Northern Ireland Assembly

Research and Information Service Briefing Paper

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Public Finance Scrutiny Unit[1]

Financing the Draft Budget 2015-16

Paper 2 of 5

As part of the five-part series on the Draft Budget 2015-16, this Briefing Paper presents key considerations arising from the Executive's proposed use of finances that are outside UK Government allocations (the Block Grant and Annually Managed Expenditure): these finances include borrowing, regional rates revenue, water charging and European Union funding.

[1] Other teams within RaISe contributed to the research and compilation of this Paper.

Key Points

- Under current devolution, to fund the Budget, the Executive can avail of financing measures that are outside United Kingdom (UK) Government allocations (the Block Grant and Annually Managed Expenditure): these measures include, borrowing, regional rates, water charging and European Union funding;
- The Executive may borrow from the UK Government to manage short-term cash flow and to fund capital investment *via* the Reform and Reinvestment Initiative (RRI);
- Since its inception in 2003/04, the Executive's use of RRI borrowing has steadily increased, and the Executive has exceeded the annual RRI borrowing limit of £200 million on several occasions;
- The Draft Budget 2015-16 proposes to allocate £63.4 million of Non-ring-fenced Resource Departmental Expenditure Limit (DEL) for RRI interest repayments in 2015-16; and the Executive forecasts interest repayments to be £35 million in 2024-25.[2]
- The Executive proposes to increase the Regional Rate only in line with inflation. This would result in an estimated £649·8 million revenue for the Executive in 2015-16.
- Northern Ireland households are unique in the UK in not paying a direct charge for water and sewage services.
- The Executive currently subside Northern Ireland Water by approximately £300 million per annum to cover water charges. The level of subsidy is forecasted to increase steadily in the coming years.
- The Executive's position to not introduce water charges appears to be at odds with Article 9 of European Union Water Framework Directive.
- The Executive needs to ensure that it has given full and proper consideration to the receipts for EU funding. This is to ensure that there will be adequate match funding from Northern Ireland's DEL, or from external private sources as appropriate, so that EU requirements are met, and European monies are not lost for Northern Ireland.

[2] Northern Ireland Executive (2014).*Draft Budget 2015-16*: http://www.northernireland.gov.uk/draft-budget-2015-2016.pdf

Introduction

This Briefing Paper is the second in a five-part series that covers key issues arising out of the Draft Budget 2015-16. The series is not intended to exhaustively address the full implications of the proposals: much of the detail that will inform impact is still to follow in terms of how each department will implement the proposals. Also, the timetable for the Assembly to scrutinise and debate the Draft Budget is extremely tight.

With these two factors in mind, and the desire to facilitate Members' participation in the Assembly's on-going discussions and deliberations about the Draft Budget 2015-16, the series addresses key issues that appear to have raised particular interest. The series complements the Lines of Questioning Briefing (NIAR 753-14, dated 4 November 2014) by the Public Finance Scrutiny Unit (PFSU) within the Research and Information Service (RaISe).

This Paper presents key considerations arising from the Executive's proposed use of finances that are outside United Kingdom (UK) Government allocations (the Block Grant and Annually Managed Expenditure): these finances include borrowing, regional rates revenue, water charging and European Union funding.[3] Throughout there are potential scrutiny points to facilitate the Assembly's deliberations on the Draft Budget.

The paper is presented as follows:

- Section 1: Borrowing
  - 1.1: General Borrowing Provision
  - 1.2 Temporary Borrowing Provision
  - 1.3 Borrowing under Reinvestment and Reform Initiative
- Section 2: Receipts and Charges
  - 2.1: Regional Rates
  - 2.2: Water Charges
- Section 3: European Union Funding
- Section 4: Concluding Remarks

1 Borrowing

This section first highlights Northern Ireland's borrowing powers, as specified by the prevailing financial arrangements under current devolution, including those proscribed in statute, and those created by the Reinvestment and Reform Initiative (RRI). Thereafter it sets out key considerations arising under the Draft Budget that raise potential scrutiny points for the Assembly.

[3] For information about Block Grant and AME allocations, refer to Briefing Paper 1 in this series – NIAR 766-14.

1.1 General Borrowing Provision

The Executive has borrowing powers under section 1 of the *Northern Ireland (Loans) Act 1975 (the 1975 Act).*[4] Sub-section 2 of *the 1975 Act* sets an overall limit on borrowing at £2,000 million. The *Northern Ireland (Miscellaneous Provisions) Act* 2006 extended this borrowing limit to £3,000 million.[5] This borrowing provision essentially permits the borrowing of funds by the Executive. The Draft Budget 2015-16 proposes to use this borrowing power under RRI (see subsection 1.3).

