Northern Ireland Fiscal Council

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Mr Matthew O'Toole
Chairperson to the Committee for Finance

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Dear Matthew,

An Interim Fiscal Framework for NI and comments on June Monitoring

On 21 May 2024 the UK Government and NI Executive published *"The agreement between the Northern Ireland Executive and the United Kingdom Government on the Northern Ireland Executive's Interim Fiscal Framework."*[1] This followed the UK Government's financial package for a restored Executive published in February 2024.

The creation of a Fiscal Framework for the NI Executive will put it on a par with the Governments in Scotland and Wales, where such frameworks already exist. The Interim Framework is the initial step towards a final Framework for the NI Executive's funding arrangements, and it is intended to focus on elements that can be implemented relatively quickly. In this letter we offer some thoughts on what has been agreed and what is still to be discussed. We also provide a short summary of the main points from the June Monitoring round, published by the Department of Finance on 1 July.[2] We will publish this letter on our website week commencing 9 September 2024.

As regards the Interim Fiscal Framework, we consider the following issues:

- What is covered by the interim Fiscal Framework
- Needs-based funding and the revised Barnett Formula
- Impact on future years

[1] https://www.gov.uk/government/publications/northern-ireland-executives-interim-fiscal-framework
[2] https://www.finance-ni.gov.uk/news/executive-agrees-june-monitoring-allocations#:~:text=The%20Executive%20has%20today%20agreed,and%20new%20build%20social%20housing.

- The stabilisation of NI's public finances
- What remains to be agreed in a final Fiscal Framework.

What does the interim Fiscal Framework cover?

The Interim Fiscal Framework fleshes out aspects of the UK Government package that helped restore the Executive, although some critical points remain to be agreed.

The Interim Fiscal Framework consists of seven main elements:

1) Operational details of the new 24 per cent needs-based funding factor that increases the generosity of the Barnett Formula. This takes effect from 2024-25;

2) An option to review this figure if "*multiple independent and credible sources provide evidence*" that NI's need for Block Grant funding per head relative to equivalent UK Government spending in England is greater or less than 124 per cent;

3) An agreement to review the 2026-27 'cliff edge' in NI funding implied by the structure of the restoration financial package at a future Spending Review;

4) Formalisation of the proposed increases to the Executive's annual capital borrowing capacity, initially moving from £200 million to £220 million per annum in 2024-25 and then rising in line with inflation[3] from 2025-26;

5) Delivery of the non-Barnett funding under the restoration financial package;

6) Updates on the Executive's Sustainability Plan, Strategic Infrastructure Plan and the establishment of the Public Sector Transformation Board; and

7) A summary of the components to be included in a final Fiscal Framework.

In the following sections we consider the elements that have moved on since the package was first agreed.

Needs-based funding

The February 2024 financial package committed the UK Government to a Welsh-style 'needs-based factor' that will apply from 2024-25 and see future Barnett consequentials received by NI increased by 24 per cent when overall funding lies at or below estimated need. This reflects the fact that the UK Government accepts that the NI Executive needs to spend more per head than the UK Government does in England on equivalent public services to deliver similar quality and outcomes – and that in the absence of a top-up of this type the funding premium over English spending would shrink over time (the 'Barnett squeeze'). 24 per cent was chosen because the NI Fiscal Council estimated in May 2023 that this was roughly the spending premium NI required to deliver equivalent services, although we noted that the precise figure depends on various judgements over which reasonable people could easily disagree.

The Secretary of State said when the package was announced that this top-up would be worth around £785 million over the next 5 years, implying that that funding is currently below estimated need and that the 24 per cent top-up applies to all Barnett consequentials over this period. We estimate that the prospective value has increased to roughly £815 million since then because of the increases in public services spending announced in

[3] Using the GDP deflator measure of inflation

the UK Government's March 2024 Budget and incorporated in the Office for Budget Responsibility's latest forecasts, and changes in expected relative population growth.

