agreement of the detail of the Draft Budget, there is no doubt as to the likely relative 'winner' among the departments:

> *"Even before the pandemic struck the returning Executive had agreed that health would be its top priority. The focus of this Draft Budget was therefore on providing significant additional resources with a view to transforming the health service and hence improving health outcomes overall."*

Resource spending

The main focus of the departmental allocation is on resource spending, which covers the day-to-day running costs of public services, administration and grants. Table 4.3 shows the proposed resource allocations by department in each year of the Budget period alongside the latest published forecast of spending in the current (pandemic-distorted) year, 2021-22, from the Department of Finance's October In-year Monitoring Round (IMRI). It shows that the Department of Health accounts for slightly more than half the total, with Education and Justice the next two largest spending departments with shares of around 18 and 8 per cent respectively.

Table 4.3 – Resource allocations by department in cash terms[30]

Department	2021-22 (October)	2022-23	2023-24	£ million 2024-25	Share in 2024-25 %
Health	6,991	6,782	6,947	7,109	51
Education	2,500	2,431	2,471	2,503	18
Justice	1,179	1,118	1,129	1,122	8
Communities	905	839	838	840	6
Economy	1,166	832	842	841	6
Agriculture etc	568	551	567	571	4
Infrastructure	485	444	448	450	3
The Executive Office	139	211	231	231	2
Finance	261	168	172	174	1
NI Assembly Commission	45	48	48	49	0
Public Prosecution Service	37	35	35	35	0
Food Standards Agency	14	12	12	12	0
NI Audit Office	8	9	9	9	0
NI Public Services Ombudsman	4	4	4	4	0
NI Authority for Utility Regulation	0	0	0	0	0
Total	**14,301**	**13,484**	**13,754**	**13,951**	**100**

Source: Department of Finance

Table 4.4 shows the same allocations in real terms, adjusting for inflation using the OBR's October forecast for the UK GDP deflator. The final column shows the percentage change in real terms funding from 2021-22 to 2024-25. But it is important to remember that spending this year continues to be distorted by the extra UK funding arising from the response to the Covid-19 pandemic.

[30] Cash terms' here means not adjusted for inflation. This is sometimes also referred to as 'nominal terms'

Table 4.4 – Resource allocations by department in 2021-22 prices

Department	2019-20 (Outturn)	2021-22 (October)	2022-23	2023-24	£ million 2024-25	2024-25 v 2019-20 %
Health	6,305	6,991	6,602	6,620	6,654	6
Education	2,256	2,500	2,366	2,355	2,343	4
Justice	1,140	1,179	1,088	1,076	1,050	-8
Communities	836	905	817	799	786	-6
Economy	1,073	1,166	810	802	787	-27
Agriculture etc	216	568	536	540	534	147
Infrastructure	427	485	432	427	421	-1
The Executive Office	77	139	205	220	216	182
Finance	176	261	165	164	163	-8
NI Assembly Commission	34	45	47	46	46	36
Public Prosecution Service	37	37	34	33	33	-10
Food Standards Agency	10	14	12	11	11	9
NI Audit Office	7	8	9	9	8	24
NI Public Services Ombudsman	3	4	4	4	4	25
NI Authority for Utility Regulation	0	0	0	0	0	158
Total	**12,597**	**14,301**	**13,126**	**13,106**	**13,058**	**4**

According to the Draft Budget: *"Resource Budgets are set on an incremental basis – that is they are substantially based on the previous year's budget with additions or reductions applied as appropriate".* Table 4.5 and 4.6 show the different stages of the process. Table 4.5 shows the steps for total spending in each year of the Budget period. Table 4.6 looks at each department individually, but only for the first year of the Budget – 2022-23. The steps are:

- The Department of Finance starts by **calculating a baseline** level of spending for each department *"by taking the previous year's budget and adjusting it for certain factors including time-bound allocations"*, for example temporary Covid-19 spending, farm and fisheries support, and that financed by UK funding for political agreements. *"This allows the Executive to begin the Budget process with a starting position where budgets are not influenced by time-limited factors."*

- The first additions to the baseline are the **specific allocations agreed with the Treasury at the Spending Review** and the earmarked funding for political agreements confirmed by the Secretary of State shortly afterwards – both of which are now incorporated in the Block Grant and have to be taken as given for the Draft Budget. The former are dominated by farm and fisheries support (allocated to Agriculture), with a smaller allocation for security funding (to Justice). The New Decade New Approach political agreement funding for transformation is allocated entirely to Health.

