Northern Ireland Affairs Committee Inquiry – written evidence from Pivotal

Funding and delivery of public services: follow-up inquiry

Summary

Stability in government is essential for the proper use of public finances and the effective delivery of public services. Recent periods without the NI Assembly and Executive have been very damaging. Public services are in a very poor state, especially in health, but also water infrastructure, housing, school buildings, police numbers, and the environment. It is therefore very welcome that the Assembly and Executive have been restored. We encourage all concerned, including the UK Government, to do what they can to ensure the continued effective operation of the institutions.

It is important that the UK Government provides financial settlements for Northern Ireland that are fair and sustainable. Recent years have been characterized by over-stretched budgets, huge uncertainty, and short-term rescue packages. The upcoming UK Spending Review provides the opportunity to put NI's finances on a more stable, multi-year platform.

As well as a fair and sustainable funding settlement from the UK Government, the Executive must also take steps to ensure it gets the best from its own budgets, through appropriate short-term efficiencies, together with longer term transformation. Increased revenue raising should also be fully considered as an option for generating more funding for services. There is no one lever to pull here to manage NI's finances; all these elements together are important.

Is NI is adequately funded by the UK Government? The Fiscal Council has estimated NI's need to be 24% above England's, and concluded that NI is funded at slightly above this level at present, if the additions from the 2024 financial package are included. It is important that NI continues to receive funding at least at this level of relative need. However, is also clear that public services in NI as currently configured are not affordable with this level of funding. This emphasises the need for a clear focus on reform and transformation, to deliver services in more cost effective ways.

A specific issue that must be addressed is the 'cliff-edge' in funding that NI is facing in 2026-27, when the additions in the 2024 financial package no longer apply. This would result in a drop in funding of around £520m, which would be impossible to manage without catastrophic impacts.

The UK Government has a role in supporting the Executive in its efforts to transform public services and manage public budgets, for example sharing expertise and good practice examples. It needs to do so while respecting the Executive's responsibility for devolved decision-making.

The UK Budget in autumn 2024 provided significant additional funding, which has given welcome relief for NI's finances. Together with efforts across departments to reduce spending, this should mean that a balanced budget can be achieved for 2024-25. However, it will be important for the Executive to consider carefully how it spends the £1.5 billion injection of additional funding in 2025-26. There is a risk that it could just disappear into keeping services running, when in fact it needs to be used much more strategically to bring about improved outcomes and longer term reforms.

Full response

Pivotal is an independent think tank which aims to contribute to better policy-making in Northern Ireland. Launched in 2019, Pivotal does deep-dive research reports into current topics (for example Reconciliation and deprivation: twin challenges for Northern Ireland and Economic inactivity in Northern Ireland), as well as publishing regular reviews of how government is functioning (for example The first seven months of the restored Northern Ireland Executive). You can find out more about Pivotal and our work on our website here .

Pivotal values this opportunity to provide evidence to the Committee, which expands on the oral evidence provided to the Committee on 15 January 2025. It offers an updated view on many of the issues raised in Pivotal's response to the previous Committee's inquiry on this topic in spring 2023.

After some introductory and contextual comments, this evidence submission responds to each of the points raised in the terms of reference.

Introductory comments

Stability in government is essential for the effective use of public finances. It is impossible to get the best from public budgets or improve public services, let alone plan for the future, with stop-start government. Unfortunately, the absence of the Northern Ireland Assembly and Executive in recent years has had a serious effect on budgetary management and a damaging impact on public services. Pivotal therefore welcomes the commitment of the Northern Ireland Executive parties to the continued operation of the institutions. For its part, the UK Government, along with the Irish Government, needs to do all it can to support the continued operation of stable and effective government here.

There is no one solution or lever to ensure effective funding for public services in Northern Ireland. Funding and managing NI's finances is about a balance of measures, including a fair and sustainable needs-based funding settlement from the UK Government, short-term cost-cutting and efficiencies, longer term savings through transformation and reform, and additional local revenue raising. In the longer term, additional devolution of tax-raising powers could be added to this list of options.

