Northern Ireland Assembly

Committee for Finance and Personnel

OFFICIAL REPORT (Hansard)

Budget 2015-16: Pre-consultation Briefing by DFP

11 December 2013

NORTHERN IRELAND ASSEMBLY

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Members present for all or part of the proceedings:
Mr Daithí McKay (Chairperson)
Ms Michaela Boyle
Mrs Judith Cochrane
Mr Leslie Cree
Mr Paul Girvan
Mr John McCallister
Mr Mitchel McLaughlin
Mr Peter Weir

Witnesses:

Mr Mike Brennan	Department of Finance and Personnel
Mr Peter Jakobsen	Department of Finance and Personnel
Mr Jeff McGuinness	Department of Finance and Personnel

The Chairperson: I welcome Mike Brennan — Mike, you are very welcome back to the Committee — Peter Jakobsen and Jeff McGuinness from central expenditure division (CED). Mike, do you want to make some opening comments before we go to questions?

Mr Mike Brennan (Department of Finance and Personnel): Thank you, Chair. Briefly, by way of background, I apologise for not being here two weeks ago, but we received some feedback from the Treasury that the autumn statement was going to have some material changes to both 2014-15 and the Budget year 2015-16, so we thought it better to wait and reflect that in the papers that we have for you this morning. Indeed, the Minister just issued his paper to the Executive on the 2015-16 Budget position earlier this week. I think that it was issued yesterday or the day before.

We have given you a presentation pack, and we will walk through that shortly, but I will flag up some key issues. As I said, the Executive have now received a paper on the initial position for 2015-16. What we would also like to do this morning is give you an update on some stakeholder briefing sessions that DFP officials have been having with key external stakeholders and their views on the 2015-16 Budget. Also, we will walk the Committee through some key opening assumptions that we have asked the Executive to consider.

The Chairperson: Thank you, Mike. The headline from the autumn statement was obviously the additional £136 million from the Barnett consequentials. How much of that amounts to non-ring-fenced funding over which the Executive have discretion? How beneficial is the ring-fenced funding to the Executive in comparison?

Mr Peter Jakobsen (Department of Finance and Personnel): It is all funding that the Executive have discretion over. It is resource DEL, financial transactions capital, and capital. The table on the fourth slide of the presentation breaks it down. The resource DEL is not ring-fenced; it is all non-ring-fenced that the Executive can allocate.

Mr Brennan: The Executive can allocate that £97 million of resource DEL to anywhere they wish.

Mr Jakobsen: The only ring-fenced element is the financial transactions capital. That has to be used for loans or equity investment in the private sector.

The Chairperson: Is that the £22·3 million?

Mr Jakobsen: Yes, and the £3·3 million in 2014-15.

The Chairperson: The third slide states:

> *"The Capital DEL included £104.3m of Financial Transactions capital which can only be used to offer loans or equity investment to the Private Sector."*

The presentation also states:

> *"Increasing emphasis on Financial Transactions Capital require innovative approaches and greater cooperation with the private sector."*

Why is there an increasing emphasis on that type of capital funding? How will that work in practice? What are the pros and cons compared with conventional capital and other borrowing options, such as the reinvestment and reform initiative (RRI)?

Mr Brennan: There is a range of issues that relate to the use of financial transactions capital. From a Treasury perspective, it sees merit in using financial transactions capital rather than conventional capital because it goes directly to the private sector as a loan or equity stake. At one level, it is seen to promote private sector activity. The other benefit is that it does not score as part of the UK national debt because it is an equity or investment stake. Therefore, it does not increase the UK fiscal deficit. At a UK/Treasury level, those are the benefits.

From a Northern Ireland perspective, the first observation to make is that there has been a long debate in this room and many others about the need to grow the private sector in Northern Ireland. This is one obvious way in which the Executive and Assembly can grow the private sector. It is not using conventional DEL to build schools or hospitals; it is money that goes directly to private sector entities to take forward the development of infrastructure in Northern Ireland.

The other benefit of using it is that there is also a profit-sharing element. Treasury does not require 100% of the financial transactions to be repaid. The Executive get to keep somewhere between 10% and 20% of the investment for reallocation elsewhere. The interest rates used on the loans are quite beneficial as well. So, it is quite an attractive way to promote infrastructure enhancement in Northern Ireland. It is also a way in which the Executive can create innovative special purpose vehicles to deliver infrastructure and take forward the development of things such as a transport hub or schools and hospital infrastructure in Northern Ireland.

