

Y Pwyllgor Cyllid

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Cynulliad
Cenedlaethol
Cymru

National
Assembly for
Wales



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Ymatebau Ymchwiliad – Ymchwiliad i arfer orau mewn prosesau
cyllidebol

Noder bod y dogfennau a ganlyn yn ychwanegol i'r dogfennau a gyhoeddwyd yn y
prif becyn Agenda ac Adroddiadau ar gyfer y cyfarfod hwn

FIN(4) – BPBP Diverse Cymru (Saesneg yn unig)

FIN(4) – BPBP Office of Parliamentary Budget Officer Canada (Saesneg yn unig)

FIN(4) – BPBP The Chartered Institute of Public Finance & Accountancy
(Saesneg yn unig)

FIN(4) – BPBP Archwilydd Cyffredinol Cymru

FIN(4) – BPBP Federation of Small Businesses

FIN(4) – BPBP Dr Joachim Wehner, London School of Economics

FIN(4) – BPBP Gerald Holtham

FIN(4) – BPBP Organisation for Economic Co-Operation and Development

FIN(4) – BPBP Cardiff Business School



Response to the National Assembly for Wales Finance Committee's Inquiry into Best Practice budget processes

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Organisation Background

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Diverse Cymru is an innovative relatively new organisation in the Welsh Third Sector, created in recognition of the realities faced by people experiencing inequality in Wales.

Diverse Cymru promotes equality for all. We believe that we can work together to challenge discrimination in all its forms and create an equitable future for the people of Wales.

Diverse Cymru aims to make a real difference to people's lives through delivering services that reduce inequality and increase independence; supporting people to speak for themselves and to connect with decision makers; creating opportunities for participation and development; raising awareness of equality issues; and inspiring people to take action against inequality.

Our current services include direct payment, self directed and independent living support for both adults and children, including managed banking and software framework development in Cardiff; a BME mental health befriending service in Cardiff and the Vale of Glamorgan; Health and Social Care Advocacy for BME people with mental health issues throughout Wales; family support, welfare benefit, income maximisation, tribunal, and general advocacy for people in Cardiff and the Vale of Glamorgan.

We produce information resources on a wide-range of equality issues, including for people affected by inequality across all protected characteristic groups and information for organisations and service providers; provide a conduit for service user voices to decision-makers throughout Wales through our

consultation and engagement work; run citizen involvement projects for people from protected characteristic groups and for carers; and co-ordinate volunteer placements both with Diverse Cymru and supporting external organisations to recruit, involve and support volunteers from under-represented groups.

We provide consultancy services on integrating equality in organisations, diversity champions, and equality impact assessments and deliver a range of training courses on a wide-range of equality related topics, including the only accredited Personal Assistant training in Wales; accredited Challenging Extremism and Hate Crime Awareness training, and training on BME mental health; Equality legislation; disability; stress; LGBT issues and more. We facilitate forums and groups that work on various issues, from improving disability access and carrying out disability access observations to equality impact assessments.

This submission focuses specifically impacts on people from protected characteristic (equality) groups. We would be delighted to assist with the development of specific work programmes, and to be involved in budgetary processes and developments affecting equality in future. We would be happy to present further evidence and views to the committee if this would be of use. We are happy for our response to this inquiry to be published.

Submission

1. With regard to equality impacts of budget processes and financial accountability there is a wealth of evidence that suggests that often small and individually justifiable negative impacts on one or more protected characteristic group can amount to significant disadvantage when viewed in conjunction with other changes across a whole system.
2. A clear example of this is welfare reform, where individually the amendments to Housing Benefit, Disability Living Allowance/Personal Independence Payments, Council Tax Reduction Schemes, Employment and Support Allowance, and Universal Credit have minor negative impacts on some groups, such as disabled people in particular. One source of evidence for the disproportionate impacts of welfare reform on certain groups is the Welsh Government commissioned research into the impact of the UK Government's welfare reforms in Wales, where stage 3 part 1 focused on the impacts on Protected Characteristic groups (<http://wales.gov.uk/topics/people-and-communities/welfare-reform-in-wales/publications/analysingreforms/?lang=en>)
3. The need to conduct comprehensive Equality Impact Assessments, which consider the compound impacts of various budgetary and financial decisions on each protected characteristic group, is clear from such cases.
4. The National Assembly for Wales is unique within the UK in having a commitment to advancing equality embedded in its founding legislation and principles. Further active commitment to equalities in Wales has been shown through adopting more stringent and appropriate specific Regulations for Wales under the Equality Act 2010.
5. Significant improvements have been made in recent years, which must be commended, including a strategic approach to conducting Equality Impact Assessments on Welsh Government budgets

and forming the Budget Advisory Group on Equality (BAGE)

6. As we enter a new era of financial powers and responsibilities devolved to Wales, it is vital that these processes and considerations, which support core aims of reducing poverty, tackling social injustice, reducing educational attainment gaps, reducing pay and employment gaps, and promoting fair life chances for people from all protected characteristics groups, are strengthened and not overlooked in favour of International Financial Standards.
7. We believe that Equality Impact Assessments, involving citizens in assessing the impacts of financial changes, and addressing negative impacts on protected characteristic groups as well as enhancing measures to close the gaps between protected characteristic groups and the wider citizens of Wales is compatible with International Financial Reporting Standards (IFRS) and International Accounting Standards (IAS) as well as other financial good practice, in that transparency and accountability can be enhanced, whilst also ensuring that policy objectives are achieved and that no group is inadvertently further disadvantaged by financial and budgetary decisions.
8. We therefore recommend:
 - 8.1. That Equality Impact Assessments become an integral part of budgetary and financial processes for all new and existing powers and processes.
 - 8.2. That Equality Impact Assessments taken into account previous and other current financial and budgetary decisions and impacts to assess the compound impacts of financial and budgetary decisions, policies and practices on each protected characteristic group.
 - 8.3. That mitigating action be considered and undertaken with regard to negative and differential impacts on particular groups before decisions are implemented.
 - 8.4. That citizens and representative organisations from each protected characteristic group and sub-group, and representing cross-characteristic groups are involved in assessing impacts from the initial point of discussing ideas, before decisions are implemented and throughout the evaluation and monitoring process.
 - 8.5. That information is provided in plain language, with financial and accountancy terms explained, to enable Welsh citizens to understand the potential impact on their own lives and to be able to feed these into processes.
 - 8.6. That the Budget Advisory Group on Equality be strengthened to reflect the potential for increased impact on protected characteristic groups of enhanced powers for Wales. This should include improving representation for each protected characteristic group and sub-group and ensuring that the issues encountered by those people with more than one protected characteristic are represented by both specialist organisations and general equality organisations.

Submission to the Finance Committee, National Assembly for Wales

Inquiry into Best Practice Budget Process

International Best Practice : What are the principles of fiscal accountability? How do other countries achieve devolved financial accountability while retaining central fiscal control?

The cornerstone of fiscal accountability in a decentralized federation is transparency. This transparency is achieved by ensuring that the fiscal planning documents are sufficiently robust to allow parliamentarians and the public to understand the broad fiscal strategy and goals of the government (over the short and medium-term), as well as a credible public accounts that identify the fiscal outcomes and explanations of any deviations of actual versus planned spending.

The OECD offers good guidance in this regard through the “Best Practices for Budget Transparency”, which enumerate the types, content, and objectives of financial documents that should be prepared over a jurisdiction’s planning cycle. Importantly, the OECD’s principles offer some flexibility to allow jurisdictions to tailor their planning and reporting cycle to their idiosyncratic needs.

In the Canadian context, the federal and provincial (subnational) governments share almost all the same tax bases. In addition, under the *Constitution Act*, they also share authority for many of the same spending areas (e.g. Natural Resources, Environment, Industrial Policy). A significant share of federal spending is also comprised of transfers to subnational governments to support healthcare and other social programs (although this is a minority of aggregate national spending).

On the revenue side, there is limited formal collaboration between the national and subnational governments. Over the past decade, the federal government has attempted to lead tax reforms through short-term incentive programs (e.g. one-time transfers to eliminate provincial capital taxes), as well as suasion (e.g. calls from the federal government to provincial governments to reduce corporate tax rates, following similar reductions in federal corporate taxes).

On the spending side, the two levels of government often attempt to coordinate their efforts through negotiation among the public service and political levels. This includes cost sharing, as well as harmonization of federal and provincial programs. With respect to the major federal transfers for healthcare and social programs, there is limited power for the federal government to control or monitor how subnational governments acquit themselves.

Lining Budgets to Outcomes: What new budget procedures are needed to improve the links between policies, spending programmes and outcomes? How would outcomes generated by the UK Government and the global economy be identified separately from those generated by local Welsh Government policies?

This is a challenge faced by any government that attempts to isolate the impacts/results of specific program interventions on the broader economy and society.

The OECD's guidance regarding performance budgeting provides a well-articulated framework for linking program spending to outcomes. This includes the incorporation of performance data into the fiscal planning documents, as well as the processes by which they are considered by parliament and presented to the public.

In the Canadian context, while the federal government and many provincial governments have adopted varying aspects of a performance budgeting regime, there is limited coordination to ensure concordance.

That said, in principle, the OECD's guidance does provide a conceptual framework to link the global and national outcomes with those of sub-national governments. This is performed by identifying the short and medium-term program outputs (i.e. the direct, measurable results of expenditures), and then setting these in the context of broader outcomes (i.e. overall results of across the economy), which are influenced by the specific program and other factors.

The Canadian federal government previously published an annual study that linked federal program interventions to broader economic and social outcomes. However, this report was discontinued in 2011, due (in part) to a perception that the report was not useful for parliamentary deliberations or budgetary decision-making.

National Assembly for Wales Finance Committee: Inquiry into Best Practice Budget Processes

A Submission by:

**The Chartered Institute of Public
Finance and Accountancy**

May 2014

CIPFA, the Chartered Institute of Public Finance and Accountancy, is the professional body for people in public finance. CIPFA shows the way in public finance globally, standing up for sound public financial management and good governance around the world as the leading commentator on managing and accounting for public money.

Further information about CIPFA can be obtained at www.cipfa.org

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1. INTRODUCTION – A WHOLE SYSTEMS APPROACH

- 1.1 CIPFA welcomes the Wales Bill published on 20 March 2014, with the accompanying Command Paper,¹ and its intention to increase the accountability of the Welsh devolved institutions. However, some issues remain as the Bill still falls short of addressing all the areas of concern raised during pre-legislative scrutiny.²
- 1.2 It is good to see that the Bill has been amended to provide the National Assembly with the power to develop its own budgetary process, by amending Schedule 7 to the *Government of Wales Act 2006*. This means that the Assembly will be able to determine its own budget process, which should link taxation, spending and borrowing plans and allow for adequate scrutiny of how the Welsh Government proposes to raise and spend public money.
- 1.3 CIPFA welcomes the Committee's inquiry and the fact that it is exploring international best practice to inform the development of a Welsh budget process, as recommended by the Silk Commission.³ It is also good to see that the Committee is exploring the potential for more outcomes-focused budget procedures.
- 1.4 Although we welcome the focus on the budget process and procedures in line with the powers proposed in the Wales Bill, CIPFA advocates a whole systems approach to public financial management.
- 1.5 In 2009, at the International Federation of Accountants (IFAC) G20 Summit, the World Bank called for a strengthening of the public finance profession in developing and emerging economies as a key step in achieving financial stability.⁴ CIPFA developed a framework, the whole systems approach, to build on that thinking, based on practical experiences and tested methodologies.⁵ Its purpose is to provide an analytical framework to support effective public financial management in all countries, enabling relevant public services for citizens.
- 1.6 Public financial management (PFM) drives the performance of the public sector through the effective and efficient use of public money. It provides leaders with information to raise finance, know if they are using resources effectively and make decisions.
- 1.7 The World Bank defines PFM in relation to its component parts: *...financial management refers to the budget, accounting, internal control, funds flow, financial reporting and auditing arrangements by which they receive funds, allocate them and record their use.*⁶
- 1.8 CIPFA defines PFM in relation to its contribution to achieving strategic and operational objectives as a key aspect of good governance, placing relevance and

¹ [Wales Bill](#) and [Cm8838, Wales Bill: Financial Empowerment and Accountability](#), March 2014.

² Public Finance, [Work still to be done on Wales Bill](#), 24 March 2014

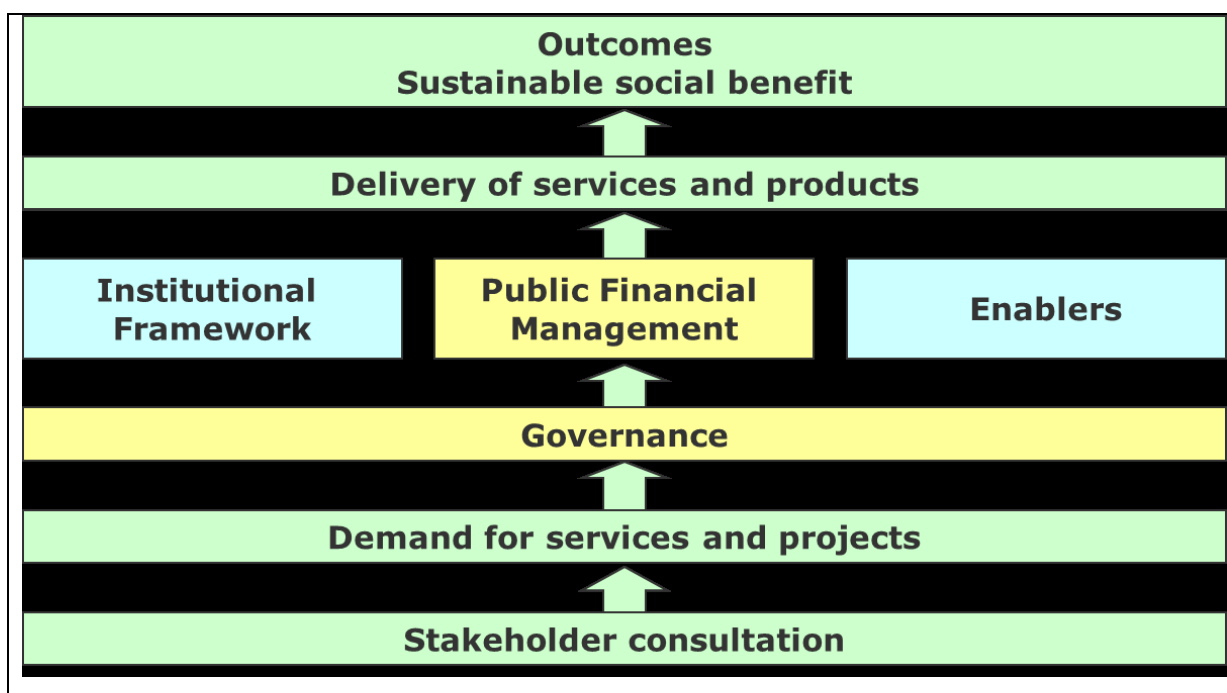
³ Commission on Devolution in Wales, [Empowerment and Responsibility: Financial Powers to Strengthen Wales](#), November 2012

⁴ IFAC, [Recommendations for the G20 Nations – Meeting of September 24 – 25, 2009](#)

⁵ CIPFA, Public Financial Management: A Whole System Approach, [Vol I: The Approach](#) and [Vol II: Additional Material](#)

⁶ World Bank, Projects, Financial Management

effectiveness at the heart of the PFM objectives: *PFM is the system by which financial resources are planned, directed and controlled to enable and influence the efficient and effective delivery of public service goals.*⁷ Thus, the whole is greater than the sum of the parts:



1.9 The whole system approach to the design and improvement of PFM is based on the argument that PFM will be more effective and sustainable if balanced across the full range of PFM processes. The model can be used to examine, formulate and improve PFM design. It distinguishes a number of process elements:

- **Legislation** – sets the regulatory framework for PFM, determining the powers and mandatory requirements within which public sector bodies raise and spend money. Legislation should be transparent and applied predictably so it can be consistently administered and can be navigated by civil society.
- **Standards** – established principles/rules governing the actions/behaviours of public sector bodies to achieve compliance with a common set of non-statutory requirements. Such standards include those set by international bodies such as the International Federation of Accountants (IFAC) and CIPFA, by national governments, professional bodies or on a sectoral basis.
- **Execution: Strategy and Planning** – processes which set the direction for activities requiring financial management in short, medium and longer term and frameworks within which financial performance is managed.
- **Execution: Operations** – principal financial operations needed to maintain financial discipline and resilience, deliver services and enable desired outcomes. Generally the focus is on national budgeting and accounting systems in this area. In practice while central government set the framework for spending it will be departments and other bodies who carry it out. It is important to consider the whole range of operations and the level at which they are undertaken to plan and create capacity building initiatives.

⁷ CIPFA, Public Financial Management: A Whole System Approach, [Vol I: The Approach](#)

- **Execution: Monitoring and Internal Control** – processes designed to measure progress and achievement of milestones and keep organisations on track to achieve their objectives.
- **Assurance** – formal processes to assure stakeholders on standards and effectiveness, carried out at arm’s length from the operations they examine. The rigour, professionalism and independence of these processes contribute to public trust.
- **Scrutiny** – to oversee, influence and challenge the allocation of resources and the administration of public money. Scrutiny processes create a demand for transparency and improve accountability and build pressure for an open and honest public sector. Scrutiny is an important system of checks and balances and a way of enabling the citizen’s voice to be heard by executive authority.
- **Learning and Growing** – processes enabling public sector organisations to reflect on and learn from best practice to develop knowledge and capabilities. Such processes enable organisations to become more effective, achieve results more efficiently, sustain improvements and take responsibility for future development.

1.10 Given the package of financial powers proposed in the Wales Bill, A Welsh budget process should be considered in the context of the whole system of PFM within which it will operate, rather than in isolation.

1.11 CIPFA recommends that:

- **Although the Committee’s inquiry is focused on best practice for the budget process, this should be considered in the context of the whole system of PFM within which it will operate, rather than in isolation.**
- **The Committee should work with the Welsh Government to better understand the current system of PFM and how this could be improved to provide a whole systems approach in the context of additional powers.**

2. REAL FINANCIAL ACCOUNTABILITY

- 2.1 The Silk Commission's part 1 report considered a range of evidence on the principles for funding, one of which was stated to be accountability.⁸
- 2.2 The Good Governance Standard for Public Services⁹ states that real accountability requires a relationship and a dialogue, and involves *an agreed process for both giving an account of your actions and being held to account; a systematic approach to put that process into operation; and a focus on explicit results or outcomes. Real accountability is concerned not only with reporting on or discussing actions already completed, but also with engaging with stakeholders to understand and respond to their views as the organisation plans and carries out its activities.*
- 2.3 The International Monetary Fund (IMF), in a discussion paper on fiscal accountability, consider that fiscal transparency is an essential prerequisite for real financial accountability, and they define such transparency as: *the clarity, reliability, frequency, timeliness, and relevance of public fiscal reporting and the openness to the public of the government's fiscal policy-making process—is a critical element of effective fiscal management.*¹⁰
- 2.4 Accountability, however, is only one element of good governance¹¹ and in isolation will not provide for good stewardship of public funds. The achievement of good governance is dependent on the achievement of all the pillars required:
- Accountability – capacity to call public officials to task for actions;
 - Transparency – low-cost access to relevant information;
 - Predictability – result primarily from clear laws and regulations which are known in advance and uniformly and effectively enforced; and
 - Participation – required to generate consensus, supply reliable information and provide a reality check for government action.
- 2.5 In line with the Good Governance Standard for Public Services, CIPFA considers that true accountability requires an open dialogue and that the Committee should continue to work with the Welsh Government to improve the financial and performance information available for scrutiny to aid in transparency and accountability, and to help ensure that the Welsh budget process is informed by and adheres to all the pillars of good governance.
- 2.6 In their Part 1 report the Silk Commission stated that: *In accordance with our principle of transparency, we believe that the Assembly's procedures for the consideration of taxation, borrowing and spending should reflect international best practice.*¹²

⁸ Commission on Devolution in Wales, [Empowerment and Responsibility: Financial Powers to Strengthen Wales](#), November 2012

⁹ The Independent Commission for Good Governance in Public Services, [The Good Governance Standard for Public Services](#), 2004

¹⁰ International Monetary Fund, [Fiscal Transparency, Accountability, and Risk](#)

Prepared by the Fiscal Affairs Department in collaboration with the Statistics Department

Approved by Carlo Cottarelli, August 7, 2012

¹¹ The Independent Commission for Good Governance in Public Services, [The Good Governance Standard for Public Services](#), 2004

¹² Commission on Devolution in Wales, [Empowerment and Responsibility: Financial Powers to Strengthen Wales](#), November 2012

2.7 CIPFA agrees with the Silk Commission that to ensure full financial accountability of the Welsh Government for their financial decisions, the Welsh budget process should link the three elements of tax, borrowing and spending plans, and that all three elements should require approval by the Assembly. It is essential that each element should be as transparent as possible, to enable effective scrutiny of the Welsh Governments plans, both by the Assembly and it's committees, as well as wider civic society.

