



Northern Ireland
Fiscal Council

Bringing transparency to NI's public finances

Long-term projections of the NI Executive Block Grant

TECHNICAL PAPER 01/23
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Executive Summary

- The NI Executive Block Grant accounts for approximately 95 per cent of the resources allocated to public services as part of the NI budget process.
- The Block Grant for 2022-23 is £15.5 billion which is 29 per cent higher per head of population than equivalent UK Government spending in England. NI has had a Block Grant spending premium since the 1970s and it remains higher than most estimates of the relative need for public spending in NI (currently around 20 per cent higher than in England). But the premium has fallen sharply in recent years, contributing to the financial challenges currently facing NI departments.
- This paper sets out the approach adopted in producing the long-term projections of the NI Executive Block Grant presented in the NI Fiscal Council's *Sustainability Report 2022*. These are based on projections published by the Office for Budget Responsibility (OBR) in July 2022 that UK public spending (excluding net interest payments on public debt) will increase to 48 per cent of GDP in 2071-72.
- The baseline projection is for the NI Executive Block Grant to increase to £29 billion (2020-21 prices) in 2071-72. This is equivalent to annual average real terms growth of 1.6 per cent compared with 2.2 per cent growth for UK Government equivalent spending.
- As a result, the NI Executive Block Grant per head of population is projected to be only 6 per cent higher than equivalent spending in England by 2071-72. In the medium term, the spending premium (including non-Barnett allocations) is expected to fall below the relative need for public spending in NI by 2030-31.
- If UK public spending grew at a slower rate, this would reduce the long-term projections of the NI Executive Block Grant compared with the baseline projection but would also result in a smaller fall in the spending premium. In contrast, if the NI population was larger this would increase the Block Grant but also hasten the reduction in the spending premium. A needs-based adjustment in line with the approach previously agreed for the Welsh Government would prevent the spending premium from falling below the relative need for public spending in NI.
- Setting the NI Executive Block Grant based on the taxes and duties paid by people living in NI would result in a substantially lower level of funding being available with public spending 27.5 per cent lower than in England, far below relative need.
- This is the first set of long-term projections produced by the NIFC in respect of the NI Executive Block Grant. These will be built on and developed as part of future Sustainability reviews, hopefully in collaboration with colleagues producing similar projections for the Scottish and Welsh Block Grants.

Introduction

The purpose of this technical paper is to set out how the NI Executive Block Grant projections presented in the Northern Ireland Fiscal Council (NIFC) publication, *Sustainability Report 2022*, were produced.¹ It also includes additional sensitivity analysis and a discussion of areas where the analysis could be further developed.

Changes in the Block Grant each year depend on spending decisions by the UK Government, but there is benefit in knowing whether it will grow faster or slower than equivalent UK spending. In addition, it is important to understand what the implications will be in terms of public spending per head of population to inform the NI Executive's approach to delivering public services and the amount of income required from other sources such as the Regional Rate.

At the outset it should be noted that the Block Grant projections presented in this paper are not predictions or forecasts. Instead, they are conditional projections of how the NI public finances might evolve over time if policy does not change. In addition, the approach to projecting the Block Grant for the NI Executive is somewhat less complex than for the other Devolved Administrations as there is not the same need to project what the future adjustment will be in respect of devolved taxes. This may change if there is agreement to devolve any of the major taxes or duties to the NI Executive.

The preparation of these projections of the NI Executive Block Grant was informed by advice and input from officials in the Office for Budget Responsibility (OBR), HM Treasury and the Scottish Fiscal Commission (SFC). The NIFC is very grateful for their support although responsibility for the projections is the Council's alone.

Background

The Block Grant accounts for 95 per cent of the spending allocated to NI departments in the 2022-23 Final Budget plans for NI departments.^{2,3} It is comprised of the Resource and Capital Departmental Expenditure Limits (DELs).⁴ Although the technical definition of the Block Grant also includes depreciation and impairments (referred to as ringfenced Resource DEL), for the purposes of this paper and for ease of understanding these elements are not included in what is termed the Block Grant in the analysis set out below.

The Block Grant equates to only 57 per cent of total identifiable public spending in NI, which also includes spending in NI by Whitehall departments as well as Annually Managed Expenditure (AME). The proportion of identifiable spend in NI funded by the Block Grant has risen slightly since 2016-17 as shown in Chart 1 below. As the NI Executive has limited control of the other sources of funding for public spending in NI, the focus in terms of fiscal sustainability tends to be on the Block Grant.

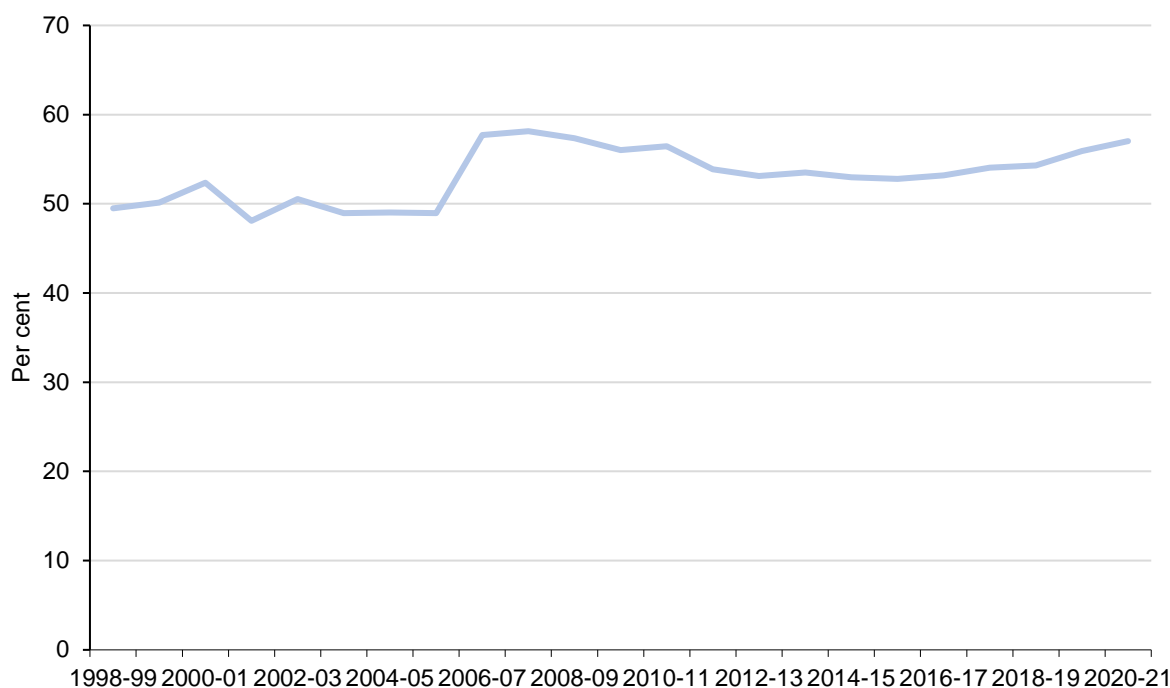
¹ <https://www.nifiscouncil.org/publications/sustainability-report-2022>

² https://www.finance-ni.gov.uk/sites/default/files/publications/dfp/Northern%20Ireland%20Budget%202022-23_0.pdf excluding funding and allocations from Reserve Claim

³ Although the Budget documents also include the Annually Managed Expenditure allocations to NI departments, these are based on the forecasts of the required spending rather than being at the discretion of NI Executive Ministers.

⁴ Further detail on the UK Budget budgeting framework is available in the HM Treasury Consolidated Budgeting Guidance (2021-22) https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1104980/2021-22_CBG_For_Publication_.pdf (Chapter 1)

Chart 1 - NI Executive Block Grant (excluding depreciation and impairments) as a percentage of total identifiable spending in NI



Source: HM Treasury PESA

The planned level of the Block Grant each year is initially set as part of the preceding UK-wide Spending Review and may be revised in each subsequent fiscal event. For example, the NI Executive Block Grant (excluding depreciation and impairments) for the years 2022-23 to 2024-25 of £14.8/15.0/15.2 billion was initially set as part of the 2021 UK Spending Review, the outcome of which was published in October 2021.⁵ Since then, net additional allocations totalling £0.7 billion have been made for the 2022-23 financial year as part of the 2022 Main Estimates and 2022 Spring Statement as well as the carry forward of unspent funding from 2021-22.

Approximately 97 per cent of the current NI Executive Block Grant in 2024-25 was determined through the Barnett formula⁶ and baseline⁷, based on the latest plans, with the non-Barnett additions relating mostly to replacement funding for previous EU support for farming.⁸ The increase in the proportion of the Block Grant determined through the Barnett formula in 2022-25 in part reflects the withdrawal of previous time limited funding from political agreements.

Chart 2 below shows that the NI Executive Block Grant tends to move in line with UK Government equivalent spending over time. However, as the Barnett formula provides the Devolved Administrations with broadly the same increase in spending per head of population as in England, the higher baseline per head in NI means that

⁵ Autumn Budget and Spending Review 2021: A Stronger Economy for the British People https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1043689/Budget_AB2021_Web_Accessible.pdf (Table E.2)

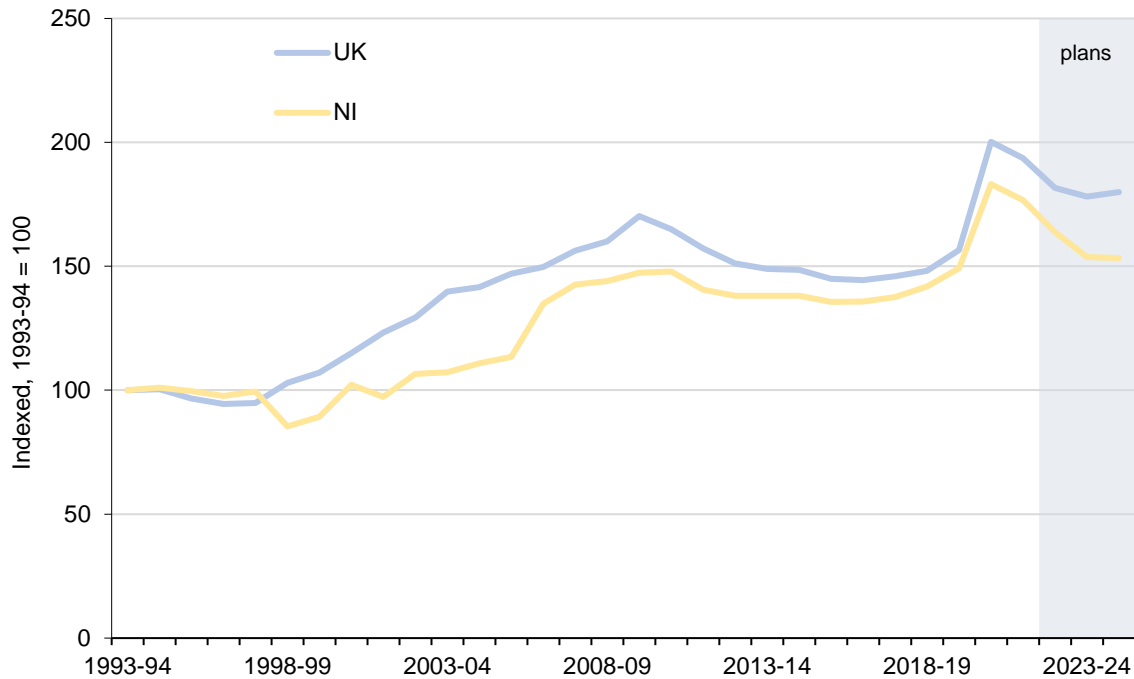
⁶ An explanation of the operation of the Barnett formula is set out in Chapter 5 of the NIFC 2022 Sustainability Report <https://www.nifiscouncil.org/publications/sustainability-report-2022>

⁷ It is assumed that most of the baseline allocation will have been determined through the Barnett formula although a proportion of historic funding will have been set prior to the introduction of the Barnett formula in the late 1970s as well as any permanent non-Barnett allocations made since then.

