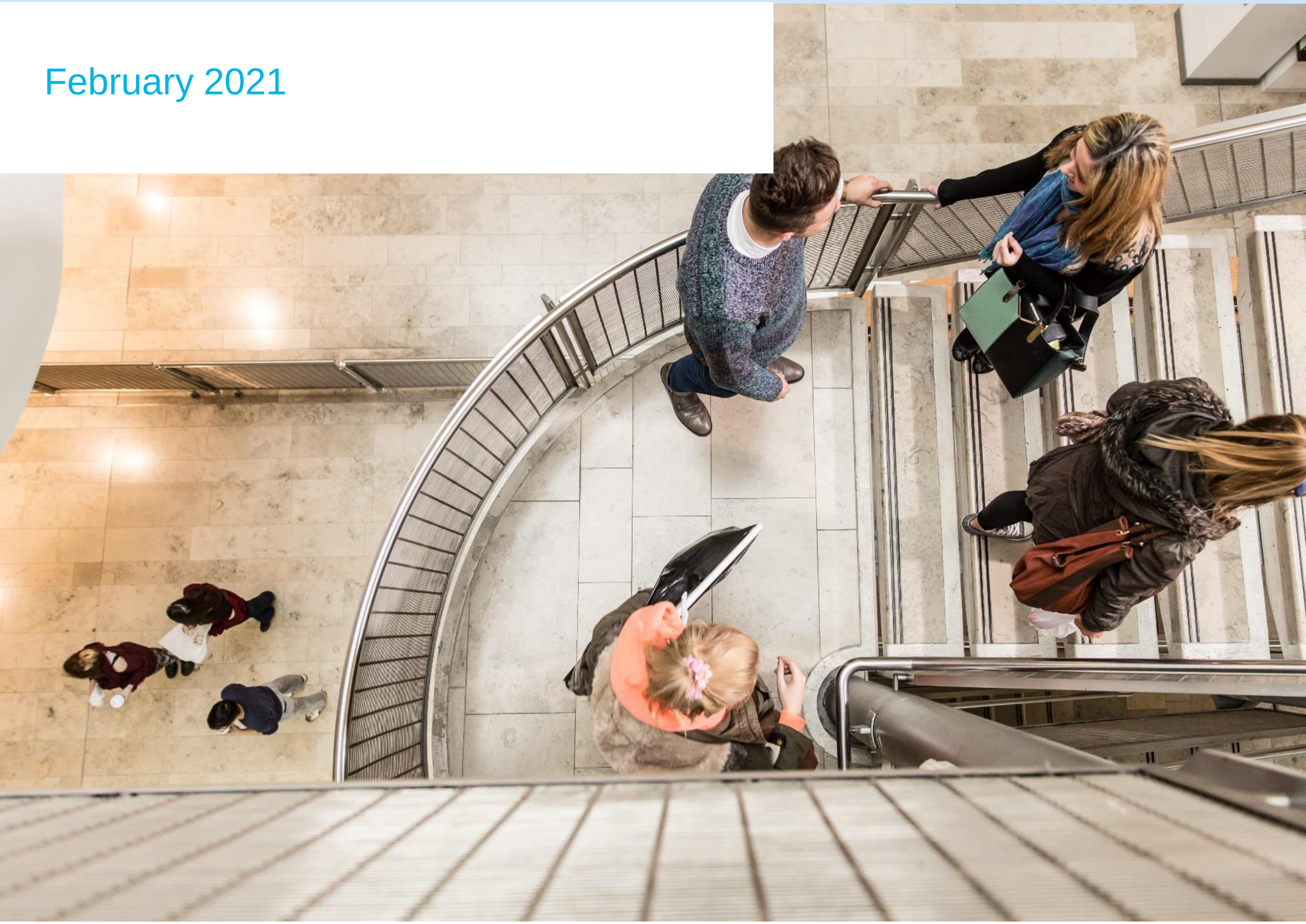
Department of Finance 2021-22 Draft Budget Consultation

A response from the UUEPC

February 2021



2021-22 Draft Budget Consultation Response

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2021-22 Draft Budget Consultation Response

1. Introduction

Background

1. The Finance Minister published his 2021-22 Draft Budget on 18 January 2021 for consultation. This paper provides a response to the Minister from the economist team in the UUEPC and the wider Ulster University Business School.

Format of response

2. This paper includes the following sections:

- Economic context – the budget consultation paper itself includes an economic context and this paper does NOT seek to repeat the analysis undertaken. However, the UUEPC has undertaken some analysis on the economic impact of the pandemic and some important findings are presented.

- Funding and Budget analysis – an overview of budget income and allocation of spending.

- Economic observations on the budget – a discussion of the economic policies required to support a 'building back better' agenda which should be a priority in the Final Budget.

- Other observations and suggestions – broader comments on the budget to promote best use of public funds. These are intended as suggestions to the Minister and the NI Assembly more generally.

