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

Northern Ireland's public finances and the UK Government's financial support package for the restored Executive

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Introduction

Unlike the UK Government, Northern Ireland (NI) is required by legislation to run a balanced budget when paying for public services.[1] But in 2022-23 spending by NI departments ran 2 per cent ahead of available funding and the Treasury had to provide a £297 million short-term loan from its Reserve to bridge the gap. Far from running a surplus this year to pay the money back – as Treasury rules in principle require – the budget gap has widened further and in the absence of further funding could have been on course to reach around £1 billion if public sector workers get backdated pay deals in line with their counterparts in Great Britain.

Against this backdrop, on 11 December 2023 the UK Government offered the NI political parties a multi-part package of short- and longer-term financial support if they returned to Stormont. The parties said that this was insufficient and the UK Government put a more generous package on the table on 19 December. Following the amendments to the Windsor Framework sought by the Democratic Unionist Party and the subsequent publication of the UK Government's Command Paper, the Secretary of State published a summary on 13 February 2024 outlining the detail of the deal as set out in the settlement letter from HM Treasury.[2] In the light of the settlement, the new Executive will now have to set a balanced Budget for 2024-25 and prepare a fiscal sustainability plan to unlock some parts of the package.

The Council has provided informal support and information when asked during the negotiations, but with details of the settlement now published we[3] thought it would be useful to provide a briefing on the current budget difficulties and the financial package. We welcome the fact that the package has been set out in greater detail than some of its predecessors, but questions and uncertainties remain. We focus on three issues: first, the operation of the proposed Welsh-style 'needs-based factor in the Barnett Formula' when the Block Grant funding premium relative to England would approach need from below rather than from above as in Wales; second, the possible 'cliff-edge' drop in funding in 2026-27 when one short-term component of the package expires; and third, the 'strings attached' to some parts of the package.

The rest of the briefing describes:

- The scope of the NI budget.
- How the Block Grant is determined.
- Why NI departments have been overspending against available funding.
- What the UK Government offered the parties to return to Stormont.
- Some implications and uncertainties around the funding package.

[1] Individual Whitehall departments must not spend more than the level of funding approved by Parliament each year.
[2] https://www.gov.uk/government/news/uk-government-confirms-33bn-spending-settlement-for-restored-northern-ireland-executive
[3] The Northern Ireland Fiscal Council was established in 2021. It is chaired by Sir Robert Chote and the other members are Maureen O'Reilly, Professor Alan Barrett and Dr Esmond Birnie. Our aim is to bring greater transparency and independent scrutiny to the region's public finances, to inform both public debate and policy decisions to the benefit of everyone in NI.

1. What does the NI budget cover?

Whether it is the Executive or the UK Secretary of State in charge, the NI budget has three main components (within its 'Departmental Expenditure Limits' or DELs) and in each one spending is supposed to be kept in line with available funding:

- Day-to-day resource spending on public services and administration (including the pay of public sector workers), largely funded by the UK Government Block Grant, with smaller contributions from fees and charges and rates on domestic and non-domestic properties.

- Conventional capital spending, largely funded by the Block Grant with a smaller contribution from borrowing (subject to an annual limit set by the UK Treasury and a cumulative limit set out in legislation).

- Financial transactions capital spending, which can only be used to inject capital into or lend to the private sector (including universities), funded by the Block Grant. This funding stream is routinely underspent.

Capital spending (on infrastructure and the like) helps determine the quality and quantity of public services that departments and public bodies can deliver in the long term and is also potentially important for economic growth and development. But the present challenges are most acute in the resource budget, which is by far the largest component of this departmental spending at £14.3 billion or roughly £18,700 per household (net of spending financed by fees and charges) in 2022-23. The conventional capital spending allocation was £2.0 billion or £2,600 per household.

Table 1 shows where the Secretary of State's final resource budget was allocated in 2022-23, by department. Health (which is integrated with social care in NI, unlike in England) accounted for around half the budget, with education and justice the next largest spenders. The NI departments have relatively broad responsibilities, delivering some services (notably social care and education) that are delivered or funded by local councils or by the UK Government in the other nations/regions.

Table 1.1 - NI departmental resource budgets 2022-23

£ million	2022-23	Percentage of total departmental allocations
Health	7,343	51.2
Education	2,648	18.5
Justice	1,185	8.3
Communities	853	5.9
Economy	781	5.4
Agriculture etc.	564	3.9
Infrastructure	522	3.6
Finance	179	1.2
The Executive Office	154	1.1
Minor departments	112	0.8
Departmental allocations	**14,341**	**100.0**

Source: NIO

Unlike its Scottish and Welsh counterparts, the NI Department for Communities has responsibility for almost all state pension and social security spending in the region. To the extent that the generosity of these systems is kept in line with the rest of the UK, as has largely been the case since NI was established in 1921, the cost[4] is treated by the Treasury as 'Annually Managed Expenditure' (AME) and met directly by the UK Government separately from the Block Grant (and so does not appear in Table 1). But if the NI Executive decides to be more generous, the additional cost must be met from its resource budget, from the Block Grant, rates, fees and charges.

[4] Administration costs are treated as DEL and have to come from the resource budget

2. How is the Block Grant determined?

The UK Government Block Grant covers around 95 per cent of the Executive's DEL expenditure (i.e. departmental resource and capital spending). This is higher than the proportions in Scotland and Wales, where their governments have greater tax-raising and borrowing powers. The Scottish and Welsh Governments levy income, property transactions and landfill taxes, with their Block Grants reduced to reflect the revenue foregone by the UK Government. The NI Executive levies only domestic and non-domestic rates, referred to as the 'Regional Rates'. NI's 11 local councils also levy their own domestic and non-domestic rates.

The resource portion of the Block Grant has two components: a historic core element adjusted over time according to the Barnett Formula and smaller 'non-Barnett additions'. The latter include special funding packages associated with political agreements to sustain or restore the Stormont institutions, such as the New Decade New Approach agreement in 2020,[5] as well as funding for City and Growth Deals. These funding packages are typically time-limited and earmarked for particular purposes, rather than available for the Executive to spend as it wishes.

The core resource Block Grant amounted to approximately £1.9 billion in 1979-80 (£9.0 billion in 2022-23 prices) and since then has been adjusted each year according to the Barnett Formula.[6] This ensures that when the UK Government changes departmental budgets for spending in England, Wales or Scotland for which the UK Government is responsible for in those nations, but the Executive is responsible in NI, the Block Grant increases by roughly the same amount in cash terms per head. These additions are referred to as 'Barnett consequentials'. (NI's 'raw' Barnett consequentials are reduced by 2.5 per cent as a rough-and-ready adjustment for the fact that the NI Executive can reclaim VAT on a greater proportion of its spending than Whitehall departments and the other devolved administrations – putting it in a position more similar to local authorities in Great Britain.) The resource Block Grant allocation totalled £13.5 billion in 2022-23, comprising the £13 billion core component and £0.5 billion in non-Barnett additions.

