



MITIGATING THE RECESSION: OPTIONS FOR THE NORTHERN IRELAND EXECUTIVE

March 2009

This paper is intended to stimulate discussion and does not necessarily reflect the views of all Members of the Board of ERINI. Where exceptions exist these are highlighted for the relevant proposals.

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Introduction

1. Over the past year the world economy has been moving rapidly into possibly the worst recession in 60 years, and the United Kingdom is firmly at the eye of the storm. Devolution in Scotland, Wales and Northern Ireland was launched in the most benign economic circumstances imaginable and the recession will be the first real test of the effectiveness of the devolved institutions in showing that they can independently make a significant difference when faced with a major economic challenge.

2. Northern Ireland cannot escape the consequences of recession and the extraordinary reversal of fortune in countries such as Iceland and, nearer home, the Republic of Ireland, show how vulnerable small economies are in these circumstances. Nevertheless, while the Northern Ireland Executive has limited powers and room to manoeuvre it is not without options to help mitigate the worst effects of an economic downturn.

3. This paper is an attempt to spell out what these options are and to assess their utility. It provides a general overview of how the recession has developed, the steps that have been taken by the United Kingdom Government to stabilise the situation and an assessment of how the downturn will proceed in Northern Ireland. The paper then looks at the practical options available to the Northern Ireland Executive, starting with a frank assessment of the state of the public finances that are the ultimate constraint on what can be done.

Origin and Nature of the Recession

4. The proximate causes of the recession have been the near simultaneous collapse of confidence in financial markets (the credit crunch) and a precipitous fall in asset values, especially in the property markets. In turn consumer and business confidence has rapidly collapsed. The roots of the financial crisis go back much further to the liberalisation of markets and the development of increasingly complex and exotic forms of securitisation starting in the 1970s and reaching a peak in the early years of this century. At a more fundamental level both the US and UK economies have been running very substantial

trade deficits over many years and relying on investment from surplus countries to fund the gap, a practice that is fundamentally unsound.

5. In the period between September and Christmas 2008 the banking systems in the US and the UK came close to collapse (indeed Lehman Brothers did collapse on 14 September 2008) and had to be bailed out or, in the case of some banks, nationalised. However, these bailouts have merely contained the situation pro tem they have not enabled banks to resume normal operations and in particular they have left large (indeed unquantifiable) toxic debts on bank balance sheets which is effectively undermining the money markets.

6. In the meantime, with credit and demand drying up the crisis has started to penetrate the real economy. Growth in all the developed countries has dipped sharply with most now recording a technical recession (two successive quarters of declining output). The latest IMF forecasts for the US, UK and the Euro Area show negative growth in all areas in 2009. For some smaller economies, such as Ireland, the downturn has been both rapid and severe with growth forecasts showing a fall of 5 per cent in a year compared to the current position.

7. In the labour markets the counterparts of falling growth is rising unemployment and short-term working. The unemployment count in the UK in November rose to 1.92 million or 6.1 per cent, the worst figure for a decade.

8. It is important to understand how serious this situation is becoming. The banking system in the UK and in many other countries is badly damaged and dysfunctional. Monetary policy in the conventional sense of interest rate control is defunct with people willing to hoard any amount of money rather than invest (a situation referred to as 'the liquidity trap' by economists and not seen in the UK since 1947)¹. At the same time the cost of propping up the banks has pushed the public finances into disarray. By the end of 2008 the UK public sector debt stood at £697.5 billion or 47.5 per cent of GDP but is set to rise to £1 trillion by 2012. If banks are nationalised the value of their liabilities would

¹ Hoarding in this sense means that individuals are unwilling to hold investment assets whose value is likely to fall and instead prefer to hold cash or pay off debt.

double this figure². Though not unsustainable these borrowing figures do limit the government's ability to craft a substantial fiscal stimulus. They also put strong downward pressure on the currency and the £ sterling has lost approximately one-third of its value against the dollar and the euro during the past year³.