Table 1 shows our estimate of how this additional funding accumulates over time. The calculations assume that UK Government public services spending rises in line with the current Spending Review plans for 2024-25 and thereafter in line with the provisional spending envelope that the Treasury provided to the OBR for the March 2024 Budget. It also assumes that in future years the same proportion of total public services spending is 'Barnettable' as in 2021-22, which seems reasonable in the absence of detailed plans.[4]

On the latest figures the annual value of the top up would be worth almost £295 million by 2028-29, an increase in the core Block Grant of around 1.8 per cent relative to the position with no top-up at all. This gain may seem relatively modest, but over the longer term – by arresting the Barnett squeeze – the top-up will help put the Executive's finances on a more sustainable footing as the premium of Block Grant funding over equivalent spending in England would otherwise tend to zero, other things being equal.

The Secretary of State's assessment of the potential gain confirms that the UK Government believes that NI's funding premium is currently lower than need, before the impact of the financial package, but without providing a precise estimate.[5] The top-up would move NI's total funding per head gradually towards 124 per cent of spending in England, but not take it straight there. Alas we cannot say precisely how close it would get over this period. A summary of all the fiscal elements in the UK Government deal is at Annex A.

Table 1 – Profile of additional 24 per cent from proposed Barnett adjustment

£ million	**2023-24**	**2024-25**	**2025-26**	**2026-27**	**2027-28**	**2028-29**	**Total**
Additional 24% Barnett consequentials, as published February 2024[1]	-	40	91	151	218	288	**788**
Percentage increase in overall core Block Grant	*-*	*0.3*	*0.6*	*0.9*	*1.3*	*1.7*	
Additional 24% Barnett consequentials, updated basis[2]	-	46	97	157	223	294	**816**
Percentage increase in overall core Block Grant	*-*	*0.3*	*0.6*	*1.0*	*1.4*	*1.8*	

Note[1]: Estimated additional Barnett consequentials based on OBR November 2023 EFO spending projections, and ONS population projections

Note[2]: Updated estimated additional Barnett consequentials based on OBR March 2024 EFO spending projections, and ONS population projections January 2024

Source: HM Treasury, Office for Budget Responsibility, Office for National Statistics, NIFC calculations

The Interim Fiscal Framework reinforces the top-up commitment and confirms that a needs-based factor of 24 per cent will apply from 2024-25 to "*new Barnett consequentials arising since the Executive was restored in February 2024*". This explicitly includes the Barnett consequentials arising from the spending increases announced in the March 2024 Budget (with the top-up from that worth around £24 million) but appears to remove any

[4] We provide updated estimates based on two scenarios later in this letter.
[5] We estimated it to be a percentage point or two above need with the financial package included.

potential for further back dating to any Barnett consequentials received prior to this date. We understand that the Executive had initially pressed for a retrospective settlement.

One new detail in the Interim Framework is that if the Executive's total DEL funding[6] is above the relative need level of 124 per cent, the 24 per cent uplift will be suspended in favour of a 5 per cent uplift factor. This is the same figure as in Wales. In our report on the updated estimate of the relative need for public spending in NI[7] we suggested that a higher transitional rate of around 10 per cent might be appropriate in NI given the higher estimated level of relative need for NI (24 per cent) compared to Wales (15 per cent, as estimated by the Holtham Commission in 2010).

The NI transitional rate may end up operating differently to that in Wales, but we will not know for certain until:

1) the Final Fiscal Framework for NI is agreed and includes the mechanics of how and when the transition factor will apply, and
2) the first review of the Welsh Framework is carried out before the transitional period ends.

