House of Commons

Northern Ireland Affairs Committee

Oral evidence: The funding and delivery of public services in Northern Ireland, HC 1165

Tuesday 4 July 2023

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Watch the meeting

Members present: Sir Robert Buckland (in the Chair); Stephen Farry; Claire Hanna; Carla Lockhart; Jim Shannon.

Questions 214 – 228

Witnesses

II: Sir Robert Chote, Chair, Northern Ireland Fiscal Council; Dr Lisa Wilson, Senior Economist, Nevin Economic Research Institute.

Written evidence from witnesses:

– [FPC0028] - Northern Ireland Fiscal Council

– [FPC0002] - Nevin Economic Research Institute

Examination of witnesses

Witnesses: Sir Robert Chote and Dr Lisa Wilson.

Chair: It is my pleasure to welcome members to the second session of this morning's Northern Ireland Affairs Committee meeting. I am delighted to be joined in person by Sir Robert Chote, chair of the Northern Ireland Fiscal Council. Online, we have Dr Lisa Wilson, the senior economist at the Nevin Economic Research Institute. Welcome to you.

Q214 **Claire Hanna:** I wanted to set the context and the scene by asking for your view of the budget 2023-24 and its implications for the delivery of public services in Northern Ireland.

Sir Robert Chote: It is a great pleasure to be here. It is a difficult environment for this budget. If you were to go back to the 2021 spending review at the UK level, which was setting out what would initially have been implied for the block grant over this period, that was probably a more generous/higher outcome than many people were anticipating at the time. Circumstances have moved on since then and you have had a combination of pay and inflation pressures, which squeezed the resources available out of any given cash budget. That, of course, is a UK-wide issue and not one that is specific to Northern Ireland, but would have put spending Departments and public services under pressure wherever that was.

It is conspicuous, if you look at what happened in 2022-23, that that did not result in Whitehall Departments busting their spending limits or overspending against the amounts they had been allocated, whatever your view of the appropriateness of those amounts. In Northern Ireland, there was overspending against available financing last year. As you will recall, that was the position that the Secretary of State inherited when caretaker Ministers left in October.

The NIO managed to squeeze down the prospective overspend, but, at the end of the day you ended up with the initial NIO budget needing to borrow roughly £300 million in terms of a drawdown on the Treasury reserve that would, on the face of it, have had to come out of the block grant for 2023-24. That would have been a very difficult position. You would have compounded the pressures at the UK level, the additional impact of the Barnett squeeze, which I am sure we will get into as well, which is ongoing for Northern Ireland, and those particular issues around the overspending and the need to claw that back.

The situation has been eased somewhat by the agreement that the Secretary of State has managed to reach with the Treasury. That is effectively pushing back by a year the date at which that £300 million has to be repaid, with a commitment by the Secretary of State to, as it were, give up any additional Barnett consequentials that arise this year towards that and to look with the Treasury at using some unspent allocations that were already there.

Even without that £300 million being clawed back in its entirety in the year, it is a tough proposition. If you read the newspapers and see what people are saying on the ground, in terms of the delivery of public services and the Departments, there is danger of a further overspend. The pressures are considerable. In both absolute terms and relative terms, it is a difficult environment.

Q215 **Claire Hanna:** Not to absolve Stormont Ministers of their responsibilities, but it was probably the worst possible context for discipline in spending, in terms of those pay and inflationary pressures and Ministers not being in place to do monitoring and reallocation throughout the year. What impact do you think the lack of an Executive has had on that spending and, potentially, spending for the year to come?

Sir Robert Chote: As I say, the first point to make is that it would have been a difficult environment anyway because of the inflation and pay pressures in general, and you also have the ongoing Barnett squeeze.

There are a number of the dimensions, not just the absence of the Executive but the inheritance from the beginning of 2022-23. There was no agreed budget from which everybody could start. There was an attempt to get to that, but in the end the Department of Finance and the Finance Minister were only able to publish a draft budget for the year entirely for consultation, although there was broad agreement, for example, about health being relatively favoured within that. You did not have that.

As you described, you had this rather odd position—it was an untested model under MEPOC—where caretaker Ministers were in place, assisted by their accounting officers in the form of Permanent Secretaries, but they knew they were not going to be holding the parcel at the end of the year, which affects the way in which people end up taking decisions. The relative autonomy of Ministers, their ability to place ministerial directions and, at the end of the day, their ability to spend money that they had no guarantee would be there through the course of the year were all problematic elements of that.

Another was that you did not have the in-year monitoring mechanism through which, during the course of the financial year, the Department of Finance, relatively transparently compared to the way budgets are managed in the UK, re-examines the overall spending envelope—for example, whether the block grant has moved or not—and talks to Departments about whether they have unexpected needs or, indeed, an unexpected lack of need that means money can be put back into the pot. That can be done relatively transparently. It is reported to the Assembly Committee. In the absence of the Speaker, there were no Assembly Committees either. That set of mechanisms, which you would normally hope would encourage good budget management through the year, were not there. The political leadership that would be provided by a sitting Executive and Assembly was lacking.

