Northern Ireland Fiscal Council

Sir Robert Chote
Chairman

info@nifiscalcouncil.org
5th Floor
9 Lanyon Place
Belfast
BT1 3LP

Kenneth Gibson MSP
Convener
Finance and Public Administration Committee

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Dear Kenneth,

The Scottish Fiscal Commission's first fiscal sustainability report

Thank you very much for your letter of 1 March 2023 requesting written input in support of your committee's scrutiny of the Scottish Fiscal Commission's (SFC) approach to producing a sustainability report within a devolved context.

As you noted in your letter, we in the NI Fiscal Council have recent experience in producing our first sustainability report. We have produced a short note that explains in summary our approach and methodology. I attach a copy for your information and I hope it may be useful for your upcoming discussions with the SFC.

We understand that the SFC's approach to its first sustainability report is rather different from the way in which we tackled it. This is entirely understandable given the very significant differences between Scotland's fiscal framework and the much more limited tax powers devolved to NI. Having said that, here are several areas in which both the NIFC and SFC share common objectives and difficulties, including:

- Explaining the framework for public finances in both NI and Scotland is challenging to do succinctly and accurately. In the end, we opted to produce a detailed Comprehensive Guide,[1] which we intend regularly to revisit and update;

[1] https://www.nifiscalcouncil.org/files/nifiscalcouncil/documents/2021-11/the-public-finances-in-northern-ireland-final-version_0.pdf

- Achieving consistency with the approach taken at the UK level by the Office for Budget Responsibility while recognising the complexities of asymmetric devolution. In this regard, we faced perhaps a slightly less daunting task than our colleagues in the SFC because we do not currently have to wrestle with the intricacies of tax forecasting or significant Block Grant Adjustment mechanisms; and,
- Comparable data, as we have noted in our reports, is not always as readily available as one might expect it to be, and this presents barriers when one comes to consider the expenditure needs arising from different devolved policy areas.

Despite these challenges, we believe we have produced robust and valuable sustainability reports, which have been broadly welcomed by NI departments and commentators. I am aware that the NIFC staff team works collaboratively with their SFC counterparts, which is an approach that as a Council we have very much encouraged and welcomed.

I look forward to reading both the SFC report and the outcome of the committee's deliberations and scrutiny.

For you information, I have included a copy of our forthcoming publications as Annex A to this letter.

With best regards,

Sir Robert Chote

Chair of the NI Fiscal Council

ANNEX A

NI Fiscal Council Upcoming Publications

The NIO's 2022-23 Budget for Northern Ireland: an assessment
Expected release date: March 2023

Technical Paper 02/23: Estimate of the relative need for public spending in Northern Ireland
Expected release date: Spring 2023

The 2023-24 Budget for Northern Ireland
Expected release date: dependent on 2023-24 Budget process

Technical Paper 03/23: The In-Year Monitoring process
Expected release date: Spring / Summer 2023

Sustainability Report 2023: *special focus* - Infrastructure
Expected release date: Autumn 2023

The public finances in Northern Ireland: a comprehensive guide (v2 - updated 2023)
Expected release date: Winter 2023

NIFC Sustainability Report: Approach and Methodology

Approach

At UK level, the Office for Budget Responsibility (OBR) regularly assess the sustainability of UK public finances, including preparing a 50-year projection of public spending, revenue, borrowing and debt. The fiscal position is judged to be unsustainable if spending is set to exceed tax revenue sufficiently such that public borrowing and debt rise inexorably as shares of Gross Domestic Product (GDP)

At a Northern Ireland level sustainability cannot be assessed in the same way. The NI Executive's ability to borrow and accumulate debt is much more constrained – by legislation and agreement with HM Treasury.

As with Whitehall departments and other devolved administrations, the Treasury divides the Executive's spending into Departmental Expenditure Limits (DEL) which can be planned and controlled over several years and Annually Managed Expenditure (AME) which is more volatile and demand led. Expenditure covered by DEL includes building costs, public sector pay, and grants. Whereas AME includes expenditure on public sector pensions and social security benefits.

The NIFC's assessment of sustainability focuses on spending covered by DEL which covers the day-to-day costs of public services, grants and administration, plus capital investment. The majority of this expenditure (over 80%) is funded via the core Block Grant from the UK Government. The Block Grant applies the Barnett formula to changes in spending in England (or England and Wales or GB) announced at Westminster Budgets and non-Barnett additions which may include funding for political agreements or funding to replace funding previously received from the European Union (EU).

Given the Executive's limited room for manoeuvre in determining the overall size of its budget, sustainability in NI is best interpreted largely as a question of sufficiency - can the Executive deliver the same quantity and quality of public services as in the rest of the UK? As well as a need to make the most efficient use of the funding available.

The Barnett Formula gives the devolved administrations a population share of changes to spending in England. However, this does not account for differences in need based on different age structures, different economic structures and weaknesses, historical impacts etc. However, judging the quality and quantity of services in NI relative to other nations/regions is not straightforward, as data is not always comparable across the regions. The purpose of devolution is to allow policy decisions on various matters to diverge according to local preferences and needs. So our approach, where possible, is to identify data that are comparable across the UK (e.g. by using expenditure data under the international measure of Classification of Functions of Government (COFOG)).

If prospective funding did look insufficient on current policy, the options for the Executive would be:

- to accept relatively lower public service provision;
- to try to increase the efficiency with which services are provided;
- to cease or reduce the provision of lowest priority services;
- to make additional fiscal effort (raising the Regional Rates and/or fees and charges);
- to seek greater tax raising or borrowing powers from the UK Government; or,
- to seek additional funding from the Treasury either as part of another political agreement or more durably by trying to persuade the UK Government to incorporate an assessment of relative need for spending per head to deliver equivalent services in the calculation of the Block Grant.