Welsh funding is currently above the level of need and so the transitional needs-based factor of 5 per cent is being applied to slow the decline to the 115 per cent level. The wording of the Welsh Fiscal Framework implies a single transitional period, which will end when the funding premium drops to 115. At that point the text of the framework implies that the transitional rate ceases and the long-term rate of 115 applies from then on, even if funding rises back above need, for example because of relatively low population growth. However, at the point when the Welsh funding premium reaches 115, the Framework will be subject to review and there may be some negotiation around how the needs-based factor switches between the transitional and long-term rates. According to the Welsh framework: *"The first review will take place before the end of the block grant funding transitional period, and may include input from independent bodies."*

Another point of clarification offered by the Interim Framework is that the non-Barnett funding for the restoration package is excluded when assessing whether funding is above or below need. According to our calculations, the current premium for NI excluding the package funding sits at around 120 – 122 per cent of that in England, however we do not know what methodology for calculating this premium will be agreed between Treasury and the Executive as part of the Final Fiscal Framework.

In our previous analyses we noted that Treasury has not published a consistent time series estimate of the funding premium. As part of this Interim Fiscal Framework the UK Government and the Executive "*will agree a detailed methodology for assessing relative funding. At each future Spending Review and annual autumn fiscal event a transparent assessment will be conducted to identify Northern Ireland's relative funding per head.*" This is a welcome development and if published would improve transparency around the public finances. The detail of this methodology could make a significant difference to whether NI is considered to be funded below or above need (and by how much either way), as we showed in our report on the UK Government's financial support package for the restored Executive. Considerations around exactly what is included, and how these factors are incorporated into the final Framework will be important to NI's future settlements.

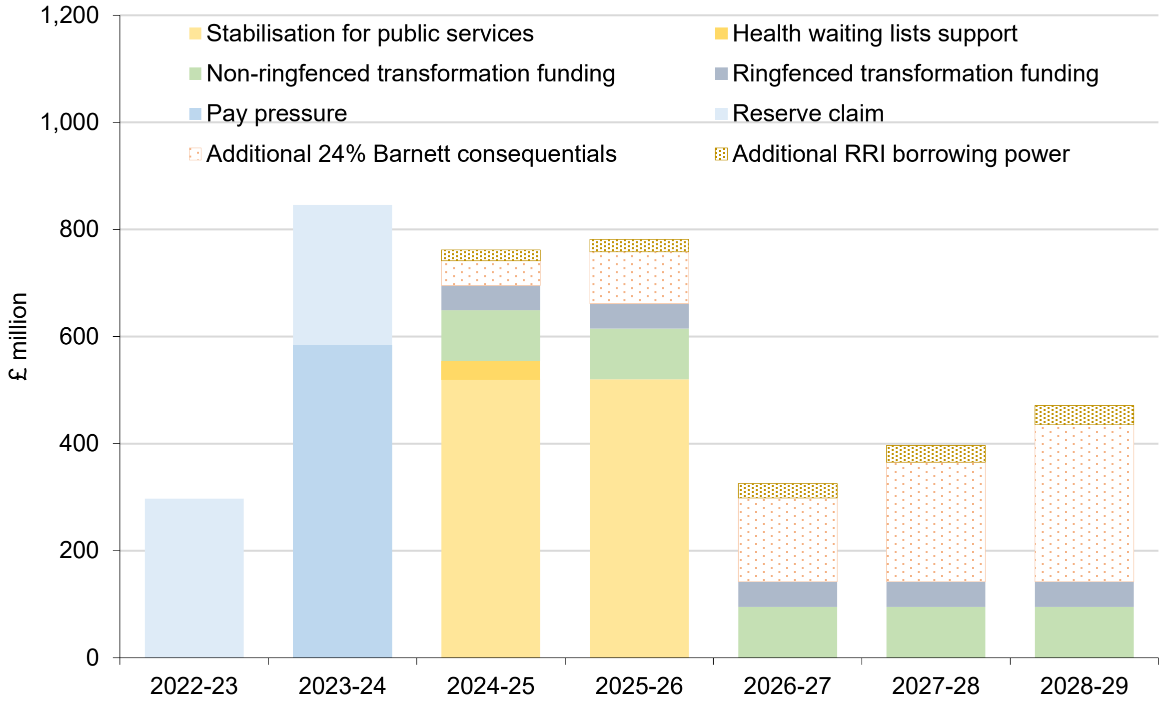
[6] Total DEL includes RDEL (excluding RDEL depreciation and impairments) and CDEL. When calculating relative funding, the Interim Fiscal Framework excludes the non-Barnett restoration package.
[7] https://www.nifiscalcouncil.org/publications/updated-estimate-relative-need-public-spending-ni