2. Economic context

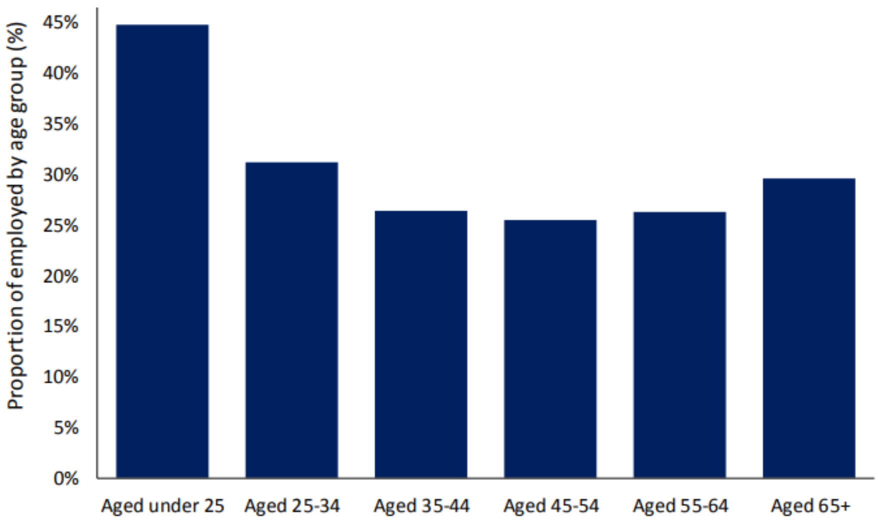
Introduction

1. This section of the response complements the 'Economic Context' section of the Draft Budget document and highlights the findings from UUEPC research undertaken over the last year.

The young and the lower paid are the most impacted

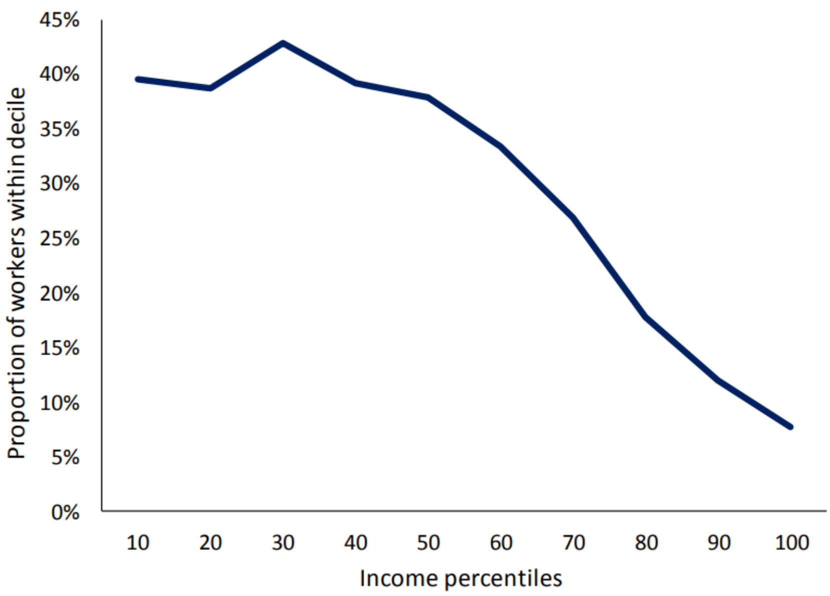
2. In Northern Ireland, proportionally the young and those at the lower end of the earnings spectrum have been the most impacted by the pandemic (see charts 2.1 and 2.2 below).

Chart 2.1: Furloughed/ laid-off as a % of total employed by age group, NI, Q2 2020



Source: LFS and UUEPC analysis

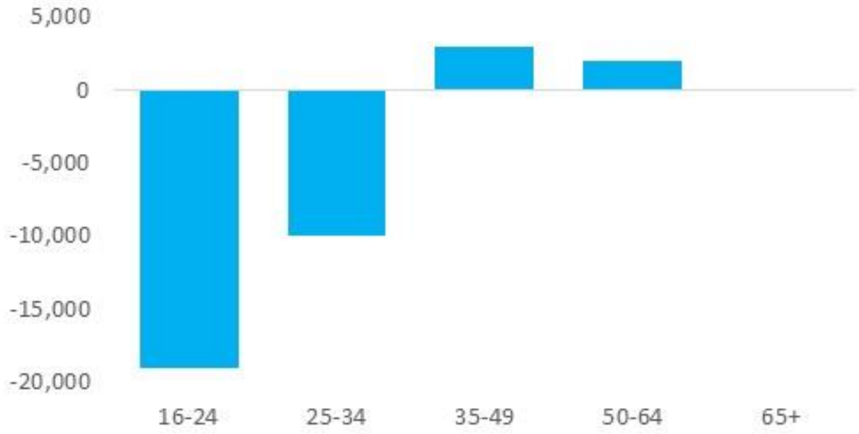
Chart 2.2: % Furloughed/ laid-off by earnings decile, NI, Q2 2020



Source: LFS and UUEPC analysis

3. More recent Northern Ireland labour market information (Chart 2.3) also confirms the employment prospects of young people have been the most impacted by COVID.

