
CENTRAL GOVERNMENT

PUBLIC EXPENDITURE IN NORTHERN IRELAND

PUBLIC EXPENDITURE OVERVIEW

Public expenditure in Northern Ireland is subject to two separate controls - the Departmental Expenditure Limit (DEL) and Annually Managed Expenditure (AME). DEL and AME together make up Total Managed Expenditure (TME).

DEL totals are fixed for a three-year period in National Spending Reviews (carried out by Treasury biennially). There are two main types:

1. Assigned - devolved administration have full discretion to determine where it is allocated; and
2. Non-Assigned - spending on items where provision is not directly determined through the Barnett formula.

AME is controlled on an annual basis, based on updated forecasts. This is because AME is largely comprised of demand led programmes (e.g. social security benefits), which cannot be reasonably subject to multi year limits.

Reflecting the differing nature of these controls, the main focus of the Budget process in Northern Ireland is on the DEL, in that the greater part of the DEL (known as the 'Assigned DEL') is subject to allocation at the discretion of the Secretary of State (or the Executive under devolution), in accordance with local needs and priorities.

Table 1 shows the Northern Ireland allocations for 2004-05 to 2007-08.

Table 1: The NI Allocations for 2004-05 to 2007-08

| | £ million | | | |
|--------------------------------------|--------------------|-----------------|-----------------------------|-----------------|
| | Outturn 2004-05 | 2005-06 | Plans 2006-07 2007-08 | |
| Departmental Expenditure Limit (DEL) | | | | |
| • Current Expenditure | 6,478.3 | 6,860.8 | 7,246.7 | 7,574.9 |
| • Capital Expenditure | 802.1 | 832.5 | 945.2 | 994.0 |
| Annually Managed Expenditure (AME) | 5,970.1 | 6,832.9 | 7,008.5 | 7,286.7 |
| Total | 13,250.5 | 14,526.2 | 15,200.4 | 15,855.6 |

The most fundamental point to note is that all allocations are made on the basis of a clear separation between **current expenditure** and **capital investment**.

The former element reflects the ongoing cost of providing services (for example pay, operating costs, and grants to other bodies) whereas capital investment reflects the investment in assets which will provide or underpin services in the longer-term (for example, in schools, hospitals, roads, etc).

Within current expenditure there is also a ring fenced component, "administration costs", representing the costs of supporting central government activity (mainly civil service running costs). Last year the Northern Ireland administrative cost allocation for 2005-06 to 2007-08 was held flat at the 2005-06 cash level. In addition to this there will be a reduction of 2,300 in the number of civil servants by 2007-08.

The following describes the budgetary structure, which provides a clear separation of actual consumption and investment¹:

- **Current Expenditure** – the Resource DEL excluding capital grants and including ring-fenced **administration costs**. From 2005-06 the Treasury has imposed a further control within the overall current expenditure budget, in that switches from non cash to cash spend, cannot exceed £20 million in any year; and,
- **Capital Investment** – which comprises the Capital DEL (for expenditure which enhances or creates an asset of Government), and capital grants, which support investment by other bodies, including some public bodies as well as the private and voluntary sectors. (Prior to 2006-07 capital grants were part of Resource DEL).

Therefore the Total Managed Expenditure is made up of the following:

$$TME = Resource\ DEL + Capital\ DEL - depreciation\ in\ DEL + AME$$

European Union Funds

Expenditure supported by receipts from the European Union Structural Funds including any matching funding from the Member State (but not private or voluntary sector contributions) is a call on the Northern Ireland DEL. Budget provision for spending in Northern Ireland on the European Union Programme for Peace and Reconciliation 2000 – 2004 (PEACE II) is fully covered by ring-fenced allocations in the Non Assigned DEL, and is fully additional to the Assigned DEL. Provision was made in SR2004 to extend the PEACE II Programme for a further two years to 2006.

The full cost of other projects and programmes which receive support from the EU Structural Funds expenditure, including the Community Initiatives counts against the Assigned DEL.

¹ For more information on Resource Budgeting and Accruals Accounting see Annex 3a.

