STRAND 1: FINANCE ISSUES
PAPER BY THE BRITISH GOVERNMENT

1.1 By way of background, Annex A describes the existing arrangements relating to Northern Ireland public expenditure, and Annex B describes the proposed arrangements relating to the Scottish Parliament and Welsh Assembly.

1.2 This paper suggests some key issues, relating to Finance, which Talks participants might consider in the context of options for new democratic institutions. It should be noted that, on many of the issues considered below, agreement would need to be reached with the Treasury in the context of whatever political settlement was agreed.

1.3 The paper proceeds on the assumption that the arrangements for determining and allocating public expenditure in Northern Ireland after a settlement should continue to be based on the operation of the "Barnett" formula to generate a figure for the size of the NI 'block'.

2. What public expenditure programmes should new political institutions in Northern Ireland be responsible for?

2.1 This would effectively be determined by the range of functions to be devolved to new political institutions in Northern Ireland from among those for which the Secretary of State is currently responsible. So Talks participants may wish to take account of the implications of assuming financial responsibility for the range of functions which they consider appropriate for the new institutions.

3. Resource issues not covered by the "Barnett" formula

3.1 Some public expenditure issues (eg provision for Social Security Benefits, special cases such as EU Peace and Reconciliation Programme) are currently settled with the Treasury separate from the Barnett formula (see para 8 of Annex A). In relation to these:

(a) should new political institutions in Northern Ireland act in support of the Secretary of State in dealings with the Treasury? or

(b) should the Secretary of State deal with the Treasury, on behalf of the new political institutions, on these issues? or

(c) should the new institutions deal direct with the Treasury?

3.2 The Secretary of State would have the advantage of a seat in Cabinet when public expenditure issues were being decided at the UK level. New political institutions in Northern Ireland would, on the other hand, have a more intimate knowledge of the spending needs and priorities.

4. One Block or two?

4.1 If only some of the Secretary of State's current responsibilities were transferred to new political institutions in NI, would it nonetheless be better for both transferred and reserved functions to be managed as a single Block, or for the new institutions to have a separate Block?

4.2 A single Block would facilitate reallocations between transferred and reserved (Secretary of State) functions but might create friction between the new political institutions in Northern Ireland and the Secretary of State; a separate Block would give new political institutions a greater autonomy over transferred programmes but would tend to reduce flexibility.

4.3 In either case, the Treasury would be likely to regard NI expenditure as a single Block for the purpose of considering claims on the Reserve.

5. Allocations of the NI Block to Departmental programmes

5.1 New political institutions in Northern Ireland would be given a Block total to be divided up according to their priorities.

(a) in determining what and how much to bid for within the Block total, would Departmental Committees/Heads of Departments operate a weighted majority/require sufficient consensus?

(b) assuming bids exceeded the NI Block total, how would the new political institutions reach timely decisions on allocations to programmes and to spending bodies? Would a Finance and General Purpose Committee, operating on a weighted majority/sufficient consensus basis, undertake the arbitration role? If not, how would decisions be reached?

6. Allocations to North/South programmes

6.1 Should the NI contributions to any North/South implementation body or mechanism be resourced out of the NI Block (either directly or through relevant Departmental programmes), on a basis determined by the new political institutions in NI, or should they be funded independently?

6.2 An advantage of such allocations being resourced from a Northern Ireland Block would be that their priority in relation to Departmental allocations would be determined by elected representatives in a direct competition for resources.

7. Local taxation

7.1 At present, DFP negotiates a level of Rate Support with the Treasury and this effectively determines the extent to which Regional Rate-payers contribute to the cost of Block services. As NI Rate Support, at around 84%, is significantly higher than in England, Scotland and Wales, the Treasury favours progressive increases in the Regional Rate so as to reduce the cost to the GB taxpayer.

- subject to satisfying the Treasury that, in the context of a political settlement, Regional Rate-payers were making an appropriate contribution to the cost of Block services, would Talks participants favour new political institutions in Northern Ireland having the discretion to propose increases in the Regional Rate, over and above what normal Rate Support settlements would imply, as a means of financing additional Block expenditure?

7.2 The advantage of this discretion would be that it would allow new political institutions in Northern Ireland to pursue expenditure objectives on the basis that the Regional Rate-payers would meet the cost, with the new political institutions accountable to them. However arrangements would be needed to ensure that any additional Social Security Benefits costs arising from the exercise of this discretion might be charged to the Northern Ireland Block, and that increases in such self-financed expenditure did not threaten public spending targets.

7.3 The potential disadvantages are that it could be difficult to reach agreement with the Treasury on whether/at what level NI local taxation was making an appropriate contribution to Block services; and that new political institutions in NI might be reluctant to contemplate imposing additional tax burdens, at least in their early years.