Chart 2.3: Change in employment by Age (Yr on Yr to Nov 2020)



Source: LFS, UUEPC analysis

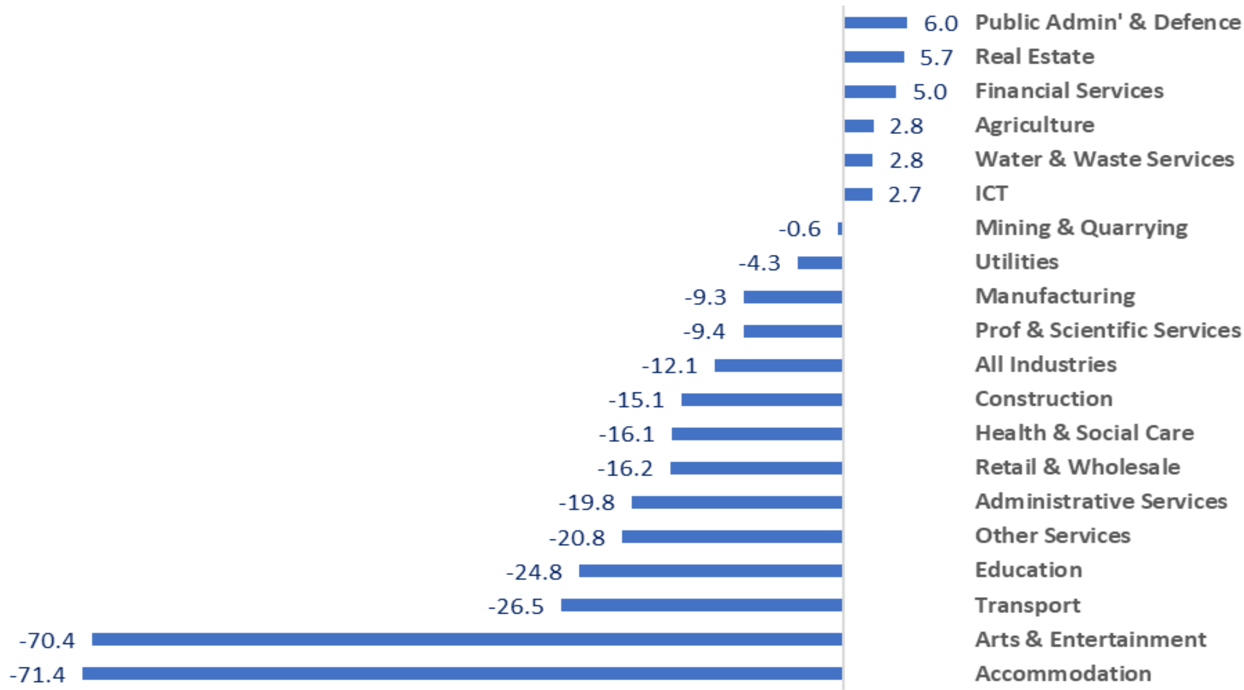
4. The latest Labour Force Survey (LFS) data shows a fall in employment of 24k in the three months to November 2020, from the same three month period the previous year. Most of these losses were experienced by those in the 16-24 age group (loss of 19k), followed by the 25-34 age group (loss of 10k). Those above the age of 35 experienced a net increase in employment.

5. Typically, young people are more primed for re-skilling and up-skilling, but without an associated budget to support the additional numbers of people and potentially new initiatives that deliver qualifications relevant to the labour market, the 'new unemployed' may be directed to programmes that do not meet their needs and/ or are under-resourced.

Sectors most impacted

6. This differential impact between groups most impacted is explained by a sectoral analysis of the areas of the economy most affected by the pandemic, primarily Accommodation (Hospitality) and the Arts & Entertainment sectors. The retail sector has also been significantly impacted, but this is less apparent in the chart below because essential (typically food) retail has been allowed to continue trading and performed well. These sectors tend to pay lower wages and employ younger people.

Chart 2.4: Economic output (GVA) growth/ contraction rates (%) by sector, NI, 2020 (estimated)



Source: UUEPC analysis

3. Funding and budget analysis

Introduction

1. This section compares funding (i.e. income) between 2020-21 and 2021-22 and also provides a high-level analysis of the budget allocation.

Funding (non-COVID)

2. The largest source of income comes through the NI Block Grant, in the form of Resource DEL (for operational or running costs, e.g. salaries), Capital DEL (for capital expenditure e.g. roads) and Financial Transactions Capital (for loans or equity investment to the private sector for investment in infrastructure, in addition to Capital DEL).

