Northern Ireland Fiscal Council

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Chairman

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The NI Fiscal Council

- Created following the New Decade New Approach agreement in 2020
- One of 40+ official-but-independent fiscal watchdogs worldwide
- Two reports each year required by current Terms of Reference
  - How the Executive balances its Budget (last December)
  - Sustainability of the NI public finances, split on this occasion into two volumes
    - General discussion of sustainability (today)
    - Special focus on health, with accompanying Nuffield Trust paper (September 27)
- Part of a broader mission: transparency and independent scrutiny

Overview of the report

- Fiscal (un)sustainability at the UK level
- How to interpret sustainability for the NI Executive
- Relative spending and need between NI and UK/England
- The ‘Barnett squeeze’ on the Block Grant
- Topping up the Block Grant

How fiscal sustainability is usually judged

- Project public spending and tax revenues forward over 50 years, assuming current policies are maintained
- Current policy unsustainable if this results in the budget deficit, debt stock and debt interest payments rising indefinitely as % of GDP
- This is not a forecast. In such a scenario, fiscal policy would have to be tightened long before a 50-year horizon was reached

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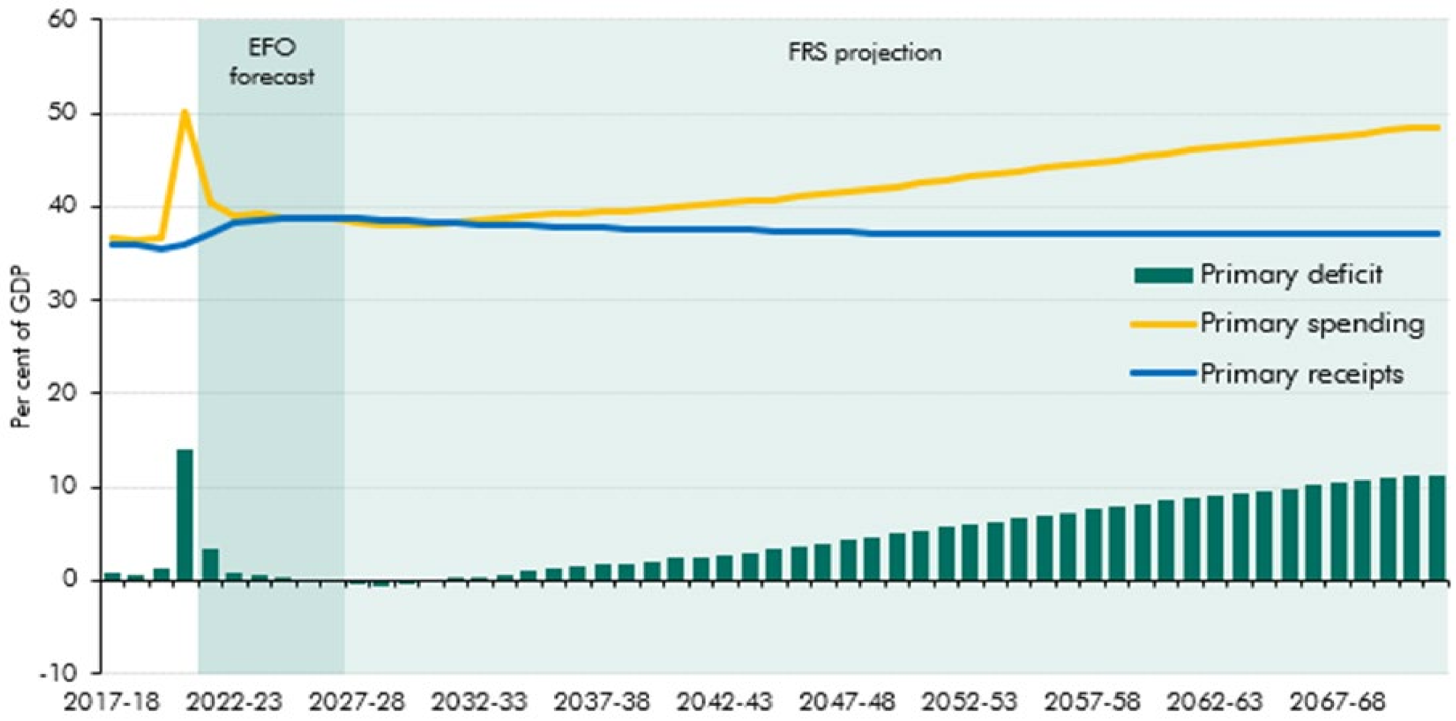
The OBR’s view of UK sustainability