None of these measures is sufficient in isolation. All are needed in combination. We would stress particularly that the view that more funding should be provided by the UK Government for Northern Ireland is not the whole answer, particularly given the steps that have been taken recently towards a fairer assessment of NI's need for public spending. In particular, much greater attention should be given to how funding is spent in Northern Ireland and whether changes can be made to ensure better outcomes for people here from the funding that is available.

While this evidence submission focusses on public finances and public services, a key to long term sustainability in Northern Ireland is a vibrant, growing and inclusive economy. The UK Government and NI Executive should therefore always give consideration to how public budgets are being used to promote productivity, skills development, infrastructure, innovation, entrepreneurship and R&D.

Context for public spending and public services in Northern Ireland

Before responding to the issues requested by the Committee, below are some important points of context.

It is very welcome that the Executive has been restored and that Northern Ireland has proper decision-making again after two years without government. There is also now a draft Programme for Government setting out the Executive's shared aims, a legislative programme, and a draft Budget for 2025-26. The Executive needs now to use these to focus on delivering better public service outcomes. It must improve what people are experiencing day to day (especially in the health service), for the sake of individuals' quality of life, their ability to work and participate in their communities, and the wider economy.

Public service outcomes in Northern Ireland are very poor compared to the rest of the UK

- Health – NI has the longest waiting lists in UK by a long way. 0.5m are people waiting for a first consultant appointment (total population 1.9m). The median waiting time is 59.6 weeks, even though the target is that no one should wait more than 52 weeks. In England, only 3.3% of patients wait for more than one year. In NI, more than half wait for more than one year.
- Housing - 47,000 households are waiting for social housing.
- House building – the construction of 19,000 homes is unable to proceed because of wastewater capacity constraints.
- Education – NI has a divided education system (only 8% of children attend integrated schools) and a GCSE attainment gap of 24 percentage points depending on social background (60% of children entitled to free school meals get 5 A*-C GCSEs including England and Maths, compared to 84% of children not entitled to free school meals).
- Productivity and skills - NI's productivity is amongst the lowest of UK regions. NI has a high percentage of people with no/low qualifications, a lower percentage of graduates, and not enough people with mid-range vocational qualification.
- Planning - the average processing time for planning applications is nearly twice the 30 week target
- Water quality - only one-third of rivers and 14% of lakes have good ecological status

Public finances in Northern Ireland has been in a repeated cycle of 'just surviving' in recent years with hugely stretched budgets, cuts to some services, and industrial action over public sector pay. The position has been managed via one-off rescue packages or flexibilities from the UK Government, particularly to cover public sector pay pressures (which make up 59% of NI's total resource DEL). NI needs a much more strategic and sustainable approach to public finances. It is encouraging to see the steps that have been taken towards this since the Executive returned in

February, including the financial package that accompanied restoration, the Interim Fiscal Framework and the Budget Sustainability Plan. There has been a constructive and business-like approach from the UK Government and the NI Executive in these discussions, with both recognising their responsibility to ensure NI's finances are fair and sustainable. Looking ahead, multi-year budgets are essential, which the UK Spending Review in 2025 should enable. The Spending Review offers an opportunity to put NI's finances on a more sustainable and predictable basis, rather than lurching from one year to the next with one-off rescue packages.

It is vital that NI's funding arrangement from UK Government is fair and accepted. The NI Executive can then get on with managing its own budget and improving public services, rather than repeated disputes with UK Government.

Transformation of public services is essential. In both public services and public finances, Northern Ireland is reaping the rewards of unstable/absent government and poor decision-making in the past. Even when the Executive has been in place, there has been a short term approach, a lack of strategic planning and departments operating in silos. Public service transformation has not happened to anything like the degree it is needed. The challenge now is for the Executive to make the necessary difficult decisions about how public services are delivered, recognising that these choices may be unpopular. Transformation must be prioritised and UK Government should support that in whatever way it can.