2.8 CIPFA recommends that:

- **The Committee build on the existing relationship with the Minister for Finance and her department to continue to improve the financial and performance information available for scrutiny to aid in transparency and accountability, and to help ensure that the Welsh budget process is informed by and adheres to all the pillars of good governance.**
- **A Welsh budget process should link the three elements of taxation, spending and borrowing plans and that all three elements should require approval by the Assembly. The process should allow for adequate scrutiny of how the Welsh Government proposes to raise and spend public money.**

3. THE BUDGET PROCESS

3.1 The Silk Commission considered extensive evidence on international fiscal systems, in terms of mechanisms used to fund sub-national governments, which was published¹³ and considered in their Part 1 report.¹⁴ Similar research on international fiscal systems was undertaken and presented to the Calman Commission.¹⁵ A more comprehensive review was undertaken by the IMF in 2007.¹⁶

3.2 Although such research provides a large body of information on the fiscal systems used to fund various tiers of government internationally, many of the examples found internationally are federal systems, and therefore making direct comparisons to the UK system of devolved government is problematic.

3.3 Given the large body of work undertaken in relation to fiscal systems, here the focus is on international examples of budget process and procedures, rather than funding systems. We would encourage the Committee to consider these as part of a whole systems approach. The following sections consider the budget process in terms of:

- Integration of financial planning with wider strategies;
- The role of government and parliament;
- The timing of the budget process;
- Support for scrutiny and access to information; and
- Public engagement in the budget process.

3.4 Many of our comments here are derived from a review of various papers prepared by the Organisation for Economic Co-operation and Development (OECD). Useful references, which the Committee should review, are the OECD Best Practices for Budget Transparency,¹⁷ and their International Database of Budget Practices and Procedures.¹⁸ The database is a particularly rich source of information on budget procedures, as it covers all the elements of the budget process, enabling such information to be seen for individual countries or country groups. It shows information on the following: general information; budget formulation; passing the budget; budget execution; accounting and audit; and performance management.

3.5 The OECD are currently consulting on Draft Principles of Budgetary Governance,¹⁹ the ten draft principles being:

- Fiscal policy should be managed within clear, credible and predictable limits.
- Top-down budgetary management should be applied to align policies with resources.
- Budgets should be closely aligned with government-wide strategic priorities.
- Budgets should be forward-looking, giving a clear medium-term outlook.
- Budget documents and data should be open, transparent and accessible.

¹³ Commission on Devolution in Wales, [Context paper: International fiscal systems](#), 8 November 2012

¹⁴ Commission on Devolution in Wales, [Empowerment and Responsibility: Financial Powers to Strengthen Wales](#), November 2012

¹⁵ Commission on Scottish Devolution, Independent Expert Group, [First Evidence from the IEG to the Commission](#), November 2008.

¹⁶ International Monetary Fund, [Fiscal Federalism in Theory and Practice](#) (1997)

¹⁷ OECD [Best Practices for Budget Transparency](#)

¹⁸ OECD, [International Database of Budget Practices and Procedures](#).

¹⁹ OECD, [Draft Principles of Budgetary Governance – Public Consultation](#).

- The budget process should be inclusive, participative and realistic.
- Budgets should present a true, full and fair picture of the public finances.
- Performance, evaluation and value for money should be integral to the budget process.
- Longer-term sustainability and other fiscal risks should be identified, assessed and managed prudently.
- The integrity and quality of budgetary forecasts, fiscal plans and budgetary implementation should be promoted through rigorous, independent quality assurance.

3.6 CIPFA recommends that:

- **In considering the development of a Welsh budget process the Committee applies the above principles, and that the Committee should wish to discuss proposals for the budget process with the OECD before implementation.**

Integration of financial planning and wider strategies

3.7 The budget process is concerned with financial planning, and in the public sector, this tends to dominate the financial cycle. This stage should be considered in the context of the whole systems approach as described above. CIPFA considers it is essential that financial planning should be linked to the strategic and corporate planning processes,²⁰ and that the budget is simply a plan of action. Such annual plans should be developed in the context of a longer-term financial strategy, supporting the strategic objectives of government and should integrate capital, revenue and treasury management planning.

3.8 Evidence would suggest that this is not always the case. A discussion paper by the Audit Commission on world class financial management suggests that: *In many public sector bodies, the annual financial planning process is often only loosely connected to the strategic and service planning process.*²¹

3.9 An example of how the federal government of Australia implements an integrated planning and reporting framework to encourage good financial management and accountability is shown in [annex A](#).

3.10 CIPFA recommends that:

- **The Committee work with the Welsh Government to ensure that financial planning is linked to wider strategic planning, building on improvements already underway, such as bringing responsibility for the Programme for Government reports into Strategic Budgeting and Planning. Such links should be formed with all the Welsh Government's strategic planning, across portfolios.**
- **The budget as an annual plan, should be developed in the context of a longer-term financial strategy, supporting the strategic objectives of government and should integrate capital, revenue and treasury management planning.**

²⁰ CIPFA, [Integrated Planning: An Overview of Approaches](#), 2006

²¹ Audit Commission, [World Class Financial Management: a discussion paper](#), 2005

Role of Government and Parliament

- 3.11 The roles, responsibilities and powers of both Government and Parliament in the budget process vary between countries. In some countries Parliament has a strong direct influence on the budget process while in others there is less influence. This is sometimes due to the culture and nature of politics, especially in coalition situations where debates and discussions on spending plans and priorities can occur outside a parliamentary setting. In such a situation the debate can be short with the focus on voting.
- 3.12 An extensive body of work exists on the role of the legislature in the budget process. The OECD's International Database of Budget Practices and Procedures provides country-specific information on the role of the legislature.²² Other works have been undertaken by the OECD²³ and IMF,²⁴ amongst others. One academic in particular has constructed an index of 36 countries examining the parliamentary capacity for financial scrutiny.²⁵ The index considers six factors for legislative control:
- amendment powers
 - reversionary budgets
 - executive flexibility during implementation
 - timing of the budget
 - legislative committees
 - budgetary information.
- 3.13 The results of this study reveal substantial variation, with Westminster systems, such as in the UK, scoring close to the bottom of the index. These findings suggest that for some countries the 'power of the purse' is an important safeguard, whereas for others it remains a constitutional myth.
- 3.14 The authorisation of the budget should be more than just a formal exercise to comply with requirements, The legislature is the seat of overall political and financial accountability and it's role should not be to merely rubber-stamp decisions already taken.
- 3.15 The budget process should be seen as a key process which works best when both government and parliament cooperate within an agreed framework. It should be noted that while in some countries failure of a government to get its budget approved is seen as a 'vote of confidence' issue this is not true for all countries.
- 3.16 It is worth drawing attention to the findings of the Howatt Review in Scotland.²⁶ The then Minister for Finance and Public Service Reform appointed the group to review the Scottish Government's budgets (except local authority expenditure) to identify any that did not fit with their commitments and priorities or were not performing well. They were also tasked with proposing action, where appropriate, and to identify the implications of any proposed changes. One of the conclusions

²² OECD, [International Database of Budget Practices and Procedures](#).

²³ OECD Journal on Budgeting, [The Changing Role of Parliament in the Budget Process](#), B Andersen, 2009 (Vol 1); OECD Journal on Budgeting, [Role of the Legislature in the Budget Process: Recent Trends and Innovations](#), P Posner and CK Park, 2007 (Vol 7 No 3).

²⁴ International Monetary Fund, Working Paper WP/05/115, [Who Controls the Budget: The Legislature or the Executive?](#) I Lienert

²⁵ Political Studies, [Assessing the Power of the Purse: An Index of Legislative Budget Institutions](#), J Wehner, 2006 (Vol 54, 767–785)

²⁶ Report of the Budget Review Group, [Choices for a Purpose : Review of Scottish Executive Budgets](#), July 2006

of the review was that the approach to financial planning needed to have a more robust challenge function, strongly supported by the Director of Finance.

3.17 International experience would support this recommendation, and examples are shown in [annex A](#).

3.18 CIPFA recommends that:

- **The Committee should consider the roles and powers of other legislatures, and use this evidence base to inform the development of a Welsh budget process. We also suggest that the Committee could ‘benchmark’ any proposals for a Welsh budget process against the index and database detailed above, to assess how they would compare with other international processes.**
- **The Committee build on the existing relationship with the Minister for Finance and her department to establish an agreed framework for the budget process, in which the Government and Assembly work together, and which encourages good PFM as part of a whole systems approach.**

Timing of the budget process

3.19 The budget process should incorporate adequate time allocated to enable robust committee scrutiny and informed debate. To allow for informed debate and scrutiny the budget should be presented to the legislature at least 2-4 months prior to the beginning of the financial year.²⁷ The following is intended to provide some benchmark data in terms of time allowed for budget scrutiny in other legislatures.

3.20 The time available for budget scrutiny varies greatly between countries, for example, in the lower house of India (Lok Sabha) the budget debate lasts up to 75 days, in Germany it is up to 4 months, and in the US Congress the process can be even longer.²⁸ Further international examples are provided in [annex A](#).

3.21 In recent years the UK Government’s Spending Review cycle has become less reliable, with delays to their publications and the Spending Round 2013 providing figures for only two years (2014-15 and 2015-16), with no forecasts for financial years beyond the next UK general election. As the timetable for the spending review cycle is subject to political influence, it should not dictate the timing of the Welsh budget process and risk such potential instabilities.

3.22 CIPFA recommends that:

- **The Committee consider carefully the timing of the budget process, to ensure that proposals include adequate time for scrutiny, debate and public engagement, and the time allowed should meet at least the minimum prescribed by the OECD.**
- **A Welsh budget process and timeline should not be designed around the UK Government’s spending reviews, but instead should be based**

²⁷ OECD, [Best Practices For Budget Transparency](#)

²⁸ OECD, [International Database of Budget Practices and Procedures](#)

on a sound timetable which is prepared to be adapted by exception if necessary.

Support for scrutiny and access to information

- 3.23 Strong and capable committees allow the legislature to develop expertise and play a greater role in the budget process. The World Bank state that: *Committees are the 'engine room' of the legislature...It is here that in-depth and technical debate can take place, away from the political grandstanding that often characterizes proceedings in the chamber.*²⁹
- 3.24 CIPFA welcomes the fact that the Assembly has already made progress in implementing the advice of the Silk Commission that: *the National Assembly Commission may wish to consider building up capacity and expertise for financial scrutiny through the training of Members and through the research and committee support that Members receive.*³⁰
- 3.25 Different committees should deal with different facets of public finance management, thus giving a strong and robust systems for scrutiny of the entire budget. In general, it is in committees where the potential for amending powers lies. An example of how the Swedish parliamentary committees operate in the budget process is provided in [annex A](#).
- 3.26 It is essential that the legislature and its committees have access to support and independent expertise to enable budget scrutiny. Many overseas parliaments either use, or wish to use, independent experts during the budget process in order to avoid over-reliance on government data and allow more independent scrutiny. Independent expert roles can typically include:
- Determining, examining, verifying or proposing the economic assumptions used in the budget model (e.g. from a macro-economic viewpoint);
 - Costing /verification of alternative budget proposals; and
 - Testing / verification of Government spending initiatives, plans or claims.
- 3.27 While macroeconomic policy is not a devolved matter, with the devolution of tax powers, the government's proposals for the introduction of a tax may result in the Assembly having to consider the macroeconomic impact of taxation decisions in the future.
- 3.28 The Finance Committee has previously made use of expert advisers for scrutiny of the budget, an option not yet taken up by subject committees in the Assembly. Other Parliaments, including Westminster, rely on a more formal and permanent system of support in the form of independent units. A clear issue in this respect is not whether the permanent unit is truly 'independent' of government but whether its work is seen as, and trusted to be, completely unbiased. Such trust must be earned and can be easily lost.
- 3.29 The Scottish Parliament have established a Financial Scrutiny Unit³¹ within their existing Information Service (sPICE). The unit provides independent analysis and support to committees of the Scottish Parliament and to individual Members on

²⁹ World Bank, [Effective Financial Scrutiny: The Role of Parliament in Public Finance](#), J Wehner.

³⁰ Commission on Devolution in Wales, [Context paper: International fiscal systems](#), 8 November 2012

³¹ Scottish Parliament Information Centre, [Financial Scrutiny Unit](#)

budgetary issues, including costing of specific spending proposals, and research on all areas of the economy and public finances.

- 3.30 In 2010, the UK established the Office for Budget Responsibility (OBR),³² to provide independent fiscal and economic forecasts on which to base budget decisions. The Chair of the OBR has stated that its establishment was a response to the need in the UK for credibility of fiscal management, which had been undermined by over-optimistic public finance forecasts.³³
- 3.31 Examples of support for budget scrutiny in other countries are provided in [annex A](#).
- 3.32 Committees also need access to administrative information. For example some information in Norway continues to be provided by the Ministry of Finance which has a long tradition of providing objective and unbiased information to Parliament.³⁴ In Germany the budget committee interacts with government departments through regular briefings and expenditure reports, and in India the Public Accounts Committee receives reports and departmental accounts and revenue receipts from the comptroller and auditor general.³⁵
- 3.33 Regular communication and consultation between government and the legislative committees increases the capacity of the legislature to scrutinise the budget, and following approval, augments the authority of the government to properly implement the budget.

3.34 CIPFA recommends that the Committee considers:

- **Making wider use of independent expert advice during the budget process and encouraging the other committees of the Assembly to do so.**
- **The merits of establishing a dedicated financial scrutiny unit, perhaps within existing structures, such as the Scottish Parliament’s Financial Scrutiny Unit.**
- **Building on the existing relationship with the Minister for Finance and her department to continue to improve the financial and performance information available for scrutiny, and to encourage other Welsh Ministers to engage with their appropriate subject committees in a similar manner to improve the information available for budget scrutiny across all portfolios.**

Public engagement and transparency

- 3.35 One of the key roles of the legislature in considering the budget is to open the process up for debate in civic society and bring in the ‘public voice’. As discussed above, the Good Governance Standard for Public Services³⁶ states that real

³² [Office for Budget Responsibility](#)

³³ Chote, Robert (2011), Presentation to the 3rd Annual meeting of OECD Parliamentary Budget Officials, Stockholm, April 28.

³⁴ OECD, [Budgeting in Norway](#)

³⁵ Budget preparation and Approval, S Schiavo-Campo in Budgeting and Budgetary Institutions, 2007, World Bank.

³⁶ The Independent Commission for Good Governance in Public Services, [The Good Governance Standard for Public Services](#), 2004

accountability involves: *...engaging with stakeholders to understand and respond to their views as the organisation plans and carries out its activities.*

- 3.36 The IMF's Code of Good Practices on Fiscal Transparency,³⁷ highlights the importance of public availability of information, open processes of budget preparation, execution and reporting and independent reviews and assurances of the integrity of fiscal forecasts, information and accounts. All of which function to raise public awareness and build public confidence in the credibility of the budget.
- 3.37 The Good Governance Standard for Public Services³⁸ provides some general examples of good practice in engaging stakeholders and making accountability real, including the following:
- Assessing the effectiveness of policy and arrangements for dialogue with service users and accountability to the public, to evaluate their impact on decisions and to decide what improvements may be needed.
 - Use of a range of models, from citizens' juries to community time banks (mutual volunteering by members of the public, working alongside service providers to support their neighbours), to promote public involvement.
 - Publication of information on research into the public's views. It is important to include the diversity of the public and of service users in this information, to give a complete and accurate picture.
 - Assessing the extent to which these principles of good governance are applied, and report publicly on this assessment, including an action plan for improvement where necessary.
 - Systematic '360-degree' feedback from a representative sample of stakeholders, can provide valuable insights about the organisation's relationships.
- 3.38 The degree of public involvement in the budget process differs from country to country and may be heavily affected by the government as well as parliament itself. Examples are provided in [annex A](#).
- 3.39 The budget is the single most important policy document of government, where policy objectives are reconciled and implemented in concrete terms. Budget transparency is a key element of good government. As a consequence, the OECD has developed a set of best practice in this area.³⁹
- 3.40 The OECD best practice advocates the publication of a pre-election report. This would serve to illuminate the general state of government finances immediately before an election. This fosters a more informed electorate and serves to stimulate public debate. The OECD recognizes that the feasibility of producing this report may depend on constitutional provisions and electoral practices. Optimally, it should be released no later than 2 weeks prior to elections. Such a practice, if adopted in Wales, may increase the interest in engaging with the budget process amongst the electorate.
- 3.41 The OECD, also recommends the issue of a long term report. This should assess the long term sustainability of current Government policies. It should be released

³⁷ IMF, [Code of Good Practices on Fiscal Transparency](#), 2007

³⁸ The Independent Commission for Good Governance in Public Services, [The Good Governance Standard for Public Services](#), 2004

³⁹ OECD, [Best Practices For Budget Transparency](#)

at least every 5 years or when major changes are made in substantive revenue/expenditure programmes. The report should assess the budgetary implications of demographic change, such as population ageing and other potential developments over the long term (10-40 years). Again, such a report demonstrating the long-term impact of budget decisions and how they will impact on civic society may serve to increase public interest and engagement.

3.42 The International Budget Partnership (IBP) collaborates with a network of civil society organizations around the world to reform government budget systems and influence budget policies. Their Open Budget Initiative⁴⁰ is a global research and advocacy programme to promote public access to budget information and the adoption of accountable budget systems.

3.43 In 2006 the IBP launched the first Open Budget Survey,⁴¹ which evaluates whether governments provide public access to budget information and enable participation in the national budget process. The survey covers 100 countries and is undertaken biennially. It covers the transparency of the budget process, as well as the broader accountability landscape, as assessed through the lens of civil society and citizen engagement in budget processes as well as the oversight role of legislatures and supreme audit institutions.

3.44 From the results of the survey, the IBP have also constructed an Open Budget Index (OBI) to measure the overall commitment to transparency and allow for comparisons to be made between countries. This assigns a score to each country based on the information it makes available to the public during the budget process.

3.45 CIPFA recommends that:

- **When considering the budget process the Committee bear in mind the IMF's standards for openness and transparency and build these into the process.**
- **The Committee take note of the good practice recommended by the Good Governance Standard for Public Services and the OECD and attempt to build in such practices to the budget process.**
- **The IBP's Open Government Survey should be considered and lessons learned from other countries. The Committee should aim for a budget process which would score highly on the Open Budget Index, and may wish to consult the IBP when developing proposals to ensure public engagement is a focus of a Welsh budget process.**

⁴⁰ International Budget Partnership's [Open Budget initiative](#)

⁴¹ International Budget Partnership, [Open Budget Survey 2012](#)

4. PLANNING AND BUDGETING FOR OUTCOMES

- 4.1 CIPFA welcomes the fact that the Committee are exploring the potential for more outcomes-focused budget procedures, building upon their increased focus in recent years on value for money and seeking to improve the links between the Programme for Government (PfG) and the budget process.
- 4.2 CIPFA advocates a more outcomes-based approach to budgeting and financial management, as discussed above in relation to the whole systems approach, in our publication *at the edge of chaos and ready for outcomes*,⁴² and in our recent submission to the Scottish Parliament.⁴³ In the latter we propose that a consistent public management system integrating funding distribution, service delivery mechanisms and outcomes should be developed to support the achievement of best value for taxpayer funds, financial sustainability in service provision, and an embedded outcomes focus in budgeting, monitoring and accountability.
- 4.3 Outcomes-based budgeting is a form of performance budgeting, and presents the purpose and objectives for which funds are required, costs of programmes and activities required to achieve those objectives and the outputs to be produced under each programme. A comprehensive system will quantify the entire results-based chain:
- Inputs and intermediate inputs – resources required to produce outputs.
 - Outputs – quantity and quality of goods/services produced.
 - Outcome – progress in achieving programme objectives.
 - Impact – programme goals.
 - Reach – people who benefit/disbenefit from a programme.

Current budget approach

- 4.4 The current budget approach taken by the Welsh Government is incremental and is designed to meet their reporting obligations to HM Treasury,⁴⁴ and reflects the organisational structures within the Welsh Government itself. Such an approach is primarily input-based and we believe there is a need to move towards a more outcomes-based approach to public service management and to improve the quality, availability, evaluation, monitoring and reporting of data in relation to outcomes. This time of change with the devolution of further powers could represent an opportunity to adopt such an approach.
- 4.5 We understand that this year, for the first time, responsibility for the annual Programme for Government (PfG) report has been moved into the Welsh Government's Strategic Budgeting department. Although this is a welcome development and indicates the intention to provide closer links between the budget and PfG, the emergence of any visible improvement in linking budgets and outcomes is likely to be a long term process and will require the co-operation of all departments within the Welsh Government.

⁴² CIPFA, [Public Finances: At the Edge of Chaos and Ready for Outcomes?](#) March 2013.