⁸ £313/ £327/ £329 million in 2022-23, 2023-24 and 2024-25 respectively.

the NI Executive Block Grant tends to grow at a slower rate than total UK DEL, leading gradual convergence in funding per head of population over time.⁹ The large increase in the NI Executive Block Grant in 2006-07 reflects the transfer of Policing and Justice functions to the NI Executive.¹⁰

Chart 2 - NI Executive Block Grant (excluding depreciation and impairments) and UK Government DEL (2021-22 prices, 1993-94 = 100)



Source: HM Treasury PESA and deflator series

Convergence occurs more rapidly if UK public spending is growing at a faster rate. This can be seen in the plans for the 2021 Spending Review period with average annual real terms growth of 3.8 per cent for UK DEL between 2019-20 and 2024-25 compared with 1.3 per cent for the NI Executive.¹¹ Chart 3 shows that this will result in the NI Block Grant premium (i.e. the percentage difference between the NI Executive Block Grant and equivalent UK Government spending per head of population in England) falling from 38 per cent in 2017-18, to 29 per cent higher in 2022-23, and then 25 per cent higher in 2024-25. Excluding the non-Barnett additions results in an even faster decline in the NI Block Grant premium to 21 per cent by 2024-25.¹²

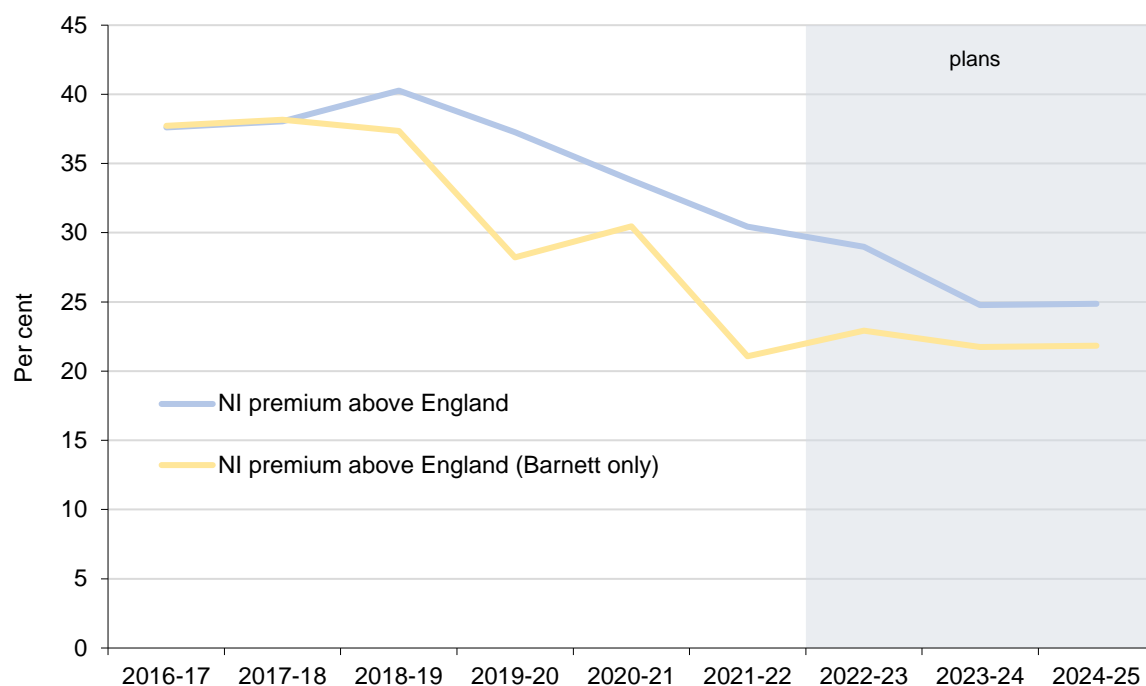
⁹ In theory there will never be complete parity in spending per head because of the small amount of the NI Executive Block Grant that was set prior to the implementation of the Barnett formula. However, other factors such as the relative rate of growth in the NI population will impact on the rate of convergence and the long-term position. Slower population growth than in England will tend to reduce the rate of convergence while faster growth would accelerate convergence and result in a long-term level of spending below that in England.

¹⁰ Although responsibility for the function was devolved in 2010, the associated funding was recorded under the NI Executive Block Grant retrospectively from the 2011 version of PESA which presented figures back to 2006-07.

¹¹ Autumn Budget and Spending Review 2021: A Stronger Economy for the British People https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1043689/Budget_AB2021_Web_Accessible.pdf (Table E.2)

¹² As approximately one quarter of spending by Whitehall department is on functions such as Defence which are reserved or excepted matters, the UK Government equivalent spending set out in Chart 2 is calculated by applying the Barnett formula comparability factors to the level of spending for each Whitehall department (see Appendix D, Table D.1). Although some of this expenditure is for the benefit of people living in Wales and Scotland, this is only a small proportion, with the spending divided by the population in England.

Chart 3 - NI Executive Block Grant (excluding depreciation and impairments) premium



Source: HT Treasury PESA and NIFC calculations

The change in the level of the NI Executive Block Grant each year will depend on the amount of funding allocated to or deducted from comparable services in the rest of the UK as well as the consequential impact on the NI Executive Block Grant. In respect of the former, this will be determined by:

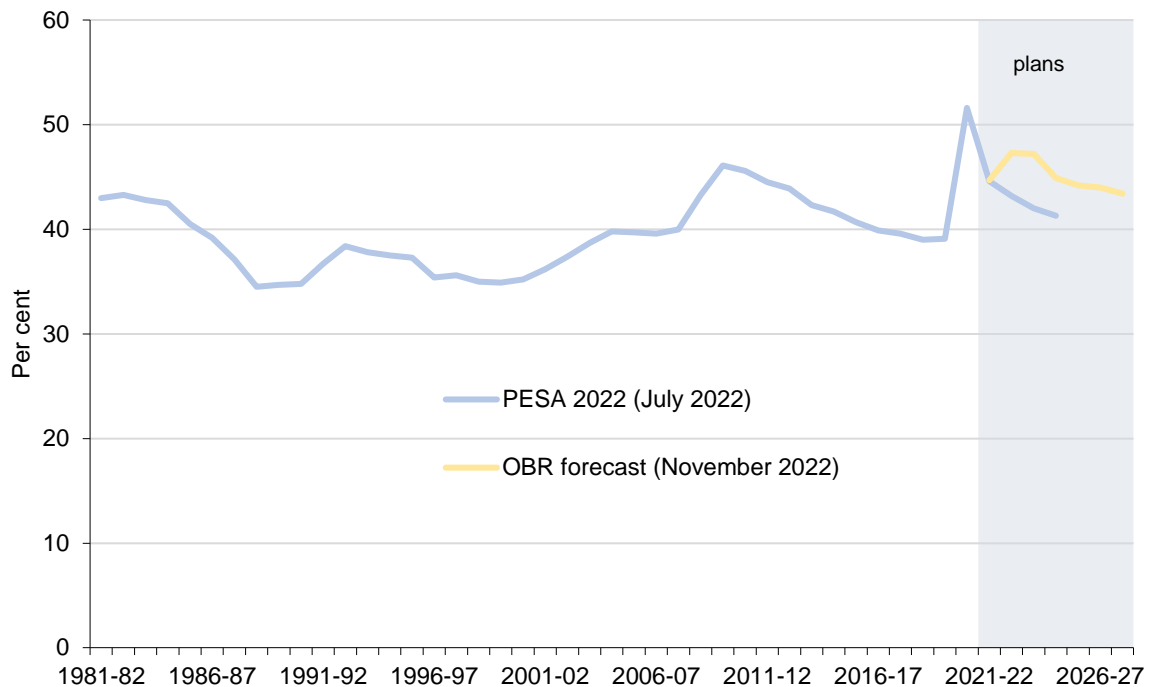
- The change in the **size of the UK economy in real terms** which in the long term depends on the growth potential of the economy, based on factors such as competitiveness, skills, innovation, investment and entrepreneurship. The average annual real terms growth in the UK economy has fallen from 2.8 per cent between 1981-82 and 2001-02 to 1.5 per cent over the past twenty years with the OBR forecasting that it will increase by 1.4 per cent each year on average over the long term¹³;
- The **rate of inflation**. The GDP deflator measure of economy wide inflation averaged 4.3 per cent a year between 1981-82 and 2001-02 compared with 2.2 per cent over the past twenty years with the OBR forecasting that it will increase by 2.3 per cent each year on average over the long term;
- **Total public spending as a proportion of the economy**. This has been on an upward trend since the late 1980s, as shown in Chart 4, with spikes in 2008-10 due to the recession associated with the financial crisis and in 2020-21 due to the response to the Covid-19 pandemic. Although Chart 4 shows that public spending had been projected to fall to 41 per cent of GDP

¹³ Fiscal risks and sustainability report (OBR) https://obr.uk/docs/dlm_uploads/Fiscal_risks_and_sustainability_2022-1.pdf (Table 4.2)

by the end of the current Spending Review period based on the March 2022 Budget (as reflected in the 2022 version of PESA), the latest OBR forecast is that it will fall only to 43 per cent by 2027-28; and

- NI Executive Block Grant equivalent government spending by the UK Government as a proportion of total public spending.** Slightly under 50 per cent of total UK public spending is on Annually Managed Expenditure including social security benefits and debt interest payments.¹⁴ In addition, as approximately one quarter of DEL spending is on reserved or excepted matters this means that less than two-fifths of UK public spending is subject to the Barnett formula. While the UK Government has some scope to increase or decrease the total amount of UK public spending and the distribution of this funding between different spending areas, this is limited by the cost of borrowing and the scale of previous spending commitments.

Chart 4 - UK Total Managed Expenditure as a percentage of GDP



Source: HM Treasury PESA and OBR Economic and Fiscal Outlook 2022

In respect of the consequential impact on the NI Executive Block Grant this will be determined primarily by:

- The size of the NI population relative to that in England** (or England & Wales or UK for some minor departments) which has remained broadly unchanged at 3.4 per cent over the past thirty years (Appendix A, Chart A.1). The latest ONS projections suggest that the NI population will fall to 3.0 per cent of that in England by 2070 (Chart A.2);

¹⁴ Table 1.1, PESA 2022 indicates that Total AME was £500 billion in 2021-22 compared with Total Managed Expenditure of £1,060 billion.

