Northern Ireland Fiscal Council
Bringing transparency to NI's public finances

Barnett squeeze confronts Executive with tough choices

The NI Executive's ability to deliver public services comparable to those in England is coming under increasing pressure from a squeeze on the Block Grant, according to the NI Fiscal Council's first annual report on the sustainability of NI's public finances. This will require determined efforts to use its funding as efficiently as possible and perhaps additional revenue-raising.

Today's *Sustainability Report* is one of two required each year from the Council, alongside an assessment of how the Executive balances its budget. Today's report will be followed on September 27 by a supplementary volume on sustainability in the health system, the Executive's biggest budget item.

The Executive's spending on public services is largely financed by a core Block Grant from Westminster, which evolves according to the Barnett Formula. Put simply, this ensures that when the UK Government increases spending in the rest of the UK on services for which the Executive is responsible in NI, the Block Grant rises by broadly the same amount in pounds per head. But spending per head was much higher in NI than England when the formula was introduced, so this produces a 'Barnett squeeze' with the percentage premium of the Block Grant over equivalent UK government spending shrinking over time.

As result of the formula and lower 'non-Barnett additions' from political agreements and other sources, the Block Grant per head is set to fall from 38 per cent above equivalent UK Government spending in 2017-18 to 25 per cent above at the end of the current UK Spending Review period in 2024-25.

Various studies have been undertaken to estimate the premium necessary to deliver equivalent public services in NI to those in England or elsewhere in the UK, based on different characteristics of the population. (For example, you might expect NI to need to spend more per head on education because it has a younger population, greater deprivation and more people in rural areas.) None of these studies is particularly recent, but our review suggests that the relative 'need' for spending may be about 20 per cent higher in NI than England.

The report projects that the Block Grant per head premium could fall below this level in the early 2030s, dropping below 10 per cent in the late 2040s and to just over 5 per cent by the end of our 50-year projection in the early 2070s.

This would confront the Executive with several choices, and it would presumably combine a number of them:

- simply to accept a lower quality and quality of services than England.
- to try to increase the efficiency with which NI services are provided.
- to cease or reduce the provision of lowest priority services.
- to make additional 'fiscal effort' (raising Regional Rates and/or fees and charges, with domestic water charges most frequently suggested).
- to seek greater tax raising or borrowing powers from the Treasury.
- to seek additional funding from the UK Government.

Additional funding from the UK Government could be attached to another political agreement designed to restore or sustain the Stormont institutions, like the New Decade New Approach agreement of 2020. But financial support of this type is typically time-limited and earmarked for particular purposes, which is not conducive to long-term planning and reform.

A more durable option would be to seek a similar agreement with the UK Government to that reached by the Welsh Government in 2016, setting a floor under the Block Grant premium at an agreed estimate of relative need (15 per cent in that case, based on analysis by the Holtham Commission) and an additional uplift to Barnett formula increases (5 per cent in this case) to slow the rate at which the premium approaches the floor.

In addition to assessing the sustainability of the Executive's finances, the report notes that the UK Office for Budget Responsibility has recently (and not for the first time) concluded that the UK public finances are on an unsustainable trajectory as population ageing and rising costs in health put upward pressure on spending and the loss of fuel duty from the transition to electric vehicles puts downward pressure on tax revenues. This implies a need for fiscal tightening at some point that would affect people in NI through some combination of higher taxes, reduced welfare or pension payments, or lower public services spending (relative to the projected upward trend) that would feed through to the Block Grant via the Barnett formula.

In this regard, the Barnett formula implies a Barnett paradox. The more rapidly the UK Government increases its spending on public services, the more rapidly the NI Block Grant rises in absolute terms but the quicker the premium between the Block Grant and equivalent UK Government spending shrinks in relative terms. Equivalently, a programme of spending cuts at the UK level – which many commentators expect – would reduce the absolute level of the Block Grant and the Executive's spending but would ease the Barnett squeeze.

Notes to editors:

1. The full report is available here: https://www.nifiscalcouncil.org/publications
2. Further information on the NI Fiscal Council is available here: https://www.nifiscalcouncil.org/
3. Follow us on Twitter: @NIFiscalCouncil