8. Other Tax-raising powers

8.1 The Scots Parliament (but not the Welsh Assembly) will have powers to vary the basic rate of income tax by up to 3p in the pound, to finance additional Block expenditure.

- should new political institutions in Northern Ireland have a similar power?

8.2 Advantages and disadvantages are broadly as for the Regional Rate; moreoever additional administrative costs for the Inland Revenue would be charged to the Northern Ireland Block.

ANNEX A

NORTHERN IRELAND AND PUBLIC EXPENDITURE

Purpose of paper

1. This paper describes the scope of Northern Ireland public expenditure; how the total of Northern Ireland public expenditure is determined; how that total is allocated to spending programmes within Northern Ireland; how the total is financed.

2. The paper also refers to the role of Parliament in relation to Northern Ireland public expenditure and the role of the NI Audit Office and Public Accounts Committee.

The scope of Northern Ireland public expenditure

3. The Secretary of State for Northern Ireland is responsible for:

	1996/97 £m
Non-Block	
National agriculture	178
Block excl Social Security Benefits	
NI agriculture	159
Industry, Energy, Trade and Employment	529
Transport	178
Housing	248
Environment	263
Protective Services (Fire)	43
Education, Arts and Libraries	1409
Health and Personal Social Services	1603
Other Public Services	88
Law and Order (NIO)	901
Total Block excl Social Security Benefits	5599
Social Security Benefits	3190
TOTAL	8789

4. Thus the Secretary of State is responsible for public expenditure on matters which are, under the NI Constitution Act, defined as "transferred" (eg agriculture, education, health, economic development) and matters defined as "reserved" (eg police, prisons, criminal justice).

5. The Secretary of State is not responsible for other elements of public expenditure in Northern Ireland (eg Northern Ireland Court Service, Army, Inland Revenue, Customs and Excise).

How is total NI public expenditure determined?

6. For the purpose of this paper, NI public expenditure is defined as those elements which are the responsibility of the Secretary of State.

7. The level of UK public expenditure, including that for Northern Ireland, is set through the annual Public Expenditure Survey (PES). The level of expenditure for eg 1996/97 and the two subsequent years was decided during 1995, and the level of expenditure for each national expenditure Programme is announced in the Chancellor of the Exchequer's Financial Statement and Budget Report. The level of expenditure for Northern Ireland - covering both Northern Ireland Departments and the Northern Ireland Office - is currently determined within that system.

8. The overall level of expenditure provision for the Northern Ireland Block excluding Social Security Benefits is normally set primarily by means of a "comparability formula". This formula adjusts the Block excluding Social Security Benefits by 2.87% of changes to comparable GB programmes, reflecting NI's proportion of the UK population.

9. This system is not immutable. It is open to the Treasury to abrogate the

operation of the formula by seeking to reduce NI expenditure; it is also open to the Secretary of State to bid for additional resources beyond those available under the comparability formula if she considers that NI's needs would not be adequately met by the formula. Any such bid can be taken to suspend the operation of the comparability formula, and thus leave all NI expenditure open to detailed Treasury scrutiny.

10. The Secretary of State has substantial discretion to allocate resources to meet her assessment of public expenditure needs and priorities within the Block excluding Social Security Benefits.

11. Two other elements of NI public expenditure are separately determined:

(a) Social Security Benefits - which are resourced on a basis which reflects parity of Benefit conditions and rates with GB;

(b) National Agriculture - which is subject to a separate negotiation involving the Treasury and the Secretaries of State for MAFF, Scotland, Wales and NI.

How the NI total is allocated to NI programmes

12. Within the Northern Ireland Block excluding Social Security Benefits, DFP operates its own annual Public Expenditure Survey. NI Departments and the NIO submit expenditure proposals for the next three years, including bids for any additional resources which they consider necessary.

13. These submissions are normally presented in April/May, and DFP discusses them with departments in the ensuing months.

14. It is not until autumn that the overall level of resources available for NI becomes known as a result of the UK PES. At this stage, the DFP Minister

makes recommendations to the Secretary of State on which bids should be met, where reductions should be made etc.

15. When the Secretary of State decides on allocations to departmental programmes, usually in late November, departments then translate those allocations into detailed budgets for their own functions and eg Education and Library Boards, Health and Social Services Boards.

16. This year, the annual public Expenditure Survey has been suspended to allow for the Government's "Comprehensive Spending Review". This was launched to examine thoroughly all public spending across the UK to ensure that it aligns with the Government's priorities and that resources are used to best effect. All Departments including Northern Ireland are due to report shortly on the outcome of their respective CSRs. The annual Public Expenditure Survey cycle will then resume.

