Northern Ireland Assembly

Research and Information Service Briefing Paper

Paper 114/14 | 12 November 2014 | NIAR 771-14

The Public Finance Scrutiny Unit

Draft Budget 2015-16 and key aspects of Treasury discretion

Paper 5 of 5

As part of the five-part series on the Draft Budget 2015-16, this Briefing Paper seeks to explore key aspects of the proposals that are based on Treasury's discretion:

- The proposed method for repayment of funding from the UK Reserve; and,
- The proposed use of Reinvestment and Reform Initiative borrowing to fund potential workforce restructuring.

Neither can occur unless Treasury approval is granted. To facilitate the Assembly's consideration of the Draft Budget, scrutiny points are highlighted throughout the Paper.

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Key points

- £200 million of the financing of Draft Budget 2015-16 remains at the discretion of the Treasury; and,

- If Treasury approval is not forthcoming, the Executive may need to find up to £200 million from elsewhere in the 2015-16 allocations, i.e. from other departments' budgets, or from raising more revenue.

Introduction

This Briefing Paper is the fifth 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 Library Service (RaISe).

Treasury's discretion arises from the prevailing arrangements for devolution, the current Public Finance Framework is highly centralised. A number of elements of the public expenditure budgeting and control system are dependent on Treasury policies and practices, which place restrictions on how the Executive can commit resources.

Those that are explored in in this Paper concern:

- The Executive's proposed method for repayment of funding from the UK Reserve (Section 1);
- The Executive's proposed use of Reinvestment and Reform Initiative borrowing to fund potential workforce restructuring (Section 2); and,

Finally, Section 3 provides some brief concluding remarks.

1. Repayment of the UK Reserve

On 13 October 2014, the Minister of Finance and Personnel made a statement to the Assembly on the outcome of the Executive's consideration of the October 2014-15 Monitoring Round.

In his statement, the Minister announced that the Chancellor of the Exchequer had agreed that the Executive can:

> *…gain temporary access to the National Reserve to draw down £100.0 million to assist the Executive in 2014-15. This amounts to less than 1% of our Resource DEL.*[1]

The third Briefing Paper in this five-part series on Draft Budget 2015-16, (*Access to funding from the United Kingdom Reserve* NIAR 693-14), explains the mechanisms through which the Executive is able to gain access to additional temporary funding from the United Kingdom (UK) Reserve. Importantly, NIAR 693-14 establishes that the Executive **must** repay the UK Reserve from its 2015-16 funding.

This section now expands on the repayment of the UK Reserve, drawing on the Draft Budget 2015-16 proposals.

1.1. Draft Budget 2015-16: proposal to repay the UK Reserve

On 3 November 2014, the Minister of Finance and Personnel made a statement to the Assembly on the Executive's Draft Budget 2015-16. In this statement, the Minister said:

> *Members will recall that to help alleviate the significant pressures facing the Executive in 2014-15, the Chancellor agreed access to the National Reserve of up to £100 million. This must be repaid from the Executive's 2015-16 Budget.*
>
> ***I have approached the Treasury seeking the flexibility to reclassify funding raised from the sale of Capital assets to Resource** in order to alleviate the additional pressure this would place on the Executive's Resource DEL.*[2] [emphasis added]

The key point here is that Treasury permission is required for the Executive to use this approach to repay the UK Reserve. The reasons for this are explored in the following subsection.

[1]http://www.dfpni.gov.uk/statement-on-october-monitoring-round-2014-15.pdf see page 3
[2]http://www.dfpni.gov.uk/draft-budget-for-2015-2016.pdf see page 8

1.2. Reclassification of Capital DEL to Resource DEL

As noted above, the Executive's Draft Budget 2015-16 is predicated on the assumption that the Treasury will allow reclassification of Capital DEL funds raised from the sale of assets to Resource DEL. **If Treasury does not, there will be a shortfall of £100 million in the Non-ringfenced Resource DEL side of Draft Budget 2015-16. This will place immediate pressure on the Executive's expenditure plans.**

Under the prevailing Public Finance Framework of current devolution, such a reclassification would be unusual. This is because it is a fundamental principal of the prevailing Budgeting Framework that capital and resource funds are treated separately. The Treasury's *Consolidated Budgeting Guidance 2014-15* states:

Departments have separate budgets for:

Resource	*Current expenditure such as pay or procurement and including depreciation, which is the current cost associated with the ownership of assets.*
Capital	*For new investment and net policy lending.*[3]

The above shows that **the capital budget is to be used for investment, not for repayment of resource claims from the UK Reserve due to the Executive's failed resource expenditure control in the preceding year.**

In this context, it may be relevant that on 1 July 2013, the previous Minister of Finance and Personnel made a statement to the Assembly in which he explained:

However, the Executive had a £71·3 million resource-to-capital reclassification built into their Budget position for 2013-14. That meant that the Executive had the capacity to reverse this switch, which would provide more RDEL at the expense of less CDEL.[4]

If a similar position had applied to the Executive's resources for 2015-16, it may have potentially made it more likely that the Treasury would have allowed the reclassification. However, DFP has avised that there were no previous resource to capital switches in 2015-16.[5]

[3] https://www.gov.uk/government/publications/consolidated-budgeting-guidance-2014-to-2015/consolidated-budgeting-guidance-2014-to-2015#overview-introduction-to-budgeting

[4] http://www.niassembly.gov.uk/Assembly-Business/Official-Report/Reports-12-13/01-July-2013/#7

[5] Email from DFP Official to RaISe, dated 10 November 2014

1.3. Gordon Brown's 'Golden Rule'

In 1997, Gordon Brown established the Golden Rule which requires the public sector to borrow only what it needs to pay for capital investment, and to finance its remaining current spending from tax and other revenues.[6]

There has been much discussion and controversy surrounding this Golden Rule. In particular, it has been argued that the previous Labour Government did not comply with its own most important fiscal rule.[7]

The Institute for Fiscal Studies has commented that:

> *The golden rule was designed to help achieve intergenerational fairness by ensuring that the current generation of taxpayers pay only for the public spending from which they benefit.* ***It was also intended to remove a possible bias against investment if and when public spending has to be restrained. In such a situation, it might be more tempting to cut capital rather than current spending*** *because it normally takes longer for voters to feel the effects of cuts in capital spending on the quality of public services.[8] [emphasis added]*

Put simply, it appears that the Golden Rule was initially developed precisely to avoid the sort of situation upon which the Executive's Draft Budget 2015-16 is predicated. In other words, because of the failure to control resource expenditure in 2014-15, the Executive has proposed using funds that would otherwise be available for capital investment to repay the UK Reserve.

The impact of this particular Draft Budget proposal is less funding for capital investment.

Scrutiny point: is the proposed practice short sighted, given its anticipated impact on capital expenditure?

1.4. Further issues

The PFSU's Lines of Questioning Briefing (NIAR 753-14, dated 4 November 2014) raised two further issues in relation to repayment of the UK Reserve. These are repeated here for completeness.

1.4.1. Asset disposal

The Draft Budget 2015-16 document states that:

[6] http://www.prnewswire.co.uk/news-releases/gordon-browns-july-1997-budget-speech-156180625.html
[7] See, for example, http://www.economicsuk.com/blog/000008.html , http://www.telegraph.co.uk/finance/2937435/Brown-has-broken-his-original-golden-rule.html ,and http://www.iea.org.uk/sites/default/files/publications/files/Binding%20the%20hands%20of%20government-1.pdf
[8] http://www.ifs.org.uk/budgets/gb2009/09chap5.pdf (see page 83)

> *..the draft Budget has set aside £100 million centrally in anticipation of approval from HM Treasury for [the UK Reserve] to be repaid from our Capital Budget.*[9]

Arguably, this does not make it entirely clear that the Executive's intention is for the £100 million to be repaid from the disposal of capital assets.

Important questions are raised:

Scrutiny points: what has the Executive done to estimate the amount of money that is to be raised via asset disposal?

How rigorous is this estimation?

Secondly, aside from the robustness of any forecasts, there are wider economic questions:

Scrutiny points: is it prudent to reduce capital investment spending power in 2015-16, in order to compensate for the failure to control resource expenditure in 2014-15?

If so, how?

1.4.2. Budget management

Finally, there is the potential for concern about the Executive's ability to implement Draft Budget 2015-16:

Scrutiny points: how confident can the Assembly - and the public - be that the Executive will contain in-year expenditure pressures in 2015-16, without having to resort to emergency temporary access to the UK Reserve, as it is doing in 2014-15?

can the Executive assure the Assembly and the public?