A number of stakeholders have made arguments that the needs estimate and hence the top-up factor should be higher or lower than the 24 per cent premium that we estimated and that was incorporated in the original funding package. The Interim Fiscal Framework agreement says that: *"The UK Government 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."* Some indication of flexibility was no doubt helpful in securing the Executive's agreement but finding "multiple independent and credible sources" seems a tough ask when relatively few bodies undertake analysis in this area.

Softening of the fiscal 'cliff edge'

In our report on the restoration package, we highlighted the cliff-edge drop in funding in 2026-27, when the short-term elements of the package come to an end but the impact of the Barnett top-up is not yet large enough to compensate (Chart 1). We commented that the cliff-edge could be brought forward to 2025-26 if the Executive fails to meet its sustainability objectives and is required to pay back up to £559 million it owes the Treasury to cover previous overspending. The establishment of an interim Transformation Board is a signal that the Executive is progressing work in this area. To avoid accusations of 'marking its own homework' it may be advisable for the Board in its final form to include greater independent representation from outside the Civil Service.

Chart 1 – Components of the UK Government funding package



Source: HM Treasury, NIFC calculations

In the Interim Framework the Treasury agrees "*to review and discuss the Northern Ireland Executive's funding approach, including concerns about 2026-27 funding, at the relevant Spending Review*". This does not commit it to take a softer line, however the Framework does go on to say: *"The Northern Ireland Executive's budget for future years, as is the case for all other devolved administrations and UK Government departmental budgets, will be set by HM Treasury at the next Spending Review. 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 per cent level of relative need in future financial years".

This suggests that there may be some other mechanism that could temporarily lift the Block Grant to the 124 premium until such time as the revised Barnett Formula mechanism takes full effect. The Interim Framework does not specify what this might be – for example, additional non-Barnett funding, a re-baselining exercise, or a reworking of the methodology to be used to determine the current funding premium.

Stabilisation of the Executive's finances

As noted above, the UK Government agreed in the restoration package to defer up to £559 million of debt repayments for two years, or to have that debt permanently written off if the Executive publishes and implements a plan 'to deliver sustainable public finances and services' by May 2024[8] (which has since been extended to August 2024) and include at least £113 million of revenue raising. The revenue-raising element in particular has seen numerous headlines with Executive Ministers effectively ruling out a number of options floated by the Secretary of State during the period prior to Executive reformation.

The Interim Framework states that the Sustainability Plan *"will demonstrate how the Northern Ireland Executive intends to deliver a balanced budget in 2024-25 and future years, including looking at options to deliver efficiencies and generate revenue. The Plan will cover how the Executive intends to meet the condition in the financial package to raise at least £113 million in additional revenue from 2025-26".* Annex C to the Interim Framework more specifically sets out the scope of the Sustainability Plan, listing six key elements to be covered. These include:

- the process to deliver balanced budgets in 2024-25 and also following completion of the next Spending Review;
- an assessment of the existing in-year monitoring process (with reference made to giving consideration to our 'Improving Transparency of In-Year Monitoring' publication)[9];
- an assessment on the sustainability of funding of Executive policies including delivering efficiencies, revenue raising, self-financed expenditure, and enhanced borrowing powers;
- an assessment of how the Executive will raise at least £113 million in additional revenue from 2025-26; and
- how budget management tools could be used to ensure the delivery of balanced budget.