<u>Approval by Parliament</u>

17. The Public Expenditure Survey is conducted internal to Government, and expenditure decisions taken within it require the approval of Parliament before taxpayers' money is used to finance them. Thus the expenditure plans for the year ahead are incorporated into Northern Ireland Main Estimates which are drawn up by each NI Department and which must be approved by DFP which then presents them to Parliament. In the case of the NIO, Estimates must be approved and presented to Parliament by HM Treasury following consultation with DFP. There are usually two or three Parliamentary opportunities to discuss NI public expenditure in the transferred field:

(a) Main Estimates (usually May-June)

(b) Autumn Suppelmentary (December) - taken only if necessary

(c) Spring Supplementary (February/March)

Since Main Estimates are approved too late to authorise expenditure for the beginning of the financial year on 1 April, money is also voted "on account" for the incoming financial year at Spring Supplementaries stage, to enable government expenditure to continue until the Main Estimates are formally voted through Orders in Council known as "Appropriation Orders". The debates are an opportunity for Members to raise any matter of public concern in the transferred field, and they avail themselves of this opportunity.

18. During the financial year it remains open to the Secretary of State to reallocate resources within the Block excluding Social Security Benefits to meet emerging priorities, proposing Supplementary Estimates as necessary to Parliament. In practice, additional demands are usually balanced by reduced requirements. If this is not the case, it could be necessary to take action to reduce expenditure in discretionary areas and, in exceptional circumstances, a bid on the UK Contingency Reserve may be submitted to the Treasury.

<u>How is NI public expenditure financed?</u>

19. NI public expenditure is financed partly by revenue raised in NI:

		1996/97	£m
(a)	NI's share of UK taxation (the "attributed share") eg income tax, VAT, corporation tax;	3685	
(b)	National Insurance Contributions paid by NI residents	1051	
(c)	the Regional Rate;	215	
(d)	miscellaneous other receipts	443	

and partly by revenue raised in GB.

(e)	NIO grant-in-aid to the NI Consolidated Fund	2419	

	- financed from UK Consolidated Fund;	
(f)	transfer to NI National Insurance Fund from GB National Insurance Fund;	75
(g)	NIO expenditure on Law and Order services - financed from UK Consolidated Fund	901
	TOTAL	8789

20. Items (a)-(f) finance "transferred services" administered by NI Civil Service departments; item (g) finances "reserved" services administered by the NIO.

21. Items (e)-(g) are the main components of the GB "subvention" to NI, which also includes eg expenditure on the NI Courts Service which is outside the responsibility of the Secretary of State.

Regional and District Rates

22. The principle is that total rates raised in NI should make a broadly equivalent contribution to the cost of local authority-type services as local taxation does in GB, subject to an appropriate level of rate support which takes account of NI circumstances.

23. The Regional Rate is struck by DFP and contributes to the cost of local authority-type services administered by central government.

24. District Rates are struck by each District Council and contribute to the cost of District Council services. For technical reasons they do not contribute to the financing of NI public expenditure as defined in para 3.

25. The level of NI rate support is subject to annual negotiation between DFP and the Treasury. At present NI's level of rate support (84%) is significantly higher than in England, Scotland and Wales, which effectively means that Northern Ireland ratepayers make a smaller contribution to local-authority type services than do council tax payers in GB.

Receipts from the European Union

26. The definition of Northern Ireland public expenditure in paragraph 3 includes expenditure financed by receipts from EU programmes including the Structural Funds. Most Structural Fund receipts are taken into account when the public expenditure total is set, so that it is greater than it would have been if the Structural Fund receipts were not available.

27. All Structural Fund receipts are paid to Northern Ireland departments, brought to account by them, and passed on as appropriate to final recipients.

28. EU Structural Fund receipts to programmes for which the Secretary of State is responsible amounted to over £200 million per annum over the six years from 1994 to 1999. However, it is important to acknowledge that there may be significant changes for Northern Ireland's Structural Fund receipts after 1999.

29. The EU Peace and Reconciliation programme is a special "ring-fenced" addition to the Northern Ireland public expenditure programme, separate from the effect of anticipating general Structural Fund receipts.

30. Northern Ireland also received further EU funding of approximately £184m in 1996/97 from the Guarantee Section of the European Agricultural Guidance Fund. Under this, money is passed from the EU to the farmer, mainly via the Intervention Board Executive Agency.

