

# Northern Ireland Interim Fiscal Framework

## **Implementation Update**

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# Annex E - Relative Funding Methodology

A.1 The Northern Ireland Executive and UK Government have agreed the methodology for assessing relative funding. This methodology is designed to compare Northern Ireland Executive un-ringfenced<sup>1</sup> block grant funding per head to equivalent UK Government funding per head in the rest of the UK (i.e. UK Government funding in other parts of the UK on areas that are devolved in Northern Ireland).

A.2 This methodology will be used at each spending review and annual autumn fiscal event to determine when relative Northern Ireland Executive funding per head is below 124% of comparable UK Government funding per head, at which point the needs-based factor of 24% will apply in the Barnett formula for new Barnett consequentials.

A.3 The needs-based factor of 24% will apply in the financial year when relative Northern Ireland Executive funding is projected to be below 124% to the nearest 0.1% (below 124.05%).

A.4 If Northern Ireland Executive funding is at or above 124% (at 124.05% or above), a 5% transitional factor will apply.

A.5 The agreed methodology involves four steps:

- i. Northern Ireland Executive funding is based on the block grant total DEL before any adjustments for tax devolution<sup>2</sup>. As agreed in the Interim Fiscal Framework, for the purposes of this calculation, un-ringfenced funding from the 2024 Northern Ireland Executive restoration financial package is not included. The agriculture funding un-ringfenced and baselined for the Northern Ireland Executive from 2025-26 at Phase 1 of Spending Review 2025, and comparable UK Government funding in England, will also not be included in the relative funding calculation.
- ii. Equivalent UK Government funding for the rest of the UK is calculated at spending reviews by multiplying each department's total DEL by the comparability factor used in the Barnett formula<sup>3</sup> (where the comparability factor reflects the proportion of each UK Government department's spending on areas that are devolved in Northern Ireland). By

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<sup>1</sup> Including Barnett based and non-Barnett block grant funding.

<sup>2</sup> Financial Transactions Capital (FTC) and Non-cash budgeting categories (e.g. ringfenced RDEL depreciation and impairments) are excluded from the relative funding per head calculation as it is a ringfenced budgeting category and is not relevant to the need calculation.

<sup>3</sup> The comparability factors used will be those in the most recent Statement of Funding Policy unless there are machinery of government or other changes that are not captured by those factors. Revisions to comparability factors for the purposes of measuring relative funding will need to be agreed by the UK Government and Northern Ireland Executive.

exception, certain funding lines which significantly distort departmental budgets may be stripped out of departmental totals and considered as individual programmes for the purposes of these calculations. At the autumn fiscal event, all comparable UK Government funding at programme level between the spending review and fiscal event is then added.

- iii. An adjustment is made to each of the above to deal with the unique treatment of non-domestic Rates (see below), and to remove ringfenced non-Barnett additions to the Northern Ireland Executive's block grant.
- iv. The ONS principal population projections are used to calculate funding on a per head basis.

A.6 An adjustment for the non-domestic Rates is required when calculating relative funding for all devolved governments. While non-domestic Rates are devolved in Northern Ireland, uniquely for a devolved tax, the Barnett formula applies to non-domestic Rates revenue in England. The agreed solution is to add non-domestic Rates revenue into the funding totals calculated in steps one and two above. To remove the effects of divergent policies, the assumption is made that non-domestic Rates revenues in Northern Ireland would have grown at the same rate per head as in England in the absence of devolution. In addition to using English non-domestic Rate revenues, the growth in these revenues is used to calculate the Northern Ireland non-domestic Rate numbers for calculating relative funding. This approach is also used for calculating Welsh Government relative funding.

A.7 The four steps in the relative funding methodology are set out below. This methodology has been agreed between HM Treasury and the Northern Ireland Department of Finance.

# Step 1: Northern Ireland Executive Funding

A.8 Northern Ireland Executive Funding is based on the block grant total DEL before any adjustments for tax devolution. As agreed in the Interim Fiscal Framework, for the purposes of the relative funding calculation, un-ringfenced funding from the 2024 Northern Ireland Executive restoration financial package is not included. The agriculture funding un-ringfenced and baselined for the Northern Ireland Executive from 2025-26 at Phase 1 of Spending Review 2025, and comparable UK Government funding in England, will also not be included in the relative funding calculation.

## Impact of tax devolution

A.9 To reflect tax devolution in Northern Ireland, there is a corresponding block grant adjustment for the Northern Ireland Executive. For the Executive, this is currently only for long-haul Air Passenger Duty.

A.10 The block grant adjustments for tax devolution are deductions which account for the revenue lost by the UK Government as a result of devolution. This follows the principle that neither government should be better or worse off purely due to having devolved a tax power. If there was no block grant adjustment, the UK Government would lose tax revenue in Northern Ireland but still face the same obligations to fund the Northern Ireland Executive, and therefore be worse off. Likewise, the Northern Ireland Executive would benefit from a new devolved revenue source, while retaining the same UK Government funding and be better off.