The Operational Programmes for the 2000 – 2006 round of Structural Funds for Northern Ireland including the Community Initiative Programmes (INTERREG III, URBAN II, LEADER+ and EQUAL) specify Departments' responsibilities as Implementing Bodies and as Accountable Departments for measures within the various Programmes. This Budget includes full provision for the associated public expenditure cover required to enable departments to ensure the successful implementation of these Programmes.

THE SOURCES OF FUNDING FOR THE PRIORITIES AND BUDGET ALLOCATIONS

The main source of funding for public expenditure within Northern Ireland remains the block grant from the Treasury, funded through the proceeds of general taxation across the United Kingdom. Changes in the level of funding for Northern Ireland from this source are determined via the application of the "Barnett Formula" – in simple terms Northern Ireland benefits from a population based share of changes in funding for comparative spending programmes in England.

Material allocations from this source are made in the process of National Spending Reviews, which usually take place every two years. As 2005 is not a Spending Review year, no additional resources have been allocated to Northern Ireland via this route, however some marginal resources were made available in the course of the Chancellor's Budget in March 2005, and in his Pre Budget Report (December 2005).

In July 2005, the Treasury announced revised arrangements for the next National Spending Review. Instead of holding a Spending Review this year the Government will conduct a Comprehensive Spending Review (CSR) leading to an outcome in 2007 to cover the three years 2008-09 to 2010-11. As the total public expenditure envelope for Northern Ireland for 2008-09 will not be known until 2007, the current Priorities and Budget only covers the two years (of 2006-08), rather than the normal three-year period.

Further details of the funding framework for Northern Ireland, within the UK context, are set out in the Treasury publication "Funding the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly" (July 2004). The Budget document is written in the context of a devolved Assembly in Northern Ireland. However the principles within it have been maintained in the current period of direct rule. The publication can be viewed on the budget website².

² www.pfgbudgetni.gov.uk/

Other Sources of Funding

There are two main ways in which the gross spending power available to the Secretary of State in Northern Ireland can be increased (outside the nationally determined allocations which flow from the proceeds of general taxation). These are the **Regional Rate** and the **borrowing power within the Reinvestment and Reform Initiative**. Details of both are set out below.

Regional Rate

There are two elements to the rates bills paid by both households and the non-domestic sector in Northern Ireland. The **district** element, set by each of the twenty-six District Councils, is used to finance the cost of services provided by those councils. The **regional** element is determined by the Secretary of State (or by the Executive and Assembly under devolution), and generates additional resources to support the full range of regional public services in Northern Ireland.

As well as providing additional revenue for local public services in its own right, there is a link between the Regional Rate and access to borrowing under the terms of the Reinvestment and Reform Initiative (RRI), which provides extra resources available for capital investment. Access to borrowing under the RRI is conditional on increases in local revenues that close the revenue gap between Northern Ireland and England.

Households in NI contribute, via the domestic rate (both regional and district), only around half the amount to support local public services compared with equivalent payments by households in England. That gap means that less is available to pay for local services here, and the Government has concluded that there is scope to raise additional revenue through this mechanism, for spending on local services. Accordingly, the Regional Domestic Rate has been increased by 19 per cent in 2006-07, with the increase for 2007-08 being maintained at the level set in last year's Budget (6 per cent). This increase will raise an additional £20 million, over previous plans, for investment in local public services in each of the next two years.

The Housing Benefit system provides assistance with rates payments to low income households. Housing benefit is available to tenants in the private and social rented sector, and to owner occupiers. Through this system, people in receipt of Income Support, income based Jobseeker's Allowance or the guarantee element of State Pension Credit usually get the maximum amount of housing benefit, and therefore do not pay any rates. In certain circumstances, assistance may also be available to those who are not in receipt of any of these benefits, including working households.

On the non-domestic side, there will be a 3.3 per cent a year increase in each year. This recognises that business and commercial rates levels in NI are already broadly in line with levels in GB.