The Northern Ireland Position

9. The banking system in Northern Ireland is almost entirely owned externally as part of larger UK and Irish bank groups. The system is basically focused on retail operations with comparatively narrow margins and exposure to more exotic transactions is low. Nevertheless, since most local banks are subsidiaries of institutions that are in the teeth of the financial storm such as the Royal Bank of Scotland they will suffer some damage as their parent companies are forced to restructure. Being minor players in the wider drama does not offer much protection when cost cutting measures begin to bite. In line with the general uncertainty in the market there is some reluctance to lend and much tighter conditions on lending but the flow of funds has not dried up entirely.

10. In the real economy analysis is hampered by the lack of timely data at a regional level. Output (Gross Value Added) data typically lags by up to two years. Nevertheless, sectorally it is clear that several industries are either in or about to enter a recession of uncertain severity and duration. The construction industry is clearly suffering from the collapse of confidence in the housing market and the shortage of finance especially for first time buyers. The evidence from other sectors is patchy with financial and business services in decline along with hotel and restaurants. Food and drink on the other hand is holding up so far as is the ICT sector.

11. Local unemployment is rising fast with an additional 3000 claiming benefit in February 2009 bringing the total claimant count to 42,000, an increase of 18,100 or 75.7 per cent over the year. The worrying factor, however, is the trend of change. Of the twelve local authority areas in the UK experiencing the fastest increase in unemployment over the past year, 6 are in Northern Ireland. Three of these authorities recorded over 150

² Adding these figures can be misleading because the corresponding assets (eg houses or property) do not, by convention, enter the government balance sheet.

³ A falling exchange rate increases the competitiveness of UK exports and there are complaints from some trading partners that this is a form of protectionism.

per cent increase and one, Magherafelt, saw unemployment rise by 232 per cent. Thus, even though absolute numbers are still comparatively small increases are disproportionately skewed towards Northern Ireland.

How Do Recessions Proceed?

12. All recessions exhibit both differences and similarities. The starting points can be quite different but once established the progress of recession is reasonably well understood.

- The starting point for the current recession is in the financial and property sectors thus there is a near immediate impact on anything directly related to these sectors. The construction sector declines rapidly and with it ancillary services such as real estate agencies and mortgage providers.
- There is then an expanding wave of collateral damage into other services such as lawyers specialising in conveyancing. Businesses dependent on turnover in the housing market such as furniture and fittings, flooring, the production of concrete, bricks, tiles and timber come under pressure as demand falls.
- If, as is currently the case, the recession also involves a credit crunch, lending is hit and the liquidity of firms begins to dry up. Larger companies find it increasingly difficult to re-finance debt. Private credit also declines and consumers begin to hoard cash. Reduced spending impacts on the retail sector usually starting with higher valued goods but working its way down the value chain. Less efficient retailers start to close and there may be consolidations.
- If the recession becomes widespread across countries then falls in national and global demand impacts severely in manufacturing and hence exports. This may be offset to some degree by depreciation of the currency but the underlying problem is lack of demand.
- Through all these phases unemployment rises steadily reinforcing decline and putting pressure on the public finances through additional payments and lower tax receipts.

- In a financial crisis monetary policy (interest rates) becomes progressively less effective since people prefer to hold cash rather than assets that are declining in value (the liquidity trap). The final expedient of 'quantitative easing' or printing money may come into use but with severe longer-term risks.

13. Many of the points in this stylised chronology can be identified at both the UK and Northern Ireland level at present. Policy is increasingly driven by attempts to tackle the underlying drivers of recession and to mitigate the worst industrial and social effects (for example, support for small businesses and actions to stem home repossessions). All of the macro policy instruments and many of the micro schemes now in use are solidly within the purview of the UK government rather than devolved institutions but there is still some room to make a difference at the local level.

What has the UK Government Done?

14. In addition to actions to rescue the banking system the UK government has introduced a range of fiscal and regulatory measures to stimulate demand and support business. The main components are:

- Continuing support for the banks with an initial £37 billion tranche of capitalisation now reinforced by a further £20 billion. In addition there are guarantees representing contingent liabilities of upward of £600 billion.
- Value added tax cut to 15 per cent for one year worth about £12 billion in revenue foregone. The impact is an average of £260 saving per household per year.
- Adjustment to personal allowances brought in temporarily after the abolition of 10 per cent Income Tax rate now made permanent – about £2 billion per annum in lost revenue.
- A £4 billion initial package for small businesses.
- Pension increases and Christmas bonus enhancements for pensioners.