- The **operation of the Barnett formula** which has remained largely unchanged for NI since it was introduced in 1979. However, the 2022 NIFC Sustainability Report highlighted the potential for the spending per head premium in NI to fall below the level of relative need for public spending with one option in response being for an additional needs-based adjustment to be included in the formula, in line with the approach previously agreed for the Welsh Government¹⁵; and
- The **extent of non-Barnett additions** which is largely the result of political decisions, although some are for technical reasons due to changes in the accounting rules and/or the result of spending being reprofiled. Although individual non-Barnett allocations are mainly time-limited, they have tended to be replaced as other issues have arisen.

Methodology

In light of the different factors that influence the level of the NI Executive Block Grant, there are a number of different approaches and assumptions that can be adopted in producing long-term projections. The approach used in preparing those presented in the NIFC *Sustainability Report 2022* was to apply the Barnett formula to the OBR projections for UK public spending (excluding net interest payments on public sector debt) and the ONS population projections. The main data sources used are set out in Appendix B.

Plans are currently in place for the NI Executive Block Grant up until the year 2024-25. On this basis, the long-term projections for the NI Executive Block Grant cover the 46-year period between 2025-26 and 2071-72.

The starting point is the OBR's long-term projections for non-interest UK public spending as a percentage of GDP from the July 2022 *Fiscal risks and sustainability* (FRS) report summarised in Table 1 below. These are primarily based on the expected changes in the age structure of the UK population, with an ageing population increasing the demand for health, pensions and social care but reducing the demand for education. There is also anticipated to be further growth in health spending due to non-demographic factors such as advances in medical diagnostics and treatments.

¹⁵ UK and Welsh Government Fiscal Framework Agreement <https://www.gov.wales/sites/default/files/publications/2018-11/agreement-on-welsh-government-fiscal-framework.pdf>

Table 1 - OBR Non-interest UK public spending projections

	Per cent of GDP						
	Estimate		FRS Projection				
	2021-22	2026-27	2031-32	2041-42	2051-52	2061-62	2071-72
Health	9.1	8.3	8.7	10.1	11.7	13.3	15.0
Adult social care	1.2	1.4	1.5	1.8	2.0	2.3	2.5
Education	4.2	4.2	3.8	3.4	3.5	3.5	3.3
Pensions & Benefits	12.3	12.4	11.9	12.5	13.3	14.7	15.3
Total age-related spending	26.8	26.3	25.9	27.8	30.5	33.7	36.1
Other departmental capital spending	2.3	2.8	2.8	2.8	2.8	2.8	2.8
Other spending	11.3	9.6	9.5	9.5	9.5	9.5	9.6
Total Spending	40.3	38.7	38.3	40.2	42.8	46.0	48.4

Source: OBR, Fiscal risks and sustainability report 2022

The OBR projections are for non-interest UK public spending to increase by 2-3 percentage points of GDP each decade between 2031-32 and 2071-72, primarily due to an increase in the share of GDP accounted for by public spending on Health. In contrast, the share of GDP accounted for by non age-related public spending is not projected to change significantly.

The projections of non-interest UK public spending as a percentage of GDP are 3.6 percentage points higher by 2071-72 in the latest OBR assessment compared with the previous OBR *Fiscal sustainability report* in 2018. This is primarily due to the projected increase in Health, Adult social care and capital spending reflecting policy changes announced in the interim, such as the reform of charging for Adult social care. While the subsequent forecasts set out in the November 2022 OBR Economic and Fiscal Outlook¹⁶ imply that public spending will be a higher share of GDP in 2026-27 (and probably 2031-32) than set out in Table 1, the long-term projections still appear reasonable.

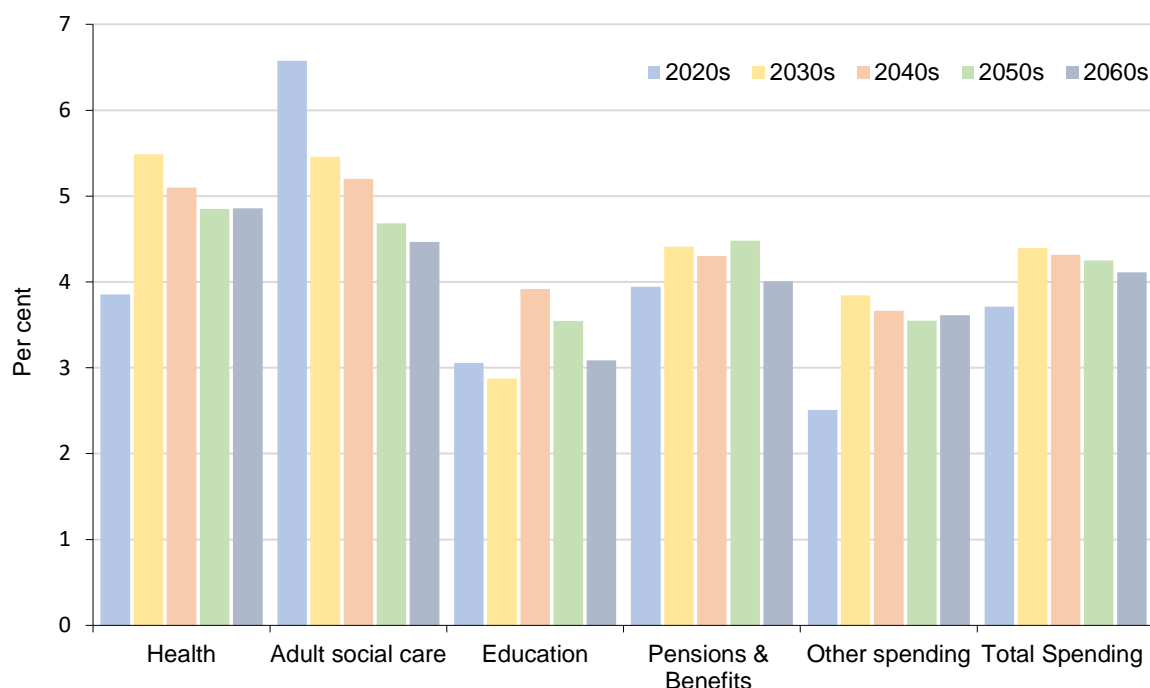
Although not directly comparable, the latest figures for NI suggest that identifiable public spending was equivalent to 52 per cent of GDP in 2019¹⁷ which was 19 percentage points higher than for the UK. The OBR projections that the public spending share of UK GDP will increase by 12 percentage points between 2019 and 2071 imply that identifiable public spending would reach 63 per cent of GDP in NI by 2071-72, with further indirect multiplier effects on economic activity. Such an increase in the predominance of the public sector would be expected to have implications for the wider NI economy.

The OBR projections for nominal UK GDP are then used to convert the projections in Table 1 into cash terms and then into projections of average annual nominal growth for each of the main spending areas. Chart 5 shows that UK public spending on Adult Social Care is projected to grow at broadly the same rate as Health in the long run but with most of its increase in the 2020s. Total UK public spending is projected to increase by an average of 4.2 per cent per annum in cash terms between 2026-27 and 2071-72

¹⁶ OBR Economic and Fiscal Outlook - November 2022 https://obr.uk/docs/dlm_uploads/CCS0822661240-002_SECURE_OBR_EFO_November_2022_WEB_ACCESSIBLE.pdf (Chart 17)

¹⁷ NI GDP of £44,011 million for 2019 from ONS Regional Gross Domestic Product: All Regions <https://www.ons.gov.uk/economy/grossdomesticproductgdp/datasets/regionalgrossdomesticproductallnutslevelregions> compared with Identifiable expenditure of £22,726 million from Table 9.1a of PESA 2022. Figures for UK of £2,017,344 million and £663,261 million.

Chart 5 - Projected Average annual nominal growth in UK public spending



Source: OBR Fiscal risks and sustainability report 2022

Given that the GDP deflator is expected to increase by 2.3 per cent per annum over this period, this implies annual average real terms growth of 1.9 per cent in total UK public spending between 2026-27 and 2071-72. This compares with 0.9 per cent in the 1980s, 2.3 per cent in the 1990s, 4.4 per cent in the 2000s and 0.3 per cent in the 2010s.¹⁸ The OBR projections are therefore broadly in line with the 2.0 per cent annual average real terms growth in UK public spending over the past 4 decades. Although public spending is projected to increase as a percentage of GDP over this time, this is offset by the assumed slower growth in GDP.

The average annual nominal growth rates for each main spending area are applied to the 2024-25 spending plans for the nearest equivalent UK Government department to produce long-term projections of the total DEL for each UK Government department. This is relatively straightforward for the Department of Health and Social Care and the Department for Education, which accounted for 73 per cent of UK Government spending, that is equivalent to that of the NI Executive, in 2021-22. As the OBR projections are not disaggregated for the other UK Government departments the projections for “Other spending” are applied, except for the Department for Work and Pensions. A further issue is that the OBR projections are for Total Managed Expenditure, including Annually Managed Expenditure when the 2024-25 spending plans are in respect of total DEL only.

The projected increase in the total DEL for each UK Government department each year is used to calculate the associated Barnett consequentials for the NI Executive. Although the projected NI population as a percentage of England is used for most of the large departments, NI as a percentage of England & Wales is used for some departments such as the Home Office to reflect the fact that responsibility has not

¹⁸ Public Expenditure Statistical Analyses 2022
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1091951/E02754802_PESA_2022_elay.pdf (Table 4.2)

been devolved to the Welsh Government. The latest comparability factors from the 2021 Statement of Funding Policy are applied with no change assumed over the longer term in respect of the transferred functions set out in Schedules 2 and 3 of the Northern Ireland Act 1998.¹⁹ An example of the calculation of the projected Barnett consequentials is set out in Appendix C for the 2025-26 financial year.

The projected Barnett consequentials for the years 2025-26 to 2071-72 are added to the planned NI Executive Block Grant for 2024-25 with no adjustment made to reflect the non-Barnett allocations currently included. It is assumed that these are either replaced or mainstreamed into the Block Grant over the longer term. The additional Barnett consequentials for 2024-25 as a result of the decisions set out in the 2022 Autumn Statement have not been incorporated into the baseline position.

In comparing the projections of the NI Executive Block Grant it is necessary to adjust the total DEL for UK departments each year to exclude the programmes that the NI Executive is not responsible for, such as Defence. This is achieved by applying the Statement of Funding Policy comparability factor to the actual/projected level of expenditure for each Whitehall department as shown in Table D.1 in Appendix D for 2020-21. The UK Government equivalent level of spending of £365 billion in 2021-22 accounts for 67 per cent of the total DEL for UK departments or 78 per cent of the total DEL excluding the Devolved Administrations. An adjustment is not included in respect of non-domestic business rates in England. If this was included, the level of UK Government equivalent spending would be lower and the NI Executive Block Grant premium would be higher.