The Block Grant has always been higher per head in Scotland, Wales and NI than equivalent spending by the UK Government in England. The UK Government has long recognised that this is appropriate "broadly reflecting that the costs of providing public services are also higher in these nations than the UK average".[7] Unfortunately, as we discuss further below, the Treasury does not publish a consistent time series estimate of this premium, but the Secretary of State did say on 20 September 2023 that "the NI Executive receives around 20 per cent more per head than equivalent UK Government spending in other parts of the UK".[8]

Various studies have estimated the 'need' for higher public spending per head in the devolved administrations, with the most recent cross-nation study undertaken by the Holtham Commission in 2010 based on indicators including population sparsity, income deprivation, ill health, ethnicity and numbers of children and old people. If

[5] https://assets.publishing.service.gov.uk/media/5e178b56ed915d3b06f2b795/2020-01-08_a_new_decade__a_new_approach.pdf
[6] https://archive.niassembly.gov.uk/io/research/1201.pdf
[7]https://assets.publishing.service.gov.uk/media/655c909b046ed400148b9d2f/Statement_of_Funding_Policy_November_2023__FINAL_.pdf (paragraph 2.9)
[8] https://www.gov.uk/government/news/secretary-of-state-writes-to-northern-ireland-civil-service-on-sustainable-public-finances

spending per head in England is £100, Holtham concluded that the need for spending per head to deliver equivalent services was £121 in NI (excluding policing and justice), £115 in Wales and £105 in Scotland. Actual spending per head at the time would have been higher than estimated need in Scotland and NI (although no precise estimate was published as part of the Holtham Review) but was slightly lower in Wales (at £112). The Barnett Formula was only ever intended to be a short-term arrangement, but the historic generosity of Scottish Block Grant funding relative to estimated need has long been cited as an obstacle to replacing it with an explicitly needs-based funding mechanism applied uniformly across the UK. (Public spending per head is currently 15 per cent higher in Scotland than the UK average.[9])

The NI Fiscal Council updated the Holtham estimate of relative need for NI in a relatively broad-brush way in May 2023 to reflect the latest data and the devolution of responsibility for policing and justice to the Executive in 2010.[10] Our central estimate was slightly higher than Holtham's at £124 for every £100 spent in England (which for simplicity we refer to as a relative need of 124 or a premium of 24 per cent), largely reflecting the presumed need for relatively high spending on policing and justice as result of NI's unique political and security situation. But both we and Holtham noted that our precise estimates were sensitive to many judgements, for example the weighting given to different indicators, whether you consider each administration's ability to raise tax revenue and the way in which relative need for spending on policing and justice is estimated and incorporated.

[9] https://researchbriefings.files.parliament.uk/documents/SN04033/SN04033.pdf
[10] The Northern Ireland Act 1998 (Devolution of Policing and Justice Functions) Order 2010 https://www.legislation.gov.uk/uksi/2010/976/contents/made

3. Why have NI departments been overspending?

There are probably several reasons why departmental spending has been running ahead of available funding for the past two years. Among them:

Structural features of NI budget management and control

Even in normal times the NI Department of Finance is in a less powerful position than the UK Treasury to keep tight control over departmental spending. This in part reflects the greater legislative autonomy of NI departments, relative to Whitehall ones, as well as the fact that the Executive is designed to be a multi-party coalition in which Ministers do not take collective responsibility for its decisions and actions. In contrast to Scotland, each NI department also has a separate Accounting Officer, reinforcing the autonomy of individual departments.

Past decisions on spending and revenue raising

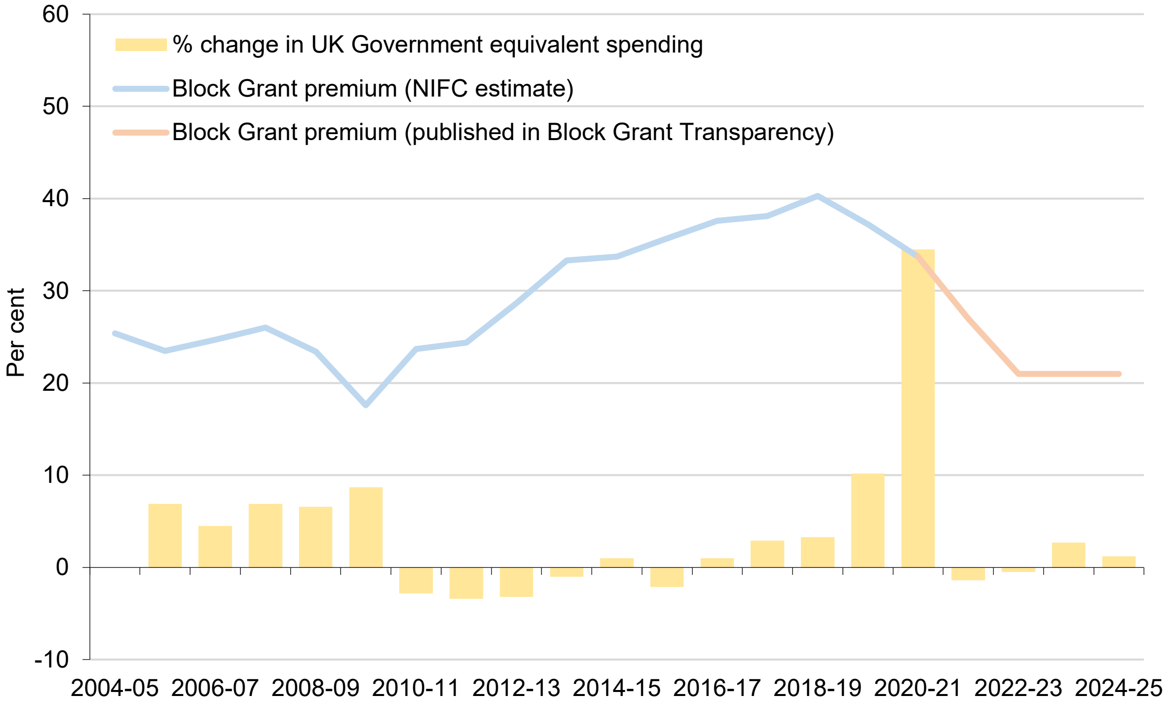
The NI Executive has in the past tended to take decisions on public service provision, welfare payments and revenue raising that are on balance more generous than in GB, crowding out other potential calls on the resource budget. These include the absence of domestic water charging, lower levels of rates and greater rate reliefs, welfare reform mitigations, lower tuition fees, more generous concessionary travel, free prescriptions and covering domiciliary care costs. These 'super-parity' decisions cost more than £600 million in 2021, far outweighing rarer 'sub-parity' decisions, notably less generous financial support for childcare. Super-parity decisions were more affordable in the past because the funding premium relative to England was significantly higher than relative need.

The ongoing 'Barnett squeeze'

As we have noted, when the UK Government increases spending per head in England on services that the Executive provides in NI, under the Barnett Formula the Block Grant increases by an equivalent amount per head in cash terms. But because the Block Grant is higher per head to begin with, this gradually erodes the percentage premium by which it exceeds spending per head in England – and thus the ability of NI to maintain the relative quality and quantity of public services. This 'Barnett squeeze'[11] goes into reverse when UK Government spending in England is being cut.

[11] https://www.nifiscalcouncil.org/publications/press-release-sustainability-report-2022

Chart 3.1 – NI Block Grant per head (excluding depreciation and impairments) premium compared with UK Government equivalent spending in England



Source: HM Treasury PESA and Block Grant Transparency, NIFC calculations

Chart 3.1 shows our own estimates of the premium by which the NI Block Grant per head exceeds equivalent UK Government spending in England, based on spending statistics published last summer. Where explicit Treasury estimates have been published for recent years, we have used those, indicated by the pink line. But it has been impossible to secure a consistent and up-to-date Treasury back series. This is regrettable, especially since as part of the funding package (as we describe below) the UK Government has included a mechanism to move the premium towards 24 per cent over the long term, but we cannot be sure from what starting point. The most recent Treasury figures (published in its Block Grant Transparency publication in December 2021) show an expected premium of 21 per cent over the three years of the current Spending Review, but that may have changed as subsequent budget allocations added to the Barnett squeeze.

