



**Northern Ireland
Assembly**

**COMMITTEE FOR
FINANCE AND PERSONNEL**

**OFFICIAL REPORT
(Hansard)**

Spending Review and Budget 2010

3 November 2010

NORTHERN IRELAND ASSEMBLY

**COMMITTEE FOR
FINANCE AND PERSONNEL**

Spending Review and Budget 2010

3 November 2010

Members present for all or part of the proceedings:

Ms Jennifer McCann (Chairperson)
Mr David McNarry (Deputy Chairperson)
Mr Paul Girvan
Mr Simon Hamilton
Mr Daithí McKay
Mr Mitchel McLaughlin
Ms Dawn Purvis

Witness:

Professor David Heald) University of Aberdeen

The Chairperson (Ms J McCann):

Professor Heald, you are very welcome. I have just explained to the Committee that you did not have time to prepare a paper for today's session. Please cover some of the main points in more detail than we would normally ask for if we had a paper. I will then open up the session to questions.

Professor David Heald (University of Aberdeen):

Many thanks for the invitation. Obviously, I do not know the detailed numbers in the way that the Department of Finance and Personnel would. Furthermore, I have not seen some of the

papers. However, I have some general points that I believe are very important for the Committee to consider. The settlement for the Executive and the other devolved Administrations is much less bad than it might have been, given all the talk of 10% or 20% cuts that had dominated the London newspapers in particular.

It is very important to recognise that although people criticise the Barnett formula, it is the Barnett formula that is now protecting the devolved Administrations. Given the mechanical nature of the formula consequentials, the fact that education and health in England either received increases or did not take significant cuts, fed through as the driving factors in the consequentials that the devolved Administrations receive. The difference, of course, is the treatment of local government in England, which maps onto some of the Executive functions in Northern Ireland. Therefore, the real-terms cuts of 8%, 10%, or whatever, are actually not the kind of system-destroying cuts that people have been talking about.

I think that Simon Hamilton raised this issue in one of his questions to Michael Brennan: the Committee ought to think about what is happening on the welfare side. The welfare budget is enormously complicated and I would not dream of understanding how it affects Northern Ireland. If there are cutbacks in disability and housing benefit, that will affect the people of Northern Ireland even though it does not directly affect the Executive. However, it will affect public services because more demands are likely to be made on Executive services. There are two issues: the welfare side is probably more severe than anybody expected, but what has actually happened to the resource budget of the Assembly is not as severe as it might have been, given all the rhetoric.

It is very important to protect capital expenditure as much as possible. Obviously, one does not want bad capital projects — the quality of capital projects is important — but Northern Ireland is heavily dependent on the public sector and the construction sector. My understanding is that the construction sector is quite localised, so the regional multipliers in Northern Ireland will be quite high from capital spending. Therefore, one ought to think about the question of whether room can be found to move money from resource into capital.

In a Scottish context, I have been a very strong devolutionist and have been involved in the

arguments for devolution in Scotland since the 1970s. However, in a largely grant-financed devolution system, the Treasury currently holds too much power. The unilateral decisions to end the end-year flexibility (EYF) system are seriously damaging. That was a very good system that arose during the spending review system from 1998 onwards. One does not want a situation again whereby people paint buildings simply to spend money at year end. The Treasury seems to have unilateral discretion to take decisions on issues that fundamentally affect the financial management of the devolved Administrations. The fact that the EYF built up very strongly in the first 10 years of devolution reflected the fact that public spending was growing faster than the absorptive capacity. It is all right to have more money for health, but if we cannot hire doctors and nurses, the money will not be spent sensibly. Therefore, the EYF was an important mechanism for cushioning that pressure and preventing people from wasting the money.

There are important constitutional questions about the future of devolution. The devolution system has had 10 years to bed down during a period of very strong increases in public expenditure. The situation has now changed, and many things that are happening in England, such as the abolition of primary care trusts and the scale of reductions in local government expenditure, will, in my view, be quite destabilising to public service provision in England. However, the fact that the consequentials come together to feed the Northern Ireland Budget means that Northern Ireland, Scotland and Wales can insulate themselves from some of those pressures.