Source: OBR

- Spending rises because of ageing and other health cost pressures
- Revenues fall slightly as the shift to electric vehicles reduces fuel duty
- So ex-interest deficit rises and so too the headline deficit and debt

What does this mean for NI?

- Some fiscal tightening necessary to restore sustainability, relative to scenario in which upward pressure on spending accommodated

- Which would affect people in NI via some combination of
    - Higher UK taxes
    - Lower benefit and state pension payments
    - Lower UK spending on public services (relative to projected trend), which would be reflected in a smaller NI Block Grant and Executive spending

Sustainability and the Executive

- Unlike the UK Government, the Executive's borrowing is limited by legislation (£3bn in total) and agreement with HMT (£200m a year) and it can only borrow from the UK Government
- So it cannot run an explosive deficit ending in a debt crisis
- Public services spending largely financed by the Block Grant, with modest additions from borrowing, Regional Rates and fees & charges
- Sustainability = sufficiency? Given the importance of the Block Grant and the Executive's relatively limited ability to top it up, can it expect to fund public services comparable to those in England?

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Relative need for spending per head

- Widely accepted that DAs need to spend more per head than UK Government spends in England to deliver comparable services

- For example NI may need to spend more per head on education because of younger population, greater deprivation and rurality

- Various official estimates of relative need since 1979 - HMT, Executive and Holtham Commission

- Can then compare Block Grant per head premium over equivalent UK Government spending to these estimates of premium necessary to deliver equivalent quality and quantity of services