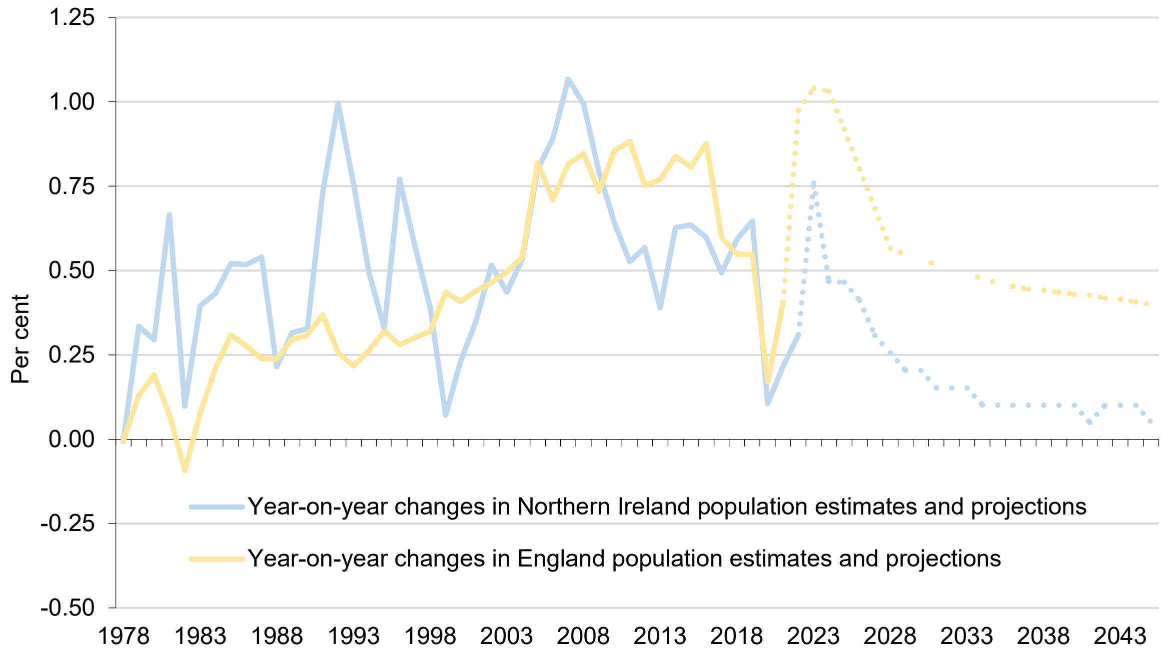
These estimates of the premium show the Barnett squeeze easing during the post financial crisis 'austerity' period and then tightening more recently as the UK Government stepped up public services spending following the Brexit vote. This illustrates the 'Barnett paradox' highlighted in our *Sustainability Report 2022,* namely that the faster the Block Grant rises in absolute terms, the faster it shrinks relative to equivalent UK Government spending in England.[12] The recent fall in the Block Grant premium has been compounded by the expiry of some of the non-Barnett additions arising from previous political agreements. It may well be that the level of the premium is less important as a driver of recent overspending than the relatively rapid pace with which it has declined in the last few years.

[12] https://www.nifiscalcouncil.org/publications/press-release-sustainability-report-2022 and https://www.nifiscalcouncil.org/publications/sustainability-report-2022

In addition to the impact of Barnett consequentials and non-Barnett additions, the premium of Block Grant funding per head over equivalent UK Government spending in England is also affected by changes in the relative size of the NI and English populations, because the historic component of the Block Grant to which the Barnett consequentials are added is not adjusted for these changes. Assume, for example, that in year 1 the NI Block Grant was 20 per cent higher than equivalent UK Government spending in England and that in year 2 there is no change in UK Government spending (and therefore no Barnett consequentials) but that the NI population is static while the English population grows by 2 per cent. This would increase the premium from 20 per cent to roughly 22 per cent, increasing the relative generosity of NI's funding per head but not the absolute amount paid.

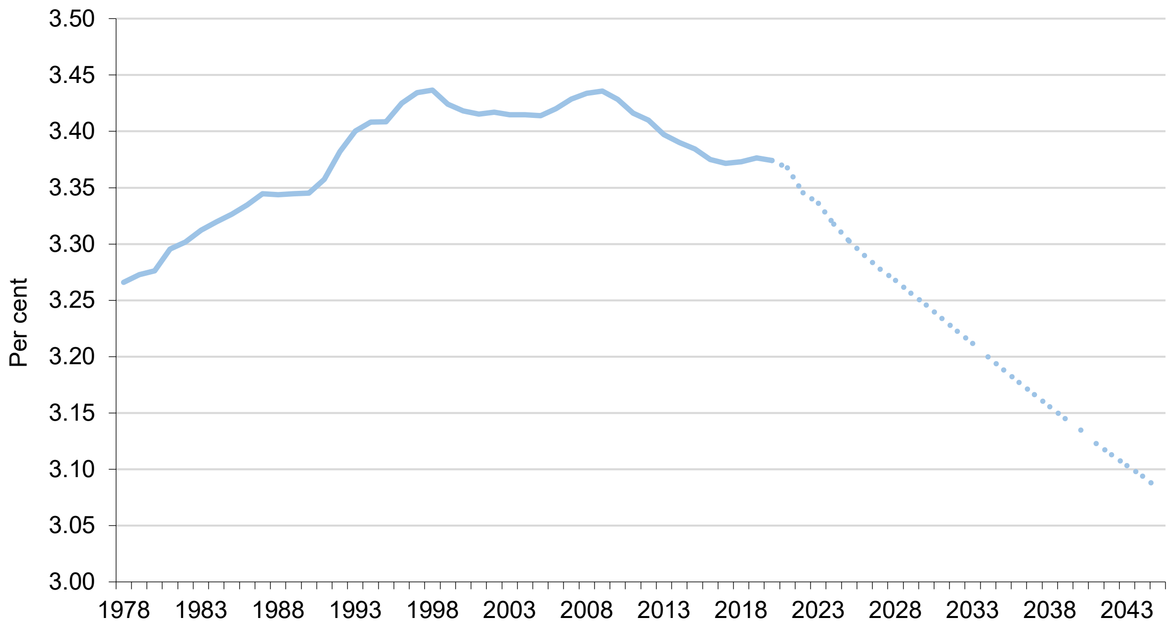
Charts 3.2 and 3.3 show the year-on-year growth in the NI and English populations since the Barnett Formula was first implemented and over the next 20 years as projected by the Office for National Statistics (ONS), and the consequences for the size of the NI population relative to England's. The NI population rose relative to England's from the late 1970s to the late 1990s, which would have reinforced the Barnett squeeze over this period. NI's population was then broadly stable relative to England's through the first decade of the 2000s, before falling in the 2010s. The fall during the 2010s would have reinforced the 'Barnett loosening' of relative funding as UK spending was cut during the austerity period, helping to explain the rise in the premium shown in Chart 3.1. The latest ONS projections – published on 30 January 2024 – show the fall in the NI population relative to England's continuing over the next 20 years, and more rapidly than in the previous projection (in part because of higher assumed net immigration which is thought more likely to flow into England than NI). The NI population is projected to grow by 3.4 per cent over this period, compared to 10.9 per cent growth in England. But projections of this sort are course uncertain, and the outturn figures quite variable as Chart 3.2 shows.

Chart 3.2 – Year-on-year growth in NI and English population



Notes: Percentages are based on mid-year estimates and mid-year projections. 2021-based interim projections shown as dotted line
Source: ONS

Chart 3.3 – NI population as a percentage of England's population



Notes: Percentages are based on mid-year estimates and mid-year projections. 2021-based interim projections shown as dotted line

Source: ONS

Inflation and public sector pay pressures

The longer-term financial pressures arising from the Barnett squeeze have been compounded by the unusually high rates of inflation that the UK has experienced over the last two years, resulting from the overheating economy and rises in energy and fuel costs triggered by the Ukraine war. These have increased the cost of delivering public services both directly and by prompting higher public sector pay settlements. The UK Government has increased its cash spending plans somewhat in response, having already provided a relatively generous settlement as part of the 2021 Spending Review. This has generated Barnett consequentials that increase the Block Grant. But this has intensified the Barnett squeeze in a particularly acute way.