⁴³ [CIPFA Submission to the Scottish Parliament, Local Government and Regeneration Committee: Flexibility and Autonomy of Local Government](#), March 2014

⁴⁴ As set out in HM Treasury's [Consolidated Budgeting Guidance](#)

- 4.6 A pilot project in Scotland suggests there is a strong foundation for the development of outcome-based budgeting in the public sector under current devolved arrangements.⁴⁵ The project supported two Community Planning Partnerships (CPPs) to understand how their budget decisions affect the delivery of their outcomes (as set out in Standard Outcomes Agreements). Barriers currently preventing this outcomes approach from being fully implemented were identified, but it was found that a consistently applied and mainstreamed outcome planning framework could help to tackle these issues. The project clearly identified the need for significant local and national change in processes and cultures. There is clear consensus that a stronger focus on outcomes is needed.⁴⁶
- 4.7 The move towards an outcomes-based regime is no easy task, with establishing and agreeing measurable policy outcomes being problematic at a technical, professional and political level. In our submission to the Commission on Public Service Governance and Delivery,⁴⁷ we suggested a five point blueprint for public services in Wales, including an integrated system of performance management and measurement which enables tracking of public performance from government level all the way to local delivery level, and how this could be used to better link performance to budget decisions.

Performance or Outcome Budgeting – International Experience

- 4.8 The last two decades have seen increased enthusiasm for performance management and budget reforms. The experience with various forms of performance budgeting are wide ranging. Most of the reforms are still experimental and there are no truly mature examples of an integrated performance budgeting system. However, there are lessons to be learned from international experiences.
- 4.9 The OECD International Database of Budget Practices and Procedures.⁴⁸ is a rich source of information on budget procedures, and part 6 of the database records information in relation to how countries conduct and integrate performance management into their budget processes. The World Bank also provides information on international good practice, reference models and case studies on performance budgeting.⁴⁹
- 4.10 In 2005 the OECD undertook a survey on performance information across their member countries,⁵⁰ which provides an overview of the development and use of performance information in the budget process. This looked at:
- Different approaches to performance budgeting;
 - Different institutional roles/responsibilities in developing performance information;
 - Trends, challenges and success factors for implementation; and

⁴⁵ [Outcome Budgeting in the Scottish Public Sector: Final Summary Report](#)

⁴⁶ Scottish Government, Commission on the Future Delivery of Public Services, [Report on the Future Delivery of Public Services by the Commission chaired by Dr Campbell Christie](#), June 2011

⁴⁷ CIPFA, [The Commission on Public Service Governance & Delivery: A Five Point Blueprint for Public Service Reform in Wales](#), September 2013

⁴⁸ OECD, [International Database of Budget Practices and Procedures](#). Part 6 Performance Management.

⁴⁹ World Bank, Budget preparation: [Policy Based Budgeting](#)

⁵⁰ OECD Journal on Budgeting, [Performance Information in the Budget Process](#), Curristine T, 2005 (Vol 5 No 2)

- How the information is used in the budget process, and what factors contribute to this.
- 4.11 The survey found that the majority of countries undertake performance-based budgeting at the level of the central Ministry for Finance, in that performance information is used to inform, but not determine, budget allocations. It also found that the main reason for not using performance information is a lack of a method by which to integrate it into the budget process.
- 4.12 Examples of how performance based budgeting has been implemented in other countries are provided in [annex A](#).

Critical conditions for performance budgeting

- 4.13 A number of critical factors are likely to influence the success or failure of any reforms to introduce performance or outcomes-based budgeting, particularly in terms of generating and maintaining the momentum for reform. Such factors include:
- **Motivation to change** – consensus amongst participants is essential. Officials will need to understand the motivation for performance measurement and budgeting and political will is critical to implementation of results-based accountability.
 - **Legislative support** – strong and consistent political support from the legislature is essential for success. Budget reform inevitably impacts on all levels of government, but cannot operate independently of the political environment. Legislators should be involved in establishing performance goals, developing performance indicators, monitoring the performance process and evaluating performance results. Reform will not succeed if the legislature and executive have conflicting objectives or understandings of why reform is necessary.
 - **Public support and engagement** – reforms should provide direct benefits for stakeholders and the wider public. Without public involvement performance budgeting risks becoming a bureaucratic exercise detached from citizens priorities. Public involvement improves the meaningfulness of the data generated and reported and ensures credibility.
 - **Administrative capacity and bottom-up approach** – reforms should take account of administrative systems already in place and help departments and agencies to develop approaches suitable for their own contexts, rather than impose systems which are not operationally feasible in reality. Issues that need to be considered include: staff training, IT systems and accounting systems in place and the financial cost of reforms.
- 4.14 In Canada,⁵¹ changes to the public financial management system have generally been implemented by ‘piloting’ or testing the proposed changes prior to full scale implementation. This may be an approach to consider to aid in determining whether all the above critical factors are in place and identify any potential problem areas or unintended consequences.

⁵¹ OECD, [Budgeting in Canada](#)

4.15 CIPFA recommends that:

- **The Committee should work with and encourage the Welsh Government in its endeavors to better link the Programme for Government and other government strategies to the budget process and use information on priorities and performance to inform budget decisions.**
- **The Committee should explore the potential for a more outcomes-based approach to budgeting and financial management, in the context of a whole systems approach. This should aim to provide a consistent public financial management system integrating funding allocation, service delivery mechanisms and outcomes to support the achievement of best value for taxpayer funds, financial sustainability, and an embedded outcomes focus in budgeting, monitoring and accountability.**
- **In doing so the Committee should consider international examples of performance based budgeting and the lessons learned from these. In particular the rich sources of best practice and guidance provided by the OECD and World Bank.**
- **The Committee should also consider the critical factors required for performance based budgeting before considering any proposals for reform, in particular the administrative capacity of the Welsh Government to implement such an approach. Piloting any changes may help in identifying potential issues.**
- **In exploring a more outcomes-based approach the Committee should work with the Welsh Government to address the inherent issues of determining measurable policy outcomes at a technical, professional and political level. If such an approach were adopted in Wales, CIPFA would be committed to working with the Assembly, the Government and wider partners to aid in establishing clear and measurable outcomes to underpin such an approach.**

5. IMPLEMENTING THE DEVOLVED FINANCIAL POWERS

5.1 In the whole systems approach to public financial management (PFM),⁵² CIPFA define a number of elements, including legislation, which sets the regulatory framework, determining the powers and mandatory requirements within which public sector bodies raise and spend money. It should be transparent and applied predictably so it can be consistently administered and can be navigated by civil society. Such legislation should cover:

- **Taxation raising powers** – the government’s definition of powers to raise taxation. Powers may vary at different levels of administration: national, regional and local government. There may also be a range of taxation sources (e.g. property, income, sales taxes). Powers to levy local taxes may be limited by national government.
- **PFM legislation**– powers and limits of operation, including over budgets, charging and spending. This may also include requirements to be detailed in Standards.
- **Funding conditions** – terms on which funds may be received and applied. These are binding in that spending outside these terms will be repayable.
- **Accounts and audit requirements** - prescription of essential elements of accounting and auditing in the public sector.
- **Public access to information** – requirements to define public rights to information held by public sector organisations to support accountability, transparency and equity.

Legislating for a Welsh Budget Process

5.2 The Wales Bill provides for the Assembly to legislate to set its own budget procedures, by amending Schedule 7 to the *Government of Wales Act 2006*.

5.3 The budget principles and rules should be legislated for in descending order: the constitution (or devolution law in this case), an overall framework law, other laws and regulations, such as those governing taxes and the annual budget law. Only the most fundamental principles should be incorporated into the highest levels of legislation. Consistent with those principles, a framework law, should contain the basic rules for managing the public finances, allocating powers, accountabilities and oversight, such as the *Public Finance and Accountability Act (Scotland) 2000*.⁵³ Below this there may be further levels of instructions on administrative issues and budget preparation. Finally, proposals for the coming financial year should be incorporated into an annual budget law.

5.4 The framework law, often referred to as an organic budget law, or public finance act, should define:

- The overarching objectives of public financial management – fiscal control, strategic resource allocation, operational effectiveness, service orientation.
- The principles – accountability, integrity, transparency, compliance with rules, participation.

⁵² CIPFA, Public Financial Management: A Whole System Approach, [Vol I: The Approach](#) and [Vol II: Additional Material](#)

⁵³ [Public Finance and Accountability \(Scotland\) Act 2000](#)

- The process – budget preparation, execution, reporting, audit.
 - The responsibilities – of whom, for what, how and when; including the division of responsibilities between the government and legislature.
- 5.5 More specifically an organic budget law should contain the following elements:
- Introduction to the objectives and principles;
 - Definitions – including of fiscal deficit;
 - General provisions, such as the basis of accounting and financial reporting;
 - Rules of budget coverage and presentation – including treatment of extra-budgetary funds and fiscal risks;
 - Stages and rules for budget preparation – including powers of amendment such as in year changes via supplementary budgets;
 - Procedures for budget debate, scrutiny, approval and legislative amendment;
 - Principles and rules of external audit;
 - Accountability provisions; and
 - Often relations with local government are also included.
- 5.6 As noted above, such an organic budget law should have as its introduction a clear statement of the fundamental principles of good governance and public finance. Such principles should include:
- No monies to be collected or expended, services provided nor exemptions granted unless authorised.
 - Transparency of financial and service information – not only openness but positive effort to provide budgetary information, and government priorities and plans in accordance with international standards on fiscal transparency⁵⁴ in usable form.
 - Compliance of fiscal policy with wider economic and social objectives – including the placement of the annual budget process in a multiyear perspective
 - Individual responsibility of ministers, senior officials, accounting officers, etc for the acquisition, use, accounting and reporting of public resource and the taking of measures to prevent abuse of such resource.
 - Public financial management is conducted to ensure expenditure control, efficient resource use and service provision and high integrity.
 - Unity of the budget and Treasury to enable comparisons of the relative effectiveness of different types of planned expenditures.
 - Conformity with accepted international standards of budget preparation and execution, financial management and control and audit.
- 5.7 Such framework law should also include provision to spend based on provision in previous year, in the absence of budget approval prior to the beginning of the financial year. Similar to those arrangements currently provided for in Section 127 of the *Government of Wales Act 2006*.⁵⁵
- 5.8 There is no generally accepted best practice in budget legislation. Laws need to be drafted to suit legal, cultural, and political conditions. To aid in understanding public finance law and assist in reviewing or drafting legislation, a database of current organic budget laws has been established. These laws have been collected

⁵⁴ As detailed by the IMF's [International Standards Related to Fiscal Transparency](#)

⁵⁵ [Section 127](#), *Government of Wales Act 2006*

from numerous sources, including World Bank and IMF staff, country Finance Ministries, and consultants.⁵⁶

Legislating for Welsh Taxes

5.9 As discussed above the Government's powers to raise taxation should also be enshrined in legislation. Again this involves a hierarchy of legislation, which should be transparent and predictably applied.

5.10 The tax powers of the Welsh Government are set out in the *Wales Bill*. Following enactment of the Bill, the Welsh Government will likely legislate to provide for general tax conditions, administration and management. In Scotland, the *Revenue Scotland and Tax Powers Bill*⁵⁷ has been introduced by the Scottish Government for these purposes.

5.11 Further legislation will then be required for each tax, to set out the specific conditions, arrangements and rates for that tax. For example, in Scotland the *Land and Buildings Transaction Tax (Scotland) Act 2013*,⁵⁸ and the *Landfill Tax (Scotland) Act 2014*,⁵⁹ have been passed in preparation for the implementation of these two taxes under financial powers devolved under the *Scotland Act 2012*. Similar legislation would have to be brought forward in the event that any new Welsh taxes are proposed.

5.12 CIPFA sit on the Welsh Government's Tax Forum and from this we understand that the government intends to:

- consult on legislation dealing with general principles of tax collection and management in Autumn 2014; and
- consult on legislation on a Welsh Tax on Transactions involving interests in Land (WT TIIL), as a potential replacement for Stamp Duty Land Tax in Spring 2015.

5.13 CIPFA recommends that:

- **The Committee work closely with the Welsh Government to formulate framework legislation, as described above, to establish and provide for a Welsh budget process.**
- **As there is no generally accepted best practice for budget legislation, the Committee should consider the conditions, including those identified earlier in this paper, applicable in Wales, and should consider international examples of budget law to identify which elements are most suited to the Welsh context.**
- **The Committee consult with the Welsh Government on their proposals for tax policy and legislation to inform the development of their plans.**

⁵⁶ [Joint World Bank- IMF Country Budget Law Database](#)

⁵⁷ [Revenue Scotland and Tax Powers Bill](#)

⁵⁸ [Land and Buildings Transaction Tax \(Scotland\) Act 2013](#)

⁵⁹ [Landfill Tax \(Scotland\) Act 2014](#)

6. TAX DEVOLUTION, BLOCK GRANT REDUCTION AND ASSOCIATED RISKS

Block grant adjustments – Stamp duty land tax and landfill tax

6.1 The Command Paper accompanying the Wales Bill sets out that the Silk Commission's recommendation that the adjustment of the block grant for Stamp Duty Land Tax (SDLT) and landfill tax should not be indexed against the corresponding UK tax base.⁶⁰ This means that the Welsh Government will carry the full responsibility for managing any volatility of these devolved tax revenues. The Command Paper states:

...it is not straightforward to identify the precise nature (or size) of such an adjustment that both governments agree is likely to be equitable in the longer term.

6.2 The Command Paper suggests a similar mechanism to that proposed for business rates, that is, making a deduction to the Barnett baseline, so reducing all subsequent consequentials. However, while business rates have a Barnett comparability factor, other taxes do not. It is suggested that a similar effect could be achieved by reducing all Barnett consequentials by a small percentage, reflecting the proportion of Welsh Government spending funded by the devolved taxes. The Command Paper states that: '*Growth in the devolved taxes would therefore replace the amount deducted from Barnett consequentials.*'

6.3 This potentially raises two issues. Firstly, how would the 'small percentage' deduction be decided upon? Secondly, the suggestion that growth in these taxes would replace the deduction from the block grant. These two taxes represent policy levers which could potentially be utilised by the Welsh Government to help towards achieving their economic and environmental objectives, respectively. Development of tax policy along these lines would likely result in reductions in the revenues collected from replacement taxes, rather than growth. Therefore, such a deduction may actually act as a disincentive to use of these taxes as policy levers.

6.4 The issue of the block grant adjustment for these taxes was a point of contention during the Scottish Parliament's scrutiny of the *Scotland Act 2012*. The intention was that there would be a one-off reduction to the block grant which would then be deducted for all future years. This deduction was to be calculated on the basis of actual outturn data for SDLT and estimates of revenues for landfill tax.⁶¹ However, it became apparent that there was considerable volatility in forecasts for SDLT, and the Chief Secretary to the Treasury suggested that the most reliable approach would be to look at five year averages.⁶² Given events in recent years, this led to some disagreement over the time frame to be used, and the Finance Committee noted:⁶³*...it is unsurprising that the Scottish Government prefers an adjustment based on a five year average pre-devolution of SDLT while the UK Government favours an adjustment which includes a forecast of receipts post-devolution.'*

⁶⁰ [Cm8838, Wales Bill: Financial Empowerment and Accountability](#), March 2014

⁶¹ [Strengthening Scotland's Future](#), Cm 7973, November 2010

⁶² Scottish Parliament Finance Committee (2013g) Official Report 1 May 2013. Edinburgh: Scottish Parliament. Available at - <http://www.scottish.parliament.uk/parliamentarybusiness/28862.aspx?r=8292&mode=pdf>

⁶³ Scottish Parliament Finance Committee (2013c) *8th Report 2013 (Session 4) Report on implementation of the financial powers in the Scotland Act 2012*. Edinburgh: Scottish Parliament. Available at - http://the.scottish.parliament.uk/S4_FinanceCommittee/Reports/fiR-13-08w.pdf

- 6.5 In response to the Committee's report the UK Cabinet Secretary for Finance, Employment and Sustainable Growth stated: '*The two key points here are the level at which to set the initial block grant adjustment, and whether there should be any further changes to the adjustment thereafter (...) They remain under discussion and no agreement has yet been reached.*'
- 6.6 The Command Paper accompanying the Wales Bill states: '*The Government continues to discuss this proposal, and other options, with the Scottish Government and has now opened similar discussions with the Welsh Government.*'⁶⁴
- 6.7 CIPFA recommends that:**
- **The Committee seek clarity from the Minister for Finance on her discussions with HM Treasury in relation to the deduction mechanism for these taxes, and what mechanism the Welsh Government would like to see implemented.**
 - **The Committee explore with the Minister her intentions for using these devolved taxes as policy levers, and how the potential impact on overall funding is being considered.**

Block grant adjustment in the event of income tax devolution

- 6.8 The Wales Bill provides for the devolution of income tax powers, subject to a referendum. It retains the controversial 'lockstep' constraint, meaning that all income tax rates would have to rise or fall together, similar to that in the *Scotland Act 2012*. This constraint remains despite the fact that it has been criticised by all four party leaders in the Assembly, as being unfit for purpose.⁶⁵
- 6.9 The Command Paper⁶⁶ sets out the detail of how block grant adjustments would be made to account for income tax revenues, along the lines of the Silk and Holtham recommendations.⁶⁷ Deductions are proposed to be by indexed deduction, i.e. linked to changes in the UK's tax base. This would involve a first year reduction which would then be indexed against growth in the UK tax base to give the deduction for future years. Indexing to the tax base incorporates the 'no detriment' principle, as in Scotland, as the UK tax base reflects decisions made at the UK level. To manage risks during the transfer of powers there will be a transitional period of two to three years, as in Scotland.
- 6.10 In transitional years, and year 1, the actual deduction to the block grant will be determined by the amount of tax revenue generated by the Welsh rate of income tax, set at 10p, as forecast by the Office for Budget Responsibility (OBR). Should the Welsh Government set the rate at 10p, then the OBR forecast will determine the amount of tax revenues due to the Welsh Government and the deduction to the block grant. If the Welsh Government sets an alternate rate, the OBR forecasts of Welsh revenues will be paid to the Welsh Government, and the block

⁶⁴ [Cm8838, Wales Bill: Financial Empowerment and Accountability](#), March 2014

⁶⁵ Wales Online, [Parties unite to condemn 'lockstep' shackles on income tax powers for Wales](#), February 2014

⁶⁶ [Cm8838, Wales Bill: Financial Empowerment and Accountability](#), March 2014

⁶⁷ Commission on Devolution in Wales, [Empowerment and Responsibility: Financial Powers to Strengthen Wales](#), November 2012 and independent Commission on Funding and Finance for Wales, [Fairness and Accountability: a new funding settlement for Wales](#), July 2010.

grant deduction determined by a separate forecast of the amount of revenue that would have been generated by a 10p rate.

- 6.11 In subsequent years, the deduction made in the previous year will be indexed against movements in the corresponding UK tax base. Thus, if the UK tax base were to contract, the block grant adjustment would also decrease by a corresponding percentage, and vice versa.
- 6.12 It should be noted that initially the size of the income tax bases in Wales and the UK will be based on forecasts. Thus, there will be a reconciliation process by which forecasts will be replaced with actual figures. This will show whether an adjustment for over/under payment needs to be applied for the following financial year. This reconciliation process is likely to be subject to a time lag, around a year after the end of the financial year, thus there could be considerable catch up across financial years in terms of adjustments.
- 6.13 The expectation is that forecast error for revenues (based on the devolved tax base) will be similar to forecast error for the block grant adjustment (based on the UK's tax base). This should therefore minimise the extent to which post-reconciliation adjustments need to be made.
- 6.14 It has been suggested that historically the Welsh tax base has grown more slowly than that of the rest of the UK. However, in their context paper, the Silk Commission appeared to find no evidence of this.⁶⁸ Should this prove to be the case, then the retention of the lockstep constraint may lock in such slower growth.