As elsewhere, there is ever-increasing demand for public services, putting upward pressures on spending now and into the future. For example, health spending is estimated to need to rise by 6% per year just to maintain the same level of service (because people are living longer with more complex conditions, more treatments are available, and cost inflation). In the next 25 years, NI's population aged over 67 is forecast to double, while the working age population will fall slightly. In addition, the costs of climate change will put further pressures on public finances. Public services as they are currently configured in Northern Ireland are barely affordable now, and will certainly not be affordable in the future. This underlines the importance of reform to how services are delivered.

Current assessment of need

In our comments in this section, we draw on the invaluable work of the independent Northern Ireland Fiscal Council and others. Pivotal has not done its own analysis about the level of need in NI.

At the outset it is important to note that the Barnett formula is a relative system that gives Northern Ireland (and Scotland and Wales) additions to funding that are based on funding increases in England, proportionate to population size. The biggest determinant therefore of how much public funding increases in Northern Ireland is how much funding increases in England. This 'input' into the Barnett formula is far more important in determining how much funding NI receives than any needs based adjustment factor. Austerity across the UK since 2010 has fed through into far lower funding additions for Northern Ireland, contributing to stretched public finances and services, as has happened elsewhere.

In asking whether the recently agreed 124% ‘needs based factor’ is sufficient, it is helpful to consider two questions:

1. *Is 124% the correct assessment of need in Northern Ireland compared to England?* That is a subject of debate, but on balance the NI Fiscal Council have concluded this is a reasonable estimate of need, having considered the various methodologies in detail in several recent reports. However, they have been clear that different data and methodologies could be used (noting that some of these produce a percentage lower than 124%). The Interim Fiscal Framework invited the NI Executive to provide multiple independent and credible sources making the case for a different percentage, although it is not clear whether any such evidence will be produced at this stage.

2. *If 124% is the correct level, is Northern Ireland getting that amount?* The latest Fiscal Council analysis says that NI is funded at around 125-127% at present. However, this is because of one-off additions for 2023-24, 2024-25 and 2025-26 in the recent restoration package. Without these, ‘basic Barnett’ for Northern Ireland would be only be around 120% of England’s funding per head.

A very important issue therefore emerges in 2026-27 when the one-off additions from the restoration package are no longer in place, leaving NI funding <u>below</u> 124% of England until the mid-2030s. It is difficult to see any rationale for this cliff-edge, which if unaddressed, would lead to a drop in funding for Northern Ireland in 2026-27 of around £520m.

Pivotal would suggest that a continued focus on whether the needs based adjustment should be a different figure from 124% may not be a particularly fruitful use of time and effort, and risks being a distraction from other important issues. While it may be important in principle, an increase of a couple of percentage points to the needs based adjustment would only result in relatively small additions to Northern Ireland’s total funding. It would certainly not be the solution to all NI’s public finance problems.

Finally in this section, it important to consider how we got to this position. We note that Northern Ireland is currently funded slightly above 124% of England’s funding per head, but NI is still struggling to manage within this budget and deliver adequate public services. Unfortunately, it would seem that funding at the current level of need is still insufficient to deliver public services as currently configured in NI. Why is this? In the past, NI was funded well above need, for example at 130-140% of England’s funding per head from 2013-19. This included receiving 140% of England’s funding as recently as 2018-19 (although this then fell rapidly to around 121% in 2022-23). The higher level of funding was largely due to one-off funding additions above ‘basic Barnett’. It is therefore unsurprising that NI has struggled in the last few years to deliver services with only around 124% of England’s level of funding, having been used to 130-140%. This implies that delivering public services as they are currently configured in Northern Ireland requires more funding than a needs based assessment would suggest. The reasons for this might include: higher delivery costs per head in key public services; a lack of public service transformation; reluctance to raise revenue locally (including no water charges); and some more generous public provision in NI (e.g. lower tuition fees).

What the Final Fiscal Framework should include

The agreement of the Interim Fiscal Framework (IFF) in May was a very important step towards putting Northern Ireland's finances on a more sustainable footing and getting agreement on issues that had been causing uncertainty and difficulty. The constructive approach taken by the NI Executive and the UK Government was welcome.