1.1.1 General Borrowing rules: Treasury Statement of Funding Policy

Her Majesty's Treasury (the Treasury) publication *Funding the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly: Statement of Funding Policy* is the keystone of the financial arrangements under current devolution – i.e. the Public Finance Framework – which governs the public expenditure system in Northern Ireland and the other devolved administrations. The *Statement of Funding Policy* is usually revised and updated alongside UK Spending Reviews. At a high level, it establishes the requirement for the Executive to manage its financial position within the limits that are set during UK Spending Reviews. The relevant paragraphs for general borrowing include the following:

> *7.1 The devolved administrations have the reserve power to set maximum capital expenditure for capital investment by local authorities (District Councils in Northern Ireland) and other public bodies. Borrowing counts towards the Public Sector Net Cash Requirement (PSNCR) and hence, is included within the devolved administrations' total budgets each year as a control mechanism, so that any increases in borrowing must be offset by reductions in other spending. The effect is to reduce the level of grant from the United Kingdom Government and hence to restore the United Kingdom borrowing position.*

And:

> *7.2 Generally the financing costs of higher borrowing are met locally - either from the assigned budget itself, from local taxation or through higher charges for services. Local authority capital is funded through a balance of borrowing, where financing costs must be met by local authorities, and capital grants, where financing costs are met by the United Kingdom Exchequer. In cases of a significant shift in the balance between borrowing and capital grants, the* ***Treasury reserves the right to adjust***

[4] *Northern Ireland (Loans) Act 1975*: http://www.legislation.gov.uk/ukpga/1975/83/section/1
[5] *Northern Ireland (Miscellaneous Provisions) Act 2006*: http://www.legislation.gov.uk/ukpga/2006/33/section/22

> ***the assigned budget for the financing costs of this shift.*** [6] [emphasis added]

1.2 Temporary Borrowing Provision

Temporary borrowing provision for the Executive allows the use of borrowing to manage **temporary** shortfalls in budgets. It is proscribed by section 61 of the *Northern Ireland Act 1998* (*the 1998 Act*) as follows:

> *The Secretary of State may advance to the Department of Finance and Personnel sums required for the purpose of—*
>
> *(a)meeting a temporary excess of sums to be paid out of the Consolidated Fund of Northern Ireland over sums paid into the Fund; or*
>
> *(b)providing a working balance in the Fund.*[7]

The funds are issued from the *National Loans Fund* under terms agreed by Treasury.[8] Section 61 of the *1998 Act* also sets the aggregate outstanding amount of principal loans at £250 million.[9]

1.2.1 Temporary Borrowing rules: Treasury Statement of Funding Policy

Relevant paragraphs of the *Statement of Funding Policy* regarding temporary borrowing include the following:

> *7.3 Each Secretary of State may lend the devolved administration sums required for meeting temporary excess in expenditure over income or providing the devolved administration with a working balance. The Treasury may issue to the Secretary of State such sums out of the National Loans Fund. These loans should be repaid by the devolved administration to the Secretary of State at such times, methods and interest rates as the Treasury determines. Sums received by the Secretary of State will be paid into the National Loans Fund. The aggregate outstanding amount of principal loans made shall not exceed £500 million for the Scottish Executive and the Welsh Assembly Government and £250 million for the Northern Ireland Executive.*[10]

Simply stated, under the current devolution arrangements, the Executive can borrow up to £250 million per year to meet a temporary shortfall in budgets.

[6] HM Treasury (2010).*Statement of Funding Policy*: http://webarchive.nationalarchives.gov.uk/+/http:/www.hm-treasury.gov.uk/d/sr2010_fundingpolicy.pdf

[7] *Northern Ireland Act 1998: http://www.legislation.gov.uk/ukpga/1998/47/section/61*

[8] National Loan Fund makes loans to various statutory public sector bodies and provides the finance needed by the Public Works Loan Board for its loans to prescribed bodies, mainly local authorities.

[9] *Northern Ireland Act 1998: http://www.legislation.gov.uk/ukpga/1998/47/section/61*

[10] HM Treasury (2010).*Statement of Funding Policy*: http://webarchive.nationalarchives.gov.uk/+/http:/www.hm-treasury.gov.uk/d/sr2010_fundingpolicy.pdf

Scrutiny Points:

1. Did the Executive consider using this temporary borrowing facility to help finance the 2015-16 Draft Budget?
2. If so, what was its rationale for not using the temporary borrowing facility?

1.3 Borrowing under Reinvestment and Reform Initiative

Introduced in 2002, the Reinvestment and Reform Initiative (RRI) provides the Executive an additional borrowing facility of up to £200 million a year from the National Loans Fund to fund capital investment.[11] The additional borrowing under the RRI initiative is broadly equivalent to the local authority prudential borrowing powers in the rest of the UK. It addresses the fact that the Executive retains control over a range of functions which are normally the responsibility of local government in Scotland and Wales.