We noted earlier that increases in comparable UK Government spending per head in England are matched in cash rather than percentage terms in increases in the Block Grant. So if the UK Government were to decide to increase spending by x per cent – to finance an x per cent pay settlement or to accommodate an x per cent increase in the costs – the increase in the Block Grant would not be sufficient to do so in NI. If NI departments choose to match the pay settlement or accommodate the cost increases, they would have to make savings elsewhere or overspend. And we have estimated that if the NI departments were not to overspend this year they would already have to reduce resource spending by 3.3 per cent this year compared to a 0.7 per cent equivalent cut for Whitehall departments.[13]

[13] https://www.nifiscalcouncil.org/publications/nios-2023-24-budget-northern-ireland-initial-summary

Pay pressures are also particularly challenging for the NI budget because of its relatively high level of public sector employment – 11.6 per cent of the population compared to about 8.1 per cent for England.[14] Take health workers, for example. There are around 59,000 Agenda for Change[15] (FTE) staff in NI compared with 1,078,000 in England.[16] If the NHS/HSC gave all staff a £1,000 bonus,[17] it would cost £59 million in NI and £1,078 million in England. A £1,078 million increase in funding for England would yield around £36 million in Barnett consequentials for the NI Block Grant - £23 million less than would be required to deliver pay parity.

The absence of the Stormont institutions

Managing the NI budget in the face of the Barnett squeeze and an inflation shock would be hard at the best of times, but the underlying structural challenges to budget management in NI are compounded during periods when the Stormont institutions are absent.

The NI Executive and Assembly ceased functioning on 4 February 2022, having failed to agree a Budget for 2022-23 that departments could use as firm plans. Departmental Ministers remained in office and in charge of spending as 'Caretaker Ministers' but knew that they would be so only until 28 October 2022 and not to the end of the financial year. Departments were given indicative planning envelopes representing funding that they might reasonably expect to receive in a budget brought to a future Executive. But they were also told that some money was being held centrally for later allocation. The Finance Minister advised colleagues not to cease services where there was a reasonable expectation that their department would receive further funding, but also not to spend too much. Not surprisingly, this encouraged Ministers to overspend the sum held centrally, presumably in part based on mutually inconsistent assumptions about the size of the slices of this cake that each would receive. The unusual governance structure of Ministers without an Executive led to less clarity about accountability, and an undermining of normal spending scrutiny processes. The absence of an Executive also prevented the Department of Finance from carrying out the 'In-Year Monitoring Rounds' at which it usually adjusts spending allocations to reflect changing needs and overall funding.

At the end of the caretaker period, responsibility for managing the budget passed to the Secretary of State for NI working with the NI Civil Service in departments. Despite approving a costly pay award for health staff after Ministers had stepped down, they succeeded in roughly halving the projected overspend in 2022-23 to £297 million, with the Treasury agreeing on 27 April 2023 to provide a short-term loan from the Reserve to make up the difference. Normally this would have to be repaid in the following year, but the Treasury acknowledged that this was unrealistic and said that it could be repaid using any new 2023-24 Barnett consequentials and

[14] ONS Public Sector Employment dataset 21 December 2023 https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/publicsectorpersonnel/datasets/publicsectoremploymentreferencetable and ONS population estimates 30 January 2024 https://www.ons.gov.uk/peoplepopulationandcommunity/populationandmigration/populationprojections/datasets/2014basednationalpopulationprojectionstableofcontents

[15] Agenda for Change is the current NHS grading and pay system for NHS staff across England, Wales, Scotland and Northern Ireland, with the exception of doctors, dentists, apprentices and some very senior managers.

[16] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1092270/NHSPRB_2022_Accessible.pdf (para 4.132)

[17] https://www.bbc.co.uk/news/uk-64973045

some unspent earmarked funding packages, with any residual to be repaid in 2024-25. Around £92 million of Barnett consequentials have been set against the Reserve claim to date.

However, the spending pressures have only intensified in 2023-24 and neither the Secretary of State nor the NI Civil Service have felt they have the legal authority and/or political legitimacy to take significant decisions to axe spending commitments or raise more revenue. The breaching of spending limits in 2022-23, and the inevitable need for the Treasury to provide a short-term bail-out, may also have removed some of the fear and stigma from departmental overspending and changed behaviour accordingly. That effect could be compounded as a result of the even larger overspend that would have been anticipated this year in the absence of additional funding being agreed.

4. What has the UK Government agreed?

To encourage the Democratic Unionist Party to allow a return to Stormont, the UK Government put forward a potential financial support package for a returning Executive on 11 December 2023 and then a more generous one on 19 December 2023 when the parties said that the first was insufficient. Following the DUP's decision to return, in response to amendments to the Windsor Framework, further negotiations on the financial package took place and the Secretary of State published a summary of the final settlement on 13 February 2024 containing modest changes from the 19 December proposal.[18] The settlement offers upfront financing to deal with the near-term budget problem as well as an adjustment to the operation of the Barnett Formula that would move funding towards our broad-brush estimate of relative need and end the long-term Barnett squeeze.

The package published on 13 February 2024 has eight main components. These are:

- One-off funding of up to £584 million to meet pay pressures in 2023-24 through a claim on the Treasury Reserve that the Executive need not repay. This would cover much of the £634 million that a leaked letter from the Head of the NI Civil Service[19] indicated would be needed annually to maintain "broad parity" between pay in the NI public sector and in Great Britain, the majority of which relates to health and social care staff. If the Executive chose to spend less than £584 million on a backdated pay deal, there is flexibility for the rest to be used to help address the non-pay overspend.

- A Welsh-style 'needs-based factor' that will apply from 2024-25 and see future Barnett consequentials received by NI increased by 24 per cent. The Secretary of State indicates this is worth £785 million over the next 5 years. As discussed below, this would move NI's total funding per head gradually towards 124 percent of spending in England, but not take it straight there.

- An additional one-off £520 million of funding in each of 2024-25 and 2025-26, roughly the amount that the NI Department of Finance estimates that departments would have gained had the proposed 24 per cent Barnett uplift been put in place at the last UK Spending Review in 2021.

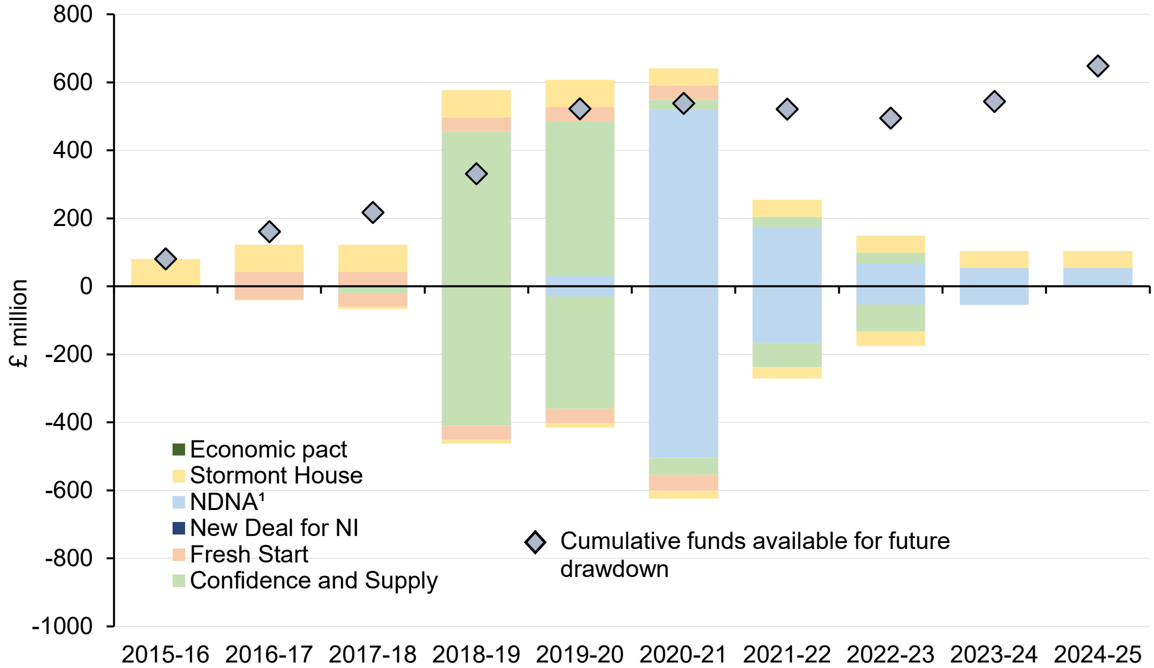
- Deferring up to £559 million of debt repayments for two years. This includes the £297 million claim on the Reserve to cover the overspend in 2022-23, which leaves £262 million to put towards non-pay overspend pressures this year. Should the 2023-24 pressures exceed this, there is flexibility to utilise some of the £584 million allocated for pay pressures. This debt will be written off entirely if the Executive publishes a plan to deliver sustainable public finances and services by May 2024[20] and then implements it.