- A new loan guarantee scheme for small and medium size businesses but some of this may be a re-announcement rather than new money.
- £3 Billion of capital projects brought forward.

15. On the other hand, to help pay for these actions at least in the future, some severe increases in taxes and reductions in public spending have been foreshadowed in the Pre Budget Report and may be taken further in the forthcoming Budget.

- National insurance up by 0.5% from 2010.
- A new higher income tax rate of 45% for those earning over £150,000 per year.
- Sever cuts in public expenditure growth post 2010 from 2% to 1.2% per annum on average. This will reduce the growth of spending power available to Northern Ireland since our public resources are overwhelmingly dependent on the Barnett formula which generally provides a population based share of additional expenditure in England. Because expenditure per head in Northern Ireland is much higher than our population share a rule of thumb is that a 1% growth of comparable spending in England permits 0.75% growth in Northern Ireland.

What Can the Executive Do?

16. The remainder of this paper addresses the question of what options are open to the Northern Ireland Executive to help mitigate the effects of recession and position the region to take maximum advantage of an upturn when it appears.

17. However, before looking at specific options it is necessary to examine the condition of the public finances in Northern Ireland since these dictate the resources that are available to the Executive to pursue new initiatives and to reinforce existing schemes. Not all Executive actions are resource dependent but the most important of them are so it is essential to understand the fiscal limits that constrain them.

The State of the Public Finances

18. The funds that are available for discretionary expenditure by the Executive are those within the Departmental Expenditure Limit (DEL) agreed with the Treasury in successive spending reviews. Part of the overall spending power derives from receipts from the regional rates and other receipts from the sale of assets so projections for these, and any concessions that reduce potential receipts, are an important part of the fiscal balance.

19. The budgets for Northern Ireland departments for the remaining two years of the latest spending review are shown in the table below.

Table 1		
Budgets for NI Departments		
	Current Expenditure	
	£ Million	
Department	2009/10	2010/11
Agriculture	238.4	245.4
Culture/Arts/Leisure	113.7	119.7
Education	1,879.1	1,961.0
Enterprise/Trade/Investment	223.9	229.8
Employment/Learning	784.5	833.1
Finance	163	161.1
Health	4,076.4	4,273.6
Environment	136.8	136.7
Regional Development	308.6	334.6
Social Development	523.4	523.1
OFMDFM	80.5	86.4
NI Assembly	47.6	47.6
Totals	8,575.9	8,952.1

20. These are substantial sums but it is important to understand that they are based on a series of assumptions and projections and that with the passage of time new expenditure pressures inevitably emerge. The most important such factors are:

- In the strategic expenditure stocktake, completed in December, departments identified some £233/301.7 million in additional current expenditure pressures in 2009/10 and 2010/11⁴ as opposed to potential surrenders of £29.6/21.1 million. Not all of these pressures are unavoidable and Ministers hope to use under spends from year to year to cover these but it must be remembered that the original budget figure work was based on an over-commitment of resources of £80 million and £60 million in these years and these shortfalls have to be covered by carry forward before any new pressures are addressed⁵.
- On the capital budget pressures of £175.6 million in 2009/10 and £435.4 million in 2010/11 have been identified. Most of this is shortfalls in receipts from projected asset sales. The sale of Crossnacreevy has fallen through and Housing Executive sales of houses have basically collapsed. Since we are only at the beginning of a recession, further shortfalls in receipts cannot be ruled out. (The collapse of the Workplace 2010 programme led to a shortfall of £175 million in receipts but these relate to the 2008/09 year and so have been covered).
- The Executive has inherited back pay claims for civil servants which may exceed £100 million (some estimates are double this figure). The financial settlement in November provided access to an additional £100 million within the CSR period (2008/09 to 2010/11) to meet these costs but anything in excess will be a direct pressure on expenditure. Indeed, there is evidence that access to £100 million really means additional borrowing from the Treasury which will have to be repaid in the future with interest and bringing forward expenditure from future years which will leave uncovered pressures there. There is also no existing cover for the consequential increase in the pay baseline that will carry into future years.