There appears to be no specific legislative provision proscribing the creation of the RRI. However, DFP advises that borrowing under this initiative is covered implicitly by the *1975 Act* and the *Northern Ireland Miscellaneous Provisions Act 2006.*[12] Moreover, the Executive's Budget 2011-15 describes RRI as follows**:**

> *Announced in May 2002, [RRI] included a new borrowing power intended to support a very substantial infrastructure investment programme in Northern Ireland. This borrowing is subject to annual limits determined by HM Treasury and at present this limit is £200 million per annum.*[13]

1.3.1 Annual borrowing limit and RRI

On a number of occasions since 2002 the Executive has negotiated with the Treasury to increase Northern Ireland's annual borrowing limits; most notably in 2011-12 when a rescue package for the Presbyterian Mutual Society was agreed. The table below shows the actual and planned use of RRI borrowing facility since the initiative began.[14] The highlighted segments show where the Executive appears to have breached the £200 million annual limit since the creation of RRI:

[11] Spending Review 2013 confirmed a temporary additional borrowing limit of £250 million support investment in shared housing and education projects. .

[12] E-mail correspondence from DFP. Received by RaISe on 11January 2014.

[13] Northern Ireland Executive (2011).*Budget 2011-15*: http://www.northernireland.gov.uk/revised_budget_-_website_version.pdf

[14] Table reproduced from Northern Ireland Executive (2014). Draft Budget 2015-16: http://www.northernireland.gov.uk/draft-budget-2015-2016.pdf

£million

	NLF Borrowing	On-Balance Sheet PFI	Total Use of RRI Borrowing Facility [3]
2003-04	79.4		79.4
2004-05	168.7		168.7
2005-06	162.9		162.9
2006-07	214.6		214.6
2007-08	97.6		97.6
2008-09	16.6	243.4	260.0
2009-10	113.1	132.9	246.0
2010-11	[1] 36.9	200.0	236.9
2011-12	[2] 375.0		375.0
2012-13	150.9		150.9
2013-14	195.9		195.9
2014-15 *(plans)*	264.9		264.9
2015-16 *(plans)*	226.8		226.8
TOTAL	**2,103.5**	**576.3**	**2,679.8**

[1] 2010-11 includes borrowing to fund NICS Equal Pay claim – funded from previously undrawn borrowing
[2] 2011-12 includes £175 m additional borrowing power iro Presbyterian Mutual Society rescue package
[3] In any other year total use of borrowing in excess of £200 million is due to HM Treasury approved access to previously undrawn borrowing, or new borrowing under T:BUC

The above table shows that the 2015-16 RRI borrowing limit has again been extended to £226.8 million. The Draft Budget 2015-16 document gives the following explanation for this extension:

> *Under "Together: Building a United Community" (T:BUC), announced in 2013, the Executive will be able to access an additional £100 million to use on shared education or housing projects. This is profiled over three years beginning 2014-15 and it therefore increases the 2015-16 RRI borrowing limit to £226.8 million.*[15]

Scrutiny Points:

1. How does the Executive's record in exceeding its annual borrowing limit in terms of both incidence and degree compare to Best Practice in this area?

2. How does the Executive aim to plan more effectively so that it ensures it decreases both the incidence and degree to which it exceeds its annual borrowing limit?

[15] Northern Ireland Executive (2014).Draft *Budget 2015-16:* http://www.northernireland.gov.uk/draft-budget-2015-2016.pdf

1.3.2 Total Use of RRI Borrowing in Northern Ireland

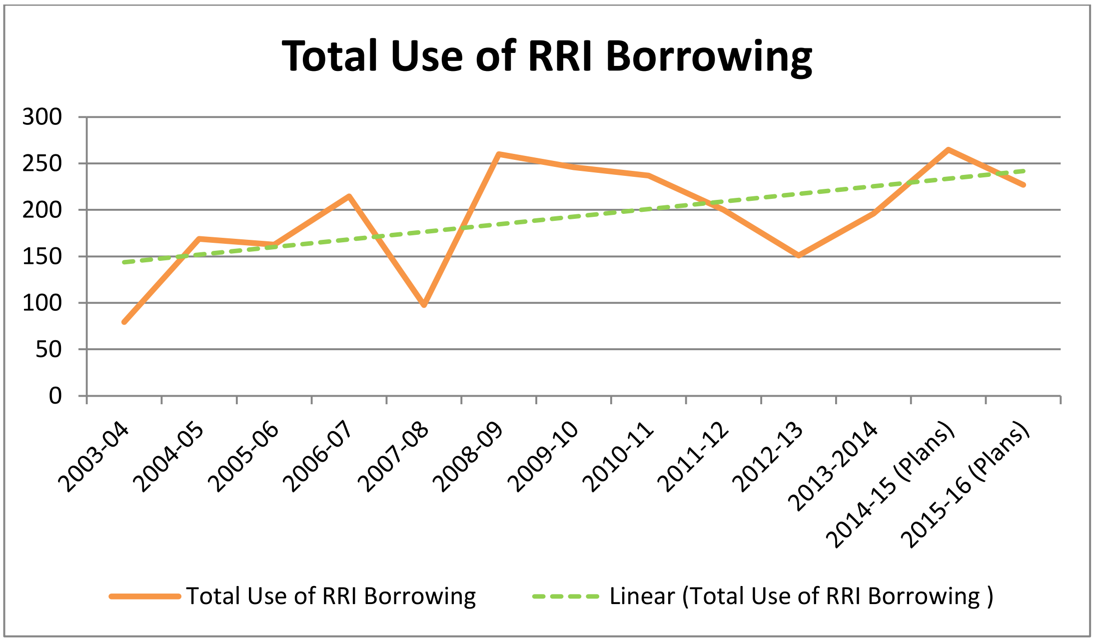
The total principal outstanding at 31 March 2014 was £1,764,957,340. £1,392,481,799 of this amount related to borrowing under RRI.[16] The Draft Budget 2015-16 presents the level of outstanding debt in respect of RRI at £1,734 million.[17]