With the scope of the Sustainability Plan agreed, as noted in Annex C of the Interim Framework, *"agreement of this list fulfils the condition for the £559 million debt write-off that the scope and structure of the Sustainability Plan will be agreed by May 2024."* That leaves the full Sustainability Plan to be published by August 2024 and the raising of £113 million in additional revenue the only outstanding condition in this respect.

In our recent report on the NI Executive's 2024-25 Budget we noted how the Budget balanced but there remained difficult decisions ahead. We would expect this Sustainability Plan to address some of the issued we raised. The opposition of the then Health Minister to

[8] https://www.finance-ni.gov.uk/publications/letter-finance-minister-chief-secretary-treasury
[9] https://www.nifiscalcouncil.org/publications/technical-paper-0523-improving-transparency-year-monitoring

the Budget, and comments that no "Ulster Unionist Party health minister would approve cost-saving measures 'with such catastrophic impacts' "[10] as those needed to live within the allocation for Health (prior to the June Monitoring round), indicate that the Executive may struggle to balance its books. We discuss the impact of the June Monitoring round in more detail below. It has improved the situation, especially for Health, but this is in the absence of any pay uplifts in this financial year.

The package also included an expectation that the Executive will publish a "comprehensive and costed long-term strategic infrastructure plan". The Interim Framework provides further clarification on what is expected within this plan, with publication required by Autumn 2024. As we noted in our most recent Budget assessment, we understand that work on an Investment Strategy is ongoing and we would expect it to be published within the timeframe set in the Framework.

What has yet to be agreed?

The Interim Framework identifies five key components for consideration in a final Fiscal Framework agreement. These are:

- Principles of fiscal devolution.
- Block Grant Adjustments.
- Budgetary management tools.
- Implementation arrangements.
- Forecasting responsibilities.

The Interim Framework however does not provide any further detail or indication of what will make up the detail undelying these components. It also only goes part way towards offering clarification on the matters contained within. A move towards a Fiscal Framework is a positive one however the Interim Framework lacks sufficient detail to understand fully the longer term impact.

Summary of the June Monitoring Round

The overall resource DEL spending plans published in the Executive's Budget 2024-25 document implied that spending by NI departments would be 1.7 per cent lower in 2024-25 than in the final plans for 2023-24. The allocations made in June Monitoring now imply an increase of 1.2 per cent. The additional funding for this year includes £23.9 million generated by the 24 per cent uplift applied to Spring Budget Barnett consequentials, and also anticipated Barnett consequentials arising from the Westminster Main Estimates. Anticipating Barnett Consequentials from Westminster Main Estimates before Parliamentary confirmation is unusual. The Finance Minister has recognised the risk that funding might be lower than this but argues that developments during the year could offset this risk. Provisionally banking future consequentials been done at this stage to release earlier in the year funding that might reasonably be anticipated, so that services do not suffer unnecessarily.

In our Budget report we noted that bids from departments for additional resources outstripped the sums actually allocated by 3 to 1. In this round it has increased to 6 to 1 on resource (£1.3 billion of bids to £213 million of allocations) and 9 to 1 on capital (£520 million of bids to £57.5 million of allocations). This may be an indication of growing pressures across departments. Our

[10] https://www.itv.com/news/utv/2024-05-27/drastic-health-spending-cuts-would-still-leave-189m-deficit-swann-warns

report suggested that careful management was required by the Executive to avoid overspending, especially in the context of the pressures in Health. Health has now received over £100 million of additional funding that should reduce the risk of overspending.

Our assessment of the Budget 2024-25 initial plans highlighted that it was the first time that Health's share of resource allocations had fallen over the course of a budget period, to 51.2 per cent of the total in 2024-25. Additional funding has been allocated to Health in June Monitoring, but its share has continued to fall to 50.8 per cent of the total (Table 2). In absolute terms, however, Health has seen an important improvement in its financial position. Health was previously sitting at a 2.3 per cent reduction against 2023-24 final plans, that has now decreased to a 0.1 per cent reduction – i.e. a near enough 'flat cash' position. The Department still faces inflationary pressures, but the position is significantly improved over the opening position and this partly addresses the points we noted about the relative decrease in the Health budget in our report. The Department of Health may even see an increase (in cash terms) this year if it receives any additional funding at the October or January Monitoring rounds.