[18] https://www.gov.uk/government/news/uk-government-confirms-33bn-spending-settlement-for-restored-northern-ireland-executive
[19] https://www.irishnews.com/news/northern-ireland/urgent-action-needed-civil-service-head-jayne-brady-tells-heaton-harris-5PQZWJUBAJOQJCRCNFSPOWHDUQ/
[20] https://www.finance-ni.gov.uk/publications/letter-finance-minister-chief-secretary-treasury

What has the UK Government agreed?

- The Executive will have increased spending power of up to £708 million generated through the reprioritisation of existing UK Government funds (£623 million) and new UK Government funding streams (£85 million), with £235 million earmarked for public services transformation. This funding will be available over a five-year period starting in 2024-25, with the earmarked public services transformation element to be released at the discretion of a (yet to be established) Public Sector Transformation Board. We assume that the reprioritisation element refers to some of the stock of unspent funding from previous non-Barnett additions to the Block Grant (such as those relating to political agreements) and UK Government-administered funding pots including Levelling Up. Chart 4.1 illustrates the funding offered (above the axis) and spent (below the axis) under various packages in recent years. The cumulative stock of such funding is set to reach £650 million next year, with the main sums left unspent from the Stormont House Agreement and New Decade New Approach in 2020 (the most recent such agreement).[21]

Chart 4.1 – NI's political agreement funding and expenditure from 2015-16 to 2024-25



Note: excludes non-Barnett packages packages run by NIO (NDNA and New Deal funding)
Source: Department of Finance

- An additional £34 million to tackle hospital waiting lists exacerbated by Covid, presumably by allowing some of the backlog to be treated in the private sector. The Department of Health has estimated that a five-year plan to substantially reduce waiting lists and meet long-term demand could cost £700 to 900 million.[22]

[21] For more information on non-Barnett funding see our Comprehensive Guide https://www.nifiscalcouncil.org/publications/public-finances-ni-comprehensive-guide-november-2021 (pages 50-54)
[22] https://www.niauditoffice.gov.uk/files/niauditoffice/documents/2023-10/NI%20Audit%20Office%20Report%20-%20Tackling%20Waiting%20Lists.pdf (page 9)

- A 10 per cent increase in the £200 million annual limit on capital borrowing by the Executive under the Reform and Reinvestment Initiative (RRI) in 2024-25, followed by increases in line with inflation. This is forecast to provide around £135 million of additional borrowing capacity by 2028-29.

- The UK Government commits to open discussions with the Executive on a new Fiscal Framework. This might include the possibility of devolving more tax-raising powers, following the example of Scotland and Wales and reflecting the May 2022 report of the NI Fiscal Commission.[23] The Executive has indicated it could discuss in greater detail the current level of need in NI, which the Council has estimated in a broad-brush way to be around 124 per cent of that in England.[24] The Framework would need to put in place the precise details of how the needs based adjustment would work. It might also consider how the Treasury would treat the uplift at any future point where total funding was to exceed relative need, either as a result of population changes or non-Barnett additions. The discussions might also cover the Executive's resource borrowing powers and whether it should run a contingency reserve (like Scotland and Wales) to smooth its spending rather than relying on Budget Exchange which only limited underspends to be carried forward from one year to the next.

[23] https://www.fiscalcommissionni.org/evidence/fcni-final-report-more-fiscal-devolution-northern-ireland
[24] https://www.executiveoffice-ni.gov.uk/news/executive-discuss-financial-stability-prime-minister#_ftn1

5. Questions raised by the package

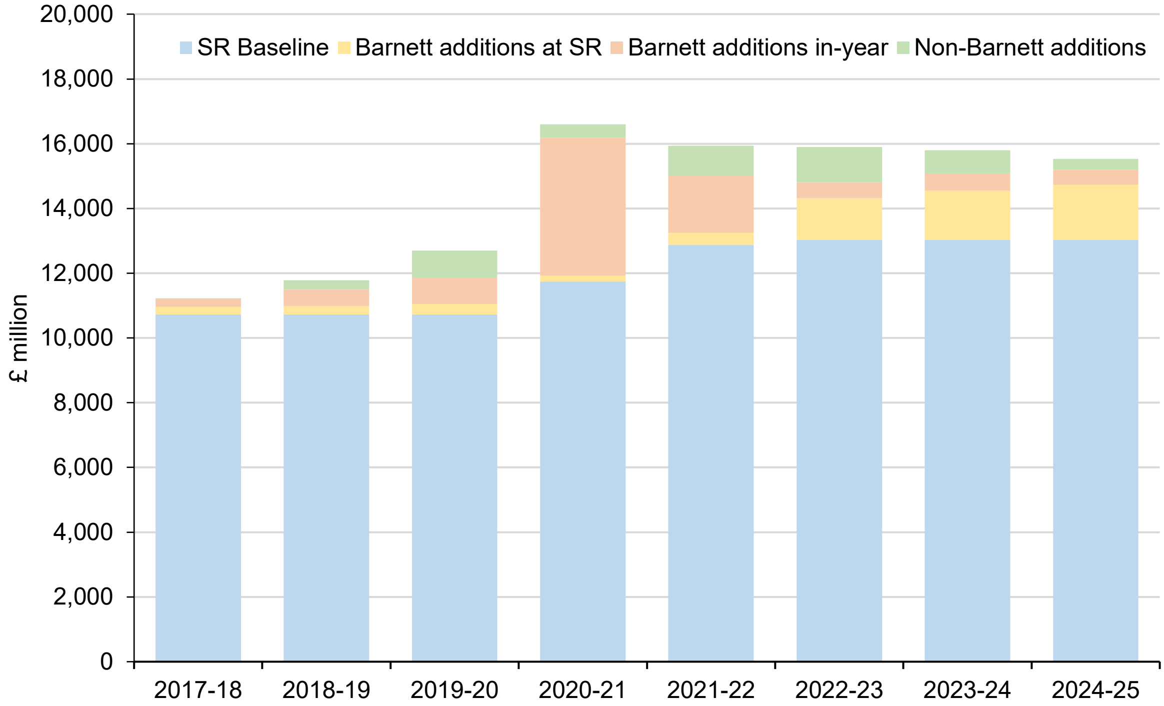
Reflecting the UK Government's discussions with the NI Civil Service, as well as with the parties, the funding package has two objectives: first, to stabilise the short-term budget crisis and, second, to move to a more sustainable long-term funding model that would support public service transformation and make future crises less likely.