Sustainability of public finances in NI requires funding per head at least equal to some appropriate (albeit hard to estimate) measure of relative 'need' for spending per head. This 'need' would reflect the proportion of people requiring each service (due to the age structure and other characteristics of the population), as well as the factors impacting the cost of providing it (e.g. population sparsity).

The Barnett squeeze "is an issue with the Barnett Formula which can lead to a gradual convergence in funding per head in the devolved administrations and England" Holtham Commission Report[1].

Methodology

The NIFC uses the OBR's most recent assessment of the sustainability of the UK public finances in the *Fiscal Risks and Sustainability Report* (FRSR) as a starting point. This is because any cuts to or constraining of growth in public services spending deemed necessary to move the UK public finances to a more sustainable path would have implications for the Block Grant which pays for most of the NI Executive's spending. The OBR intends to publish the FRSR annually, however, if this were not the case in a particular year the NIFC Sustainability report would be tailored to update the current position using other published data, such as population projections.

Fiscal sustainability has a long-term perspective, the fundamental question is:

> "Can current policy settings and decisions be realistically maintained over the long term or whether a future government would at some point need to change them?"

If current policy is deemed unsustainable it signals the need for present and near future policymakers to consider when and what action might be taken.

As at the UK level, the NIFC is interested in NI's long-term outlook for income and spending,[2] as well as whether demographic and non-demographic influences might require policy

[1] https://researchbriefings.files.parliament.uk/documents/SN06288/SN06288.pdf

[2] The NIFC Terms of Reference require us to provide an annual report on the sustainability of the Executive's public finances, including the implications of spending policy and the effectiveness of long-term efficiency measures

changes. But the consequences of remaining on an unsustainable path are different to UK level and so too are the potential responses available to NI policymakers.

In order to determine the sustainability of NI's public finances an assessment is made of:

- **Comparison of the characteristics of NI population compared to the rest of the UK** - Do they imply a need for a higher amount of public spend per person than in England? This uses information from various reports. An assessment of characteristics such as
    - *size and age structure* – using ONS and OBR population projections including proportions of population aged 65 and above, 16-64 and under 16.
    - *poverty and social deprivation* – this is not easy to compare across the UK as deprivation scores are not directly comparable. Therefore, the NIFC uses the ONS data which underpins these: working-age economic inactivity, unemployment, relative proportion of people in poverty (households with disposable household income below 60% of that region's median in that year), persistent low income (been in relative low income for at least 3 out of past 4 years), rate of child poverty.
    - *socio-economic factors* – for example using the *State of the Nation* publication from the Social Mobility Commission to compare regions on qualification levels, wages, proportion of high-paid jobs, rate of job creation and new start-up growth.
    - *health of the population* – a 'special focus' sustainability report was published alongside the first sustainability report. Among other things, this included an assessment of real per capita health spending across the regions from HM Treasury in PESA
    - *population dispersion* – rurality is difficult to compare across UK nations – the report used publish reports including the House of Lords *Fact File Rural Economy*, Nuffield Trust *Rural Health Care*.

- **Examine relative levels of spending per head between NI and England**, to monitor the extent of convergence with levels in England and to assess whether this is appropriate for NI's level of needs. This may include an assessment of the Barnett squeeze – which causes per head spend to converge to English levels over the long term. Meaning future increases in UK Government spending in England on services the NI Executive is responsible for will not generate proportionate additional funding per person via the Barnett formula. This uses per head spending from HM Treasury in PESA at times adjusted to remove Whitehall spending which is not comparable and therefore the Barnett formula does not apply. Long term forecasts use OBR 50-year projections in FRSR and estimate Barnett consequentials based on the projections. Various scenarios, which can be adjusted, are also forecast. The first report included:
    - Need – having a fiscal floor of 120% of England's spend per head
    - Needs adjustment of 20% on the Barnett consequentials also adjusted for slower population growth
    - Increasing fiscal effort – increasing regional rates bills by 50% by 2028-29

- **In addition to assessing the projected path of the Block Grant, we also considered NI Executive generating additional financing**, as mentioned above. In our first report – relying on the final report from Independent Fiscal Commission for NI - we concluded that the Executive had options in the long run, including the– partial devolution of income tax and full devolution of stamp duty land tax, landfill tax and air passenger duty. Also investigated are raising additional income via powers NI Executive has including:

- *Regional Rates* – increasing regional rate poundages and reducing reliefs and allowances.
- *Capital Borrowing* – increasing the borrowing maximum level from £200 million to £340 million. Forecasting repayment costs which are a loss of regional rate income which could be used for resource spending.
- *Fees and charges* – this is difficult to project, the largest ones are non-domestic water charges, Health Trust receipts and tuition fees. Additional fees and charges could include domestic water charges and bring average household bills for rates and water charges to England level.
- *Other external funding* – such as non-Barnett additions to block grant (typically one off or time limited and earmarked for a particular purpose), EU funding (there is a risk that NI will receive less of this sort of funding in long term than it would have received from the EU).

Working with Others

Throughout the production of these forecasts the NIFC have met and shared methodology with DoF, the OBR and their Scottish counterparts in the Scottish Fiscal Commission. All of which have provided valuable input and comment.

As mentioned above, the NIFC also produced a special focus piece in parallel with the Sustainability report which focused on the largest area of DEL spend in NI – Health.