Northern Ireland Assembly

# Research and Information Service Briefing Paper

Paper 06/15 | 26 January 2015 | NIAR 34-15

**Public Finance Scrutiny Unit**

# Final Budget 2015-16: Initial Considerations

Following the Draft Budget proposals and related public consultation, as well as the *Stormont House Agreement*, this Briefing Paper outlines initial considerations arising from the Executive's revised allocations. The allocations were presented to the Assembly on 19 January 2015, in the form of the Final Budget 2015-16.

## Introduction

Throughout on-going deliberations on the Budget, the Executive has made clear that revenue collected in Northern Ireland (NI) is significantly less than total public sector expenditure, necessitating a large fiscal transfer from the United Kingdom (UK) to NI. Public expenditure in NI is projected to continue to drop year-on-year in real terms during the life of the next Comprehensive Spending Review (CSR) period.[1] (The next CSR is expected after the UK general election in May 2015.)

In his statement accompanying the Draft Budget 2015-16, the Minister for Finance and Personnel (the Minister) stated that NI's fiscal transfer is estimated to be £9.6 billion (based on the most current available figures).[2] Therein, he further announced that NI's 2015-16 budget settlement from Westminster resulted in a real-terms reduction of 1.6% in Resource[3] Departmental Expenditure Limits.[4] He reiterated this in the Budget 2015-16 document, which he presented to the Assembly on 19 January 2015:

> *The Chancellor of the Exchequer has made it clear that the wider UK Economy must control its debt and that any tax gains from economic growth will be used to target the national deficit. This means that the Northern Ireland public sector will continue to face a sustained period of budget constraint.*[5]

To facilitate the Assembly's debate on the Final Budget – scheduled for 27 January 2015 - this Briefing Paper outlines initial considerations arising from recent budgetary announcements following the *Stormont House Agreement* in December 2014. First, the Paper highlights how the outcome of the political negotiations in December re-defined the parameters in which the Final Budget could be made. Thereafter it presents a number of charts and infographics to simply contextualise and highlight the Executive's changes. This is followed by a section highlighting initial considerations relating to the economy, which arise from the Final Budget.

This Paper is not intended to exhaustively address the full implications of the Final Budget: much of the detail that will inform impact is still to follow in terms of how each department will implement its budgetary allocation.

## 1. Stormont House Agreement

The *Stormont House Agreement*, (the Agreement) interceded between the publication of the Draft and Final Budgets, making it a unique feature in the 2015-16 budgetary process. Finalised in December 2014, following inter-party and inter-governmental

[1] http://www.northernireland.gov.uk/budget-2015-16.pdf (page 20)
[2] http://aims.niassembly.gov.uk/officialreport/report.aspx?&eveDate=2014/11/03&docID=211611
[3] See section 2 for definition
[4] http://aims.niassembly.gov.uk/officialreport/report.aspx?&eveDate=2014/11/03&docID=211611
[5] http://www.northernireland.gov.uk/budget-2015-16.pdf (page 7)

talks, it provided the Executive with a number of additional financial levers, including extra funding and flexibility on certain issues. The Agreement states:

> *The [UK] Government has developed a comprehensive financial support package to help the Executive deliver across its priorities. The total value of the Government package represents additional spending power of almost £2 billion.*[6]

Funding flexibility measures include:

- Up to £50 million additional Capital DEL[7] for new shared and integrated education projects;
- Flexibility to use £200 million of Reinvestment and Reform Initiative (RRI) borrowing to fund a Voluntary Exit Scheme for the Public Sector;
- An additional £100 million of borrowing for capital projects; and,
- Up to £30 million of Resource DEL for the funding of bodies to deal with the past.

Remarking on the Agreement's potential impact on capital investment, the Minister of Finance and Personnel stated:

> *The Executive's 2015-16 Budget allows for £1.1bn of departmental capital spend. In addition to this £50m provided under the Stormont House Agreement for shared and integrated education, this will increase the potential departmental capital spend to £1.2bn.*[8]

On the issue of the Voluntary Exit Scheme for Public Sector workers, he commented:

> *The flexibilities agreed in the Stormont House Agreement to utilise up to £200m of RRI borrowing to pay for a VES in 2015-16 will greatly assist the Executive in its aim to reform and restructure.*[9]

The Agreement re-defined the parameters in which the Budget could be made. The following section sets out the Executive's allocations in the Final Budget.