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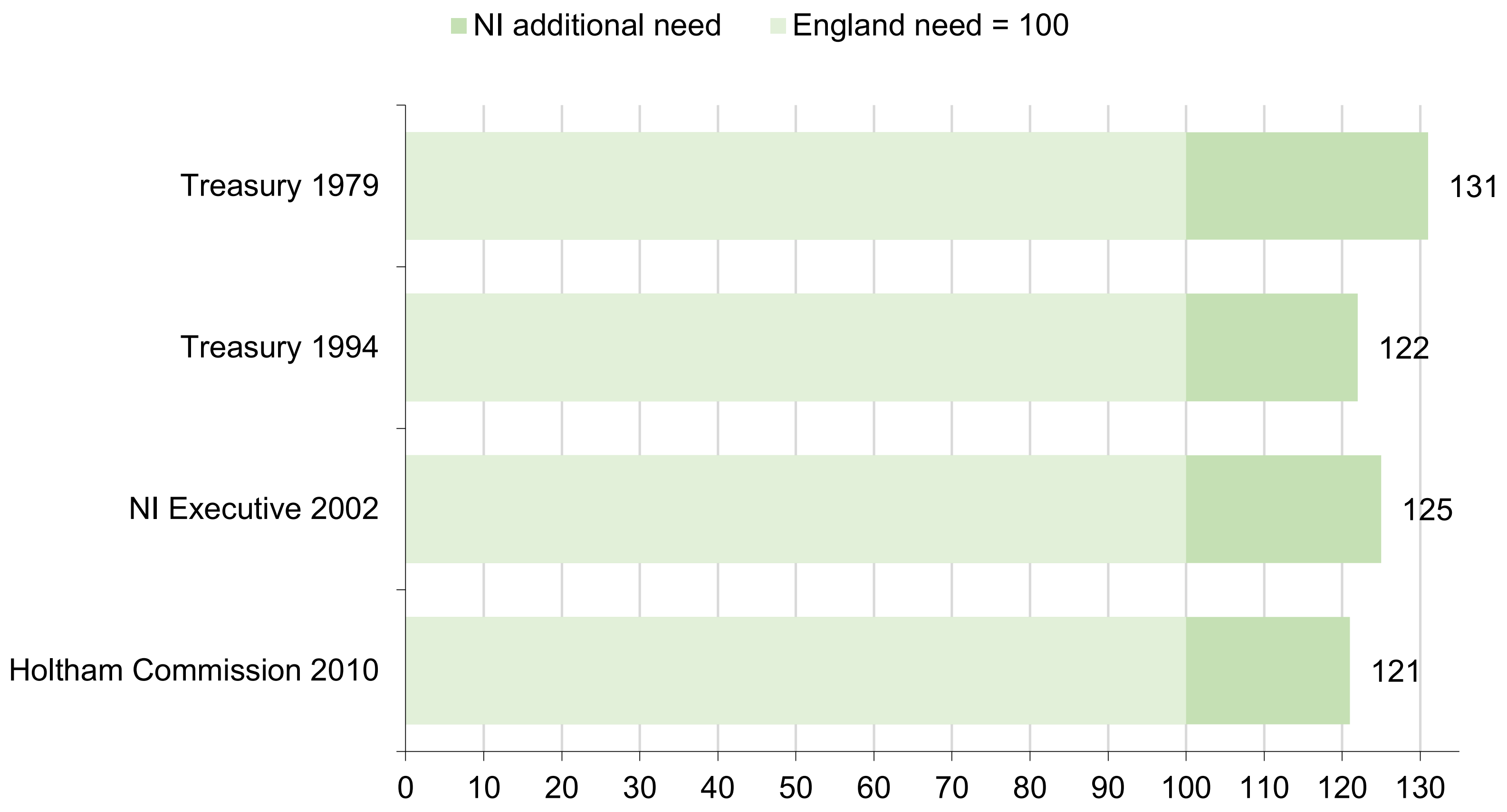
Results of past needs assessments



Sources: House of Lords - The Barnett Formula - Select Committee on the Barnett Formula; Department of Finance; Independent Commission on Funding and Finance for Wales.

