

**PUBLIC EXPENDITURE IN THE REGIONAL ECONOMY OF NORTHERN
IRELAND: HAS THE GROWTH OF THE 1970s BEEN SUSTAINED?**

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1. INTRODUCTION

In recent decades political and economic interest has focused on a phenomenon known as the 'growth of government', a euphemism for rising public expenditure. Studies that have focused on the process are broadly classified into three distinct areas - those that highlight the phenomenon (Saunders and Klau, 1985); those that identify the contributory factors (Henrekson, 1990) and those that embrace both approaches (Lybeck and Henrekson, 1988; Gemmell, 1993). Whilst such studies highlight the differing rates of growth in public expenditure across the industrialised nations of the world, there are a number of common strands. For example, the 1950s and 1960s were generally viewed as a period of stable growth, whereas in the 1970s, especially since the first oil crises of 1973, there was dramatic growth due to rising levels of unemployment and expansionary fiscal policies. However, the 1980s and 1990s represent a sea change in the pattern of public expenditure growth. During this period the consensus has been that the size of the public sector has exceeded the willingness of the voter-tax-payer to finance it. As a result, there is greater pressure on fiscal budgets and policies¹ have been introduced to reduce the role of the public sector generally and public expenditure in particular.

Clearly the above reference to the international literature on the growth of public expenditure is intended merely as background to this paper, for, whilst the same phenomenon is under examination, the context is somewhat different. Northern Ireland (NI), during the period under review, was not a sovereign state but rather a region of the United Kingdom (UK) ruled directly by central government in London, with only a limited degree of autonomous power (Barnett and Hutchinson, 1998a). This has important implications for public finance issues, particularly when we consider any fiscal imbalance between public revenue and public expenditure. We return to this point at a later stage of the paper.

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In terms of the overall objective of the paper, the primary focus for analysis relates to the way in which the growth of public expenditure in Northern Ireland has changed since the 1970s. Simpson (1980) documented this period and highlighted that public expenditure grew at a dramatic rate, due to a combination of factors: expanding the level of public services; counteracting local economic problems, particularly job losses within the manufacturing sector and addressing the problems of the so-called 'troubles'. However, what of the 1980s and 1990s? Has this period marked a change in the pattern of public expenditure growth in Northern Ireland? Has there been a return to a level of public expenditure more in keeping with the rest of the UK? It is to these issues that this paper seeks to address.

We begin the next section with a brief examination of the mechanism through which public expenditure is allocated to Northern Ireland. The issue that is central to this section is that of the Barnett formula - the method for allocating increments/decrements in public expenditure to the regions of the UK. We then place the discussion in context by examining the trends in public expenditure from 1982 to 1995 across the four territorial regions of the UK: England, Scotland, Wales and Northern Ireland. In the fourth section we analyse the trends in Northern Ireland public expenditure, in total and by function and economic category. The fifth section briefly examines the issue of funding, with two important and interrelated questions being addressed: what proportion of Northern Ireland public expenditure is financed by revenue generated within Northern Ireland? What is the scale of the fiscal support or the *subvention* from the UK central government? The final section of the paper assesses the impact of the imbalance between public revenue and public expenditure in Northern Ireland and presents some concluding remarks.

2. ALLOCATION OF PUBLIC EXPENDITURE IN THE UK

Within the annual *Public Expenditure Survey* (PES) which, until recently², has been the focus for all expenditure decisions in the UK, Northern Ireland public expenditure is allocated by means of a block/formula system. The origins of this approach can be traced back to the mid 1970s when the issue of devolution for Scotland and Wales was debated. Whilst a period of almost twenty-five years will have elapsed from the time of debate to fruition³, the process more clearly specified the expenditure responsibilities of the territorial departments (Heald, 1992). For the purposes of planning and regularity, Northern Ireland - similar to Scotland and Wales - has been treated as a single block within the annual PES system. Although the respective Secretaries of State have discretion to switch funds within their block, this discretion is limited in that any changes must be shown to be consistent with national government policy. In Northern Ireland, the block allocates almost all programme expenditure (98 percent in 1995/96) - expenditure by the local agricultural department on national agricultural and fisheries support is excluded. However this overstates the real discretion open to the Secretary of State as social security is 'ring-fenced' (Thain and Wright, 1995). Once this item is deducted, the block, or more specifically the managed block, comprises 63 percent of programme

expenditure in Northern Ireland in 1995. In 1978 a 'formula' was introduced, based on the population balance between England, Scotland and Wales, which allocates marginal changes in block expenditure to the aforementioned regions. The formula used the ratio of 85:10:5 reflecting the relative share of each region.⁴ The formula is commonly referred to as the 'Barnett formula', after Joel Barnett, the Chief Secretary to the Treasury in the 1974-79 Labour government in the UK. Similar arrangements were agreed for Northern Ireland⁵, although its formula is expressed in percentage terms and is based on the provinces share of total UK population, rather than that of Great Britain (GB) as is the case for Scotland and Wales. It is important to stress that the formula is only applied to expenditure within the blocks managed by the Secretaries of State; non-block expenditure is determined through the conventional bidding process.

Heald (1994) argues that there are two components to block expenditure: (i) the inherited expenditure base which dates back to the period when the formula was first implemented and (ii) the incremental expenditure determined by the application of the formula. In 1992 the formulas were adjusted to take account of population changes revealed in the 1991 Census returns.⁶ For Northern Ireland this meant that the block was adjusted by applying a percentage of 2.87 (previously 2.75) to the totality of changes in comparable GB programmes. A more recent amendment in 1997 has resulted in the province's share rising to 2.91 percent. As Heald (1992) observes, the formula arrangements would ensure that if public expenditure were to rise over time in real terms, then the formula would tend to bring territorial expenditure into line with that prevailing in England. Section 3 will highlight if this has been the case.

Although the equitable nature of the block/formula system is not an issue that we seek to debate within this paper, it is nonetheless important to highlight a number of features that influence its operation. For example, whilst the procedure possesses the obvious benefits of being simple to operate and relatively inexpensive in terms of administration costs, there is concern that it is too generous to the territories and is also open to abuse. One problem has been that the formula used the same population proportions from 1978/79 to 1993/94, not taking into account any changes in this variable.⁷ In the context of Scotland, the well-documented decline in population⁸ would explain the advantage that this region received in terms of identifiable public expenditure per capita, see Section 3, and also suggests that any process of convergence of per capita relatives would be prevented. Although relative population increases have worked in the opposite way for Northern Ireland, the allocation of resources above comparability has partly offset this. The label given to this process is that of formula bypass (Heald, 1994). For example, the regions tend to benefit from the fact that additional expenditure allocations occurring during the financial year - pay awards is one example - are allocated on the basis of actual cost, not through the formula. Therefore, since regions such as Scotland and Northern Ireland spend more per capita on health (a labour intensive service) than England, they are likely to gain a larger share of additional resources; more than what the

Barnett formula would dictate. However, the consensus appears to be that the allocation of public expenditure in the territories has generally been on the basis of need and despite being a non-statutory arrangement, there is what Thain and Wright (1995, p.316) remark as, a “*willingness on both sides (UK Treasury and territorial departments) to take the rough with the smooth .. that gains will be offset by some losses*”. What concerns us now is whether the block/formula arrangements have secured their long-term aim of bringing about a convergence in per capita expenditure in Scotland, Wales and Northern Ireland with that prevailing in England?

