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Public Finance Scrutiny Unit

In-year Reductions to Departmental Resource DEL: the October 14-15 Monitoring Round

This Briefing Paper outlines relevant background information and presents two models the potential impact of ringfencing on the budgets of Northern Ireland departments if spending reductions are applied in the forthcoming October Monitoring Round.

Departmental Abbreviations

Executive Departments	
DARD	Department of Agriculture and Regional Development
DCAL	Department of Culture, Arts and Leisure
DE	Department Education
DEL	Department of Employment and Learning
DETI	Department of Enterprise, Trade and Investment
DFP	Department of Finance and Personnel
DHSSPS	Department of Health, Social Services and Public Safety
DOE	Department of the Environment
DOJ	Department of Justice
DRD	Department of Regional Development
DSD	Department of Social Development
OFMDFM	Office of First Minister and Deputy First Minister
Non-Ministerial Departments	
AOCC	Northern Ireland Assembly Ombudsman and Complaints Commissioner
FSA	Food Standards Agency
NIA	Northern Ireland Assembly
NIAO	Northern Ireland Audit Office
NIAUR	Northern Ireland Authority for Utility Regulation
PPS	Public Prosecution Service

Introduction

This Briefing Paper has been prepared for the Assembly to support its consideration of the October Monitoring Round.

Section 1 sets out background information to establish the parameters in which the resource allocations/reductions will be made in the forthcoming October Monitoring Round.

Section 2 provides further context, outlining merits and demerits of ringfencing, which were identified during the UK Government's *Spending Round 2013* (SR 2013).

Although Northern Ireland's monitoring processes under devolution are outside and different to those at the UK level, general ringfencing considerations arising at the UK level arguably have relevance in the current Northern Ireland context. It is anticipated that the Executive's approach during the October Monitoring Round will be to protect certain budgets; similar to its decision during the June Monitoring Round, when it ringfenced the budgets of DHSSPS, DE, NIAO and AOCC.

With this in mind, for illustrative purposes, Section 3 models two possible outcomes arising from the forthcoming October Monitoring Round to aid Assembly discussion in this area (of course there could be others). These potential outcomes are:

- A) continued protection for DHSSPS, DE, NIAO, and AOCC; and,
- B) no protection for any department.

Throughout the Paper, scrutiny points are highlighted to facilitate Assembly business.

1. Background

On 31 July 2014, the Minister of Finance and Personnel made a written statement to the Assembly on the outcome of the 2014-15 June Monitoring Round. As part of the process of the In-year Monitoring of public expenditure in Northern Ireland, the Executive agreed to £77.9 million of reductions to Departmental Resource Department Expenditure Limits (DEL).¹

A reduction of 2.1% was applied to the 2014-15 budget resource monitoring totals of all departments (including non-Ministerial departments) except: NIAO; AOCC, DHSSPS and DE. The Minister of Finance and Personnel's written statement on the outcome of the June Monitoring Round does not explain the reasons for the protection of the NIAO and AOCC baselines. In relation to DHSSPS, he stated:

*The Executive remains extremely concerned by the deteriorating financial position of the health sector in Northern Ireland.*²

The Minister further noted that DHSSPS has registered Resource expenditure pressures of £160 million for this financial year. In relation to DE, the Minister stated that conferring protection was necessary "*in order to obtain Executive agreement*".³

The Minister's written statement also noted that the Executive agreed to review its decision *not* to exempt the Assembly at October Monitoring.

In addition to the above reductions, and in line with usual practice, departments also surrendered 'reduced requirements' as part of the June Monitoring Round.

Reduced Requirements

Reduced requirements are defined in DFP's publication *In-year Monitoring of Public Expenditure: 2014-15 Guidelines*⁴ as:

...amounts arising as a result of:

- *increased levels of receipts not inextricably linked to additional expenditure necessarily incurred;*
- *unplanned asset sales (i.e. above those included in the relevant budget position);*
- *a service or function requiring less than its existing provision;*

¹Written Ministerial statement, 31 July 2014, available online at: <http://www.dfpni.gov.uk/statement-on-june-monitoring-round-2014-15.pdf> (accessed 4 August 2014) (see Table H)

²Written Ministerial statement, 31 July 2014, available online at: <http://www.dfpni.gov.uk/statement-on-june-monitoring-round-2014-15.pdf> (accessed 4 August 2014) (see page 11)