The most significant elements of the IFF would seem to be:

- Agreement from the UK Government to NI planning on the assumption of receiving funding at or above 124% of England's funding per head in future financial years.
- Commitment to review and discuss concerns about the 2026-27 cliff edge as part of UK Spending Review.
- New 124% 'needs based factor' to be applied from date when Executive restored
- Future review of 124% 'needs based factor' if multiple credible sources provide evidence.

Looking ahead to the Final Fiscal Framework, it will be important for the UK Government and the NI Executive to agree:

- How to address the 'cliff-edge' in 2026-27 when the one-off additions from the restoration financial package are no longer in place. It is essential that this cliff-edge is removed to avoid Northern Ireland having an enormous drop in funding (of around £520m, equivalent to falling back to around 121% of funding in England). This would have a catastrophic effect on service delivery. The UK Government has already committed in the IFF to NI planning on the assumption of funding at or above 124% of England's spend per head in future years, so it looks like a top-up will have to be given. Given that this will be a recurring issue every year, it would make more sense to uplift NI's baseline rather than having a series of one-off additions.
- Whether there will be any change to the 124% 'needs based factor' (for example if multiple credible evidence sources are provided for a different percentage).
- The methodology for applying the 'needs based factor' in practice, who will be involved in determining how it is calculated, and how any disputes will be resolved.

Revenue raising

The main revenue raising mechanism available to the NI Executive is regional rates on domestic and non-domestic properties (around £1.5 billion is raised in total rates annually). There is no charge for domestic water in Northern Ireland, so overall households pay much lower local charges in NI rather in the rest of the UK (between £550 and £900 less per household annually in 2021 according to NI Fiscal Council analysis).

Northern Ireland's politicians are always reluctant to raise more revenue locally. Historically, the Executive has chosen to keep domestic and non-domestic rates low in order not to increase costs for households and businesses. For example, despite a public finance crisis, the NI Executive chose to only increase domestic rates by around inflation in 2024-25 (4%) which meant little extra revenue in real terms was raised by that route.

However, it is important to remember the scale of potential additional revenue that could be raised. NI Fiscal Council have estimated that a 10% increase in (domestic) rates would yield additional income of £70-75m, which would only make a small contribution to NI's public finances. At the same time, a rates increase on this scale would be unprecedented and would be likely to be sharply resisted because of the financial impact on households.

The most significant example of other potential revenue raising that has not been pursued is domestic water charging. NI households do not pay for water in the same way as in the rest of the UK, with funding for NI Water coming from the block grant. The failure to raise revenue through domestic water charging is one of the reasons behind chronic under-investment in NI's water infrastructure over decades, resulting in the current collapse in the waste-water capacity and the subsequent impact on housing and other development. NI Fiscal Council estimate that an additional charge of £800 per household (which would bring NI household charges into line with average water plus council tax payments in England) could raise an additional £615m per year. This would however be a significant extra charge on households, and would be strongly opposed by most if not all of NI's politicians. It would also take several years to implement, even if it were agreed.

A related issue is that there are a range of other areas where NI provides services either free or at lower charges than in the rest of the UK, including lower student tuition fees, welfare reform mitigations, domiciliary care and concessionary public transport fares. In total, these add up to around £250-350m (see Fiscal Commission NI final report) . (Note there are also a small number of policy areas where NI provides considerably less free of charge than other parts of the UK, most notably government-funded childcare.) While these are legitimate policy choices for a devolved administration, it is not appropriate for the NI Executive to take policy decisions which reduce the amount of funding available to it, and then argue that it does not have enough funding to spend on other things.

There are some other fees and charges raised across Northern Ireland (e.g. car parking, planning fees, some health charges), but these are relatively small in comparison to total spending. While they might contribute to increased revenue raising, they are unlikely on their own to raise a significant amount. Hence the need for any new revenue raising to focus on rates and/or water charges which are paid by most households.

Pivotal would suggest that more local revenue raising should be given proper consideration by the NI Executive, for at least four reasons:

1. Increasing the amount of funding available to spend on local services;
2. If appropriately structured, enabling a fair and progressive system that requires a greater contribution from those who are able to pay more;
3. Fairness in public finances across the UK, noting that at present NI raises far less in household charges than England, Scotland and Wales;
4. Demonstrating NI's commitment to taking action to manage its own finances.