It has to be said that the Department of Finance in the Northern Ireland context is at the best of times in not quite as powerful a position as the Treasury is to crack the whip in managing public expenditure at the UK level, partly because Departments have greater formal autonomy within the Executive structure than they do here. Because it is also a mandatory coalition with no expectation or requirements of collective responsibility, the Department of Finance's position as a putative first among equals is not quite the same as the Treasury's anyway.

There was combination of underlying factors and a perfect storm of UK-wide and Northern Ireland-specific issues.

Q216 **Claire Hanna:** Dr Wilson, I have similar questions for you. What is the budget going to do in terms of the delivery of public services? What impact will not having Ministers in place have on trying to do that? Could you also comment on the impact of the repayment of the £297 million? The Treasury has decided that it wants to recoup that in two years. Is there any legal reason why that has to be done within such a short space of time?

Dr Wilson: Thank you to the Committee for having me along to deliver evidence this morning.

I will start with the £297 million and the impact of that. The position that has been taken is overly punitive. It appears to be one that is waving a stick at the Northern Ireland Executive to get back into place. Would the scale of the overspend have been £297 million if the Executive had been in place? The position on this has been both understated and overstated in the analysis and commentary around it.

In terms of overstatement, we were in a particularly tight environment in the circumstances that, as you outlined, Claire, all our economies were encountering. Even if Ministers had been in place, they would have been faced with the challenge of how to prevent overspend. In-year monitoring would have prevented some of that, so in that sense it is understated.

The overspend of £297 million is now flowing into the next number of years. To balance the books last year, the money would have needed to come in the form of cuts or the divvying up of funding. When we look at how the £297 million was spent, it was not spent on sweets: it was spent on basic public services. We need to be very careful about overstating the lack of care that was taken by the caretaker Ministers in spending that, but we should also not forget that in-year monitoring would have prevented some of that.

We have ended up with £297 million almost as if it is an exact figure. It came from somewhere around £800 million, which was talked about when it was first mentioned, down to that. That is where the effect of not having the Executive in place to prevent some of these things has been understated.

In terms of going forward and the repayment of the £297 million, I firmly believe that it is overly punitive and will have a longer-term impact on Northern Ireland's ability to make its public finances sustainable. It is going to be a massive impingement this year and into next year in a continuing environment of public spending pressures right across the UK.

In terms of the legals, Claire, I do not know. To be honest, I am not a legal expert. In terms of the economics of this and the sustainability of the budget going forward, in any kind of agreement or deal being made with the UK Government and the Northern Ireland Executive, the first thing that would need to go would be this £297 million. That would set a fair place in which the Northern Ireland Executive might be able to get back into a position where they can talk, albeit with continuing spending pressures, and go forward from there.

Q217 **Jim Shannon:** Thank you, Sir Robert and Dr Wilson, for your submissions so far. Just yesterday in Parliament, the Secretary of State for Health announced very clearly extra moneys for health. The Barnett consequential means that some of that money comes to us in Northern Ireland. I know it all depends on a working Assembly for that money to go specifically to health, which is one of the issues, but it does illustrate that the Government have a commitment to the Barnett consequential and to Northern Ireland.

My colleague Gavin Robinson, the Member for Belfast East, is on record, in some of the discussions he has had and in some things he has done in the media as well, as saying that the Barnett consequential is not keeping up with the costs that are coming through. To follow on from Claire, how can the Government better define Northern Ireland's block grant? Mindful of rising prices, population growth and infrastructure demands across health, education, roads and everything else, there really has to be a better method of doing that.

Some suggestions have been put forward. I will quote their words—Robert, these words will probably mean a whole lot to you; I have to say they do not mean a whole lot to me. Big words sometimes confuse people. They referred to "fiscal equalisation systems", but what they are thinking about is a better way of doing it. Australia has an example of that. Of course, Australia has a higher cost of living, but it also has higher wages, so I do not know whether it is a fair comparison. How do we do it better? That is the question.

Sir Robert Chote: There is a lot in that. Let me start with a brief comment. You mentioned what happens when the UK Government increase spending on health and the consequences that has for Northern Ireland. As you rightly say, under the Barnett formula, in effect, when the UK Government increase spending in England, say, on the things for which the Executive is responsible in Northern Ireland, it increases the block grant by the same amount in pounds per head. The logic of that is simply that, if the UK Government are using UK-wide taxes to spend in one part of the country, you do not want other parts to be disadvantaged by that.

In the event that the UK Government are doing that to fund pay awards or indeed inflation, one of the challenges is that the Barnett formula works by matching the sum of money that goes into the block grant in pounds per head and not in percentage terms. If Northern Ireland starts with higher spending per head and a higher pay bill per head, and the UK Government increase their pay bill and give the same amount in pounds per head to Northern Ireland, it does not fund the same percentage increase in pay. That confronts Northern Ireland Departments with the choice between fully matching the pay deal or taking economies elsewhere.