A.11 The practical result of this, is that the Northern Ireland Executive receives less funding from the UK Government as a result of tax devolution. The Northern Ireland Executive then makes policy choices and, depending on economic conditions, the devolved tax revenues generated may leave overall Executive budgets better or worse off than before tax devolution.

A.12 For the purposes of calculating relative funding for the Northern Ireland Executive and UK Government, the Northern Ireland Executive block grant total DEL is used before any adjustments for tax devolution. This removes the impact of the Northern Ireland Executive's policy choices on devolved tax from the relative funding calculation, as the Executive's policy choices do not affect the block grant adjustment and therefore the funding provided by the UK Government.

A.13 Similarly, Northern Ireland Executive revenue generated from the Regional Rate is not included in the relative funding calculation – the rationale on the non-domestic Rate is outlined below. For the domestic Regional Rate, revenue is not included as the UK Government does not receive comparable Council Tax revenue in England which is retained by local authorities.

### **Total DEL block grant included in calculation**

A.14 Only un-ringfenced funding will be included in the relative funding calculation and as explained below, ringfenced non-Barnett additions will not be included as they are provided for a specific purpose. The un-ringfenced funding provided in the 2024 Northern Ireland Executive restoration financial package will also not be included in the calculation as agreed in the Interim Fiscal Framework.

A.15 The un-ringfenced block grant total DEL used in the calculation will first assume the use of the 5% transitional factor in the Barnett formula as the minimum funding level for the Northern Ireland Executive. This mirrors the approach used when calculating the Welsh Government's relative funding and which needs-based factor applies in Wales (5% transitional or 15%). If the Northern Ireland Executive's relative funding is below 124% to the nearest 0.1%, a 24% needs-based factor in the Barnett formula will then be applied.



## Step 2: Equivalent UK Government funding for the rest of the UK

**A.16** Equivalent UK Government funding for the rest of the UK is calculated at spending reviews by multiplying each department's total DEL by the comparability factor used in the Barnett formula (where the comparability factor reflects the proportion of each UK Government department's spending on areas that are devolved in Northern Ireland). By exception, certain funding lines which significantly distort departmental budgets may be stripped out of departmental totals and considered as individual programmes for the purposes of these calculations. At the autumn fiscal event, all comparable UK Government funding at programme level between the spending review and fiscal event is then added.

**A.17** This reflects the agreed approach to comparability factors and how they are calculated, as outlined in the Statement of Funding Policy Annex B.

**A.18** The programmes which are not included in comparability factor calculation are discussed and agreed with the devolved governments at the relevant spending review. The comparability factors used for this calculation will be those published in the most recent Statement of Funding Policy unless there are machinery of government or other changes that are not captured by these factors.

**A.19** The agriculture funding un-ringfenced and baselined for the Northern Ireland Executive from 2025-26 at Phase 1 of Spending Review 2025, and comparable UK Government funding in England, will not be included in the Northern Ireland Executive un-ringfenced TDEL included in the relative funding calculation.

**A.20** Revisions to comparability factors for the purposes of measuring relative funding would be agreed by the UK Government and Northern Ireland Executive. There are no plans to remove un-ringfenced agriculture funding from the comparability factors.

**A.21** The calculation of relative funding methodology at the spending review will determine whether a 5% or 24% needs-based factor is applied in the Barnett formula to changes to UK Government department funding agreed at the spending review. The autumn budget calculation will then determine whether a 5% or 24% needs-based factor applies to in-year changes for the following financial year. There will not be any changes to spending review Barnett

consequential even if a different needs-based factor applies in-year i.e. if the needs-based factor for a given financial year changes from 24% at the spending review to 5% in-year there would not be a decrease to the Barnett consequential provided for that financial year at the spending review, and vice versa if the factor is 5% at the spending review and 24% in-year.

## **Examples of distortive funding previously stripped out of comparability factors**

**A.22** At Spending Review 2020, given the exceptional circumstances in relation to Covid-19 and the end of the EU transition period, programme level comparability was applied in these areas. This was necessary to ensure the devolved governments received comparable funding as departmental comparability factors (based on Main Estimates 2020-21) did not adequately reflect the geographic scope of planned departmental spending in these areas.

**A.23** For example, the Department for Health and Social Care was procuring Covid-19 tests and vaccines for the whole of the UK so Scotland, Wales and Northern Ireland received a share of the tests/vaccines rather than a share of the funding. Conversely, the Department for Transport was providing exceptional support to rail operators in England so a programme level approach again ensured the devolved governments received comparable funding.

**A.24** For Spending Review 2021, the use of departmental comparability (whether based on Main Estimates 2020-21 or Main Estimates 2021-22) would again not provide the devolved governments with comparable funding in all areas. As this meant some programme comparability needed to be used, the departmental comparability calculated at Spending Review 2020 (for the first time since 2015) were re-used. Programme level comparability was then applied where departmental comparability did not adequately reflect the geographic scope of planned departmental spending. This therefore included certain programmes in relation to Covid-19, EU Exit and the use of the financial assistance powers in the UK Internal Market Act 2020.