3. REGIONAL PUBLIC EXPENDITURE IN THE UK

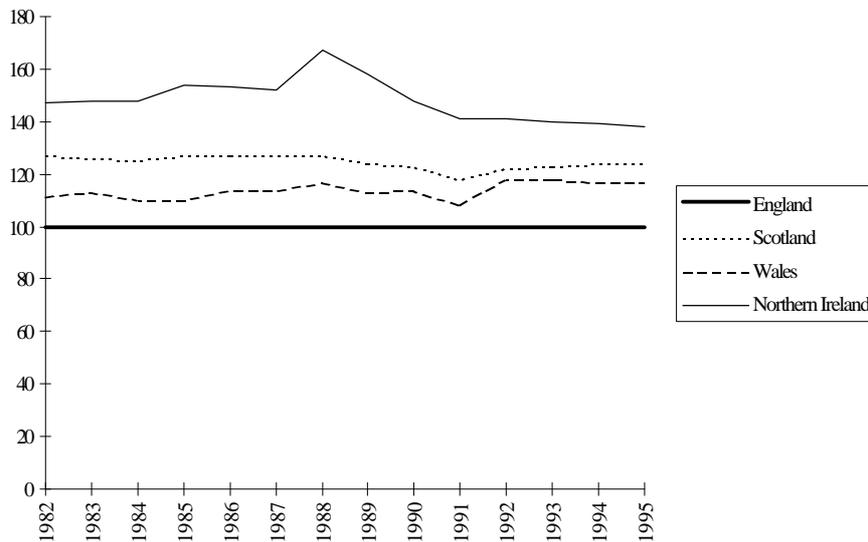
Comparisons between Northern Ireland and the rest of the UK in terms of public expenditure are difficult, given that there is a lack of information regarding the flows of expenditure *between* the regions of Great Britain. The approach that the UK government has employed to counteract this problem has been to introduce the concept of ‘identifiable’ expenditure, on a cash and per capita basis. Essentially this refers to that portion of public expenditure that can be identified from official records as having incurred on behalf of a particular population. It is this figure that has been used as the basis for political debate regarding issues of subsidisation across the regions of the UK, particularly in Scotland and Northern Ireland. Therefore, given the prominence that the variable has received it is important to outline a number of its features. Firstly, the figure does not take account of overall public expenditure. Identifiable public expenditure currently accounts for around 85 percent of total public expenditure in the UK - defence and overseas aid are the two major areas omitted as they are considered to be incurred on behalf of the UK as a whole. Secondly, it is impossible to construct a consistent time series of identifiable public expenditure, certainly over the long run. This reflects the fact that the series is based on the PES system and thus the figures are only consistent for as long as the survey is. Moreover, redefinitions of public expenditure, such as that which occurred in 1990 when local authority expenditure was removed and substituted with support/grants from central to local government, means that whereas identifiable expenditure analysed the old planing total until 1988, it is now analysed by the *General Government Expenditure* (GGE). The GGE is a national accounts aggregate which covers expenditure by central and local government, *not* transfers between them. With due emphasis placed on these caveats, we are now in a position to consider Figure 1 which represents identifiable public expenditure per head in Scotland, Wales and Northern Ireland, with England set to 100 for the period 1982-95, a period where UK public expenditure continued to grow (Heald, 1997).

The trends in Figure 1 would highlight that public expenditure per capita in Northern Ireland is higher than the other regions of the UK, although there appears to be a degree of convergence. For example, from 1982 to 1987 identifiable public expenditure per capita in Northern Ireland was, on average, 50 percent greater than in England; 34 per greater than in Wales and (only) 19 percent greater than in

Scotland. The two years - 1988/89 and 1989/90 - were somewhat unique in Northern Ireland as far as public expenditure was concerned in that the Industry, Energy, Trade and Employment component was enlarged due to the privatisation of Shorts Brothers and Harland and Wolff.

From 1990, identifiable public expenditure per capita in Northern Ireland has remained higher than any other region of the UK, however the differential has narrowed. For example, up until 1995, the level on average has been 41 percent higher than in England; 22 percent higher than in Wales and 15 percent higher than in Scotland. However, what do these figures suggest about the process of convergence?

Figure 1 Per Capita Identifiable Public Expenditure in Scotland, Wales and Northern Ireland as a percentage of English Identifiable Expenditure.



Source: Various Issues of Public Expenditure Analyses: Statistical Summary

From the trends illustrated in Figure 1, there are two points to stress. Firstly, whilst there has been some reduction in the growth of per capita expenditure in Northern Ireland, Figure 1 illustrates that the level still remains different from and higher than the level prevailing in the other regions of the UK. Secondly, it is difficult to determine the impact of the Barnett formula on the basis of Figure 1. For instance, identifiable public expenditure includes the social security programme, but this is outside the managed block and thus outside the scope of the Barnett formula. Once the social security programme is deducted the process of convergence is shown to be even weaker (Barnett and Hutchinson, 1998a). Clearly the process of convergence

has been hampered by failure to revise the formula (until recently) on the basis of population shifts - to the benefit of Scotland - and also the allocation of additional resources above comparability in the case of Northern Ireland. We now turn to examine public expenditure and the funding arrangements in the province in greater detail.

4. PUBLIC EXPENDITURE IN NORTHERN IRELAND, 1980-1996

The difficulty in compiling a consistent time series of public expenditure in Northern Ireland is a reflection of the frequent definitional and accounting revisions that are common in most macroeconomic variables, but particularly within public spending. In an effort to highlight these problems, but also for purposes of coherence, we address three areas in this section. Firstly, the definition of public expenditure used within the paper is clarified. Secondly, a brief discussion is made regarding the way in which public expenditure is measured. Finally, public expenditure is analysed by total, and then decomposed by function and economic category.

Definition of Public Expenditure

Although there is no unique definition of public expenditure, see McNutt (1996), in the context of this paper the term is used to include all expenditure by general government and the external financing requirements of public corporations and nationalised industries. As subsequent tables will indicate, the classification of public spending in Northern Ireland may be termed as the programme total, covering expenditure by the central government departments, *the Northern Ireland Office* (NIO) and the *Ministry of Agriculture, Fisheries and Food* (MAFF). Although the official presentation of public spending has focused, until recently, on the *New Control Total* (NCT)⁹ which mainly nets out the cyclical element in the social security budget, this was not pursued in the paper as it would lower the *actual* level of public spending in the province. Items excluded in the definition of public expenditure are the spending by other UK central government departments which are active in providing services in the province - courts service (Lord Chancellor's department) and the extra cost of the army (Ministry of Defence).

Measurement of Public Expenditure

In common with the definitional issues previously outlined, there is no single nor uniformly acceptable measure of public expenditure. Whilst the most common approach has been to relate public spending to *Gross Domestic Product* (GDP), there is, at least, one methodological problem associated with this. For example, total public expenditure relative to GDP includes one component, transfer payments, that forms part of the numerator but not part of the denominator.¹⁰ Henrekson (1990) outlines that the ratio, given the presence of taxable transfers, may actually exceed unity. However, despite this problem we use the ratio in this paper to approximate the level of public expenditure in Northern Ireland, not just because it is the most commonly used but also because there are no superior alternatives.

The conversion of public expenditure from cash to real terms gives rise to the question of appropriate deflators. The standard procedure has been to deflate the monetary value by a single deflator, usually the GDP price deflator (Mullard, 1993). However, this approach is unsuitable given that the series is too general to account for inflation within government. We favour the series used by Simpson (1980) and derived from various issues of the National Income Blue Book, namely an index of the price of goods and services purchased by the public sector in the UK. The figures are rebased to 1990 prices.