The challenge of forecasting

- 6.15 As discussed above, calculation of the block grant deductions, as well as the ability of the Welsh Government to plan its finances, will be based on forecasts of the revenues from the devolved taxes. Such forecasts will be prepared by the OBR, as is the case for Scotland. In preparing these forecasts for the devolved administrations, the OBR cannot utilise the same methodology as they do for UK forecasts, due to a lack of information at the level of the devolved regions.
- 6.16 This means that the forecasts are based on the devolved regions historic share of the relevant UK tax, and assume that this remains at the recent average level.⁶⁹ These forecasts are subject to change due to a number of factors, including forecasts for the wider economy and UK Government changes to tax policy. Concerns have been raised regarding the level of variance in these forecasts.⁷⁰ If we consider how the most recent Scottish forecasts differ from those published one year ago, we can see the extent of the difference.
- 6.17 This is likely to impact on the ability of government to adequately plan their finances and assess whether plans are financially sustainable for the future. It may also mean that revenue borrowing powers may have to be used, and so

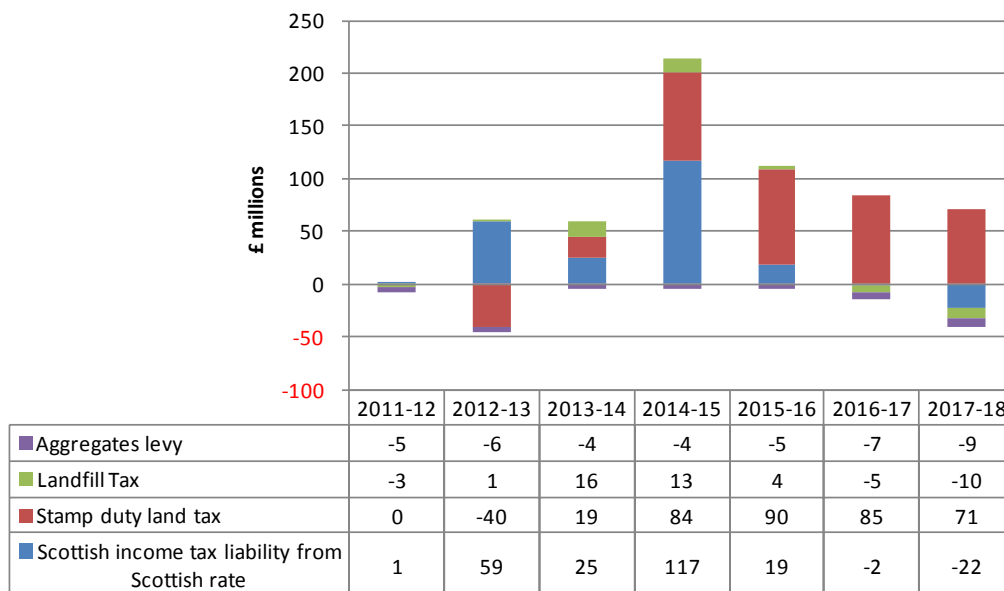
⁶⁸ Commission on Devolution in Wales, [Economic Context In Wales](#), 2012

⁶⁹ OBR, [Methodology Note: Forecasting Scottish taxes](#), March 2012.

⁷⁰ Scottish Parliament, Finance Committee, [8th Report 2013 \(Session 4\) Report on implementation of the financial powers in the Scotland Act 2012](#), October 2013.

generate greater liabilities, or reduce public spending, to compensate for errors in forecasting rather than poor economic performance.

Variation in Scottish tax forecasts between March 2013 and March 2014



Source: OBR, Economic and fiscal outlook: Scottish tax forecasts, , [March 2014](#) and [March 2013](#).

Note: Forecasts assume that the 10p rate of income tax is levied and that current rates of other taxes are retained.

6.18 Thus, the devolution of tax powers will give greater autonomy and accountability to, but will also mean that there is the potential for greater variability in the resource available, as Wales will bear the risk of changes in the levels of tax revenues, whether this be due to economic performance or forecasting errors. In turn, this will have implications for wider policy decisions and the future sustainability of public services. Improvements in the availability and clarity of financial and economic information would help to identify such risks, aid in decision making and provide greater public confidence in the accuracy of the financial position and plans for the future.

6.19 CIPFA recommends that:

- **The Committee seek to form a close relationship with the OBR in order to be aware of, and help inform, the processes and issues associated with producing Welsh tax forecasts.**
- **The Committee seek evidence from the Treasury and the Welsh Government on their views of the potential impacts of the lockstep constraint, together with the proposed mechanism of block grant deduction.**

Other budget risks

6.20 Most of the risks identified above in relation to tax devolution are likely to be able to be managed by utilising revenue borrowing powers. However, the increased powers and accountability, and responsibility for budget procedures also raise a further risk in terms of fiduciary risk. This is grounded in the principle that no funds can be raised or spent without approval by elected representatives. Thus,

the government has fiduciary responsibility to ensure that the budget is executed as approved by the legislature.

- 6.21 The World Bank⁷¹ defines fiduciary risk as the risk that government spending diverges from the plans authorised in the budget. However, a broader definition refers to the additional risk that funds are wasted or spent ineffectively:

*'...the risk that funds are not used for the intended purposes; do not achieve value for money; and/or are not properly accounted for. The realisation of fiduciary risk can be due to a variety of factors, including lack of capacity, competency or knowledge; bureaucratic inefficiency; and/or active corruption.'*⁷²

- 6.22 Although such risks generally raise concern in relation to use of international development aid funding, they are equally applicable to national budgets and should be safeguarded against. The adoption of robust budget procedures as discussed above, a move towards a more outcomes-based focus on public financial management and robust scrutiny of how the Welsh Government are executing their budget by the Committees of the Assembly should serve to act as safeguards against such risk.

6.23 CIPFA recommends that:

- **The Committee bear this risk in mind when developing the budget procedures discussed above, and encourage other Committees in the Assembly to undertake robust budget monitoring throughout the financial year, to ensure that budgets are being executed in line with the plans approved by the Assembly.**

⁷¹ World Bank, 2003 country financial accountability assessment guidelines to staff

⁷² Department for international Development, [Managing Fiduciary Risk when Providing Financial Aid](#), 2011

ANNEX A: INTERNATIONAL EXAMPLES

Integration of financial planning and wider strategies - Australia

In Australia, the Department of Finance and Administration of the federal government implements an integrated planning and reporting framework to encourage good financial management and accountability.⁷³ A high level corporate plan containing key objectives and performance measures is updated annually by the Executive and is utilised to set the values and direction. Four year business plans are then prepared by departments specifying the contribution they will make to the overall objectives, detailing the underlying assumptions and risks. The Executive reviews and approves these plans and detailed annual budgets are prepared. Business plans and budgets are directly linked to performance agreements. Reports of performance are prepared each month, as well as management reports incorporating analysis of variance and full-year forecasts, and these are reviewed by the Executive.

Role of Government and Parliament – The Netherlands and Sweden

In the Netherlands,⁷⁴ Government departments are not good at 'volunteering' savings. As a result the Ministry of Finance has become knowledgeable about departmental operations and often suggests what departments can do to make savings.

In Sweden,⁷⁵ the Ministry of Finance challenges and queries department estimates for programmes – for example what assumptions were used and how realistic they are. Departments often over-estimate requirements. The Ministry of Finance provides cabinet with recommendations on the 27 area aggregated figures as well as details of the departmental submissions.

Timing of the budget process – The Netherlands and Slovenia

In the Netherlands,⁷⁶ the annual budget consists of a memorandum overview and 23 budget bills (expenditure areas). MPs have two weeks to question Ministers on spending proposals. Opposition parties can put forward 'shadow proposals' but importantly these will (almost invariably) be costed by the Central Planning Bureau. Re-allocation between the 23 separate budget heads is extremely rare.

Detailed scrutiny of each of the 23 budget heads is carried out by subject committees. Although some changes may be made within the head total figure these are not normally significant. Generally any proposal will be expected to state which other programme (within the head) is to be cut or what ongoing revenue source will fund it.

In Slovenia,⁷⁷ the Budget is set for two years on a rolling basis (i.e. it is an annual event). There is a very detailed chart of accounts with some 9,000 lines of budget at the lowest level of authorisation. The budget is set out in both objective (programme/service) and subjective (type of spend e.g. employees) terms. This is to ensure a detailed and tight control over spending and to enforce accountability. This

⁷³ Australian Government, Department of Finance, [Budget process](#)

⁷⁴ OECD, [Budgeting in the Netherlands](#)

⁷⁵ OECD, [Budgeting in Sweden](#)

⁷⁶ OECD, [Budgeting in the Netherlands](#)

⁷⁷ OECD, [Budgeting in Slovenia](#)

however requires allowable virement⁷⁸ rules to maintain flexibility. Subject committees have 10 days to suggest amendments to the budget proposals. The Finance Committee then co-ordinates and reviews the subject committee feedback or proposals and the budget. The Finance Committee has 5 days to formalise suggested amendments. The Government then tables a second budget which may take into account some or all of the proposals.

Support for scrutiny and access to information – Sweden, Canada, the Netherlands and Norway

In Sweden, historically the process of budget approval by the parliament (Riksdag) was described as undisciplined. Debate often focused on individual appropriations with little consideration of the overall effects. The total spending envelope only became clear at the very end of the process. Parliament recognised the need for reform in the 1990s and established a commission to bring forward proposals. The reformed process consists of 3 steps: parliament fixes the aggregate level of spending and revenues in the Spring Fiscal Policy Bill, tabled in April and approved 2 months later. The budget is tabled in September, after which the Finance Committee considers and recommends the allocations to each of 27 expenditure areas. Following approval of the division of aggregate expenditures by the house, various sectoral committees allocate funding to individual appropriations within their spending areas. These committees are permitted to change the appropriations, but must do so only within the agreed total for that spending area. The budget is approved in December, prior to the commencement of the financial year in January.⁷⁹

In Canada, the Office of the Parliamentary Budget Officer (PBO)⁸⁰ was established in 2008. This position was established in response to political events rather than financial pressure, mainly due to reports of misadministration reported to the auditor general. Within three years, the PBO had achieved an impressive record, including five economic and fiscal updates and more than 20 research reports, which have been widely praised.⁸¹ There remains debate as to whether this position should be replaced by an independent office, backed by legislation to strengthen accountability.

In the Netherlands,⁸² the Central Planning Bureau (CPB),⁸³ was founded in 1945 and plays a key role in the development of the budget policy contained in the Coalition Agreements. The CPB is a unique institution. It is a Government institution but is completely independent; it commands the trust of all political parties and the public at large. Prior to elections, the CPB will issue its economic forecast for the coming four years. All political parties use the CPB economic assumptions as the basis for their policy platforms. The larger political parties submit their policy platforms to the CPB ahead of elections for costing and to assess their economic impact. When new policies, or policy compromises, are being negotiated, the CPB will assess their impacts as well.

⁷⁸ Virement - an administrative transfer of funds from one part of a budget to another.

⁷⁹ OECD, [Budgeting in Sweden](#)

⁸⁰ [Office of the Parliamentary Budget Officer](#)

⁸¹ Brooke, J. (2010), 'The Parliamentary Budget Officer Two Years Later: A Progress Report', *Canadian Parliamentary Review*, (33): 37.

⁸² OECD, [Budgeting in the Netherlands](#)

⁸³ [CPB Netherlands Bureau for Economic Policy Analysis](#)

In Norway,⁸⁴ Statistics Norway⁸⁵ is independent from the Government. Some of its research is requested by the Government, but most of it is done independently. Part of their research is funded by a Research Council where Statistics Norway competes with other research institutions for support. Since 1990, Statistics Norway is also obliged to serve political parties in Parliament, who can ask for calculations and model simulations of certain policy proposals. Such an approach if adopted here could assist in the development of alternative spending proposals.

Public engagement and transparency – Canada, Romania and OECD evidence

In Canada,⁸⁶ efforts have been made to improve the Government's financial position, mainly through changes in process and control over Government's own departmental budget preparation process. Included however was also a 'pre-budget consultation process' designed to remove some of the secrecy surrounding the budget preparation process. This helped to involve the public in a 'mature' debate with an awareness of the economic and financial situation and involve the Opposition. By consulting with Parliament and the public the main issues of contention can be identified by the Government and adjusted where necessary before the budget is considered in Parliament.

In Romania,⁸⁷ the Government is required to consult with the Economic & Social Council (CES) which consists of Government, employers associations & trade unions. The CES acts as a useful sounding board for policies, however its actual influence and power is limited.

Also of interest to the committee may be the OECD document, Strengthening participation in public expenditure management: policy recommendations for key stakeholders.⁸⁸ Rather than attempting to summarise this extensive policy briefing, here we draw attention to some overseas practices, which are underway to strengthen participation:

Phase 2 – Analysis – this stage begins once the budget has been presented in the legislature. At this point in the cycle, the budget is subject to the highest level of public scrutiny. This is the primary phase for legislative participation in the budget process – Parliaments will scrutinize the contents of the budget and depending on the political and institutional environment, seek to amend particular items, At this point, civil society organizations such as the Institute for Democracy in South Africa (IDASA) and the Institute for Economic Affairs in Kenya will conduct budget analysis. Their work seeks to demystify the inaccessible aspects of the budget for the general public and legislators and to highlight the underlying policy implications of the budget for objectives such as poverty reduction. CSOs often make this critique the subject of public debate by using the media and they may also form alliances and share information with the legislature in order to increase the effectiveness of their advocacy efforts.

⁸⁴ OECD, [Budgeting in Norway](#)

⁸⁵ [Statistics Norway](#)

⁸⁶ OECD, [Budgeting in Canada](#)

⁸⁷ OECD, [Budgeting in Slovenia](#)

⁸⁸ OECD, [Strengthening participation in public expenditure management: policy recommendations for key stakeholders](#), 2002

Phase 4 – performance evaluation – final phase of the cycle involves assessing the performance of the public services that the budget funds. The critical participatory element of this phase is citizens feedback about the quality of access to and satisfaction with the services they receive from Governments. One instrument to collect this information, administered by civil society groups or independent groups hired by the Government are "report cards" – surveys that focus on people's experience of public services.

Performance or Outcome Budgeting – International Experience

Denmark's Performance Management Model⁸⁹

All ministries and agencies of the Danish government have performance management arrangements . Performance contracts exist between ministries and agencies for the production of the agency's outputs and outcomes. These were piloted in the 1980s but are now an integrated feature of management of the public sector. Quality of the contracts has improved over time, but the quality of the descriptions of outputs and outcomes could be better.

Annual reports are produced showing results achieved relative to those set out in the performance contracts, or all specified outputs and outcomes. These are published three months before the end of the financial year and are audited by the national audit office.

There is also a performance-related pay system, introduced in the 1990s, which links the salary of an agency's director general to the achievement of results specified in the performance contract.

This system serves as a formal structure under which the ministries and agencies can discuss results to be achieved and ministries can indicate priorities. This framework has developed a more results-based culture in the public sector.

New Zealand – Contractualism and output appropriations

New Zealand⁹⁰ has adopted a private sector management approach to government functions. It reorganised its civil service and made all public positions contractual, based on an agreed set of results. Agency heads are held responsible for delivery and reporting of expected outputs relative to targets and budgets, and statements of intent commit ministers to achieving progress towards outcomes. Programme management was decentralised and managers given flexibility and autonomy in budget allocations and implementation within the defined framework and budget. Their accrual-based budgeting and accounting system enables a complete picture of the actual cost of each activity to be seen.

In terms of budget reforms, the 1989 Public Finance Act shifted the emphasis of the budget from inputs to outputs. Departments receive appropriations for the purchase of outputs. The Fiscal Responsibility Act 1994 required government to state fiscal objectives and report progress on achieving outputs.

⁸⁹ OECD Journal of Budgeting, Budgeting in Denmark, Blondal, JR and Ruffner, M, 2004 (Vol 4 No1).

⁹⁰ Treasury Board of Canada, Linking Resources to Results, 2003

Output appropriations encourage a focus on what is delivered, and the value obtained from government spending rather than how allocations are made. Resources are linked to results at three levels:

- Resources are appropriated against expected outputs in the budget;
- Resources are reported against actual output performance; and
- Actual outputs (and outcomes) are tracked and reported against targeted performance.⁹¹

The contractualism approach to outputs has led to improvements in the machinery of government and financial performance of the public sector. Departments have a clear indication of what is expected, their output is clear and fully costed and departmental heads have discretion to manage resources and operations. Budget reforms in New Zealand have gained much attention over the last two decades, and together these two reforms have been credited with the improved efficiency of the public sector.

Malawi – Budget reform with little benefit

Malawi's reform programme⁹² began in 1995 with the reallocation of spending to priority areas, a move to activity-based budgets and a bottom-up approach to budgeting. These reforms showed some benefits, such as improving the ability to link priorities and budgets at ministry level.

However, the bottom-up approach to budgeting resulted in unintended consequences, in that activity costing did not take account of the overall spending envelope, giving unpredictable budgeting and undermining the credibility of the reforms. Sector development of activity-based budgets and prioritisation of activities occurred in silos and resulted in basic compliance with procedural requirements and limited impact on spending outcomes.

In 1997 the Public Sector Investment Programme was discontinued, assumed to be replaced by the ongoing reforms. As a result of this the Ministry of Finance had little information on ongoing investment projects, and few of these were included in the development budget.

Since that time further reforms have tried to address these issues and adopt further improvements. However, in the meantime significant transaction costs have been incurred and much information has been lost.

This example highlights the importance of considering individual reforms in the wider context of the whole system of public financial management and taking account of local conditions and circumstances as well as capacity and the introduction of reforms in a rational sequence.

⁹¹ New Zealand Treasury, A Guide to the Public Finance Act, 2005.

⁹² Swedish international Development Agency, Public Financial Reform in Malawi, Durevall, D and Erlandsson, M, 2005.

Budgeting for Outcomes in the US

The Government Finance Officers Association (GFOA) of the US and Canada promote an approach known as Budgeting for Outcomes (BFO) for Smaller Communities.⁹³ This describes the approach to budgeting in four steps:

- Determine the price of government – how much revenue will be available?
- Determine the priorities of government – what results matter most to citizens?
- Decide the price of each priority result – how much should we spend to achieve each result?
- Decide how to deliver each priority at the set price – how can we best deliver the results that citizens expect?

In contrast to traditional incremental budgeting, where the starting point is what was funded by a department in the previous budget, the starting point becomes what results the jurisdiction wants to achieve. The budget office works with results teams to identify activities and programs most likely to achieve results rather than on allocating budgets. Elected officials spend more of their time making decisions on how much revenue citizens can afford to provide and on choosing results and less time on deciding how much money to cut from the budget and where to cut. The incentives for agencies and departments change from making it difficult for the budget office to find places to cut their budgets to figuring out what activities work best to achieve results and how to provide those activities at lower cost.

A number of jurisdictions in the US have adopted this approach, from states to county school districts. In 2002 the State of Washington used the BFO approach to deal with a \$2 billion deficit.⁹⁴

Budgeting for outcomes across central and devolved governments - Australia

In relation to how an outcomes-based approach to budgeting could work in the devolved context, the Committee may wish to consider the public financial management framework in Australia, which operates a federal system.⁹⁵ Their budget and financial management approach focuses on outputs and outcomes and this has evolved from reforms undertaken in the early 1980s. It consists of a comprehensive framework formed around the following goals:

- Improving the quality of services;
- Making the operations of government more efficient;
- Increasing the chances that policies which are chosen and implemented will be effective;
- Enhancing the transparency of government operations; and
- Making savings in expenditure.

The Australian Government's framework places a strong emphasis on outcomes and outputs as the basis for performance information. Outputs are the goods and services produced by the individual department or agency on behalf of Government for external

⁹³ GFOA, [Budgeting for Outcomes](#)

⁹⁴ [A solution for uncertain times: Budgeting for Outcomes](#), Kinney AS and Stein B, California Counties, May/June 2008

⁹⁵ [Australia's Experience in Utilising Performance Information in Budget and Management Processes](#), Report for the 3rd Annual Meeting of the OECD Senior Budget Officials Network on Performance and Results

organisations or individuals. Outcomes are defined as the Government's objectives for each portfolio. Outcomes are the results or impacts that the Government actually wants to achieve.

Departments and agencies are responsible for measuring and assessing the performance of outcomes and outputs. Within departments and agencies, there is likely to be strategic planning at the outcomes level as well as the organisation level. Most agencies will also develop longer-term plans that stretch for three to five years and review changes on an annual basis. In the budget and in annual reports, agencies are required to report at the outcome level and annual report requirements also require that agencies report, at a minimum, on the organisational basis as well.

Portfolio Budget Submissions and Annual Reports prepared by departments and agencies provide a comprehensive report to the Government, Parliament and public on resourcing and performance by outcome and output. These provide public information on performance targets at the beginning of the year and a report against these at the end of the year. However, this information is not yet well integrated into the annual budget process.

At present, there is no mechanism, and no incentives, to ensure that performance information is taken into account on a standard basis when the Government is making budget decisions. A further challenge is that the nature of Commonwealth expenditure is not always amenable to the outcomes and outputs framework, for example the Commonwealth has less direct involvement with the delivery of health and education outcomes than many other countries do.

The Australian focus on outcomes has identified two recurring themes in establishing good performance information:

- the quality of performance information in relation to agency contributions to outcomes and outputs; and
- the limited use of the performance information for decision making in the budget context.

With respect to outcomes and outputs, it is important to ensure links between programmes, outputs and outcomes are clear and measured effectively – particularly if this performance information is to inform budget decision making.

With respect to enhancing the utility of performance information for budget decision making, a major challenge in introducing a more systematic approach to programme reviews will be to ensure that it adds value to Government considerations, uses agency resources efficiently and does not become a mechanistic exercise.

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Dea J. Jones

FINANCE COMMITTEE INQUIRY INTO BEST PRACTICE BUDGET PROCESSES

Thank you for your letter of 28 March 2014, inviting me to provide written evidence to the Finance Committee to assist you with your inquiry into Best Practice budget processes. The 'call for evidence' covers a wide range of ground and I trust that my comments will be of assistance to the Committee.

Before addressing each of the specific questions set out in the call for evidence, I thought it would be useful for me to set out some general observations.