Table 3.1: Northern Ireland Core DEL

	2020-21 £'m	2021-22 £'m	% change
Resource DEL	11,555.10	11,596.00	0.35%
Conventional Capital DEL	1,480.60	1,578.00	6.58%
Financial Transactions Capital (FTC)	194.60	73.60	-62.18%
	13,230.30	13,247.60	0.13%

Source: DoF Draft Budget 2021-22

3. Overall the Core DEL settlement is flat, with the increase in Capital DEL offset by a larger fall in FTC. In addition to Core DEL, the NI Executive received funding from a range of other sources. The following comments are made in respect of these other sources of income:

- New Decade New Approach – £350m of funding was made available in 2020-21 for 'general pressures' as a one-off payment. This is not available in 2021-22.
- EU funding – the Shared Prosperity Fund (SPF) is the UK replacement for EU Structural Funds. There are limited details on the SPF, but it is understood that the SPF will not provide a full replacement for EU Structural Funds and it will not be devolved, but rather administered as a UK wide fund. This raises significant questions around the basis on which funding will be allocated and implications locally;
- Fresh Start – it appears that £166.7m was made available in 2020-21 (exc security costs), compared to just £28.4m in 2021-22.
- Confidence & Supply funding – an extra £27.3m is available in 2021-22 for ultra-fast broadband.

- Reinvestment and Reform Initiative (RRI) – the NI Executive will borrow £140m in 21-22 compared to £0 in 2020-21 and £9.6m in 2019-20.

- Other income – Departments can generate additional funding through charging for some services (e.g. public transport) and sale of assets. Additional Barnett allocations may result in additional funding for the NI Block. These can be significant but are also uncertain and so are excluded from the budget. Importantly, income generated in the current year is significantly lower than in previous years as a result of services being closed and reduced demand (e.g. for public transport).

4. Overall resource funding is very tight, but RRI borrowing should provide additional capital funding, but **this collectively presents a very challenging funding settlement.**

Resource DEL Budget

5. The Department of Finance has presented the Draft Budget for 2021-22 against a 'Baseline' for each Department. The 'Baseline' is taken from the previous years budget but makes adjustments for factors such as time-bound allocations. It is not the same as the 2020-21 budget.

6. Table 3.2 sets out the 2021-22 Baseline and Draft Budget alongside the percentage change (for the Ministerial Departments only) as presented in the Draft Budget paper.

Table 3.2: Resource DEL: 2021-22 Baseline and Draft Budget (Ministerial Departments only)

Resource DEL £million	2021-22 Baseline Position	2021-22 Draft Budget	% Change
Agriculture, Environment & Rural Affairs*	498.7	544.2	9.1%
Communities	782.0	824.8	5.5%
Economy	805.4	821.3	2.0%
Education	2,259.6	2,300.7	1.8%
Finance	166.8	170.4	2.2%
Health	6,102.4	6,451.9	5.7%
Infrastructure	417.9	420.7	0.7%
Justice	1,070.8	1,125.0	5.1%
The Executive Office	95.3	118.4	24.2%
Departmental Allocations	**12,198.9**	**12,777.4**	**4.7%**

* DAERA 2021-22 Baseline has been adjusted for Farm Payments

7. This presents an increase of 4.7% across the Ministerial Departments, which seems at odds with the very challenging funding settlement. Separately, the UUEPC has set out

in Table 3.3 below a comparison between the 2021-22 Draft Budget with the 2020-21 Budget Outcome.

Table 3.3: Resource DEL: 2020-21 Budget Outcome and 2021-22 Draft Budget (main Departments only)

Resource DEL £m	2020-21 Budget Outcome	2021-22 Draft Budget	% Change
Agriculture, Environment & Rural Affairs*	226.1	544.2	140.7%
Communities	823.8	824.8	0.1%
Economy	817.7	821.3	0.4%
Education	2,276.1	2,300.7	1.1%
Finance	168.6	170.4	1.1%
Health	6,158.4	6,451.9	4.8%
Infrastructure	417.9	420.7	0.7%
Justice	1,111.2	1,125.0	1.2%
The Executive Office	98.0	118.4	20.8%
Departmental Allocations	**12,097.8**	**12,777.4**	**5.6%**

* The DEARA 2020-21 Budget did not include Farm Payments

Comments on Resource Budget

8. Comparing both budgets sets out a more challenging funding allocation across the Ministerial Departments and is more consistent with the budget settlement. (As explained in the Draft Budget report the DEARA budget increase reflects the inclusion of Farm Payments, previously funded by the EU CAP).

9. **However, it is not clear that either analysis provides a like-for-like comparison. Presenting the 2020/21 Baseline against the 2021/22 Baseline would have provided greater transparency to allow for analysis and comparison. Separately, the one-off items of expenditure each year could also have been set out to allow for a more informed response.**

10. Based on the limited analysis possible, as an Economic Policy Centre, **it is concerning that additional funding does not appear to have been identified to support the rebuilding of the economy post-COVID.** The economy has suffered a shock unprecedented in scale and the budget allocation for the Department for the Economy is below (in real terms) its pre-COVID budget.