[6] Stormont House Agreement available at https://www.gov.uk/government/publications/the-stormont-house-agreement
[7] See section 2 for definition.
[8] Budget 2015-16 Ministerial statement available at http://www.dfpni.gov.uk/statement-by-finance-minister-budget-2015-16.htm
[9] *Ibid*

# 2. Final Budget Allocations Explained

The Executive does not have discretion over Annually Managed Expenditure (AME) funding[10]. This Paper is therefore concerned with Departmental Expenditure Limits (DEL) allocations, namely:

- **Ring-fenced Resource DEL** is that which has been ring-fenced by the Treasury in order to cover the non-cash cost of depreciation and impairments;
- **Non ring-fenced Resource DEL** reflects the on-going cost of providing services (e.g. pay or operating costs); and,
- **Capital DEL** reflects investment in assets which will provide or underpin services in the longer term (for example schools, hospitals, roads etc). Capital DEL is also disaggregated into conventional Capital and Financial Transactions Capital; the latter of which can be used only to provide loans to, or equity investment in, the private sector.[11]

Using charts and infographics, this section is presented as follows:

- Figure 1 shows total resources available to the Executive, by Treasury classification;
- Table 1 shows total DEL by department, in descending order;
- Figure 2 shows total proposed DEL allocations, by department;
- Figure 3 shows proposed Non-ringfenced Resource DEL allocations, by department;
- Figure 4 shows proposed Total DEL allocations, by department and Treasury classification;
- Figure 5 shows the difference in proposed Non-ringfenced Resource DEL allocations from draft to revised Budget; and,
- Figure 6 shows the percentage change in Non-ringfenced Resource DEL from Baseline to both the draft, and the revised Budgets.

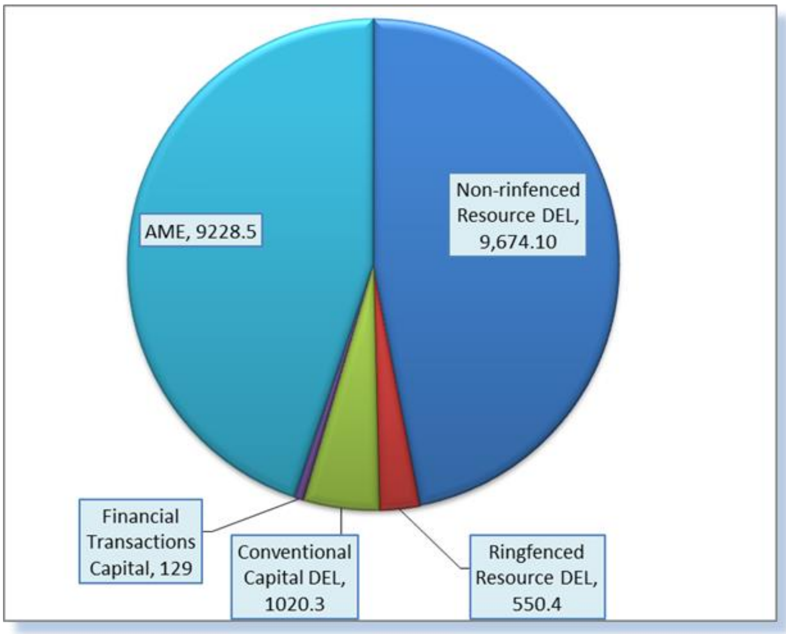
DEL figures are presented in terms of:

- **Resource** (Non-ringfenced Resource and Ringfenced Resource DEL); and,
- **Capital** (Conventional Capital DEL and Financial Transactions Capital (FTC)).

[10] AME figures are included in the Appendix of the revised Budget Document available at : http://www.northernireland.gov.uk/budget

[11] For further information on Financial Transactions Capital please refer to RaISe paper NIAR 082-14

### Figure 1: Total resources available to the Executive, by Treasury classification (£ millions)




### Table 1: Total proposed DEL allocations, by department, descending value

| Department | Total DEL (£m) |
|---|---:|
| DHSSPS | 5,028.8 |
| DENI | 2,061.6 |
| DOJ | 1,224.7 |
| DEL | 899.2 |
| DRD | 770.1 |
| DSD | 724.7 |
| DETI | 251.8 |
| DARD | 240.3 |
| DFP | 198.5 |
| DOE | 165.7 |
| DCAL | 105.2 |
| OFMdFM | 73.6 |

