



Northern Ireland
Assembly

Committee for Finance and Personnel

OFFICIAL REPORT (Hansard)

Review of the Operation of the
Barnett Formula:
Department of Finance and Personnel

17 February 2016

NORTHERN IRELAND ASSEMBLY

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Members present for all or part of the proceedings:

Mr Daithí McKay (Chairperson)
Ms Claire Hanna (Deputy Chairperson)
Mr Leslie Cree
Mr Gordon Lyons
Mr Ian McCrea
Mr Máirtín Ó Muilleoir
Mr Jim Wells

Witnesses:

Mr Stephen Barrett	Department of Finance and Personnel
Mr Alan Ramsey	Department of Finance and Personnel
Mr Tony Simpson	Department of Finance and Personnel

The Chairperson (Mr McKay): We have a heavy agenda today, so we will go straight into the questions, if that is OK.

Mr Tony Simpson (Department of Finance and Personnel): Absolutely.

The Chairperson (Mr McKay): The Department's commitment is to keep convergence under consideration: how and when does the Department plan to analyse and monitor changes in convergence?

Mr Simpson: The public expenditure allocation that we receive is something that we are always mindful of and always keep under review. The report was very thorough and well thought-out, and it took on board a lot of input from academic and constitutional experts.

Convergence is a long-term feature. The report's findings are something that we do not dispute, and we are mindful of the impact that it has. However, as is presented in the report, it is at times when expenditure is either decreasing or flat, when inflation is low or when Northern Ireland's population is increasing at a lower rate than the UK average that the Barnett formula works in our favour. In the current environment of constrained public expenditure, we are largely shielded from the impact of convergence.

It is something that we will continue to monitor, but, given the spending review outcome that we have just had, it is less of a pressing issue at present. It is something that we will keep under review rather than saying, "We are going to do a big report in the next month or two and see what the impact is".

The Committee's report has been useful in shining a light on the issue yet again, but it is something that we are mindful of.

The Chairperson (Mr McKay): How do you monitor it at the moment? You do not see it as a pressing issue at the moment, so —

Mr Simpson: On convergence, we are always focused on ensuring that we have a sufficient allocation and on getting the best outcome for Northern Ireland. Given the spending review outcome that we have had in recent months, we do not envisage seeing convergence move in any great direction. That is something that we have been able to take on board in the outcome of the spending review.

Mr Stephen Barrett (Department of Finance and Personnel): A key publication for us is the annual public expenditure statistical analyses (PESA), which much of the information in the report is based on, and we will continue to monitor that in the years ahead to see how our public expenditure compares with the rest of the UK.

The Chairperson (Mr McKay): Rather than calling for a switch to a needs-based assessment, the Committee's recommendation on developing a local case on need was for a pre-emptive measure in the event either that the Westminster Government decided to dispense with or alter the Barnett formula or that the formula no longer met our spending needs in future. Moreover, the previous Minister's response emphasised that our higher public expenditure per head is:

"totally justified given the level of need locally."

What scope is there to underpin that position through DFP establishing an up-to-date evidence-based case on our local needs to defend the Executive's future funding position?

Mr Simpson: There are a couple of points to make. The Government have signalled that there is no intention of moving away from Barnett in the near future and that they are committed to it. A significant body of work was done around 2000-01 to come up with a needs-based assessment. The key factor in being able to undertake a needs assessment is having the data and information. In Northern Ireland, we have a wealth of statistical information on socio-economic factors and the full range of factors needed to make a needs assessment. A methodology is largely in place. The challenge with a needs assessment would not perhaps be as much doing it and constructing as the bilateral engagement with the Government to agree how you measure it. It is difficult to do something pre-emptively and say, "Right, here is our assessment of need". That work was done. I note that Professor Holtham has provided some evidence to the Committee on that to set out what Northern Ireland's need is. That largely tallied with the work that was done in 2000-01, which suggested that our need was around 20% to 25% higher than the English average spend. We have that wealth of information there. If there was ever any indication that the Government were going to move away from Barnett, we would need to open engagement with them on that. We largely have the information, and we will look at it as and when the need arises.