[9] http://www.northernireland.gov.uk/draft-budget-2015-2016.pdf (see page 33)

2. Workforce restructuring

In his 3 November 2014 statement to the Assembly on the Executive's Draft Budget 2015-16, the Minister of Finance and Personnel announced that officials in the Department of Finance and Personnel (DFP) have been developing a workforce restructuring plan. He stated that:

> *Elements of this restructuring such as any voluntary exit scheme will require setting aside upfront funding. Funding of this scheme will be vital to ensure we can deliver the restructuring our public sector requires to enable it to live within the ever more constrained Resource DEL position.*
>
> *I have begun negotiations with HM Treasury to approve the use of £100 million of RRI borrowing to capitalise the cost of this workforce restructuring.*[10]

The second Briefing Paper in this five-part series on the Draft Budget, *Financing the Draft Budget 2015-16* (NIAR 768-14) presents key considerations about the Executive's proposed use of borrowing, among other things.

This section expands on that, drawing out key elements of those financing mechanisms that are directly reliant on Treasury discretion, as highlighted in the Minister's statement cited above.

2.1. The Reinvestment Reform Initiative (RRI)

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. The additional borrowing under the RRI initiative is broadly equivalent to the local authority prudential borrowing powers in the rest of the UK.[11]

There appears to be no legislative basis for the creation of the RRI. However, DFP advises that borrowing under this initiative is covered 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]

[10] http://www.dfpni.gov.uk/draft-budget-for-2015-2016.pdf (see page 13)
[11] RRI 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.
[12] E-mail correspondence from DFP. Received by RaISe on 11 January 2014.
[13] Northern Ireland Executive (2011).Budget 2011-15: http://www.northernireland.gov.uk/revised_budget_-_website_version.pdf

The cited passage clearly illustrates that the intent of the RRI was to support infrastructure investment. Obviously, priorities and circumstances change, but the point remains that the use of RRI borrowing to finance workforce restructuring appears to be a departure from its original intent.

Scrutiny point: does the proposed use of RRI borrowing contravene the scheme's intention?

2.2. Further issues

The PFSU's Lines of Questioning Briefing (NIAR 753-14, dated 4 November 2014) raised two further issues in relation to the proposed use of the RRI borrowing facility. These are repeated here for completeness.

According to the Draft Budget 2015-16 document, Northern Ireland's projected level of indebtedness in 2015-16 is £1.7billion, or £948 per head.[14]

Scrutiny point: is it prudent to fund redundancy or other restructuring measures by increasing debt?

Further, the Lines of Questioning Briefing noted that the Executive proposes to draw down the maximum amount available under RRI borrowing rules, to "*continue boosting the local economy and construction sector.*"[15]

Scrutiny points: how does the Executive's proposed use of half of the RRI facility (i.e. £100 million) for "workforce restructuring" support either boosting the local economy or the construction sector?

What is the Executive's rationale for keeping "local taxes low" by increasing borrowing, and thereby shifting the burden of current expenditure to future generations? Is this approach prudent?

Aside from these wider economic points, there remains the issue of what happens if the Treasury does not approve the proposed use of RRI. The Draft Budget 2015-16 is predicated upon the assumption that approval will be forthcoming.

Scrutiny point: does the Executive have a 'Plan B' if the Treasury does not permit the capitalisation of workforce restructuring? What is it?

[14] http://www.northernireland.gov.uk/draft-budget-2015-2016.pdf (see page 29)
[15] http://www.dfpni.gov.uk/draft-budget-for-2015-2016.pdf (see page 7)

3. Concluding remarks

In combination, the two issues considered in this Paper centre on Treasury's approval for the use of £200 million to finance of the Draft Budget 2015-16 in the manner proposed by the Executive.

On 5 November 2014, DFP was asked during evidence to the Committee of Finance and Personnel about the use of capital receipts for repayment of the UK Reserve. DFP replied:

> *Our Minister has been engaging with the Chief Secretary to the Treasury and has written to him formally. We have not yet received a response, but we are hopeful that we will.*[16]

And later:

> *I do not think that we would have built that in if there was an extreme level of uncertainty. However, of course, until you get something in black and white, you cannot say definitively that it has been approved.*[14]

Scrutiny point: can DFP update the Assembly on its more recent discussions with the Treasury about this issue?

[16] Official report, 5 November 2014, http://aims.niassembly.gov.uk/officialreport/minutesofevidencereport.aspx?AgendaId=10441