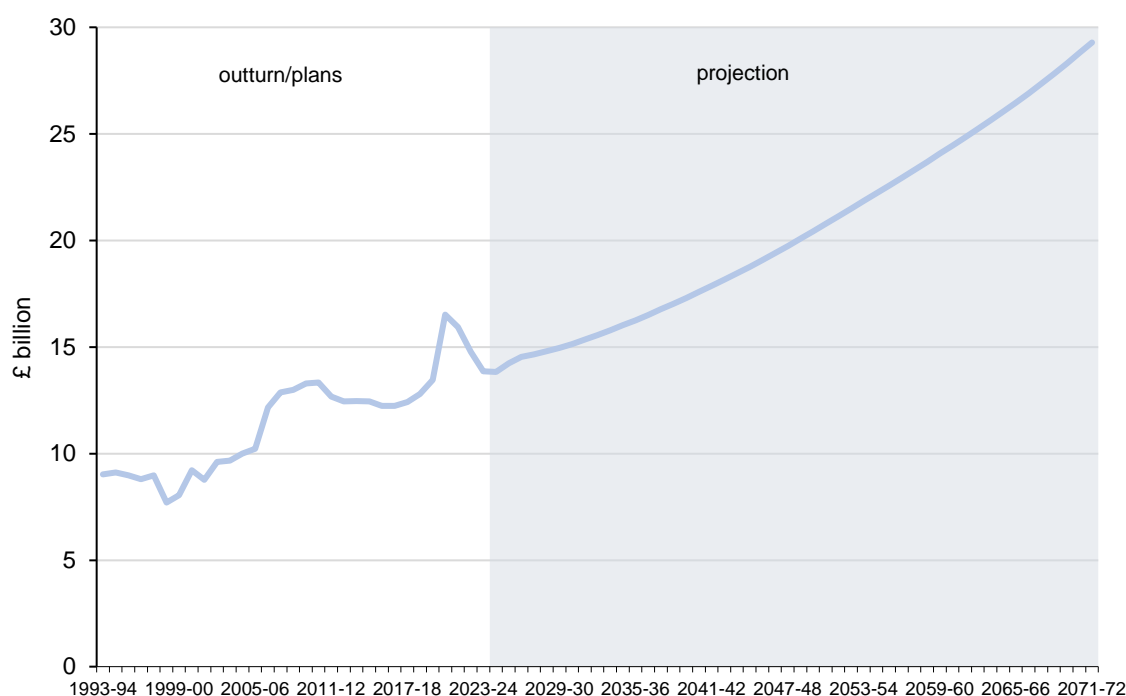
NI Executive Block Grant projections

Under the baseline projections the NI Executive Block Grant is expected to rise from £15.2 billion in 2024-25 to £90 billion in 2071-72 in current prices or £29 billion in 2021-22 prices. Chart 6 shows that this would represent a continuation of the general trend over the past three decades with projected annual average real terms growth of 1.6 per cent between 2024-25 and 2071-72 compared with 1.4 per cent between 1993-94 and 2024-25. The long-term average annual real terms growth in the NI Executive Block Grant is projected to be lower than the projected growth of 2.2 per cent in equivalent spending by UK Government departments.²⁰ The year-to-year volatility in the outturn figures for the Block Grant, with the extreme example being the spike in 2020-21 due to the response to Covid-19, highlights that the Block Grant is unlikely to follow the projected smooth path set out in Chart 6.

¹⁹ Northern Ireland Act 1998 <https://www.legislation.gov.uk/ukpga/1998/47/contents>

²⁰ The growth rate for UK Government equivalent spending is higher than the 1.9 per cent figure quoted above for total UK public spending because it excludes reserved functions or functions funded through AME which are projected to grow at a slower rate than Health.

Chart 6 - Baseline projections of NI Executive Block Grant (2021-22 prices)



Source: OBR, NIFC calculations

Although the slower growth in the NI Executive Block Grant is offset to an extent by the impact of the projected decline in the relative size of the NI population Chart 7 shows that the NI Executive Block Grant would be expected to fall from 25 per cent higher than UK Government spending per head of population in 2024-25 to 6 per cent higher in 2071-72.

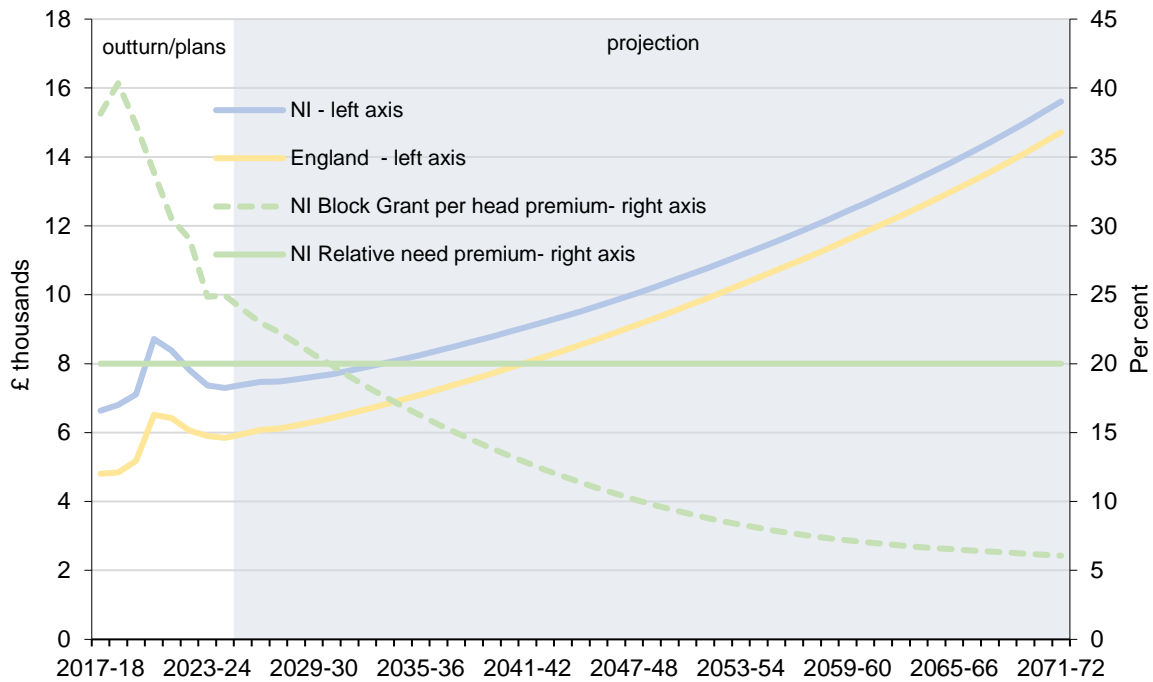
Although it has been higher than relative need for many years, the NI spending premium is expected to fall below the additional need for public spending in NI compared with England of 20 per cent (discussed further below) by 2030. Based on the Treasury comparisons of the relative funding for the Devolved Administrations²¹ and more up to date estimates of relative need, the NI spending premium may already be at the level of relative need. Compounded by the apparent evidence of higher levels of public sector inefficiency in NI²² as well as the relatively low household contribution to the funding of public services²³, this would suggest that it will be a significant challenge for NI departments to deliver services comparable to those in the rest of the UK in the short, medium and longer term.

²¹ Block Grant Transparency: December 2021 indicates that funding per head for the NI Executive is 21 per cent higher than UK Government equivalent spending. <https://www.gov.uk/government/publications/block-grant-transparency-december-2021>

²² NIFC Sustainability Report 2022: special focus - Health reported that the unit cost of providing hospital services was 36 per cent higher in NI than England <https://www.nifiscouncil.org/publications/sustainability-report-2022-special-focus-health>

²³ Table 6.2 of the 2022 NIFC Sustainability report indicates that that the average Regional Rates bill in NI was £1,036 in 2021-22 compared with the average Council tax bill in England of £1,426 while there is no domestic charges for water services in NI compared with an average bill of £408. Increasing the NI household contribution to 80 per cent of that in England, reflecting lower average earnings and house prices, would provide approximately £320 million in additional funding (£80 million Regional Rate, £240 million Water charges), equivalent to around 2 per cent of the Block Grant.

Chart 7 - Baseline projections of NI Executive Block Grant per head of population (2021-22 prices)



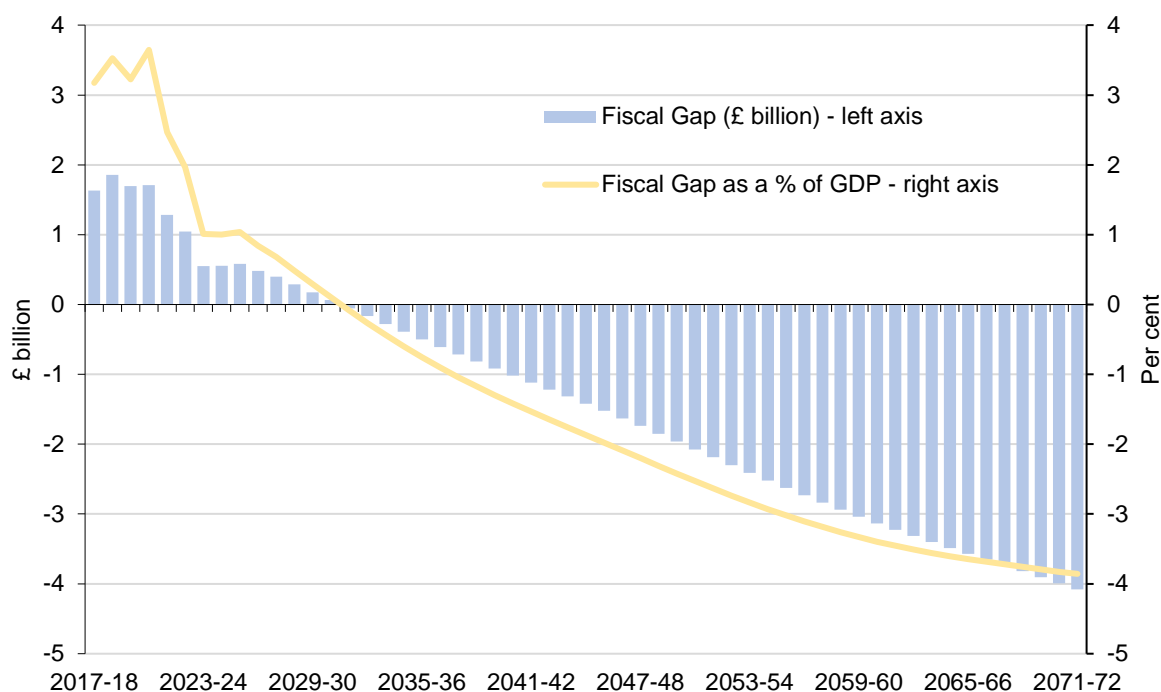
Source: OBR, NIFC calculations

In its recent consultation paper, *Approach to Fiscal Sustainability*²⁴, the Scottish Fiscal Commission (SFC) proposed that the sustainability of the Scottish Governments finances could be measured by the projected percentage “annual budget gap”. This measure is expressed as the change in revenue or spending as a percentage of GDP required to close the projected gap between Scottish Government spending and revenue each year.

Chart 8 presents estimates of the annual budget gap for NI using a different approach to projecting spending and revenue. This reflects the higher relative level of need for public spending in NI and the devolution of fewer tax powers. The projected level of NI spending is based on the NIFC projections for UK Government equivalent public spending per head of population with a 20 per cent NI needs premium adjustment while the level of revenue is the projected NI Executive Block Grant. Chart E.1 in Appendix E shows that NI GDP has been a steady 2.2 per cent share of UK GDP over the past two decades with this proportion applied to the OBR projections of UK GDP to derive projections of NI GDP.