Capital DEL Budget

11. Table 3.4 below sets out a comparison of the 2021-22 Capital Budget allocation with the previous year.

Table 3.4: Capital DEL: 2020-21 Budget Outcome and 2021-22 Draft Budget (main Departments only)

Capital DEL £million	2020-21 Budget Outcome	2021-22 Draft Budget	% Change
Agriculture, Environment & Rural Affairs	98.5	95.5	-3.0%
Communities	214.1	224.8	5.0%
Economy	86.1	89.8	4.3%
Education	157.3	158.3	0.6%
Finance	31.9	45	41.1%
Health	295	326.5	10.7%
Infrastructure	558.2	693.2	24.2%
Justice	88.1	96.4	9.4%
The Executive Office	18.1	15.3	-15.5%
Total Departmental Allocations	**1,547.30**	**1,744.80**	**12.8%**

Source: DoF

12. The following comments are made in respect of the Capital Budget:

- Overall, there is a significant increase in the capital budget, with the largest increase, in financial terms, being allocated to Infrastructure and then Health.

- Justice, Economy and Communities have all been allocated increases above inflation.

- Although no information is provided in the Draft Budget document, the allocation of capital budgets is often determined by the status of individual projects (i.e. if they are 'ready to go').

COVID

13. In addition to the core DEL, an additional £538.2m of Resource DEL and £3.5m of Capital DEL has been made available in respect of COVID. The Department of Health has been allocated £380m, just over £30m has been allocated to the holiday meals scheme (for eligible school children) and £127m held centrally until Final Budget.

2021-22 Draft Budget Consultation Response

Summary of Budget comments

14. The following points summarise the budget comments:

- The budget settlement is tight and represents a broadly 'flat cash' position as identified in the document;

- It is difficult to provide an informed response on the change to the Resource budget because the information provided does not allow for a like-for-like comparison. Based on the information provided, it appears there is no additional funding identified to build a competitive, regionally balanced and sustainable economic recovery;

- The Capital budget has an increased allocation, presumably funded by the higher level of RRI borrowing, with most of the increase being allocated to Infrastructure.

4. Economic observations on the Budget

Introduction

1. This section builds on the analysis in Section 3 above and focuses on economic issues and policies for the NI Executive to consider.

The need for a two phase approach – 'survival' then 'building back better'

2. Although we are now approaching 12 months since COVID-19 became a global pandemic, it is a mark of the significance of the impact of this virus that most economies remain in highly restrictive lockdowns. As a result, the Executive should have in place a two-phased strategy to protect the economy and jobs:

   - Phase 1: Survival – our current phase and almost all interventions to date have focused on protecting businesses and jobs from the worst impacts of the pandemic. These interventions have been introduced both at the national and devolved levels.

   - Phase 2: Building Back Better – over the last decade as the economy recovered from the Global Financial Crisis, significant numbers of jobs were created, but many of those jobs have been in lower paid, lower productivity areas. As the economy recovers from his current crisis, emphasis should be placed on improving competitiveness, leading to higher productivity and in turn better paid jobs.

     The remainder of this section focuses on the 'building back better' agenda.

Jobs first will be the call

3. As outlined in the initial sections of this paper, the labour market has held up remarkably well. However, it is important to note that although initial forecasts, including from the UUEPC, suggested the claimant count could continue rising to over 100k (following the initial jump from 30k to 60k in April and May 2020), those were based on the UK Government's CJRS (furlough scheme) ending in October as was originally announced. Therefore, the possibility remains that as Government supports are withdrawn, many more jobs could be lost and businesses fail.

4. In that scenario, there will be significant demand for a 'new' Jobs Fund, similar to schemes introduced after the financial crisis to support the creation of jobs for those most disadvantaged in the labour market. It is highly likely a programme of this nature will be taken forward, but it is important that lessons from previous experience are learned.

5. A new Jobs Fund should be time bounded in nature, to provide immediate support to those most impacted, but a longer term strategy and series of policy interventions should be developed to create higher paid, higher productivity jobs.

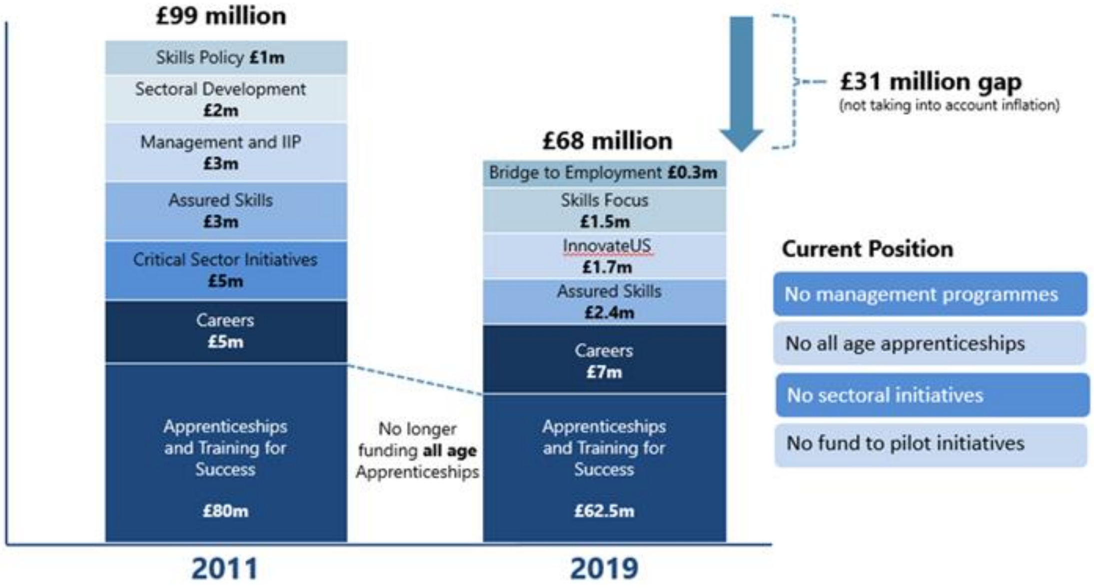
Develop a more competitive, regionally balanced, inclusive economy through developing the skills base, promoting innovation and encouraging entrepreneurialism