**Figure 2: Total proposed DEL allocations, by department (£ millions)**

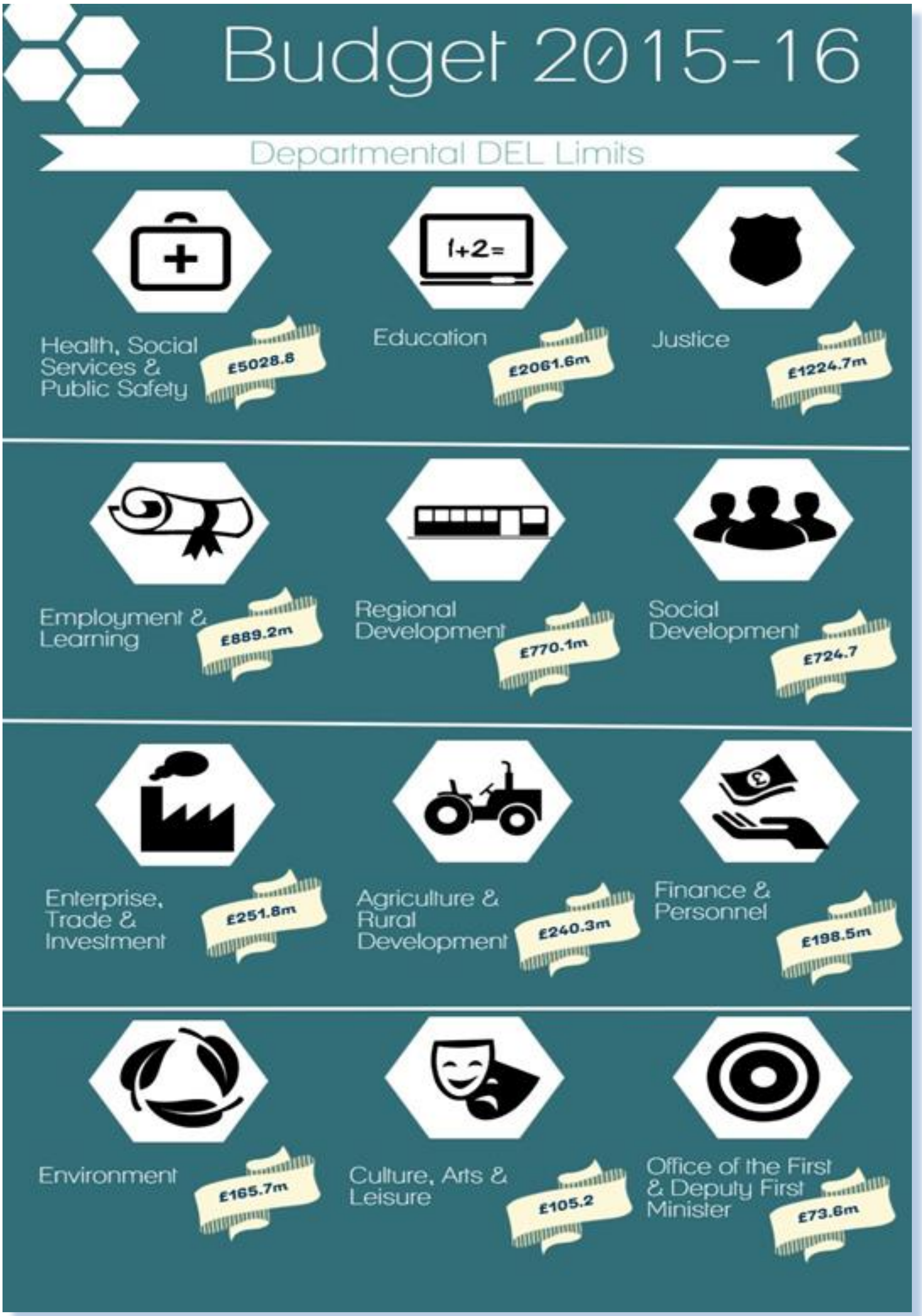


**Figure 3: Proposed Non-ringfenced Resource DEL allocations, by department (£ millions)**

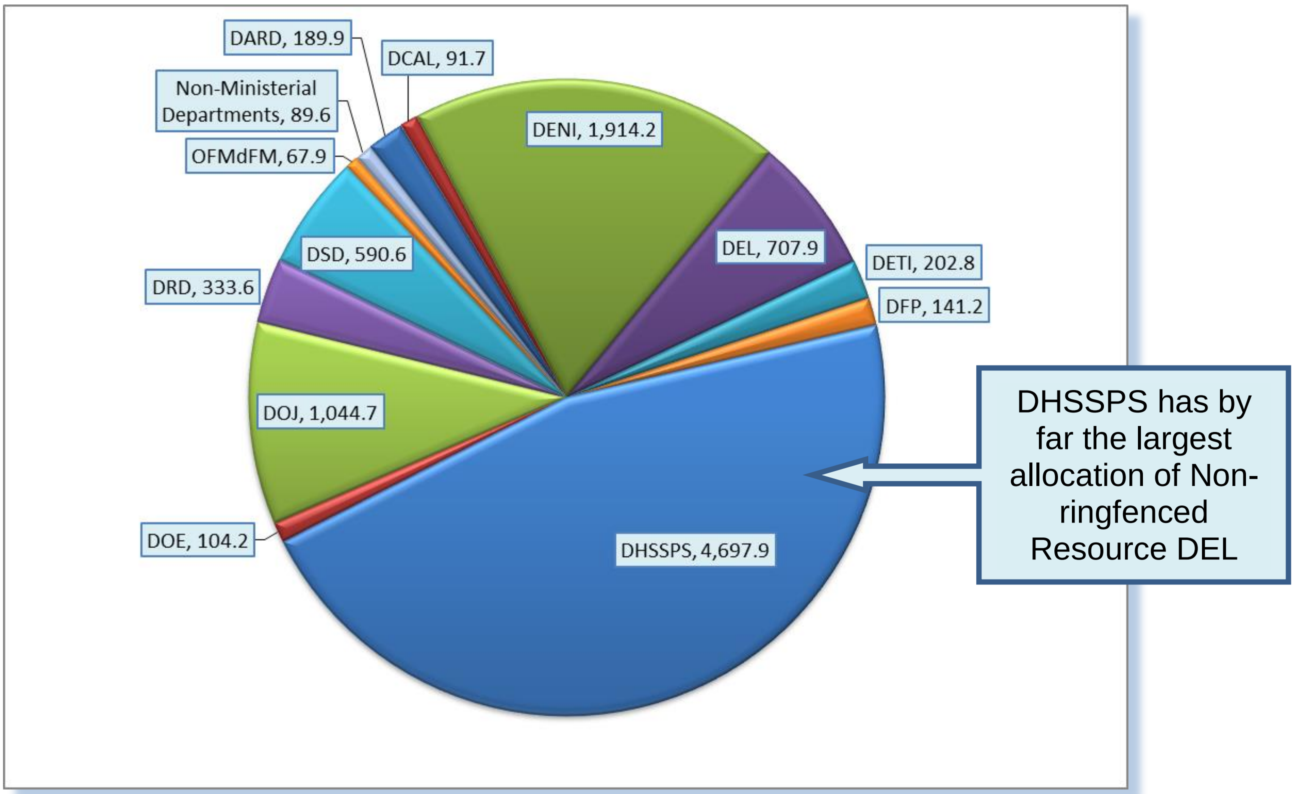