Mr Cree: On the transparency of Barnett, particularly on the calculation of the Barnett consequentials, I notice that the previous Minister stated:

"Treasury has provided the department with high level figure-work ... This has been sufficient for officials to ensure that the Barnett formula is being applied consistently and correctly."

What detail is provided in that data?

Mr Barrett: We receive high-level detail of allocations to English Departments through the spending review process. There is then the application of population percentages and comparability factors to derive the outcome for Northern Ireland.

Mr Cree: What are the comparability factors?

Mr Barrett: They are detailed in the statement of funding policy. They assess how spend under the devolved Administration compares with expenditure in English Departments. We receive that information out of the spending review and are then in a position to assess whether the Barnett

formula has been applied consistently with how it should have been in line with the statement of funding policy.

Mr Cree: There is nothing to hide there. Can that information be published?

Mr Barrett: We would probably need to consult the Minister and Treasury, particularly Treasury, to see that they are content that that information is released into the public domain.

Mr Cree: It is very sensitive. Is it even available to the Committee? We would like to get into that detail.

Mr Barrett: We can certainly look at that.

Mr Cree: Can you do that? Thank you.

Mr Ó Muilleoir: Thanks, gentlemen. Sorry that I missed the very start. I was in the Library studying. That used to be my excuse in school, too.

Mr Cree: He was reading the paper. That is what he means.

Mr Ó Muilleoir: Tell us a little more about how the Scottish are getting on. Mr Swinney has said that he does not want to negotiate Barnett, but we are also aware that, as they talk about moving forward on income tax and so on, they want there to be no detriment, in particular to their voters in Scotland. It seems to me that we take a very trusting attitude to the Treasury here regarding the fiscal settlement and Barnett. The Treasury has all the cards to play. We are sending our A-team guys. When we send you over there, we know that you will get a good conclusion to negotiations, but it seems to me that we are not as assertive as the Scots. The report states that London decides how the devolved regions will be funded — it is their call and there is nothing that we can do about it. It basically goes on to say that, when we get into a barney or a negotiation with London, we do well. The Scottish seem to be a little less trusting. Am I wrong in that? Do you have a more collegial relationship with Treasury than the Scots do?

Mr Simpson: There are two elements to that, Máirtín. A lot of the recent noise has been around how the negotiations are going about how the Scottish block grant will be adjusted. Take that out of the equation for a second and look at how the Barnett settlement delivers for Scotland and Northern Ireland. I would not comment on the relationship. The Minister pointed to this in her response: Barnett delivers what we see as a fully justified allocation. I think that it is 23% higher than the UK average and 26% higher than the English average. It therefore delivers for Northern Ireland the highest spend in the UK. The question is this: if you were seeking to challenge Treasury and unpick Barnett, do you think that that would be advantageous and deliver a better outcome? That is the first point to make about whether we sought to engage in the past on Barnett.

The second element concerns what Scotland is doing around the devolution of tax powers. It has tried to ensure that the block grant adjustment mechanism that is applied to Scotland is as favourable and fair to Scotland as it can be. They are ahead of us in that process. When we negotiate on corporation tax, for example, we will seek to be equally robust and will challenge them to ensure that we get a mechanism that is as fair for Northern Ireland. As you will have picked up from the press coverage around the discussions, different methods of adjusting the block grant are being looked at. There are pros and cons to those. The Scots are reportedly in favour of particular mechanisms, while the Treasury is advocating alternatives. That is where the discussion is going. When we are in that place with corporation tax, we will be equally robust, to ensure that we get a mechanism that does not disadvantage Northern Ireland.

Mr Ó Muilleoir: The Scots wanted an independent commission to look at that. Is anybody listening to that request? Is there any progress being made on that call by the Scots for an independent commission to look at the whole funding settlement and formula?

Mr Simpson: It is not something that I am in a position to comment on. Obviously, Scotland has its own independent fiscal council. The Scots see a role for that. They will need to discuss with Treasury the role of that body and the role of the Office for Budget Responsibility (OBR), for example.

Mr Ó Muilleoir: In trying to learn from what the Scots are doing on income tax, you use in your response the figure of £325 million as being the possible hit to the block grant if we are to devolve corporation tax from 2018 onwards. That figure seems to be a wee bit out of date.

Mr Simpson: It is.