- The next stage was to **reduce the funding for each Executive department other than Health by 2 per cent of its baseline**. This raises about £118 million a year, enough to increase Health spending by around 2 per cent of its baseline (as Health accounts for roughly half the total baseline). As the Finance Minister put it: *"With the funding provided by the Chancellor's Spending Review falling short of what was judged necessary to fund the*

Executive's priorities, this Draft Budget proposes that other departments contribute 2 per cent of their opening baseline towards the health service."

- The Finance Minister has then proposed a set of **specific allocations** to departments earmarked for particular purposes. The largest are £146 million (in 2024-25) for The Executive Office to cover funding for pensions to victims of the Troubles, payments to those who suffered historical institutional abuse, and an inquiry into Mother and Baby Homes, followed by £44 million for the Department for Communities to cover the 'super-parity' cost of ongoing welfare reform mitigations. These were originally put in place when the Executive finally agreed to implement the 2012 UK welfare reforms under the Fresh Start Agreement. Primarily they insulate NI benefit recipients from the impact of the benefit cap and the 'bedroom tax'.

Table 4.5 – Total departmental resource allocations

			£ million
	2022-23	**2023-24**	**2024-25**
Baseline	**12,005**	**12,005**	**12,005**
+ Specific allocations at Spending Review	347	362	364
+ Political agreements funding	49	49	49
– 2 per cent reduction outside Health	-118	-118	-118
+ Specific allocations at Draft Budget	246	273	277
+ General allocations at Draft Budget	954	1,183	1,375
Total	**13,484**	**13,754**	**13,951**

Source: Department of Finance

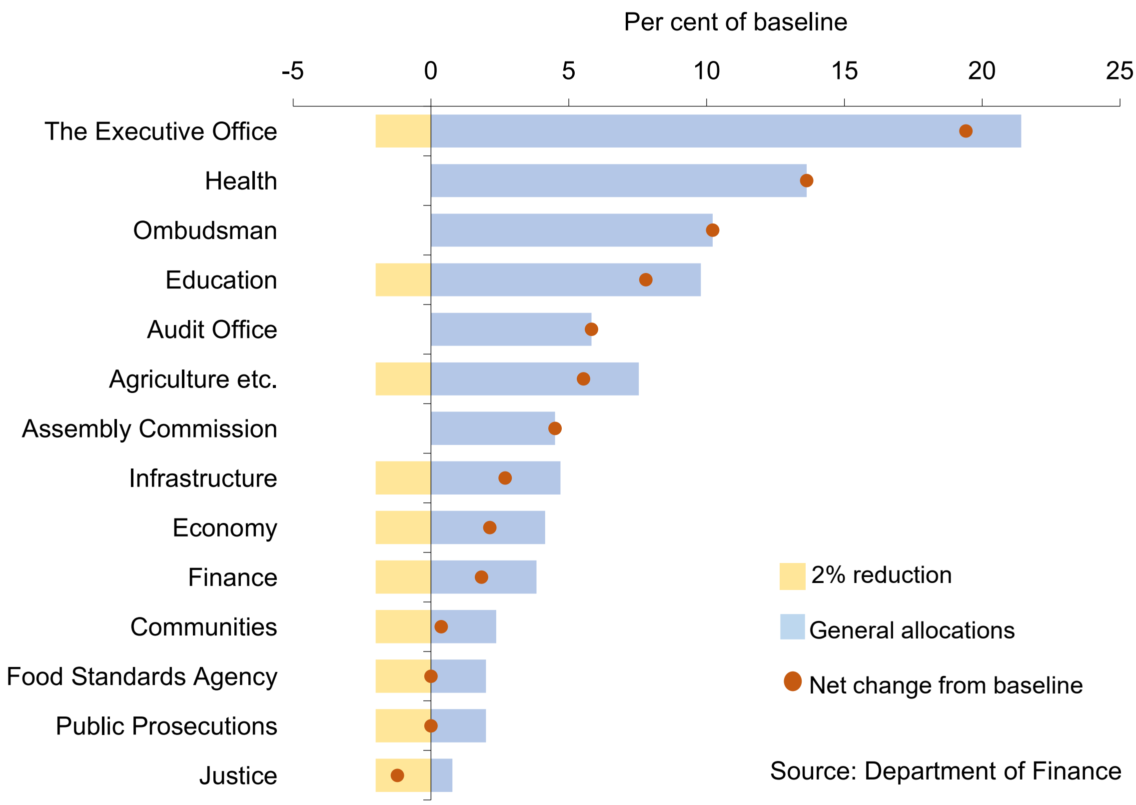
Table 4.6 – Departmental resource allocations in 2022-23