²⁴ <https://www.fiscalcommission.scot/publications/approach-to-fiscal-sustainability-consultation-paper/>

Chart 8 - NI Executive Block Grant Projected Annual Budget Surplus/Deficit (2021-22 prices)



Source: NIFC Calculations

Chart 8 shows that the NI Executive had a significant Block Grant annual budget surplus of £1.7 billion in 2019-20 (2021-22 prices). However, this has fallen to £1.1 billion in 2022-23 and is expected to fall further to £0.6 billion in 2024-25. The speed of the reduction is a contributing factor to the funding pressures identified by the Minister of Finance for the 2022-23 financial year.²⁵ The NI Executive funding position is expected to move to an annual budget deficit by the 2030s, which is projected to increase to £4.1 billion each year by 2071-72, equivalent to 3.9 per cent of NI GDP. It should be noted that these figures do not include the lower household contribution to the funding of public services in NI. They also do not take account of Annually Managed Expenditure such as social security and pensions which are assumed to be fully funded by the UK Government.

Sensitivity analysis

The baseline projections set out above represent the most likely trajectory of the NI Executive Block Grant over the period to 2071-72. However, they are based on a number of assumptions and the actual outcome may differ substantially. In this context, five alternative scenarios were developed.

Scenario 1: UK public spending as a % of GDP does not increase

The OBR projections set out in Table 1 imply that non-interest UK public spending as a proportion of GDP will increase significantly over the next 40 years. However, the OBR also highlight that, based on current policies, this will result in borrowing

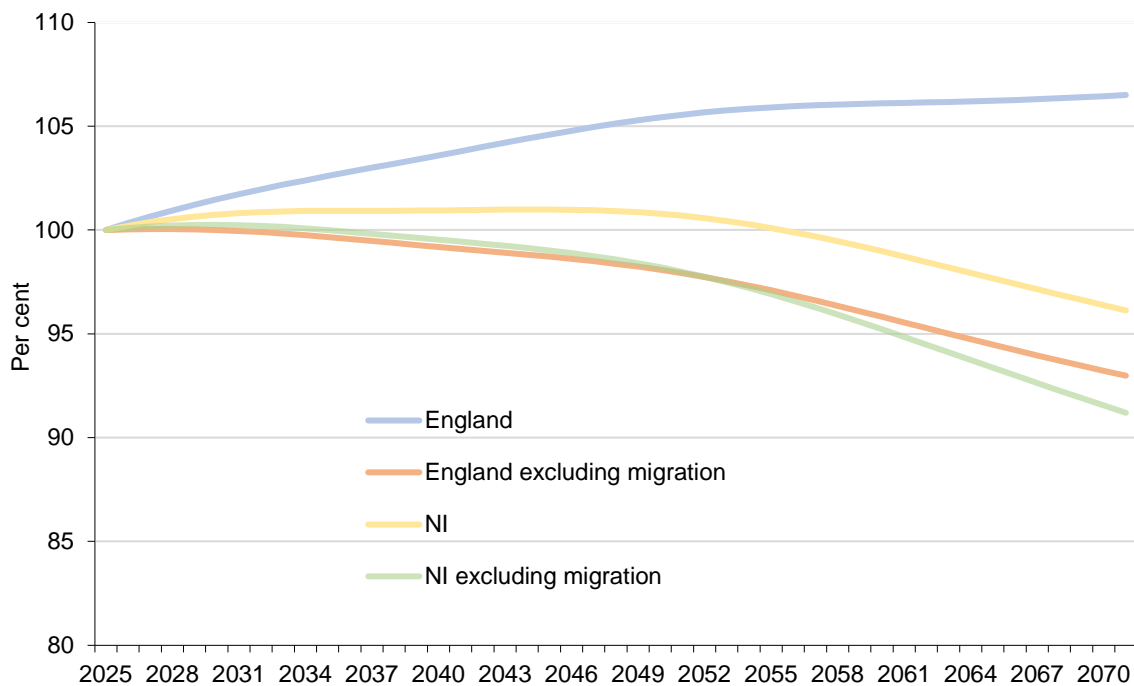
²⁵ DoF Written Ministerial Statement October 2022 http://www.niassembly.gov.uk/globalassets/documents/official-reports/written-ministerial-statements/2022---2027/department_finance_budget-2022-23.pdf

and debt rising to unsustainable levels.²⁶ While the projected gap between spending and revenue is expected to be addressed in part by increases in taxes and duties, Chart 4 shows that public spending in the UK as a share of GDP is forecast to be the same in 2027-28 as it was in the early 1980s. In order to reflect the possibility that spending will grow at a slower rate than under the baseline projections, Scenario 1 is based on UK public spending as percentage of GDP for each of the main spending areas not changing between 2026-27 and 2071-72.

Scenario 2: NI population as a % of England does not change

The ONS population projections imply that the NI population will fall by 3.9 per cent between 2025 and 2071 while that for England will increase by 6.5 per cent. The implied reduction in NI’s population as a percentage of that in England from 3.3 per cent to 3.0 per cent would reduce the funding allocated to NI through the Barnett formula. However, the difference in the population trends is primarily due to the assumed level of migration in England. Chart 9 shows that the projected trend in the NI and England populations is more similar if migration is excluded. Scenario 2 is based on the NI population as a percentage of that in England, England & Wales and the UK not changing over time.

Chart 9 - Population projections for NI and England (2025=100)



Source: ONS UK population projections

Scenario 3: Adjustment for need

The different socio-economic characteristics of the UK regions and nations have implications for the relative need for public spending in each. In its 2022 Sustainability Report the NIFC concluded that “...20 per cent looks a reasonable ballpark figure for the additional spending per head required in NI to deliver

²⁶ UK Public sector borrowing rising to 11.2 per cent of GDP by 2071-72 and public sector net debt reaching 267 per cent of GDP compared with 84 per cent in 2026-27 on an upward trend, both on an upward trend. https://obr.uk/docs/dlm/uploads/Fiscal_risks_and_sustainability_2022-1.pdf (Table 4.11)

comparable services". Although the Barnett formula currently does not include an additional needs adjustment for NI, the consequential for Wales have been uplifted since 2017 by a transitional needs-based factor of 5 per cent. This will be increased to a permanent rate of 15 per cent (based on the previous estimates by the Holtham Commission²⁷) once the overall Block Grant funding premium for Wales is no longer above this rate.²⁸

In the context that the NI Executive Block Grant per head of population relative to UK Government spending was closer to its estimate of relative need (6 percentage points higher²⁹) than Wales (8 percentage points higher) for the 2020 Spending Review period the application of a transitional rate of around 10 per cent could possibly have been justified for application in the subsequent 2021 Spending Review. This would have increased the funding available to the NI Executive over the period 2022-23 to 2024-25 by around £580 million.

The outcome of the 2021 Spending Review was that the NI Executive Block Grant per head of population fell to 121 per cent of UK Government equivalent spending excluding non-Barnett additions.³⁰ This is equal to the relative level of need estimated for by the Holtham Commission and 1 percentage point higher than the assessment by the NIFC. Reflecting the higher level of need for public spending in NI as well as the application of a needs-based adjustment for the Welsh Government, Scenario 3 is based on the application of a transitional need adjustment factor of 10 per cent until the mid-2030s and then the full 20 per cent thereafter. The emerging work by the NIFC to update the Holtham Commission estimate of the relative need for public spending in NI would suggest that there has not been a significant change in the overall estimate of relative need over the past decade. On this basis it is assumed that the relative need factor does not change apart from a downward adjustment over time to reflect slower projected population growth in NI compared with England.

Scenario 4: Increase in VAT abatement factor

Unlike government departments in the rest of the UK, VAT charged on the supply of goods and services to NI Executive public bodies is refunded by HMRC.³¹ As a result, the Barnett formula includes a VAT abatement factor of 2.5 per cent for NI only. The estimated cost to HMRC of the VAT relief was £530 million in 2021-22 equivalent to around 3.3 per cent of the NI Executive Block Grant.³² However, the Block Grant for 2021-22 includes £2.3 billion of additional non-Barnett allocations while the baseline level of the Block Grant will include the inherited level of the Block Grant prior to the introduction of the Barnett formula as well as previous non-Barnett additions/deductions that have been made permanent. Scenario 4 is based on an increase in the VAT abatement factor to 5 per cent to reflect the potential cost of the relief.

²⁷ Independent Commission on Funding & Finance for Wales Final Report (July 2010)

<https://www.gov.wales/sites/default/files/publications/2018-10/fairness-and-accountability.pdf> (Chapter 3)

²⁸https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1030043/Statement_of_Funding_Policy_2021_-_FINAL.pdf (Paragraph 3.21)

²⁹ HM Treasury Block Grant Transparency (June 2021) Explanatory Note indicated that Block Grant funding per head of population for the NI Executive was 27 per cent higher than UK Government spending for 2020-21 while that for the Welsh Government was 23 per cent higher. The Holtham Commission estimated that the need for public spending in NI was 21 per cent higher than England while that for Wales was 15 per cent higher.

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/995939/Block_Grant_Transparency_2021_Explanatory_Note_.pdf

³⁰https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1040846/BGT_Explanatory_note_HMT_template_.pdf (Table 4.C)

³¹ Value Added Tax Act 1994 (Section 99) <https://www.legislation.gov.uk/ukpga/1994/23/section/99>

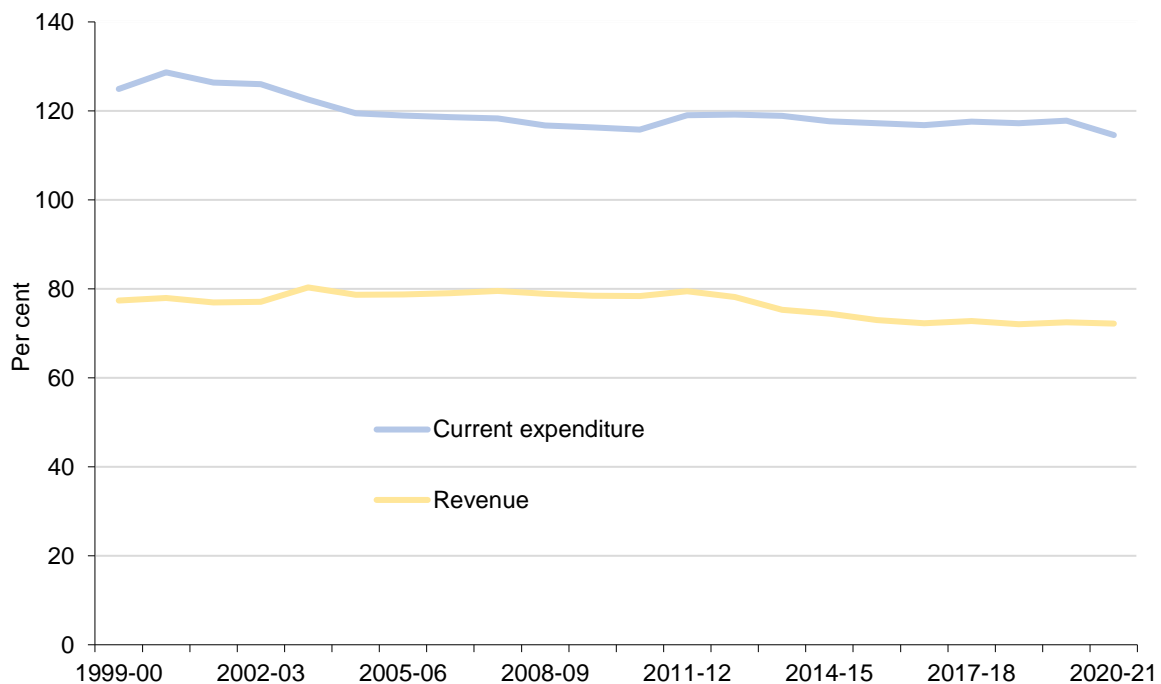
³² HMRC Structural tax relief statistics (December 2021) <https://www.gov.uk/government/statistics/minor-tax-expenditures-and-structural-reliefs>

Scenario 5: Block Grant based on taxes and duties collected from NI

In line with the monetary and fiscal union between the different parts of the UK a long-standing principle is that NI should receive funding sufficient to deliver comparable services to that in the rest of the UK provided that people living in NI are subject to the same taxes and duties. A proportionate reduction would be made to the Block Grant if responsibility for any tax or duty was devolved to offset the loss of income to the Exchequer.