Mr Ó Muilleoir: Where —

Mr Simpson: The more up-to-date figure is £275 million in the third year, ramped up from introduction, so it is 2021.

Mr Ó Muilleoir: Is that set against an 18% rate of corporation tax in Britain — England, anyway — at that stage?

Mr Simpson: Yes, but, owing to the way in which corporation tax returns are made, the full effect of that reduction in the UK rate is not felt in the year when it is £275 million. The corporation tax payments of many companies are lagged, so we will not see the full benefit of that cut to 18% until the year after. The full-year ramp-up is £275 million.

Mr Ó Muilleoir: Are you standing over that figure? That still seems to be too high. Is that the figure that you are working on today? The figure here is £325 million. You saved £50 million in two minutes. Your best calculation is that it will cost the block grant £275 million.

Mr Simpson: That is the estimate that we have been provided with by Treasury. It has updated the figure to reflect both the movements to 19% and 18% in the UK rate and the updated UK forecast for corporation tax receipts. There are assumptions that underpin that, and we are seeking to discuss and debate those with Treasury, as we have questions around the basis for those figures. It is the latest figure that we have from Treasury, but will that be the final bill? It could well change. We will seek to challenge Treasury on that.

Mr Ó Muilleoir: I think that the figure is wrong and that the assumptions are too much in favour of the Treasury over us. I think that it will be considerably less than £275 million. I suppose that this D-Day is coming more and more quickly. We started talking about it in late 2014, and now 2015 has gone. It is certainly an area in which we want the pencil sharpened and a really robust case made. I think that the Treasury is chancing its arm with the £275 million figure.

Mr Simpson: Another point that I want to make is that that is the net cost to the block grant. It reflects the direct costs of immediately cutting the tax rate for all companies currently here and the behavioural impacts that there may be from companies seeking to relocate from GB to Northern Ireland. A four-year review mechanism is being established as part of the Fresh Start Agreement, and one of the key elements of the costs that we are looking at is behavioural costs, because there more assumptions that need to be made in advance about what the behaviours of firms are likely to be. That is a particular aspect of the costs that we will seek to challenge.

Mr Lyons: We obviously want to get the best deal that we can from the Treasury on corporation tax, and figures have been thrown around so far. What work has the Department carried out on the second-round effects, which are the direct benefits that the Treasury will get as a result of us cutting corporation tax, VAT, income tax or whatever. In order that we can present the strongest possible case, can you tell us whether DFP has done any work on the Treasury's potential yields in that regard?

Mr Simpson: It was set out as part of the Fresh Start Agreement that those second-round effects would not be included in the adjustments made to the block grant. That is our position based on the outworking of that agreement. We are very mindful of what has been happening in Scotland with how the no-detriment principle will be applied. We watch that with interest to see what implications there may be for Northern Ireland, and we will advise on that.

We do not have specific estimates for the increase in tax yields. However, research done by the Ulster University has indicated that, by 2034, the economy will be 9% greater in size. It would be reasonable to assume that, if the economy is that much bigger, there could be a comparable impact, to some degree, on some of the taxes that are particularly sensitive to changes in economic activity, such as income tax and VAT. When we see those yields increase very much relates to the future.

The Ulster University's research also shows that the benefits — when we start to see the employment gains — are back-ended. It will take some years for firms to adjust their investment decisions, so you will not see those benefits materialise until later. I expect that you will see something similar with the benefits. We therefore might not expect to see the other tax yields increase significantly in the initial years; in fact, there could be a dip in tax yields as we pay the cost of corporation tax while waiting for the benefits to kick in.

Mr Lyons: OK. The Department's response on the issue of deductions from the Northern Ireland block grant, arising from the devolution of corporation tax, states that provision will be made for:

"a very clear scrutiny and approval role for the Committee and Assembly."

Do you have any more detail on what that will mean?

Mr Simpson: Not at this time. Obviously, corporation tax devolution has significant public expenditure implications. It is only right and proper that, as part of the budgeting process and getting agreement on how we utilise those powers, that be presented to both the Assembly and the Committee.

Mr Lyons: OK. That is fine. Finally, I want to move on to another issue, which is "English votes for English laws". I am not asking you to make any political comment on that. One of the issues that I have with English votes for English laws is that there are very few laws that are really just English laws. As you know, in health, education and other spending, that has a direct consequence on the other devolved regions. Following on from that, has the Department made an assessment of the potential implications or risks for the Northern Ireland block grant from English votes for English laws?

