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# **SPENDING REVIEW 2002 AND WHAT IT MEANS FOR NORTHERN IRELAND'S BUDGET 2002**

This paper gives a brief overview of the Spending Review 2002 and its relationship with the Budget 2002. It also looks at the background to public expenditure in Northern Ireland and the controls that it is subjected to.

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## **SUMMARY OF KEY POINTS**

- Treasury Spending Reviews take place every two years and set out spending plans for public expenditure in the UK.
- The last spending review took place in 2000 and set the allocations for all the devolved administrations for the period 2001-02 to 2003-04.
- Spending Review 2002 (SR 2002) will cover the period 2003-04 to 2005-06.
- Parallel to the SR2002, the Northern Ireland devolved administration is conducting a review of spending for public expenditure in Northern Ireland, known as Budget 2002. This will set plans for Northern Ireland, agreed by the Executive to deliver the priorities and actions outlined in the Programme for Government.
- The spending power available in Budget 2002 will mainly be determined by the outcome of SR2002.
- SR2002 will place emphasis on ensuring that departments have the resources and plans to deliver the priorities that the Government has set itself.
- SR2002 will be the first Spending Review to be conducted and published on a resource budgeting basis.
- It is likely that there will be no significant increase in public expenditure in the 2002 Spending Review. However, the Chancellor did announce an increase of £1 billion for health across the UK for 2002-03, but this will be confirmed in his statement in July.
- Since allocations are determined by the Barnett Formula and as there are to be no major increases in spending for England, Northern Ireland DEL figures are not expected to rise significantly in the coming years either.

## CONTENTS

|       |  |   |
|-------|--|---|
| 1.    | Introduction .....   | 1 |
| 2.    | Spending Reviews .....   | 1 |
| 2.1   | Spending Reviews and the Decision Making Process .....                     | 3 |
| 3.    | Spending Review 2000 .....   | 3 |
| 3.1   | Spending Review Coverage .....   | 3 |
| 4.    | SR2002 .....   | 4 |
| 4.1   | SR2002 Outputs: .....  | 4 |
| 5.    | Background to Public Expenditure in Northern Ireland .....                 | 5 |
| 6.    | Budget 2002 and preparing for SR2002 .....                                 | 6 |
| 6.1   | Indicative Minima .....  | 6 |
| 6.1.1 | Reductions as a percentage of indicative DEL allocations for 2003-04 ..... | 7 |
| 7.    | Conclusion .....   | 8 |

## **SPENDING REVIEW 2002 AND WHAT IS MEANS FOR BUDGET 2002**

### **1. INTRODUCTION**

Treasury Spending Reviews take place every two years and set out spending plans for the delivery of public services and for public expenditure in the UK. The last Spending Review took place in 2000. It set allocations for all Whitehall Departments and the devolved administrations in Scotland, Wales and Northern Ireland for the period 2001-02 to 2003-04. As this period draws to an end the Government is currently undergoing the next Spending Review. 2002 Spending Review (SR 2002) will cover the period 2003-04 to 2005-06. Due to the nature of budgetary planning there is some overlap between Spending Reviews, which cannot be avoided.

In parallel to SR2002, the Northern Ireland devolved administration is conducting a review of spending. The local process is known as Budget 2002 and it will set out spending plans agreed by the Executive to deliver the priorities and actions in the Programme for Government to cover the period 2003-04 to 2005-06.

The spending power available in Budget 2002 will mainly be determined by the outcome of the SR2002, which will be announced in July 2002 by the Chancellor of the Exchequer. Therefore work that is currently being undertaken by Departments and the Executive in preparation for Budget 2002 will need to respond to the Treasury outcome once it is known.

In order to fully understand Budget 2002, it needs to be placed in the wider context of SR2002. This paper will provide a background to spending reviews and explore the processes and relationship between Treasury Spending Reviews and the local spending review process.

### **2. SPENDING REVIEWS**

The introduction of Treasury Spending Reviews began with the Comprehensive Spending Review (CSR) in 1998 shortly after the new Labour Government took office. Prior to this annual reviews took place in the form of public expenditure surveys. The CSR was a rigorous examination from a zero base of all public

expenditure to ensure that it was aligned with the new Government's priorities.

Northern Ireland participated fully in the review and the spending of both the Northern Ireland Office and Northern Ireland departments was subject to detailed scrutiny.