To highlight Northern Ireland's high reliance on borrowing, the Draft Budget 2015-16 document comparatively states:

> *The Scottish Government under the Scotland Act 2012 has a borrowing limit of £2.2 billion, which equates to £415 per head of population. Our projected level of indebtedness in 2015-16 of £1.7 billion equates to £948 per head of population.*[18]

It is important to note that the *Scotland Act 2012* empowers the Scottish government to borrow for capital purposes up to a cumulative maximum of £2.2 billion **from 2015**. This highlights that Northern Ireland is currently more reliant on borrowing than Scotland, even if the Scottish government used its full borrowing limit immediately.

The chart below shows the total use of RRI in Northern Ireland since the initiative began in 2003-04.[19] (Figures for 2011-12 are adjusted to reflect the additional £175 million rescue package to the Presbyterian Mutual Society.) The trend line highlights the increasing use of RRI borrowing since the scheme was initiated.



[16] Correspondence from Department of Finance and Personnel to Committee For Finance and Personnel. Dated: 3 September 2014. Received by RaISe: 4 November 2014.
[17] Northern Ireland Executive (2014).Draft *Budget 2015-16:* http://www.northernireland.gov.uk/draft-budget-2015-2016.pdf
[18] Northern Ireland Executive (2014).Draft *Budget 2015-16:* http://www.northernireland.gov.uk/draft-budget-2015-2016.pdf
[19] Chart produced by RaISe relying on figures contained in Draft Budget 2015-16.

The Draft Budget 2015-16 document addresses the increasing overall level of indebtedness in Northern Ireland, in particular that which apparently results from RRI borrowing, where it states:

> *The Executive are in the process of considering mechanisms for capping RRI borrowing to ensure that the overall level of borrowing remains within manageable limits.*[20]

Scrutiny Point:

How does the Executive plan to finance capital projects in future years, without having to rely on borrowing, given its apparent increasingly significant reliance on RRI and the general restriction on funding from the UK government?

1.3.3 Costs of Borrowing under RRI

The allocations received *via* RRI borrowing are recorded as Annually Managed Expenditure (AME), and therefore are not included in the Executive's Departmental Expenditure Limit (DEL). However, interest payments are recorded as DEL, and then taken off the Executive's total DEL amount. The Draft Budget 2015-16 allocates £63.4 million of Non-ring-fenced Resource DEL for RRI interest repayments in 2015-16.[21]

The Draft Budget 2015-16 document further states:

> *Although interest repayments reduce over the term of the loan, the annual interest repayment based on the loans planned to the end of 2015-16, i.e. without taking account of any additional borrowing, will still be approximately **£35 million in 2024-25**.*[22] [Emphasis added]

Scrutiny Points:

1. Given that the proposed use of RRI borrowing to finance capital projects would cost the Executive £63.4 million in interest payments in 2015-2016, how did the Executive assure itself that the cost benefit/value for money analysis was sufficiently robust?

2. How much of the principal loan amounts would be repaid each year?

3. Does the £35 million interest repayment figure include an allowance for interest rate changes in the years up to 2025?

4. Given the apparent increased reliance on RRI in Northern Ireland since its introduction, what is the likelihood that this £35 million figure will not be surpassed?

5. How has the Executive made this determination?

[20] Northern Ireland Executive (2014).Draft *Budget 2015-16:* http://www.northernireland.gov.uk/draft-budget-2015-2016.pdf
[21] Northern Ireland Executive (2014).Draft *Budget 2015-16:* http://www.northernireland.gov.uk/draft-budget-2015-2016.pdf
[22] Northern Ireland Executive (2014).Draft *Budget 2015-16:* http://www.northernireland.gov.uk/draft-budget-2015-2016.pdf

2 Receipts and Charges

This section takes a preliminary look at receipts and charges that could help finance the budget, i.e. Regional Rate and Water Charging. This section is not intended to be exhaustive; rather, it simply aims to open up discussion, and thereby help to promote robust consideration of the Draft Budget proposals.

2.1 Regional Rate

The Draft Budget 2015-16 describes the Regional Rate as follows:

> *The Regional Rate, which is determined by the Executive, generates* ***additional resources*** *to support central public services that are the responsibility of the Executive.*[23] [emphasis added]

The Regional Rate element of household rate bills makes up only a portion of the total bill. The other element of household rate bills is a District Rate charge. The District Rate is similar to the Regional Rate. However, revenue goes to the ratepayers' district council to fund local services in the council area, not to the Executive to fund Northern Ireland-wide services.

