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AQW 24719/22-27

Eoin Tennyson has asked:

To ask the Minister of Finance, pursuant to AQW 22838/22-27, to detail the terms of reference of Professor Holtham's independent review of Northern Ireland's level of need.

ANSWER

A copy of the Terms of Reference agreed with Professor Holtham to conduct his independent review of the North's level of need has been provided as an annex. A copy has also been placed in the Assembly library.

Signed:



John O'Dowd MLA

Date:

01/04/2025

NORTHERN IRELAND'S LEVEL OF NEED – AN INDEPENDENT REVIEW

TERMS OF REFERENCE, JANUARY 2025

Context

1. The Finance Minister signed the Interim Fiscal Framework (IFF) on behalf of the NI Executive on 21 May 2024¹. This interim framework set out a new needs-based factor for Northern Ireland and provided greater clarity on the implementation of the financial package which accompanied the restoration of the Executive.
2. The UK Government stated in the IFF that the 24% needs-based factor “will help ensure the Northern Ireland Executive has the resources necessary to deliver comparable public services to elsewhere in the UK.” The IFF also stated, “HM Treasury recognises the relative need of Northern Ireland,” and “until budgets are confirmed at the Spending Review, the Northern Ireland Executive will continue to plan on the assumption that they will be funded at or above the 124% level of relative need in future financial years.”
3. Taken together, these commitments from the UK Government recognise that; the Executive faces higher costs in delivering public services, the Executive should have the resources necessary to deliver comparable public services to elsewhere in the UK; and the additional cost to delivering public services in NI relative to England is 124%.
4. The 124% level of need used by the Government is, “based on a range suggested by the independent Northern Ireland Fiscal Council,” and the Government agreed that it will, “consider a review of Northern Ireland’s relative need if multiple independent and credible sources provide evidence that relative need is different to 124%.”
5. With the next Spending Review scheduled for completion by Spring / Summer 2025 it is imperative that Northern Ireland’s new funding arrangements operate in a way that ensures the necessary resources are provided to deliver comparable public services to elsewhere in the UK. Part of these arrangements is confirming whether,

¹ [Northern Ireland Executive's Interim Fiscal Framework - GOV.UK](#)

based on the latest evidence, 124% is the most robust and accurate estimate of need for NI.

6. These Terms of Reference provide parameters for a review to be conducted by an independent expert in the field of public finances and needs-based funding to provide conclusions on whether 124% is the appropriate estimate of Northern Ireland's level of need.
7. This review will consider the approach taken by the Holtham Commission and the Northern Ireland Fiscal Council (NIFC) with particular emphasis on the 124% main estimate produced by the Council which has been used by the Government as the basis for setting NI's needs-based factor.
8. The principles underlying both the Welsh Fiscal Framework and the NI Interim Fiscal Framework is that citizens of the UK should be able to enjoy government services of the same or similar standards wherever they lived. Finance for devolved territories should be such as to make that possible given the circumstances of the place.
9. The independent expert will be supported in their work, including for any official statistics and data analysis, by the Department of Finance and the Northern Ireland Statistical and Research Agency (NISRA) as required.

Holtham Commission approach

10. The approach deployed by the NIFC in generating a Northern Ireland needs-based factor is primarily based upon the approach used by the Independent Commission on Funding and Finance for Wales (Holtham Commission), which established a level of need for Wales². The NIFC adapted this work to produce an estimate of relative need for Northern Ireland.
11. The Holtham Commission looked to derive a needs-based formula based on the principles of simplicity and completeness with a small number of needs indicators covering demographics, deprivation, and cost. The Commission found that it was

² [Holtham Commission - Final Report 2010](#)

possible to replicate to a high degree of accuracy the funding allocations of very complicated needs-based formulae using only a few key needs indicators – using 6 indicators explained over 95 per cent of the variation in funding.