Department	**Base-line**	**Specific allocation at SR**	**Political agreement funding**	**2 per cent reduction**	**Specific allocation at DB**	**General allocation at DB**	**£ million TOTAL**
Health	6,070		49			664	6,782
Education	2,270			-45	22	185	2,431
Justice	1,086	31		-22	16	5	1,118
Communities	782			-16	50	23	839
Economy	818			-16	4	27	832
Agriculture etc	224	316		-4		15	551
Infrastructure	421			-8	16	16	444
The Executive Office	61			-1	138	13	211
Finance	168			-3		3	169
NI Assembly Commission	46					2	48
Public Prosecution Service	35			-1		1	35
Food Standards Agency	12			0		0	12
NI Audit Office	9					0	9
NI Public Services Ombudsman	4					0	4
NI Authority for Utility Regulation	0						0
Total	**12,005**	**347**	**49**	**-118**	**246**	**954**	**13,484**

Source: Department of Finance

- The final step is to make **general allocations**, *"which along with their baseline funding, may be spent at the discretion of Departmental Ministers"*. The Department of Finance tells us that: *"The process of calculating the general allocations is an iterative one based initially on the Public Spending Directorate's assessment of bids received from departments and the level of funding available."* They rise from £954 million in 2022-23 to £1,375 million in 2024-25 and are essentially the fruits of the increase in the Block Grant settlement described in Chapter 2. As Table 4.6 illustrates, they are far from uniform and in most departments more than outweigh the impact of the 2 per cent cut. Health receives more than two-thirds of the general allocations and of the £664 million it receives in 2022-23 (which rises to £990 million by 2024-5), the 2 per cent cuts relative to baseline elsewhere contribute less than 20 per cent – most comes from the higher Block Grant. One might argue that the combined impact of the 2 per cent cut and the general allocations is the best indicator of the 'winners and losers' from the proposals. Chart 4.3 shows the average impact over the three years 2022-23 to 2024-25 as a percentage of the baseline for each department. Among the big departments, Education and Agriculture fare best after Health.

Chart 4.3 – Average change in funding from baseline



Conventional capital and FTC spending

In contrast to the incremental approach taken with the resource allocations, the Draft Budget says that *"capital allocations were determined on a zero-based approach informed by an assessment of the capital requirements of individual* *departments"*. But even though the size of the allocations is based on a bottom-up assessment, only some of the money is earmarked for particular projects (and has to be returned to the Executive if it is not used for that purpose). These include 'Flagship projects', such as the A6 Road, the Belfast Transport Hub, Casement Park, the Mothers and Children's Hospital and the NI Community Safety College, as well as City and Growth Deals and Green growth projects. Barring these *"Ministers will have the flexibility to allocate funding to individual projects"*.

Table 4.7 shows the proposed conventional capital allocations by department, plus the latest forecast for 2021-22 from the October In-Year Monitoring Round. It shows that in 2022-23 the largest proposed allocations were to Infrastructure (40 per cent) and Health (18 per cent). Comparisons with previous years are less meaningful for capital than resource funding. For example, a department may require significant construction costs for a large project in the first year of the Budget but not need the same amount of capital in future years.