⁴ Compared to their position at the start of the Executive's Budget for the period 2008/9 to 2010/11.

⁵ Over commitment means planning to spend more than is available in the hope that the traditional tendency to spend less than is available will be minimised.

- Because of the downturn in the housing market and in commercial property, projections for regional rate receipts must be suspect. The ability to rely on buoyancy in the market to hold up receipts has all but vanished.
- Various policy decisions, such as freezing domestic rates, transport for the elderly and free prescriptions, pose a mounting pressure. If there are no corresponding policies in England then there is nothing received through the Barnett formula to fund these policies.
- A further looming pressure comes from the UK government decision to raise resource releasing efficiency savings for Whitehall departments to 5% within the CSR 2007 period. To the extent that these departments have expenditures that are paralleled in Northern Ireland (Scotland and Wales too) the extra efficiency savings they have to surrender rather than re-cycle within the current target of 3% would mean a cut in the Northern Ireland public expenditure block. The funding rules for the devolved administrations allow for an across the board reduction to expenditure equivalent to any similar reduction for UK departments which would mean a cut of some £200 million per year for the Northern Ireland budget. Alternatively these reductions could be taken through a reverse application of the Barnett formula with cuts ranging up to £140 million over each of the next two years. All of the devolved administrations are disputing these cuts and arguing for the need to preserve jobs in both the public and private sectors but the UK public finances are equally in dire need of savings.

The Water Issue

21. The issue of water charges needs particular consideration since it illustrates how complex and difficult are some of the policy issues the Executive has inherited.

22. When the Northern Ireland Water Company was created, it was on the basis of an agreement with the Treasury that water charges would be introduced and the company would essentially become self-financing. On this basis, the company was treated as what is known as a self financing public corporation so that the capital charges that all public bodies must make on their assets would not count against the Executive's budget.

Indeed, the value of the capital base for the water company was written down massively to keep these charges down.

23. In the event, the Executive decided not to introduce water charges and this has triggered two consequences. The first and most obvious is that the receipts from water charges have not materialised so the water company's deficits have had to be covered from general public expenditure. This pressure amounts to over £500 million over 2009/10 and 2010/11. The second consequence is less obvious but crucially important. Since Northern Ireland Water has clearly not become self-financing, the Office for National Statistics which determines the status of bodies for national accounting purposes has reclassified it as a non departmental public body of the parent department, Regional Development. As a result the original value of its capital base (over £6 billion) has been restored and this now attracts capital charges that do score against the Northern Ireland public expenditure block. These capital charges are not cash payments but they do count against the Executive's budget and would squeeze out other expenditure if they had to be absorbed. In total, the charges amount to £400 million for each of the next two years.

24. In the financial package agreed in November 2008, the Prime Minister agreed to waive these charges for 2008/09 and 2009/10, but not beyond⁶. The message is thus clear, water charges have not gone away and the Executive have, at most, another year to sort this problem out before the costs of the current arrangements begin to escalate.

25. Some commentators, including importantly the trade unions, are opposed in principle to the introduction of separate household water charges, preferring instead that the costs are met from the regional rate or public expenditure. In the same vein the Independent Water Review Panel have suggested a charging model that is essentially a 'water rate' using the same base as for the rates and the same billing system but ring-fencing the amount for water on the actual bill. Both of these approaches mean that effectively the bulk of the Water Company's income would come from taxation (water rates would be compulsory and for all practical purposes an extension of the regional rate). It is difficult to see how the Office of National Statistics could avoid classifying a Water Company, most of whose income comes from general taxation, as other than a part of

⁶ Thus, of the £900 million package over two years announced in November, £800 million is basically an accounting adjustment and not real money.

central government. This, of course, would trigger the escalating costs for the Northern Ireland public expenditure block already discussed⁷.