As detail of the package has now been published, attention may well focus on three questions: first, does the package deliver a realistic prospect of Block Grant funding in line with 'need'; second, does the short-term budget support on offer provide stability or imply a disruptive and implausible 'cliff-edge' when it expires; and third, how will decisions be taken on components of the package that have conditions attached?

Does the package deliver funding equal to estimated need?

As we have noted on many occasions, a key feature of the Barnett Formula is that it determines changes in the core Block Grant from one year to the next but not its aggregate level in a bottom-up way. There is no explicit connection between the overall levels of funding per head generated by the Formula and estimates of relative need. At the beginning of each UK Spending Review, the Treasury sets a baseline for the core NI Block Grant that reflects core funding in the previous year minus any Barnett consequentials that arise from temporary or one-off increases in equivalent UK Government spending that will not carry through to future years. Any subsequent changes in equivalent UK Government spending generate Barnett consequentials that cumulate over the Spending Review period until the baseline for next Review is set. As noted, the Formula adjusts for relative population size so that any rise or fall in equivalent UK Government spending per head is broadly matched in cash terms by a rise or fall in the Block Grant per head. Chart 5.1 shows the core Block Grant broken into baselines and Barnett consequentials in recent years, with the spike in 2020-21 reflecting the impact of Covid-related spending.

Chart 5.1 – Sources of funding for the NI Block Grant



Source: Block Grant Transparency

As noted above, because the core Block Grant per head was well above equivalent UK Government spending when the Barnett Formula was first implemented, and because the Formula matches spending increases with Block Grant increases in cash rather than percentage terms, other things being equal the percentage premium of the Block Grant over equivalent spending will gradually tend to zero (in other words, a relative funding level of, say, 120 will tend over time towards 100).

Under the funding settlement, NI's future Barnett consequentials will be increased by 24 per cent (reflecting our broad-brush estimate of relative need) from 2024-25. This mechanism is based on the deal agreed between the UK and Welsh Governments in 2016 following the Holtham Commission. Holtham estimated that Wales had a relative spending need of 115. At the time of the agreement the Treasury estimated that the actual spending premium would be around 120 during the 2015 Spending Review period. Under the deal, the UK Government agreed to put a floor under the Welsh Block Grant per head at a premium of 115 and to slow its decline towards that level by providing a 5 per cent uplift to any Barnett consequentials until it got there (at which point the uplift would move to 15 per cent to stabilise it at that level).

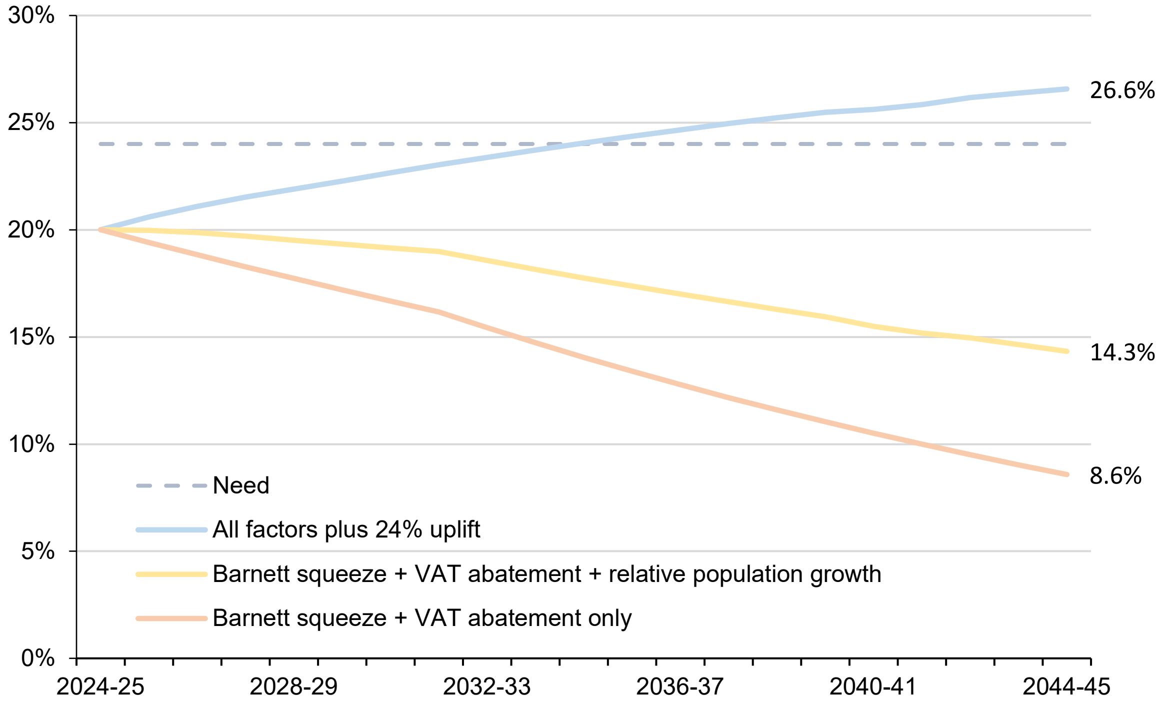
A crucial difference in the case of NI is that actual spending would start below the 124 estimate of relative need rather than above it as in Wales (although exactly how far below is impossible to know without access to the Treasury's calculations of relative funding per head).[25] Other things being equal, providing a 24 per cent uplift to any further Barnett consequentials would see the premium rise gradually towards that level so there would be a ceiling rather than a floor at 124.

[25] Treasury last published the NI spending premium in December 2021, when it was 121, having fallen from a value of 127 the year before. More recently, the Secretary of State said on 20 September 2023 that "the NI Executive receives around 20 per cent more per head than equivalent UK Government spending in other parts of the UK".

But this ignores relative population changes.[26] As we have seen, the ONS expects the NI population to grow more slowly over the next 20 years than England's – and by a greater margin in its projections published on 30 January than previously. If this comes to pass, this will push the funding premium up and potentially through the 124 relative needs 'floor' implied by the uplift. This effect has been visible in Wales, where the Block Grant funding premium has not declined significantly towards the 115 relative needs floor in recent years, as would otherwise have been the case, because the Welsh population has grown more slowly than England's.

If we assume for the sake of illustration that: i) the NI Block Grant baseline set for the next Spending Review period starting in 2025-26 is £15.4 billion, ii) that this were to be equivalent to a 20 per cent premium over equivalent UK Government spending and iii) that equivalent UK Government spending rises by 2.7 per cent a year until 2031-32 (in line with average forecast growth for UK departmental spending in the OBR's November 2023 Economic and Fiscal Outlook), and thereafter by 4.1 per cent a year (keeping it broadly stable as a share of UK GDP), then the Block Grant funding premium over equivalent UK Government spending would evolve over the next 20 years as shown in Chart 5.2. Taken alone, the Barnett squeeze and the VAT abatement would see the funding premium fall from 20 per cent in 2024-25 to 8.6 per cent in 2044-45, but the population effect would offset around half this decline and see it drop only to 14.3 per cent. Applying the 24 per cent uplift against this baseline would see funding rise steadily to the 124 level of relative need by 2035-36 and further above it to a premium of 26.6 per cent in 2044-45.