RRI Borrowing

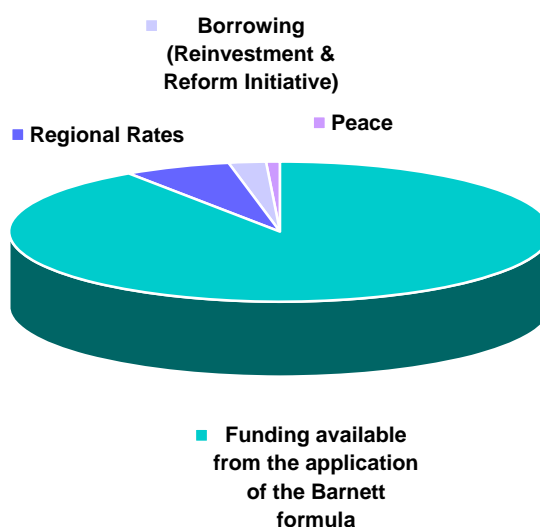
The Reinvestment and Reform Initiative, announced by the Prime Minister and Chancellor of the Exchequer in 2002, has given Government greater freedom and flexibility to deliver improvements in public services through access to funding, over and above the amounts determined by the Barnett Formula. This is in the form of a borrowing power to be financed by increases in the Regional Rate. This source of funding is to be used exclusively for capital investment, as opposed to current consumption.

The Priorities and Budget allocations for 2006-07 and 2007-08 are based on continued RRI borrowing of £200 million per year.

Summary – Sources of Funding

The following chart shows the extent of these various sources of funding.

Figure 1: Funding Sources for the NI Departments



OTHER ISSUES WHICH IMPACT ON USE OF AVAILABLE RESOURCES

As well as the additional resources available from the above, better use of the resources available to Northern Ireland is facilitated by the prudent use of an overcommitment assumption, and by delivering greater efficiency in public service delivery. Further details are provided below.

Planned Overcommitment

In response to the need to manage the implications of the rapid growth in public expenditure that has occurred in recent years and, in particular, to reduce levels of year-end underspend, an element of planned overcommitment has been included in recent Budget allocations. This approach, which has been an effective way of maximising spend by departments, and

hence reducing the extent of year-end underspend in Northern Ireland, involves making a prudent estimate of likely year-end underspend, and effectively over allocating resources to departments by that amount.

In the course of last year's Priorities and Budget process, the level of overcommitment was set at around 2 per cent on the current expenditure side, reflecting actual spending performance up to and including the 2003-04 financial year.

Further analysis of the pattern and level of spend by Departments, based on both 2004-05 outturn and the position to date for 2005-06, that suggests a reduction in this level is appropriate and the figures have been revised to £130 million in 2006-07 and £121 million in 2007-08 (or around 1.6 per cent).

Efficiency Gains

In line with the approach adopted by the Government at national level, last year the Secretary of State set targets for the public sector to achieve cumulative efficiency gains of 2.5 per cent a year over the period 2005-06 to 2007-08, with at least half of these gains releasing resources for reallocation to priority front line services. While this approach does not in itself increase the total amount available for spending in Northern Ireland, it does increase the amounts available for priority front line services.

Departments have developed plans and produced Efficiency Technical Notes outlining how they intend to deliver their efficiency targets. Implementation is underway and departments are monitoring achievement of targets on a quarterly basis to enable Ministerial monitoring on a six monthly basis.

Reprioritisation

Within any planning period, and as described above, the scope to allocate resources is constrained by the amounts that can be made available from new sources.

In order to create additional scope to reallocate resources from lower to higher priority areas, the Secretary of State has reduced the expenditure allocations previously earmarked for lower priority programmes by 3 per cent and 4 per cent respectively in each of the next two years. This will require the departments affected to reduce levels of activity in their lowest priority spending areas and/or to deliver existing levels of activity more efficiently.

BUDGET ALLOCATIONS

Although the rate of growth in the level of public expenditure has moderated in recent years, compared to the previous period of rapid growth, it is still growing in real terms (i.e. above the rate of inflation). Public expenditure per head of the population is 29 per cent higher in Northern Ireland than in the rest of the UK. The fiscal deficit – or the amount by which local public

spending exceeds our taxes and revenues – exceeds £5 billion a year. The revenue raised for local public services from the local domestic rating system is only half the equivalent figure for the rest of the UK. Without water charges, up to £300 million a year is being diverted from other public services to pay for the water service. In addition, public sector pay levels have been growing faster than inflation, meaning that more money has had to be diverted into meeting rising pay costs across many parts of the public sector.