Given that the gross domestic product (GDP) deflator is now 2.7% — the DFP officials said that the projected figure for the future is about 2% — the crucial question is what will happen with pay. If pay does not go up and there are no pay rises in the public sector, one will absorb a lot of that real-terms reduction. Therefore, one has to communicate to people that there will be a very clear trade-off in the devolved Administrations between jobs and pay rises.

Mr McLaughlin:

You are very welcome. In your experience, and given the challenge that now faces this devolved Assembly, where are the real opportunities to identify additional revenue-generating ideas within the legislative powers of the Assemblies?

Professor Heald:

That question has two parts. I have, for a long time, been supportive of increased tax powers for the Scottish Parliament. I was one of the people who devised the “tartan tax”, which has never been used by the Scottish Parliament because there was too much money around and there was no need for it. The build-up of EYF indicated that people could not spend the money that they had, let alone use the tartan tax. I gave evidence to the Calman Commission in Scotland, and I am in favour of increasing tax powers. However, I do not accept the “devolution max” scenario whereby all the devolved Administrations would finance all their spending through their own taxation. However, the direction ought to be a move towards more tax powers.

It is noticeable in Scotland — I am sure that it is the same in Northern Ireland — that, because the block grant rose so fast, there was no pressure to use tax powers. In fact, over the period, it is certainly true for Scotland and, I suspect, for Northern Ireland, that less money has been raised in terms of internally generated revenue.

I know that there has been debate about water charges in Northern Ireland. However, it is clear that in a period of expenditure plenty, it is very difficult to persuade people to accept new charges or increased existing charges. I suspect that that will be different over the next 10 years. In principle, I believe that it would be better that devolved Administrations raised more of their own money, but within the constitutional structure of the United Kingdom and the centralised fiscal control of the Treasury, I think there are limits on how far you can go, but I would wish to move.

The Chairperson:

On the back of that, can you identify any potential areas in which long-term efficiencies can be achieved?

Professor Heald:

I have limited practical knowledge of the government of Northern Ireland. In 2003, I wrote a report for the then Northern Ireland Economic Council on the funding system, which touched marginally on government structure. Looking in from the outside, it is obvious that the structure of Northern Ireland government is very complicated. I am fully aware of the historical and

current reasons for some of that complication. One of the things I would urge the Executive and you, the scrutiny Committee, to recognise in the current context is that one can not only do things that destabilise the system, but things that represent sensible belt-tightening.

I would urge Northern Ireland to rationalise the machinery of government in the way that one would wish to do anyway. Government in Northern Ireland is too complex; it has too many Departments and public bodies. Some of the reasons for the multiplication of public bodies may no longer be so important. The structure needs to be simplified. However, you must not get into a situation in which the system is thrown into complete chaos at a time when you have to manage budgetary reductions. There would then be all sorts of wasted expenditure on severance payments that are avoidable, after which people turn up in other parts of the system in some future role, leading to scandals about such matters that damage public trust in government.

If you have good control of pay, and you can persuade people in Northern Ireland that there is a jobs/wages trade-off while sensibly doing the rationalisation that you want to do, you can achieve expenditure reductions on the resource side without destabilising the system. Obviously, there are going to be some ramifications of destabilisation in England.

Mr Hamilton:

You made a point about the pay bill and the need for balance. The choices are neither easy nor desirable, but there has to be a balance between trying to keep as many people as possible in public sector employment, avoiding some of the negative consequences that you talked about, including fairly hefty pay-offs in some cases, and freezing pay. The Westminster Government have decided to go for a freeze, and there is some debate about whether we should do that here. What is the Scottish Parliament doing about that? What is their approach? It is relevant here that we may be able to control the Northern Ireland Civil Service, which accounts for approximately 15% of the public sector, but we have limited or no control over the remainder of the public sector and the issues that that throws up.