6. The longer term policy agenda to 'build back better' should focus on creating a more competitive and inclusive economy around key themes such as:

- **Developing the skills base** – this is relevant across the entire skills spectrum. Firstly, by reducing the number of young people with low/ no skills and encouraging them to remain in education to the level appropriate with their skills and abilities (the only long term sustainable way to develop an inclusive economy). Secondly, ensuring young people are given the right advice and guided towards career pathways in tertiary level education, that best suit them and also meet the needs of the economy. Finally, providing upskilling and re-skilling opportunities for those already in or seeking to re-enter the labour market.

  This is against the backdrop of falling investment in skills over the last decade.

  Chart 4.1: Estimated change in spending on industry skills and careers – 2011 and 2019



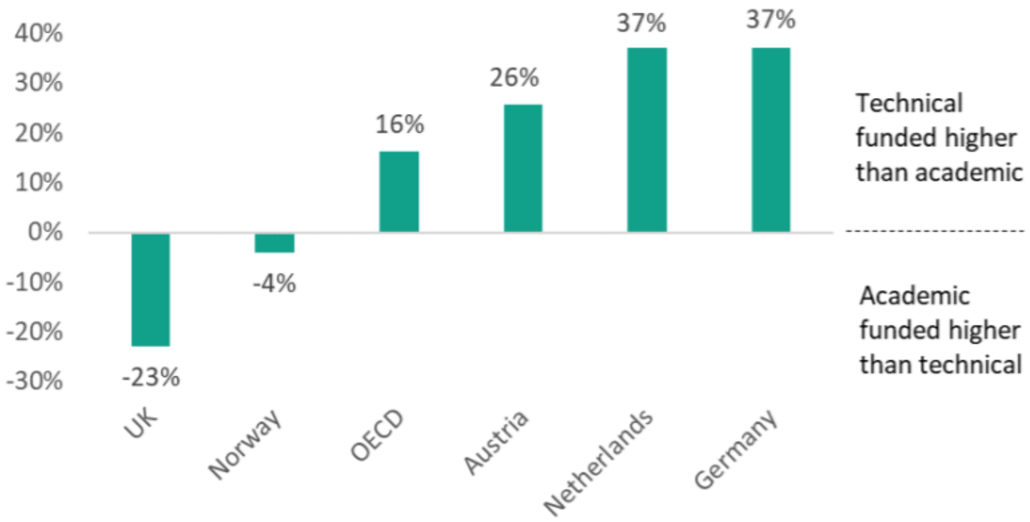
  Source: DfE

  Moving forward job opportunities are more likely to be created in higher skilled sectors and therefore supplying businesses with those skills is good for both people and firms.

  In addition, funding for Higher Education in Northern Ireland is lower than in England. In 2019/20 **funding per home student in Northern Ireland amounted to £8,316 compared to £9,379 in England**. For Ulster University alone this amounted to a funding differential of £13.1m in year and a cumulative shortfall of £138m over the period 2010/11 to 2019/20 (at 2020 prices).

Separately, the skills gap across the UK is exacerbated by significant underfunding in technical education compared to OECD benchmarks.

Chart 4.2: Funding gap between academic and technical upper secondary education, 2016



Source: OECD

- **Promoting innovation** – successful economies promote a culture of innovation and investment in research & development across its business community. This increases productivity which is the foundation for higher wages. This is typically associated with higher value-added, typically high-tech sectors where Northern Ireland has key strengths for example Life & Health Sciences; Advanced Manufacturing; and ICT.

  However, it is also important to drive innovation across all sectors in the economy and 'non frontier' firms to raise productivity, in the first instance, closer to UK averages.

  Furthermore, innovation should not be restricted to the private sector. COVID has changed the way in which all organisations (public and private sector) deliver services to their customers/ users. Developing a culture of innovation in the public sector should also help address the many challenges caused by the indirect impact of COVID.