There is a second issue at the moment, which is part of the issue about paying back the £297 million. If there are Barnett consequentials that arise this year, even though they are disadvantaged in terms of being cash rather than percentage, the Northern Ireland Departments will not see that this year because it will effectively come off the £297 million. In practice, that means the Departments will still get the benefit, but they will get it in 2024-25 and not 2023, because it reduces the repayment of the upfront loan next year rather than boosting the block grant this year. It still presents additional complexities there.

The broader question you raised is about whether there is a better way to do this. The model we have fallen into by historical accident essentially starts with spending per head across all three of the devolved Administrations being much higher than it is in England. The Barnett formula, because of that cash rather than percentage matching, erodes that relatively favourable position over time. This is the famous Barnett squeeze.

For a long period, that may not be particularly consequential. If you are starting with a level of funding that is considerably higher, arguably, than an estimated level of need, bringing it closer to the level of need is not the end of the world. If you are in a situation—this appears to be the one Northern Ireland is in at the moment—where the premium is broadly in line with external estimates of the additional spending per head that Northern Ireland needs to do—for example, because of its relatively rural population, relatively different age structure, deprivation, and so on—the issue that raises in your mind is whether you should move more to a system where block grant funding is more directly linked to estimates of need rather than whittling away this historically accidental premium.

A fiscal equalisation payment—the jargon to which you refer—is essentially how different countries deal with this question across subnational governments, such as the provinces and territories in

Canada, states in Australia or Länder in Germany, that the cost of providing public services and the ability to raise tax revenue will differ from place to place. The alternative mechanisms in different countries are ways of trying to deal with that in order to put different subnational governments on a more level playing field in terms of the public services they could realistically provide.

Some of them do that by explicitly adjusting for the fact that it may be more difficult for some subnational governments to raise revenue. In some cases, it is more expensive to deliver the public services. In some cases, it is a combination of the two. If you look at the deal that was done for Wales, a floor was put under the block grant premium—in other words, the level of block grant funding relative to equivalent spending in the UK per head—based on relative cost. Gerry Holtham, whose work underpinned that scheme, said that in an ideal world you would also adjust for what is called in the jargon taxable capacity or, in other words, the ability to raise revenue from tax. That was not taken on, but the international models use some combination of reflecting the differences in the cost of providing public services and the differences in your ability as a subnational government to raise as much money per head as anybody else could do with the same set of policies.

Q218 **Jim Shannon:** Is the Australian system an option?

Sir Robert Chote: As I recall, the Australian model is primarily based around the revenue differences rather than the spending differences. For the provinces of Canada, for example, it is more based on relative revenue-raising capacity. For the territories like Yukon or Nunavut, where you have large geographical areas with relatively small populations, the focus is more on the relative cost. In a way, it is a more extreme example of the Northern Ireland rurality issue. It is just more expensive to provide public services if your population is more widely distributed.

Q219 **Jim Shannon:** I do not doubt that some change is needed. It is just about what is best. Having bits of this and bits of that might be a way of doing it. What are your thoughts? Do you feel the Canadian one is a better example, perhaps?

Sir Robert Chote: I have not looked in sufficient detail at the individual models to say which we would go to. We should look at the precedent that has been set in the UK. At the end of the day, this will have to be a model that the Treasury is content with. Looking at what has been done already for Wales and the additional proposals around that, I imagine that would be the place where the discussion would start, rather than a much broader constitutional change, because that would have other implications. For example, the different treatment of provinces and territories in Canada is partly related to their broader governmental autonomy. That is essentially about whether they have powers devolved from the federal Government or whether they are set out in the constitution. You would be opening a much larger constitutional can of worms.

Looking at the Welsh model, does it make sense to have a floor under the block grant per head relative to equivalent spending? In addition, do you want to take account of taxable capacity? If this is going to be part of a discussion, I suspect that is probably where it will start.

Dr Wilson: We have the Fiscal Council to thank for this notion and the discussion around the Barnett squeeze. This is one of the fundamental benefits of putting in place the Fiscal Council. We are starting now to see really important public finance points and issues come to the fore due to the existence of the Fiscal Council. That is entirely welcome. It is the organisation that has really brought to life the Barnett squeeze and its impact over time.

As for whether there is a particular urgency around correcting this, it might not be today or tomorrow, but we need to do something to fix it. The Barnett squeeze is important. We are starting to see it bite, particularly because we are in an inflationary environment. Robert identified some of these issues around how it bites both because of the inflationary environment and because you are doing things in public sector pay and then you have to find money elsewhere to match what you might be paying in England.

In that sense, there is benefit in moving towards a needs-based model in order to ensure that Northern Ireland has the relative ability to fund the same public services that are available across the rest of the UK. That is not least because—it is a political point that is talked about constantly—of how Northern Ireland needs to become more fiscally prudent and live within its means. In many senses, moving to a needs-based model would move that conversation to a more sensible place. It would move it to a place where the UK Government are not constantly holding the pen and saying, "You are all living outside your means."