Trends in Public Expenditure in Northern Ireland, 1980-1996

Table 1 outlines public expenditure by total and functional category for the period 1979/80 - 1995/96. Simpson (1980) analysed an earlier period (1967/68 - 1978/79) and found that real public expenditure had grown significantly¹¹, but the most dramatic period of growth was concentrated in the early 1970s. Reference to Table 1 would illustrate that whilst public expenditure in Northern Ireland has continued to grow, the rate has been nothing as dramatic as that experienced in the 1970s. Table 1 shows that total public expenditure grew over the period by 8.4 percent in real terms, which represents an annual growth of only 0.5 percent. The table also displays the sensitivity of public expenditure to movements in the economic cycle. For instance, periods of growth are particularly associated with recessionary conditions such as 1990/91-1992/93, where real growth was almost 8 percent. However, it is perhaps by examining the PE/GDP¹² ratio that the most revealing aspects of public expenditure in Northern Ireland emerge. For example, whilst the ratio is substantially higher in Northern Ireland relative to the UK as a whole¹³, there has been a general downward movement over the period; from 68.9 percent in 1979/80 to 59.1 percent in 1995/96. This finding is consistent with the international experience¹⁴, which, as Oxley and Martin (1991) argue, reflects concerns over the impact of a continuing public sector expansion on private sector performance¹⁵ and greater appreciation of the social costs of higher taxation.

	PE/GDP in parentheses	Energy, Trade & Employment	and Roads	Services	and Order**	Science, Arts and Libraries	and Social Services	Security	Public Services		
1979/80	6261 (68.9)	263	864	280	526	258	628	963	945	1464	35
1980/81	5834 (70.5)	176	676	240	478	244	636	916	968	1432	32
1981/82	5727 (71.5)	168	633	220	413	238	619	880	963	1526	28
1982/83	5735 (71.1)	202	561	180	460	239	597	864	953	1610	31
1983/84	5844 (70.6)	228	547	190	458	270	591	888	971	1662	40
1984/85	5924 (69.9)	230	611	178	491	210	609	845	971	1736	42
1985/86	5960 (66.4)	211	612	170	479	211	632	834	967	1799	46
1986/87	5950 (63.8)	206	466	167	440	213	659	912	983	1853	52
1987/88	6015 (63.6)	193	483	153	417	225	708	928	1002	1856	48
1988/89	6347 (64.6)	173	843	160	388	231	708	942	1033	1815	53
1989/90	6208 (62.0)	199	720	165	289	225	756	970	1026	1816	44
1990/91	5899 (58.4)	195	382	150	246	235	732	1006	1050	1836	44
1991/92	6099 (58.3)	200	334	155	240	163	793	1059	1099	1966	48
1992/93	6342 (59.8)	197	321	151	234	175	853	1077	1124	2118	47
1993/94	6607 (60.5)	221	364	151	205	173	859	1081	1159	2267	55
1994/95	6752 (59.9)	255	366	150	192	176	847	1098	1203	2348	64
1995/96	6786 (59.1)	233	353	143	202	178	802	1113	1247	2411	51

* Includes expenditure in Northern Ireland by the Ministry of Agriculture, Fisheries and Food (MAFF)

** Includes expenditure by the Northern Ireland Office

*** Between 1979/80 and 1982/83 the functional classification excludes expenditure on Common Services - functions do not sum to total in this period. Thereafter this is spread across the various other programmes

**** ERDF - European Regional Development Fund

Source: Expenditure Plans and Priorities (Northern Ireland) - various issues

However, to correctly interpret this pattern of public expenditure growth in Northern Ireland, we must examine the functions and economic categories on which it has been spent. A revision in the presentation of public expenditure by economic category means that the analysis on this component is over the shorter period, 1983/84-1995/96.

On the basis of the functional analysis of public expenditure presented in Table 1, we have some indication of the areas of priority in public spending. Unlike Simpson (1980) there is no classification made between social and economic services since this approach appears to be on a purely arbitrary basis and the interpretation simplistic. Rather from Table 1, it appears that those areas of growth include law and order (27.7 percent); health (31.7 percent); education (15.6 percent) and social security (64.7 percent). Those services that have experienced a real reduction over the period include agriculture (11.4 percent), industry/employment (59.1 percent) and transport/roads (61.6 percent). Obviously the growth in the social security programme is the one area that presents the greatest worry to policy makers. The programme offers little in the way of public service provision and is more a reflection of local economic problems, particularly the high level of unemployment. For example, the province over the period reviewed had an average unemployment rate of 13.4 percent, compared with a GB average of 8.3 percent.

Finally, before we analyse public expenditure by economic category it is important to outline the share that each function made to total public expenditure. Table 2 outlines this for the financial years 1979/80, 1986/87 and 1995/96.

Table 2: Percentage Share of Public Expenditure in Northern Ireland

	1979/80	1986/87	1995/96
Agriculture (& MAFF)	4.2	3.5	3.4
Industry etc	13.8	7.8	5.2
Transport and Roads	4.5	2.8	2.1
Housing	8.3	7.4	3.0
Environment	4.1	3.6	2.6
Law and Order (& NIO)	10.0	11.1	11.8
Education	15.2	15.3	16.4
Health	15.1	16.5	18.4
Social Security	23.4	31.1	35.5
Other Public Services	1.4	0.9	0.8

Source: Northern Ireland Expenditure Plans and Priorities - various issues

The main point to be drawn from this is that social security is the most dominant function in the whole public spending programme, followed by health and education. Law and order, whilst experiencing significant real growth - due to the volatile

security situation over most of the period - only accounts for 11.8 percent of the total in 1995/96.

For purposes of planning, public expenditure is decomposed by function and this has the benefit of highlighting those areas of priority that have contributed to the overall trend in the total. An economic classification, however, allows for an assessment of the inter-relationship between public spending and the rest of the economy; it provides some indication of the way in which public spending has affected the Northern Ireland economy. Table 3 shows the breakdown of the public expenditure total by economic category for the period 1983/84 - 1995/96. The first two components in Table 3 - departmental running costs and other public service pay¹⁶ - can broadly be taken to indicate the contribution that public sector employment has had on public expenditure. The sum total of both these categories increased in real terms over the period by 18 percent, or 1.4 percent annually. This moderate rate of growth can be contrasted with that observed by Simpson (1980) who highlighted that a similar component - current expenditure on goods and services - grew substantially over the period 1967/68-1978/79.¹⁷

The reason for this disparity is due, in the most part, to the pattern of public sector employment. For example, Barnett and Hutchinson (1998b) showed that the most rapid period of expansion in public sector employment took place in the 1970s - 40 percent between 1970 and 1974 and a further 25 percent between 1974 and 1979. However, subsequent to this period of growth there has been a steady decline in public employment levels (9.5 percent between 1980 and 1994). This trend is perhaps the main explanation for the moderate growth in public expenditure shown earlier. In other words, the economic arguments for a downsizing of government (Musgrave, 1997) may be viewed in Northern Ireland as a reduction in the absolute level of public sector employees.

Table 3 also illustrates that the subsidies component fell substantially by 30 percent in real terms. This is similar to the downward trend in capital grants which fell by 49 percent and movements in both these variables would reflect the growing reticence of the public sector to provide wholesale financial support to the private sector. This factor can be observed in two key policy documents - Pathfinder (DED, 1987) and Competing in the 1990s (DED, 1990). The aim of both these documents was to identify problems in the Northern Ireland economy and one common thread was that heavy reliance on public funds by many local companies was insulating them from genuine competition and thus hindering innovation and growth. These documents, particularly the latter one, stressed that public assistance should be limited to providing help in overcoming constraints on competitiveness (Clulow and Teague, 1993).

Table 3: Public Expenditure in Northern Ireland by Economic Category (STG£ 1990)

	1995/96	1994/95	1993/94	1992/93	1991/92	1990/91	1989/90	1988/89	1987/88	1986/87	1985/86	1984/85	1983/84
Departmental running costs (net of related receipts)	513	533	547	559	561	528	508	469	476	459	446	440	
Other public service pay & other current expenditure on goods and services	2528	2483	2393	2331	2292	2294	2252	2254	2207	2148	2073	2048	2576
Subsidies	291	286	276	252	269	253	267	295	298	315	414	431	415
Current grants	2947	2890	2817	2625	2412	2205	2163	2201	2230	2239	2168	2117	1986
Net capital expenditure on assets	263	276	275	291	271	260	257	230	230	218	199	201	279
Capital grants	180	203	224	209	247	261	286	308	354	417	439	404	352
Lending and other financial transactions	65	83	76	74	48	98	476	589	217	151	217	283	237
TOTAL	6786	6752	6607	6342	6100	5899	6208	6346	6012	5948	5957	5924	5845

It is this movement away from general fiscal support to that which is more focused and specific which accounts for the trends observed in both subsidies and capital grants.