- **Encouraging entrepreneurialism and business starts** – Northern Ireland has one of the lowest business churn rates in the UK (i.e. low business births and deaths). Economies with higher rates of business churn tend to be more dynamic and with businesses in higher value-added, high skilled, high growth sectors. The latest labour market data also indicates that the largest fall in employment over the last year has been within the self-employed group.

Business start-up is a fundamental basis for job creation in any economy, therefore, encouraging entrepreneurial activity in priority sectors promotes sustainable economic growth.

Reshaping the High Street and not replacing like-with-like

7. The retail sector was facing fundamental challenges prior to COVID and the pandemic has accelerated the established trend to greater on-line purchase activity. This was demonstrated most recently when ASOS and Boohoo purchased the Topshop and Debenham brands respectively but did not purchase their stores, to move their businesses entirely on-line.

8. This all points to a long term decline in employment in the retail sector and reducing share of the urban centre footprint allocated to retail space. Conversely, the transport and logistics sectors are likely to see increases in employment and increased demand for large out-of-town distribution centres.

9. This is a global trend and Government policy must shift to take account of this new reality. Moving forward, displaced employees will need re-skilled in the higher growth/ job creation sectors. In addition, ensuring urban centres retain their vibrancy will require an increase in the residential, leisure/ hospitality and office footprints to replace former retail space. Significant research has been conducted in this area, but a fundamental shift in how Governments tax properties in urban centres vis-a-vis out of town (not just out of town retail) will be critical.

Creating a zero-carbon economy will require a 'Whole of Government' response and can help support economic growth

10. The Draft Budget makes no specific mention of funding to help Northern Ireland achieve its environmental targets. Whilst environmental issues (as with economic issues) must be considered as part of a longer-term strategy, and not necessarily within a one-year budget, tackling the climate crisis will require a response across all Government departments. As a result, funding coordination will be required and therefore a specific reference within the Budget would have been merited.

11. UUEPC research has shown Northern Ireland to have the highest percentage of electricity generated from renewable sources and it's natural/ geographic assets as well as expertise in clean energy technologies create an opportunity to develop this renewable energy sector further. There is also the potential to introduce programmes (funding dependent) to upgrade/ retro-fit the housing stock to make them more energy efficient.

12. As well as delivering environmental benefits, there is also the potential to deliver significant economic benefits and create jobs.

5. Other observations and suggestions

Introduction

1. This section sets out broader observations and suggestions identified.

Linking funding to Programme for Government (PfG) priorities and an outcomes-based framework

2. The Draft Budget, as presented, allocates funding to individual Government Departments. On one level this is a reasonable approach because Departments spend the money, but it re-enforces the status quo and a siloed approach to service delivery. In contrast, the PfG has been developed using an outcomes-based framework and target indicators are monitored for each PfG objective.

3. In challenging times with a challenging budget settlement, priorities will change and allocating funding along PfG priorities, would give the Executive and the public greater transparency on how the money is being allocated.

4. It is recognised that the PfG is a multi-year plan and therefore it may be more appropriate to align it with a multi-year budget. Nevertheless, as a minimum, a signalling of this intention would be important.

Health spending increases are not sustainable in the longer term

5. As per this Draft Budget document, Health is budgeted to consume 50% of the total Resource Departmental Budget in 2021/22 compared to 46% in 2015/16 and 42% in 2010/11. Clearly the pandemic has created huge demand on the health service over the last year, with the prospect of a significant backlog of non-COVID cases to be treated in the coming years. This will put further pressure on the Executive's budget, but long term this increase in spending is not sustainable.

6. It has been acknowledged for some time that difficult decisions need to be taken and given the pressures on budgets, measures such as the prescription charges, water charges, tuition fees and the welfare reform mitigations will have to be re-visited.

Reform is critical

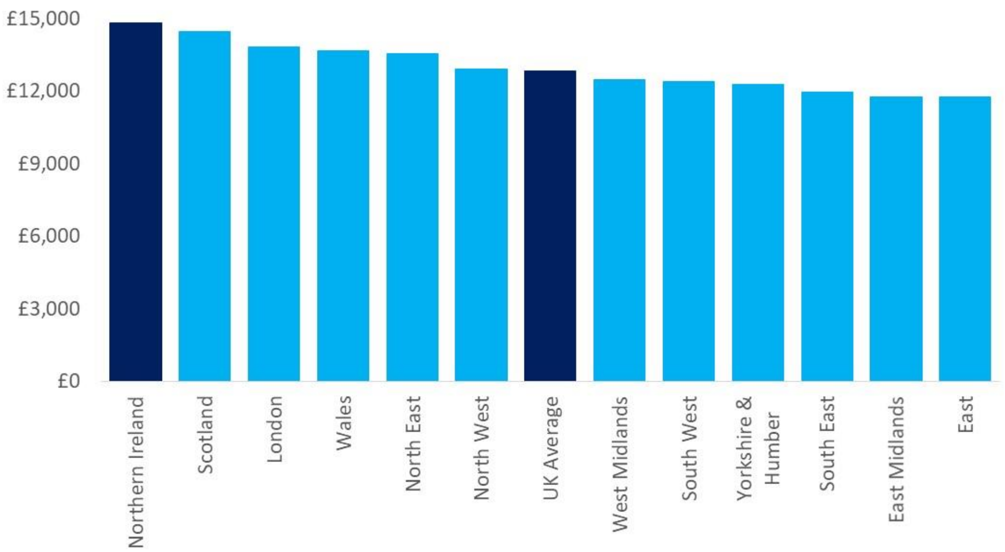
7. This crisis has fundamentally changed the way public services are delivered and whilst there is an expectation of a return to something 'closer to normal' when the vaccine programme is fully rolled out, some new ways of working are more efficient and should be retained. The crisis has therefore created a potential environment for reform based on the lessons learned over the last year.