I would put it in that place. The Fiscal Council has just done the numbers on this. When you look at the money Northern Ireland needs, it is getting about what it is. It avoids that conversation around, "You are spending 20% more than everybody else is." It puts it in that place. Again, as I said earlier, we are not spending it on sweets. It is sensible to look in the longer term at something like a needs-based model.

Similar to what Robert said, a move towards fiscal equalisation could take into account both need and revenue-raising capacity. We should look at revenue-raising capacity in Northern Ireland. In the current conversations, a lot has been thrown on the revenue-raising capacity of Northern Ireland being able to fix all of our budget woes going forward. That is not the reality.

Q220 **Stephen Farry:** Good morning to our witnesses. To a certain extent we have already discussed the Barnett formula and the Barnett squeeze. We have identified some of the problems and some of the potential solutions. I just want to follow up on that and talk about some of the practicalities around the process of change. I am conscious that the process in Wales had a commission and took some time to work through this, among other things.

At present the Northern Ireland parties are talking under the aegis of the Northern Ireland Civil Service around a potential package to help the current situation. The Barnett formula has been part of that discussion.

I have a two-part question to both of you. Realistically, how should we, as Northern Ireland parties and potentially as the Northern Ireland Executive, go about the process of seeking change, particularly in the context of what may become a very quick negotiation if the Executive is restored in Northern Ireland? What would be the key aspects that you would recommend in terms of our starting point for any negotiations with Treasury in that regard? Are you available?

Sir Robert Chote: Yes—I am not sure it quite falls within my remit to tell you how to negotiate a package. Let me just make a couple of observations. If these issues around the long-term approach and the relative merits of Barnett versus a more needs-based system are part of the discussion, that is a welcome thing.

If you look at the financial components of some of the past packages that have been used to either restore or sustain Stormont, they have often taken the form of one-off lumps of cash earmarked for particular purposes and time-limited. That is not the best basis upon which to try to do workforce, public service or reform planning. There is a danger: if you get a dollop of money, do you make sure you can spend it before you get it out of the door? That has happened before. There is still some unspent money from previous packages. This comes back to where the £297 million might be repaid from.

If the discussions that are taking place well above my pay grade are about how this could be sensible and sustainable for the longer term, rather than just being a dollop of grease to help a machine move in the short term, that would be a very desirable outcome. If the negotiations and the discussions get down into the detail of the numbers around this, one has to recognise that different people will take a different view of relative need. It would not surprise me to guess which would be the higher estimate of relative need if the parties and the Treasury were stuck at the table in front of me, but I do not have a window into people’s souls.

I would certainly want to have some sort of mechanism whereby there is an agreement on how these numbers are come up with between Treasury, NIO and DoF. Hopefully we can at least have an agreed set of starting points, because the Treasury uses a slightly different definition of the premium, depending on the treatment of business rates and things like that, to the one we have set out in the report. All of that can and should be sorted out in such a way that we can hopefully put out a shared set of facts from which we are starting, rather than, as you say, getting to the last minute of a negotiation, suddenly discovering that somebody thought this number meant X and somebody else thought it meant Y, and the whole thing potentially foundering on that.

The other thing to be realistic about is that you can do all the detailed analysis and spreadsheet-ery that you like, but, at the end of the day, this will be a political agreement. The financial bit of it will, I presume, be only one part of a broader package and nothing is agreed until everything is agreed.

Dr Wilson: In terms of moving forward and negotiating, to get the Executive back into place we do not necessarily need to have the structures to move towards a needs-based approach. If we did, we would be out for a little while longer. The important thing is to have a commitment to look at a needs-based approach or to put in place a commission, as we have seen in the case of Wales, to look at this independently and outline what it would mean.

The second bit, which links to this, is that even moving towards a needs-based system or a more relative model of fiscal equalisation does not necessarily correct some of the budget sustainability issues that Northern Ireland is facing. That almost stands aside from this.

As I mentioned, if you look at the relative needs-based approach, as currently set out by the Holtham Commission, on which the Fiscal Council has run the numbers, we are getting to about where we are at next year or the year after. The spending pressures are not ending. There is a conversation around budget sustainability going forward that is irrespective of that move towards a needs-based approach.

One of the most difficult things about moving towards more sustainable public finances is how to make the transformation. This transformation costs money. As we have seen outlined in the Bengoa report, for example, health expenditure needs a 6% increase just to stand still. We have had that once over the past 10 years pre-covid.

In that environment, it is not surprising that some of the health transformations we would like to see have not been made. Those would make efficiency gains and would get us on to a more sustainable path. That should be part of the transformation process going forward, aside from the move towards a needs-based approach or changing the Barnett formula towards something else.