The Chairperson: It is open to the private sector. Does that include the third sector?

Mr Brennan: It does. Office for National Statistics rules mean that it includes anything outside what is deemed, under international accounting standards, to be a public sector entity. For example, charities would score as well. It is anything that is not controlled or influenced by the Executive.

The Chairperson: Any questions, members? Peter, you are always good for ones.

Mr Weir: I think that we are all just looking forward to the turkey. *[Laughter.]* It was a good presentation.

Mr Cree: I have a question about the benefits of the financial transactions being treated much differently. Does that have any impingement on EU rules? Does it obviate them?

Mr Brennan: Treasury has adopted the approach as a way of managing the fiscal position and the national debt moving forward. It is an innovative way of getting money out to take forward infrastructure development. I do not believe that Treasury would do that in a way that would put it offside with EU Commission rules or Eurostat or Organisation for Economic Co-operation and Development (OECD) definitions of what is or is not part of the national debt.

Mr Cree: But does it get around it?

Mr Jeff McGuinness (Department of Finance and Personnel): We have been very clear with Departments that are considering using financial transactions that they need to be very sure that there are no state aid implications. Departments will be looking, on a case-by-case basis, at how those EU rules work in those cases.

Mr Brennan: The big concern is that you could, for example, create a special purpose vehicle to take forward, say, the construction of a road, and you would give it a loan, but it might be a loan that is so competitive that the banking sector could cry foul. As Jeff said, you would be in breach of state aid rules. So, we have to be careful that we do not step offside in the construct of some of the projects. For example, that is why, when DETI and DARD decided to take forward the agrifood loan scheme using financial transactions (FT) capital, there was quite close discussion and then collaboration with the local banks to make sure that all parties were happy with the rules that applied.

Mr Cree: I think that I will take your word "innovative" as being a suitable one.

The Chairperson: Slide 10 refers to resource savings. It states that:

> *"departments will have to deliver resource savings in 2015-16. This is likely to continue until at least 2017-18."*

What is the anticipated level of resource savings required in percentage terms? What approach will be taken to identifying and achieving those savings? How will that compare with the drive for efficiencies and savings in other Budget processes that we have discussed?

Mr Brennan: I draw your attention to slide 6, entitled "UK Public Expenditure Projections", which sets out the Office for Budget Responsibility's forecast for public sector current expenditure moving forward. That is the first determinant of what we think will happen on the resource side for the Executive and Assembly. If those numbers are true, the Treasury will then apply the Barnett formula to those numbers to determine what the resource allocation to Northern Ireland will be.

Those numbers are probably the worst-case scenario, because, as you will have noted in the autumn statement, the UK Government applied a resource DEL baseline cut of 1·1% across all Departments. When we got wind of that initially, in advance of the autumn statement, the numbers were quite horrific, because that would have meant our resource DEL being cut by about £20 million a year. However, the benefit of the Barnett formula is that, because the UK Government then gave protection to Health and Education, that applied to Northern Ireland, and we have full comparability in those areas. So, instead of us having a 1·1% cut, our cut was small; it was 0·2%. The money then went back into business rates and free school meals, so we ended up being up by £136 million.

What, I think, will happen to the resource DEL is that Treasury will apply cuts based on the numbers set out in slide 6, but, as long as it continues to afford protection to Health and Education in Westminster and the Barnett formula still stands, Northern Ireland will be relatively protected.

The Chairperson: Slides 12 to 14 refer to engagement having commenced with key stakeholders, in addition to the Minister's Executive colleagues. What specific stakeholders have been involved in the engagement to date? Is there a related timetable, which members can access, for the next stages of the Budget process?

Mr Brennan: We have met a wide range of external stakeholders, including trade unions, the Northern Ireland Council for Voluntary Action (NICVA), the voluntary and community sectors, the Confederation of British Industry (CBI), the Institute of Directors (IoD) and the Equality Commission. A range of external parties have expressed an interest in the budgetary process. We have agreed to engage with them constantly as we move through the Budget process and keep them up to date.

The Minister has issued a paper to the Executive — I think that it was issued yesterday morning — which sets out an indicative Budget timetable. However, it is up in the air because a couple of Ministers — the Health Minister and the Regional Development Minister — have written back asking for the Budget timetable to be compressed. In Health's case, the trusts want earlier information on their budgets for 2015-16. Similarly, as Regional Development has a large capital spend, the Regional Development Minister thinks that it needs to know earlier than three months before the start of the financial year what its capital budgets will be because it needs to plan water and roads infrastructure, for example. That issue has gone to the Executive and will be considered next Monday when the Executive meet. Ideally, we want the Budget process to effectively conclude by autumn rather than the normal December time.