**Figure 4: Proposed Total DEL allocations, by department and Treasury classification (£ millions)**

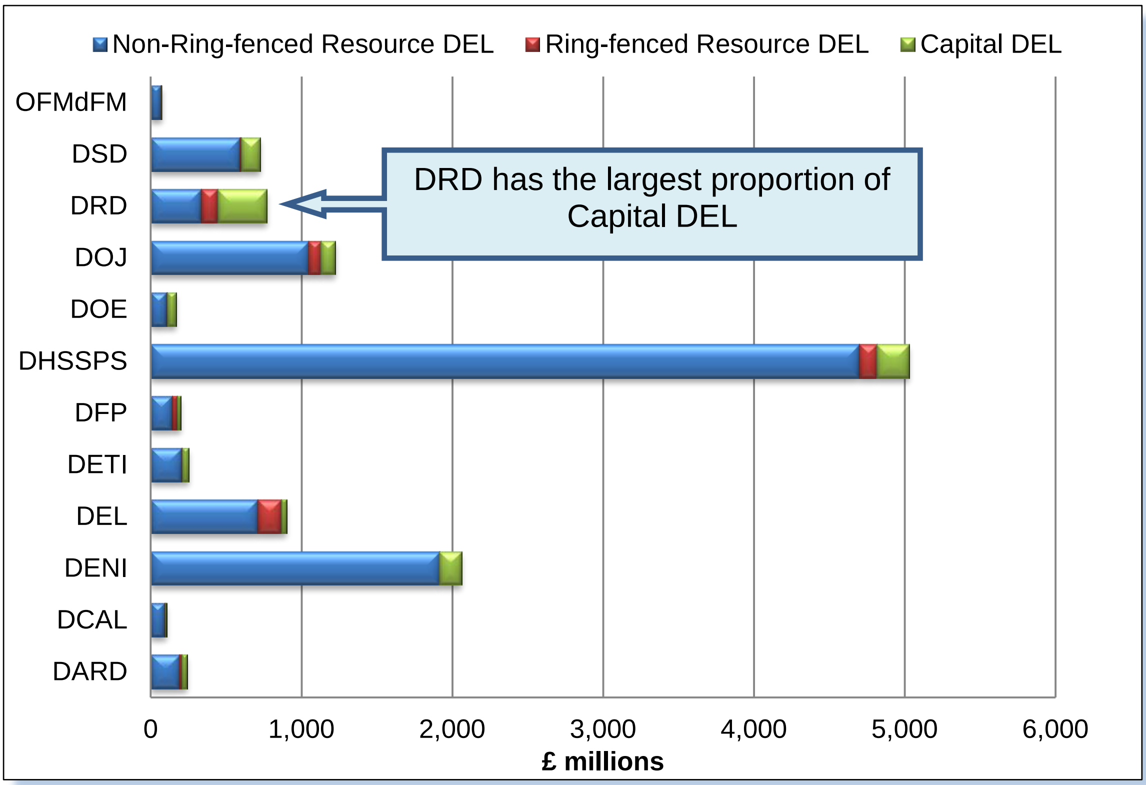


**Figure 5: Difference in proposed Non-ringfenced Resource DEL allocations from draft to revised Budget 2015-16, (£ millions)**