26. The debate on financing water has become polarised with direct charging at one extreme and a service more or less entirely dependent on public finance at the other. Direct charges would solve the public expenditure dilemma but are politically very difficult. On the other hand, a service funded mostly from taxation will impose crippling costs on the Executive's budget as time goes on with nothing being received through the Barnett formula to help defray the expense. Perhaps a way forward would be to seek a compromise with water charges phased in over a reasonably long period (say five years) to an initial point where the company could be re-classified as self financing – this would require something above half of its costs to be covered by direct charges – with the balance of finance met through a grant from the parent department. Some additional relief might be given by allowing a degree of offset against rates though this would be a further call on the Executive's budget in revenue foregone. After the initial phasing in period the situation could be reviewed. **[In view of the opposition in principle by the trade unions to direct charging for water this approach would not be endorsed by the trade union members of the Board of ERINI].**

Policing and Justice

27. It is possible, that within the next two years, responsibility for some or all elements of policing and justice will transfer from the Northern Ireland Office (NIO) to the Northern Ireland Executive. This would involve transferring over 20 bodies and their respective budgets. The total spend of the NIO is about £1.2 billion per annum, mostly on police and prisons. In addition, responsibility for the Courts, which have been carried out by the Lord Chancellor's department, would also transfer. Unless there is a proper financial settlement to accompany these transfers, any shortfall will have to be picked up by the existing NI public expenditure block. Indeed even if the full budgetary pressures for those programmes that are currently known are met at the point of transfer the future contains significant dangers for the Executive's budget. Expenditure on these functions is roughly

⁷ The Independent Water Review Panel were clearly aware of the expenditure implications of the water company's classification but seem not to recognise that the classification decision is not a matter for a deal between the Executive and the Treasury but the responsibility of the Office of National Statistics, an independent body required to maintain the integrity of the national accounts.

twice as expensive in Northern Ireland compared to the rest of the UK but the Barnett formula will deliver additional resources in this area based on additions to the proportionately much smaller spending in England. Any shortfall arising from this Barnett diet will be a direct pressure on the Northern Ireland budget.

28. This brief survey indicates that the financial situation facing the Executive is very tight and, consequently, there is very little capacity to launch new and expensive initiatives to address the recession unless existing programmes are cut back. Since the public expenditure block carries no reserve even very modest new pressures such as the compensation to farmers for dioxin poisoning had to be funded by a levy on other programmes. So far, the Executive have not faced a cuts exercise and there is no apparent appetite to do so. Consequently, new measures to combat the recession have to be considered in the context of binding financial constraints.

Actions on Construction

29. Construction has been the hardest hit sector so far in the downturn, principally because the housing market has effectively seized up. It is natural, therefore, to look at ways of freeing up or accelerating spend that will maintain employment in this sector.

(i) *Bringing Forward Capital Projects*

30. At £1.4 billion, the capital programme is already large but there is some scope for re-phasing, to bring forward smaller and more labour intensive projects at the expense of pushing larger projects into future years. However, re-phasing takes time and will disrupt the capital programme so the benefits of this approach need to be weighed carefully against the costs in the longer term. What cannot happen without the approval of the Treasury is that the budget allocations for capital that have been planned for forward years are brought forward to the present. Thus, the approach is constrained by the totality of the capital allocation in the immediate period.

(ii) *Re-examining the Balance Between Public Private Partnerships and Conventional Procurement*

31. Public Private partnerships (PPP) are arrangements, whereby the private sector borrows and builds on behalf of the public sector, which then contracts for the use of the facility over a long period. PPPs are a central part of the current investment strategy but in current market conditions, these projects will find it difficult to proceed. For a start, borrowing by private sector companies is becoming very difficult, and there are doubts about the viability of some companies or consortia and the thinly capitalised Special Purpose Vehicles they use to deliver PPPs. In addition, changes to International Financial Reporting Standards mean that in most cases, PPPs will start to come back onto the balance sheet for the public sector which makes them less attractive. There may, therefore, be a case for pushing PPPs into the future when conditions could be more propitious and bringing forward conventional procurement projects when this can be done in a reasonable time.