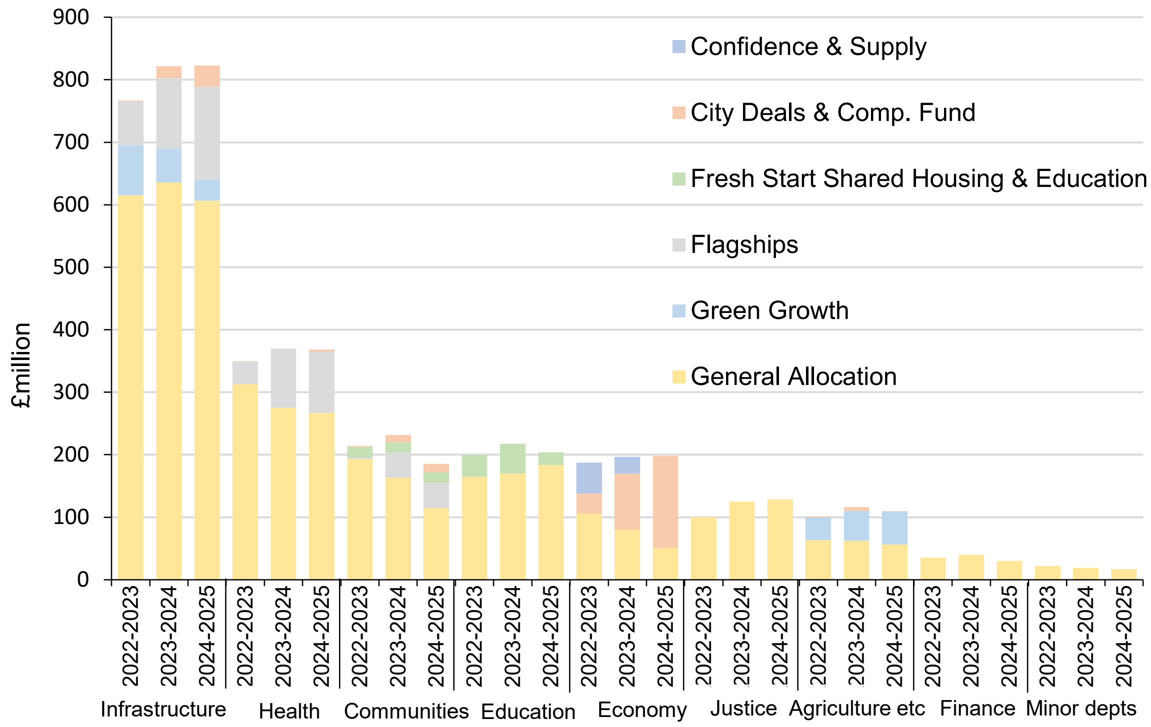
Table 4.7 – Capital allocations by department in cash terms

Department	2021-22 (October)	2022-23	2023-24	£ million 2024-25	Share in 2024-25 %
Infrastructure	753	767	822	823	40
Health	353	350	370	368	18
Communities	220	214	232	185	9
Education	208	199	218	204	10
Economy	148	187	197	198	10
Agriculture etc	99	101	116	110	5
Justice	86	100	125	129	6
Finance	41	35	40	30	1
The Executive Office	14	15	15	15	1
NI Assembly Commission	1	4	3	1	0
NI Audit Office	5	3	0	0	0
Public Prosecution Service	1	0	0	0	0
Food Standards Agency	0	0	0	0	0
NI Public Services Ombudsman	0	0	0	0	0
NI Authority for Utility Regulation	0				0
Total	**1,928**	**1,976**	**2,137**	**2,063**	**100**

Source: Department of Finance

Chart 4.4 shows the departmental allocations split by type. It is noticeable that flagship and city deals funding is back loaded towards the end of the Draft Budget period.

Chart 4.4 Capital allocations by department and type



Source: Department of Finance

Table 4.8 shows the allocation for Financial Transactions Capital (FTC) spending, which is split between Communities (mostly, for housing) and Economy (for investment projects via Invest NI). As noted above, a larger proportion of putative FTC spending is being held centrally than of resource or conventional capital (in 2022-23 at least). In that year £50 million has been allocated to the NI Investment Fund, a *"private sector organisation that works alongside government investing in the transformation of the region for the long-term, supporting economic growth and the low carbon economy"* and £50 million awaits allocation to departments. No FTC is held the centrally for the following two years as the 2022-23 funding reflects a burst of spending at the end of the Help to Buy scheme in England that feeds through into Barnett consequentials.

As we point out in our *Guide*, the Executive tends to underspend its total allocation of FTC to a considerable degree – and much more than for resource and conventional capital. This reflects the relative inflexibility of its potential use.

Table 4.8 – FTC allocations by department in cash terms

Department	2022-23	2023-24	£ million 2024-25	Share in 2024-25 %
Communities	52	55	52	84
Economy	4	12	10	16
Total	**56**	**66**	**62**	**100**

Source: Department of Finance

5 Concluding reflections

Having described the context for and the content of the Draft Budget, we conclude with some brief reflections on different themes ahead of the Final Budget:

- **Balancing the Budget**: the dogs that didn't bark
- The absence of a **Programme for Government**
- An **Investment Strategy?**
- **Public sector pay policy**
- The **transparency** of the Budget documentation
- Seizing the opportunities of a **multi-year Budget**

Balancing the Budget: the dogs that didn't bark

As we have described in earlier chapters, the Draft Budget achieves balance in the sense that proposed departmental spending allocations and forecast debt interest costs are fully covered by a combination of external (primarily Block Grant) funding, Regional Rates revenue and capital borrowing that lies within the limits set down in legislation and subsequent agreement with the Treasury. Helped by an unexpectedly big increase in the Block Grant, the Draft Budget freezes Regional Rates poundages to help vulnerable firms and households and delivers significant increases in health spending. Other departments were asked to accept 2 per cent cuts in their baseline spending, but in most cases these reductions have been offset or more than offset by general allocations financed from the Block Grant.