³Written Ministerial statement, 31 July 2014, available online at: <http://www.dfpni.gov.uk/statement-on-june-monitoring-round-2014-15.pdf> (accessed 4 August 2014) (see page 12)

⁴DFP (2014) 'In-year Monitoring of Public Expenditure: 2014-15 Guidelines', paragraph 5.12. At time of writing, it is not yet available online. Definition extracted from a copy provided to RaISe. 2013-14 Guidelines are available at: <http://www.dfpni.gov.uk/in-year-monitoring-of-public-expenditure-2013-2014>

- *savings from changes to pay/price assumptions; and,*
- *a decision to cease or reduce a service or function (other than departmental proposals for the reduction/cessation of expenditure lines to meet pressures arising elsewhere with the department).*

The 'reduced requirements' surrendered by departments, together with the 2.1% reductions, were used during June Monitoring to fund a number of reallocations to other departments, and also to meet prior Executive commitments.⁵

At present, how baseline reductions, if any, should be applied is still to be decided by the Executive. Having said this however, DFP has stated in a letter to the Public Finance Scrutiny Unit (PFSU) with RaISe that:

*...whilst it is for the Executive to decide the basis of the £87 million reduction to be applied in October, it is **likely to be calculated on the Opening Monitoring position** not the June monitoring outcome.⁶*
[emphasis added]

Welfare Reform

In the current context, it is also worth noting that the issue of how to fund the financial penalties notified by the United Kingdom (UK) Government in relation to welfare reform has not yet been fully resolved by the Executive. In his written statement however, the Minister of Finance and Personnel said that the Executive had agreed to further adjustments in departmental baselines in the October Monitoring Round:

The Executive has agreed to further Resource DEL reductions in the October Monitoring Round to cover the welfare reform penalties. If there is no agreement on Welfare Reform this would amount to the full £87 million penalty, which would be a further 2.3 per cent reduction for those departments not protected. Any reduced requirements declared in the October Monitoring Round by individual departments will be used to reduce the level of any adjustments applied to that department in the October round.⁷

The reference in the cited passage to 'protection' could suggest that the Executive may again ringfence the budgets of some departments in the October Monitoring Round. The approach of ringfencing some departmental budgets at the expense of others has been used by the UK Government since 2010, as noted below in Section 2 of this Paper, which looks at key potential implications that may arise from ringfencing policies.

⁵Written Ministerial statement, 31 July 2014, available online at: <http://www.dfpni.gov.uk/statement-on-june-monitoring-round-2014-15.pdf> (accessed 4 August 2014) (see page 11)

⁶Letter from DFP official to RaISe, ref RR/002/11-15, dated 21 August 2014

⁷Written Ministerial statement, 31 July 2014, available online at: <http://www.dfpni.gov.uk/statement-on-june-monitoring-round-2014-15.pdf> (accessed 4 August 2014) (see page 13)

2. Merits and demerits of ringfencing

This section sets out key general considerations about ringfencing, which were identified by various interested parties in the run-up to the UK Government's SR 2013. At that time, it was widely expected that certain elements of public expenditure would be protected. Despite the differences between the UK and NI levels, this information arguably has general relevance. It is intended to provide some useful insight for the Assembly when scrutinising the Executive's decisions during the October Monitoring Round in Northern Ireland and how the Executive exercised its discretion when dividing resources among departments.

First it outlines some points of principle and general commentary; followed by consideration of the detailed reports of the UK Parliament's Treasury.

2.1. General commentary

The Institute for Economic Affairs,⁸ a free-market think tank, wrote an open letter to the *Daily Telegraph* co-signed by the Centre for Policy Studies, The Institute of Directors, Politeia, Respublica, and the TaxPayers' Alliance which called on the Chancellor to:

*...abandon the Government's policy of implicit and explicit ring-fencing of certain areas of spending. In this spending review, areas such as health, overseas aid and development, and non-contributory benefits for older people should all be considered as areas in which savings can be made.*⁹

The authors acknowledged that it was acceptable to prioritise certain areas of spending over others, but went on to comment that:

*Ring-fencing certain spending areas as a device for sending a political message or as a means of positioning a political party is no substitute for proper sustainable reform.*⁹

At around the same time, and towards the other end of the left-right political spectrum, the Chief Economist of the *Institute for Public Policy Research* wrote that the policy of ringfencing NHS and schools expenditure was "unsustainable". He argued that:

*By the time these cuts are fully implemented, on the government's current approach, other departments could have seen their budgets cut in real terms by one-third. This represents a massive reallocation of government spending to the NHS and schools; the sort of reallocation that should follow a systematic review of spending that weighs up the benefits of spending on the NHS and schools against other spending.*¹⁰

⁸<http://www.iea.org.uk/about>

⁹<http://www.iea.org.uk/in-the-media/media-coverage/government-should-abandon-ring-fencing>

¹⁰<http://leftfootforward.org/2013/05/ring-fencing-the-nhs-and-schools-is-no-longer-viable/>

After the SR2013 announcement in June 2013, the Director of the *Institute for Fiscal Studies* also picked up on the point the relative shift in resources from certain spending areas to the ringfenced areas. Indeed, he argued that the approach may need to be reconsidered. He stated:

*...the protection of the NHS and schools and pensions at least through to 2015–16 while all else is being cut, is leading to continued change in the shape of the state. These ring fences will have to be looked at again if we continue to cut overall spending.*¹¹

A leading article in *The Spectator* picked up the theme, describing ringfencing as “madness” before arguing that:

*The scale of the [public expenditure deficit] problem should be far too great for any budget to be ring-fenced, let alone the budgets of Health and Education — two of the biggest-spending departments.*¹²

The article built on the argument advanced in the Institute for Economic Affairs’ letter that no area should be off limits in considering how to reduce spending. It stated:

*It’s inconceivable that [the Chancellor] has been through the Health and Education budgets line by line and concluded that there is no fat to be trimmed.*¹²

In the political arena, the press reported that the plans to ringfence health, pensioner benefits, schools and international aid expenditure were under attack from within the Cabinet. Leaving politics aside however, there were numerous contributions to this debate from a range of viewpoints.

2.2. The UK Parliament

In the UK Parliament, the House of Commons Treasury Committee reported on 20 April 2013 on the Chancellors Budget 2013. The Committee addressed ringfencing directly:

*...the complete protection of ring-fenced departmental budgets will become more difficult for the Government with each successive year of tightening. Ring-fencing carries political attractions for any government, but it threatens to reduce scrutiny of ring-fenced spending, it can lead to waste or worse and it can distort the balance of spending as a whole.*¹³

On 11 September 2013, the Treasury Committee published a further report, subsequent to SR2013. The Committee took evidence from a range of experts, and

¹¹http://www.ifs.org.uk/budgets/sr2013/paul_johnson.pdf

¹²<http://www.spectator.co.uk/the-week/leading-article/8922381/cut-the-ring-fence/>

¹³<http://www.publications.parliament.uk/pa/cm201213/cmselect/cmtreasy/1063/1063.pdf> (see page 63)

this report included a section specifically focused on ringfencing. The report highlighted the following key considerations:

1) Unprotected areas take a bigger cut

The Committee reported the relatively straightforward, yet important, point that ringfencing shifts the burden of cuts from protected to unprotected spending areas. In other words, those areas outside the ringfence take a bigger cut than if reductions are evenly applied across the board.

The report cited evidence from Phillip Booth of the Institute of Economic Affairs. He made a direct link between ringfencing and the scale of the cuts being undertaken in non-ringfenced departments:

Self-imposed ring-fences around foreign aid and NHS spending together with less formal ring-fences around spending on the elderly, spending on schools and, to a lesser degree, spending on in-work benefits means that all the work in terms of cutting government spending falls on a relatively small number of departments (at a time when debt interest is also rising)¹⁴

This point is illustrated in Section 3 of this Paper, which models the potential relative impact of ringfencing in Northern Ireland under two assumptions (as specified in the introduction to this Paper).

Point for scrutiny: the Assembly may wish to consider the potential impact of ringfencing on unprotected departments, as illustrated in Section 3, as well as the extent to which this reflects the Executive's priorities, as outlined in the Executive's Programme for Government.