Revenue from the Regional Rate is unhypothecated, which means that the Executive can use it to fund any project, as it is not restricted to any specific spending programme; but such use must comply with applicable Treasury rules.[24] In his statement on the Draft Budget 2015-16, the Minister of Finance and Personnel stated:

> *One way in which the Executive may increase their spending power is through the revenue raised by the regional rate. In the 2011-15 Budget, the Executive, recognising that householders are still dealing with the impact of the downturn on their incomes, agreed that the domestic and non-domestic regional rates would be increased only in line with inflation. I am pleased to announce that this will continue to be the case for 2015-16. This will result in an estimated 2015-16 regional rate income of £649·8 million.*

And:

> *I make no apology for keeping local taxes low. Yes, there are public sending consequences. But it is the right thing to do. I believe in keeping as much money as possible in people's pockets. Taking it from them might give us some short term public spending satisfaction but the impact on consumer confidence and economic recovery should not be dismissed.*

[23] Northern Ireland Executive (2014).Draft *Budget 2015-16:* http://www.northernireland.gov.uk/draft-budget-2015-2016.pdf

[24] For example: Treasury Rules state that Capital spending allocations from Westminster cannot be used for resource category spending.

> *Keeping local taxes low is the right thing for the people of Northern Ireland.*[25]

The Minister of Finance and Personnel appears to suggest a link between higher local taxes (rate bills) and a resulting fall in consumer confidence, which would negatively affect the Northern Ireland economic recovery. In the same statement, the Finance Minister also stated the following:

> *My department have - with the agreement of the Executive - been developing a workforce restructuring plan. This will embrace all possible personnel interventions including a recruitment freeze, suppressing vacancies, use of temporary staff, pay restraint and a voluntary exit mechanism to reduce workforce numbers.*[26]

The decision to increase Regional Rate income by the level of inflation comes at a time when the Executive is confronted with a range of pressures that necessitate £872 million worth of reductions to the Resource budget.[27] It is also happening when the Executive's Resource budget is effectively reduced by 1.6%.[28]

Scrutiny Points:

1. Is the Executive keeping the Regional Rate low to soften the blow on consumer confidence, given Executive proposals are to be forthcoming about workforce restructuring in the civil service?

2. Can the Minister of Finance and Personnel outline DFP's initial views on how the anticipated workforce restructuring proposals would impact on consumer confidence, given the high levels of public sector workers in Northern Ireland; particularly the impact of those proposals relating to pay restraint?

3. Given that the Regional Rate constitutes only a part of the Northern Ireland total household rates bill, what are the Minister's views on raising the Regional Rate by a small, above inflation, percentage, given that it would provide much needed extra revenue for the Executive, without necessarily affecting consumer confidence?

4. Given the limited options available to the Executive under current devolution for increasing revenue, and the apparent restriction on funding from UK government, and Northern Ireland's current public finance situation, is it prudent that the Executive does not avail of the revenue raising potential of the Regional Rate?

[25] NI Assembly Official Report (3 November 2014). *Finance Minister Statement on Draft Budget 2015-16*.: http://aims.niassembly.gov.uk/officialreport/report.aspx?&eveDate=2014/11/03&docID=211611

[26] NI Assembly Official Report (3 November 2014). *Finance Minister Statement on Draft Budget 2015-16*.: http://aims.niassembly.gov.uk/officialreport/report.aspx?&eveDate=2014/11/03&docID=211611

[27] Northern Ireland Executive (2014).Draft *Budget 2015-16:* http://www.northernireland.gov.uk/draft-budget-2015-2016.pdf

[28] Northern Ireland Executive (2014).Draft *Budget 2015-16:* http://www.northernireland.gov.uk/draft-budget-2015-2016.pdf

2.1.2 Varying the domestic rates maximum capital limits

The following sub-section sets out how a change in the current regulations that set domestic rates maximum capital limits at £400,000 could provide a revenue-raising policy lever in relation to Regional Rates.

If the rateable capital value for a property exceeds the maximum capital value, rates are chargeable only in respect of the maximum, rather than the rateable capital value. The current regulations set the maximum capital value at £400,000.[29] One potential revenue raising lever that is open to the Executive in terms of Regional Rates is increasing the cap on domestic rates bills for properties valued at £400,000 or more.

The following example demonstrates the effect of the maximum capital value limit; if a domestic property is listed with a rateable capital value of £580,000, the rates payable on that property would be applied *as if* the property were listed at £400,000. Therefore any increase in the maximum capital rate value would result in higher rate bills and an increased level of revenue for the Executive from the Regional Rate.

The table below shows the amount of additional regional revenue raised by each new 11 district council under the following variations in maximum capital value:[30]

- Raising maximum capital value limit for domestic rating to £450,000;
- Raising maximum capital value limit for domestic rating to £500,000;
- Raising maximum capital value limit for domestic rating to £600,000; and,
- Removing the maximum capital value limit for domestic rating.