Under the terms of the Belfast Agreement, the Assembly assumed responsibility for spending on transferred services. This has subsequently necessitated detailed local spending reviews during Treasury reviews to ensure that efficient allocations of resources are in line with Executive priorities.

Following the CSR, subsequent Spending Reviews have included a thorough review of departmental aims and objectives to find the best way of delivering the Government's objectives. Key features of the reviews are:

- Departments taking a more fundamental look at the effectiveness of spending, rather than falling into the familiar annual exercise of bidding for extra resources.
- A focus on objectives and outcomes, allowing the Government to look across the work of departments to find cross-departmental solutions to achieve its objectives and to encourage joint working.
- Directing spending towards the Government's key objectives, education, health, transport and law and order, in new three-year spending plans.
- The introduction of Public Service Agreements (PSAs), detailing the exact outcomes departments will deliver with the money provided, such as better health and higher educational standards. The Government monitors progress against PSA targets, and reports in detail in annual Departmental reports, giving Parliament and people the opportunity to evaluate progress<sup>1</sup>.

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<sup>1</sup> [www.hm-treasury.gov.uk/spending\\_review/spend\\_index.cfm](http://www.hm-treasury.gov.uk/spending_review/spend_index.cfm)

**2.1 SPENDING REVIEWS AND THE DECISION MAKING PROCESS**

At UK level, Treasury gathers information from Whitehall Departments and negotiates with departments on spending requirements. Proposals are put forward to the Cabinet Committee. Final decisions are then taken by Cabinet and announced by the Chancellor. Allocations for the devolved administrations are then based on the Barnett Formula, which is a population based share of planned changes in comparable spending in England (see Annexe 1 for more detail on the Barnett formula).

**3. SPENDING REVIEW 2000**

The [2000 Spending Review](#) (SR2000) set new three year spending plans up to 2003-04, using 2001-02 (the last year of the plans set in the 1998 CSR) as the first year of the new plans (see diagram below). The Review did not repeat the lengthy item by item (also known as zero budgeting) examination of programmes undertaken in the CSR. However some issues were reviewed in depth, including 15 [Cross-Cutting Reviews](#) of policy areas that cut across traditional departmental boundaries.

**3.1 SPENDING REVIEW COVERAGE**

|       |       |       |       |       |       |       |
|-------|-------|-------|-------|-------|-------|-------|
| 99/00 | 00/01 | 01/02 | 02/03 | 03/04 | 04/05 | 05/06 |
|-------|-------|-------|-------|-------|-------|-------|

1998 CSR

SR 2000

SR 2002

#### 4. SR2002

The emphasis of SR2002 will be on ensuring that departments have the resources and plans to deliver the priorities that the Government has already set itself. The Review includes several new [Cross-Cutting Reviews](#) and will also update Public Service Agreements (PSAs), [Service Delivery Agreements](#) (SDAs) and [Departmental Investment Strategies](#) (DISs). The new Cross-Cutting Reviews are:

- Children at Risk
- Improving the Public Space
- Role of the Voluntary Sector in Delivering Services
- Science and Research
- Public sector labour market

The main developments in this Spending Review compared to previous exercises will be:

- SR2002 will have a greater emphasis on the [evidence base for policy-making](#).
- SR2002 will be the first Spending Review to be conducted and published on a full [resource budgeting basis](#); and
- Consideration will be given to the need to plan in some areas beyond the three year horizons. Thus, building on the Transport 10 Year Plan and the NHS Plan<sup>2</sup>.

##### **4.1 SR2002 OUTPUTS:**

**SR2002** will have five main outputs<sup>3</sup>:

**Departmental Expenditure Limits** will roll forward existing spending plans for 2003-04 and settle new plans for 2004-05 and 2005-06. Current signals from Treasury are there will be very limited growth in overall DEL baselines in SR2002 period apart from technical adjustments. The review will not be zero based, but an agreed number

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<sup>2</sup> [http://www.hm-treasury.gov.uk/Spending\\_Review/spend\\_sr02/spend\\_sr02\\_index.cfm](http://www.hm-treasury.gov.uk/Spending_Review/spend_sr02/spend_sr02_index.cfm)

of baseline areas will be jointly examined in some depth with a view to assembling evidence about effectiveness, and in some cases moving to wind down spending over the SR2002 period.