(iii) *The Housing Programme*

32. Within the capital programme the housing budget in particular has come under great strain. The opening baseline for housing in the 2007 Spending Review had been essentially flat for some time and the collapse of the receipts from house sales has been catastrophic. At this time there is no prospect of the target for new social housing being met with the resources available. In these circumstances innovative thinking is required such as buying up private sector housing stock at discounted prices (the purchase of ex-army houses in Lisburn is a good example) and extending the involvement of the Housing Executive in co-ownership schemes. There is also an opportunity to see if it is possible to make better use of the existing stock of social housing. This might be done by encouraging existing tenants who are in housing inappropriate to their needs or location to shift to other accommodation with financial compensation thus freeing up housing units in areas of greatest pressure.

33. The model for financing social housing which is based on grant aiding Housing Associations who can lever additional private borrowing and paying for this through a combination of mainstream public expenditure and the receipts from the sale of the existing social housing stock is looking increasingly unstable. In this model all of the risk

of not meeting targets for sales of the housing stock fall on one department whereas the target for social housing new build is an Executive collective priority. The recession in the property market has revealed the weakness of this approach and some new thinking on the future financing of social housing is badly needed.

Actions to Relieve Credit Difficulties

34. The Executive has no formal power over the financial system or the banks so the main thrust of the policy, to overcome the credit crunch, must come from the UK Government. However, there are a few things the Executive might do that could be helpful.

(i) Advance Payments

35. Where sound companies are being held back from public procurement by credit difficulties, there is an option to consider making advance payments to alleviate cash flow problems. This is against accounting practice and would need Ministerial authority but it is an option that could, in extremes, be used.

(ii) Encouraging Bank Lending

36. While the Executive can try to persuade the banks to make prudent loans, it is worth remembering that the public sector is a very large customer of the banks. Indeed, there is a single bank contract for the civil service. Making it clear that the future placement of such contracts will be influenced by the behaviour of the banks in this crisis would be a way of reinforcing the message to start lending.

(iii) Encouraging Participation and Leveraging National Schemes

37. The UK Government runs various schemes to assist small and medium sized enterprises to access loans. The Small Business Loan Guarantee Scheme which guarantees bank loans up to £275,000 is a good example and a new scheme for larger businesses has been announced. The Executive should encourage local companies to take full advantage of such schemes. However, additional leverage for local firms may be

obtained if the Executive was willing to cover some of the premiums (typically 2%) which have to be paid by companies accessing these schemes.

(iv) Triage

38. Not all companies can be saved from the threat of recession but it is clear that some companies/sectors are vital for the strategic development of the Northern Ireland economy in the longer term. Losing this capacity in a recession would be a grave setback for future prospects. It would be sensible, therefore, for DETI and Invest NI to apply a triage to their client base, identifying first those companies that are strategically important and defending them as far as possible, second, those companies that, although not in the first rank, deserve additional protection and finally those companies that are of less importance for the future. This is not a process that can be done transparently, but it is, nevertheless, essential that public resources are concentrated on those activities that have the greatest importance for the long term survival of the economy.

Energy and Energy Efficiency

39. Energy is expensive in Northern Ireland and everything that can be done to keep prices down, through competition and savings on energy use, should be pursued.

(i) A Single Electricity Contract for the Public Sector

40. Collectively, the public sector is an extensive user of electricity for offices, hospitals, schools and other facilities. It would be worth examining, therefore, whether this purchasing power could be translated into a lower public sector tariff in the Single Electricity Market. A smaller version of this idea would be for the Housing Executive to act as a purchaser/supplier of electricity for its tenants, with the aim of securing a lower tariff. It would, of course, be the responsibility of the Regulator to ensure that the energy companies did not merely recoup any loss of revenue by increasing charges to other customers.

(ii) Energy

41. Energy efficiency measures offer substantial pay back, but over the longer term. The Executive should do all it can to absorb some of the up front costs of schemes for providing low energy lighting and home insulation, leaving those in greatest fuel poverty to reap the longer term benefits.