2) Ringfencing may create an incentive for 'gaming' the rules

The Committee's report also highlighted views that the policy of protecting certain budgets could lead to departments attempting to 'game' the rules by arguing that certain areas of expenditure should be within the ringfences:

The Institute for Government drew attention to the attempt by some departments "to reclassify their spending within protected budgets". They told us that "it was widely reported that BIS wanted to reclassify academic medical research funding as part of the NHS budget". They acknowledged that "almost all these attempts to break the ring-fences were unsuccessful", but said that these attempts to breach the ring-fence "attracted unnecessary attention and energy". We questioned the Chancellor about attempts to breach the ring-fences in this way. He told us that the Government had "rejected precisely what ... might have been tempting for

¹⁴ <http://www.publications.parliament.uk/pa/cm201314/cmselect/cmtreasy/575/57504.htm> (see paragraph 10)

me to do, which was to tuck things into the ring fence". He confessed that "there was a proposal early on in the spending round to shift some budgets into the health ring fence—medical training, medical research and Army medicine". However, he stressed that the Government had "rejected" such proposals and that "Medical research and medical training stay in BIS, and Army medicine stays with the Ministry of Defence".[46] The one exception, the Chancellor told us, was social care.¹⁵

The cited passage highlights the potential risk that ringfencing may cause departments to devote their energies to trying to circumnavigate cuts, in place of trying to implement them efficiently and effectively.

Point for scrutiny: the Assembly may wish to seek assurances from the Executive/departments that appropriate safeguards are in place to prevent 'gaming' of ringfence boundaries.

3) Scrutiny may be reduced inside the ringfence

The Treasury Committee's report made a further point that may be of particular interest to the Assembly and its statutory committees.

In our Report on the 2013 Budget, we argued that ring-fencing tends to reduce the scrutiny of ring-fenced spending, can lead to waste or worse, and if persisted with will distort the balance of spending as a whole. As the Chancellor argues, ring-fencing is an expression of political preference supported by the ballot box. However, spending in ring-fenced departments may receive less scrutiny than that in departments competing for resources. The Government must remain alert to this danger. The Government should place in the public domain its own assessment of the value for money of ring-fenced departments and its rationale for keeping the ring-fences.¹⁶

In other words, there may be a danger that because a particular department's budget has been ringfenced, its expenditure and planning could be inadequately scrutinised. In fact, there may be a case for *closer* scrutiny of a ringfenced budget to ensure that protection does not mask or entrench inefficiencies or wasteful spending.

Point for scrutiny: the Assembly may wish to ensure that the Executive's decision-making in relation to ringfencing is clearly explained and justified in a timely manner.

Secondly, those statutory committees scrutinising departments whose budgets have been protected may wish to ensure that there is still adequate focus on the potential to generate savings and to release resources for use elsewhere.

¹⁵ <http://www.publications.parliament.uk/pa/cm201314/cmselect/cmtreasy/575/57504.htm> (see paragraph 15)

¹⁶ <http://www.publications.parliament.uk/pa/cm201314/cmselect/cmtreasy/575/57504.htm>

3. Potential outcomes of the October Monitoring Round

Using illustrative figures, and bearing in mind the general ringfencing considerations highlighted in Section 2, this section models the potential impact of ringfencing on the budgets of the Northern Ireland departments if spending reductions are applied in the forthcoming October Monitoring Round. These models are:

- A) continued protection for DHSSPS, DE, NIAO, and AOCC; and,
- B) no protection for any department.

Thereafter there is a comparison of the outcomes under each model.

When considering this section, members are reminded that the following caveats apply to the illustrative figures used in each models:

- Budgeting and public expenditure decisions are political. This Paper does not comment on the rights or wrongs of Executive decisions in these matters;
- This Paper provides figures that are intended to show the impact of ringfencing certain departments' budgets. RalSe emphasises **the figures are for the purpose of illustration**, based on reasonable assumptions, to help inform the Assembly's consideration of the Executive's decisions;
- At the time of writing, **it is unknown what level of reduced requirements may be surrendered by departments in October Monitoring**. Such surrenders are made public only at the time to the Minister of Finance and Personnel's statements to the Assembly on the outcome of each Monitoring Round. Therefore, the illustrative figures in this section are on the basis that a *total* of £87 million will be required through reductions from departments' budgets. **If** there are reduced requirements surrendered through October Monitoring, they may offset the reductions to some extent.
- As noted earlier, the basis for any reductions has yet to be agreed by the Executive, but DFP indicated to the PFSU within RalSe that it is "*likely to be calculated on the Opening Monitoring position*"¹⁷. On this basis, the illustrative figures shown in this section are calculated on departmental Opening Monitoring baselines.
- Finally, the illustrative figures used in both models (A and B) are presented on the basis that the Assembly **will** have its budget adjusted in line with all the other Ministerial and non-Ministerial departments.