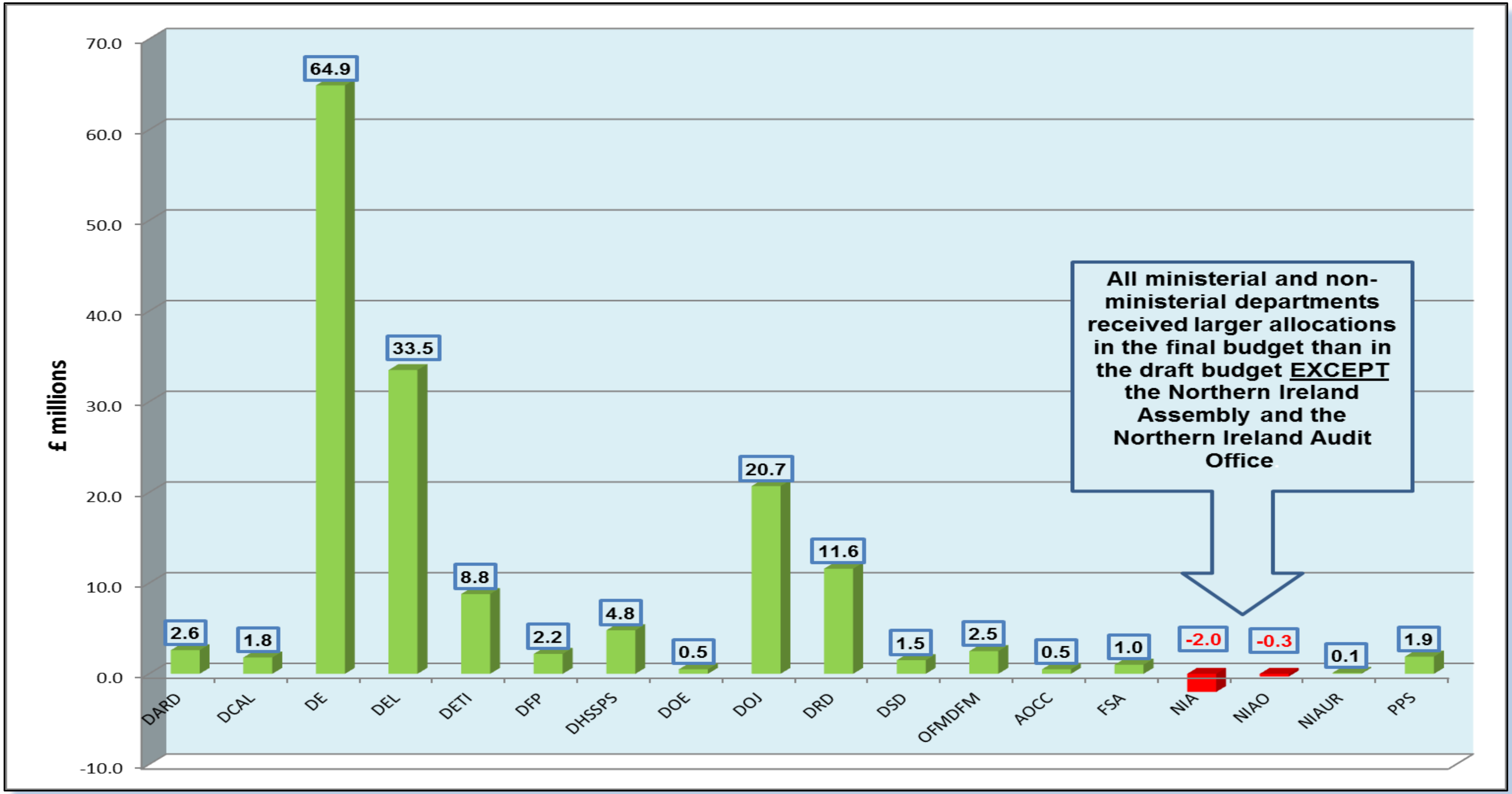
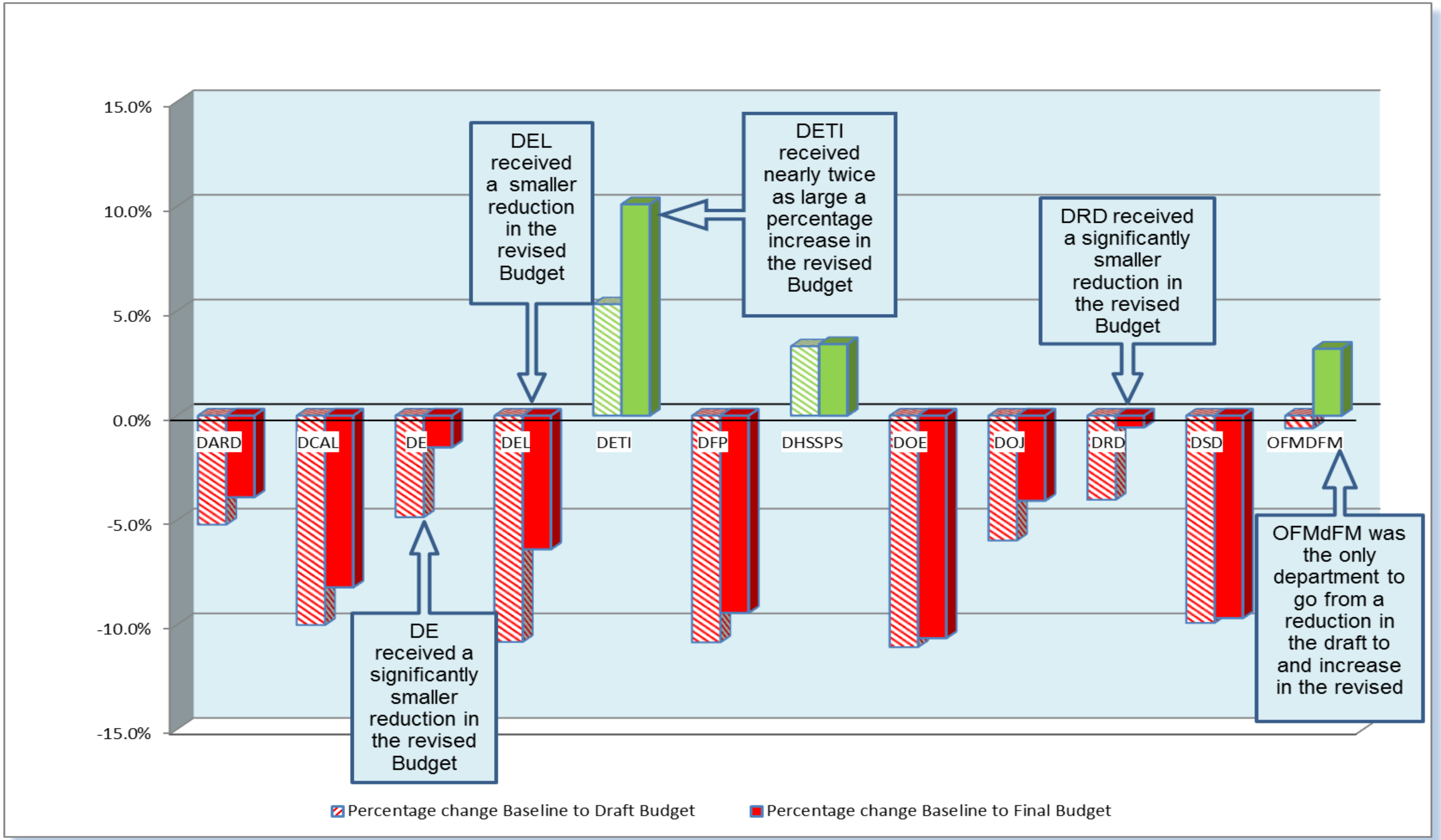


**Figure 6: Percentage change in Non-ringfenced Resource DEL from Baseline to both draft and revised Budget 2015-16**



# 3. Initial Considerations Relating to the Economy

This section highlights initial considerations relating to the economy, which arise from the Final Budget allocations.