The new financial powers that are to be devolved to Wales under the Wales Bill represent both real opportunities and significant challenges for the National Assembly and the Welsh Government. This will be the first time that tax-raising powers have been devolved to Wales, and it will be imperative that the associated risks are fully understood and well-managed. I think that both the Finance Committee and also the Public Accounts Committee will have important roles to play in scrutinising the new arrangements, both during their development and also once they come into operation from 2018.

The Committee will be aware that I am keen to ensure that, wherever possible, I and the staff of the Wales Audit Office provide real-time input and commentary on significant public sector developments in Wales. Whilst I need to ensure that my independence as the statutory external auditor is safeguarded at all times, it is obviously better for us to seek to ensure that public bodies 'get it right first time' rather than simply issue retrospective audit reports criticising their shortcomings. I am therefore pleased that the Welsh Government has invited a senior member of my team to participate as an observer on their 'Welsh Treasury Implementation Programme Board', and also to attend meetings of the Finance Minister's 'Welsh Tax Forum'.

More generally, it is encouraging to see that senior Welsh Government officials are adopting an inclusive approach to wider stakeholder engagement from the outset of their implementation programme. This includes establishing productive lines of communication with their counterparts in the Scottish Government, who are currently grappling with similar challenges regarding devolved taxation powers within their own context.

My responses to each of the specific questions posed within the call for evidence are set out below.

Part 1 of the Inquiry

Question 1: International best practice – What are the principles of fiscal accountability? How do other countries achieve devolved financial accountability while retaining central fiscal control?

Response:

I have not undertaken any specific audit work to date in this area. However, I commend to the Committee's attention the draft '*Principles of Budgetary Governance*' that were recently published¹ by the Organisation for Economic Co-operation & Development (OECD), as these will be of significant relevance to the Committee's consideration of this topic.

The ten principles identified by the OECD are that:

- i. Fiscal policy should be managed within clear, credible and predictable limits;
- ii. Top-down budgetary management should be applied to align policies with resources;
- iii. Budgets should be closely aligned with government-wide strategic priorities;
- iv. Budgets should be forward-looking, giving a clear medium-term outlook;
- v. Budget documents should be open, transparent and accessible;
- vi. The budget process should be inclusive, participative and realistic;
- vii. Budgets should present a true, full and fair picture of the state of the public finances;

¹ <http://www.oecd.org/gov/budgeting/Draft-Principles-Budgetary-Governance.pdf>

- viii. Performance, evaluation and value for money should be integral to the budget process;
- ix. Longer-term sustainability and other fiscal risks should be identified, assessed and managed prudently; and
- x. The integrity and quality of budget forecasts, fiscal plans and budgetary implementation should be promoted through rigorous, independent quality assurance.

I note that these OECD principles have a particular resonance within the Welsh context, given that the Government of Wales Act 2006 places a statutory duty on the Welsh Government to promote sustainable development. Since 2009, the policy of the Welsh Government (as set out in *'One Wales, One Planet'*) has been to make sustainable development² the central organising principle of Government.

This long-standing duty and policy commitment is likely to be strengthened by a new set of sustainable development duties under the Future Generations Bill, when this is published later in the summer. In my response³ to the White Paper consultation on a sustainable development bill, I noted the central role that budget-setting plays in the delivery of public sector policy. It would therefore appear sensible for the National Assembly to evaluate the Welsh Government's eventual proposals for implementation of the devolved taxation powers against both the OECD's principles and also its own sustainable development duty. I suggest that the Committee may also wish to seek an early assurance from the Welsh Government that these principles are being embedded into policy development.

² **'Sustainable development** means enhancing the economic, social and environmental well-being of people and communities, achieving a better quality of life for our own and future generations in ways which:

- Promote social justice and equality of opportunity; and
- Enhance the natural and cultural environment and respect its limits – using only our fair share of the earth's resources and sustaining our cultural legacy.

Sustainable development is the process by which we reach the goal of sustainability.'

'One Wales, One Planet', Welsh Government, 2009

³ www.wao.gov.uk/sites/default/files/download_documents/SD_White_Paper_response_final.pdf

Question 2: Are the devolved powers tailored to the Welsh devolution settlement – as the powers in the Wales Bill are based on those in the Scotland Act, does this create unforeseen problems in Wales?

Response:

There are some real advantages to the fact that the powers in the Wales Bill are based on those in the Scotland Act, in that Wales is approximately two years behind Scotland in terms of implementation plans. This provides significant opportunities for all those engaged on the devolution of financial powers to Wales to learn from the experiences of those currently engaged in the Scottish project.

Early indications are that this process of observation, discussion, comparison and reflection is getting underway well, with officials in both Cardiff and Edinburgh exchanging views and sharing their learning. I think it will be important that this dialogue continues throughout the project and that all transferable learning (whether key success factors or potential pitfalls) is captured and evaluated as early as possible.

One important issue that will certainly impact differently on the Welsh arrangements is geographical, as around 60 per cent of the Welsh population live within one hour's travel from the border with England, compared with just 10 per cent in Scotland. This means that the 'cross-border' fiscal risk factors associated with unintended macro-economic consequences (in either direction) between Wales and England are likely to be significantly higher than those faced by Scotland.

These cross-border factors will play out in different ways for each of the taxes that are expected to be devolved to Wales, but their expected impacts will need to be carefully evaluated on each occasion when any differentiation in taxation rates is proposed between Wales and England.

Question 3: Linking budgets to outcomes. What new budget procedures are needed to improve the links between policies, spending programmes and outcomes? How would outcomes generated by the UK Government and the global economy be identified separately from those generated by local Welsh Government policies?

Response:

It is undoubtedly important to see that links are made wherever possible between policies, spending programmes and outcomes. This maxim holds true under the existing financial settlement, whereby the Annual Budget Motion focuses almost entirely upon the Welsh Government's spending plans, but it will become even more important once an element of fiscal devolution is in place for Wales from 2018 onwards.

However, in practice a note of caution is required here, as I think that it is generally hard and often impossible to identify outcomes generated by the UK Government and the global economy separately from those generated by local Welsh Government policies.

Whilst outputs can in some cases be used as reasonable proxy measurements of outcome, the measurement of outcome itself (which is often qualitative, rather than quantitative) is generally fraught with difficulty. In particular, causative economic effects are notoriously hard to tease out individually, and the Welsh economy is so closely integrated into the wider UK and global economies that isolating any single specific outcome as being the result of a single specific cause is highly problematic.

Part 2 of the Inquiry

Question 4: Tax and borrowing issues identified in the Holtham Report; e.g. the impact on the block grant and the 'indexed method' for adjustments; the basis of the devolved taxes; the lack of a needs based floor; no clear resolution of 'convergence' issues; what is the tax yield and what borrowing could be made against this income; what would be the basis of any new taxes and will they be governed by principles or rules?

Response:

As Auditor General, it would be inappropriate for me to offer views to the Committee on what are, essentially, policy matters for the Welsh and UK Governments. However, one factual observation I should like to make is that the nature of the taxation base is a key predictor of the Welsh Government's ability to borrow against the expected tax yield.

Importantly, each of the specific taxation powers being devolved to Wales contains a significant degree of inherent volatility, even before any changes in existing rates of tax are contemplated. For example:

- the level of revenue raised annually from non-domestic rates and from landfill tax is driven by fluctuations in economic activity; and
- the level of revenue raised annually from stamp duty land tax (or from any Welsh replacement property tax based on transactions, rather than equity value) is driven by the historically highly variable volume of annual transactions within the Welsh residential housing and commercial property markets.

Similarly, any proposed changes to the rates at which individual Welsh taxes are levied will drive further potential volatility in the forecasts for the revenue that will be raised. This element of uncertainty will be particularly hard to model accurately in the early years of the devolved powers, in the absence of an established trend history for Welsh fiscal policy.

All of this suggests to me that the ability of Welsh Ministers to borrow against future revenues from devolved taxation powers (as set out in the Wales Bill) may be significantly constrained in practice, especially in the first few years beyond 2018.

Question 5: Managing budgetary risk - what additional budgetary risks are introduced by the new powers and how will these be monitored and managed (e.g. how are shortfalls in revenue managed)?

Response:

As I have indicated in my response to Question 4, I suggest that the ability of the Welsh Government accurately to anticipate volatility in its future revenue streams will be the key additional budgetary risk that is introduced by the new powers.

To manage this risk effectively, the existing capacity of the Welsh Government for economic modelling and forecasting may need to be reviewed and enhanced, as the existing focus on expenditure funded by the Welsh block will only form part of the overall picture post-2018. Modelling changes in population behaviour (and addressing both intended and unintended consequences, including likely avoidance/evasion rates), will be an important element of understanding the likely revenue impact of proposed changes in individual tax rates etc.

I also note that the full devolution to Wales of non-domestic rating (NDR) represents a risk transfer from Westminster to Wales, as the current pooling and reallocation of NDR receipts at the UK level will be discontinued. Fluctuations in Welsh NDR receipts will therefore in future be borne solely by the Welsh Government, whereas currently these are mitigated by the smoothing effect of a UK-wide pooling arrangement via the Welsh block. The potential benefit to Wales is that any future increase in the generation of Welsh NDR receipts will be retained in Wales, but the downside is of course that the opposite case also applies.

Shortfalls in revenue can take one of two forms: planned or unplanned. Any planned or expected reductions in future revenue can be managed via robust budget setting, assisted by access to planned borrowing. However, unplanned or unexpected in-year revenue shortfalls will need to be swiftly identified and appropriate mitigating action taken. In the latter case, the existing arrangements for reducing (or deferring) planned in-year expenditure will of course continue to operate, but the Welsh Ministers will also have the option to increase in-year revenue income and / or to extend the use of their new borrowing powers within the limits approved by the UK government.

In any event, robust scrutiny of any proposed amendments to the annual Budget approved by the National Assembly, whether in respect of taxation, borrowing or expenditure, will be essential.

Question 6: How can the new budget processes be made transparent and understandable to all stakeholders, and how can stakeholders engage and participate in the budget process.

Response:

I would encourage the Committee to adopt a broad definition of the term 'stakeholder' when considering this aspect of the new financial powers. Welsh taxpayers, whether individuals or companies, can be expected in future to take a heightened interest in how their taxes are to be used by the Welsh Government, and other stakeholders will include the UK government and potential investors in Wales. This will especially be the case in the event that referendum approval is sought for the devolution of Income Tax-varying powers to Wales.

Transparency and understandability will therefore be important in all aspect of the budget-setting, approval and financial reporting processes. This in turn could be expected to stimulate greater stakeholder engagement and participation, and is also relevant in the context of the proposed Future Generations Bill.

I therefore suggest that consideration should be given to the publication of an annual 'Whole of Government of Wales Account' (WGWA) from 2018-19, equivalent to the existing set of Whole of Government accounts that is currently prepared at the UK level by HM Treasury. This could provide both the National Assembly and Welsh taxpayers with a comprehensive picture of the Welsh finances, both income and expenditure, and a coherent understanding of total assets, liabilities and future spending commitments. (I note that statutory authority for the preparation and audit of a WGWA already exists under Section 141 of the Government of Wales Act 2006, subject only to agreement with HM Treasury.)

Unlike the existing Welsh Government annual consolidated resource account, a WGWA would also include those elements of the Welsh public sector that are not under the direct ownership of the Welsh Government, including local government, the Welsh Government Sponsored Bodies and the NHS Trusts. Together with enhanced reporting to the National Assembly of the Welsh Government's taxation, borrowing and expenditure intentions, in my view this could facilitate greater transparency and enhance the ability of Assembly Members to scrutinise the executive.

In this regard, I entirely endorse a recent statement by my colleague the Auditor General for Scotland, who said that:

"Comprehensive, transparent and reliable public sector financial reporting...helps decision-making, by providing evidence about the long-term consequences of different options. It ensures public bodies can be held to account for their decisions and helps encourage confidence, so public and investors trust in the decisions of government".

I also strongly suggest that Wales, and the scrutiny function within the National Assembly itself in particular, will need input from the UK's Office for Budget Responsibility (OBR), or from an equivalent new Welsh body in terms of independent, expert commentary and analysis of the macro-economic implications of the Welsh Government's fiscal, borrowing and expenditure plans. In particular, this would provide assessments of the likely revenue effects of any specific proposals to move away from UK-wide taxation rates etc.

I understand that the UK Government has already indicated that the OBR will be asked to provide an initial forecast of the revenues from each of the taxes to be devolved to Wales. However, the availability of specialist OBR-type support on a continuing basis would greatly assist Assembly Members in assessing long-term fiscal sustainability and performance against fiscal and expenditure targets, and would provide both capacity and expertise well beyond that which could reasonably be expected from the Members' Research Service.

Question 7: UK budget planning - how does the Assembly work with Welsh Government, UK government and other public bodies under the new arrangements; how should the budget process be timetabled to meet Welsh and UK Government requirements (e.g. UK spending reviews)

Response:

I am aware that some preliminary work is already underway within the Welsh Government to identify the key timetable issues, including the various 'critical path' dependencies that exist in respect of HM Treasury's information requirements and the Westminster Parliamentary timetable. All of these factors will need to be mapped and then addressed as part of the Welsh Treasury implementation programme.

This is necessarily a complex process, and I would urge that the final arrangements are kept as streamlined as possible to minimise bureaucracy, whilst ensuring that sufficient time is allowed at each stage of the consultation and approval process for robust scrutiny of budget proposals.

In my view, the key to success will be the provision by the Welsh Government of budgetary information to both the UK Treasury and to the National Assembly in a clear and consistent manner and at an appropriate level of detail to allow timely challenge and scrutiny without unnecessary delay.

Question 8: Implementation – *how does the Assembly formally implement the devolution of the financial powers; how does the Assembly scrutinise, approve and monitor the Welsh Government's annual tax, borrowing and expenditure requirements; how does Welsh Government seek approval for new tax and borrowing powers from HM Treasury, and what role should the Assembly have in agreeing such changes.*

Response:

These remain essentially policy matters at present but, as with the issues covered under Question 7, the mechanical arrangements for scrutiny, approval and monitoring of the Welsh Government's fiscal, borrowing and expenditure proposals will require careful consideration alongside the development in due course of the Welsh Government's own detailed arrangements for the production of those proposals.

The existing arrangements within the Westminster Parliament, and the arrangements currently being developed for the Scottish Parliament certainly both offer reasonable starting points for the development of arrangements for Wales, but it will be equally important not to slavishly replicate what happens elsewhere if that is unsuited to the specific Welsh context.

My staff will be working closely with both Welsh Government and National Assembly officials to provide an external audit perspective on the robustness of whatever is developed, and I would certainly wish to alert both the Finance Committee and the Public Accounts Committee should we identify any unresolved concerns during that process.

If you would like any further information in respect of the material contained in this response, please do let me know.



HUW VAUGHAN THOMAS
AUDITOR GENERAL FOR WALES

cc Ms Bethan Davies, Committee Clerk



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21st May 2014

Jocelyn Davies AM
C/O Bethan Davies
Finance Committee
National Assembly for Wales
Cardiff Bay
Cardiff
CF99 1NA

Dear Jocelyn

RE: Best Practice Budget Processes

FSB Wales welcomes the opportunity to present its views to the Finance Committee on the National Assembly's budget processes. FSB Wales is the authoritative voice of businesses in Wales. With 10,000 members, a Welsh Policy Unit, two regional committees and twelve branch committees; FSB Wales is in constant contact with business at a grassroots level. It undertakes regular online surveys of its members as well as a biennial membership survey on a wide range of issues and concerns facing small business.

Introduction

FSB Wales has previously argued for an enhanced treasury function as part of the Welsh Government to increase the quality of financial decision making (attached are a discussion paper on a Welsh Treasury and the recent FSB Wales response to pre-legislative scrutiny of the Wales Bill). This is particularly prescient given the additional fiscal powers provided for by the Wales Bill currently in Parliament. With numerous competing priorities for resources, FSB Wales feels that increasing the transparency of the budget process would enable greater public scrutiny and accountability. This was reflected in our response to both parts of the Commission on Devolution in Wales' work. The FSB believes that this position is consistent with those who would wish to see Wales establish a growing economy built on genuine principles of sustainable development.

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Treasury Function

The Welsh Government has historically taken an approach to capital investment based on departmental priorities that has led to a relatively fragmented approach to the allocation of resources. Encouragingly, this is recognised in the Wales Infrastructure Investment Plan (WIIP), which is a welcome addition to the capacity of the Finance Department.

One of the strongest elements of the WIIP is its stated preference for the *5 case model* approach to appraising the business cases of prospective capital investments. Developed in partnership with the UK Government's Treasury, the *5 case model* is taken from the Green Book approach to investment allocation and will surely help to further the Welsh Government's stated aims of strengthening cross-departmental processes.

The UK Government's Treasury is renowned for its rigorous approach to the allocation of resources. A simple replication of this in Wales would not necessarily be appropriate. However, a strengthened treasury function in Wales could go much further in applying the Green Book principles to the Welsh Government's £1bn capital budget across departments. Moreover, it could play a significant role in determining the priorities of any future capital investment from borrowing powers, should they be devolved as recommended by the Silk Commission.

Economic Data

At present, there is a lack of economic data relating to Wales. This is in marked contrast to other devolved administrations where extensive economic statistics are produced and analysed to inform decision making. For instance, the Scottish Government will receive identical tax powers under the Scotland Act 2012 but has a number of economic publications to aid its decision making such as quarterly GDP figures and significant input-output data developed under the Scottish National Accounts Project. This enables tax changes to be modelled and better informs decision making. FSB Wales would argue similar provision should be made for Wales as part of an enhanced treasury function. This would then feed into discussion around the budget at an early stage in the process.

FSB Wales accepts many of the arguments which contend that assessing the effectiveness of public policy initiatives by recourse to data based on Gross Value Added (GVA) or for that matter Gross Domestic Household Income, is not always successful. However, the absence of regular data of this kind compounds the difficulty of assessing the impact of government policy and spending. As an organisation committed to developing a sound evidence base for intervention, we believe that regular and up to date reporting on productivity via the production of quarterly GVA statistics is required.

We also hold that publishing reliable and contemporary data is a key element of enabling the National Assembly and the wider public sphere to hold the Government of Wales and its associated bodies such as the Wales European Funding Office among others to account for its spending decisions.

Finally on the matter of economic data, we believe that the development of a suite of indices alongside regular reporting of Wales GVA, is possible (as we have stated above it is undertaken in other parts of the UK) and can be developed to demonstrate the wider value of government spending. It can also help in promoting sustainable development as well as tackling poverty and promoting genuine economic convergence.

Revenue Data

Presently, there is little statistical data available to document how much revenue is likely to be raised from taxation in Wales, except for the recent experimental statistics provided by HMRC on tax receipts disaggregated on a four nation basis.

The Silk Commission's published research papers highlight a number of alternative forms of fiscal federalism within an international context. For example, the Government of New South Wales has its own Treasury that forecasts and reports on revenue raised within the state and provides policy analysis to inform the fiscal policies of the NSW Government. Additionally, Government Revenue and Expenditure Scotland (GERS) seeks to approximate Scottish tax receipts and provide finer detail on public finance that enables wider debate in civic society.

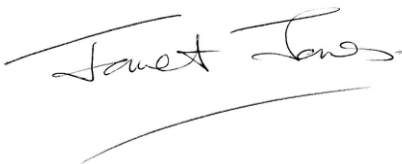
FSB Wales believes Wales needs similar accounting systems that would allow the modelling of economic decisions, enabling more coherent planning of policy decisions regarding the Welsh tax base. This could take the form of a Government and Expenditure Wales document.

Tax Impact Assessment

FSB Wales would like to see Tax Impact Assessments accompany any decision made around devolved taxation in Wales. This would seek to adopt best practice in assessing the impact of policy measures in a similar way to Regulatory Impact Assessments as specified under the Government of Wales Act 2006 for all Welsh legislation. Ideally, the process governing this would be thorough, including early implementation in the decision making process and well resourced analysis with independent input to ensure impacts are properly measured.

I hope you find the comments of FSB Wales of interest.

Yours sincerely



Janet Jones
Wales Policy Chair
Federation of Small Businesses Wales

FSB Wales

Draft Wales Bill

9th January 2014





Draft Wales Bill – Evidence to the Welsh Affairs Committee The Federation of Small Businesses Wales

The Federation of Small Businesses Wales welcomes the opportunity to present its views to the Welsh Affairs Committee on the draft Wales Bill. FSB Wales is the authoritative voice of small businesses in Wales. With 10,000 members, a Welsh Policy Unit, two regional committees and twelve branch committees; FSB Wales is in constant contact with small businesses at a grassroots level. It undertakes a monthly online survey of its members as well as an annual membership survey on a wide range of issues and concerns facing small business.

Introduction

FSB Wales has been heavily involved with the Commission on Devolution in Wales (Silk Commission). In order to inform our responses to both parts of the Silk Commission, FSB Wales undertook four consultation events with members across Wales, two in North Wales and two in South Wales. This enabled us to submit informed positions on both parts of the Silk Commission's work and to engage fully in the details of the Welsh devolution settlement.