Mr Simpson: I am not aware of a specific assessment. We would be mindful of the impact of any decisions that then impact on spending levels in GB, which would then, through the Barnett formula, impact on the consequentials that we receive. It is difficult, because, at this point, we cannot foresee what that might mean for voting patterns and how that would translate into spending profiles.

Ms Hanna: Máirtín touched on how much more ambitious the Scots are and how much more delivery they achieve with their devolution. I am aware that the previous Minister met her Scottish and Welsh counterparts in August. I think that they were looking at the spending review and the statement of funding policy. What was the outcome of those meetings, specifically about the infrastructure, spending and Barnett consequentials of High Speed Two (HS2)?

Mr Barrett: As you know, in the run-up to the spending review, there was some uncertainty around the outworkings of HS2, in particular over whether we would receive comparability through the Barnett formula. Thankfully, that has been resolved in the spending review. We will receive Barnett consequentials and comparability in relation to HS2 allocations.

Generally speaking, the Minister routinely engages through trilateral meetings with his colleagues in Scotland and Wales on a range of issues, many of which are coming out of the spending review; for example, the apprenticeship levy. We will continue to do that to ensure that we get the best outcome for Northern Ireland.

Ms Hanna: I was going to ask you where that relationship is going and whether we are ensuring that we are, I suppose, stealing their ideas, basically — I was trying to think of a better euphemism for that. Will that continue? Are the Minister and the Department actively looking at the added value that Scotland, in particular, is getting, and are they planning to replicate that?

Mr Barrett: There will certainly be continued engagement with colleagues in Scotland and Wales. We can continue to assess closely developments in those regions to ensure that, if there is anything that we can learn from them or work together on to guarantee the best mutual outcome for all, we will do it.

Ms Hanna: I am new to the Committee. The statement of funding policy was quite out of date. What were the most significant changes to it?

Mr Barrett: To be honest, the changes were fairly minor. They were mainly presentational-type changes. There were no substantive changes to the nature or basis on which we receive funding. There was an update to the comparability factors; namely, an assessment of how spending locally

compares with spending in the UK. Other than that, there were no substantive changes to the Barnett formula.

The Chairperson (Mr McKay): From reading some of the recent news articles on the face-off between Holyrood and the Treasury, you always get the impression that the officials and certainly the Ministers are a lot more bolshie with Treasury. That is the perception. The optics are that they appear to be meeting the Treasury head-on. Should we adopt that approach as well? Is it the approach that we adopt? Do officials from Belfast go over to Treasury and stick it up to them or not? It is an important question to ask.

Mr Simpson: I suppose that one thing to say is this: where we differ in how we see how things should be treated, we robustly argue the case with the Treasury officials. I assure the Committee that, when we deal with Treasury, we ensure that, if we have good arguments to put forward, we certainly put them forward and put them forward strongly. When the Minister meets colleagues, he does likewise, as, I am sure, did his predecessors.

The Chairperson (Mr McKay): The concern would be that, with corporation tax being transferred, we want more fiscal powers here to better the outcomes for the people we represent, but we need to make sure that we get the right deal. I get a sense from what is being said in Scotland that they would walk away from the new powers to be conferred, including income tax and VAT, if there were no acceptable deal on the fiscal framework. The concern here would be that we are rushing into corporation tax without dotting the i's and crossing the t's.

Mr Simpson: Timing is important. Scotland is further down the devolution path than us on this, but it is important to bear it in mind that they have been talking for a significant period about the powers that it is going to have devolved. There is a lot of focus and negotiation now as Scotland gets to a very critical point. When we are at that point and as we move towards it, I would not expect to see any material difference. We will be equally challenging, and, when there is a final agreement to be made on how a mechanism will be applied to Northern Ireland, we will be equally robust. The noise around the Scottish debate — that is the best way in which to describe it — is increasing as Scotland gets quite close to a deal. The timing issue is slightly different here, as we are not at that point yet. We will get to it.

The Chairperson (Mr McKay): No members have any other questions, so thank you very much, folks.