This implicit form of subvention means that while the taxation and duty revenue from people living in NI was 27.5 per cent lower per head of population than England in 2019-20, the level of public spending in NI (including AME spend and spending by Whitehall departments) was 17.8 per cent higher as shown in Chart 10 below.³³ If the NI Executive Block Grant in 2019-20 of £12.7 billion had been based on the amount of taxes and duties collected from people living in NI compared with England, it would have been £6.7 billion³⁴ or 47.2 per cent lower, more than the entire DEL spending by the Department of Health. Scenario 5 involves the Block Grant being set at the amount of taxes and duties collected in NI on a phased basis with the Block Grant per head falling to 72.5 per cent of that in England by 2071-72.

Chart 10 - NI Public sector revenue and current expenditure per head of population as a percentage of England



Source: ONS Country and regional public sector balances

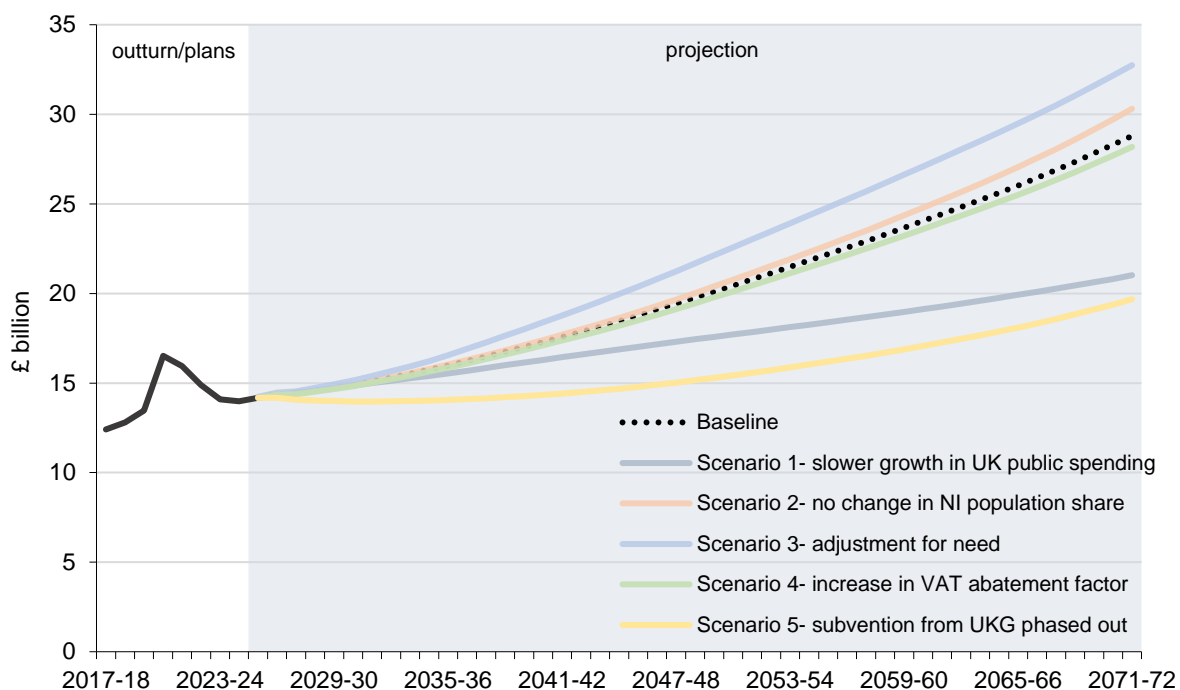
Chart 11 compares the projections of the level of the NI Executive Block Grant under each of the 5 scenarios compared with the baseline projections. Scenario 1 highlights the importance of the OBR assumption that non-interest UK public spending will increase as a proportion of GDP with the NI Block Grant projected to

³³ UK Country and Regional Public Sector Finances (2020-21) <https://www.ons.gov.uk/economy/governmentpublicsectorandtaxes/publicsectorfinance/articles/countryandregionalpublicsectorfinances/financialyearending2021>

³⁴ UK Government equivalent spending per head of population times 72.5 per cent times NI population.

be 27 per cent lower by 2071-72 (compared with the baseline projections) if it is instead assumed that there is no change in the UK public spending share of GDP. In contrast, the Block Grant is projected to be 5 per cent higher than the baseline projections if the NI share of the UK population is not assumed to change (Scenario 2) while including an additional needs adjustment would increase the Block Grant by 14 per cent (Scenario 3). Increasing the VAT abatement factor has a limited impact (Scenario 4) while the largest impact comes from the Block Grant being set at the level of taxes and duties collected from people living in NI (Scenario 5).³⁵

Chart 11 - Alternative scenario projections of the NI Executive Block Grant (2021-22 prices)



Source: NIFC calculations

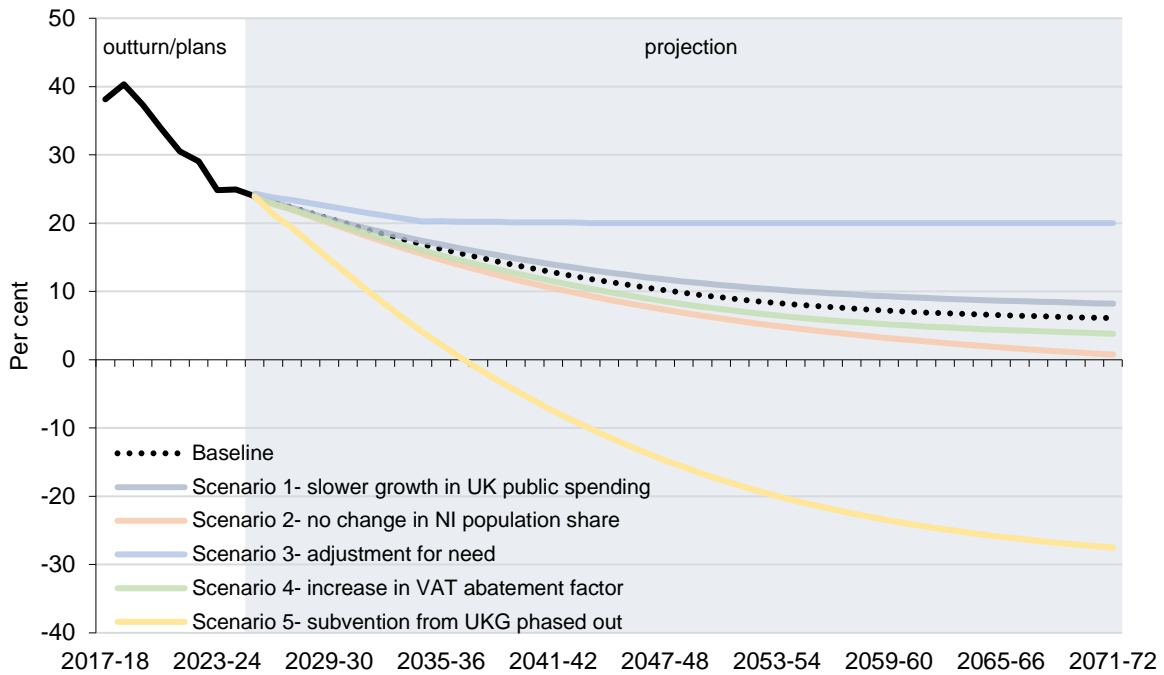
In terms of the Block Grant per head of population, Chart 12 shows that the slower growth in UK public spending under Scenario 1 will result in a less steep rate of convergence than under the baseline projections. Although the NI Executive Block Grant is projected to be higher if NI's share of the UK population does not fall under Scenario 2, this also means that the available funding is spread over more people resulting in a faster rate of convergence in the Block Grant per head of population. By design the additional needs adjustment prevents the NI Block Grant premium falling below 20 per cent under Scenario 3. In contrast the Block Grant per head of population in NI rapidly falls below that in England, even if the subvention is only gradually removed, under Scenario 5. This would have serious implications for the delivery of public services unless replaced by substantial replacement funding from another source.

However, under all the projections other than Scenario 3, the Block Grant per head of population in NI compared with England will fall below the 20 per cent estimate of relative need by the 2030s, representing a challenge to the delivery of public

³⁵ Although referred to as the 'subvention', 'fiscal transfer' or subsidy that NI receives from the rest of the UK, deficits and surpluses are not precise measures of transfer when the UK public sector as a whole is in surplus or deficit

services, albeit less acute than the more fundamental change to the funding arrangements for the NI Executive under Scenario 5. Comparisons of each scenario based on a simplified form of the SFC proposed annual budget gap measure are set out in Charts F.1 and F.2 in Appendix F. Other than under Scenario 3, there is projected to be a significant and growing annual budget deficit in respect of the NI Executive Block Grant over the medium to longer term.

Chart 12 - Alternative scenario projections of the NI Executive Block Grant premium per head of population



Source: NIFC calculations

Areas for further development

The projections set out above represent the first attempt by the NIFC to produce long-term projections for the NI Executive Block Grant. Updated projections will be produced following the publication of new long-term projections for UK public spending by the OBR, expected next in 2024.

Although the projections are considered reasonable there is scope for refinement, as part of the preparation of the next set, in the following areas.

a. Adjust OBR projections for change in NI population age structure

The OBR projections for age-related UK public spending reflect the expected change in the UK population by age group which may differ from that in NI. Therefore, NI population projections could be used to populate the OBR spending projection calculations to provide an indication of the extent to which spending pressures would be different in NI. However, it should be stressed that the NI Executive Block Grant will still be based on the allocations to Whitehall departments and therefore, the UK population age structure projections.

b. Refine linkage between OBR spending projections and UK Government spending plans

A simple approach was adopted to the matching of the OBR projections for the main spending programmes to Whitehall departments. Although there was a close match for Health and Education which account for the majority of UK Government spending equivalent to that by the NI Executive, there is some scope for improvement in respect of the other departments as well as capital spending and Adult social care.

c. Refine comparability factors for minor departments

The comparability factors used to calculate the Barnett consequentials are taken directly from the Statement of Funding Policy. The one exception is Small and Independent Bodies where a simple average of the comparability factors for each of the 24 bodies has been used. This estimate could be improved by reflecting the different budget levels of each organisation when calculating the comparability factor and/or calculating Barnett consequentials for each body.

d. Non-domestic business rates

The long-term projections set out above do not include the impact of changes in non-domestic business rates in England. The Devolved Administrations are responsible for business rates in NI, Scotland and Wales, retaining all the receipts received in addition to their respective Block Grant funding. In England, local authorities retain a portion of the business rates but return the rest to the Exchequer in what is termed by Treasury as the Central Share. This is used to fund public services provided by UK Government departments that can result in Barnett consequentials.