**Public Service Agreements** will roll forward and in some cases further develop the objectives and targets agreed as part of SR2000. Evidence about performance against the 1998 CSR and SR 2000 targets will be factored into resource decisions. Targets will be revised where external influences have made them substantially easier or more difficult to achieve, or where significant resource changes have been agreed as part of the Review.

**Service Delivery Agreements:** a more streamlined approach is proposed that will focus on how departments plan to deliver PSA and key targets.

**Cross-cutting reviews** will largely feed into departmental reviews although some may result in changes to cross-cutting budgets and targets.

**Departmental Investment Strategies** will be revised to take account of the Government's emphasis on the delivery of capital programmes.

## **5. BACKGROUND TO PUBLIC EXPENDITURE IN NORTHERN IRELAND**

Public expenditure in Northern Ireland is subject to two separate controls: Departmental Expenditure Limits (DEL) and the Annually Managed Expenditure (AME). It is the DEL totals that are fixed in Treasury Spending Reviews for a three-year period. AME, which is comprised mainly of demand driven items, is funded on the basis of need, e.g. social security benefits. Due to the fluctuating nature of demand driven items, AME is negotiated on an annual basis.

The greater part of DEL is known as the 'Assigned DEL.' It is funded by Barnett. and may be allocated at the discretion of the Executive. The remainder is 'Non Assigned DEL' and is not funded by Barnett. It has been provided for particular purposes and may not be reallocated by the devolved administration without the agreement of the Treasury.

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<sup>3</sup> HM Treasury, SR2002 Guidance



The focus of Budget 2002 is on Executive decisions and will therefore be concerned with decisions relating to the Assigned element of departmental programmes referred to as 'Departmental DEL.' However it should be noted that Non Assigned Items ("Other DEL") generally complement Assigned DEL. This is the case for instance when looking at the benefits arising from EU Peace Funding within the context of certain DSD programmes. Non Assigned DEL and AME figures will therefore be included for completeness in the Budget.

## **6. BUDGET 2002 AND PREPARING FOR SR2002**

As previously outlined it is likely that there will be no significant increase in public expenditure in the 2002 Spending Review. The Chancellor however did announce an increase of £1 billion for health across the UK for 2002-03 in his Pre-Budget Report on 27 November 2001. It may be possible that some of this money might be rolled forward to 2003-04. However the position cannot be confirmed until the Chancellor's statement in July.

As the allocation of funding is determined by the Barnett formula the implication of no major increases in spending programmes in England would mean that Northern Ireland DEL figures for 2003-04 to 2005-06 would not rise significantly in subsequent years<sup>4</sup>.

With no imminent increase in public expenditure, the baseline or starting point for Budget 2002 has had to take account of this.

### **6.1 INDICATIVE MINIMA**

To address this problem, the Executive agreed, as part of Budget 2001, to hold back sufficient funds to provide a clear starting point for Budget 2002. This is known as the indicative minima. (Treasury has also indicated that it will be reducing some spending programmes in UK Departments<sup>5</sup>).

The indicative minima was established by reducing the indicative DEL allocations, which were set in December 2000 for each department for 2003-04 by around

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<sup>4</sup> Northern Ireland Executive, Budget 2002-03

<sup>5</sup> HM Treasury, SR2002 Guidance

£125million. Executive Programme Fund allocations were not included in these calculations.

Components of DEL baselines were reduced for administration costs (pay and non pay costs) and capital. In setting the indicative minima, the Executive has held back a lower proportion of the previous indicative amounts in respect of health and schools. This is in recognition of the particular priorities of these services.

#### **6.1.1 REDUCTIONS AS A PERCENTAGE OF INDICATIVE DEL ALLOCATIONS FOR 2003-04**

|                  | <b>Pay costs</b> | <b>Non pay costs</b> | <b>Capital</b> | <b>EPF</b> |
|------------------|------------------|----------------------|----------------|------------|
| All Departments  | 98%              | 95%                  | 90%            | 100%       |
| Health/Education | 99%              | 97.5%                | 90%            | 100%       |

Source: Central Expenditure Division, DFP, 2002

Some Departments might be concerned that setting indicative minima has planning implications and that by imposing cuts; the Executive has already taken decisions on allocations prior to the commencement of the Budget 2002 process. However it has been accepted by the Executive that the indicative figures for 2003-04 first produced in Budget 2001-02 are no longer appropriate in view of the forthcoming Spending Review<sup>6</sup>. The setting of an indicative minima has been viewed as a necessary **starting point** for Budget 2002 in that it will enable the Executive to respond to pressures through an assessment of need. This will be worked through between Departments, Executive Ministers and Assembly Committees and will be informed by the production and scrutiny of Departmental Position Reports, the Executive Position Report and the Needs and Effectiveness Reviews<sup>7</sup>.

