

DEPARTMENT OF FINANCE & PERSONNEL

Craigantlet Buildings

Stormont Estate

BELFAST BT4 3SX

Tele: 028 9052 0444

Direct Line: 028 9052 7437 or 27437 on Network

Fax: 028 9052 9148 or 29148 on Network

From: Dr Andrew McCormick

Second Permanent Secretary

**Ms Ros Dunn
Head of Devolved Countries & the Regions
HM Treasury
Parliament Street
LONDON
SW1 3AG**

8 October 2003

Dear Ros

NIE: PROCEDURES UNDER DIRECT RULE

1. In light of the exchanges over Civil Service pay and our Draft Budget, I thought it would be helpful to set out our perspective on how procedures should work between DFP and Treasury during the present period of suspension of devolution.

Background

2. Throughout the 1980s and 1990s, under a long period of continuous direct rule, Treasury made it clear that its interest in relation to financial business in relation to the Northern Ireland Departments was confined to issues which had potential repercussions for the rest of the UK. This was formalised in the Block Budget Groundrules. The underlying point was that DFP was and remained the Treasury Department in relation to the Northern Ireland Departments, with responsibility for the planning and management of the Block Budget, for approving Estimates and presenting them to Parliament, and giving account to Parliament for the discharge of these function – uniquely, throughout that period, a DFP official was the Treasury witness at PAC hearings in relation to NI Departmental expenditure.
3. Apart from the determination of public expenditure allocations, the main substantive issues which gave rise to formal involvement of Treasury Ministers and officials in our business were topics such as Departmental Running Cost allocations (where there was a clear need for consistency of policy across the UK), some large inward

investment industrial development cases (where the criterion of potential repercussiveness was relevant), and aspects of the treatment of EU receipts.

The key point was and is that Treasury accepted – on the Parliamentary record - that it had no formal locus in relation to the allocation of resources within the Northern Ireland spending allocation to public services. This point was in common with the treatment of the Scottish and Welsh blocks under direct rule (Melvyn Jeremiah, circa 1987, "A Block is a Block is a Block!"), though some aspects mentioned above were unique to Northern Ireland.

Budget Announcement

5. It follows that practice under direct rule never included Treasury involvement in Northern Ireland Public Expenditure announcements, because the Treasury had accepted explicitly that these were matters entirely within the discretion of the Secretary of State. We followed exactly the same practice last December when Ian Pearson, on behalf of our Secretary of State, announced the spending allocations in the revised Budget in December of last year. This was our practice and we see no reason whatsoever to make any change. We believe there is at least thirty, if not eighty, years of history on our side of this particular argument. I do apologise that our previous practice of giving some advance information was not honoured on this occasion, but we have had to work frantically to complete this task ahead of a possible Election announcement which would have made our timetables impossible.
6. On the particular points in Mark Parkinson's e-mail of yesterday to Richard Pengelly, I want to give you some assurances. First of all I hope you will acknowledge that in the material issued yesterday, we have taken a clear and more direct stance on the necessity of fair treatment across the UK than in any previous public announcement. I would draw your attention in particular to the documents on the DRD website (www.waterreformni.gov.uk). In paragraph 16 of the "Statement" (see link under 4th paragraph of introduction on the website), at paragraph 16, DRD said the following:

"Some have suggested that water and sewerage services should be paid for through general taxation. But this would imply that we ask taxpayers in Great Britain to pay more when we are already paying much less than they are in general taxation and local revenue. The Government's clear position is that we would regard that as unfair to other parts of the UK. Northern Ireland is receiving a fair share of national taxation, and the Northern Ireland Executive sought and has been given a unique means of addressing the problem of past under-investment through the RRI. But we have to ask those in Northern Ireland who are able to pay more to do so towards the valid cause of improving public services".

7. In this quotation, I hope you will note how firmly Ministers' collective responsibility for defending Barnett has overridden the doubts which DFP officials have put to you many times on the implications of Barnett for Northern Ireland public services – in the present context we have to accept this obligation in all public statements.
8. Certainly all the public reaction to the Budget announcement on Monday, and the Water Consultation Report released at midnight that night, has focused on Direct Rule Ministers imposing and taking forward the Government's collective agenda and facing

up to the difficult decisions which, as you will recall, were never expressed clearly or publicly under the period of devolution.

2006-07

9. Thus we hope that the overall impact of what we have done in the last 48 hours is actually very helpful from the Treasury's point of view. On the concerns in Mark's e-mail, we have made it very clear that the figures for 2006-07 are for planning purposes only and will be reviewed fully in the forthcoming Spending Review. We fought long and hard to secure three-year planning in last year's cycle under the Executive and see no reason against adopting working assumptions for planning purposes in the present cycle. It is simply impossible to make sensible plans for capital expenditure without some kind of assumptions for the new third year.
10. In detail, what we did was assume, in line with all that has been said by the Chief Secretary and the Chancellor, that Whitehall Departments should expect no increase in real terms. We applied that, not to our own DEL, but as a basis for calculating what might flow through Barnett, and go alongside the Barnett consequential from the Health settlement announced last year. This allowed us to calculate what the DEL might be for 2006-07 and provide a basis for planning.
11. On borrowing, the new amount we have projected as a possible borrowing figure for 2006-07 is not £328 million but £200 million. Again we have emphasised that this is provisional and subject to review – but it is the lowest figure that would credibly take forward the RRI approach. All that we have said is based very solidly on the commitments given by the Prime Minister and the Chancellor that, if additional revenue is raised on the agreed basis, we will have access to RRI borrowing. The details are based exactly on the use of the formula agreed with DCR. I do recognise that this all needs to be formalised in proper correspondence at official and ministerial level to confirm the details of the borrowing formula, but we are and were in no doubt that the basis for making this projection exists. Richard Pengelly would be very happy to talk through the detail of this with your team and show that our calculations are fully in line with all we have shared with you through the recent months.
12. Following the announcement, the one thing that has caused most hostile reaction to is the announcement of rates increases which are necessary to trigger the revenue that gives rise to the borrowing, which simply shows how much more we need to do to get the key messages of RRI across, and how much we need the borrowing power to sell the kinds of reforms that are needed.
13. On Peace II, you will be aware that spending on Structural Funds programmes continues for two years after the date when a programme ceases to commit funds to projects. The closing date for the allocation of resources under PEACE II is December 2004; consequently the closing date for expenditure under the Programme is December 2006 and hence the allocation specified in the 2006-07 year. This therefore relates entirely to the funding already agreed for the PEACE II Programme and does not imply in any way that there is any commitment to Peace funding beyond that already agreed.