Therefore, there is a need to adjust the Block Grant to ensure that the Devolved Administrations do not benefit from both the business rates generated locally and those collected in England. This is achieved by applying the Barnett formula to an increase or decrease in the Central Share of the business rates in England. For example, changes to business rate reliefs in England were announced as part of the 2021 Spending Review at a cost of £1.6 billion in 2022-23. This resulted in a fall in the Central Share and the funding available for allocation to Whitehall departments which would otherwise have resulted in additional Barnett consequentials. In response, £52 million in additional Barnett consequentials were provided to the NI Executive.³⁶ The OBR projects that taxes, other than those related to the transition to net-zero, will increase broadly in line with GDP, meaning taxes remain largely constant as a share of GDP, which appears a reasonable starting point in making an adjustment to the long-term Block Grant projections.

The impact of non-domestic business rates also complicates the comparisons of Block Grant per head of population. Given that the Central Share of England business rates is included within the UK Government equivalent spending it would be better for this element to be removed, which is not the case for the projections set out above.

³⁶ HM Treasury Block Grant Transparency (December 2021) <https://www.gov.uk/government/publications/block-grant-transparency-december-2021>

e. Use of TME projections for DEL expenditure

The projections for the NI Executive Block Grant are based on the OBR projections for Total Managed Expenditure (TME) applied to the UK plans for DEL, although the largest Annually Managed Expenditure (AME) items such as Pensions and Benefits are projected separately by OBR and are therefore not included. However, in 2019-20 18 per cent of Department of Health & Social Care TME was in respect of AME and 36 per cent for the Department for Education. In addition, there does not appear to be a stable relative position with total UK DEL falling from 57 per cent of TME in 2009-10 to 47 per cent in 2019-20. Therefore, depending on the extent to which OBR adopted a different approach to AME spending, and the impact that this had on the projections, it may be necessary to adjust the projections of UK public spending to better reflect the impact of AME.

f. Use of alternative population projections for NI

In addition to the use of the NI population projections published by ONS, alternative population projections could be produced for NI.

While the changes set out above would be expected to improve the accuracy of the projections of the long-term NI Executive Block Grant it would not be anticipated that they would result in a materially different set of projections to those presented in this paper.

Conclusions

The Block Grant is the main source of funding available to the NI Executive when making budgetary decisions. This means that it has a significant impact on the quantity and quality of public services delivered for the benefit of the people of Northern Ireland. It is therefore important to examine how it is projected to grow over time which is why the NIFC included long term projections in its first Sustainability report. At the same time, it is recognised that the absolute value of the Block Grant in any given year financial year provides little insight on its own. It is for this reason that it is compared with equivalent spending by the UK Government per head of population as well as the planned real terms growth in the Block Grant compared with previous years.

Although the long-term projections set out above suggest that UK public spending will grow broadly in line with the historic average over the coming decades, the application of the Barnett formula means that the NI Executive Block Grant will grow at a slower rate than UK Government equivalent spending, resulting in a gradual convergence in spending per head of population between NI and England. In the context of evidence that the need for public spending in NI is around 20 per cent higher in NI than England, this would imply that there will be a significant challenge in delivering the same level of public services in NI as in England.

While the baseline projections of the Block Grant represent the best available estimate at the current time these were based on assumptions in respect of UK public spending, the relative growth in the NI population and the operation of the Barnett formula. If the actual position is not in line with these assumptions, then the impact on the Block Grant could be significantly different with most of the risk on the downside, further highlighting the need for a floor for the NI Executive Block Grant along the lines of that already agreed for the Welsh Government. At the same

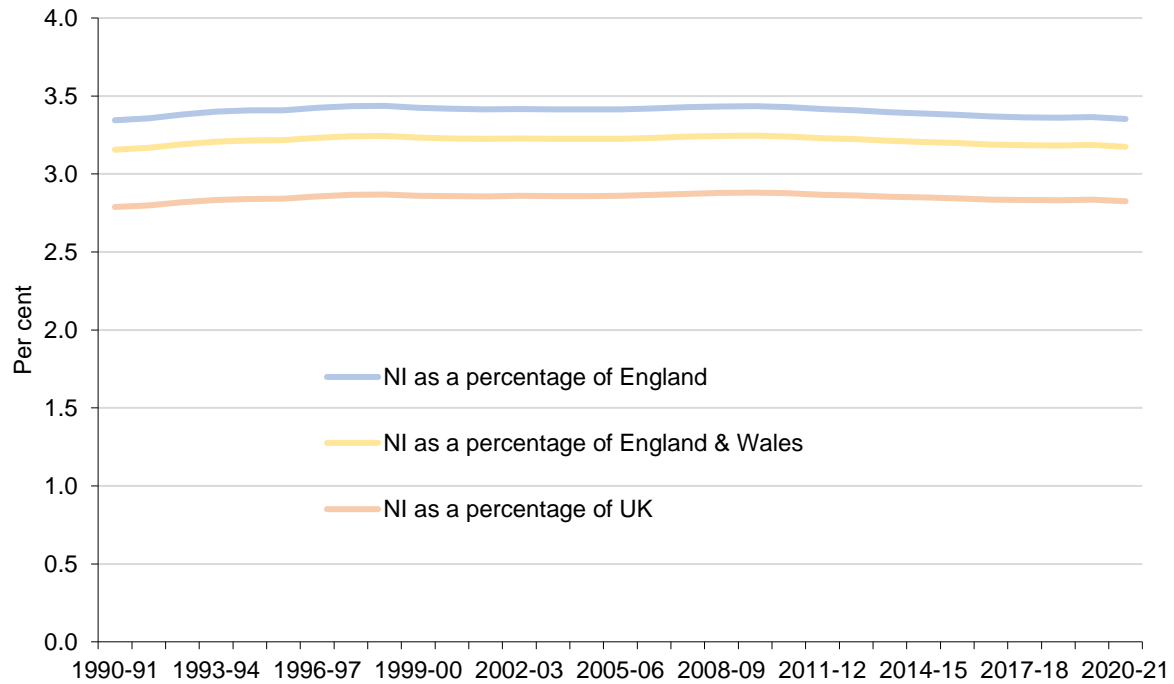
Long-term projections of the NI Executive Block Grant

time, while the Barnett formula has been subject to much criticism and many calls for change, the available budget could be much smaller under more fundamental changes to the funding of public services in NI.

This is the first set of long-term projections produce by the NIFC in respect of the NI Executive Block Grant. These will be built on and developed as part of future Sustainability reviews, hopefully in collaboration with colleagues producing similar projections for the Scottish and Welsh Block Grants.

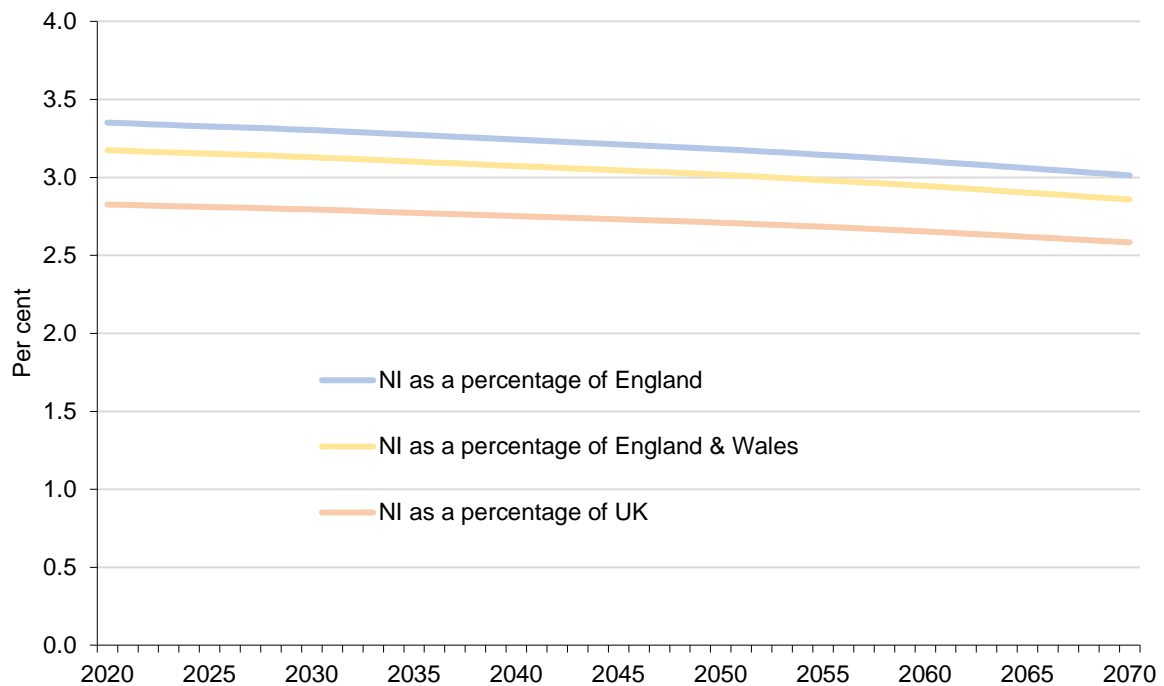
Appendix A

Chart A.1 - NI population as a percentage of the rest of the UK (1990-2020)



Source: ONS

Chart A.2 - NI population as a percentage of the rest of the UK (2020-2070 projections)



Source: ONS

Appendix B

Data Sources

The main data sources used in producing the long projections for the NI Executive Block Grant were:

- (1) OBR long term projections for UK public spending and nominal GDP from the July 2022 *Fiscal risks and sustainability* report supplemented by annual data provided separately by OBR;³⁷
- (2) 2024-25 total DEL spending plans for UK Government departments from the HM Treasury publication *Public Expenditure Statistical Analyses (PESA)*;³⁸
- (3) Barnett formula comparability factors from HM Treasury publication 2021 *Statement of Funding Policy*;³⁹
- (4) ONS population projections for UK nations;⁴⁰ and
- (5) HM Treasury Gross Domestic Product (GDP) deflators for 2017-18 to 2026-27⁴¹ and OBR long term projections.⁴²

³⁷ Fiscal risks and sustainability https://obr.uk/docs/dlm_uploads/Fiscal_risks_and_sustainability_2022-1.pdf (Table 4.9)

³⁸ Public Expenditure Statistical Analyses 2022 <https://www.gov.uk/government/statistics/public-expenditure-statistical-analyses-2022> (Table 1.10)

³⁹ Statement of Funding Policy 2021

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1030043/Statement_of_Funding_Policy_2021_-_FINAL.pdf (Paragraphs B.12 and B.14)

⁴⁰ National population projections - Office for National Statistics

<https://www.ons.gov.uk/peoplepopulationandcommunity/populationandmigration/populationprojections/datasets/2014basednationalpopulationprojectionstableofcontents>

⁴¹ GDP deflators at market prices, and money GDP September 2022 <https://www.gov.uk/government/statistics/gdp-deflators-at-market-prices-and-money-gdp-september-2022-quarterly-national-accounts>

⁴² Fiscal risks and sustainability https://obr.uk/docs/dlm_uploads/Fiscal_risks_and_sustainability_2022-1.pdf (Table 4.2) - 2.3 per cent.