Mr Mitchel McLaughlin: I have a quick question. With the financial transactions capital and the innovative approach, is it a question of sitting back to see what the private sector does or have we got any point people teasing out those innovative ideas and approaches?

Mr Brennan: To be honest, it is having to be driven completely by officials in DFP and colleagues in the Strategic Investment Board (SIB). Our worry is that if we sit back and wait for the private sector bodies to come to us, it will be too late and the money will surrendered to the Treasury.

Mr Mitchel McLaughlin: That is exactly my point.

Mr Brennan: We have been coming up with a range of schemes in DSD, DRD, Health and Education to put to those Departments to suggest to them that they go out and think about whether they are viable or not. However, we are having to drive it very much from the centre because we do not have the luxury of waiting for private sector companies to come to us.

Mr Mitchel McLaughlin: There may be a need to be careful and prudent about what is said before those are brought to full maturity, but is it possible to, at some stage, give the Committee a sense of what is being teased out and tested with the market?

Mr Brennan: Yes, we are exploring a wide range of options. Some of them are quite straightforward in that the private sector company pulls down the money and goes ahead with the delivery of a project. However, the more innovative approaches in, for example, transport and agrifood require us to construct quite complex vehicles in the private sector to take forward the delivery of the projects. You tend to find that, when you go out to some Departments, there is a reluctance on their part because they are not used to dealing with the concepts, and, rather than take this FT capital next year, they want to hold off for three or four years in the hope of getting a conventional capital bid met at a later stage. They do not like new, innovative or unanticipated proposals to be put them. As I said, we do not have that luxury; we have to force this through now.

Mr Mitchel McLaughlin: I do not claim to understand this entirely, but it strikes me that there may be, for instance, an approach that would help us to explore the possibility of the air routes and connectivity with the airport operators. The issue of air passenger duty is at the core of that. Can we work with the carriers and the airports in some kind of joint venture and maybe take an equity stake to see if we can open up those routes?

Mr Jakobsen: We can. We have already talked to the airports. Nothing has come of it so far, but we will continue to have that conversation. We have been around everyone out there already.

Mr Mitchel McLaughlin: OK. I am pleased with that.

Mr McCallister: I have a follow-on question. I take it that you can use the very straightforward stuff, such as if we do not have enough capital to build a new school. Surely, we have plenty of those projects in the pipeline across Departments from schools to health centres to whatever. I would have thought that we could be fairly quick in getting to the point of using —

Mr Jakobsen: It is not quite as straightforward because it is repayable. Normally, those are funded through a grant that is not repayable. This is repayable funding. It has to be through some sort of PFI arrangement where it is paid back through the revenue budget. It makes it much more complicated and potentially more expensive.

Mr McCallister: It would mean that, for example, you could have a school four or five years more quickly than waiting about in the expectation of getting capital down the track at some point.

Mr Brennan: You mentioned Health, and the Executive have already agreed allocations to the Department of Health, for example, using FT capital to build new GP and dental surgeries. Where that was funded from conventional capital previously, FT capital is now used to fast-track that development. As recently as last night, I talked to Department of Education officials about using FT capital to take forward the construction of schools. What would happen is that the private sector body would come along and say, "Right, Education, give us a portfolio or a bundle of schools projects that you want delivered over a five- or 10-year period". That private body would then draw down the FT capital and work with Department of Education officials to bring various schools projects on line. Obviously, there would be a repayment, so they would use their equity or loan investment to repay the FT capital that they got to build the schools.

Those discussions are ongoing. Things such as GPs and dental surgery projects are already up and running.

Mr McCallister: Across government, there will be a lot of projects that should be in the system. I accept the bidders' point that such capital has to be built in to budgets, because you obviously have to repay it. However, I think that you could bring forward some of the very needy projects. If you need pointing in the right direction, I have a few schools in South Down and a bypass or two.

The Chairperson: Mike, I have a final question. Can you give us some indication of when returns on that will be completed? Do you have an idea of when Committees will be able to start to engage other Committees and when we will be able to start to engage with the Departments?