Draft Wales Bill

FSB Wales broadly welcomes the draft Wales Bill and believes it largely reflects the recommendations of the Silk Commission, which were based on a strong body of evidence. However, there are a number of areas that need to be addressed or clarified in relation to the Bill as it passes through Parliament. They are as follows:

- **Non-Domestic Rates (Business Rates):** The draft Wales Bill appears to contain no reference to the full devolution of Non-Domestic Rates, despite the Explanatory Memorandum stating; *"The draft Bill also implements the Commission's recommendation to fully devolve business rates in Wales"*.¹ As both the Silk Commission part one report and the UK Government's response note, legislation relating to Business Rates is already devolved under the Government of Wales Act 2006, although the wording relates only to *'local government finance'*. This ambiguity has led to a situation where it is not clear which mechanism will enable the full devolution of business rates and whether this will be as the result of initiation from Welsh Government or the UK Government.

While the Scottish experience is not directly transferable to Wales due to the important differences between reserved and conferred models of devolution, the Scotland 1998 Act has a far more explicit wording on this matter, stating in an exception to a reservation on financial and economic matters; *"Local taxes to fund local authority expenditure (for example, council tax and non-domestic rates)"*.² FSB Wales suggests that the draft Wales Bill could be amended to create a similar explicit statement to provide clarity. This could be done either by amending Schedule 7 paragraph 12 of the Government of Wales Act 2006 to include wording similar to the Scotland Act 1998 or by placing non-domestic rates explicitly

¹ Draft Wales Bill. P. 68.

² Scotland Act 1998. Schedule 5, Part II, Section A1. [Online]. Available at: <http://www.legislation.gov.uk/ukpga/1998/46/contents> (accessed 8th January 2014).



in the list of devolved taxes under Part 4A as proposed by the draft Wales Bill, thereby adding it to the proposed paragraph 16A of Schedule 7 in the 2006 Act.

The wording in the draft Wales Bill could allow for any secondary legislation needed to remove the existing joint accounting arrangements and move Non-Domestic Rate receipts from Departmental Expenditure Limits to Annually Managed Expenditure, essentially moving NDR from the block grant to an income stream, for the purposes of the Welsh Government's budget. This would be carried out with agreement from both the Welsh and UK Governments.

- **Income Tax:** FSB Wales has been supportive of the income tax proposals outlined in the Silk Commission's recommendations noting that income tax is also a form of business tax for many of our self-employed members. However, FSB Wales believes the 'lock-step' model proposed in the draft Bill is ill suited for devolution. FSB Wales believes the lock-step model is unlikely to be used by the current or future Welsh Governments as it does not provide sufficient flexibility in policy decision making. For instance, a policy of reducing the higher rate of taxation could be examined under the Silk Commission's original proposals that could prove beneficial to our members.

This is significant because the availability of capital borrowing powers is contingent on the level of income tax devolution available to the Welsh Government, following a successful referendum. The lock-step model is less attractive and would therefore discourage the Welsh Government from pursuing devolution and the additional capital borrowing powers that would accompany it.

- **Air Passenger Duty:** The Silk Commission recommended the devolution of Air Passenger Duty (APD) on short haul flights; bringing Wales into line with Northern Ireland's current competencies. FSB Wales was disappointed not to see further consideration of this issue as was the case with Stamp Duty Land Tax and believes devolution of this tax would be beneficial to businesses in Wales. Our position remains that the rationale behind fiscal autonomy is the potential to create attractive differences in tax policy in Wales. FSB Wales maintains that Air Passenger Duty has similar characteristics to Stamp Duty Land Tax, including an immobile tax base, and is therefore suitable for devolution to Wales. The decision to omit APD for short haul flights in the Wales Bill is therefore counterintuitive.
- **Future tax devolution:** FSB Wales notes that the Silk Commission recommended Corporation Tax should be devolved to Wales only if similar devolution occurs in Northern Ireland and Scotland. The Commission also stated in recommendation 9 that there should be a presumption in favour of devolution for any new UK taxes³. While FSB Wales members consulted in our initial response were undecided on whether Corporation Tax should be devolved they felt Wales should not be at a competitive disadvantage if similar opportunities were to arise in Scotland and Northern Ireland. This necessitates a mechanism within the Wales Bill for adding additional taxes to the Welsh Government and National Assembly's remit. FSB Wales believes this should be included in the Wales Bill.

³ Commission on Devolution in Wales. 2012. *Empowerment and Responsibility: Financial Powers to Strengthen Wales*. P.76 & 84.



- **NI Relief and Capital Allowances:** While not recommending the devolution of Corporation Tax or National Insurance Contributions, the Silk Commission did suggest in recommendations 14 and 15 that the Welsh Government should be able to fund differential reliefs in Wales⁴. Both these recommendations were accepted by the UK Government. This could be used for instance to provide capital allowances in enterprise zones, or a targeted reduction in employer NICs to accompany schemes such as Jobs Growth Wales. This could provide a more efficient means of supporting the employment of targeted groups. While recognising that welfare issues are not devolved, such an approach would allow the Welsh Government the flexibility to stimulate employment and job creation in a targeted way.

FSB Wales would like further clarification on the mechanism that would allow this to take place. If primary legislation is required to enable this to happen then this should be done through the Wales Bill. Recommendation 10 also suggested that the Welsh Government should be able to fund tax reliefs on other taxes in agreement with the UK government⁵. This issue should be considered by the Committee.

- **Treasury Function (including tax impact assessment)** – The Silk Commission suggested any new fiscal powers should be accompanied by appropriate treasury capacity in Wales. While this is largely a matter for the Welsh Government, FSB Wales has previously argued that far more robust economic statistics are needed on the Welsh economy to inform decision making on tax changes. For instance, the Scottish Government will receive identical tax powers under the Scotland Act 2012 but has a number of economic publications to aid its decision making such as; Government Expenditure and Revenue Scotland, quarterly GDP figures and significant input output data developed under the Scottish National Accounts Project⁶. All this enables tax changes to be modelled and better informs decision making. FSB Wales would argue similar provision should be made for Wales.

Returning to the draft Wales Bill, FSB Wales would like to see the Bill amended to include provisions for Tax Impact Assessments. This would seek to adopt best practice in assessing the impact of policy measures in a similar way to Regulatory Impact Assessments as specified under the Government of Wales Act 2006 for all Welsh legislation. Ideally, the process governing this would be thorough, including early implementation in the decision making process and well resourced analysis with independent input to ensure impacts are properly measured. However, FSB Wales recognises that the exact impact assessment process would be a matter for the Welsh Government and not for the draft Wales Bill.

Conclusion

FSB Wales welcomes the opportunity to contribute to the pre-legislative scrutiny of the draft Wales Bill. FSB Wales believes the Silk Commission process provided a thorough basis on which to devolve fiscal powers to the Welsh Government and National Assembly for Wales and looks forward to the Welsh Affairs Committee scrutiny of the UK Government's proposals. This should include further

⁴ Ibid. P.87 & 90.

⁵ Ibid. P.76.

⁶ Scottish Government. Scottish National Accounts Project. [Online]. Available at: <http://www.scotland.gov.uk/Topics/Statistics/Browse/Economy/SNAP> (accessed 8th January 2014)



consideration of a number of issues including the process by which NDR will be devolved and the ability for the Welsh Government to create tax reliefs in certain areas.

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The Federation of Small Businesses

The FSB is non-profit making and non-party political. The Federation of Small Businesses is the UK's **largest campaigning pressure group** promoting and protecting the interests of the self-employed and owners of small firms. Formed in 1974, it now has **200,000 members across 33 regions and 194 branches**.

Lobbying

Our lobbying arm - led by the Westminster Press and Parliamentary office - applies pressure on MPs, Government and Whitehall and puts the FSB viewpoint over to the media. The FSB also has Press and Parliamentary Offices in Glasgow, Cardiff and Belfast to lobby the devolved assemblies. Development Managers work alongside members in our regions to further FSB influence at a regional level.

Member Benefits

In addition, Member Services is committed to delivering a wide range of high quality, good value business services to members of the FSB. These services will be subject to continuing review and will represent a positive enhancement to the benefit of membership of the Leading Business Organisation in the UK.

Vision

A community that recognises, values and adequately rewards the endeavours of those who are self employed and small business owners within the UK

The Federation of Small Businesses is the trading name of the National Federation of Self Employed and Small Businesses Limited. Our registered office is Sir Frank Whittle Way, Blackpool Business Park, Blackpool, Lancashire, FY4 2FE. Our company number is 1263540 and our Data Protection Act registration number is Z7356876. We are a non-profit making organisation and we have registered with the Information Commissioner on a voluntary basis.

Associate Companies

We have two associated companies, FSB (Member Services) Limited (company number 02875304 and Data Protection Act registration number Z7356601) and NFSE Sales Limited (company number 01222258 and Data Protection Act registration number Z7315310).

FSB Wales Discussion Paper

A Treasury
Function for
Wales

21st November 2012





Introduction

In its submission to the Silk Commission, FSB Wales highlighted the need for greater accountability arrangements within Welsh Government to ensure that value for money is being maximised through capital investment.

FSB Wales has previously argued in favour of a treasury function for Wales that would strengthen the Welsh Government's Finance Department and enable it to place economic growth at the core of decision making over capital investment in Wales. The FSB believes that this position is consistent with those who would wish to see Wales establish a growing economy built on genuine principles of sustainable development.

However, FSB Wales is also firmly of the view that the good intentions shared by many in seeking to create for Wales a sustainable economic future, must now be matched by action built on strong and principled leadership from within the Welsh Government.

Responding to the Silk Commission: Creating a Welsh Treasury

FSB Wales recognises the Welsh Government's concern over the challenges it faces in its capital expenditure budget. Capital expenditure is often vital to driving economic growth in Wales by providing important jobs in the construction industry as well as laying the foundations for future economic growth by building the critical infrastructure on which Wales' businesses rely. FSB Wales agrees that the Welsh Government is likely to have great difficulty in delivering the infrastructure investment businesses in Wales need while its capital budget decreases by 41 per cent over the budgetary period.

FSB Wales welcomes the recent agreement on borrowing powers between the Welsh and UK Governments that has in principle opened the door to additional powers to leverage capital investment; however, more could still be done. The linchpin of the argument for further fiscal devolution advocated by the Commission on Devolution in Wales (Silk Commission) is accountability and FSB Wales endorses its recommendations that will lead to empowerment and responsibility. This accountability is needed if borrowing powers for capital expenditure are to be devolved and used effectively. However, there must also be greater accountability within Welsh Government in order to ensure every Welsh penny spent on capital expenditure is maximising Wales' economic prosperity.

Two changes to the heart of governance in Wales should go hand in hand with the move towards greater borrowing and fiscal responsibility advocated by the Silk Commission¹. These are; a more rigorous process for allocating capital expenditure in Wales and a step change in capacity to provide improved modelling of public policy decision making. This would mean the creation of a treasury function in Wales, a finance department with economic growth at its core as advocated by the Silk Commission in line with earlier FSB Wales recommendations.

¹ Commission on Devolution in Wales. 2012. *Empowerment and Responsibility: financial powers to strengthen Wales*.



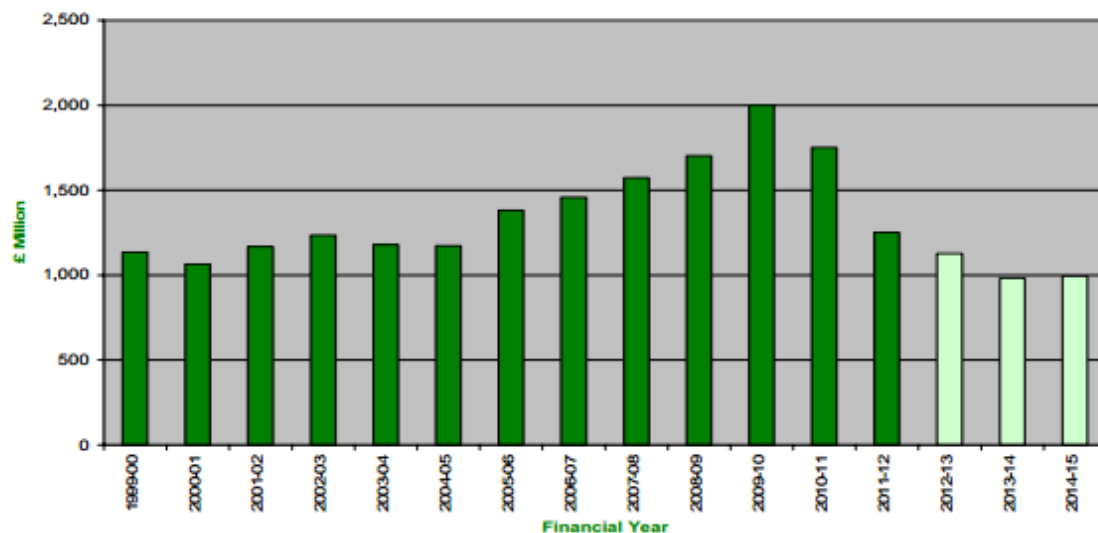
Prioritisation of Capital Investment

The Welsh Government has historically taken an approach to capital investment based on departmental priorities that has led to a relatively fragmented approach to the allocation of resources. Encouragingly, this is recognised in the Wales Infrastructure Investment Plan (WIIP) which states:

“Historically the Welsh Government made decisions on infrastructure need and investment largely within departmental portfolios, each with its own framework of strategies and investment plans, published policies and programme management.”²

In times of rising capital expenditure, the demerits of such an approach were not as obvious as might have been expected. However, the Welsh Government’s declining capital budget has sharpened focus on producing value for money and prioritising capital spend on projects that bring real return to Wales³. Looking to the future, it is important that Wales has a treasury function that is fit for purpose and can deliver the capital investment that businesses need. It is also important to acknowledge the instability of the wider economic environment, with a growing uncertainty from Europe and the prospect of prolonged low levels of economic activity on the horizon.

Chart 1.2 – Wales Capital Departmental Expenditure Limit in Real Terms since Devolution (2010 – 11 prices)



In this respect, the Wales Infrastructure Investment Plan is a welcome addition to the Finance Department’s capacity. Indeed, one of the strongest elements of the WIIP is its stated preference for

² Welsh Government. 2012. Programme for Government: Chapter 1 – Stronger Foundations for Growth and Jobs [Online]. Available at: <http://wales.gov.uk/docs/caecd/publications/120522wiipchapter1eng.pdf> (Accessed 16th November 2012).

³ Welsh Government. 2011. Draft Budget for Growth and Jobs [Online]. Available at: <http://wales.gov.uk/docs/finance/report/111004narrativeen.pdf> (accessed 16th November 2012).



the use of the *5 case model* approach to appraising the business cases of prospective capital investments⁴. Developed in partnership with the UK Government's Treasury, the *5 case model* is taken from the Green Book approach⁵ to investment allocation and will surely help to further the Welsh Government's stated aims:

*"We will be supplementing departmental processes and building on previous mechanisms by strengthening cross-departmental procedures, including more rigorous, consistent evaluation and ranking of investment options and establishing a new Strategic Investment Committee to support Ministerial decisions. These new procedures will be used to inform decisions on allocating around £250m of capital reserves available in 2013-14 and 2014-15, details of which will be set out in the autumn. The Strategic Investment Committee will also play a key role in advising Ministers on the development of new innovative funding mechanisms."*⁶

The UK Government's Treasury is renowned for its rigorous approach to the allocation of resources. A simple replication of this in Wales would not necessarily be appropriate. However, a strengthened treasury function in Wales could go much further in applying the Green Book principles to the Welsh Government's £1bn capital budget across departments⁷. Moreover, it could play a significant role in determining the priorities of any future capital investment from borrowing powers, should they be devolved as recommended by the Silk Commission⁸.

Modelling fiscal policy decisions

Creating a strengthened treasury function in Wales by emboldening the Welsh Government's Finance Department is the first step in ensuring the Welsh Government's budget is used in the most effective manner to deliver sustainable economic growth.

This was also strongly supported by the Silk Commission that recommended a Welsh Treasury, including the aspects discussed below, to manage further fiscal powers. Internationally, a greater variety of data exists at regional level on economic performance thus facilitating a much wider debate on allocating resources. If the Welsh Government is to assume greater fiscal accountability then similar resource must be available within the Welsh Government's Finance Department to model public policy decisions. As the Holtham Commission noted in its final report:

"Should tax-varying powers be devolved, Welsh Ministers are likely to require some specialist support to help determine tax policy. Perhaps counter-intuitively, the need for expert advice might be greater for some of the smaller taxes which primarily have a policy rationale than for income tax, which has a revenue-raising objective...we envisage that some enhancement

⁴ Welsh Government. 2012. *The Five Case Model: a tool for better decision making* [Online]. Available at: <http://wales.gov.uk/funding/wiip2012/5casemodel/?lang=en> (accessed 16th November 2012).

⁵ Welsh Government. 2012. *Delivering Public Value From Spending Proposals: Green Book guidance on public sector business cases using the five case model* [Online]. Available at: <http://wales.gov.uk/docs/caecd/publications/1210035cmfullguidance.pdf> (accessed 16th November 2012).

⁶ *Ibid*

⁷ Welsh Government. 2011. *Draft Budget for Growth and Jobs* [Online]. Available at: <http://wales.gov.uk/docs/finance/report/111004narrativeen.pdf> (accessed 16th November 2012).

⁸ Commission on Devolution in Wales. 2012. *Empowerment and Responsibility: financial powers to strengthen Wales*. P.119



*to the Assembly Government's Finance Department would be necessary once any tax-varying powers are devolved, though this is likely to comprise a fairly small unit of specialists, including economics and statistical expertise.*⁹

Presently, there is little statistical data available to document how much revenue is likely to be raised from taxation in Wales, except for the significant work carried out by the Holtham Commission in 2007-08 and the Silk Commission for the period 2007-11.

The Silk Commission's published research papers highlight a number of alternative forms of fiscal federalism within an international context¹⁰. For example, the Government of New South Wales has its own Treasury that forecasts and reports on revenue raised within the state and provides policy analysis to inform the fiscal policies of the NSW Government¹¹. Additionally, Government Revenue and Expenditure Scotland (GERS) seeks to approximate Scottish tax receipts and provide finer detail on public finance that enables wider debate in civic society¹².

Wales would need a similar accounting system that would allow the modelling of economic decisions, enabling more coherent planning of policy decisions regarding the Welsh tax base. This was discussed by constitutional expert Alan Trench who noted:

*"Among the signal services that the Holtham Commission has done is to provide more accurate and up-to-date data about Wales's public finances than we've ever had before, particularly about tax revenues. On the basis of their figure (£17.1 billion), I've calculated that in 2007-08 Wales's fiscal deficit was £6.3 billion. That's a terrifying sum: just under a quarter of all public spending in Wales, and over 14 per cent of national income (gross value added) generated in Wales.*¹³

Allowing disaggregated detailed data to be collected on a Wales level would help the Welsh Government to ascertain areas of policy development to maximise future growth potential in the Welsh economy. It is therefore encouraging to see the Silk Commission recommend an emphasis on strengthening the Welsh tax base as a key element of a Welsh Treasury; FSB Wales would like to see this put into practice¹⁴.

⁹ Independent Commission on Funding and Finance for Wales . 2010. *Fairness and Accountability: A new funding settlement for Wales* [Online]. Available at:

<http://wales.gov.uk/docs/icffw/report/100705fundingsettlementfullen.pdf> (accessed 16th November 2012).

¹⁰ Commission on Devolution in Wales. 2012. *International Fiscal Systems* [Online]. Available at:

<http://commissionondevolutioninwales.independent.gov.uk/files/2012/11/Context-paper-International-Fiscal-Systems.pdf> (accessed 20th November 2012).

¹¹ New South Wales Treasury. 2012. *Report on State Finances* [Online]. Available at:

http://www.treasury.nsw.gov.au/_data/assets/pdf_file/0020/24059/2011-12_NSW_Report_on_State_Finances_small_dnd.pdf (accessed 20th November 2012).

¹² Scottish Government. 2012. *Government Expenditure and Revenue Scotland* [Online]. Available at:

<http://www.scotland.gov.uk/Topics/Statistics/Browse/Economy/GERS> (accessed 16th November 2012).

¹³ Trench, A. 2010. *Doing the sums* [Online]. Available at: <http://www.clickonwales.org/2010/08/doing-the-sums/> (accessed 16th November 2012).