Appendix C

Table C.1 - Calculation of Projected Barnett consequentials for 2025-26

	Increase in Whitehall department budget (£ million)	NI share of Population (%)	Comparability factor (%)	VAT abatement factor (%)	Barnett consequentials (£ million)
	(A)	(B)	(C)	(D)	(A*B*C*D)
Health and Social Care	10,901	3.33	99.5	97.5	352
Education	3,435	3.33	100.0	97.5	111
Home Office	277	3.15	74.1	97.5	6
Justice	193	3.15	99.9	97.5	6
Law Officers' Departments	13	3.15	90.1	97.5	0
Defence	816	2.81	0.0	97.5	0
Single Intelligence Account	61	2.81	0.0	97.5	0
Foreign, Commonwealth and Development Office	197	2.81	0.0	97.5	0
DLUHC - Housing and Communities	149	3.33	100.0	97.5	5
DLUHC - Local Government	214	3.33	100.0	97.5	7
Transport	439	3.33	95.4	97.5	14
Business, Energy and Industrial Strategy	399	3.33	7.1	97.5	1
Digital, Culture, Media and Sport	46	3.33	69.9	97.5	1
Environment, Food and Rural Affairs	118	3.33	96.9	97.5	4
International Trade	9	2.81	0.0	97.5	0
Work and Pensions	326	3.15	97.9	97.5	10
HM Revenue and Customs	86	3.33	3.4	97.5	0
HM Treasury	0	2.81	0.0	97.5	0
Cabinet Office	0	2.81	0.0	97.5	0
Small and Independent Bodies	51	3.33	41.7	97.5	1
Total	17,730				518

Source: HM Treasury PESA 2022 and Statement of Funding Policy

Appendix D

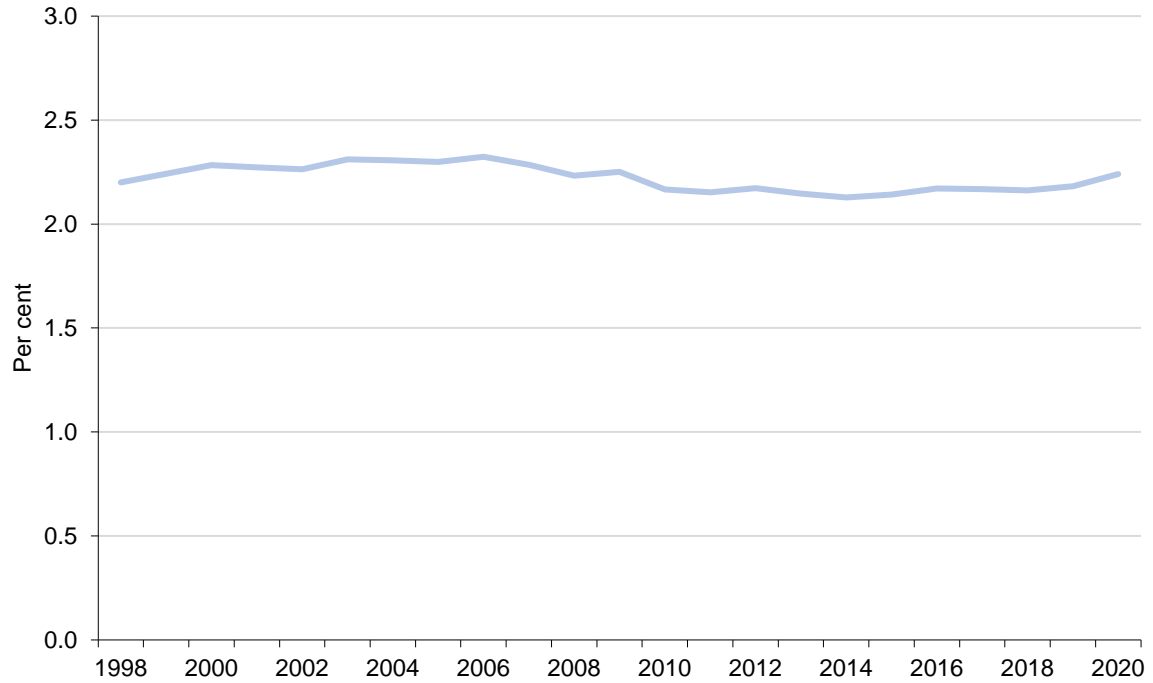
Table D.1 - Calculation of UK Government total DEL equivalent to the NI Executive Block Grant 2021-22

	Outturn Spend (£ million)	Comparability factor (%)	UK Government equivalent spend (£ million)
	(A)	(B)	(A*B)
Health and Social Care	189,758	99.5	188,809
Education	75,681	100.0	75,681
Home Office	15,295	74.1	11,334
Justice	10,187	99.9	10,177
Law Officers' Departments	682	90.1	614
Defence	45,929	0.0	0
Single Intelligence Account	3,356	0.0	0
Foreign, Commonwealth and Development Office	9,282	0.0	0
DLUHC - Housing and Communities	9,001	100.0	9,001
DLUHC - Local Government	21,262	100.0	21,262
Transport	29,728	95.4	28,361
Business, Energy and Industrial Strategy	28,354	7.1	2,013
Digital, Culture, Media and Sport	2,530	69.9	1,768
Environment, Food and Rural Affairs	5,541	96.9	5,369
International Trade	520	0.0	0
Work and Pensions	9,334	97.9	9,138
HM Revenue and Customs	6,185	3.4	210
HM Treasury	411	0.0	0
Cabinet Office	1,439	0.0	0
Scotland	42,247	0.0	0
Wales	19,455	0.0	0
Northern Ireland	15,942	0.0	0
Small and Independent Bodies	2,702	41.7	1,127
Total DEL	544,821		364,864

Source: HM Treasury PESA 2022 and Statement of Funding Policy

Appendix E

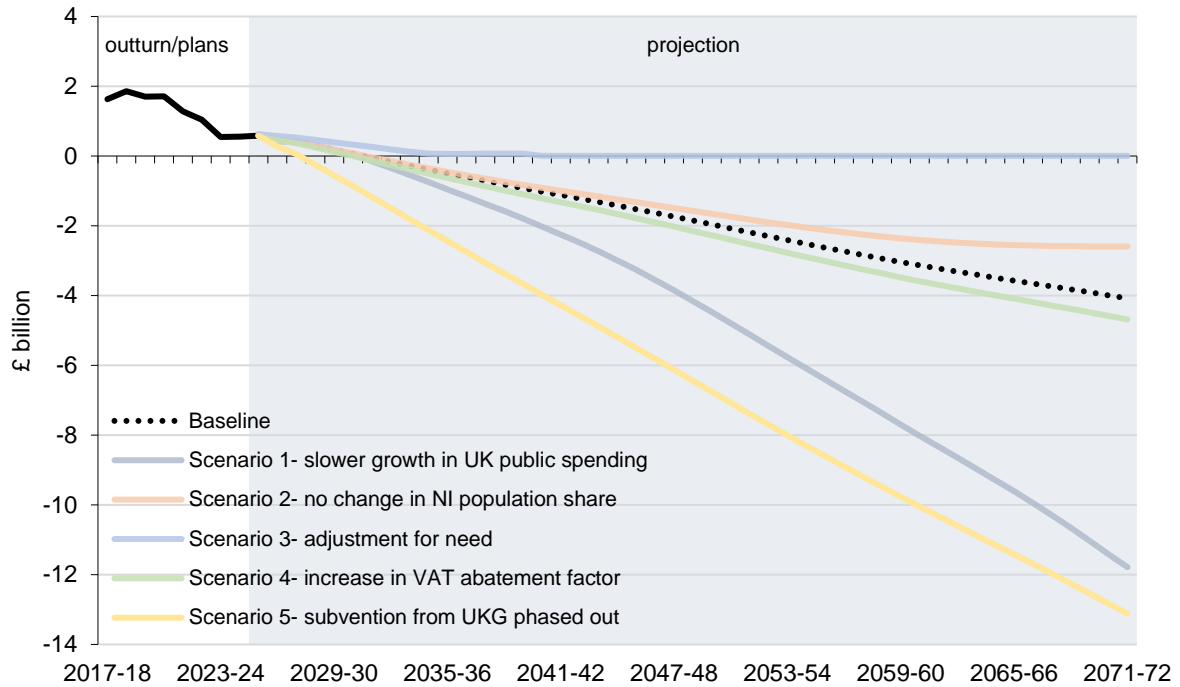
Chart E.1 - NI GDP as a percentage of UK GDP (Gross Value Added at current basic prices)



Source: ONS

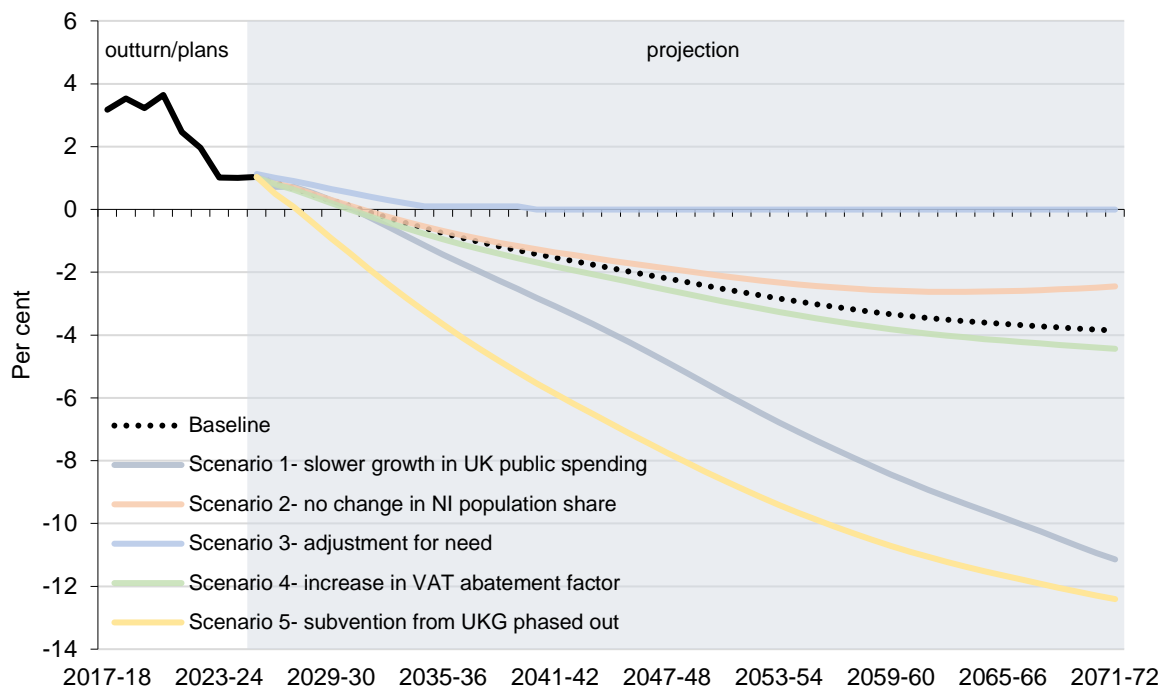
Appendix F

Chart F.1 - Projected NI Executive Block Grant Annual Budget Surplus/Deficit (£ billion in 2021-22 prices)



Source: NIFC calculations

Chart F.2 - Projected NI Executive Block Grant Annual Budget Surplus/Deficit as a percentage of projected NI GDP



Source: NIFC calculations