The budget sustainability conversation applies to both. It is slightly easier if you are in a relative position rather than having the conversation, as with the Barnett formula, in absolute cash terms. That sustainability bit needs to be taken seriously in terms of the negotiating position. If the Treasury and the UK Government are constantly asking the Northern Ireland Executive to get to a more sustainable footing, you have to ask, "What do you mean by sustainability? How do you expect us to get there in a continuous austerity environment?"

Moving forward, it would be sensible to ring-fence particular transformational funding in particular areas. We know that health is facing particular spending pressures, which are leaking through and having an impact on spending everywhere else. That is certainly where I would start.

Q221 **Stephen Farry:** Stabilisation and transformation are also key asks that might well flow from that process. Just before I conclude, in some informal discussions, nameless people in the Northern Ireland Office have slightly pushed back against this notion of the Barnett squeeze and re-examining the Barnett formula. Particularly given the whole situation in Wales, they have said, "Be careful what you wish for." If we get this wrong, is there a danger that this could backfire on Northern Ireland? Could either of you ascertain what the NIO is pushing back against?

Sir Robert Chote: I do not know about that pushback specifically. Clearly, any move to a different system involves a different set of benefits and risks. At one level, if you were to commit to a system to make your spending equal to need and it started considerably higher, that would arguably be a fairer outcome but not one you would probably be pushing for. Arguably, that would be one of the challenges of applying this uniformly across the UK because Wales, Scotland and Northern Ireland are in different position here.

In the case of Northern Ireland, historically there has been a relatively high premium, but it has shrunk and moved towards most external estimates of need relatively quickly. That is one of the sources of the pressure. It is not merely that, as Lisa said, you are roughly where you are at, but the speed at which you have got there has come as something of a surprise. It is this combination of the way in which the Barnett formula works and the removal or loss of some of the non-Barnett additions, the non-Barnett formula-related chunks of the block grant. Those have come together.

Clearly, Lisa will know a lot more about this than I do. If you go down the road of having greater tax-raising powers and consequent adjustments to the block grant, that brings in a whole different set of risks around whether you think your tax base is going to grow as quickly as the tax base in the rest of UK. Arguably, to some degree Scotland has ended up having to raise taxes in order to stand still and mitigate the crystallisation of that risk as much as to increase the level of taxation and spending. There would be different choices to make there.

There are other elements in terms of addressing the risks and challenges that are in the system at the moment. One of the reasons why the Treasury has had to take a softer line on the repayment of the £297 million—that is, not demanding it all this year but allowing it to be pushed into next year—is that Northern Ireland does not have mechanisms that allow it to smooth its spending easily across multiple years. It is not allowed to run a reserve, as Scotland and Wales can. It is not allowed to borrow to finance resource spending other than to manage cash flow within the year, which is really never necessary anyway.

The fact that Scotland and Wales have those greater abilities in part reflects how they have accepted the responsibility and the risks that are involved with greater tax-raising powers. There are a variety of trade-offs you would need to think about if you were putting together a full fiscal package, which might include discussion of a needs-based mechanism or some other funding arrangement.

Q222 **Chair:** Dr Wilson, Sir Robert mentioned that you might be in a position to talk about the devolution of taxes, and particularly the suggestion by the Independent Fiscal Commission for Northern Ireland that the apprenticeship levy, income tax and corporation tax would be the most appropriate taxes to devolve, if the circumstances were right. What do you think of that? Are there benefits to that? What benefits might evolve as a result of the devolution of such taxes to Northern Ireland?

Dr Wilson: I was one of the members of the Independent Fiscal Commission, which sent its final report to the Minister of Finance last May. As you rightly say, in it we made a number of recommendations about the devolution of further tax powers to Northern Ireland.

It is important to point out that the purpose and the remit of the Independent Fiscal Commission was to look at the technocratic possibility of devolving further taxation powers and, in that environment, whether the Northern Ireland Executive was seeking to devolve further taxation powers, which taxes might be more suitable for devolution.

If you are seeking to devolve taxation powers, it is important to make it worth your while. Therein lay the reason for our No. 1 recommendation that the tax most suitable for devolution would be income tax and then, tied to that, the apprenticeship levy. In many senses, there was nothing surprising about that recommendation, given that both Scotland and Wales have devolved income tax powers. In Wales they have not utilised the full extent of those powers, but they have in Scotland.

One of the big things we outlined in the report, which we talked about right the way through the Independent Fiscal Commission's work, is that the devolution of any taxation is not a panacea. It is not going to fix your woes. Take the example of income tax devolution. Should Northern Ireland seek the devolution of income tax? Will this be a mechanism to assist with some of our spending pressures? That is certainly not the case.

There are fundamental risks and rewards that come with the devolution of any tax. The rewards are related to having more powers over decision making and setting your own bands, rates and so on. The risks are great. The simplest way to outline the risks in relation to income tax, as we outlined in a table in the report, is this: what if Northern Ireland were to enter into a process of income tax devolution and its economy were to grow more slowly than the rest of the United Kingdom economy? That has been the case, so the risks of that are pretty big. In that environment, you would not expect the devolution of income tax to fix any of your woes. Certainly, in that environment you would probably be in a weaker public finance position.