It is unfortunate that, to date, most conversations about greater revenue raising have been shut down before they have begun. Pivotal believes that there would be ways to raise more revenue, particularly using the rates system, that would be fair and progressive (i.e. those who can afford to contribute more should be asked to do so). The above-inflation increase in the regional rate proposed for 2025-26 may indicate some slight softening of the Executive's position.

As stated in the opening section above, however, revenue raising needs to be set in the context of a range of measures to manage NI's finances. The amounts that could be raised, and the political difficulties that would be involved, mean that it is certainly not the whole of the solution to NI's public finances.

Implications of the UK Budget in Autumn 2024 for Northern Ireland

The funding allocations to Northern Ireland for 2024-25 and 2025-26 in the recent UK Budget give significant relief to NI's public finances. Allocations for both years exceeded expectations and should allow many spending pressures to be met, particularly public sector pay awards. However, Pivotal would raise a concern about just using this big injection of new funding to plug existing budgetary gaps. In our view, it is important that these recent additions are used strategically to improve and transform services.

The UK Budget gave Northern Ireland additional resource DEL (RDEL) of £609m for 2024-25. Ahead of this, the Finance Minister had reported pressures in 2024-25 of £767m, particularly to fund public sector pay awards, so the Budget addition goes a long way to addressing this shortfall. The latest update is that the forecast RDEL shortfall for 2024-25 is now around £150m, which should be manageable by paying very close attention to spending across all departments as the year end approaches.

For 2025-26, Northern Ireland's RDEL was increased by £1.2bn (9% increase on the previous year's baseline) in the UK Budget. The confirmation of the block grant has allowed the Executive to publish a draft Budget for 2025-26 for consultation (see Department of Finance Draft Budget 2025-25).

While the UK Budget additions offer welcome relief for the Executive from recent pressures on its finances, there is a risk that this funding will only go towards keeping public services running, rather being used to bring about longer term improvements or reforms. It is imperative that the NI Executive uses this funding wisely and strategically, ensuring that people in Northern Ireland experience similar improvements in health, education and other public services, and similar transformative investment in infrastructure and other capital projects, as is the ambition in England. Injections of new funding on this scale are rare, and the Executive must not miss the opportunities they provide.

Turning to specific measures in the UK Budget, concerns have been raised in Northern Ireland about two policy changes in particular:

- **Employer National Insurance Contributions (NICs) increase** – serious concerns have been raised about how businesses, voluntary sector organisations and other employers will cover the increased costs arising from the employer NICs increase, particularly for those employers whose NICs bill is too large to benefit from the higher Employer's Allowance, but who are too small to have other ways to cover or absorb the costs.
- **Agricultural Property Relief (APR) changes** – DAERA estimates that around half of all farms in Northern Ireland will be impacted by the APR change, accounting for 80% of agricultural land. This seems completely at odds with the Treasury's assessment that three-quarters of farms UK-wide will be unaffected by the changes. The difference may partly be explained by higher land values in NI, together with a higher proportion of farmers who own land rather than having tenancies.

Effectiveness of the Budget Sustainability Plan

The Budget Sustainability Plan is another positive step forward in the way that Northern Ireland's public finances are managed. It sets out the process for how a balanced budget will be achieved in 2024-25 and future years, and provides a framework for future financial planning. This should help drive improvements in public finance management now and in the future, from both the NI Executive and the UK Government in their respective roles. The plan contains many aspects of good practice, including ensuring greater transparency.

The commitment to multi-year budgets, publication of more in-year monitoring data and budgetary flexibilities are particularly welcome, as is each department having a financial sustainability plan.

The Budget Sustainability Plan seems to show a welcome movement in the Executive's approach in a number of areas, for example a stronger emphasis on efficiency savings and on reform and transformation. It also hints at the need for greater revenue raising (or income generation) locally. As set out above, all of these are needed as part of a balanced package of measures to manage NI's public finances.