¹⁴ Commission on Devolution in Wales. 2012. *Empowerment and Responsibility: financial powers to strengthen Wales*. P.135



Beyond the headline statistics around tax revenue and public expenditure in Wales there is also a greater need for the modelling of public policy priorities to ensure that the full implications of Welsh Government decisions are well understood by decision makers. All nations in Europe hold public accounts in the form of Input Output (IO) tables; this is true of Wales where Cardiff Business School have managed IO tables for more than twenty years. However, it is necessary to go beyond this to ensure any fiscal changes in Wales are done on sound economic advice, particularly through the creation of a Computed General Equilibrium Model (CGE), something already in existence in Scotland¹⁵. As Dr Crawley and Professor Munday of Cardiff Business School note in their response to the Silk Commission:

“...as yet there has been limited progress towards a full Welsh model. If Wales was to gain fiscal powers in respect of tax it would be difficult for economists to advise the Welsh Government on likely consequences without the construction of a specific Welsh Model.”¹⁶

This is reinforced by Antonia Borges of the OECD Economic and Statistics Department who says:

“Typically, the approach is used for horizontal policies that cut across many sectors, or perhaps have an impact on producers and consumers simultaneously... In this sense the impacts of tax reform, trade policy, global energy or agricultural policy, large projects or the introduction of new technologies are typical issues requiring a general equilibrium approach.”¹⁷

Such an approach to economic modelling should be examined by the Welsh and UK Governments in anticipation of any further fiscal autonomy, as prescribed by part 1 of the Silk Commission.

Gross Value-Added (GVA) for Wales is currently published annually with a significant time lag for the data meaning it is often out of date when it is published. FSB Wales would like to see far more frequent reporting of GVA for Wales, where again Scotland has taken a lead on this issue, in order to provide an up-to-date picture of economic performance.

Helpfully, the Silk Commission has recently published a paper examining GVA in Wales and its relationship to tax revenues and has called for greater clarity on key statistics such as GVA¹⁸. For the business community, the relative decline in Gross Operating Surplus, the element of GVA relating to profitability, highlights an area of future policy focus for Welsh Government, particularly as it would impact on revenue raised in Wales from taxation. Providing greater transparency in this way will enable civic society greater capacity to scrutinise decisions made by the Welsh Government and ensure that the Welsh Government is able to accurately focus its resources on projects that maximise economic development.

¹⁵ <http://www.scotland.gov.uk/Publications/2008/11/13110942/4>

¹⁶ Crawley, A. and Munday, M. 2012. *Evidence proposal for the Silk Commission: CGE for Policy Analysis* [Online]. Available at: <http://commissionondevolutioninwales.independent.gov.uk/files/2012/02/Dr-Andrew-Crawley-and-Prof-Max-Munday-Cardiff-Business-School-English.pdf> (accessed 16th November 2012)

¹⁷ Borges, A. *Applied General Equilibrium Models: an assessment of their usefulness in policy analysis* [Online]. Available at: <http://www.oecd.org/economy/economicoutlookanalysisandforecasts/35567467.pdf> (accessed 16th November 2012).

¹⁸ Commission on Devolution in Wales. 2012. *Economic Context in Wales* [Online]. Available at: <http://commissionondevolutioninwales.independent.gov.uk/files/2012/11/Context-paper-Economic-context-in-Wales.pdf> (accessed 16th November 2012).



Finally, by introducing the necessary precursors to fiscal autonomy the Welsh Government will also have the opportunity to influence the other cornerstone of financial independence in Wales; the Barnett Formula. It has long been argued that the Barnett formula has left Wales underfunded compared to her sister nations of the UK¹⁹. Academic work in Scotland has sought to understand the practical workings of the Barnett formula and concluded that it is most effective when “Political influence” is also included in bargaining discussions²⁰.

This influence can be achieved by proposing joint workings and establishing mutual benefits through a constructive framework of collective work programmes. A new treasury can model the most optimum solutions for Wales and aid in influencing decisions in a phased manner. Indeed the Silk Commission report on empowerment and responsibility proposes a similar approach:

“The Welsh Government and UK Government, and their respective Treasuries, should use both devolved and non-devolved economic powers to strengthen the Welsh tax base. The Bilateral Committee on Welsh Fiscal Devolution referred to (above) would provide a forum for creating a stronger bilateral focus on improving the Welsh economy”.

Conclusion

The Silk Commission report on empowerment and responsibility has set some key challenges for decision makers in Wales and the UK in advancing the capacity and accountability of Welsh Government. FSB Wales would like to examine what steps are necessary to begin laying the foundation for a treasury function in Wales that would strengthen Welsh public finances and place an emphasis on economic growth. Critical issues, such as the working relationship with UK wide bodies such as the Office for Budget Responsibility, Office for National Statistics and Her Majesty’s Revenue and Customs must now be explored in order to provide a firm set of proposals for the creation of a strengthened Welsh Government Finance Department. Consensual proposals building on the good work done by the Silk Commission will serve both Wales and the UK well in the future.

¹⁹ Independent Commission on Funding and Finance for Wales . 2010. *Fairness and Accountability: A new funding settlement for Wales* [Online]. Available at: <http://wales.gov.uk/docs/icffw/report/100705fundingsettlementfullen.pdf> (accessed 21st November 2012).

²⁰ The Barnett allocation mechanism: formula plus influence
Christie Alex, Swales J. Kim, *Regional Studies* Vol 44, No. 6, pp. 761-775 (2010)
<http://dx.doi.org/10.1080/00343400903107710>

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The Federation of Small Businesses

The FSB is non-profit making and non-party political. The Federation of Small Businesses is the UK's **largest campaigning pressure group** promoting and protecting the interests of the self-employed and owners of small firms. Formed in 1974, it now has **200,000 members across 33 regions and 194 branches and in the region of 10,000 of those members are from businesses in Wales.**

Lobbying

Our lobbying arm - led by the Westminster Press and Parliamentary office - applies pressure on MPs, Government and Whitehall and puts the FSB viewpoint over to the media. The FSB also has Press and Parliamentary Offices in Glasgow, Cardiff and Belfast to lobby the devolved assemblies. Development Managers work alongside members in our regions to further FSB influence at a regional level.

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A community that recognises, values and adequately rewards the endeavours of those who are self employed and small business owners within the UK

The Federation of Small Businesses is the trading name of the National Federation of Self Employed and Small Businesses Limited. Our registered office is Sir Frank Whittle Way, Blackpool Business Park, Blackpool, Lancashire, FY4 2FE. Our company number is 1263540 and our Data Protection Act registration number is Z7356876. We are a non-profit making organisation and we have registered with the Information Commissioner on a voluntary basis.

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Linking budgets to outcomes?

Comments prepared for the inquiry into best practice budget processes by the Finance Committee of the National Assembly for Wales

Thank you for the opportunity to contribute to your discussion. I would like to focus my remarks on the issue of linking budgets to outcomes, as this is an area where I believe reform has the potential to damage the ability of the assembly to hold government to account. Let me first clarify some concepts in performance budgeting, before looking at core choices in linking budgets to results and how they affect legislative bodies.

Concepts

The idea of performance is intuitively appealing – most people want governments to perform better and to improve their lives. In the US, the idea of performance budgeting dates back to the 1940s (Schick 1966, US General Accounting Office 1997). Budgeting for results has become a popular item on the reform agendas of other OECD governments in recent decades (Blöndal 2003). In the UK, the spending review system introduced in the late 1990s was linked to Public Service Agreements that suggested a greater focus on results, including outcomes. More established is the term “value for money”, which traces the link from funding to the purchase of inputs (economy), from inputs to the production of outputs (efficiency) and, finally, from outputs to the achievement of outcomes or impacts on society (effectiveness). While there is no universal language of performance these basic concepts are widely recognised (Kristensen et al. 2002).

There are different basic approaches for linking budgets to results. Schick (2003: 101) suggests two definitions of performance budgeting: a strict one, where an increment in funding is directly linked to an increment in results; and a broader one, where budgets contain information on what organisations intend to do with their resources. Similarly, Curristine and Flynn (in Cangiano et al. 2013: 229) distinguish presentational, performance-informed, and direct performance budgeting. Few governments make direct links between performance and funding on an extensive basis, while the less mechanistic use of performance information in budgetary decisions is more common. This entails using performance measures to assess the economy, efficiency and effectiveness of the activities of an organisation. Specific output and outcome measures can be, but need not be, linked to targets.

Concretely, there are four fundamental mechanisms of performance budgeting systems (Robinson 2007): programme budgeting, funding-linked performance targets, agency-level budgetary performance incentives and formula funding. Of these, a programme classification is the most important and least controversial element (Kraan 2007). Programmes are objective-based spending categories, to which performance measures can be attached. Unlike for some other budget classifications (Jacobs et al. 2009), there are no internationally fixed categories, since the structure of programmes in a budget reflects a government’s political priorities and objectives.

Implications for legislative bodies

Moving from traditional input control in budgeting to a more results-focused approach has implications for the level of detail at which a legislative body can authorise budgets. Traditional input budgets have a large number of line items – several thousand if you look at central government budgets in the United States or Germany. In contrast, a results focus typically requires a substantial reduction in the number of line items, and a higher level of aggregation. Budget systems with a focus on outcomes, such as Australia, present the legislature with highly aggregated appropriations. Once approved, these allow substantial in-year reprioritisation within departments (virement) without having to seek parliamentary approval. New Zealand, by contrast, has adopted output-based appropriations. These enable the legislature to retain more control of the activities that funds are spent on within departments while giving the executive some flexibility to move money between different output classes.

In my view, outcome-based approaches fundamentally challenge parliamentary control and accountability (see also Johnson and Talbot 2007). One reason is that outcome appropriations impose few constraints, due to their high level of aggregation. Another problem is attribution. Outcomes are typically more long-term and affected by a variety of exogenous factors that make it difficult, and often impossible, to clearly attribute responsibility to a single organisation and specific government interventions. If in addition an outcome takes years to achieve and the politician responsible for delivery changes, then accountability becomes impossible. For these reasons, outcome-based approaches are most compatible with systems where legislatures do not exercise detailed control of public finances. In contrast, outputs are produced within the boundaries of an organisation and within a shorter period of time that is more aligned with the annual budget process. Hence, outputs can be clearly attributed and provide a better basis for accountability.

More broadly, the history of performance budgeting provides valuable lessons for governments that are currently contemplating such reforms. The experience of several OECD countries suggests that the budget process easily becomes overburdened when it is the primary focus for assessing performance (US General Accounting Office 1997, Schick 2003). The integration of a large number of performance measures into budget documents can obfuscate rather than elucidate. In several countries, governments are now reducing the amount of performance information in the budget so as to declutter the documents and to refocus on financial analysis. In the Netherlands, the recent undoing of an outcome-focused budget reform in the 2000s followed increasing legislative demands for more meaningful fiscal information (De Jong 2013).

What are possible alternatives? Performance is important, and all governments should strive to achieve better results with the available resources. Performance information, including on outputs and outcomes, has an important role to play. But such information should not clutter the budget and distract from its primary role as the most important source of financial information. In fact, the assessment of performance need not be attached to the annual budget approval process. More selective and periodic programme reviews and evaluations and

value for money audits are all sensible tools that enable lesson drawing of this sort. Such information can and should be harnessed when interrogating programme-level spending data over a number of years.

To help strengthen the consideration of performance in the legislative review of government budgets, one approach is to ensure that programme-level expertise and information are injected into the process. This can be achieved by giving sectoral committees a role in scrutinising and prioritising expenditure within departments. In OECD countries, a number of legislatures have adopted a sequenced two-step process that gives the finance committee a role in considering the aggregates and how spending is divided across broad functional areas, while sector committees review the prioritisation of departmental expenditure within their available sector total (Wehner 2010). Another approach is to ensure that findings and lessons from audit scrutiny, especially from value for money audits, feed directly into budgetary decisions. For instance, in some legislatures the audit committee is a subcommittee of the finance committee, thus creating a direct link between audit review and budget approval.

Conclusions

As Allen Schick (2003) reminds us, 'Performance budgeting is an old idea with a disappointing past and an uncertain future.' Of course, questioning and analysing performance are crucial for making wise decisions about scarce resources. But the budget should not be the main vehicle for performance reforms. Outcome-based budgets and appropriations risk undermining legislative control by giving departments a blank cheque and making accountability for actual performance arguably impossible. A more sensible approach is to focus on outputs, which are embedded in wider outcomes. This could either be achieved by appropriating money by outputs, as in New Zealand, or through a sensible programme classification that allows appropriating money at that level and to which performance measures can be attached when these are directly relevant for determining allocations. Finally, information about the performance of government programmes can best be harnessed in a legislative process that gives a role to sector committees in scrutinising and prioritising spending within departments, and where audit results feed into deliberations on annual budgets.

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The Senedd Papers

#2

Taxation in Wales

An IWA discussion paper by Gerald Holtham

iwa

The Senedd Papers

#2

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Introduction to the Senedd Papers

For democracy to work there needs to be an engaged electorate and civil society. One of the core objectives for the National Assembly for Wales's Commission during the Fourth Assembly is to increase engagement with the people of Wales.

That is, we aim to create an environment that encourages interest in the work of the Assembly and facilitates participation in the Assembly's roles of legislating, scrutiny and representation.

We aim to achieve this by engaging actively and widely, and ensure that the Assembly benefits from the creative energy generated by such engagement.

An important part of that process is working with partner organisations to facilitate debate amongst wider civic society and that's why the National Assembly is supporting the Institute of Welsh Affairs in launching The Senedd Papers.

The IWA plays an important role in Welsh civic life in terms of developing Wales's public policy landscape - and by anchoring this series of discussion papers to the seat of Welsh Governance, here in our iconic building, we are highlighting the central role that the National Assembly now plays in developing and scrutinising public policy in Wales.

Dame Rosemary Butler AM

Presiding Officer of the National Assembly for Wales

IWA Foreword

Just fifteen years after the establishment of an Assembly with executive powers Wales now has a Government, a Parliament, and will soon have tax raising powers.

The third Government of Wales Bill in a decade and a half, currently before Parliament, will give the National Assembly power over Stamp Duty Land Tax and Landfill Tax. The new powers follow some – though not all – of the recommendations of the Silk Commission on financial reform for Wales. The first report of the independent commission on devolution also recommended that powers to vary income tax should be given to the Assembly, subject to a Yes vote in a referendum. It unanimously agreed that the Aggregates Levy and Air Passenger Duty be devolved to the National Assembly, however, this was not accepted by the coalition Government.

For the UK Government the devolution of tax raising powers represents an important principle in making the Assembly more accountable for raising some of the money it spends. The sums that will be raised by these ‘small taxes’ are relatively trivial, but they do unlock a revenue stream to service some borrowing powers for the Welsh Government. To access more meaningful borrowing levels, however, a referendum will need to be won, and that seems like a very remote possibility at present.

Nonetheless, an important principle has been conceded and the Welsh Government now has to ready itself to perform a new role. Whilst some of the matters that need to be addressed are largely technical they mark the opening of an important new chapter in the development of democratic devolution to Wales.

In the second of our Senedd Papers series the highly respected economist, Gerald Holtham, sets out some initial thinking on the shape of a tax policy for the next Welsh Government. As with each of the papers in the series we have sought out an expert in their field to help policy makers come up with practical proposals to consider as they shape their manifestos for the next Assembly election. Gerry Holtham is not only the author of the acclaimed report on fairer funding for Wales (which bears his name), but has had a distinguished career in the City of London, the OECD and in think-tanks in the UK and the U.S.

In this typically stimulating paper, Holtham, a Fellow of the IWA, argues that the Welsh Government must think about those taxes it already controls as well any newly devolved ones in order to optimise tax policy. His proposals are rational and progressive, but present a range of problematic choices for politicians. But with the Wales Audit Office putting the funding gap

for Welsh public services at between £2.6 and £4.6 Billion by 2025¹, our leaders have little option other than to be bold.

Once again I'd like to thank the Assembly Commission and the Presiding Officer, Dame Rosemary Butler, for their support for the Senedd Papers series.

Lee Waters

Director, Institute of Welsh Affairs

May 2014

1 Mark Jeffs, Future Pressures on Welsh Public Services, Wales Public Services 2025. 2013. (www.walespublicservices2025.org.uk)

Starting to think about tax

The Silk report has recommended the devolution of some taxes and that is embodied in the Wales Bill before Parliament. The Welsh government is ready to accept the devolution of a number of small taxes. They could be useful policy instruments and provide a moderate revenue stream that would underpin limited borrowing powers. The devolution of income tax which Silk suggested, is subject to a referendum and, at present, that looks a more remote possibility.

The Finance Minister has convened an advisory panel of tax academics and accountants and has also arranged a series of consultations on the right approach to stamp duty tax on land sales, one of the Silk taxes. (The other is landfill tax). Stamp duty is already been devolved to Scotland where it is to be reformed. In recent discussions, the Welsh construction industry and business organisations have said they want the tax devolved and reformed, and the Royal Institute of Chartered Surveyors has suggested a similar reform would also be popular in England.

There is general agreement that Wales needs to develop a stronger Treasury function before it takes on many more financial initiatives and taxation powers, both to consider tax policy and to improve project appraisal across the Welsh Government. Another function that has to be organised is tax collection and administration.

In considering tax policy, the Welsh Government must think about those taxes it already controls as well any newly devolved ones in order to optimise tax policy. The most considerable of current taxes is council tax, an important source of revenue for local authorities that raises over £1 1/4 billion in Wales. Most specialists accept that the tax is ill-structured and it is politically unpopular too. Consideration of this tax is something on which a developing Welsh Treasury should cut its teeth.

Council tax: it's a mess

Council tax is the misbegotten offspring of political misjudgment and political cowardice. Local government used to be funded by domestic rates, a tax levied on rental values of property. That tax was unpopular with homeowners, as property taxes tend to be. The reason is that people get a relatively large demand for tax and it is not associated with any income flow or transaction. It sticks out and is resented. Yet land or property taxes are loved by economists because they have two excellent features – they are hard to avoid (you can't easily hide or move a house) and they don't distort economic activity as most taxes do.

Nonetheless Mrs Thatcher's Government in the 1980s decided to gratify homeowners whom it considered its natural supporters. It abolished the rates and introduced the poll tax. The rationale was that the tax paid for local services so everyone who enjoyed those should pay – and at the same rate. The poll tax was an act of political miscalculation and the tax was no more popular than it had been when levied in the 14th century, triggering the peasants' revolt. It helped to hasten Mrs Thatcher's departure and had to go. But John Major's Government, battered by public fury, did not have the nerve to levy a proper land or property tax so we got the community charge, tied to housing, with the tax varying depending on a series of arbitrary bands on house prices. The initial cowardice was subsequently repeated in England where the tax is levied on house values that have not been reformed since 1992.

Wales did better with a revaluation in 2005, based on 2003 values, and another band was added on the top of those existing in England. It caused some political pain for Rhodri Morgan's administration and though another revaluation is due before 2015, the nerve of Welsh politicians has failed after the fuss in 2005. Yet people in expensive houses could now be paying much more tax than they are in the existing situation if the old domestic rates tax had just been retained. Mansion taxes could merely restore a situation that existed until the 1980s.

At present Council tax is regressive in property values, going up more slowly than house prices across the range. In Wales in 2013 the average council tax on the lowest band, where properties are worth up to £44,000, amounts to nearly 1.9% of the value of the property. That falls to nearly 1.5% for properties in the range £44,000-£65,000 and it goes on falling for more expensive properties. For properties worth over £424,000, the tax is just over 0.5% of capital value.

The council tax could be reformed to make it fairer, more buoyant and less likely to give rise to political tantrums when revaluations occur.

Moreover, changes to the benefit system are now making reform urgent since the UK Government has abandoned responsibility for paying the council tax of people on income support, without giving the Welsh Government all the money necessary to do so. The Welsh Government is in a position to mend council tax now; it has all the powers it needs. Reform

could take the form of a radical restructuring or a range of more modest changes.

First step: acknowledge the council tax is two things: a charge for local services and a property tax. So first of all set the charge for local services, which all householders and tenants pay irrespective of the value of the property. Then have a schedule that raises the tax more or less proportionately with the value of the property. This can be done with present council tax bands though the progression could be made more precise by increasing the number of bands. Moreover, the tax banding should not stop with a single band for house prices above £424,000 as it does now but could reflect rising valuations beyond that.

If the authorities set the rates on this reformed tax so as to collect the same revenue as it does now, the effect would be to collect much more revenue on more expensive houses and less on those at the bottom of the market. In general that would reduce the tax on poorer people who tend to live in poorer houses.

In the days before changes to the welfare system, much of the council tax on the poor was paid by housing benefit, but the UK Government has just cut the resources available for that relief by 10%. The cost of the benefit is currently some £240 million and will evidently rise over time with inflation and council tax rates. The UK Government has given Wales £220 million, leaving a shortfall of some £20 million in Wales last year that must grow with time. So now making the tax more progressive would actually relieve the burden on poor people, or on the Welsh budget, and not just help the UK Treasury as formerly.

Currently council tax in Wales is set to realise the same revenue as a pure property tax on housing would if leveled at the rate of about 0.8% of capital value. There is a perfectly proper political discussion to be had in these times of squeeze on public services, especially at the local level, whether that could be more or less.

The Mirrlees Review of the British tax system, chaired by Nobel laureate James Mirrlees and sponsored by the Institute for Fiscal Studies noted:

“...there is also evidence that people just find the idea of a tax linked to the value of their property unfair. This seems to reflect the fact that perceptions of fairness in tax are more closely linked to the relationship of the tax to flows of income than to stocks of wealth. But, both because consumption of housing services is as legitimate a tax base as any other consumption, and because it is a good complement to current income as an indicator of lifetime income or ability to pay, this does not seem to us to be a good objection—at least not economically.”²

If residential property services were taxed at the same rate as other consumption, council tax would be over 1% of house values.