Point for scrutiny: following the announcement of the October Monitoring Round, the Assembly may wish to ask the Executive to fully explain its rationale for using the Opening Monitoring position, instead of the baselines amended by the reductions applied in the June Monitoring Round.

¹⁷ Letter from DFP official to RalSe, ref RR/002/11-15, dated 21 August 2014

3.1. Illustrative reductions under Model A

With the above in mind, Model A assumes that the budgets of DHSSPS, DE, NIAO and AOCC will be protected in the same way as in June Monitoring. This Model is therefore based on the assumption that the same conditions will apply to October Monitoring as applied to June Monitoring. In other words:

- Executive agreement will only be possible with repeated ringfencing of certain budgets; and,
- The Welfare Reform penalties will be imposed by the UK Government.

Obviously the outcome of future Executive discussions on these issues remains to be seen, so Model A simply assumes that the same situation will continue to apply, for the purposes of illustration.

Table 1 shows the reductions that would be introduced under Model A (£000s).

Department	Opening Monitoring total	Reduction - Model A
AOCC	1.8	0.0
DARD	197.6	-4.5
DCAL	100.9	-2.3
DE	1,943.7	0.0
DEL	795.7	-18.2
DETI	186.5	-4.3
DFP	156.8	-3.6
DHSSPS	4,543.4	0.0
DOE	118.3	-2.7
DOJ	1,089.0	-24.9
DRD	344.6	-7.9
DSD	658.3	-15.1
FSA	8.5	-0.2
NIA	40.7	-0.9
NIAO	7.9	0.0
NIAUR	0.1	0.0
OFMDFM	69.9	-1.6
PPS	32.7	-0.7
TOTAL	10296.4	-87

Note: Because figures are rounded to £000s in the Minister of Finance and Personnel's statement, a reduction of less than £100K shows as £0.0 in the Table.

3.2. Illustrative reductions under Model B

To provide a comparator, Model B serves to show the impact of ringfencing by illustrating the effect of an equal percentage reduction to *all* departments. This Model helps to establish the consequences of ringfencing on unprotected departments.

Table 2 shows the reductions that would be introduced under Model B (£000s).

Department	Opening Monitoring total	Reduction - Model B
AOCC	1.8	0.0
DARD	197.6	-1.7
DCAL	100.9	-0.9
DE	1,943.7	-16.4
DEL	795.7	-6.7
DETI	186.5	-1.6
DFP	156.8	-1.3
DHSSPS	4,543.4	-38.4
DOE	118.3	-1.0
DOJ	1,089.0	-9.2
DRD	344.6	-2.9
DSD	658.3	-5.6
FSA	8.5	-0.1
NIA	40.7	-0.3
NIAO	7.9	-0.1
NIAUR	0.1	0.0
OFMDFM	69.9	-0.6
PPS	32.7	-0.3
TOTAL	10296.4	-87

Note: Because figures are rounded to £000s in the Minister of Finance and Personnel's statement, a reduction of less than £100K shows as £0.0 in the Table.

3.3. Comparison of Models A and B

Table 3 shows the difference in reductions under Models A and B for the purposes of comparison, and to show the potential impact of ringfencing (£000s).

Department	Opening Monitoring total	Reduction - Model A	Reduction - Model B	Difference
AOCC	1.8	0.0	0.0	0.0
DARD	197.6	-4.5	-1.7	2.9
DCAL	100.9	-2.3	-0.9	1.5
DE	1,943.7	0.0	-16.4	-16.4
DEL	795.7	-18.2	-6.7	11.5
DETI	186.5	-4.3	-1.6	2.7
DFP	156.8	-3.6	-1.3	2.3
DHSSPS	4,543.4	0.0	-38.4	-38.4
DOE	118.3	-2.7	-1.0	1.7
DOJ	1,089.0	-24.9	-9.2	15.7
DRD	344.6	-7.9	-2.9	5.0
DSD	658.3	-15.1	-5.6	9.5
FSA	8.5	-0.2	-0.1	0.1
NIA	40.7	-0.9	-0.3	0.6
NIAO	7.9	0.0	-0.1	-0.1
NIAUR	0.1	0.0	0.0	0.0
OFMDFM	69.9	-1.6	-0.6	1.0
PPS	32.7	-0.7	-0.3	0.5
TOTAL	10296.4	-87	-87	

Note: Because figures are rounded to £000s in the Minister of Finance and Personnel's statement, a reduction of less than £100K shows as £0.0 in the Table.