One surprising element of the Budget Sustainability Plan was that the £113m revenue raising requirement from the 2024 financial package will be met without making much change at all to previous plans, namely through increasing rates by just 4% in 24-25 and 5% in 25-26, plus some other uplifts to fees and charges. The conditions here appear to have been relaxed by the Treasury, including spreading the requirement to raise £113m over two years and defining it in cash rather than real terms.

Role of NIO and HMT in supporting financial stability and public service transformation

Financial stability

The UK Government needs to provide a funding settlement for Northern Ireland that is fair and sustainable. The UK Spending Review (SR) in 2025 is the key opportunity to agree a sustainable multi-year settlement for Northern Ireland for 2026-27 onwards. The SR should be used to draw a line under the unstable financial arrangements NI has had in recent years, and put it on to a sustainable footing. The UK Government and NI Executive should see 2025-26 as a 'planning year' to make preparations for this future multi-year settlement.

Once a fair and sustainable settlement is in place, the Executive can then get on with making its own decisions about how to use this funding to provide public services in Northern Ireland, based on its own Programme for Government priorities. With a fair and accepted funding package agreed, there would then be much less justification for NI going back to the UK Government seeking extra funding.

In recent years, the fall in the 'premium' Northern Ireland receives (towards 120% of England) has created huge pressures on public sector budgets. This situation has been managed by repeated one-off additions and flexibilities from the UK Government, which have uplifted NI's funding to slightly above the level of need (124%). We need to move on from this 'rescue package' approach, to give Northern Ireland a stable and predictable financial settlement, which can then be used as a basis for future planning.

In particular, Northern Ireland needs a funding settlement that enables it to make acceptable public sector pay awards each year (noting that pay makes up 59% of NI's RDEL). Repeatedly funding pay awards using one-off 'top-ups' is inappropriate, since obviously the pay awards (and further annual uplifts) then need to be funded in subsequent years also.

Finally, it is worth looking back on how the UK Government has funded Northern Ireland compared to Scotland and Wales. Over the years, NI has received a series of special funding packages above 'basic Barnett', often linked to political settlements to restore devolution. These have not been a feature in Scotland and Wales. While this extra funding has obviously been welcomed, it has meant Northern Ireland has received funding well above 'basic Barnett' in most years. This has acted to hide the impacts of the 'Barnett squeeze' over time, so when the one-off additions fell away from 2021-22, public finances were left in a very stretched position. These short-term funding boosts have also meant the NI Executive has been able to avoid making some difficult decisions over the years.

Public service transformation

Transformation in public services in Northern Ireland is essential and long overdue. Public services as currently configured are not affordable now, and will certainly not be affordable in the future as demand increases from demographic and other population changes. The primary example of this is the health service, where various independent reports have recommended reconfiguration to how, when and where services are delivered, but so far actual change has been limited. This is partly due to unstable and absent Executives, but also due to an unwillingness of NI politicians to take difficult or unpopular decisions. The Bengoa report in 2016 warned of "change or collapse" in the health service, and unfortunately we are now seeing actual collapse in many cases due to the failure to make the necessary changes.

One practical barrier in the way of transformation is that it is extremely difficult to reform public services which are not in a stable current position. The poor outcomes in NI's health service in recent years have made it almost impossible to find time or funding to prioritise transformation, since all efforts have been focused on managing day-to-day delivery.

It is primarily for the Executive to lead work on public service transformation in Northern Ireland. There is however a role for the UK Government in providing additional ring-fenced funding for transformation, which it has done on several occasions over the years, most recently through the Transformation Fund in the 2024 restoration package (although note this was a very small amount compared to the total amount of public spending in Northern Ireland). The UK Government can also offer support and expertise, particularly pointing to other parts of the public sector which have a track record of success.

Pivotal's view is that the UK Government should offer appropriate support and help to the Northern Ireland Executive, while respecting devolved decision-making. Being told what to do by the UK Government will not be welcomed, so taking a partnership approach to facilitating access to experts and examples of good practice may be much more productive.

Ann Watt, Director

15 January 2025