Chart 5.2 – Evolution of the NI Block Grant funding premium

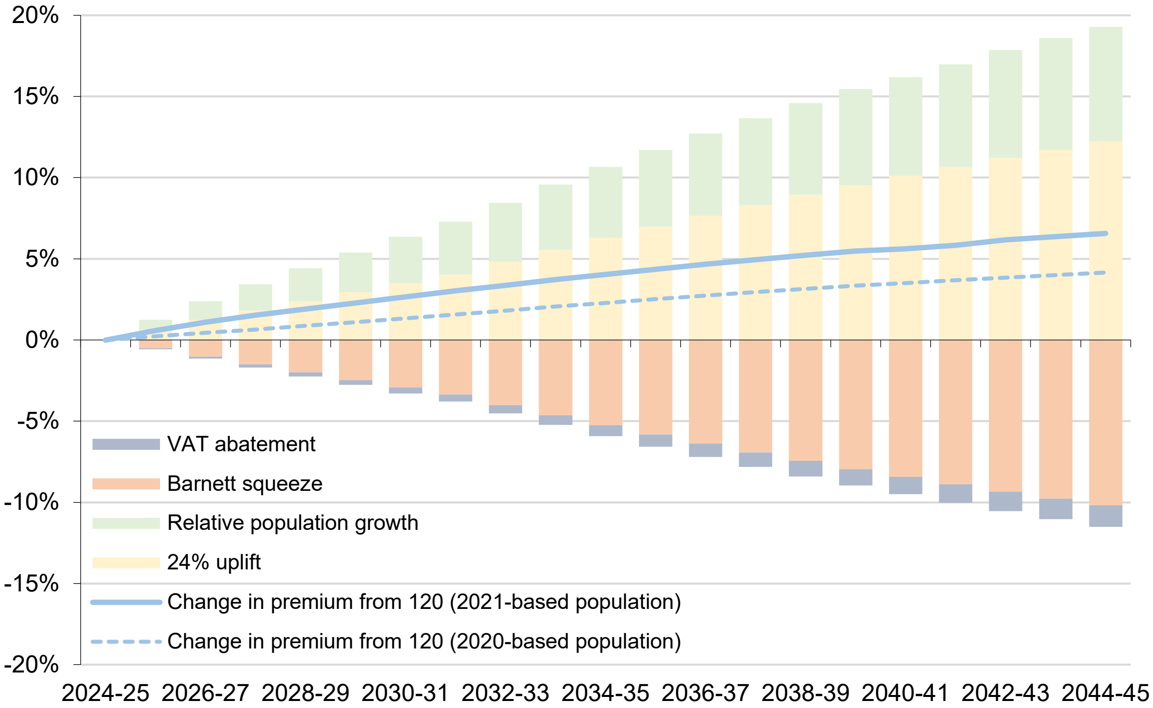


Source: NIFC calculations

[26] And time-limited top ups and other forms of non-Barnett funding.

Chart 5.3 provides an alternative visualisation of the factors that contribute to the evolution of the funding premium. It takes the overall increase in the funding premium of 6.6 percentage points – from 20 to 26.6 per cent – and decomposes it into the negative contributions from the Barnett squeeze and the VAT abatement and the positive contributions from relative population changes and the 24 per cent Barnett consequentials uplift. It illustrates again that the 24 per cent uplift slightly more than offsets the Barnett squeeze – which other things being equal would bring the funding premium up towards the 124 level of relative need – but NI's relatively slow population growth pushes the premium up further still.

Chart 5.3 - Contributors to change in funding premium from 2024-25



Source: NIFC calculations

The dotted line in Chart 5.3 shows the overall increase in the premium implied by the ONS's 2020-based population projections, which had the NI population growing by 1.2 per cent and the English population by 4.8 per cent over the next 20 years rather than 3.4 and 10.9 per cent respectively in the latest 2021-based projections. The revision to the projections since last year has increased the upward impact of relative population growth on the funding premium roughly from 4 to 7 percentage points. This underlines the uncertainty around this factor in the coming years.

The overall picture is a complicated one and our analysis is based on the brief description of how this would work in the NIO summary. But in the near term the key take-away is that the 24 per cent Barnett consequential uplift will help lift the Block Grant funding premium towards the 124 estimate of relative need – but not take it there immediately and guarantee to keep it at that level. On the assumption that the uplift operates as is proposed for Wales the additional impact of relative population growth could take funding above relative need. There is also the question (which may be covered in the Fiscal Framework discussions) of whether the Treasury would include one-off and/or earmarked non-Barnett additions to the

Block Grant in any assessment of whether funding was above or below relative need. But even on that basis a rise in funding to take it above need is not likely for several years, over which time much else could happen.

In principle the Fiscal Framework discussions could contemplate abandoning the Barnett Formula altogether and simply setting the Block Grant 24 per cent (or some other appropriate number) higher per head than equivalent UK Government spending, either immediately or with some transition path from the current level. This would deliver a floor to the Executive and a ceiling to the Treasury and avoid any distortions from relative population growth, but perhaps at the cost of greater uncertainty for departments around the cash sums involved. Needless to say, such an approach would not appeal to Wales or Scotland who would see their funding brought down to estimated need, not up to it. But, as the Welsh deal illustrates, there is no requirement to treat the nations uniformly; in various respects the UK devolved settlements already display variable geometry.

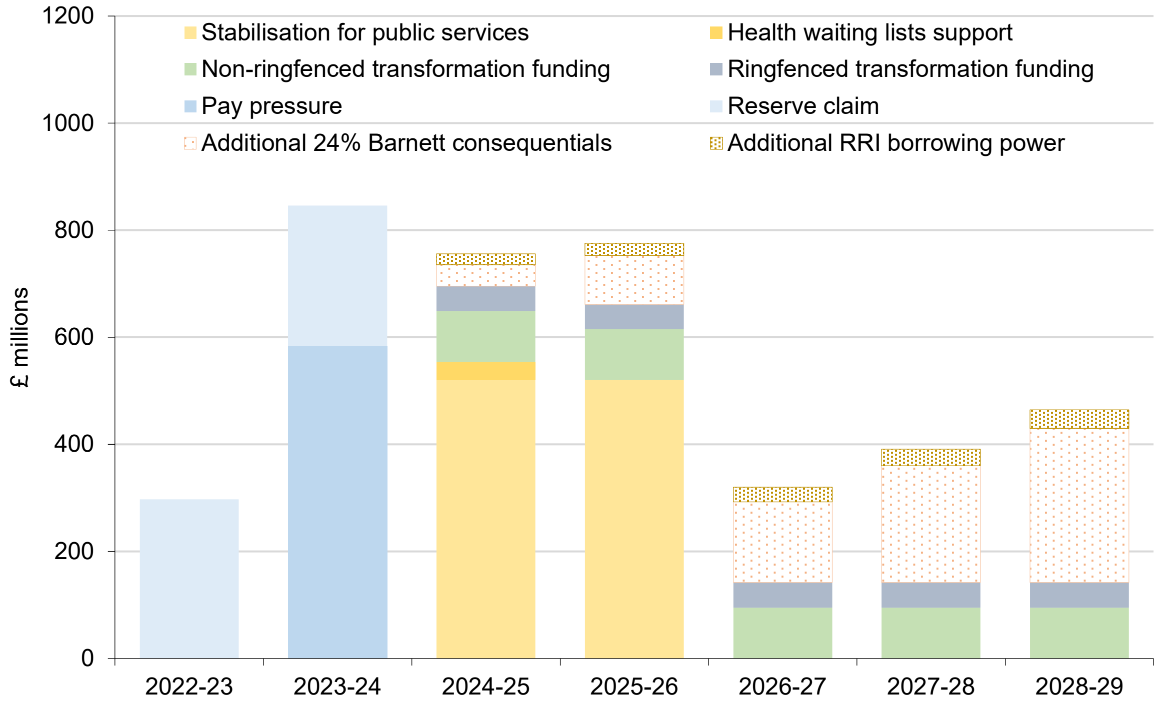
Does the short-term budget support create a 'cliff-edge'?

Introducing the needs-based 24 per cent uplift to future Barnett consequentials helps move funding for public services onto a more sustainable long-term footing. But it does not address the short-term budget crisis.