## 3.1. Economic Growth

The UK economy has shown 6 consecutive quarters of Gross Domestic Product (GDP) growth and is officially out of recession. The Ulster University Economic Policy Centre (UUEPC) asserts that consumption expenditure and business investment are driving the UK recovery, and will continue to drive economic growth over the next four years. However, the UUEPC provides the following note of caution:

> *Reductions in UK government expenditure are expected to have a negative influence on UK economic growth from 2015 – 2018 as austerity plans continue to be implemented.*[12]

The NI economy has also recovered from recession; however economic output is not yet back to its 2007 peak, despite recovery. For 2014, UUEPC forecasted Gross Value Added (GVA)[13] growth at 2.2%.[14] GVA is forecasted to slow to 1.9% throughout 2016 and to slow further to 1.3% in 2017 and 2018.[15] UUPEC attributes the reduction in public spending in NI as acting as a brake or drag on economic growth:

> *In the context of current austerity policies, slowing the growth of government expenditure or reducing the level of government expenditure will act as a brake on economic growth.*[16]

Although there are reports of NI experiencing a growing economic recovery, it remains to be seen as how the constrained public expenditure environment in NI, which includes, for example, future implementation of the Voluntary Exit Scheme and Welfare Reform, will impact on this recovery.

## 3.2. Investment

The *Stormont House Agreement* affords the Executive flexibility to use £700 million of Reform and Reinvestment Initiative (RRI) capital borrowing. The Executive's Budget 2011-15 defines RRI as follows:

[12] Ulster University Economic Policy Centre (2014) *Briefing to Finance and Personnel Committee on the draft budget 2015-16.*
[13] GVA is a measure of economic activity, similar to GDP, but excludes the impact of taxes and subsidies (most notably VAT).
[14] Ulster University Economic Policy Centre (2014) *Outlook: Autumn 2014*: http://www.business.ulster.ac.uk/nicep/docs/NICEP%20Autumn%202014%20Outlook.pdf
[15] Ulster University Economic Policy Centre (2014) *Outlook: Autumn 2014*: http://www.business.ulster.ac.uk/nicep/docs/NICEP%20Autumn%202014%20Outlook.pdf
[16] Ulster University Economic Policy Centre (2014) *Briefing to Finance and Personnel Committee on the draft budget 2015-16.*

*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.*[17]

The Final Budget 2015-16 states:

*Investment in infrastructure is a key driver of economic growth.*[18]

In its consultation response to the *Draft Budget 2011-15,* the Northern Ireland CBI stated its shared view that infrastructure investment is essential to economic growth in NI, stating:

*Capital investment in our infrastructure must remain a priority, in the context of the construction multiplier effect and its direct economic benefits – for every £1 invested there is a direct economic return of £2.84 - we have long held the view that it is crucial that we seek to maximise, where feasible, investment in infrastructure spending.*[19]

The Final Budget 2015-16 proposes the use of £700 million of capital borrowing to fund a Voluntary Exit Scheme over a period of four years, with £200 million in 2015-16, £200 million in 2016-17, £200 million in 2017-18 and £100 million in 2018-19.[20] By diverting finance away from capital projects to pay for redundancies in the public sector, this use of RRI borrowing may appear at odds with the Executive's commitment to invest in NI infrastructure.

However, it appears from the Final Budget 2015-16 that the Executive seeks to address these concerns, when it states:

*The Stormont House Agreement also provided for up to £350 million of additional borrowing to support important capital investment projects. The spending profile is across four years with £100 million in 2015-16, £100 million in 2016-17, £100 million in 2017-18 and £50 million in 2018-19.*[21]

It remains to be seen whether this level of capital investment in NI infrastructure will be sufficient to provide the necessary direct economic benefits to facilitate growth.

## 3.3. Skills and wages

A key element of the NI economic strategy is to rebalance the economy.