Professor Heald:

I completely accept your point that this is a very complicated area. I am not sufficiently involved to be able to comment in detail on what the Scottish Government is doing, but there is a

difference between imposing a pay freeze, and having discussions and a consensus that there is a trade-off. It is clear that there is going to be a trade-off in Northern Ireland between getting rid of jobs that you do not want to get rid of because they contribute positively to public services, and meeting budgetary targets. A lot will depend on the extent to which we can build a consensus that one wishes to minimise the damage. Quick expenditure reductions can end up being wasteful.

I am strongly reminded of the early 1980s cuts to English education, including universities, which took about 25 years to repair. Things that are done in haste can take a long time to repair. There has already been discussion this morning about infrastructure in Northern Ireland, but the issue is true of the UK as a whole. In the 1970s and 1980s, for various reasons, the UK neglected its infrastructure, relative to continental European countries. It has taken a remarkably long time to make any inroads into repairing that deterioration in infrastructure. One has to try to take people along with you and recognise that there are difficult trade-offs.

Ms Purvis:

Devolution in Northern Ireland came about a lot differently than in Scotland and Wales. There was probably more popular support for devolution in Scotland and Wales; I have seen that public confidence in the Welsh Assembly is high and has grown every year. We suffer a crisis of public confidence in this Assembly, although this has been the longest period of devolution since 1998. There is a link between public confidence in our political institutions here and the continuation — or not — of conflict. Do you have a view on how fair this CSR has been to Northern Ireland, given its recent history? Do you think that there is a case to be made to the Treasury regarding Northern Ireland's particular circumstances?

You talked about the dependency on the public sector and the impact that there will be, particularly on jobs. However, a heavy concentration of our public sector involves women in low-paid jobs, and I would like your view on that. Much has been made of the level of a pay freeze, for example, and how that will impact on lower-paid people.

Professor Heald:

The question about fairness is inevitably a very difficult one. I do not know the figures for

Northern Ireland, but certainly there has been concern at the UK level that of the 490,000 jobs that are expected to go across the UK, a heavy concentration are held by women. Arguments have been about whether there were proper equality assessments before the expected reductions were announced. I do not know enough detail about the circumstances of Northern Ireland, but I suspect that that is a general problem.

Your point about pay freezes and the low paid in the context of the 4.6% retail price index (RPI) and the 3.1% consumer price index (CPI) goes back to my previous answer to Simon: it is a question of whether one can build consensus. Also important is the question of whether one is part of the UK pay negotiations or whether you have got your own pay negotiations. But the point that I am making is that the more that you can contain pay costs, the less real service provision will have to be cut.

The Chairperson:

You talked about more tax powers regionally. I remember hearing something about the new revenue system in Scotland including a local income tax. I know that you mentioned adding a penny on that, one way or another, but is there some sort of initiative in Scotland to develop that even more?

Professor Heald:

My understanding is that it is the policy of the UK coalition Government to bring forward legislative proposals in connection with one of the recommendations of the Calman Commission, which was essentially the transfer of 10 income tax points from the UK Treasury to the Scottish Parliament. That is a specific proposal about Scotland. In principle, I support that being available to Wales and Northern Ireland, should they want it. The question is about the willingness to use taxation powers. People are much more willing to argue for them than they are to use the taxation powers that they have.

Mr Girvan:

David, I really appreciate your report and I welcome this opportunity to go into some detail. The Northern Ireland economy depends greatly on the public sector. It has its major problems in that our private sector is not really a large economy and we have a difficulty in transferring money

from what is currently a revenue spend to capital projects. We have a certain amount of flexibility in that regard, but, from an industrial point of view, we need to improve our infrastructure to encourage inward investment in the Province and to try to ensure that that sector grows. Scotland invested greatly in its oil industry. It spent a lot of money on its infrastructure to try to encourage involvement from private and public money. Where in Northern Ireland, other than in the construction industry, do you see an opportunity for us to do that?