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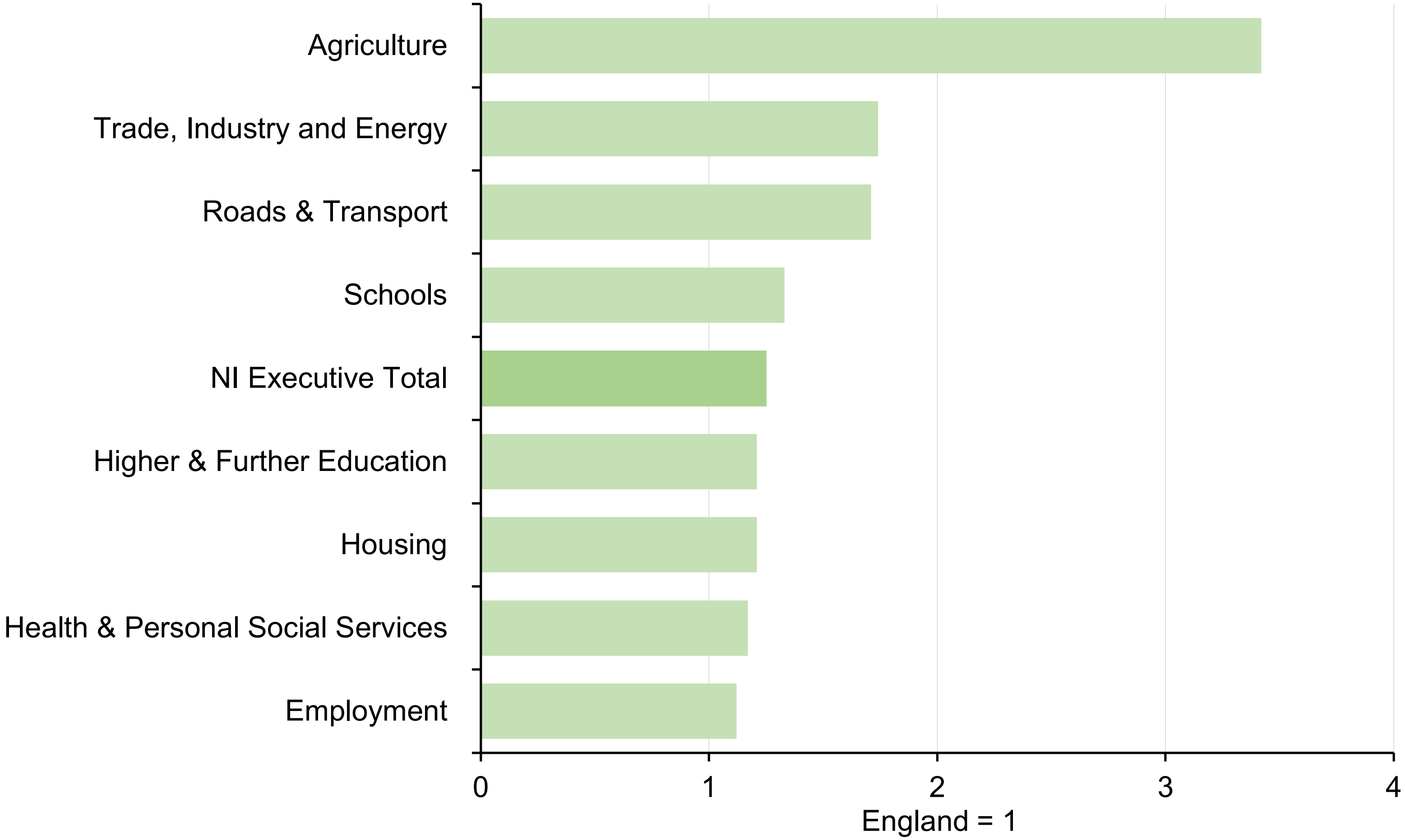
Executive's 2001-02 needs studies



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Basis of Holtham needs assessments

- Smaller scale than earlier assessments

- Drew on indicators of
  - Under-16 dependency ratio
  - Pensioner dependency ratio
  - Proportion of population from ethnic minority
  - Proportion of population claiming income-related benefits
  - Proportion of population with long-term life-limiting illness
  - Proportion of population in settlements <10k people