Education has been able to fund an uplift for non-teaching staff, a long-running issue. However, wider public sector pay demands represent a remaining pressure for many departments (particularly Health), already experiencing fiscal tightening and a finely balanced budgetary position. The quantum of pressure this fiscal year will depend on the recommendations from the Pay Review Bodies, and whether or not these will be implemented by the relevant Ministers. Recommendations have been published for teachers and some NHS workers,[11] that are above the 3 percent working assumption suggested by DoF.

Table 2 – Change in relative share of total Resource Budget

Department	Opening Monitoring Position (%)	June Monitoring Position (%)	Change (percentage points)
Health	51.2	50.8	-0.4
Education	19.0	19.1	0.1
Justice	8.3	8.3	0.0
Communities	5.6	5.6	0.0
Economy	5.1	5.1	0.1
Agriculture etc	3.8	4.0	0.2
Infrastructure	3.7	3.7	0.0
Finance	1.4	1.4	0.0
The Executive Office	1.2	1.2	0.0
Minor departments	0.8	0.8	0.0
Total	**100**	**100**	**0**

Source: Department of Finance

I hope the Committee for Finance find this commentary on the Interim Fiscal Framework and June Monitoring useful.

With best regards,

Sir Robert Chote

[11] https://www.bbc.co.uk/news/articles/c4ng05555y4o

Annex A - Summary of fiscal elements of the UK Government's financial support package for the restored Executive

£ million	**2022-23**	**2023-24**	**2024-25**	**2025-26**	**2026-27**	**2027-28**	**2028-29**
Stabilisation for public services	-	-	520	520	-	-	-
Health waiting lists support	-	-	34	-	-	-	-
Non-ringfenced transformation funding	-	-	95	95	95	95	95
Ringfenced transformation funding	-	-	47	47	47	47	47
Reserve claim [1]	297	262	-	-	-	-	-
Pay pressure	-	584	-	-	-	-	-
Total non-Barnett RDEL	**297**	**846**	**696**	**662**	**142**	**142**	**142**
Additional RRI borrowing power [2]	*-*	*-*	*20*	*23*	*27*	*31*	*36*
Additional 24% Barnett consequentials, as published February 2024 [3]	*-*	*-*	*40*	*91*	*151*	*218*	*288*
Additional 5% Barnett consequnetials, on same basis as published February 2024 [3]	*-*	*-*	*8*	*19*	*31*	*45*	*60*
Additional 24 % Barnett consequentials, updated basis [4]	*-*	*-*	*46*	*97*	*157*	*223*	*294*
Additional 5% Barnett consequentials, updated basis [4]	*-*	*-*	*10*	*20*	*33*	*47*	*61*
Published - Total value of deal	***297***	***846***	***756***	***776***	***319***	***391***	***465***
Updated value of deal 24 per cent	***297***	***846***	***762***	***781***	***325***	***396***	***471***
Updated value of deal 5 per cent	***297***	***846***	***725***	***705***	***201***	***219***	***238***

Note[1]: the repayment of the reserve is conditional on the Executive publishing and implementing a 'sustainability plan'

Note[2]: estimated additional borrow ing limits based on latest GDP deflators.

Note[3]: Estimated additional Barnett consequentials based on OBR November 2023 EFO spending projections, and ONS population projections

Note[4]: Updated estimated additional Barnett consequnetials based on OBR March 2024 EFO spending projections, and ONS population projections January 2024

Source: HM Treasury, Office for Budget Responsibility, Office for National Statistics, NIFC calculations