The one area in Table 3 that has experienced significant growth was that of current grants. This component, which mostly includes social security benefits - (82 percent in 1995/95; remainder includes grants to non-profit making bodies outside the public sector and grants to district councils) - grew by 48.4 percent over the period. This finding is consistent with that observed in Table 1, namely that policies of redistribution currently represent the core activities of the public sector in Northern Ireland. Regarding net capital expenditure on assets and lending/other financial transactions, both these components fell by 6 percent and 73 percent respectively. The high levels of spending for lending/other financial transactions in 1988/89 and 1989/90 would reflect the payments that the *Industrial Development Board* (IDB) made on behalf of the government for the privatisation of Shorts Brothers and Harland and Wolff, a point highlighted earlier in Figure 1.

5. REVENUE IN NORTHERN IRELAND, 1980-1996

One legacy of the period of devolution in Northern Ireland (1920-1972) is that a separate Exchequer still presents, for administrative purposes, the analysis of the local fiscal budget (Simpson, 1980). The implication of this is that separate revenue accounts still exist for Northern Ireland, a situation unique to the province. In this section of the paper we begin by assessing the various sources of revenue that fund the levels of public expenditure previously discussed. Then on the basis of empirical evidence, we address the two questions raised in the introductory remarks: what proportion of public expenditure in Northern Ireland is financed by revenue generated locally and what is the scale and growth of the subvention from the UK central government?

Sources of Revenue

In broad terms there are two main sources of revenue in Northern Ireland, revenues generated in or attributable to the province (tax and non-tax) and payments from the UK central government. Table 4 outlines current revenue in Northern Ireland over the period 1979/80 - 1995/96, and it is important that each component is carefully specified.

From 1972, the change in the mode of governance in Northern Ireland resulted in the previous division between transferred and reserved taxes being no longer valid. Although Northern Ireland is currently returning to a system of devolved government, the position that existed throughout the period reviewed in this paper was that of direct rule, and with this nearly all taxation was levied from Westminster. The current arrangements for devolved government in the province have made no

provision for tax varying powers, a point (and problem) that we return to in the next section of the paper.

The Northern Ireland share of taxation is remitted to the UK Consolidated Fund in the first instance, from which the local share is transferred into the Northern Ireland Consolidated Fund, although this is net of two items - the cost of collecting the taxes and the province's contribution to the European Union (EU). Calculation of the attributable share of taxes is either on the basis of proportions¹⁸ (for VAT and other taxes levied by Customs and Excise, income and corporation tax) or on the amount actually collected (for motor vehicle duty, capital gains tax, estate duty and stamp duty).

Non-tax revenue in Northern Ireland consists of rates - a regional rate which contributes to the cost of UK central government services and a district rate for the cost of local district services - and also proceeds from such areas as land annuities, interest on advances and repayment of loans.

As Table 4 illustrates, the largest area of revenue received from the UK central government is a grant-in-aid. This item, a product of the 1973 Constitution Act, abolished most of the special forms of assistance for the province and replaced them with the annually estimated grant-in-aid, which helps cover the gap between public expenditure in the province and the amount of revenue raised locally. Other items of 'support' include a balancing transfer between the GB National Insurance Fund and its Northern Ireland counterpart¹⁹ and also the refund of VAT payments by Northern Ireland government departments. These items - together with expenditure by the NIO and MAFF - form the basis of the 'subvention'. Other areas such as the cost of army operations in Northern Ireland over-and-above normal garrisoning (funded by the Ministry of Defence) and the cost of operating the courts service (funded by the Lord Chancellor's department) ought to comprise the subvention as well. However, as we excluded them from the expenditure side it would be incorrect to include them as revenue. The ensuing discussion, which outlines the trends in public revenue, presents the partial subvention in common with Hewitt (1990) and Smyth (1993) and also outlines what the level would be if defence and courts items were included.²⁰

Table 4: Northern Ireland Current Public Revenue (STG£ m)

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
	Total Revenue Generated In Northern Ireland*	Attributed Share Of UK Taxes (Net)	National Insurance Contributions	Rates	Miscellaneous Receipts	Total Receipts From UK Government**	Grant In Aid	National Insurance Transfer	VAT Refund
1979/80	3877	2535	672	271	398	1671	1463	179	29
1980/81	3640	2473	520	266	381	1511	1280	199	32
1981/82	3887	2602	563	272	451	1233	1032	169	32
1982/83	3875	2600	584	269	421	1186	1019	137	29
1983/84	3763	2414	624	261	463	1347	1187	118	42
1984/85	3778	2402	636	280	460	1494	1319	138	36
1985/86	3858	2504	599	288	466	1443	1323	83	37
1986/87	4049	2665	607	319	457	1382	1109	230	44
1987/88	4030	2667	624	311	428	1288	1058	192	38
1988/89	4104	2768	621	321	394	1758	1510	215	34
1989/90	4055	2785	610	333	327	1500	1242	227	31
1990/91	4046	2829	617	341	259	1331	1065	225	41
1991/92	3917	2757	643	202	315	1548	1409	118	21
1992/93	3555	2465	657	185	248	1992	1956	36	-
1993/94	3816	2678	676	176	286	2107	2072	35	-
1994/95	4605	3436	717	191	261	1523	1399	123	-
1995/96	4365	3207	709	202	247	1852	1749	103	-

* Total calculated by summing columns 2-5

** Total calculated by summing columns 7-9

*** Total calculated by summing column 1 and 6

Source: Financial Statement (Northern Ireland) - various issues

Trends in Public Revenue in Northern Ireland, 1980-1996

The present expenditure based system of public finance in Northern Ireland means that expenditure decisions take priority over revenue and it is only when such decisions are taken that sufficient funds are then made available for financing purposes. The obvious and natural implication of this is that less importance is attached to the revenue side of local public finance - a feature reflected in this paper. However, a closer examination of Table 4 still provides some useful information.

Table 4 shows how the sources of public revenue in Northern Ireland have altered over the period 1979/80 - 1995/96. Two interesting points emerge. Firstly, it is clear that the revenue generated in Northern Ireland only accounts for 72 percent (average over the period) of total current revenue; the balance, as we shall shortly observe, is made up of transfers from the UK central government. In certain years such as 1992/93 and 1993/94, the Northern Ireland contribution to total revenue was less (64 percent) reflecting the impact of the recession. Secondly, in answer to the question posed earlier, the proportion of public expenditure in Northern Ireland financed by locally generated revenue is somewhere between 56 and 69 percent (average of 65 percent). Specific variations will again depend on the condition of the local economy.

Table 5 illustrates the growth in the subvention from the UK central government over the period 1979/80-1995/96. The real level of the subvention (measured in 1990 prices) increased from STG£2,372 million in 1979/80 to STG£2,744 million in 1995/96 or 15.7 percent. The table also indicates that, if the additional costs associated with army operations in the province and the courts service were included, the level of the subvention would be greater by somewhere in the region of 9 to 14 percent. In 1992/93, the level of the 'full' subvention was STG£3,597 million (cash terms), which is equivalent to almost STG£2,300 per head of the population in Northern Ireland. Finally, Simpson (1980) found that the percentage of public expenditure in Northern Ireland financed by transferred funds was 38 percent. In 1995/96 the comparable figure was 40 percent. Thus a feature of public finance in Northern Ireland is that a significant proportion of public expenditure is financed by means of transfers from Westminster. Moreover, as Hewitt (1990, p.373) remarks, "*one consequence of this level of support is that a substantial proportion of capital expenditure in Northern Ireland has been funded by a surplus of current revenue over current expenditure*".