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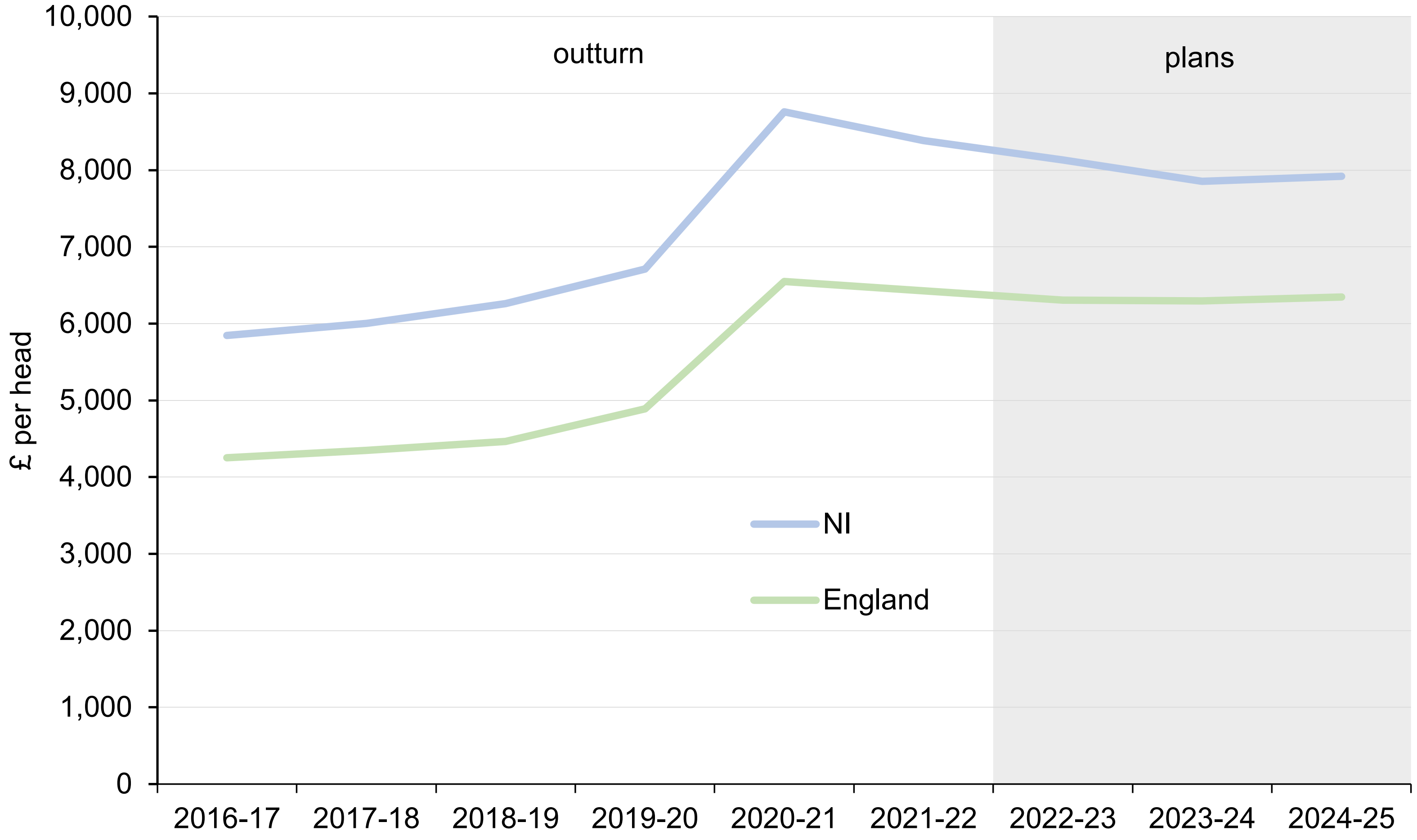
Relative spending and Barnett squeeze