Actions to Lower the Cost of Government Services

42. The Executive have already taken a range of actions to lower the cost of services to citizens. These include:

- Not imposing separate water charges for 2009/10. The issues with maintaining this position beyond 2009/10 are discussed above.
- Freezing domestic rates. This is costing £40 million this year and will be increasingly expensive as time goes on.
- Lowering the cap on capital values for rating (legislation pending).
- Freezing non-domestic rates at an estimated cost of £15 million.
- Free prescription charges from 2010/11 at a cost of at least £13 million per year.
- Free travel for the elderly at an additional cost of £4 million per year.

These subsidies do keep down the cost of living in the short term but they carry very high levels of dead weight and are quite indiscriminate. The minor subsidies such as free travel for the elderly and abolishing prescription charges are politically important and an insignificant cost so it is highly unlikely that these would be withdrawn, though with over 90% of people already exempt from prescription charges the impact of removing charges from the remainder must be skewed towards those least in need. However, before straying further along the road of dispensing subsidies it would be highly desirable if the Executive actually took stock of the true cost of the wide range of existing subsidies before proceeding further. Such a study should identify the final incidence of the subsidies (who actually benefits rather than who is supposed to benefit), the full cost to the economy as

opposed to the public finances and the degree of deadweight involved. All calculations as to the value of subsidies should take note of the increased purchasing power that accompanies falling inflation.

Addressing Unemployment and Capacity

43. Recessions produce unemployment and they also inhibit economic activity. Unemployment in Northern Ireland is low (but not inactivity) but is rising fast. An increase to 50,000 or more is quite conceivable. Adding the 100,000 inactive of working age means there is a large pool of labour that is losing skills and becoming ever more difficult to get back into work. The Executive should take short term measures to mitigate this problem perhaps, with an emphasis on young jobless.

- (i) Mobilising the further/higher education sector to provide short term, but intense training course for those entering unemployment. Innovative thinking is needed to combine courses with part-time working and making better use of concepts such as internships.
- (ii) Looking particularly at retraining ex-construction sector workers since they generally have lower qualifications and are difficult to place.
- (iii) Provide enhanced assistance for those seeking to set up in business during the recession. This has to be handled responsibly since the risks are high.
- (iv) Keep firms focused on investment in training the remaining workforce and in sustaining investment in research and development. Firms that do this will be much better placed to take advantage of an upturn when it comes.
- (v) Look at the possibility of a temporary subsidy in the short term to help firms hold on to essential skills.

Securing Additional Resources

44. We have already noted that the financial outlook is tight and that the public finances are under considerable strain. Yet, to do more, the Executive needs to generate additional resources and/or make better use of the many it has. The following are some progressively more difficult steps that might be taken to raise additional resources.

- (i) Maximise the use of end year flexibility (EYF) which is the ability to carry forward under-spending in the current year into future years, but only with the agreement of the Treasury. It is essential that departments cut down on under-spending since there is increasing difficulty in getting Treasury permission to carry these funds into future years. The carry over of current underspending over the 2007 spending review period was the subject of an agreement with the Treasury but there is no automatic right to recover underspending on capital. Surrendering unused money is fatal to any argument that Northern Ireland should be given more.
- (ii) Re-allocate among programmes and departments. During a recession, some departments will need more money and some less, so there needs to be a mechanism to facilitate this sort of redistribution. Within a financial year the monitoring rounds provide some help with reallocating funds but departments are generally reluctant to declare reduced requirements until well into the year when it is difficult to spend them on other things. A more systematic exercise may now be justified starting with a review of the Executive's priorities to establish whether they remain valid in the face of a recession. If there is a need to make changes this can only be met by some departments giving up money from their baselines so that others can be given more.
- (iii) Generating genuine efficiency savings. This is easier said than done since public services are labour intensive and efficiency cuts usually translates into some deterioration in service delivery. It is clearly recognised that there is a structural issue in Northern Ireland with too many departments and other bodies duplicating administrative functions and this would be a good place to start. The impact of enhanced UK level efficiency cuts may make this option moot since these are

designed to recover the fruits of improved efficiencies to the Treasury rather than leaving them for re-investment in the devolved administrations (see above).