Comptroller and Auditor-General

31. The Comptroller and Auditor-General for Northern Ireland authorises the

issue of public funds from the Northern Ireland Consolidated Fund and certifies the accounts of all Northern Ireland Departments and a wide range of other public sector bodies. He is also responsible for examining the economy, efficiency and effectiveness with which policy is carried out, and probing the basis of expenditure decisions. He currently submits reports to the Public Accounts Committee at Westminster, which examines officials and reports to Parliament on those issues where it considers it appropriate to do so. This independent ex-post facto examination of Government spending is an important influence on the system.

ANNEX B

PROPOSED FINANCIAL ARRANGEMENTS FOR THE SCOTTISH PARLIAMENT AND THE WELSH ASSEMBLY

1. The present arrangements for funding most of Scotland and Wales' public expenditure programmes rely on the Block and formula system of funding. Like Northern Ireland, changes in the size of the Scottish and Welsh Blocks are determined annually by reference to planned changes in comparable GB programmes using the "Barnett" formula. The Scottish and Welsh Blocks, as in Northern Ireland, do not include the agriculture, fisheries and (AFF) food programme, which is determined separately.

2. Broadly speaking, the future financial arrangements envisaged in the Government's proposals for Scottish and Welsh devolution will be governed by the same Block system of funding, adjusted to take account of the new institutions and responsibilities.

3. Thus, the budgets for the Scottish Parliament and the Welsh Assembly will be determined each year largely through the Block arrangements. Once the amount of the assigned budget for any forthcoming year is determined, the Scottish Executive, subject to the consent of the Scottish Parliament, and the Welsh Assembly will have freedom to allocate resources across the programmes relating to functions within their control.

4. Agriculture, fisheries and food (AFF) expenditure will continue to be treated separately, in both Scotland and Wales. In Scotland a significant proportion of agricultural expenditure will continue to be devoted to payments under the Common Agricultural Policy (CAP) schemes funded wholly by the EU, with the Scottish Parliament having no discretion. This, together with expenditure on Hill Livestock Compensatory Allowances, which are also set in line with EU requirements, will be settled separately each year, based on the actual requirements of the programmes. However, the balance of present AFF spending will be taken

into the new Block and annual changes will be determined according to the existing formula.

5. In Wales, the Assembly will receive, in addition to the agricultural element in the Welsh Block, an agriculture allocation to cover spending determined by the CAP together with Hill Livestock Compensatory Allowances. The Assembly will have no discretion to vary spending on these schemes.

Revenue Raising Powers

6. The Government proposes that the Scottish Parliament should be given a limited power to vary tax. It is proposed that the tax varying power should operate on income tax, because it is broadly based and easy to administer. The Scottish Parliament will have the power to increase or decrease the basic rate of income tax set by the UK Parliament by a maximum of 3p. This is consistent with the recommendations of Scottish Constitutional Convention and would allow the Scottish Parliament to increase or reduce its revenue by around £400 million each year. If future changes to the UK income tax structure reduced the value of the product of the Scottish Parliament's tax varying power, the Parliament's ability to raise or forego a similar sum, index-linked, through the tax system would be preserved. The Inland Revenue's consequential administrative costs will be met by the Scottish Parliament.

Local Government expenditure

7. The control of local authority expenditure, non-domestic rates and other local taxation will be devolved to the Scottish Parliament and the Welsh Assembly. In Scotland, the Parliament will be responsible for determining the form of local taxation, both domestic and non-domestic, which local authorities will be permitted to levy. It would therefore be able to alter the form of the Council Tax, or replace it if it so decides. Non-domestic rates will also be a devolved matter. In Wales, where the national Assembly will continue to operate within the framework of primary legislation passed by the Westminister Parliament, the role of the

Assembly in respect of Council Tax and non-domestic rates will depend on the outcome of a current review by the Government on the operation of these systems.

Accountability

8. Scrutiny of expenditure to ensure value for money and propriety will continue to be essential. The detailed arrangements which the Scottish Parliament makes to control and scrutinise the spending of the Scottish Executive will be a matter for the Scottish Parliament and its Committees. However, the Scotland Bill sets out a framework for the Scottish Parliament to establish effective scrutiny and audit arrangements. The Parliament will have put suitable machinery in place before it becomes fully operational in order to ensure that the actions of the Scottish Executive can be called to account as soon as it assumes its responsibilities. In common with other central government expenditure, the grants to the Scottish Parliament will fall to be audited by the UK Comptroller and Auditor General. In Wales, the Assembly will be required to have an audit committee, which will operate in similar way to the Public Accounts Committee of the House of Commons. It will have a key role in ensuring that money spent by the Assembly is properly accounted for and properly used. An Auditor General for Wales will audit the Assembly's accounts and those of its sponsored bodies; will be independent of the Assembly and may be supported by the National Audit Office.