Under Model A, the percentage reduction to non-ringfenced budgets is 2.29%. Under Model B, because of the size of the DE and DHSSPS budgets, the percentage reduction required is 0.84%.

Figure 1 overleaf shows the reductions that would be applied under Models A and B. Figure 2 illustrates the same figures in a slightly different way by focusing on the change in reductions that would apply if the ringfence were removed.

Figure 1: reductions that would be applied under Models A and B

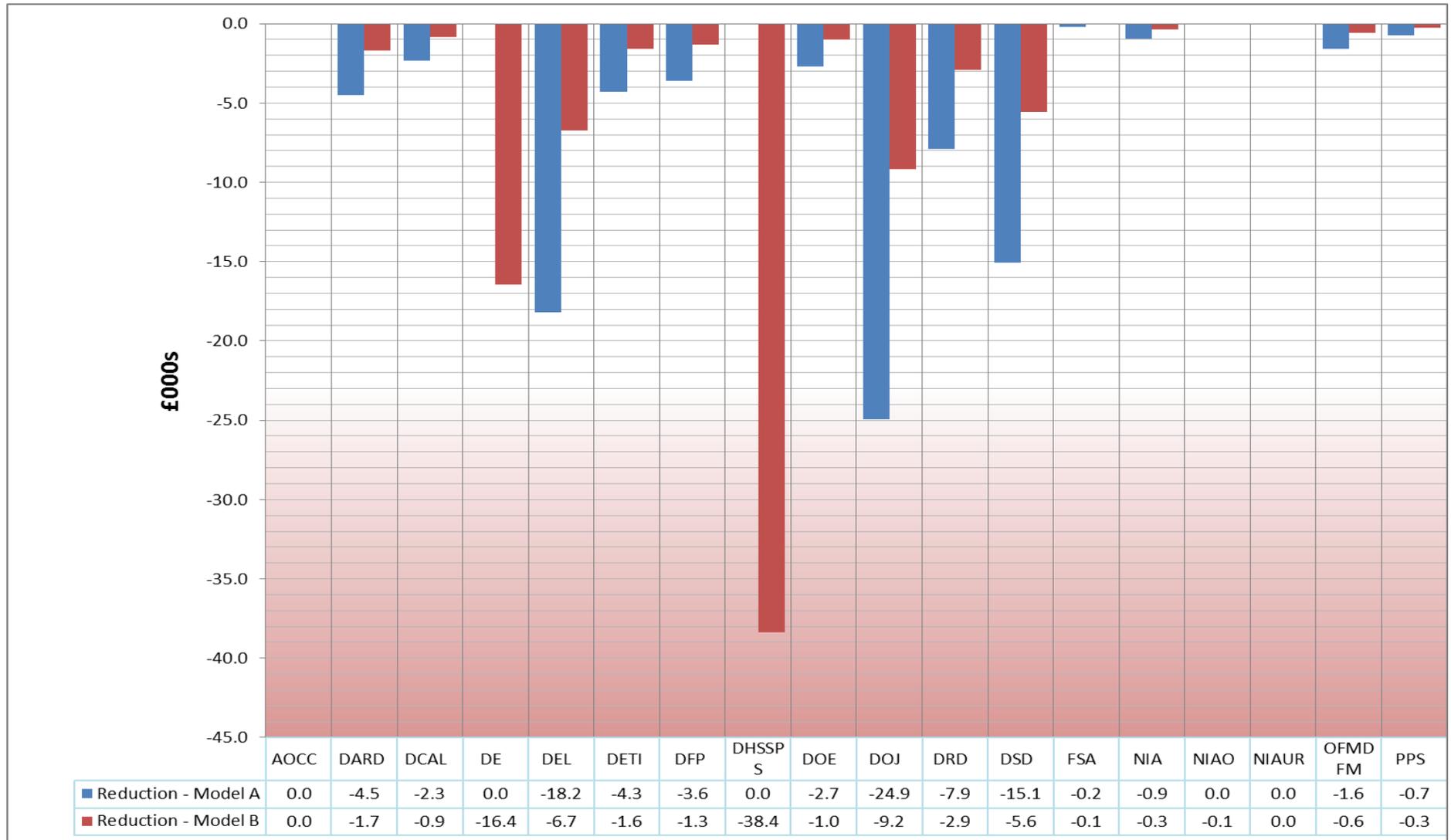


Figure 2: differential impact on departmental baselines under Models A and B