- (iv) Suspending bonuses in the public sector for the duration of the recession. The savings would be modest but the symbolism would be large. In current circumstances the tendency is to save rather than spend lump sum windfalls beyond normal pay so bonuses are generally pro recessionary. In the longer term the bonus culture in public services needs to be addressed. Bonuses for senior public servants, though modest by private sector standards, are vastly more than for rank and file employees and there is absolutely no evidence that senior staff have to be given bonuses to stop them being lured away to the private sector before retirement. If necessary the Executive should resilie from accepting recommendations from the Senior Salaries Review Body on this issue.
- (v) Possibly resurrecting Ulster Savings which offered the public the opportunity to invest in a local form of National Savings. The original Ulster Savings certificates were guaranteed by the Treasury as to capital and interest and this would be an obligation that the NI Executive would have to assume. Ulster Savings were wound up in 2004 and would require fresh legislation to re-launch.
- (vi) An additional levy on MOT tests. Raising the MOT fee to £100 with a commensurate additional registration fee for the first three years for new vehicles would generate more than £50 million per year of additional receipts. When the cost of motoring is falling in real terms (substantial discounts are now available on vehicle prices and fuel costs are well down from their peak last summer) this environmentally friendly measure is practical and also relatively easy to police since all of the necessary apparatus is already in place. It would, of course, be possible to modify this proposal to allow for exemptions and discounts for specific groups such as pensioners or blue card holders though with some reduction in yield. **[Trade union representatives on the Board of ERINI would not be in favour of this option].**
- (vii) Seek to translate UK wide assistance into a more appropriate local focus. A good example of this is the cut in VAT from 17.5% to 15% which covers the entire UK.

The cost is about £12 billion in a single year. Around 2% of UK VAT originates in Northern Ireland so if we agreed to maintain VAT at 17.5% and take the reduction as a cash transfer, it would be worth an extra £240 million to the Executive. It is at least arguable that the focused use of £240 million would be more effective than dispersing it over the entire population. There are, of course, administrative issues in isolating VAT payments in Northern Ireland but this is the sort of imaginative, though fiscally neutral, argument that the Executive should have been pursuing with the Treasury. It is now too late to press this particular example but we would urge the Executive to be alert to other opportunities to increase its flexibilities as the recession proceeds.

Conclusions

45. Devolution in the United Kingdom took place in a benign economic climate and on the back of rapidly rising levels of public expenditure. All of that has now changed. Much of the world is in recession with falling output and rising unemployment. Public expenditure growth is now greatly curtailed for the foreseeable future with knock on effects for the NI Executive's budget. Since the restored Executive set its first budget and priorities a year ago many new and potentially inescapable expenditure pressures have emerged that were not factored into the budget figure work. Moreover, since budgets have been set and expenditure programmes are underway it is very difficult to reconfigure the shape of the overall budget to meet new challenges. Within the financial year the monitoring rounds allow some resources to be marshalled but not to meet new and ongoing pressures that cross financial years. Since the public expenditure block carries no reserve the only way to increase expenditure in one area is to cut it in another and gaining the political consensus for such a change is very difficult, even for small adjustments. This is why the Executive had such difficulty in bringing forward genuinely new funded proposals when it unveiled its anti-recession package in December 2008.

46. This paper has explored a range of options that the Executive might consider both to do what it can to lessen the impact of the recession and to resolve some of the more difficult financial issues it faces. The ability of the Executive to make much of a difference in terms of the recession depends in part on what sort of recession Northern Ireland faces. The jury is still out on this question. If the recession is painful but quite short lived, the

Executive can ease some of the pain through short term measures. Some of these, such as rescheduling capital works and boosting maintenance expenditure, are standard responses that many governments will be adopting. However, if the recession is deep and prolonged the efforts of the Executive (and national governments) are likely to be much less effective. If this scenario emerges the Executive would be best treating the challenge as an opportunity to use its resources to tackle longer term structural issues such as low skills that are holding back Northern Ireland's competitiveness. This will require different and possibly much more contentious options to be pursued as well as facing up to the difficult decisions needed to raise the resources to finance them.