As described above, the package addresses the immediate budget challenge in 2023-24 by offering £584 million of additional funding to address public sector pay pressures this year and a loan (from the Reserve) of £262 million or so[27] to cover the remaining likely non-pay overspend, with the prospect that this could be written off if a package of spending cuts (presumably) and revenue increases is put in place and implemented over the medium term. But the pay deal would increase departmental spending not just this year but every year thereafter. That additional cost would be covered to a significant degree by £520 million of additional non-earmarked funding in 2024-25 and 2025-26, but when that runs out there would – other things being equal – be an abrupt 'cliff-edge' drop in funding in 2026-27 that is unlikely to be offset by increased Barnett consequentials (even with the uplift). The new formula would see around £150 million of RDEL consequentials per year generated by the 24 per cent uplift in 2026-27 based on current UK spending plans and OBR forecasts.[28] As we note below, the cliff-edge could advance to 2025-26 if the Executive were to balk at the Treasury's demand that it raise more revenue.

[27] Settlement includes up to £559 million from the Reserve for overspends in 2022-23 and 2023-24. The Reserve claim for 2022-23 was £297 million, suggesting that £262 million is available for 2023-24.
[28] Over the longer term the 24 per cent uplift from 2024-25 has the potential to result in the Executive cumulatively receiving £17 billion more funding by 2040-41 than it otherwise would.

Chart 5.4 – Components of the UK Government funding package



Source: HM Treasury, NIFC calculations

Table 5.1 – Components of the UK Government funding package

£ million	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28	2028-29
Stabilisation for public services	0.0	0.0	520.0	520.0	0.0	0.0	0.0
Health waiting lists support	0.0	0.0	34.0	0.0	0.0	0.0	0.0
Non-ringfenced transformation funding	0.0	0.0	94.6	94.6	94.6	94.6	94.6
Ringfenced transformation funding	0.0	0.0	47.0	47.0	47.0	47.0	47.0
Reserve claim[1]	297.0	262.0	0.0	0.0	0.0	0.0	0.0
Pay pressure	0.0	584.0	0.0	0.0	0.0	0.0	0.0
Total non-Barnett RDEL	**297.0**	**846.0**	**695.6**	**661.6**	**141.6**	**141.6**	**141.6**
Additional RRI borrowing power[2]	*0.0*	*0.0*	*20.0*	*23.0*	*27.0*	*31.0*	*35.0*
Additional 24% Barnett consequentials[3]	*0.0*	*0.0*	*40.0*	*91.0*	*151.0*	*218.0*	*288.0*
Total value of deal	***297.0***	***846.0***	***755.6***	***775.6***	***319.6***	***390.6***	***464.6***

Note[1]: the repayment of the reserve is conditional on the Executive publishing and implementing a 'sustainability plan'

Note[2]: estimated additional borrowing limits based on latest GDP deflators.

Note[3]: Estimated additional Barnett consequentials based on OBR November 2023 spending projections, and ONS January 2024 population projections

Source: HM Treasury, NIFC calculations

The total value of the deal including write-off of the two reserve claims and the additional funding over the next five years is around £3.9 billion, as shown in Chart 5.4 and Table 5.1. But the funding profile shown here assumes that the Executive publishes and implements a sustainability plan (including at least £113 million of revenue raising). Failure to do so would in principle require the Executive to repay the £559 million that the Executive has been offered to meet overspend pressures in 2022-23 and 2023-24, That would reduce the value of the deal to around £3.3 billion over this period and bring forward the potential cliff-edge drop in additional funding currently pencilled in for 2026-27 to 2025-26.

One response to the sharp drop in prospective funding would have been to apply the 24 per cent Barnett consequentials uplift retrospectively over the current Spending Review period (totalling over £1.4 billion) and reflect this in the baseline set for the next Spending Review beginning in 2025-26, providing an enduring uplift of around £500 million a year. The offer of £520 million in 2024-25 and 2025-26 reflects the amount that the Department of Finance estimated this would provide in those years, but the Treasury does not propose to baseline this element and include it in the Block Grant in future years.

On the face of it, imposing a sudden cliff edge in funding in 2026-27 makes little sense from a departmental and workforce planning perspective. But the Treasury may feel that the short-term support it is offering NI over the next couple of years – together with its willingness to provide (and potentially write off) short-term loans to cover departmental overspending this year and last – should provide the Executive with sufficient time and encouragement to raise more revenue and identify overdue savings and public service reforms, especially in the knowledge that the Barnett Formula will no longer impose a long-term squeeze. But others may feel that the timescale is simply too short realistically to expect that.

The deal includes short-term support plus greater long-term sustainability measures, but does it hold together in the middle? We saw most recently in New Decade New Approach (which also included one-off funding for recurrent health sector pay pressures) that following the short-term cash injection, the Executive was not able to sustain its initial momentum. The context was different, confronting Covid and cost of living pressures, but the current medium-term prospect of NI funding still lying below its level of 'need' may present a similar challenge to the new Executive in terms of need for prioritisation and reform of services.

How will the conditionality in parts of the deal work?

Two components of the settlement package have 'strings attached' – requirements that the Executive must fulfil to unlock the associated funding. This raises the questions of who will judge if the conditions have been met and how.

The UK Government has agreed to defer up to £559 million of debt repayments for two years, but the bigger prize on offer is to have that debt permanently written off. This will happen if the Executive publishes a plan 'to deliver sustainable public finances and services' by May 2024[29] and implements it. The Executive must also include a 15 per cent rise in Regional Rates (raising around £113 million) or an

[29] https://www.finance-ni.gov.uk/publications/letter-finance-minister-chief-secretary-treasury

equivalent sum from other sources to balance its Budget in 2024-25. Potential options to increase revenue and/or reduce spending have been widely discussed. As a precursor to the Executive's work on this issue, on 20 September 2023 the Secretary of State directed the NI department Permanent Secretaries to launch public consultations on revenue raising options. Proposals floated to date include:

- Removing some domestic rates allowances and non-domestic support schemes
- Introducing domestic water charges (which was ruled out by NI's First Minister on 12 February [30])
- Increasing university tuition fees (which the Economy Minister has indicated he is opposed to [31])
- Increasing private street inspection fees
- Introducing prescription and domiciliary care charges
- Reintroducing hospital car parking charges
- Reducing compensation for bovine tuberculosis.

The First Minister has "rejected government claims that Stormont parties had signed up to revenue raising measures",[32] and the Finance Minister has said that "making the write off of the £559 million for debt repayment conditional on the publication and implementation of a sustainability plan is not acceptable".[33] But if the Executive fails to deliver on this condition and loses the debt write-off, then this potentially brings forward the 'cliff edge' from 2026-27 to 2025-26.

The second area of conditionality is around the ringfenced £235 million for the transformation of public services. £47 million will be made available on an annual basis but only on approval by a new Public Sector Transformation Board. The settlement says that this Board will comprise officials from NI Civil Service and UK Government experts, but may also include independent experts. This Board will determine whether funding bids are sufficiently transformational.

Finally, the settlement includes a condition that the Executive is expected to publish a "comprehensive and costed long-term strategic infrastructure plan", but this does not appear to be linked explicitly to the increase in RRI borrowing capacity. The conditionality therefore looks more stringent for resource funding than for capital.

[30] https://www.bbc.co.uk/news/uk-northern-ireland-68273812
[31] https://www.bbc.co.uk/news/uk-northern-ireland-68266731
[32] https://www.bbc.co.uk/news/uk-northern-ireland-68273812
[33] https://www.finance-ni.gov.uk/sites/default/files/publications/dfp/Minister%20Archibald%20response%20to%20CST%20letter%20of%2013%20February%20-.pdf