<sup>6</sup> Northern Ireland Executive, Budget 2002-03

<sup>7</sup> The Executive has embarked on needs and effectiveness evaluations on programmes in health, education, housing, training and vocational education and financial assistance to industry which account for 70% of planned expenditure in Northern Ireland. The findings will be used to support the Executive's consideration of the Barnett Formula and inform Budget 2002.

## 7. CONCLUSION

Budget 2002 will shape public expenditure plans in Northern Ireland for the period 2003-04 to 2005-06. This process does not happen in isolation and is timed to coincide with SR2002. Spending power in Budget 2002 will be determined by the outcome of SR2002 and the final decision on the regional rate<sup>8</sup> when allocations for the Northern Ireland Departmental Expenditure Limit will be set over the next three years. Once the allocation has been set, the distribution of Northern Ireland DEL will be at the discretion of the Assembly through the Budget 2002 process.

Considerable preparation goes into the local Budget process, which is subject to detailed scrutiny by the Assembly. Similar to the Treasury Spending Reviews Departments will be required to take a detailed look at effectiveness of spending, particularly in light of the indicative minima and not just bid for extra resources. The introduction of Public Service Agreements (PSAs) will also require departments to roll forward PSAs from previous years and provide a more detailed approach to the delivery of PSAs through Service Delivery Agreements (SDAs).

Finally with the introduction of resource budgeting, both the local Budget 2002 process and SR2002 will be driven by its implementation. This will involve changes to the budgeting regime in Whitehall, Northern Ireland and the other devolved Institutions.

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<sup>8</sup> The Regional rate is struck by the Northern Ireland Assembly for the purpose of local financing of expenditure on public services in Northern Ireland. There is currently a review of rating policy, which is likely to feed into the Executive's negotiations during the Spending Review on the level of rate income for Northern Ireland.

## **Barnett**

The Barnett formula is a population based adjustment mechanism for determining changes to the public expenditure allocations to the devolved administrations in Scotland, Wales and Northern Ireland<sup>9</sup>. At its most basic, the output of the formula is the product of the change in planned spending in a comparable programme in England and Wales or Great Britain; the degree to which there is comparable spending by the devolved administration; and the population in the devolved administration as a proportion of the relevant population.

The Barnett formula applies only to the Assigned Departmental Expenditure Limit of the Northern Ireland Executive. Therefore the formula has a direct effect on that part of the Northern Ireland Budget that may be allocated with the full discretion of the Northern Ireland Assembly.

A major component of the Barnett is the comparability mechanism of programmes. In the majority of cases the comparable programmes is that in England or where the GB programme operates at the level of England and Wales, e.g. social security administration. Comparability refers to the degree to which the services delivered by the Whitehall departments are reflected within the budgets of the devolved administrations. Each expenditure item or sub-programme is therefore classed as either comparable or non-comparable according to the type of services and means of delivery for the corresponding service across the UK.

Using comparability figures can be of particular difficulty for Northern Ireland in relation to expenditure responsibilities that fall to local authorities in England but are the responsibility of a department of the Northern Ireland Executive. Further difficulties arise where because of differences in the organisation and management of public services the formula makes no allowance for an ongoing need in the devolved administration. An example is water and sewerage services, which was privatised in England and hence attracts no public expenditure but has been retained within Assigned DEL in Northern Ireland . Expenditure on water and

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<sup>9</sup> For a more detailed explanation and discussion on Barnett please refer to Research Paper 12/01 (September 2001) by Eileen Regan.

sewerage must therefore be met from the Northern Ireland Executive's Assigned DEL but the Barnett formula provides no resources because there is no comparable expenditure in England.

### **SR 2002 Barnett Comparability Figures**

Comparability figures can vary from one Spending Review to the next. Factors leading to variations might include changes to departments and/or delivery of programmes. However it unlikely that comparability factors in SR2002 will alter significantly and are more likely to remain largely the same as that agreed and published for SR2000<sup>10</sup>.

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<sup>10</sup> HM Treasury, Funding the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly: A Statement of Funding Policy, Second Edition, July 2000