But the Draft Budget is also notable for areas where the Department of Finance has asked for suggestions in the consultation but made no detailed suggestions or proposals of its own to comment on:

- **Should we in NI raise more money for public services. If so, how?** One option to be to raise more money through fees and charges (with domestic water charges perennially cited as the biggest potential money-raiser). The Draft Budget makes no concrete suggestions here (perhaps not surprisingly with an election looming). Neither does it canvass savings in other specific areas of 'super-parity', where policy in NI is more generous than elsewhere – for example, non-domestic Rates reliefs, welfare mitigations, tuition fees, concessionary fares, prescription charges and domiciliary care funding. Departmental estimates cited in our *Guide* suggest that the current cost of these super-parity policies may be around £600 million a year.

- **Where should we look to save money through better efficiencies?** The Draft Budget notes that: *"In setting departmental budgets, the underpinning assumption has been that departments will find the proposed 2 per cent* *reduction required to provide additional funding to health from efficiencies in the existing budgets."* It adds that: *"The challenges of doing this cannot be under-estimated and past experience implies such efficiency gains may be neither straightforward nor painless."* No concrete suggestions are made.

- **Do we need to reduce or completely stop delivering any services?** Again, the Department of Finance may have hoped that departments would identify some unnecessary activities when asked for savings. But no explicit proposals have been put forward for consultation. In terms of resource spending, though not for capital spending, we remain a very long way from zero-based budgeting.

The absence of a Programme for Government

One consistent message from stakeholders – and from the budget process report published by the NI Audit Office in June 2021[31] – is that budget allocations need to be linked more clearly to plans and targets set out in a Programme for Government (PfG). This would set out policy objectives for each of the NI departments but agreed at the level of the Executive. The Northern Ireland Act 1998 requires the Executive to bring forward such a PfG and the New Decade New Approach agreement also highlighted the importance of linking multi-year Budgets to a PfG.

But, to a great extent, progress on a PfG has advanced little since the publication of a draft in 2016. Work resumed in January 2020, following the publication of the New Decade New Approach document but was then paused in the early period of the response to the Covid-19 pandemic. A revised Framework of nine well-being Outcomes was agreed by the Executive in late 2020 as the first step in the development of a PfG, and was issued for public consultation in January 2021, closing in March 2021. But the Outcomes Framework is yet to be finalised and is unlikely to be so before the elections, given the continuing focus on the pandemic. The incoming Executive will presumably step up efforts to agree its own PfG after the election and it remains to be seen how closely this would resemble the current draft and whether it will be better linked to departmental allocations.

An Investment Strategy?

In a similar vein, it would be helpful to see at the time of the Final Budget or as soon as possible thereafter a clear strategy underpinning proposed capital spending.

In the case of resource spending, the level of funding is probably constraining what is done in terms of service delivery and public sector activity. But the story for capital seems different – in recent years a number of major projects have been repeatedly delayed – partly because of the planning system and judicial reviews of contract decisions. Additionally, the Executive has struggled to spend the FTC available to it. By implication, much of the capital budget seems either not to have been spent or has not been spent on the originally intended project.

We are told that capital spending allocations are based on a bottom-up assessment of departments' needs but there is no Executive-agreed ranking of potential projects

[31] https://www.niauditoffice.gov.uk/publications/northern-ireland-budget-process-0

by desirability (other than the relatively vague concept of 'flagship projects') or indication of how capital projects would be coordinated across departments. The Executive did publish an 'Investment Strategy' for 2011 to 2021 and a new one is needed. We understand a draft will soon be published for consultation, but ideally it would have been in place in time to shape the Draft Budget capital allocations so an opportunity may now have been missed in this respect.

Public sector pay policy

The Draft Budget notes that NI's public sector pay bill stands at approximately £7 billion, around 50 per cent of total projected resource spending. Pay policy thus has significant implications for the quality and quantity of public services that can be delivered and the number of workers that can be employed delivering them.