Professor Heald:

I am not a specialist on the Northern Ireland economy. In the short term, the issue is to make sure that the fiscal consolidation does not unnecessarily impact on the private sector. Very clearly, if there are fewer public sector employees and they earn less in real wages, they will spend less in the private sector in the form of personal consumption.

The new Government asked Sir Philip Green to complete a report on Government procurement, one of the recommendations of which was to centralise procurement more and pay suppliers more slowly. Government has special responsibilities. Before I came here, I read the Committee's report on public procurement and the report on public sector efficiencies. The Committee made a very important point in the public procurement report: within the requirements of UK and European law, the public sector has responsibilities to its suppliers. The public sector should not behave badly towards its private sector suppliers. There is obviously a trade-off. Centralising procurement in Northern Ireland may have certain cost advantages to the public sector, but bulking up the contracts to a very large size would exclude the small and medium-sized enterprises that the report concerned. It is about minimising unnecessary damage to the private sector from the fiscal consolidation.

In terms of the broader issue, I first came again to Northern Ireland in 1992. The sense that one gets here now is very different to that in 1992. In respect of public confidence of the people in Northern Ireland and of people who might invest here, the success of the Assembly and Executive is immensely important. Devolution is very important in sending a message to the outside world that may wish to invest in Northern Ireland.

Mr Girvan:

We have a problem in that we have created a culture in which Departments receive a certain amount of money and must make all of their spend. In doing so, they do unnecessary things. You made mention of coming to the end of the year and throwing another coat of paint on a building, even though it may not need it, or replacing carpets. I appreciate that there is a necessity for us to see where savings can be made. I appreciate that the spending review has allowed us to focus on areas so that there will not necessarily be big job losses left, right and centre in the public sector but that savings can be made, and spend in proper areas can be encouraged.

Capping or freezing pay for a period is a positive way to try to protect jobs and to keep an economy going, as opposed to creating more dependence on the social sector, because we have no control over the benefits system. We would like to see an opportunity for savings through welfare reform being used to contribute positively to the Northern Ireland economy.

Professor Heald:

I have already commented adversely on the Treasury removing the stock of EYF. The member raises an interesting point because Northern Ireland has kept its EYF. However, it may be that Departments were frightened of DFP taking back the money. Therefore, in a sense, EYF is a complicated issue because of the structure of government.

I will make two other points. First, I very much emphasise the Committee's scrutiny role. In a period when public spending is rising fast, it is much more difficult to get people to take scrutiny seriously. Over the next 10 years, the Committee's role is going to be more important. Secondly, in my view, bizarrely, the UK Government have announced the abolition of the Audit Commission, claiming that doing so will save £50 million. Northern Ireland will have taken the Barnett consequential of that. I argue that, as with scrutiny, the protection of audit and the protection of the budget of the Northern Ireland Audit Office are very important, because scrutiny and value-for-money audit should attract more attention during periods of financial difficulty.

The Chairperson:

In its earlier evidence session, the Committee was told that the EYF built up in previous years is

now lost.

Professor Heald:

Yes.

The Chairperson:

Do you see any logic in that decision?

Professor Heald:

Presumably, from the Treasury's point of view, there has been a big build-up of EYF over the years, although there has been some running down of it in more recent years. Presumably, the Treasury sees it as an easy kill. I think that it is an easy kill that gives very bad incentive signals to Departments. The "spend it or lose it" idea is very bad and is linked to one-year budgeting. We are talking about a four-year budget, and big efforts have been made to think beyond that one-year horizon. It is obviously difficult to bring in a budget exactly on time because the capital side depends on how bad the weather is from January to March. In my view, it is a retrograde step to cancel the EYF stock.

For some time, I have suspected that that would happen at some point in the future. However, even if the Treasury were to devise a new EYF system, people will be distrustful because of previous experience. Hence, I think that it is a question of looking for an easy kill now without proper regard to the future consequences.

The Chairperson:

No other member has indicated that they want to ask a question, so I thank Professor Heald for coming. That was very useful. If there are any more questions, may the Committee write to you for more information?

Professor Heald:

Yes. Many thanks.