Table 5: United Kingdom Subvention to Northern Ireland (STG£ m)

	Total*	Maff Expenditure In Northern Ireland	National Insurance Transfers	Grant In Aid	Northern Ireland Office Expenditure	Vat Refunds	Defence Expenditure**	Courts Expenditure
1979/80	956	37	72	590	245	12	96	4
1980/81	1098	35	99	640	308	16	111	6
1981/82	1073	35	96	585	339	18	149	7
1982/83	1141	52	85	630	356	18	143	7
1983/84	1302	51	77	775	372	27	141	14
1984/85	1479	53	95	905	401	25	121	14
1985/86	1544	65	60	955	437	27	135	13
1986/87	1606	72	175	845	481	33	144	14
1987/88	1656	69	155	855	546	31	168	16
1988/89	2159	63	185	1300	582	29	174	23
1989/90	2108	80	210	1150	639	29	201	28
1990/91	2117	86	225	1065	700	41	218	28
1991/92	2543	95	125	1495	806	22	317	32
1992/93	3236	95	40	2185	916	-	320	41
1993/94	3505	121	40	2392	952	-	-	-
1994/95	2895	141	145	1650	959	-	-	-
1995/96	3340	152	125	2129	934	-	-	-

* Total excludes defence expenditure (by Ministry of Defence) and courts expenditure (by Lord Chancellor's department)

** Discontinuity with the reporting of the UK subvention in Hansard - see endnote 20 - explains absence of figures

Source: *Financial Statement (Northern Ireland) - various issues; Hansard (House of Lords)*

6. CONCLUDING REMARKS

In comparison with the 1970s, this paper has shown that the rate of growth in public expenditure in Northern Ireland during the 1980s and 1990s has not been as dramatic. In part, this may reflect the general movement towards greater fiscal rectitude - a feature apparent in many OECD countries - although clearly the province had reached an exceptionally high level of public expenditure in 1979 and reductions, particularly given the ideology of the Conservative government at the time, were not unexpected. However, the preoccupation of policy-makers is as much focused, and perhaps more so, on the level of public expenditure as it is with the growth. In this context, Northern Ireland still has a level of public expenditure that is different from and higher than any other region of the UK. This raises two interesting questions that this paper sought to address. Why has the level of public expenditure remained high in Northern Ireland relative to the other UK regions? How has the province been able to sustain this level of public expenditure?

A combination of economic and political factors have contributed to the Northern Ireland maintaining its high level of public expenditure relative to the other regions of the UK. The social security programme grew substantially in real terms and it is also comprises the largest proportion of public expenditure. The high rate of unemployment in Northern Ireland is the main explanatory factor behind these trends observed within the social security programme. Moreover, the continuance of the 'troubles' throughout the period reviewed also necessitated the rise in the law and order budget. Obviously, if Northern Ireland were able to enjoy a sustained period of political peace this would have important implications for the structure of local public finance. Instead of the law and order budget comprising nearly 12 percent of the total fiscal budget in 1995, the proportion would more reflect the overall UK position. For example, in the UK the *Public Order and Safety* programme, which comprises expenditure on police, fire, law courts and prisons, accounts for only 5 percent of total public expenditure.

In terms of the role and operation of the Barnett formula, this paper highlighted that the degree of convergence in regional block expenditure has not happened at a rate that policy-makers would have wished. One feature of the formula is that the base (or inherited) level of public expenditure is not challenged, rather incremental expenditure is allocated by the population share. Failure to adjust the formula, until 1992, for the rising population in Northern Ireland²¹ ought to have contributed to a process of per capita convergence. However, the degree of formula bypass has worked in the opposite direction, with only a marginal degree of convergence apparent. Although UK central government has remained committed to the operation of the formula there have been some calls for its modification. Most notably, Lord Barnett himself has advocated a formula that takes account of rising levels of income per capita in the territorial regions of the UK - the Barnett Formula Mark II (Treasury Committee, 1997). Ostensibly, this proposal stems from the fact

that the present formula does not take account of spending needs, beyond population. Perhaps, as advocated by Treasury officials, it would be appropriate to conduct a needs assessment exercise, similar to that conducted by the Treasury in the late 1970s (Simpson, 1980). Results from such a study may give information relating to the appropriateness of the Barnett formula, how it relates to need and how total expenditure (and not just marginal changes) has been allocated according to need. The movement towards devolved regional government may give further impetus to this proposal.

In terms of how Northern Ireland has been able to sustain this high level of public expenditure, attention must be drawn to the revenue side of public finance. The scale and growth of the subvention - the fiscal transfer of funds from the UK Treasury to fund the deficit between tax revenue raised in the province and public expenditure incurred there - has clearly broken the link between the size of the public sector in Northern Ireland and the need to finance it from indigenous tax resources. It is important, however, to stress that the subvention is not unique to Northern Ireland; the other regions of the UK are also in receipt of similar support (Short, 1981).²² The size of the subvention is perhaps not atypical by international standards (Ahmad, 1997). Nonetheless, in the context of Northern Ireland, what are the implications of these funding arrangements, especially as we move towards a system of devolved regional government? We conclude with three observations.

Firstly, the duration and scale of the fiscal subvention to Northern Ireland has greatly enhanced the social and economic services existing in the province; it has enabled public expenditure to be maintained at a higher level than what it would have otherwise been. Quigley (1995, p.3), while conceding that the public sector still remains the dominant force within the regional economy, states that *“without the resources pumped into the province in the past quarter century, the prospects for durable peace would be much more slender”*. In other words, whilst recognising that the funding arrangements for the large public sector in Northern Ireland have hindered local economic performance there are obvious and important benefits; benefits that perhaps will only become apparent within a climate of political stability.

Secondly, although it is difficult to be precise, one compelling interpretation of events is that the subvention has enabled the public sector to continue its dominant role in the local economy, and this has adversely affected private sector activity. For example, with public wages in the province being covered by UK-wide agreements (private sector wages are determined locally) there has been the emergence of a public to private wage differential (Barnett and Hutchinson, 1998b). This wage formation factor, coupled with much private sector activity being located in low-value-added sectors, has resulted in the public sector being often viewed as an employer of the first resort. One corollary of these issues is that the public sector has traditionally attracted the more skilled and educated members of the workforce²³, and this represents a significant drain on the private sector. Obviously a convergence of public and private wages would be desirable. However, the process

whereby this could be achieved is less clear-cut. A system of decentralised public wage setting may redress the balance (Teague and McCarthy, 1995), but what of the impact on the quality of public service delivery? An alternative approach would be to stimulate private sector activity, raising average private wages and thereby eroding the differential. This approach would also represent a proactive attempt to substantially reduce unemployment in the province and thereby lessen the size of the already large social security programme. The choice will be one of the many challenges that face the new Northern Ireland Assembly.

Finally, this paper has highlighted the importance of considering public finance issues in composition; public expenditure cannot be examined separately from taxation. In the regional context of Northern Ireland, the subvention has been used to fund the high level of public expenditure, and the only criteria for sustaining the level of the subvention has been the political-will of the UK central government (McGregor, Swales and Yin, 1995). Deficit financing for national governments, on the other hand, rests with either raising taxes and/or borrowing, and this clearly represents a real constraint on policy initiatives (Bradley and Wright, 1993). But with the introduction of self-government, and the hope of political stability, public finances in Northern Ireland would be expected to improve or perhaps balance, through greater tax revenue resulting from increased private sector economic growth and reduced expenditure, particularly unemployed assistance. However, associated with this expectation, there ought to be greater appreciation for the need of the devolved government to have its own tax raising powers; a proposal not contained within the *Good Friday Agreement* (Agreement Document, 1998). For example, with the block/formula arrangements to be maintained within the devolved system, it is easy to envisage the increase in tension between the centre and the region. In certain instances, the centre may be criticised for being too parsimonious with public money, whereas the regional government could be charged by the centre for being too wasteful. In short, failure to allocate some tax raising powers in Northern Ireland - perhaps a regional income tax - will result in no clear designation of responsibility for public spending decisions.