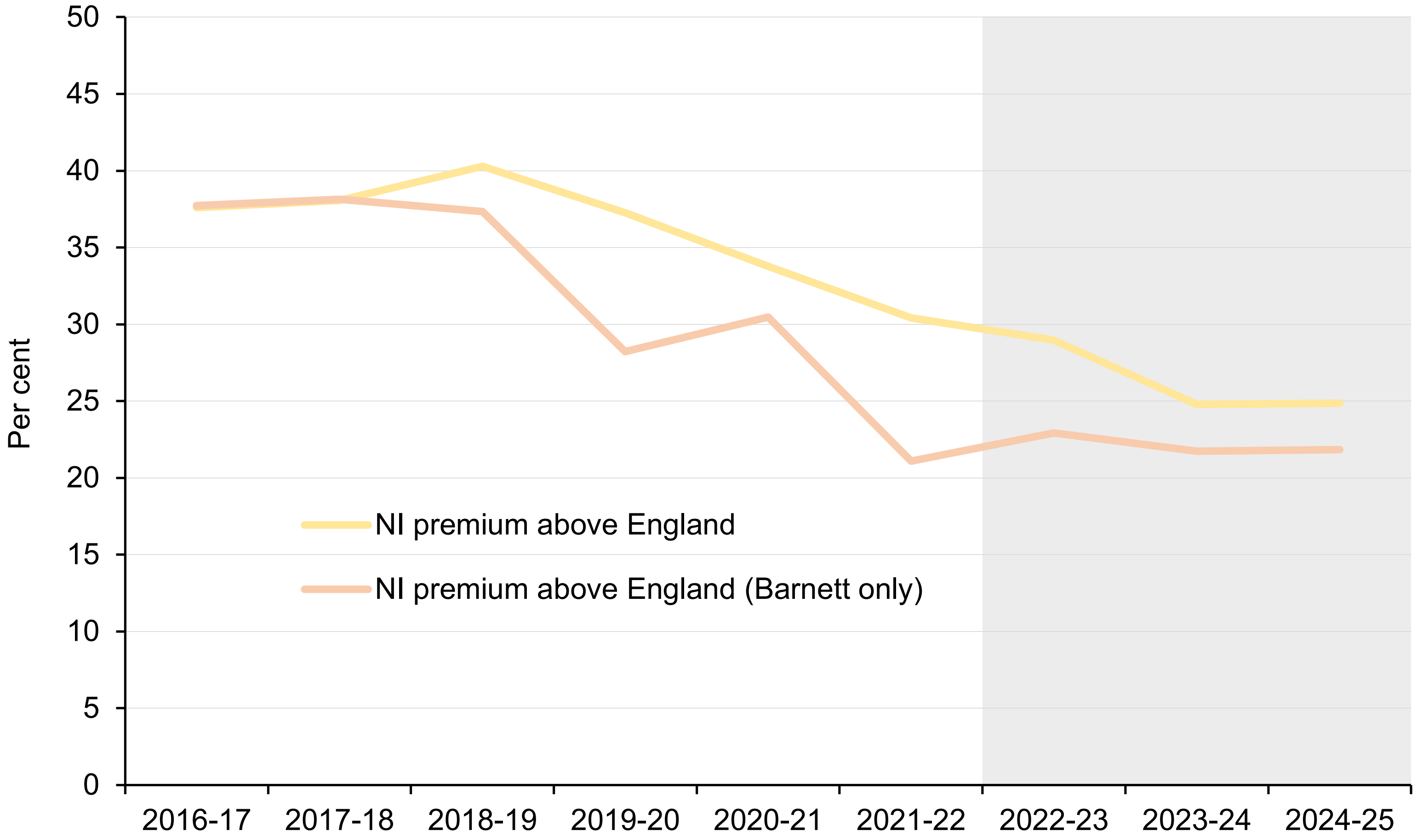
- The NI Block Grant premium over equivalent UK Government spending has been well above a 20 per cent needs estimate for years
- But gap is projected to narrow thanks to the Barnett squeeze and the end of financial support related to NDNA and other political deals
- Barnett ensures that when UK Government increases spending on services the Executive is responsible for in NI, the Block Grant rises by an equivalent amount in pounds per head
- Because the NI Block Grant is higher to begin with, this means that the Block Grant rises less in percentage terms and the percentage premium over UK Government spending shrinks over time