Water and Electricity

14. As Mark's email indicated, we are still in correspondence on aspects of water and electricity. On water, the Budget assumes and makes explicit our acceptance of the

Chief Secretary's condition from the Settlement Letter of July 2002, as subsequently confirmed formally by the Secretary of State. The Budget press release on Monday made explicit that this assumption had been made from September 2002 onwards. We have not yet factored in a change of status for Water Service simply because no decisions have yet been taken on the business model for the future – and it is increasingly clear that 1 April 2007 is a more realistic date for change than 2006. It will only be at that stage that we will need to adopt new classifications of DEL and AME expenditure: hence the figurework underlying our DEL and AME projections for the entire period of the Budget announcement remain consistent with the position previously agreed. That said, I have to reinforce that water reform in Northern Ireland is only viable if the problem currently under discussion between GEP, DCR and my team is resolved in a satisfactory manner as a matter of urgency – without that, all bets must be off. As agreed, we are in the course of preparing urgently a further paper on this issue.

15. On electricity, when we discussed this last month you clarified the most essential point, which was that there was no prospect of a unique Treasury concession in relation to this issue. That threw us back on using our own resources and the Secretary of State has decided to proceed with an intervention to reduce electricity prices making direct use of our own DEL. The approach he has adopted is the idea set out in paragraphs 46 and 47 of the paper I sent you on 16 September. Details of precisely how this will apply, and the State Aid issues, are still being pursued by DETI here. But as no special Treasury intervention is involved, our Ministers' decision on this issue does not pre-empt or cut across any outstanding correspondence with you. I did ask you and Geoffrey to consider the more detailed paper by DETI on electricity issues and if this gives rise to some new insight or idea which would be of benefit to all concerned, that would remain very welcome. But we have not counted on any such help and Ian Pearson in particular wished to proceed to make the announcement as now set out in the Budget document, which is clearly non-repercussive, as it addresses a totally unique situation.

Civil Service Pay

16. Turning to NICS pay, I have to acknowledge now that our actions on this could be caught by the application of the "potential repercussiveness" criterion mentioned above, though I note that earlier attempts by Treasury (eg in autumn 1984) to assert a more formal locus on pay were **not** confirmed in the agreed Block Budget Ground rules. The Secretary of State has just issued a letter for issue to the Chief Secretary seeking to persuade the Chief Secretary that our approach on Civil Service pay this year was the best we could do to work within the framework of Government and public sector pay policy. I would just make the points that:
 - a. there was no obligation on us to seek Treasury approval to pay remits before devolution – this did not take place at any time between the introduction of remits, following the decentralisation of pay in 1996, and devolution in 1999. My understanding is that Treasury exercised control over pay and related issues through the running cost regime, where, as I explained above, we were well used to the practise of agreeing running cost limits with Treasury through the late 1980s and 1990s;
 - b. our pay proposals this year were developed fundamentally by reference to our own analysis of the relevant issues of recruitment, retention, motivation, equity of treatment and affordability, including the central policy guidelines from

Treasury in our own context, rather than by trying to match or mimic action elsewhere. We were seeking to see through a pay strategy already set in train last year, and this constrained the scope for negotiation this year. We had to work in this way because our settlement date is 1 April, and we cannot, therefore, wait for information on the remits for GB settlements relating to 1 August onwards;

- c. Our proposals are **not** to increase pay relative to that in GB. While comparisons are more complex than they used to be, the minima and maxima of our pay scales are generally in the lower part of the range of scales across the Civil Service more generally and the proposal for this year is for these to be revalorised by 2%. Even with that revalorisation, they would still be lower than many comparable pay scales in Whitehall before any application of pay remits (which we assume will be in the order of 3.5%) across Whitehall. So I would not accept that there is a substantive issue of repercussiveness in what we have actually done on Civil Service pay in this cycle. I am prepared fully to acknowledge that Treasury has a locus where there is potential repercussiveness and on that basis we should have advised you of what we were doing on this issue at an earlier stage.

Conclusion

17. There are some fundamental points here where it is very important that we have an agreed understanding. I am not averse to your suggestion that there should be a Treasury locus in relation to Public Service Agreements where challenging quality control and assurance through Treasury and the Delivery Unit could have a distinct sharpening influence on target setting etc in relation to public services here. But I would resist strongly on principle and precedent any implication that a locus on Public Service Agreements would extend to the setting of priorities across Northern Ireland, or on any aspect of resource allocation within the fixed DEL: these have always been the final responsibility of the Secretary of State under direct rule through the whole of the 1980s and 1990s. It would also run contrary to Government policy during this current stage of the Peace process which is to maintain the system established by the Executive in warm storage, and hence to hold to the broad priorities set by local politicians which are set out in their Public Service Agreements.
18. I suggest we discuss this fully when you have had a chance to consider the points above.

Andrew McCormick

ANDREW McCORMICK