These issues not only represent a challenge for the Government in terms of raising revenues and setting spending plans, but also for managers, at all levels of the public sector, in terms of the operational management and delivery of services. They underline the fundamental importance of promoting reform and efficiency across the public sector.

Current Expenditure Allocations

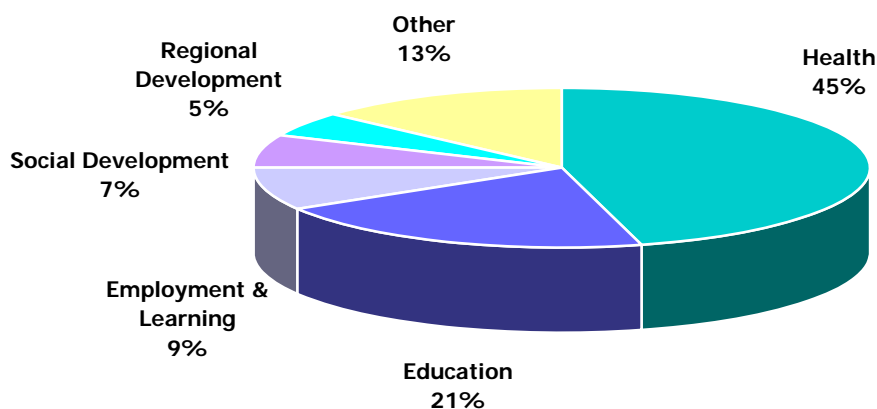
Taking account of the above additional sources of spending power the total current expenditure allocations available for distribution to local public services are:-

£ million

| | Outturn | Plans | | |
|---------------------|---------|---------|---------|---------|
| | 2004-05 | 2005-06 | 2006-07 | 2007-08 |
| Current Expenditure | 6,905.4 | 7,469.3 | 7,826.7 | 8,205.0 |

The main allocation of this expenditure by department is shown in the chart below.

Figure 2: Current Expenditure - Main Allocations by Department



Capital Investment Allocations

The capital investment set out in the Budget flows directly from the Investment Strategy for Northern Ireland (ISNI), launched alongside the Priorities and Budget document. The ISNI builds on a process, which started in May 2002 with the launch of the Reinvestment and Reform Initiative, and provides a comprehensive and strategic approach to managing the investment needs of Northern Ireland, to remedy an historic investment deficit and deliver a public sector infrastructure that is fit for the 21st century.

The ten-year Strategy allows decision makers to ensure that investment in the public infrastructure is directed to where it is most needed, is prioritised appropriately, and is delivered effectively. It provides the Secretary of State and his departments with a better strategic framework and overview within which to consider the nature and timing of investment decisions. This approach will ensure that investment efforts are directed at the highest priority areas in a way that maximises quality, timeliness and value for money.

The process will continue to be used in future years to inform investment priorities and will determine future budget allocations in respect of investment expenditure. The ISNI is fully consistent with these spending plans (i.e. for the period to 2007-08). For the period beyond 2007-08, the amounts available for investment will depend on the following factors:

- Resources made available to NI through subsequent National Spending Reviews;
- The extent to which we use the borrowing power available under the Reinvestment and Reform Initiative;
- The level of local asset disposals; and,
- The extent to which use is made of private finance.

The spending plans in the Priorities and Budget confirm the Government's intention to maintain the pace of direct investment from public expenditure and from borrowing over the next two years.