There are risks, rewards and trade-offs when it comes to the devolution of any tax. If you look through the report of the Independent Fiscal Commission, chapter 2 outlined the economic context. It was set out at the start of the report for a reason. This is fundamental. When talking about Northern Ireland and its public finances, we continuously talk about budget sustainability and public finances. So little attention is given to the overarching thing we need to talk about, which is the economic sustainability of the place. We need to give precedence to economic sustainability going forward. That is the path to budget sustainability.

Devolving income tax, the apprenticeship levy, which is tied to that, and corporation tax is not going to be the panacea to our economic woes. We need to take the economy and our productivity problem seriously, and get that on par with the rest of the United Kingdom. That is definitely the place you should begin if you are talking about budget sustainability and getting the public finances on to a more sustainable footing. The risks of income tax devolution are too large otherwise.

Q223 **Chair:** Thank you, Dr Wilson. In your answer you anticipated the questions that I wanted to ask you about what true budgetary sustainability looks like. Your point about the wider economy is one you made in your written evidence. I have a follow-up question. You mentioned productivity. What concrete steps need to be urgently taken in order to achieve that better economic performance, which will lead to better budgetary sustainability?

Dr Wilson: There are a number of things. In many ways, Northern Ireland is almost a chasm within the broader picture of the productivity problems that exist in the United Kingdom.

When we were speaking to our stakeholders throughout the Fiscal Commission, every single one, no matter who they were, brought up the issue of stability in our political institutions. That is one of the key drivers of economic growth and of businesses deciding to invest somewhere. We are seeing these things come to light in conversations across the UK. If we are to take our economy and economic growth seriously, and we know how to do that, stability is fundamental. We need to give assurances to possible investors that there is a stable environment for economic growth.

The second area in which Northern Ireland performs woefully is the education environment. We know one of the key ways to reduce the productivity gap, both Northern Ireland's gap with the UK and the UK's gap with elsewhere, is through the education piece—education, education, education—reducing the skills gap and really investing in that.

Something that is often missing from the education piece—the pieces are starting to thread together in terms of the wider policy discussion—is the importance of early years education to broader economic growth. In Northern Ireland, we can talk about super-parity issues and about Northern Ireland doing things differently.

One of the key ways we do things differently in Northern Ireland is in the provision of childcare and early years. We should not take that lightly. There is evidence for this, like the Heckman curve. We should not take lightly the serious business of early years. For people in Northern Ireland and families who are attempting to work, the investment that goes into children at that age is really lacking in terms of that broader piece about economic growth. We have seen this, thankfully, in the UK budget this year. Investment in childcare and early years has been taken seriously as a key mechanism of economic growth. There is a real need for that to be passed down into Northern Ireland and for childcare and early years provision to be the same as in England.

The third part of the productivity piece is infrastructure. This goes back to some of the comments I made in relation to Stephen's piece about the transformation bit. There is a need for large-scale investment in infrastructure. These are one-off spends, in many cases, to make large-scale investments in infrastructure such as roads, train lines, schools or other kinds of capital infrastructure. Those are the areas you need to start to focus on particularly to fix some of the productivity problems and to put the economy at the centre point of any replacement of the Executive in power.

Q224 **Chair:** Just dealing more widely with that question about improving the economy, it is probably easier for me to ask the question about whether further types of charge should be introduced. The controversial issue of water charges is always one that arouses a lot of concern and debate within Northern Ireland. There is a big difference between the position in Northern Ireland and that in England. Should local politicians look at that more seriously as an option?

Sir Robert Chote: From our point of view, again, it is not for us to recommend a particular move there. Whoever is in charge of the budget at any time needs to be looking at all the options across the spending side and the revenue side.

Taxes and charges is an interesting issue. If you are looking at the make-up of the Executive budget and the budgets of the Departments, there are a variety of fees and charges, but they are quite invisible in the way in which the documentation is set out.

If you look at where the money comes in and where the money goes out, for resource spending you have the block grant and regional rates. For capital you have the block grant and RRI borrowing. It is slightly more complicated on both of those, but the last time we looked, in about 2020, there was a contribution of about £700 million from fees and charges of different sorts, which would include non-domestic water charging, tuition fees, hospital parking fees, and so on. That is an area where we still need to do a bit more digging to work out how big those things are and what the gross total is. That is one bit of the public sector charging another bit of the public sector. Working out the overall contribution is not straightforward.

Such is the scale of the block grant that even water charging would not make a colossal difference to the overall spending envelope. If you were to move to a contribution that roughly equalises the total contribution of council tax and water charge versus equivalent rates, it would be a significant sum of money, but it would almost certainly have to be accompanied by some sort of mechanism to protect or cushion poorer households from the impact of that. Even the headline number might be somewhat overstated.