District Council	Additional Regional Rates Revenue - £450k Cap	Additional Regional Rates Revenue -£500k Cap	Additional Regional Rates Revenue -£600k Cap	Additional Regional Rates Revenue- Cap Removed
Antrim and Newtownabbey	19,000	30,000	41,000	46,000
Armagh, Banbridge and Craigavon	37,000	58,000	80,000	119,000
Belfast	449,000	776,000	1,168,000	1,811,000
Causeway Coast and Glens	36,000	59,000	80,000	109,000
Derry and Strabane	18,000	29,000	43,000	54,000
Fermanagh and Omagh	15,000	24,000	35,000	48,000
Lisburn and Castlereagh	113,000	174,000	235,000	309,000

29 *The Rates (Maximum Capital Value) (Amendment) Regulations (Northern Ireland) 2009*.

30 Table compiled by RaISe using figures supplied by DFP in correspondence dated 15 October 2014. The figures are indicative, using average amounts, ignoring some boundary changes and using combined 2014/15 District and Regional Rates. Also note that the figures are rounded to the nearest thousand pounds.

Mid and East Antrim	17,000	27,000	36,000	51,000
Mid Ulster	21,000	34,000	48,000	65,000
Newry, Mourne and Down	56,000	89,000	126,000	183,000
North Down and Ards	303,000	515,000	783,000	1,362,000
Total Additional Regional Rates Revenue	**£1,084,000**	**£1,815,000**	**£2,675,000**	**£4,157,000**

It is noteworthy that under the previous rating regulations, between 1 April 2007 and the current regulations coming into effect on 1 April 2009, the maximum capital rate value limit was £500,000.

Scrutiny point:

Given the limited options available to the Executive under current devolution for increasing revenue, and the apparent restriction on funding from UK government, and Northern Ireland's current public finance situation, is it prudent that the Executive does not avail of the revenue raising potential in making changes to the maximum capital rate value limit?

2.2 Water Charges

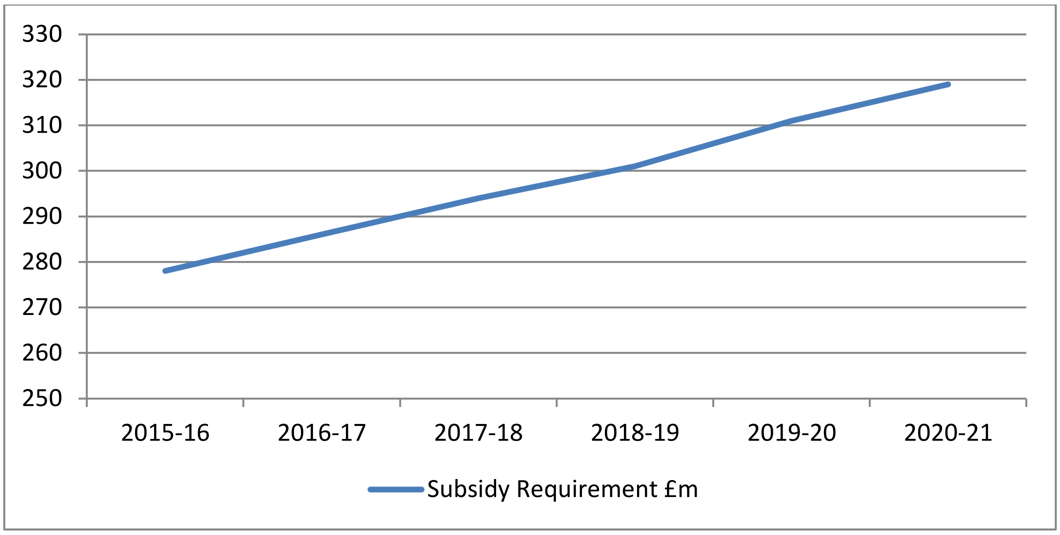
This sub-section considers water charges as a measure for revenue raising by the Executive.

2.2.1 Northern Ireland Water Subsidy

Northern Ireland households are unique in the UK in that they do not pay a direct charge for water and sewage services. Households do make an indirect contribution through the domestic Regional Rate. However, the Executive continues to subsidise this contribution with around £300 million per annum.[31] The chart below shows the level of provisional estimated subsidy from the Executive to Northern Ireland (NI) Water from 2015 to 2021.[32]

[31] Utility Regulator (2014). *Water & Sewerage Services Price Control 2015-21: Draft Determination – Annex B; Sources of Revenue:* http://www.uregni.gov.uk/uploads/publications/UR_PC15_DD_Annex_B_-_Sources_of_Revenue.pdf

[32] Chart Compiled by RaISe relying on data contained in: Utility Regulator (2014). *Water & Sewerage Services Price Control 2015-21: Draft Determination – Annex B; Sources of Revenue:* http://www.uregni.gov.uk/uploads/publications/UR_PC15_DD_Annex_B_-_Sources_of_Revenue.pdf



NI Water's heavy reliance on government for funding - approximately 76% - resulted in March 2009 in its designation as a Non-Departmental Public Body (NDPB).[33] As such NI Water is now subject to public sector governance – including the financial arrangements under current devolution - and compliance measures which govern daily operation of companies, including limited companies.