The total amounts available for allocation over the next two years are shown below:

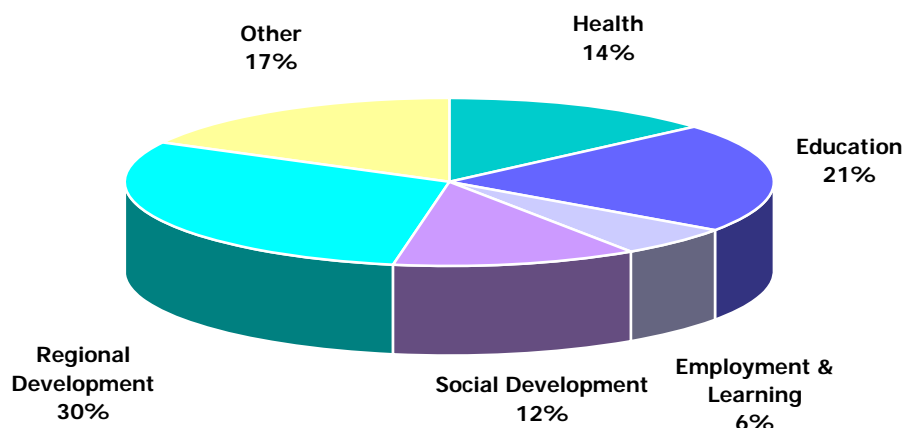
£ million

| | Outturn | Plans | | |
|--------------------|----------------|----------------|----------------|----------------|
| | 2004-05 | 2005-06 | 2006-07 | 2007-08 |
| Capital Investment | 972.4 | 1133.2 | 1304.5 | 1338.5 |

The main allocation of this expenditure by department is shown in the chart below.

The main capital investment allocations are displayed on Figure 3.

Figure 3: Capital Expenditure – Main Allocations by Department



Priority Funding Packages

The Secretary of State also established three new cross-cutting funding packages for: Children and Young people; Skills and Science; and Environment and Energy. Each will be underpinned by a greater sense of co-operation between departments.

Current expenditure allocations of £48 million in 2006-07 and £58 million in 2007-08 (underpinned by £15 million and £34 million capital investment), have been made to the funding packages.

IN YEAR MONITORING

There are traditionally four monitoring rounds during the financial year. These monitoring rounds assess current and future expenditure plans against the plans agreed in the Budget. They provide a formal system for reviewing spending plans and priorities in light of more up to date information.

At these times there are opportunities for departments to surrender resources and to bid for additional resources. These monitoring rounds recycle spare resources to urgent and unforeseen problems. The process is primarily aimed at redeploying reduced requirements, with a view to avoiding year-end underspends and is not intended to facilitate the re-opening of the Budget process. Departments must treat all allocations agreed in the Budget process as ceilings and seek to manage their activities to contain spending within those ceilings, unless and until any increase is agreed by Ministers.

Unspent allocations of the DEL Budget are carried forward from the previous year under the Treasury End of Year Flexibility (EYF) rules, this is to encourage good financial management.

ESTIMATES

The main estimates reflect the departmental Budget outcome and are agreed in June/July each year. They are an important part of the Budget process as:

- Approve areas of spending on which resources and cash may be used (Ambit).
- Details Spending Plans – spending under the main departmental objectives and expenditure broken down by function (functional line) and type (administration, other current, etc.).
- Includes DEL (assigned and non-assigned) and AME items.
- Votes the overall cash requirement.
- Base for system of physical cash control.

The supplementary estimates are changes in provision from the main estimates. They follow on from the in-year monitoring movements and are normally taken in the Spring.

BUDGET ORDER

The Budget Order gives the legal authority for spending cash and consumption of resources.

**Central Finance Group
Department of Finance and Personnel**

RESOURCE BUDGETING AND ACCRUALS ACCOUNTING

Central Government uses resource budgeting, which involves using resource accounting information as the basis for planning and controlling public expenditure. It distinguishes between resource consumption and capital investment and requires departments to match their costs to the time of the service delivery.

The framework for controlling expenditure under resource budgeting largely reflects the controls used for cash appropriations. Expenditure remains split between three year Departmental Expenditure Limits (DEL) and Annually Managed Expenditure (AME). Similarly, the End of Year Flexibility (EYF) system provides incentives for prudent spending at the end of the year.

The resource accounts are accruals based accounts. Accruals accounting is a method of recording expenditure as it is incurred, not when it is paid out and income as it is earned not when it is received. They record the full cost of activities, eg the use of assets as well as cash spent. They provide incentives for individual departments to improve the management of what they own and what they owe (their assets and liabilities).

By contrast, cash accounting records cash payments and receipts when they are made or received.