8. Other fundamental reforms are referenced within the budget document, most notably Bengoa, but it is not clear if funding is being made available in this budget to finance the reform (although it will be a multi-year programme). It is recognised that health

service workers have been under huge strain over a prolonged period of time dealing with this crisis and the demand for the non-COVID health issues arising will be a feature for several years moving forward. Therefore, a risk arises that the more fundamental reform needed could be delayed further.

9. More broadly Northern Ireland has historically had higher levels of spending per capita on public services without necessarily achieving better outcomes. Total government spending per capita in Northern Ireland is higher than all other regions in the UK (NI: £14,821 compared to UK average: £12,835). Therefore, whilst the amount of money spent is clearly important, *how* money is spent is also a critical issue. There may be some reasons to explain higher costs (e.g. more dispersed rural communities) but any reform agenda must identify lessons from elsewhere for application in Northern Ireland.

Total Managed Expenditure per capita, UK Regions, 2018



The need for multi-year budgets (or at least greater EYF)

10. It is widely recognised that managing large complex budgets on an annual basis significantly impacts the ability of Ministers and their senior officials to make longer term strategic decisions and to plan the delivery of public services.

11. We understand it was the intention of HM Treasury to provide multi-year budgets to facilitate planning and service delivery, but due to the significant uncertainty created by the pandemic, the decision was taken to operate single year budgets. Given the unique current circumstances, that decision is reasonable, but HMT rules make it very difficult for Government Departments to implement support programmes and allocate the funding before the end of the financial year.

12. This situation creates the risk that money could be spent in areas which deliver lower value for money to avoid surrendering the money to HMT at the year end. Therefore,

a relaxation of the rules to allow for greater End Year Flexibility (EYF) should be considered, before multi-year budgets can be implemented.

The approach to developing resource budgets promotes the status quo

13. The Resource Budget is set on an incremental basis (i.e. the previous year's budget is the starting point with changes applied as appropriate). This is a reasonable approach to take when setting annual operational budgets, but over the longer term it creates a culture of "we continue to do what we have always done". In addition, when funding cuts need to be made, it promotes a 'salami slicing' approach, cutting a similar proportion of funding from all programmes irrespective of their effectiveness. Where a step change is required, a more fundamental review of spending may be appropriate.

Understanding the effectiveness of Government spending

13. Observations on a budget allocation typically results in a series of comments (critical or otherwise) suggesting a greater or lesser amount of money should have been allocated to one Department over another. To make a properly informed decision, it is important to understand how well money is spent across government programmes. Additional funding could be allocated to a Department or PfG priority that enjoys cross-party and public support, but that is not a guarantee that the programme funded would deliver value for money.

14. Therefore, a framework that demonstrates the effectiveness of government spending and the 'return on investment' can help to give a better informed view when allocating funding.

15. This will be particularly important as it is apparent that the Shared Prosperity Fund (SPF), will not fully replace EU Structural Funds and therefore a robust needs-based approach should be used to identify the programmes to be retained.

COVID challenges (and funding) will continue – but for how long?

16. The budget, as presented, represents a 'Business As Usual' position, in that funding for COVID initiatives and support are not included. This is reasonable as it allows for a like-for-like comparison with previous years.

17. Schemes such as the CJRS and SEISS are administered and funded nationally and therefore will not impact the Northern Ireland Budget, but other support schemes such as non-domestic rates relief are funded locally and therefore will require either additional allocations from Westminster or a reallocation with the NI Block. As the challenges associated with COVID will continue into 2021/22, and given the UK Government has demonstrated a willingness to do what it takes, it is reasonable to assume at this point, that additional funding will follow. However, it is important that the lessons learned from the implementation of local schemes to date are applied to ensure the best use of additional COVID funding in the next financial year.

18. Separately, one obvious area for additional COVID funding is Health. Significant additional funding has been made available to address the direct impact of COVID (i.e. treating patients with the virus, purchase of PPE etc.) and this will most likely continue into 2021/22. However, the last year has left a huge challenge in terms of the indirect impact of COVID (i.e. increased waiting lists for people with non-COVID related health issues). It is not clear from the information provided, the extent to which those challenges will be addressed from the funding allocated. [It is perhaps unrealistic to expect this level of detail in a Draft Budget document, but it will be important to monitor moving forward].