In our next sustainability report we will have a particular focus on sustainability. We will look in particular at Northern Ireland Water and Translink as part of that. It is an area we are going to look at further. You are right, though: it is the first one everybody comes up with, which is always followed up by saying that it would be enormously politically difficult to introduce. The Secretary of State has raised the spectre of this in his statement. There are other things you could consider doing that might be able to bring more money in without going the full hog. It is complicated territory, but it is certainly something that I am sure will remain very much on people's agenda when they think about the possible alternatives.

Q225 **Carla Lockhart:** I just want to pick up on the prior questioning. First of all, can I thank the Fiscal Council for all that you do and all that you have been doing? It has been a really significant good piece of work, particularly in recent days around the needs-based Barnett formula. It has really got a very sensible conversation started. I want to pay tribute to my colleague Gavin Robinson, the Member for Belfast East, in relation to his desire to drive this agenda.

The Secretary of State, as you have said, has suggested a range of potential revenue-raising measures, be it water charges or the removal of free transport for our older people. In your view, can householders in Northern Ireland absorb another £1,000 within their household budgets to pay for the likes of water charges or transport?

Sir Robert Chote: Clearly, different households are going to be in different positions to confront those sorts of increases in contributions, whether they were to come from regional rates, VAT or other charging sources. We are in the middle of a difficult period for household incomes because of the inflationary squeeze at the moment. There is never an ideal time to think about these things, but this is a time when household budgets are clearly under pressure.

It is interesting that the one revenue raiser that is very clearly in scope at the moment is regional rates—it is the only major tax—and he did not choose to deploy that in setting the rates for 2023-24, no doubt partly with an eye to the state of household finances.

As I say, in some of these revenue-raising options, particularly around the water-charging one, there is a possibility that you would basically have to complicate the revenue raising in order to protect more vulnerable households. The possibility or likelihood that you might want to do that will complicate it and would also reduce the amount of money you would get at the end. None the less, it is not a surprise that everyone still continues to consider all those options.

I should also initially say thank you very much indeed for your kind remarks about the Fiscal Council. Pulling all this together has been a very enjoyable process. It is different, thankfully, from my previous role in this sort of job, which was largely about forecasting. This is more about shedding light, informing people and trying to provide a set of numbers and analysis that everybody can make use of. One thing that has been particularly pleasing is the enthusiasm and co-operation across the political spectrum from Departments and so on, and feeding into that. I hope we can be useful at the margins.

Q226 **Carla Lockhart:** I think you will play an absolutely key role in the conversation going forward. Around the change to the Barnett formula and the potential for that, in your experience or thought process, over what timescale might we see this change? Dr Wilson talked about trying to get commitments before any potential return to Stormont or in this round of the negotiations. What would be a realistic change in terms of the wheels of Treasury? I know the politics of Northern Ireland can be difficult, but I am just thinking about the wheels of Treasury and how we would work that through the system.

Sir Robert Chote: Reflecting on long and bitter experience, clearly, things often move slowly. Lisa used a good example. If you look at the way in which greater tax-raising powers came to both Wales and Scotland, that was a lengthy process. In effect, you had two commissions in each case, one examining the broad principles and one moving rather closer to that. The serious politics around that got more and more complicated.

There are a lot of practical issues, as Lisa will know a lot better than I do, around exactly what definition of income it is you are trying to tax. Would HMRC still be doing it? That is a very complicated area.

The Barnett formula is not a legal concept: it is an administrative arrangement. In that sense, it is not intrinsically complicated to move away from practically or logistically, if the Treasury were to be persuaded that that was a sensible way to operate. The fiscal framework for Wales, which had that component in it, was not hugely complicated. If this were thought to be a desirable direction in which to go, it would be sensible to get to grips with it when a package is being thought about for the restoration of the institutions. You would not necessarily need to wait for a chin-stroking exercise with a much longer timescale.

One difficult issue would be this. Let us say you wanted to have a Wales-style floor. At exactly what level would you set it? You could clearly do a lot more work, going over acres and acres of spreadsheets and coming up with precise estimates. Different people would come up with different answers, depending on rurality, deprivation and age structure, all of which matter. What weight would you place on each one of those?

This issue has been looked at several times since 1978-79 when the Treasury led the first bits of work around this when the Barnett formula came in. The numbers for Northern Ireland are all roughly in the low 120s and low 130s. There is only so much more science you can throw at these things to get it that much more precise. We have put out some estimates and we have noted that there are uncertainties around those.

There would then be a political question. If you want to agree on a number, it is going to be partly an analytical issue, but ultimately it needs to be something there is political agreement on. In order to get to an accepted needs-based process, short of a move to a more full-blown Canada or Australia-type arrangement, changing that arrangement in the Treasury statement of funding policy is a political challenge.