Endnotes

1. Perhaps the most widely documented policy designed to reduce the scale of public sector activity in the economy was that of privatisation. However, it is important to remember that the policy is likely to only affect the time pattern of public spending, as the government still remains the main consumer of services (Fleming and Oppenheimer, 1996).
2. The annual *Public Expenditure Survey* was replaced by *the Comprehensive Spending Review* in 1997. This marked an attempt by the incoming Labour administration to review all public expenditure decisions in the UK and target areas of high and low priority (Thain, 1998). One outcome of the review has been that the planning of non-cyclical public expenditure (broadly the old control total) is to be made for three years in advance (Treasury Committee, 1998).
3. Referendums for regional government in Scotland (with tax varying powers) and Wales were held on the 11 and 18 September 1997 respectively. The 'yes' vote was very decisive in Scotland - 74.3 percent for a Scottish parliament and 63.5 percent for tax varying powers (from a turnout of 60.4 percent). In Wales the 'yes' vote was only 50.3 percent (from a turnout of 50.3 percent) - no tax varying powers were offered.
4. The ratio was founded on the shares of the population of Great Britain in 1976 (rounded).
5. Since the Barnett formula was applied to Northern Ireland in 1981, a period where public expenditure reductions appeared probable, not least because of the high baseline level of expenditure in the province and the advent of the Conservative administration in the UK, the attractiveness of the formula in allocating the Northern Ireland block expenditure was obvious. Reductions faced in the province would be minimised relative to the rest of the UK. For example, if expenditure in GB on services equivalent to those in the NI block decreased by STG£100 then the NI block would experience a reduction of STG£2.87 (or from 1998 -STG£2.91).
6. Thain and Wright (1995, p.234) also suggest that the amendments to the formulas may reflect the fiscal crises in the early 1990s. "*The formula was amended in 1992, ostensibly to reflect the results of the 1991 Census, but of equal importance in the decision to revise it was the Chief Secretary's attempt to keep total spending in line with published targets*".
7. Recent debate within the UK Treasury regarding the future of the Barnett formula has resulted in one change: the government has undertaken to update the population figures underlying the operation of the formula from 1999-2000 and annually thereafter (Treasury Committee, 1998).
8. Heald (1992), using official population projections, shows that by 2031 Scotland will have experienced an absolute fall of 13.7 percent from the peak population of 1974. Perhaps the reason why the Barnett formula remained unadjusted for as long as it did was due to political expediency. For example, had the formulas been revised at a sooner date, Scotland would have fared less well and this would have done little to improve the electoral prospects of the then Conservative

administration.

9. The *New Control Total* has been replaced with *Total Managed Expenditure*, although the division between cyclical and non-cyclical expenditure remains. The cyclical part of spending - *Annually Managed Expenditure* - which includes social security spending, will be reviewed on an annual basis. Non-cyclical expenditure will be planned three years in advance under *new Departmental Expenditure Limits*.
10. Transfer payments, as the name suggests, represents a transfer of purchasing power between different socio-economic groupings in society and not payment for specific goods/services, hence it is not part of GDP.
11. At 1990 prices, the rate of growth in total Northern Ireland public expenditure between 1968/69 and 1978/79 was 43.6 percent.
12. With public expenditure figures in financial years and GDP in calendar years, the latter was adjusted *pro rata*.
13. In 1992/93 the PE/GDP ratio for the UK was 44 percent; in Northern Ireland it was 59.8 percent.
14. McNutt (1996) shows total government expenditure as a percentage of GDP in twenty OECD countries over the period 1960-1990. A common trend was that by 1990 several countries had recorded falls in their government expenditure/GDP ratio, particularly between 1985 and 1990.
15. Barnett and Hutchinson (1998b) show, by means of a neo-classical model of the Northern Ireland labour market, that a widening public/private wage differential, due to poor wage growth in the private sector, will have an adverse impact on the level of local unemployment.
16. *Departmental Running Costs*' (DRC) covers the administration costs of central government and 'other public service pay and other current expenditure on goods and services' covers the pay and pension costs of other public sector employees not included in DRCs, general administration expenses and purchases of non-capital goods and services.
17. At 1990 prices, the rate of growth in current expenditure on goods and services between 1968/69 and 1978/79 was 88.8 percent.
18. The proportions are calculated with reference to the latest statistical information available (Northern Ireland Office, 1974). Areas such as Customs and Excise, where sufficient statistical information may not be available, the Northern Ireland share will be a population proportion.
19. The *Northern Ireland Insurance Fund* (NIIF) consists of three main elements: contributions from employees, employers and the *Northern Ireland Consolidated Fund*. The deficit in the NIIF is made up of payments from the *Great British National Insurance Fund*.
20. Until 1993, the House of Lords Hansard reported each July on the 'subvention from the UK to Northern Ireland'. The inclusion of Courts Service and Ministry of Defence expenditure, using this source, is therefore from 1979/80 to 1993/94.
21. Over the period 1976-1996, the pattern of population growth in each of the four regions of the UK was as follows (ONS, 1998): Northern Ireland (increase of 9.1 percent); England (increase of 5.2 percent); Wales (increase of 4.4 percent) and

Scotland (reduction of 2.0 percent).

22. McGregor, Swales and Yin (1995, p.267) speak of the “*importance of being unnoticed*” – often the scale of regional transfers are unknown (to the advantage of deficit regions). However, as the authors indicate, Northern Ireland is the “*only region of the nation whose deficits are visible*”.
23. Barnett and Hutchinson (1998b), using *Labour Force Survey* data, illustrated the characteristics of public and private workers in Northern Ireland over the period 1984-1993. The analysis showed, *inter alia*, that public sector workers appear to be older and have superior educational attainments.

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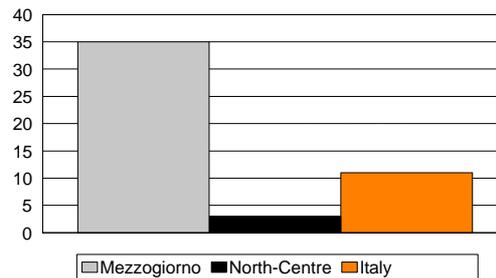
DISCUSSION

Professor John Fitz Gerald: This paper raises a number of interesting issues. The discussion of the Barnett formula highlights the absence of any explicit regional policy objective underlying the transfer of resources between the UK regions. Normally such transfers within nations do have an explicit regional objective. Within England the transfers to local authorities are based on a complicated formula intended to reflect relative “need”.

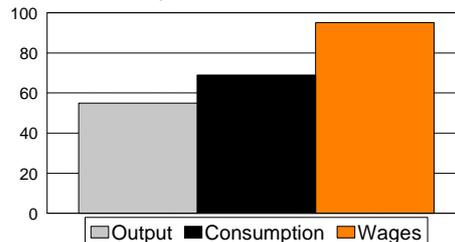
The objectives for regional policy are never clear-cut, especially in the context of an individual country. It is possible to sustain a commitment to balancing living standards within a country through income transfers over a long time. However, within the EU context there is a desire to ensure that the commitment is not open ended and that the transfers promote sustainable convergence. This involves concentrating on investment in key sectors in order to increase the productive potential of lagging regions.