Scrutiny Point:

Given Northern Ireland's current public finance situation, is it prudent that the Executive continues to subsidise NI Water to the extent that it does?

2.2.2 Funding Capital Investment

NI Water's NDPB status, coupled with its heavy reliance on sustained capital investment due to the asset intensive nature of its business, presents challenges. For example, a lack of 'end of year flexibility', coupled with recent uncertainty about the public expenditure budget and an inconsistent profile of public expenditure; in combination these factors promote short-term, stop-start investment programmes that are inefficient, and often are at the expense of larger strategic projects for which funding cannot be guaranteed.

An illustration of this is the thirteen large waste water treatment works (WWTW) to be upgraded within NI Water's PC15 programme of work (2015-21). The Executive's Investment Strategy (ISNI) projects £990 million of funding in this area. [34] However, this will leave 58 WWTW's requiring upgrading at the end of that period. Consequently, this apparent failure to invest sufficiently in drainage infrastructure potentially jeopardises future economic development across Northern Ireland.

[33] Utility Regulator (2014). *Water & Sewerage Services Price Control 2015-21: Draft Determination – Annex B; Sources of Revenue:* http://www.uregni.gov.uk/uploads/publications/UR_PC15_DD_Annex_B_-_Sources_of_Revenue.pdf

[34] Department for Regional Development (2014). *PC15 Social & Environmental Public Consultation - NI Water's Response:* *http://www.drdni.gov.uk/niw_pc15_seg_response_by_niw-including-spreadsheet.pdf*

Restrictions on borrowing are also a significant constraint for NI Water. Utility companies rely on borrowing in order to fund their capital programmes. This is an efficient way of financing the construction of long-life assets, and does not put an undue burden on the customers of today to pay for assets that will provide a service for many years to come.

UK companies such as Welsh Water are very successful in raising capital by borrowing in the form of low cost bonds raised on the private capital markets. For example, in 2006, Welsh Water issued a 50-year bond at a real interest rate of just 1.4%.[35] The ability to function without the operational and financial restrictions imposed by NI Water's hybrid NDPB status is essential to its future well-being. However, the only way this could happen in Northern Ireland would be NI Water becoming 'self-financing'; which would require at least 51% of its budget to come from water charges.

Restrictions on borrowing for NDPBs such as NI Water limit opportunities for high levels of capital investment that are needed for such an asset intensive business. The burden of capital investment in NI Water falls currently on the Executive. Arguably self-financing NI Water could fund capital investment through borrowing on the private markets, unfettered by the financial arrangements of current devolution, and consequently take advantage of low interest rates, as has been demonstrated by Welsh Water.

Scrutiny Point:

Given the limited options available to the Executive under current devolution for increasing revenue, and the apparent restriction on funding from UK Government, and Northern Ireland's current public finance situation, is it prudent that the Executive does not avail of the revenue raising potential of water charging?

2.2.3 EU Water Framework Directive

In addition to the above, it appears that the introduction of water charges arguably would promote Northern Ireland's compliance with EU Water Framework Directive (WFD), under Article 9 of the Directive. Member States are required to take account of the principle of cost recovery for water services in accordance with the *polluter pays principle*.[36] The Directive envisages that users would be required, through the application of the polluter pays principle, to pay for their water supplies in order to develop awareness and efficiency in water usage. Application of this policy has been shown to bring about behaviour changes, whilst water charges provide an important source of revenue to improve services.

The Executive's position on this issue is that the contribution made *via* the Regional Rate is sufficient to comply with Article 9. However, the lack of any clear and

[35] Glas Cymru (2001) *Glas Cymru's plans for Welsh Water* : http://nia1.me/1ey

[36] The 'polluters pays' principle is the commonly accepted practice that those who produce pollution should bear the costs of managing it to prevent damage to human health or the environment.

transparent legislation in this area, whereby consumers are informed of how much they contribute towards water and sewerage services means there is no real incentive to conserve water and is contrary to the spirit of the law contained in WFD. The application of Article 9 has been a criticism of the WFD policy, particularly in terms of inconsistencies around cost recovery. This is likely to lead to a stronger definition of cost recovery to be brought forward, which could force EU Member States to, at a minimum, provide consumers with a clear and transparent water bill.

3 European Union Funding

This section addresses European Funding, which provides the Executive with an additional source of budget finance.

European Union (EU) funding plays a significant role in Northern Ireland. Over £1 billion was received in EU Structural Funds alone between 2002 and 2012[37] *via* programmes such as the Northern Ireland Rural Development Programme, the European Regional Development Programme, the European Social Fund and the European Fisheries Fund Programme.