**A.25** The UK Government will consult with the Northern Ireland Executive before excluding any funding that would distort the calculation of relative funding.

## Step 3: An adjustment is made to each of the above

A.26 An adjustment is made to each of the above to deal with the unique treatment of non-domestic Rates (see below), and to remove ringfenced non-Barnett additions to the Northern Ireland Executive's block grant.

### Non-domestic rates

A.27 As in the Statement of Funding Policy section 3.27 to 3.30, each devolved government has full control of the structure and level of non-domestic (business) Rates within its jurisdiction. They set Business Rates policy, retain all of the revenue generated, and determine how they are spent.

A.28 Revenue generated from the non-domestic (and domestic) Regional Rate is not included in the Northern Ireland Executive's total block grant DEL used in the relative funding calculation. The UK Government's non-domestic Rate (Business Rate) revenue is included in the UK Government funding used in the comparability assessment and cannot be stripped out of the figures. This is because, uniquely for a devolved tax, the Barnett formula is applied to UK Government non-domestic Rates revenue generated in England, and then corresponding UK Government spending in England.

A.29 Non-domestic Rate revenue is scored as negative DEL and so including UK Government non-domestic Rates revenue in the relative funding calculation, but not Northern Ireland Executive revenue, would distort the calculation as UK Government funding would be artificially low and Northern Ireland Executive relative funding would be artificially high.

A.30 To avoid this distortion, there is a unique approach to the non-domestic Rate in the relative funding calculation. As with the approach to block grant adjustments in section 1 above, to avoid UK Government and devolved government non-domestic Rate policies from distorting the relative funding calculation, an assumption is made that per person non-domestic Rate revenue is the same for the UK Government in England as for the Northern Ireland Executive in Northern Ireland. By having equivalent non-domestic Rates revenue per person in the methodology, it removes the distortion and also means that the Northern Ireland Executive's relative funding is not affected (either negatively or positively) by UK Government or Northern Ireland

Executive non-domestic Rates policy, and the corresponding revenue generated in England and Northern Ireland.

## Removal of ringfenced non-Barnett

A.31 The objective of the relative funding methodology is to assess comparable UK Government and Northern Ireland Executive funding. UK Government funding in reserved areas is excluded as there is no comparable Northern Ireland Executive funding. Similarly, ringfenced non-Barnett additions to the Northern Ireland Executive will also be excluded from the relative funding calculation as it is provided for a specific purpose and:

- Either there is no comparable UK Government spending, or:
- As with the comparability factor calculations above, there is comparable UK Government funding but including it in the calculation would have a distortive effect. This is where funding is calculated using a different methodology to a population share.

A.32 As agreed in the Interim Fiscal Framework, un-ringfenced non-Barnett funding will be included in the calculation as, like Barnett consequentials, this funding can be used for any Northern Ireland Executive devolved responsibilities and therefore there is comparable UK Government spending in England.

A.33 The table below shows examples in each of these categories:

No comparable UK Government spending	
City and Growth Deals	Deals in England have a different funding model and are subject to the Barnett formula and so there is no additional comparable UK Government funding
Shared and integrated education funding	No comparable UK Government funding. Any schools spending in England has the Barnett formula applied
Windsor Framework	UK Government borders spending is reserved and UK-wide so is not included in the relative funding calculations so there is no comparable UK Government funding
Distortive funding	
Covid-19	During the Covid-19 pandemic, the UK Government procured Covid-19 tests and vaccines across the UK despite health being a devolved policy area.

	This spending was treated at a programme level in the Department of Health and Social Care's comparability factor to avoid it distorting the calculation as time-limited UK-wide spending.
IFRS16	Ringfenced funding for IFRS16 is agreed through Reserve claims based on leases agreed across different jurisdictions in the Spending Review 2021 period.

## Step 4: The ONS principal population projections

A.34 The ONS principal population projections are used to calculate funding on a per head basis.

A.35 As in the Statement of Funding Policy section 3.12 to 3.14, the population proportions used in the relative funding methodology reflect the annual mid-year estimates published by the Office for National Statistics in the summer.

A.36 The population figures are used to compare per person funding between the Northern Ireland Executive and UK Government.

A.37 UK Government funding is provided for England, England and Wales, Great Britain or UK-wide spending depending on the territorial extent of the relevant policy. Where possible, the per head calculation will reflect the territorial extent of UK Government departmental spending and the relevant population figures (i.e. Northern Ireland population as a proportion of England and Wales or Great Britain rather than England). This is consistent with the approach taken when calculating the territorial extent of UK Government spending in Wales.

A.38 Where it is not possible due to the complexity of using different population figures for different elements of UK Government departmental spending, the per head calculation will use the England only population. When the England-only population is used for the per head calculation, this means that Northern Ireland Executive funding is compared to UK Government funding for the rest of the UK but spread across only the England population, and UK Government funding is artificially higher per person (and relative Northern Ireland Executive funding per person is lower).



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