12. The Holtham Commission used six indicators to derive an overall estimate of the relative need for public services spending compared with England. These indicators were: number of children; number of older people; ethnicity; combined benefit rate; ill-health; and sparsity. To weight the six need indicators, regression analysis was used to estimate their relationship with past budgetary allocations.
13. When applied to Wales the analysis showed an overall estimate of Welsh need of between 114 and 117. The median estimate was 115, i.e. for every £100 per head spent in England, £115 per head would need to be spent in Wales to deliver the same standard of public services. The final estimate did not fully compensate for relative tax effort or the additional cost of providing bi-lingual education, either of which would have raised the estimate by one percentage point.
14. The analysis also found that the relative need for spending per head in NI was £121 and £105 in Scotland, although the estimate for NI excluded policing and justice and was considered indicative only.
15. The funding arrangements set out in the Welsh Fiscal Framework is motivated by the need for procedures governing the Barnett formula to be simple, transparent and being easy to implement, with the capacity to adapt to changing circumstances without the need for annual review or renegotiation. This is codified in the principles published in the Welsh Fiscal Framework:
 - Relatively simple to operate and understand – the funding system should use straightforward and objective calculations rather than relying on complex statistical techniques or assumptions;
 - Not subject to ongoing negotiation – aside from periodic review, the funding system should operate mechanically (like the Barnett Formula);
 - Fair funding for the long-term – the Welsh Government should have a fair level of funding based on relative need, subject to appropriate risks in relation to tax devolution.

NIFC approach

16. The NIFC produced an updated estimate for Northern Ireland's level of need in a May 2023 report³ using the same methodology the Holtham Commission had used for Wales, but updating the data used for the indicators and also factoring in Policing and Justice as a new indicator.

17. It is important to note that there are potential limitations in adopting the same approach as the Holtham Commission:

- The data which underpins the coefficients is taken from dated sources. Consideration should be given to interrogating the data to understand whether it would be possible to update this.
- The method was strictly prepared for the degree of devolution existing in Wales at the time, where c80 per cent of devolved government expenditures were on health, education and local authority support. Other devolved areas were on matters where the same considerations of relative demographics, relative health status and relative poverty were also relevant. Devolution to Northern Ireland, however, encompasses areas such as security and justice and agricultural support, which were not devolved to Wales. Moreover, those are areas where the need for expenditure is not primarily governed by the relative demographic and deprivation factors used to determine need.

18. An objective of this review is to attempt to update at least summary data for the factors whose relative status drove the Welsh formula and review whether any further consideration, over and above the evidence already provided by the Council, should be given to how non-related devolved expenditures should be handled in determining the level of need.

19. The Council noted that the Holtham Commission estimate for NI was indicative given the analysis did not include policing and justice, as this function was not devolved to the Welsh Government. In addition, the Council made the point that

³ [Updated estimate of the relative need for public spending in NI - May 2023 | NI Fiscal Council](#)

the “regression analysis did not include data for NI, but this would not make a material difference to the overall results due to NI’s small size.” That is, while expenditure data for NI was not deployed in the regression analysis, its inclusion would not have significantly altered the results given its relatively small size.

20. The NIFC’s central estimate was that NI’s level of need was 124% relative to England with a number of sensitivities showing a range of 118 to 129 around this central point.
21. The NIFC used data on the average level of spending per head on policing and justice services between 2017-18 and 2021-22 to derive its policing and justice need indicator.
22. Apart from the additional policing and justice indicator, the Fiscal Council’s work sought to remain as close as possible to the Holtham Commission approach and did not examine alternatives for the indicators used by the Holtham Commission.
23. The adoption by the UK Government of the Welsh precedent was, in part, motivated by the need for procedures governing the Barnett formula to be simple, transparent and being easy to implement, with the capacity to adapt to changing circumstances without the need for annual review or renegotiation.
24. In March 2024, the NIFC published a report⁴ with further sensitivity analysis on its estimates, following feedback from stakeholders. The additional sensitivities modelled scenarios which involved:
 - Adjusting for departmental activities.
 - Providing different approaches to Policing and Justice, particularly using different time periods.
 - Removing Covid distortions.
 - Using a weighted average methodology.

⁴ [Technical Paper 02/24: Updated estimate of the relative need for public spending in NI: further sensitivity analysis | NI Fiscal Council](#)

25. Using different assumptions for each of these differing factors was found to have an impact on the estimate of relative need in NI. Adjusting for departmental activities by modifying the policing and justice comparability factors for NI would reduce the overall level of need. Different time periods for policing and justice, i.e. using the most recent pre-Covid years only, the initial period post devolution of policing and justice powers 2010-11 to 14-15, and a long run average from 2010-21, each resulted in a higher need indicator for policing and justice and thus a higher overall level of relative need. Using a weighted average methodology rather than the proportional method used in the Council's central estimate would result in the overall level of relative need being reduced.
26. The Council's analysis combined these approaches into several illustrative scenarios which estimated that the overall level of relative need in NI could be between 123 and 128.