The *Statement of Funding Policy* explains how this funding is reflected in the Executive's budget under current devolution.[38] Key aspects of those *Statement of Funding Policy* provisions and relevant European requirements specify that the funding amount (European receipts) must be 'matched' and conditions met; whereby Northern Ireland - as a region of the UK member state – must allocate the same amount from its allocated DEL budget, or from external private sources as appropriate: (the private dimension arises from an European funding change for the 2014-20 programme period).[39] So while this EU funding increases spending power for Northern Ireland, it has to be matched using DEL; and both the receipts and expenditure must be used in accordance with the specified requirements. If this does not occur, the EU monies are lost.

Also to be noted is that actual transfer of those receipts and related expenditure occurs when the given programme actually gets underway, assuming all other relevant EU requirements/conditions are met.

In light of the above, the Draft Budget 2015-16 document states that:

[37] Northern Ireland Assembly Written Question: AQW 21495/11-15

[38] HM Treasury (2010).*Statement of Funding Policy*: http://webarchive.nationalarchives.gov.uk/+/http:/www.hm-treasury.gov.uk/d/sr2010_fundingpolicy.pdf, p. 25.

[39] Northern Ireland Executive (2014).Draft *Budget 2015-16:* http://www.northernireland.gov.uk/draft-budget-2015-2016.pdf, pp. 30-31.

…Funding cover for national match funding contributions in respect of EU Structural and Investment Programmes has been held centrally in the draft Budget and will be allocated to departments as part of the final Budget.[40]

Scrutiny Points:

1. How has the Executive undertaken an assessment to determine the level of DEL co-financing needed by individual departments for programmes already underway, as well as those that are to start, to ensure European monies are not lost to Northern Ireland?
2. To what extent has the assessment included consideration of potential impacts that would arise from changes made by the Executive to co-financing levels for EU progammes?

4 Concluding Remarks

Total public sector revenue collected in Northern Ireland is significantly less than total public sector expenditure. In his statement on the Draft Budget 2015-16, the Minister of Finance and Personnel indicated that the most current figures available (2011-12), estimate this fiscal deficit at £9.6 billion.[41] The Draft Budget 2015-16 document announced that Northern Ireland's 2015-16 budget settlement from Westminster has resulted in a real terms reduction of 1.6 per cent in Non-ring-fenced Resource DEL. The Draft Budget 2015-16 document also stated:

The [UK] Chancellor has made it clear that the wider UK economy must control its debt and that any economic growth will be used to target the national deficit. This means the Northern Ireland public sector will continue to face a sustained period of budget constraint.[42]

Given this predicted *sustained period of budget constraint* in Northern Ireland, due consideration should be given to financing measures outside the usual Westminster allocations, e.g. borrowing, Regional Rate, water charging and European Union funding.

The Executive has continually used the RRI borrowing facility to invest in capital projects since its introduction in 2003-04. However, since 2003-04 the RRI annual borrowing limit has been exceeded on several occasions. Draft Budget 2015-16 allocates £63.4 million of Non-ring-fenced Resource DEL to RRI interest repayments in 2015-16 and forecasts interest payments of £35 million in 2024-25. The use of RRI

[40] Northern Ireland Executive (2014).Draft *Budget 2015-16:* http://www.northernireland.gov.uk/draft-budget-2015-2016.pdf, pp. 30-31.
[41] NI Assembly Official Report (3 November 2014). *Finance Minister Statement on Draft Budget 2015-16*.: http://aims.niassembly.gov.uk/officialreport/report.aspx?&eveDate=2014/11/03&docID=211611
[42] Northern Ireland Executive (2014).Draft *Budget 2015-16:* http://www.northernireland.gov.uk/draft-budget-2015-2016.pdf

borrowing to fund capital projects appears to come at a cost to the Executive. It seems that the Executive should consider whether such cost represents value for money.

In the Draft Budget 2015-16 document, the Executive proposed to keep the Regional Rate element of Northern Ireland household rate bills at the level of inflation. In justifying this decision, the Executive appears to suggest a link between higher household rate bills and a resulting fall in consumer confidence; which would negatively affect the Northern Ireland economic recovery. Given the Regional Rate only constitutes a part of the Northern Ireland total household rates bill, a question arises about the basis for the Executive's assessment of consumer confidence.

By not introducing water charges to Northern Ireland, the Executive is effectively left with no choice but to support NI Water financially, by approximately £300 million a year. This subsidy is projected to increase in the coming years. NI Water's NDPB status, coupled with its heavy reliance on sustained capital investment due to the asset intensive nature of its business, presents certain financing challenges, including restrictions on borrowing and a lack of long-term strategic investment. Given Northern Ireland's current public finance situation, is it prudent that the Executive continues to subsidise NI Water to the extent does?

Finally, the Executive needs to ensure that it has given full and proper consideration to the receipts for EU funding. This is to ensure that there will be adequate match funding from Northern Ireland's DEL, or from external private sources as appropriate, so that EU requirements are met, and European monies are not lost for Northern Ireland.