Figure 1

Italian Government Borrowing, 1988 as % of GDP



Mezzogiorno Relative to Italy per head, 1987



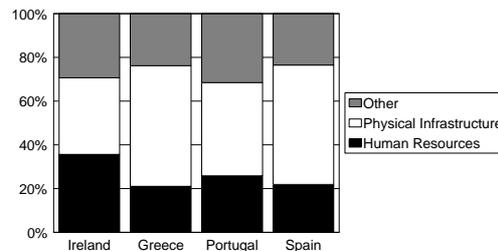
The case of the Mezzogiorno in Southern Italy is interesting. There have been very large transfers from the rest of Italy to the Mezzogiorno since the Second World War. As shown in Figure 1, in 1988 the budget deficit in the Mezzogiorno was

around 35 percent of Italian GDP. However, in spite of the huge transfer, there was no convergence in levels of output per head. Instead the transfers served to bolster income per head. Because of the long-term commitments inherent within a nation, this situation is sustainable over a long period (though it has given rise to internal political tensions in Italy).

A different approach has been taken within the EU where there is not a commitment to indefinite support for lagging regions. The support is designed to bring about convergence in output per head so that a permanent change is made in living standards – a change which will survive the termination of transfers. As a result, a major emphasis is put on using the transfers to fund investment in both physical and human capital.

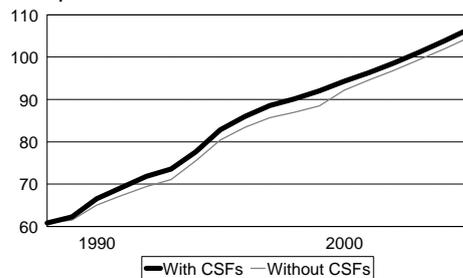
Figure 2

CSF 1994-1999 Allocation of EU Structural and Cohesion Funds



Source: European Commission: First Report on Economic and Social Cohesion, 1996

Ireland Compared to EU GNP per head at PPS with and without CSFs



In the case of the Republic of Ireland a major emphasis has been put on investment in human capital. This contrasts with the other cohesion countries where investment in physical infrastructure has taken priority. Figure 2 shows an estimate of the permanent impact which the structural fund transfers of the 1990s are likely to have on the economy of the Republic. Even if they were to end in 1999 the economy would still be better off to the tune of 2 percent of GNP. This permanent impact

derives from the lasting benefit achieved through investing in physical and human capital.

While Hutchinson's paper does not directly address these issues, it does show that expenditure on investment in different forms has fallen as a share of total expenditure. This would be in line with a model of national transfers where there is a commitment to permanent transfers to sustain the level of income per head – the model which is found in other countries. However, it differs from the EU model of regional policy.

The paper also raises the interesting possibility of crowding out of the private sector in Northern Ireland by the public sector. In a small region of a national economy the traditional crowding out mechanism, a rise in interest rates, is not relevant. However, Hutchinson raises the interesting possibility that such crowding out could occur through the labour market. While the evidence which he quotes on higher wage rates being paid to public sector workers is not necessarily evidence of such crowding out, the possibility certainly merits further research. In other regions or countries, such as Ireland, the public sector tends to employ a relatively high share of skilled people (in the civil service, education and health) so higher average earnings in the public sector is not *per se* a sign of a distorted labour market.

Mr. Tom Flynn: It gives me great pleasure to second Professor FitzGerald's vote of thanks to Dr Hutchinson for presenting what, I believe, is an interesting insight into the setting and management of public expenditure in Northern Ireland. I found the paper generally to be an accurate and relevant exposition of many of the current issues surrounding public expenditure in Northern Ireland.

At the outset, let me just very briefly outline my position within the public expenditure arena. I am currently seconded from the Economics Division of the *Department of Finance and Personnel* (DFP) to that department's *Appropriation and Resource Control Division* (ARCD). Among others, ARCD has responsibility for negotiating public expenditure changes to the Northern Ireland Block with the UK Treasury in Whitehall, including the mechanisms for delivering the changes. However, DFP also acts as Northern Ireland's treasury in exercising central control over the use of the Government's financial resources in Northern Ireland. In this context, ARCD has a further role to play in allocating and monitoring expenditure within the Block across programmes.

Public Expenditure Allocation

Dr Hutchinson alluded to the mechanisms that have existed throughout the 1980s and 1990s for determining the magnitude of public expenditure allocated to Northern Ireland, homing in on the comparability, or Barnett formula as it is affectionately known. Currently, with a few exceptions such as *Social Security Benefit*

expenditure, changes to the overall resource allocation to the Block programmes are normally determined by use of this formula. In December 1997, the government stated that the block and formula arrangements will be retained for Scotland and Wales after devolution and we expect this also to be the case for Northern Ireland.

The paper addressed the question as to whether the use of the Barnett formula has constrained the growth of government in Northern Ireland (relative to Great Britain). To the extent that it has been applied, the answer is “yes”, but formula bypass has acted to some degree against this trend. Northern Ireland has recently received its public expenditure allocations for the next three financial years as part of the outcome of the UK wide *Comprehensive Spending Review* (CSR). I shall return to this later, but at this point it is appropriate to note that Northern Ireland would find it very difficult to match the English growth rates in the government’s top priority programme areas of *Education and Health* without other programmes suffering cuts over this period. I think this vindicates the view that the formula arrangement has constrained the growth in total planned expenditure. Arithmetically, this merely reflects the fact that in Northern Ireland baseline expenditure in these programmes is proportionately much higher than in England.

However, I do not believe there is anything particularly unique about the formula mechanism. I understand the European Commission have used, and perhaps still use, a similar type of model in allocating *European Free Trade Area* (EFTA) funds. Granted, their model was more refined to the extent that it incorporated not only population share, but also criteria such as the GDP per capita index and share of employment in agriculture. But the principle, I believe, is the same.

The great advantage of the Barnett formula over alternatives such as needs assessment exercises is its simplicity. However, a price to pay for this, as Dr Hutchinson and others have correctly pointed out, is that the regions and Treasury are obliged to take the ‘rough with the smooth’. One aspect of this principle is that under strict application of the formula, total expenditure in the region will move in the same direction as in comparable programmes in England.

Whilst the use of a formula largely does away with the need to negotiate regularly with Treasury over what a region should receive, there is frequent discussion over the applicability of the formula to certain areas. Examples include where there is expenditure in an entirely new programme or sub-programme, or as the nature of expenditure in an existing one changes. For example, the allocations Northern Ireland received from *Welfare to Work*, a new programme, took account of unemployment levels in Northern Ireland, rather than just population share.

The Subvention

I would like to make one observation in relation to the so-called annual ‘*subvention*’ from Great Britain. The scale of the subvention suggests the size of the public sector in Northern Ireland exceeds the ability (and obviously the willingness) of the voter-tax-payer to finance it.

I was involved several years ago in analysing movements in the *Grant-in-Aid* (GIA) for Northern Ireland in response to claims that the annual Northern Ireland subvention from Great Britain had risen sharply in the early 1990s. In essence, the Grant-in-Aid is the amount needed to balance the receipts and payments of the *Northern Ireland Consolidated Fund* and is by far the largest component of the subvention.

During this exercise we observed that there was a striking similarity between movements in the UK PSBR/GDP ratio and the adjusted GIA/GDP ratio for Northern Ireland throughout the decade from the early 1980s to the early 1990s. The analysis concluded that as movements in the subvention’s largest component mirrored movements in the UK PSBR level, the increases in the subvention were not something unique to Northern Ireland.

Tax-varying Powers

The paper notes that there is no provision for tax-varying powers for the new Northern Ireland Assembly in the Good Friday Agreement. Consequently, the issue was not subjected to the referendum. It is the case that the Northern Ireland Bill, for instance, restricts the ability of the Assembly to vary any UK tax.

However, Dr Hutchinson does point out that Northern Ireland has two rates:

- a *District Rate* struck by each of the twenty-six *District Councils* to help pay for the services it provides; and
- a *Regional Rate* struck by the *Department of Finance and Personnel* which contributes to the financing of those services that are provided through central government departments in Northern Ireland but by local authorities in Great Britain.