Other approaches

27. Both the NIFC and the Holtham Commission follow a similar approach to measuring need, with the Council stating that they sought to remain as close as possible to the Holtham methodology. Only in examining policing and justice and producing level of need estimates for that additional indicator did their work significantly differ from Holtham.
28. It is worth considering whether there is other evidence for informing a decision on Northern Ireland's level of need and ultimately the most robust needs-based factor. There may be specific factors in Northern Ireland that generate additional costs for the delivery of public services relative to England which are not fully captured by the Holtham approach given that Northern Ireland was not its focus. Some of these may be quantifiable whilst others may be qualitative. For example, it is possible that the current methodology does not fully take into account historical factors in Northern Ireland such as the impact of the Troubles or the nature and structure of public services here, which may mean the delivery of public services could be more costly in NI than elsewhere in the UK.

Remit

29. These Terms of Reference provide parameters for a review of the current evidence to be conducted by an independent expert in the field of public finance and needs-based funding on whether 124% is the appropriate estimate of Northern Ireland's level of need.
30. The questions to be answered by this review are detailed below. The review may be expanded in overall scope as required by the independent expert, while recognising time constraints for the coming Spending Review.
31. The principle underpinning this review is that for the areas covered by the Holtham approach, and other non-related devolved expenditures, simplicity, transparency, fairness and consistency of approach should be the overriding objective. The review is not concerned with philosophical or political issues of determining absolute need but is attempting to promote consistency. The preferences and priorities revealed by government decisions elsewhere should be the ones applied in Northern Ireland.
32. It is not proposed to reexamine those preferences and priorities as they relate to the areas of devolution covered by the Welsh precedent. The Welsh exercise was conducted at a time when explicit needs-based formula were in use for resource allocation in English localities. Those formula have been superseded, making it difficult to replicate the analysis.
33. It is noted that the Government has not found it necessary to revisit the Welsh analysis but has used the coefficients derived from that analysis in setting fiscal frameworks for both Wales and Northern Ireland. The intention is to build on that foundation.

34. The independent expert will be supported in their work, including for any official statistics and data analysis, by the Department of Finance and the Northern Ireland Statistical and Research Agency (NISRA) as required.

Question 1

Is the approach used by the Holtham Commission to establish a level of need for Wales, and which was subsequently tailored by the NIFC for Northern Ireland, the best available approach for establishing a level of need for Northern Ireland?

Question 2

Is the data used by the NIFC the most appropriate and robust available?

Question 3

Are there any additional factors which should be taken into account, which have not been captured by the NIFC's main 124% estimate?

Question 4

Is the 124% main estimate produced by the NIFC the most robust and appropriate estimate of Northern Ireland's level of need?

35. Where relevant and required further additional independent evidence and expertise may also be provided in relation to subject specific matters such as Justice and Health needs, to supplement any review findings.

Timescales and deliverables

36. A draft report will be delivered to Fiscal Policy Division (FPD) officials from the Department of Finance by 27th March with a final report delivered by 4th April.

Expert Reviewer

37. The review will be conducted by Professor Gerry Holtham. Gerry is Managing Partner of Cadwyn Capital LLP and Hodge Professor of Regional Economy, Cardiff Metropolitan University. His previous roles include Chief Investment Officer of

Morley Fund Management, Director of the Institute for Public Policy Research, and Head of the OECD's General Economics Division.

38. Professor Holtham served as a member of the Welsh Assembly Government's Economic Research Advisory Panel. He chaired the Independent Commission on Funding and Finance for Wales. He is a trustee and non-executive director of the Institute of Welsh Affairs. His academic appointments include Fellow of Magdalen College, Oxford, and Visiting Fellow of the Brookings Institution, Washington DC.

39. Officials from FPD will manage the project to ensure that the terms of reference are fulfilled and will provide administrative and technical support as required.

Costs

40. It is estimated that the cost for this project will be £750 per day, paid to Professor Holtham, with the work taking up to circa 35 days to complete, and resulting in a total cost of up to £25,000.

41. Final costs will be presented in a Business Case to be drafted by FPD officials and set out in a Letter of Contract.

Key project milestones (indicative and depending on final product)

Project Milestones	To be completed by
Draft ToR	w/c 9 th December 2024
Agree ToR, timescales and begin review	w/c 20 th January 2025
Review begins	January 2025 – March 2025
Draft review shared with officials	28 th March 2025
Final review report delivered to DoF	4 th April 2025
Final review shared with Finance Minister	w/c 7 th April 2025
Research findings shared as required	From 14 th April 2025