Mr Brennan: Do you mean returns of the FT capital? It is really an ongoing process. It will continue on a daily and weekly basis over the next three or four years as projects come along. From the Committee's perspective, I think that it would be helpful if we came along once a month so that, as projects start to mature and go to the Executive, we could tell you where we are. I can think of five or six projects that are pretty well developed. Once it looks as though they have ministerial endorsement, we could come to the Committee. I mentioned the transport hub, and there are other projects relating to universities. I could talk you through how they would work in practice. The difficulty is that we cannot give you a paper in six months and say that those are the FT projects. That is because some of the big ones will still be in the pipeline and will not have got to the stage of receiving Executive endorsement. Given that you are working with the private sector, it is quite a legalistic process, because you have to get them to sign contracts. As Jeff said, you have to make sure that you do not step offside with EU state aid legislation.

As projects come along or are set into diaries, it might be better for us to come along once a month and let you know how the FT process is evolving, rather than have a once-and-for-all stocktake once a year.

Mr J McGuinness: The draft Executive paper has an indicative timetable that says that departmental returns on the wider budget for 2015-16 will come in towards the end of February. Therefore, Committees should be engaging with Departments from now until that point on getting their proposals for the wider Budget.

Mr Cree: Mike, do you have any additional thoughts on the cap on welfare spending?

Mr Brennan: To be honest, we do not really know that much in addition to what the Chancellor said during the autumn statement. Our understanding is that Treasury is really concerned that annually managed expenditure (AME) will now be greater than departmental expenditure limit (DEL) expenditure next year. So, there is an urgent need to find a way or a mechanism to control the growth in AME spend.

The system that Whitehall seems to be constructing is one whereby a target will be set on the growth in some AME categories of spend. The two exceptions are jobseeker's allowance and state pensions; everything else will be capped. That cap will be voted through at Westminster. If the cap looks as though it might be exceeded, the Secretary of State for Work and Pensions, for example, will have to go to the House of Commons to set out the justification for exceeding it. So, I think that they are trying to internalise a budget constraint in each of the Departments, particularly the Department for Work and Pensions (DWP). If the Secretary of State and DWP think that the cap is getting near the point where it is exceeded, they will slam on the brakes in certain areas to deal with that spending. However, to be honest, given that the spending items are all largely demand led, I do not think that they will get to the stage where they have complete and utter control where being able to cap spend in those largely welfare-related areas is concerned.

Mr Mitchel McLaughlin: This quick point is also about the financial transactions capital. Is there a template for the special purpose vehicle (SPV)? I would imagine that that is quite a critical development in ensuring that you do not fall into the peril of the financial aid rules and state aid rules. Are you taking responsibility for that? Is there a common template that will be applied?

Mr Brennan: No, the key rule is that the special purpose vehicle has to be outside the control of the Ministers, the Executive and the Assembly. It has to be seen to reside in the private sector and to be run by the private sector.

The nature of the SPV and what it will look like will depend on what the project is. So, for example, if you take a big project, such as the construction of a transport hub, it is unlikely that just one private sector company will take it forward; it is likely to be a conglomerate of companies. The SPV will have to be shaped in the interest of the number of parties that are taking it forward.

Mr Mitchel McLaughlin: I understand the reasons. I alluded to them when talking about state aid and why it would have to be independent of Executive control. However, if it is left to individual projects, the possibility is that there is an inherent danger that somebody will overstep the mark or that a challenge will emerge simply because there is not a common definition and protocol that can be applied across the board. Perhaps it is in everybody's interest, including the Executive's, for that to be standardised and tested against the state aid rules.

Mr Jakobsen: There is a team in the Department of Enterprise, Trade and Investment (DETI) that works very closely with the EU Commission on state aid rules. It is involved in all those schemes.

Mr Mitchel McLaughlin: Does it have to do that for every individual SPV?

Mr Jakobsen: Absolutely. It has to.

Mr Mitchel McLaughlin: Even though they could all be standardised?

Mr Jakobsen: It engages them in the projects to make sure that they are involved. They are the experts in setting interest rates and all the rest of it.

Mr Mitchel McLaughlin: It seems to be a bit riskier than it would be if we had a standardised approach.

Mr J McGuinness: The knowledge in SIB on SPVs is also very useful. It has very good background knowledge and is working very closely with each of the projects.

Mr Jakobsen: The issue is that there cannot be a standardised approach, because the rate of interest depends on the risk of the project and the company involved.

Mr Mitchel McLaughlin: I understand the variations, but there are certain parameters that cannot be stepped over.

Mr Jakobsen: As long as that team is involved, I think that we will be OK.

The Chairperson: Thanks very much again. Merry Christmas.