Recently there has been an important change with regard to the latter. Under Direct Rule, the *Regional Rate* has been treated as a source of finance for public expenditure rather than as a determinant of it. However, under devolution the local administration will have the ability to vary its public expenditure allocation (up or down) according to the level at which it sets the Regional Rate. Therefore, changes in the level of the Regional Rate will in future, albeit perhaps modestly, influence the total amount of resources available.

Inevitably, there may be some tension between a local administration and central government over what is an appropriate level of finance for the region. However,

this should be minimised by the introduction of transparency in financial relationships.

Reform of the Public Expenditure Regime

After taking office in May 1997, the Labour government in the UK launched a *Comprehensive Spending Review (CSR)*. This examined from a zero base all government expenditure to ensure that it aligned with the new government's priorities. The outcome of the national CSR was announced on 14 July 1998 in the form of a White Paper. This set out aggregate public expenditure allocations for Northern Ireland for the next three years (1999/00 to 2001/02).

The expenditure allocations were presented along the lines set out in the government's '*Economic and Fiscal Strategy Report*' setting out a new fiscal framework published on 11 June 1998. Public expenditure was thus divided between:

- a *Departmental Expenditure Limit (DEL)*, which is set for three years, thus abolishing the need for an annual public expenditure round; and
- *Annually Managed Expenditure (AME)*, which cannot be fixed for future years and must be re-examined annually. The major expenditure within AME is Social Security benefits and agricultural support payments under the Common Agricultural Policy.

The Northern Ireland total DEL and AME figures for the three-year CSR period announced in July 1998 increase from around STG£9.5bn in 1999-00 to just under STG£10.1bn in 2001-02. However, for practical purposes all expenditure over which the Secretary of State or the new Assembly will have discretion to allocate is within the DEL figures for Northern Ireland which are planned to increase from just under STG£6bn in 1999-00 to just under STG£6.3bn in 2001-02.

Northern Ireland's DEL increases have been almost entirely determined by the formula mechanism and the convergence effect is very apparent when we compare the average annual rate of increase for the NI DEL with that for the overall UK DEL over the three CSR years. The NI percentage is just under 3.6 percent per annum in cash terms, whereas the UK DEL is planned to grow by an annual average of almost 5.9 percent.

Devolution obviously presents local politicians with a major opportunity to shape future public spending in the province, closely in line with local needs and priorities. Indeed, the theory goes that such developments across the United Kingdom should lead to regional public expenditure patterns that more fully reflect the needs and wishes of local populations.

I hope my comments have given you an indication of how I, as a practitioner involved in public expenditure allocation and management in Northern Ireland, see some of the very pertinent issues raised in his paper. Once, again can I relay my thanks to Dr. Hutchinson and my appreciation for having the opportunity to come here this evening.

Mr. Sean Cromien: I would like to join with other speakers in complimenting Dr Hutchinson on his valuable paper. It is a very useful and well presented summary of the financial arrangements between Northern Ireland and the British Exchequer. I have been generally familiar with this area but have never been quite clear what the precise basis of the subvention from the British Exchequer to Northern Ireland was and how the Barnett formula operated.

Dr Hutchinson raises an interesting question when he talks about the possibility of devolving tax-raising powers to the new Assembly which has been set up under the Good Friday Agreement. He rightly comments on the perhaps surprising fact that these powers are not contained in the otherwise detailed provisions of the Agreement. As I read the Agreement, there is provision in paragraph 3 of Strand 1 for the Assembly to exercise authority *“in respect of those matters currently within the responsibility of the six Northern Ireland Government Departments”*, with the possibility of taking on other responsibilities under paragraph 26 of the same Strand. Paragraph 26 provides that the Assembly can be authorised to operate in areas at present reserved to the Secretary of State, provided this is with the approval of the Secretary of State and subject to parliamentary control. This is all that is listed.

It seems to me unlikely, however, that the Agreement has to be read in such a restrictive way as to prevent the British Parliament, if it so wishes, devolving tax-raising powers to Northern Ireland, on the lines, say, of those being devolved to the new Scottish and Welsh assemblies. I assume that the reason for the omission is merely because the Agreement is essentially a political document which concentrates on setting down institutional arrangements which are designed to bring together the present divided community in Northern Ireland, rather than an exact blueprint of all the powers that might eventually be delegated to the new Assembly.

When the Assembly comes into full operation, it will provide a unique opportunity for public debate in Northern Ireland to move away from sterile argument about the constitutional issues which have dominated discussion for the last thirty years and sectarian rows such as the question of who marches down a particular street. It will allow public debate to be restored to dealing with the normal political issues which are the bread and butter of politics in the rest of the UK, in the Republic of Ireland and in other European democracies, namely, which of the alternative uses of scarce public resources does the electorate favour - will it tolerate the closing down of some hospitals so that resources can be concentrated to improve the others; what should public housing or education policy be; how can new industry be encouraged and so

on?

I support Dr Hutchinson's view that, at some stage, tax-raising powers of some sort should be devolved to Northern Ireland. Again, such new powers would allow political debate to become more lively. They would face the electorate in Northern Ireland with decisions on varying taxes, a subject which is always an emotive issue but one which gives further choice to the electorate in deciding on alternative social and economic strategies.

An important question that arises on Dr. Hutchinson's paper is what will happen to the so-called '*peace dividend*' which will result from the reduction of public expenditure on security, courts, prisons, *etc.*. Peace will bring its own casualties in that unemployment will rise as the number of persons employed at present in these areas falls. There will also be reductions among those employed by the private sector to provide security for shops *etc.*. As it happens, one of the communities in Northern Ireland will be affected much more than the other by this development and this will raise its own problems. It is to be hoped that the money saved will not just be saved to the British Exchequer but will be diverted to other purposes in Northern Ireland, at least in part, to stimulate economic activity and provide jobs in the province.

Fr. John Brady: I enjoyed the paper very much. A highlight of it was the data in Table 1. If you add up the figures for the various types of government spending which stimulate and support economic activity they come to about STG£1.2 billion for 1995/96. The combined figures for *Health and Social Services* and *Social Security* in the same year are much higher at STG£3.6 billion. I think it is arguable that for an economy of the size of Northern Ireland, a figure of STG£1.2 billion for economic support and stimulation measures is too low. At a time of new beginning this issue should be examined.

The Republic of Ireland has found in recent years that successful and sustained stimulation of economic growth can bring down unemployment figures substantially and this trend has not yet run its full course. Large savings in public expenditure on social welfare have accrued which makes it easier to find further resources for stimulating more economic growth. In a setting of peace a similar process in Northern Ireland seems quite possible and it would seem desirable to work towards it. The technical aspects of how such a thing might be achieved would require careful consideration in the light of the processes outlined in the paper.

Response by Dr Hutchinson: I would like to express my appreciation to Professor John Fitz Gerald and Mr Tom Flynn for their contributions as discussants to my paper. Their remarks were encouraging and constructive and I now wish to briefly

comment on two points. Firstly, the point on the objective of fiscal transfers to regional economies is important and deserves more research. Clearly in the context of devolved government, the EU policy of using fiscal transfers to bolster output and not purely income per head ought to be used as the benchmark for the regional assembly in Northern Ireland. Secondly, John Fitz Gerald is correct in cautioning against the higher (unadjusted) public wage in the Northern Ireland being used to demonstrate any process of crowding out. However, in Barnett and Hutchinson (1998b), the public/private wage differential was adjusted by several key determinants such as education, experience and proportion of female workers. This adjustment, whilst narrowing the differential, did not eliminate it. Thus, preliminary evidence suggests that in the context of the labour market, there is some degree of crowding out occurring in Northern Ireland, however, this also merits additional research.