As a part of this, the strategy states that the Executive intends to:

[17] Northern Ireland Executive (2011).*Budget 2011-15*: http://www.northernireland.gov.uk/revised_budget_-_website_version.pdf
[18] Northern Ireland Executive (2015). *Budget 2015-16*: http://www.northernireland.gov.uk/budget-2015-16.pdf
[19] CBI Northern Ireland (2014) ***Response to the Finance and Personnel Committee's consideration of the draft Northern Ireland** Executive Budget 2015-16*.
[20] Northern Ireland Executive (2015). *Budget 2015-16*: http://www.northernireland.gov.uk/budget-2015-16.pdf
[21] Northern Ireland Executive (2015). *Budget 2015-16*: http://www.northernireland.gov.uk/budget-2015-16.pdf

*Improve the skills and employability of the entire work force so that people can progress up the skills ladder, thereby delivering higher productivity and increased social inclusion.* [22]

Skills and employability have long been linked to increased productivity, leading to a high value economy reflected in economic and wage growth. The Department for Employment and Learning's *Labour Market Bulleting 2013* found that:

*It has been estimated that increasing the average level of education in the labour force by one year is associated, over time, with a substantial increase in labour productivity of between 11-15%.* [23]

As such, a high value economy requires the education and skills essential to attract high wage employment. In this regard, it seems reasonable to view the extra £33 million allocated in to the Department for Employment and Learning in the Final Budget 2015-16, to develop skills in the NI workforce, as a positive step by the Executive that aims to contribute to both the overall goals of the Executive in rebalancing the economy and increased productivity, wage growth and economic development.

However, this additional allocation should be viewed against the backdrop of cuts to the Department for Employment and Learning over the last number of years. Whilst frontline services have previously been protected from many of these cuts, there are indications that areas such as Higher and Further Education (key drivers of skills development) may still need to cut student places, despite these additional resources.[24]

## 3.4. 'Change Fund'

The Final Budget 2015-16 includes a £30 million allocation for a 'Change Fund', to help stimulate innovation, improve outcomes for citizens and generate savings. The Final Budget states:

*The Fund will finance up-front investment in cross-cutting reform initiatives and preventative measures that are expected to generate savings in the longer term. It will* ***assist transformation and change in the public sector through the introduction of new innovative ways of working****.*

It goes on to state that:

*Preventative spending will be key to encouraging* ***innovation*** *in our public services and will assist in achieving better outcomes for citizens. This in turn will contribute to savings to the public purse in the longer term. The*

[22] Northern Ireland Executive (2012), Economic Strategy: priorities for sustainable growth and prosperity, http://www.northernireland.gov.uk/ni-economic-strategy-revised-130312.pdf

[23] Department for Employment and Learning, July 2013, Labour Market Bulletin 24

[24] BBC News, 19 January 2015, NI budget: Extra £150m found in final deal, http://www.bbc.co.uk/news/uk-northern-ireland-30872327

*Change Fund is an opportunity to implement initiatives that could alleviate pressure on front-line services in the longer term.*[25] ***[emphasis added]***

Although there is currently no information available on the criteria used by the Department of Finance and Personnel when allocating the financing under the Fund, it appears from the limited information in the Final Budget document that a number of the schemes are potentially a continuation of previous schemes, for example: collaborative procurement; and, apprenticeships and youth training**.**[26]

It remains to be seen whether the Change Fund will deliver its objectives,that is - helping to stimulate innovation, improve outcomes for citizens and generate savings.

## 3.5. Welfare Reform Penalties

The *Stormont House Agreement* states:

*…if the implementation of welfare reform is completed during 2015-16 (including the relevant secondary legislation) the £114m deduction will be reduced to reflect the proportion of the year prior to implementation of the measures.*[27]

However, prior to the Agreement, the Minister of Finance and Personnel stated that he had commissioned work to validate the Treasury's assessment of the level of financial penalty. In answer to an Assembly Question on 14 October 2014, the Minister noted this work, stating:

*In order to provide some much needed clarity on the impact of welfare reform, I have commissioned an independent review, the terms of reference for which have been drawn up by my officials and shared with the Department for Social Development.*[28]

The implications of Welfare Reform on the economy are yet to be realised, but the findings of the Minister's above-stated review – once they are made available - may go some way in helping to assess the level of financial penalty imposed by the Treasury.

[25] Northern Ireland Executive (2015) Budget 2015-16 Pg 45 available online at http://www.northernireland.gov.uk/budget-2015-16.pdf (accessed on 22 January 2015)

[26] The Public Finance Scrutiny Unit is awaiting additional Executive information on the criteria for allocating support under the Change Fund, together with details of the schemes for each departmental funding request. Once this information becomes available, it will be reviewed to assess how the allocation of the funding coincides with the aims of the Change Fund stated in the Final Budget.

[27] Stormont House Agreement available at https://www.gov.uk/government/publications/the-stormont-house-agreement

[28]http://www.aims.niassembly.gov.uk/officialreport/report.aspx?&eveDate=2014-10-14&docID=209460#AQO 6794/11-15