Block Grant and UK spending over SR



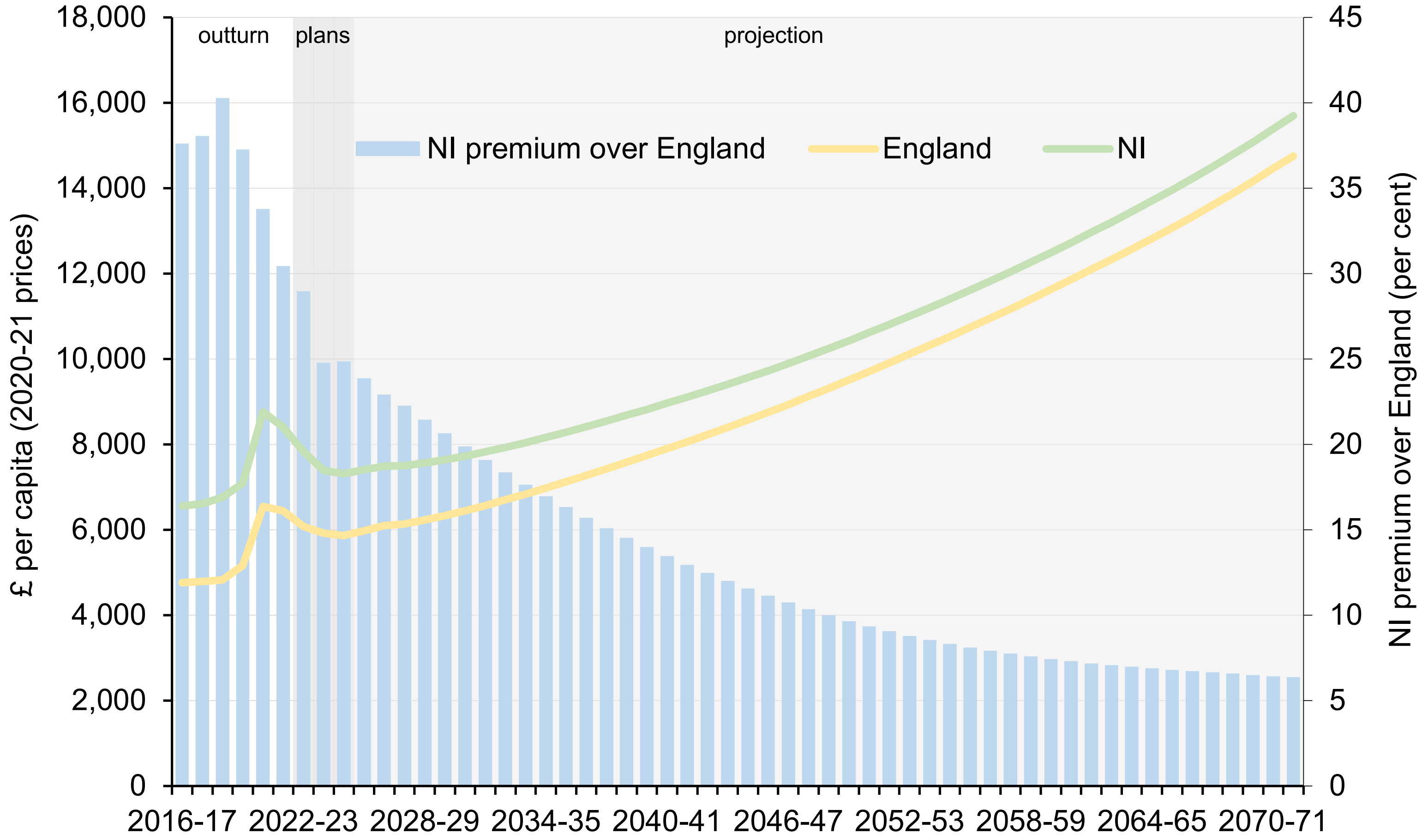
Source: HM Treasury and Northern Ireland Fiscal Council calculations

Block Grant and UK spending over SR



Source: HM Treasury and Northern Ireland Fiscal Council calculations

The long-term Barnett squeeze



Source: HM Treasury, OBR and Northern Ireland Fiscal Council calculations

What could the Executive do?

- Accept lower relative quantity and quality of services
- Cease or reduce the provision of lower-priority services
- Try to increase efficiency and value for money of existing services
- Make additional 'fiscal effort' through Regional Rates and charges
- Seek greater tax-raising or borrowing powers
- Seek more money from the UK Government
  - Attached to political agreements
  - Welsh-style needs floor on the Block Grant premium

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To conclude…

- Executive public services spending is largely funded from Block Grant
- Premium over equivalent UK Government spending is shrinking
- Could fall below 20% estimated needs threshold in early 2030s
- Barnett squeeze paradox – the faster UK spending rises, the faster the Block Rises in absolute terms but the faster it shrinks in relative terms
- Sustainability under threat in terms of relative sufficiency
- On its own, the Executive could prune services, increase efficiency, borrow a little more, raise Regional Rates and fees & charges
- And/or seek more UK funding: NDNA-style or a needs floor