Logistically, it does not necessarily need to take a huge amount of time, but that is not to underestimate the political difficulty of getting to an agreement. It will be one part of a larger package, partly about financial and budget management, but partly covering the set of other issues you would expect to be discussed in a negotiation around the terms on which the institutions would be restored. Do not go slow on it deliberately. There will be enough sand in the machine slowing things down anyway, so do press ahead. Particularly at a time when the squeeze looks like it will be tougher over the next 10 years, pushing you below most estimates of need rather than being above and getting slightly closer to them, the degree of urgency is that much greater.

Q227 **Carla Lockhart:** Your voice is as important as the political voice in all of this. Quite often Northern Ireland is accused of continually having the begging bowl out, whereas this evidence is that we are behind the curve in terms of what is needed for the people who live, work and do business in Northern Ireland.

I just have a couple more questions, if the Chair permits. Very quickly, in relation to corporation tax, the Government here have a desire to increase corporation tax across the UK. How do you see that impacting Northern Ireland's competitiveness with ROI, particularly around inward investment? That probably brings it back to that power being given to Northern Ireland.

Sir Robert Chote: I am shamelessly going to duck this one and point it to Lisa. That is not an area we have looked at. As you will be aware, the throat clearing has been done on that and that has never come there. I have detected less appetite for that than there was. Lisa will give you a more informed view.

Dr Wilson: As part of the Independent Fiscal Commission we looked at the case of corporation tax. In the end, our conclusion or recommendation was that there is a case to finalise the devolution of those taxation powers to Northern Ireland, but, as part of doing that, the Northern Ireland Executive needs to map out how that would be sustainable and answer the questions that were asked when the Northern Ireland Executive previously sought the devolution of corporation tax. The answers to those questions are very difficult and very challenging, but there should be answers.

I want to refer back to your point, Carla, about the devolution of corporation tax to make us competitive with the Republic of Ireland. Given the 12.5% rate there, are we uncompetitive as a result? One key thing that has come to light—this is certainly a key part of the discussions of public finances and corporation tax in the Republic of Ireland—is that the 12.5% rate is not the sole reason for the success of the Republic of Ireland economy. It was one policy lever that was utilised at a particular time, alongside a number of others, such as investment in education. The substantial investment in education through those years was absolutely fundamental as well.

We are also looking at an environment where the windfalls that are currently coming from corporation tax in the Republic of Ireland increasingly look unsustainable. Across the globe, we are looking at increased corporation tax rates. Granted, the global corporation tax that is being talked about is not as high as the 25% rate that the UK seems to be committed to. That can be changed without Northern Ireland necessarily having to take huge and fundamental risks. Those risks are very challenging to outline to the Treasury, if we want to convince it that devolving corporation tax is not too risky in terms of the block grant. It is a path that I would tread with caution.

In terms of our recommendations and what Treasury is willing to do, further devolution of corporation tax will be more difficult to achieve than has been talked about. In those initial years when we were discussing corporation tax, it was as though it was just going to happen. Once we came to the mechanisms, the processes and the agreements with Treasury, it all stalled. Those same challenges remain, and they are difficult challenges to get over.

There are other policy levers that could make us more competitive with the Republic of Ireland in the longer run, which I would prioritise if I was in office.

Q228 **Carla Lockhart:** Very finally, do you good folks feel like the Northern Ireland Executive has the right maturity, given the difficulties we have experienced over the last number of years, in comparison to where Wales and Scotland were in terms of getting more taxation powers devolved to them?

Sir Robert Chote: What do you mean by "maturity"?

Carla Lockhart: It is about the ability, the maturity and the wherewithal to take those powers and be able to utilise them.

Sir Robert Chote: The individuals in Northern Ireland are not intrinsically less capable of doing that than individuals in Scotland and Wales. It is interesting. In the initial discussions we had with stakeholders while the commission was still in its early days, I came across quite a lot of people who were not saying that we could not do this but who were talking about the broader challenges to do with the management of spending, long-term decision-making, getting spending decisions aligned with your programme for government and so on.

There are challenges to doing that. In order to do long-term budget planning and reform, you ideally need a combination of multi-year spending reviews in the UK, which effectively put out at least a first stab at what you think your block grant is going to be, and stable institutions at Stormont in order to make the most of that. What we have had is a long run of years in which essentially we have ended up with single-year budgets because either one or both of those things has not been in place at the same time. Given that situation, it is not a huge surprise that you do not see people rushing to say, "Yes, we are ready to have a dramatic tax devolution model." That is not to say it could not be done.

All the work that the commission has done points to the fact that there are things you could do for which there are good arguments. Crucially, if you do those things, there are potential benefits and there are risks that accompany those. If you are concerned that you are going to be disadvantaged on the block grant adjustment over what you think you can realistically get out of your revenues, that is not necessarily a no-brainer "Don't do it", but you should think carefully about the balance of risk and reward, and, crucially, the uncertainty that lies around both the risk and the reward, as well as any central guess you might make at it.

Chair: Thank you very much. I am going to have to bring proceedings to a close now. We have one or two further questions that we will put in writing to both of you. Thank you for attending today and giving your evidence; we are very grateful. I will bring the session to a formal end now.