For the first time, a statement on pay policy has been included in the Draft Budget. The Department of Finance said that it was important to set a three year pay policy *"as an integral part of the Budget process"*. And it expressed it thus:

> *"The proposed Public Sector Pay Policy for 2022- 23 to 2024-25 is a flexible one where there is no overarching limit on awards. Pay awards can be informed by a range of factors, including recruitment & retention and the advice of independent Pay Review Bodies, but where increases must be carefully managed to ensure they are affordable within departmental budgets, and enable essential public services to be sustainably funded going forward. Departmental pay increase assumptions typically average 2 per cent per year for all pay elements (i.e. both revalorisation and progression), although for some staff groups these will be higher, particularly those in the Health Service. There is also scope to offer increased awards in support of efficiency and reform. And multi-year agreements in this regard are particularly encouraged given this is a 3-year policy."*

It is important to bear in mind that there are over 100 different staff groups in the public sector. And many have their own pay determination processes. The Department of Finance's pay policy applies primarily to public bodies whose expenditure scores against the Block Grant Departmental Expenditure Limit, including staff working in NI Civil Service departments, agencies, and many Arm's Length Bodies. By contrast, staff in local councils and public corporations are not covered by the policy, and others – such as teachers, health workers and firefighters – have some current or historic linkage to GB Pay Review or negotiating bodies. As a consequence, this pay policy is only one factor contributing to the overall pay bill.

The policy is similar to the UK Government's at the Spending Review:

> *"The temporary pause in pay rises for some public sector workers was intended to ensure that the gap between the public and private sector wages did not widen further. SR21 announces that public sector workers will see pay rises over the next three years as the recovery in the economy and labour market allows a return to a normal pay setting process. The government will be seeking recommendations from Pay Review Bodies where applicable. To ensure fairness and the sustainability of the*

public finances, public sector pay growth over the next three years should retain broad parity with the private sector and continue to be affordable."[32]

The detail of the Department of Finance pay policy will be fleshed out later this year, as it was last year and in previous years,[33] in a letter NI Civil Service Finance Directors. At this stage the implications with respect to pay are still unclear but, especially in an environment of relatively high inflation, pressure on pay increases for groups to which the policy applies could represent an additional call on resources for departments during the three year Budget period.

The transparency of the Budget documentation

One key goal of the Fiscal Council is to increase the transparency of NI's public finances, both through what we publish ourselves and in what we can encourage the Department of Finance and other Executive bodies to do.

There are some useful advances in transparency in this Draft Budget:

- **Funding** related to political agreements and City & Growth Deals has been included, thanks to swift confirmation by the Secretary of State.
- Departmental allocations are shown alongside the **2021-22 agreed Final Budget positions** as well as alongside the departmental baselines.
- More detail has been provided of payments under **Public Private Partnership (PPP) and Private Finance Initiative (PFI)** projects.
- Additional details are provided of **the breakdown of principal and interest repayments** for the Reform and Reinvestment Initiative (RRI).
- The Draft Budget identifies how much of the **RRI principal** is being re-paid through Regional Rates revenue in each year.

That said, it remains the case that Budget resource and capital plans are not presented alongside a comparable set of outturn data for recent years and an up-to-date forecast for the current year.

Another area where transparency could usefully be improved is around the 'general allocations' made to departments. Much has been made of the 2 per cent cuts that most departments other than Health have been asked to accept in the Draft Budget, which conveys an aura of even-handedness. But little explanation is given of the relative size of the general allocations that departments have then been given and to what extent this reflects a rigorous attempt at priority-setting. At the margin this may help explain why broad political support has proven hard to achieve.

Seizing the opportunities of a multi-year Budget

In our response to the UK Government Spending Review, we argued that the opportunity to return to multi-year budgeting in NI after seven successive single-

[32] https://www.gov.uk/government/publications/autumn-budget-and-spending-review-2021-documents/autumn-budget-and-spending-review-2021-html
[33] https://www.finance-ni.gov.uk/sites/default/files/publications/dfp/fddof0321.pdf

year Budgets was a golden opportunity for greater long-term thinking and policy action, especially in areas like healthcare reform and infrastructure planning.

With the five parties in the Executive failing to reach agreement on the substance of the Draft Budget, this is not a particularly encouraging start. It is also notable that the Budget contains very little by way of earmarked funding for transformation – just the £49 million a year from New Decade New Approach as against £14 billion of total resource spending. And that there is very little evidence of systematic and well-explained priority-setting beyond the top spot given to Health.

That said, we have to recognise that while the financial opportunity is there to prepare a reforming multi-year Budget, the politics of agreeing one with a fresh set of Assembly elections close on the horizon are inevitably complicated and highly charged. But we must hope that the obstacles can be overcome before too long.