

Policy Research Brief

Research Monograph 10: *Funding the Northern Ireland Assembly: Assessing the Options* by Professor David Heald with A Statement by the Economic Council

Please Note: As the circumstances relating to the suspension of the Assembly on 14 October 2002 were not connected to finance, this Monograph is written on the basis that the Assembly and Executive are functioning.

Introduction

In the context of the Devolved Administration, the Northern Ireland Economic Council considered it was an appropriate time to undertake a review of how the Northern Ireland Assembly might be funded over the coming years and how it might obtain sufficient resources to achieve the policy targets set out in its Programme for Government.

Accordingly, the Council, in September 2001, invited Professor David Heald of the Centre for Regional Public Finance at the University of Aberdeen, to undertake a systematic study of public expenditure (and revenue generation) in Northern Ireland.

Background

The systematic study of public expenditure in Northern Ireland has been seriously neglected in recent years. During the 1980s and 1990s, there was a commitment by HM Treasury to allocate public expenditure to Scotland, Wales and Northern Ireland on the basis of the Barnett formula.

However, this formula, which sought to allocate increases in expenditure to the regions on the basis of population share and comparability in expenditure programmes, has not brought about the degree of convergence towards per capita expenditure in England that analysis of the formula had predicted. The lack of transparency about formula operation and about comparable expenditure in England have made it difficult to track developments from information in the public domain.

A great deal of concern has been expressed in Northern Ireland, in the media, by Ministers and by Assembly Members, that Northern Ireland is disadvantaged by the Barnett formula system. It is assumed that a needs assessment would show that Northern Ireland public expenditure is currently too low. Professor Heald's study shows that this assumption is not necessarily correct.

Research Aims:

This study, jointly funded by the Council and the Department of Finance and Personnel (DFP), has four principal aims:

- to provide a rigorous assessment of how Northern Ireland was publicly financed in the past;
- to look at recent UK public expenditure policy and trends, assessing the impact of devolution on funding arrangements;
- to consider the local revenue generation effort; and
- to consider alternative funding arrangements that might replace the Barnett formula.



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Report Findings and Proposals

- (1) **Key Finding:** *Policy capacity is required within the Executive as well as in the Assembly and civil society: this is the route to policy choice in a devolved setting with dependence on a block grant.*

Building policy capacity is a task that has to be conducted at all levels in Northern Ireland. This is not just an issue concerning public expenditure, but one affecting applied economic research and public policy development more generally. The crucial point is that capacity external to government will not emerge unless it is generously publicly funded and carefully nurtured.

- (2) **Key Finding:** *For the time being, Northern Ireland should not undermine the existing Assigned Budget arrangements, of which the Barnett formula is a key component.*

The Barnett formula seems to be extremely unpopular everywhere, though for diametrically opposed reasons. The only viable option for funding Northern Ireland devolution is a block grant system.

The Barnett formula might be modified when there is evidence that convergence is bringing expenditure indexes close to the likely level of needs indexes. An adjustment formula would be required after a needs assessment exercise, as it is unlikely that expenditure and needs indexes would coincide.

A substantial effort is required to improve the level of public understanding in Northern Ireland about how the devolved funding system currently operates. More transparent operation of the Barnett formula is a necessary precondition for this to happen. It would then be easier to conduct a debate in Northern Ireland about the future evolution of funding arrangements.

- (3) **Key Finding:** *Expenditure which has no effective comparator in England, such as water and sewerage, constitutes a specific problem in Northern Ireland.*

The size of such expenditure, and its profiling, is potentially disruptive of other programmes. Much depends upon the willingness of the Treasury, especially as convergence bites, to treat these items as exceptional. Among the policy options likely to be discussed are privatisation on the English model and recourse to charges. A partial resolution of this issue is the transferring of non-cash water costs from the Assigned Budget to Annually Managed Expenditure. However, such treatment may have implications for the policy autonomy enjoyed by the Northern Ireland Assembly and Executive over this devolved function.

- (4) **Key Finding:** *The Northern Ireland Assembly will be faced with a choice between bringing fiscal effort closer to the GB level, or accepting lower public expenditure than would otherwise be the case.*

The trade-off between expenditure and fiscal effort will become one of the most important policy issues in Northern Ireland. The Assembly does not have any tax-varying power over income tax, however, it has control over the financing of Northern Ireland local authorities and also over what, in Great Britain, would be local authority functions and finance. The Executive's decision to raise more revenue from regional rates is to be commended, but this will only be sustainable if the property taxation system is properly maintained.

There is also the question of industrial derating, which represents revenue foregone (the cost of which is now borne in Northern Ireland). Within the UK context of a block grant system, there needs to be emphasis on fiscal accountability at the margin, whereby discretion over certain revenue sources facilitates modest variations in budget size.

- (5) **Key Finding:** *The system of government in Northern Ireland is much too complex, in part for historical and contextual reasons; a systematic effort to streamline and simplify it will be required.*

Improving Value For Money is a crucial task, both for the Executive and the Assembly in its scrutiny role. Under the Assigned Budget system, 100% of savings is retained for spending on other priorities. Moreover, a precondition for convincing the electorate that more fiscal effort is required will be to provide assurance that efficiency gains have been exhausted and that the current rapid increases in public expenditure are actually improving public services. The imperative of public administration reform is widely recognised. The PPP / PFI initiative may, in certain contexts, be

useful if it leads to managerial benefits, but care is required to ensure that bills for budget-funded services are not simply postponed until some future date.

- (6) **Key Finding:** *The legitimacy of a needs assessment would be grievously damaged if the design of the exercise was imposed upon the Devolved Administrations, or if in-house calculations by the Treasury, which had been withheld from the Devolved Administrations, were released at sensitive moments.*

The role and conduct of a future needs assessment are issues that must be addressed in advance. The critical questions are, firstly, which body will conduct the needs assessment, and, secondly, what would be the terms of reference. Only after these have been established can objective indicators be brought to bear. Existing data are seriously inadequate for these purposes, especially when England is subdivided into regions.

- (7) **Key Finding:** *The Assigned Budget system affords great advantages to the Devolved Administrations.*

The Assigned Budget has shown adaptability in adjusting to the different conditions of devolved government. The crucial need is to secure much greater transparency about the operation of the Barnett formula: not just about the process, but also about the numbers, including comparable expenditure in England, changes in which generate formula consequences. The Barnett formula constitutes a vital mechanism in the overall funding system. The Devolved Administrations should not encourage criticism of this system unless they have clearly worked-out alternatives of what would take its place.

Conclusions from Council Statement:

- There appears to be a route defined for the Devolved Administration in terms of how it should increase the level of public expenditure available to it. Unfortunately, it could effectively mean increasing the taxation burden that its population faces. Only by so doing, can a case be made for approaching HM Treasury for additional aid.
- For such an approach it is reasonable to highlight that the higher relative need reflects a history of under-investment and neglect when resources were skewed towards law and order requirements.
- Any approach to HM Treasury must be done with the utmost care. The mechanics of the Barnett formula need to be fully understood before engaging in criticisms of its application.
- Triggering a formal needs assessment is fraught with danger and everyone should be aware that it is a double-edged sword.
- It is more important to appreciate absolute changes in expenditure allocations to Northern Ireland rather than be concerned about relative changes vis-à-vis England.

Copies of this publication can be obtained from the Northern Ireland Economic Council.
The publication is also available on the NIEC website:
www.niec.org.uk