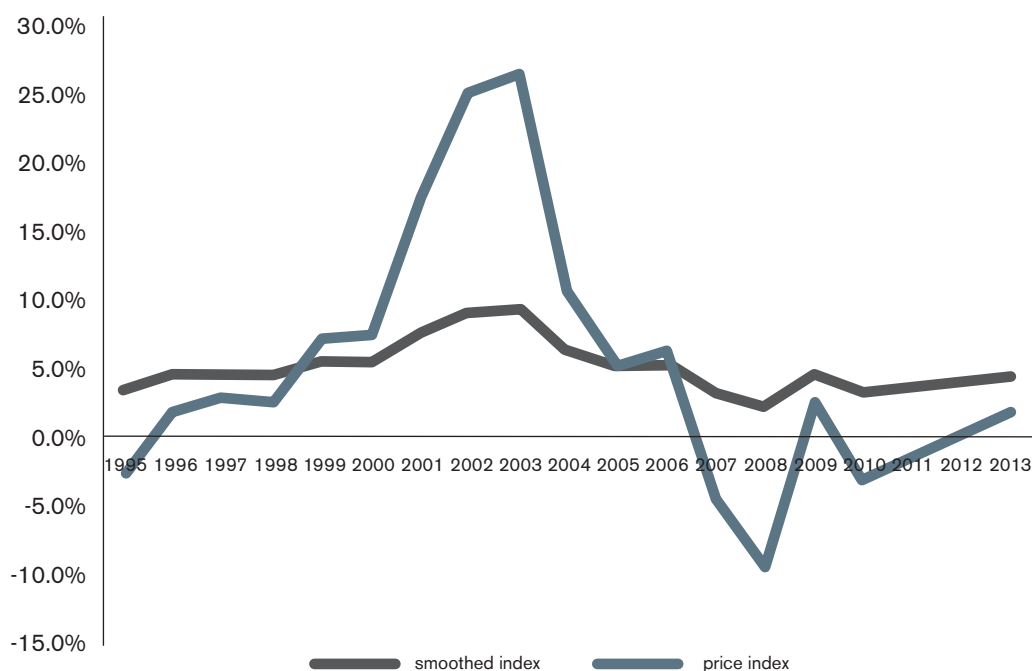
But in any case something should also be done to make the tax base more buoyant and the tax less unpopular. The first could be done by indexation. The tax base (the assessed value of houses) should rise each year with a local index of house prices. These are readily available. But the rise would need to be smoothed since house prices are volatile. The average annual rise in Wales since 1995 has been 4.9%, but in 2002 and 2003 prices rose by over 20%, and in 2007 and 2008 they fell by nearly 5% and 10% respectively.

2 *Dimensions of Tax Design: the Mirrlees Review, Oxford University Press: September 2011.*

There are various ways to smooth the indexation. One possibility would be to take a very long run average of price increases, say 20 years, and make the annual change equal to a proportion of that change and a proportion of the previous year's change. If the proportions were weighted in favour of the long-run change, the index would be quite smooth. The chart below compares the house price index for Wales with a smoothing with proportions of 0.8 and 0.2. Indexation is an approach followed in the United States and elsewhere. It leads to gradual change and does away with the ten-year fuss about whether to revalue. The process would be subject to an appeals mechanism, as is currently the case, where house values had been subject to specific factors and so did not follow the index. Indexation gives local government a buoyant tax base that rises with the costs, and means they don't necessarily have to announce changes in rates of tax just to keep revenues constant in real terms after adjusting for inflation.

Moreover, it might also help acceptability if the tax was announced as a rate and a weekly or monthly sum, which could be reduced somewhat for direct debit payments. It is the same approach that sellers of cars use – so much a week they tell you, rather than the price of the car.

— House prices and indexation



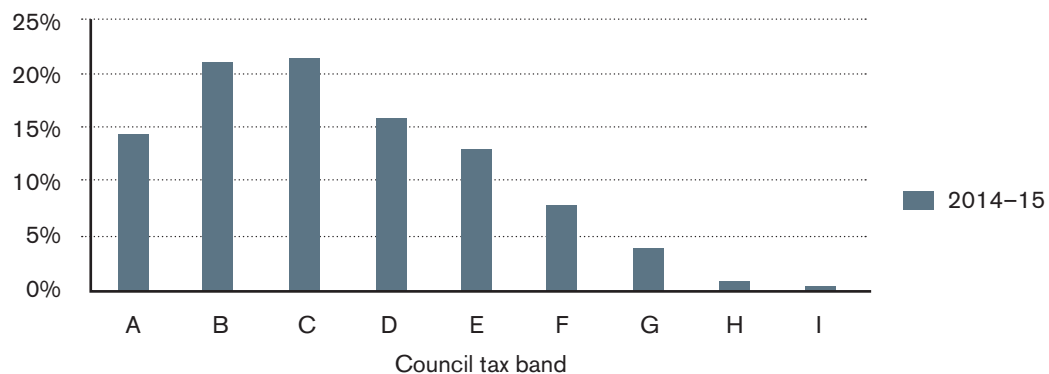
One often-cited objection to property taxes is that they hit the asset-rich, income poor, like widows living on in the family home on a modest pension. The evidence is that this is a small-scale problem in reality. Anyway it can be ameliorated by allowing council tax to roll up in such circumstances and become a charge on the house when it is sold or when the widow is deceased. At a tax rate of 0.65% the widow could stay in the house for 153 years before all the equity was gone.

An example of reform

Data exist for the number of dwellings in Wales in each band (see chart below) and the average council tax payment. We also have data for the council tax benefits relating to each band. Currently band A properties pay an average £850 a year rising to £2970 for band I (Those are all-Wales averages; the tax is set by local authorities and varies from place to place but the relation between different bands is the same everywhere).

If all eligible properties paid tax at the full rate, Wales would collect about £1.8 billion annually, but just over one third of properties are eligible for a discount. People living alone get a discount of 25%. Some 4% of properties are exempt altogether, mainly empty properties and those occupied only by students. With a collection rate of just under 97%, council tax revenues were about £1.2 billion in 2011-12, and they are expected to hit £1.5 billion in 2014-15.

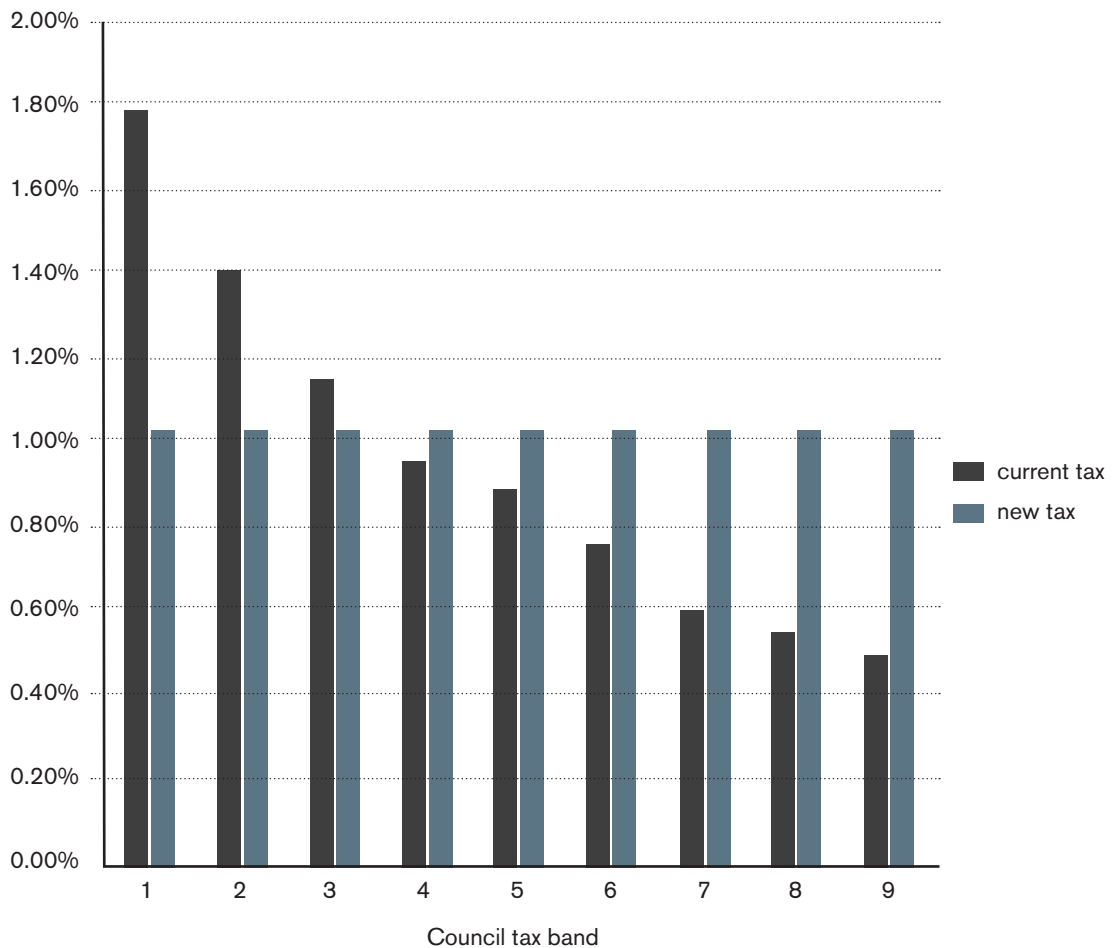
— Proportion of dwellings by council tax band



Suppose we replaced the current council tax with a payment equal to a flat sum plus a proportion of the value of the property minus a property 'allowance'. That could be done, even without reforming existing bands – although it would be better, and fairer, to increase the number of bands so that taxes more nearly reflected actual property values. However, for simplicity let's consider a reform based on current bands. For example there could be a flat payment of £350 a year plus 1.09% of the top-of-each-band property value, minus a fixed allowance of £34,000. That would yield similar revenue to the current tax.

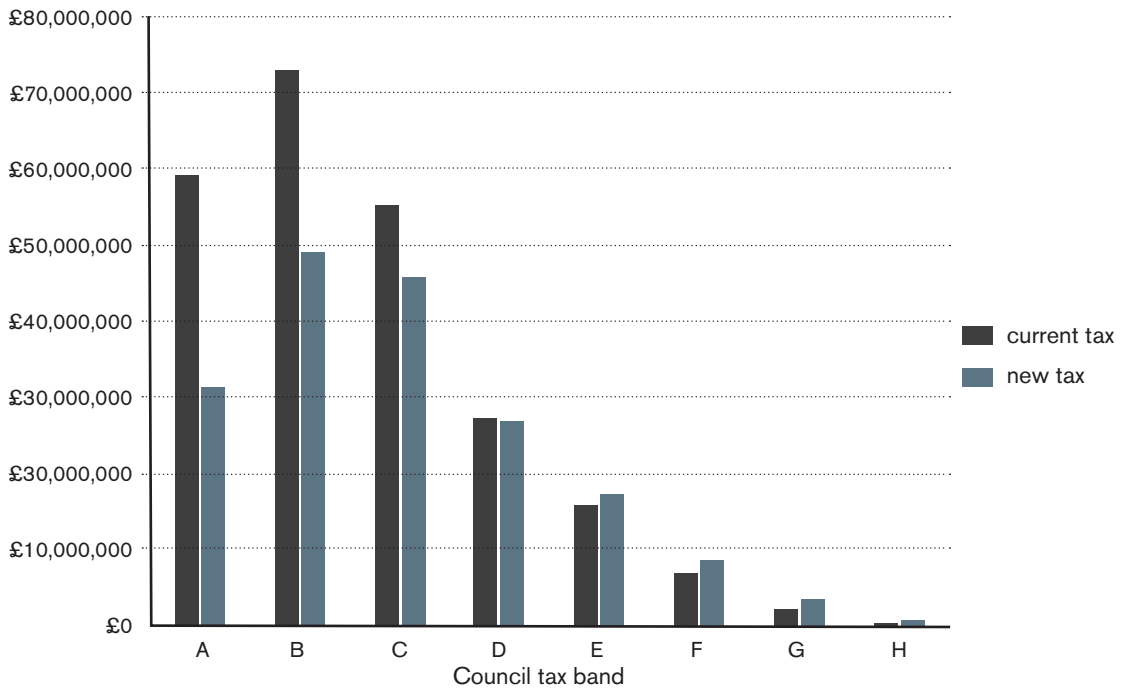
A tax “allowance” off property values combined with the fixed charge gives a strictly proportionate tax. Everyone eligible ends up paying a fraction over 1% of the band value unlike the current regressive system (*see the chart below*).

— Tax as proportion of property (band) value



Note, however, that property prices are up over 30% on average since the revaluation based on 2003, so this rate is no more than about 0.8% of current property values. Taxpayers in band D would pay a little more tax at £1318 a year instead of £1276, i.e. less than a pound a week more. But band A taxpayers would see their bills fall from £851 to £459. All the bands below D would pay less. The cost of Council Tax Benefit would therefore fall from £242 million a year to just over £190 million, a saving to the Welsh government of over £50 million a year (*see chart below*).

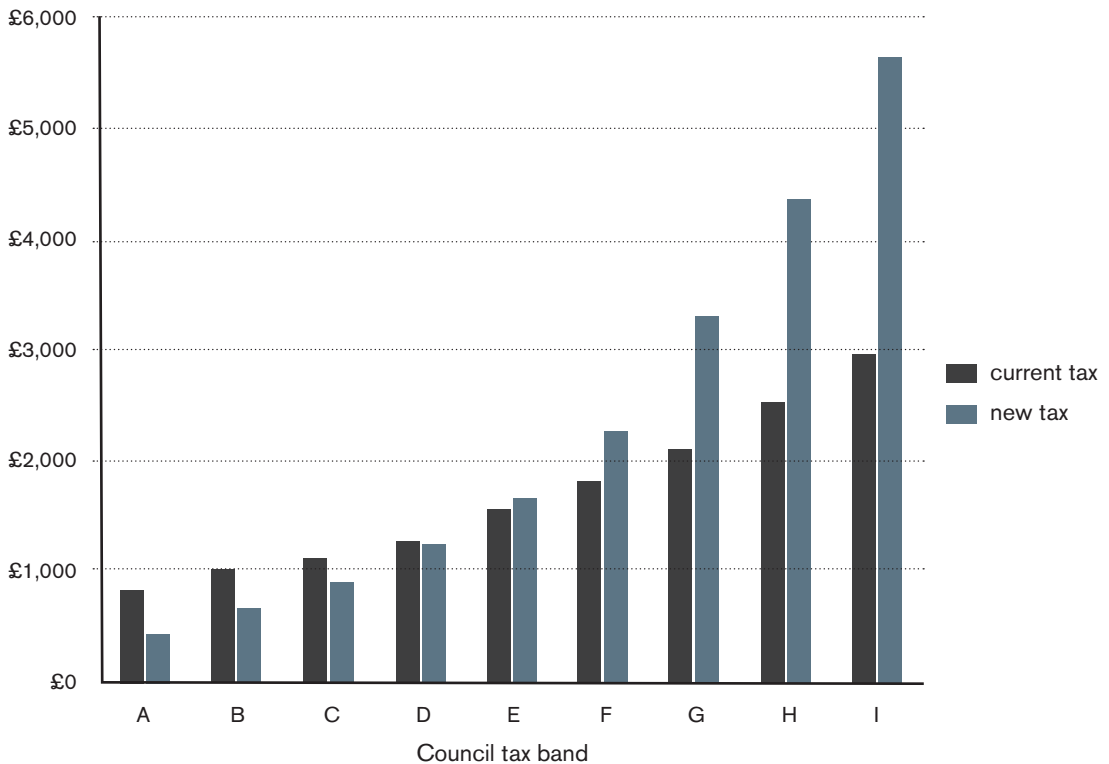
— Council tax benefit (annual sum payable by band)



The offset would come at the high end. Band H taxes would rise from £2452 to £4367. On properties worth £550,000 in band I, the bill could rise to £5565 from £2860 (see chart below).

Such large increases would certainly cause some political anguish, particularly as affluent

— Average tax per band



areas where they are most germane are often marginal political seats. They would have to be phased in over a number of years, though there are other possibilities for ameliorating the effect.

For example, there are a number of exemptions or discounts to council tax that, if removed or reduced, would yield revenue and enable somewhat lower rates to be levied overall. Authoritative analysts have criticised the single-occupant discount, for example, as unjustified. If that were phased out, another couple of hundred million pounds of tax revenue could accrue across Wales. Moreover, while discounts for second homes are allowed to local councils at their own discretion, they will soon be able to charge a premium. In Gwynedd, fully 10% of the entire housing stock consists of second homes. The Council is now to be allowed to charge a premium on second or holiday homes so it should be able to realise more revenue or reduce rates for local inhabitants. In most other parts of Wales, however, this is not likely to be a significant source of extra revenue.

An integrated tax policy

If income tax is devolved eventually, with the freedom to vary individual tax bands as recommended by the Silk Commission but currently resisted by the UK Government, reforming council tax creates another important possibility for the longer run. With council tax more progressive we could reduce upper-band tax rates on incomes since well-to-do people would be paying more tax on property.

It is widely understood that Wales could gain economically by reducing higher rates of income tax but many are concerned that doing so would conflict with the Welsh public's sense of fairness. Taxing property wealth rather than income alleviates that concern because the better off are contributing, though in a different form. Taxing wealth not income is a better option economically since it does not discourage work and is less prone to evasion.

House prices historically have averaged about four times annual earnings, though currently they are around five times. Someone in a house worth £400,000 to £500,000 might be earning £100,000 a year and would be paying a 40% tax rate on some £60,000 of that. Reducing his or her tax rate to 37% would broadly compensate for the rise in council tax. Moreover over a number of years that could result in an increase in revenue. People earning £150,000 would be better off and that would be likely to influence location decisions for people moving near the border with England. A relatively small proportionate increase in the net number of wealthy incomers to east Wales would swell the Welsh tax base.

Note the importance of thinking about tax policy in an integrated manner.

Another example concerns stamp duty. Stamp duty is already been devolved to Scotland where it is to be reformed. The current tax is slab-sided in that when the house price passes a threshold, a higher rate of tax is charged on the entire price, not just on the portion of the price that exceeds the threshold. That leads to sharp jumps in tax liability at the threshold prices and distorts the market by causing prices to cluster just below thresholds.

In Scotland it is proposed to replace this structure with a proportional tax. In recent discussions, the Welsh construction industry and business organisations have said they want the tax devolved and reformed, and the Royal Institute of Chartered Surveyors has suggested a similar reform would also be popular in England. It will be very difficult, however, to reform that tax to remove its distorting effects without sacrificing revenue - or raising rates, which the public has not been led to expect. Rather than trying to square the circle it would be better to reform the tax to remove the slab-sides that cause the distortions and accept some loss of revenue. The loss could be recouped by minor changes to council tax. Indeed, since stamp duty raises about one tenth of the revenue from council tax one could phase it out altogether if one were prepared to raise council tax receipts by 10%. That may be too radical but removing or reducing the single-occupant discount on council tax, for example, would finance a substantial reform of stamp duty.

Tax administration

The only bodies in Wales that currently have experience of tax collection and administration are local authorities. It therefore makes sense to use that experience in collecting the smaller taxes that are to be devolved, landfill and stamp duty. Both are easy to collect with conveyancing solicitors doing much of the work for stamp duty. It would make sense for them to send the money to the local authority finance department to administer. Stamp duty and landfill could be treated like business rates, collected by local authorities, pooled centrally and then redistributed among local authorities according to a Welsh government formula. That need not imply any overall increase in their funding if the Welsh government reduced the revenue support grant accordingly but it would mean more local authority spending was financed by their own tax collection. It would surely make sense if these new responsibilities were accompanied by a consolidation of tax administrations among local authorities. Local authorities may be consolidated in the near future but even if they are not it makes sense to pool certain functions. There are only some ten local authority pension funds, for example, shared among the 22 local authorities. A smaller number of tax administrations operating regionally would be appropriate and these could administer the new taxes. The Welsh Government would require a tax policy unit but would not need to create a tax administration. It would be a good story if additional Welsh tax powers were accompanied by a reduction, not an increase in the administrative overhead.

If income tax is ever partly devolved on the lines recommended by the Silk Commission, it would surely continue to be collected by HMRC. The Revenue would then transmit to the Wales the proceeds of the Welsh income tax and they would charge a fee for doing so to cover the extra costs of discriminating between Welsh and English residents for tax purposes. It is very important that the relationship between the Welsh Government and HMRC be put on a firm contractual basis with the responsibilities of each party spelled out. It will be rather easy for many people to avoid tax if English and Welsh rates differ by claiming to be in the lower-tax jurisdiction. Policing would be expensive. There is a case for ensuring HMRC is incentivised to administer the system appropriately. Perhaps instead of a fixed fee, the Welsh Government should offer a fee with an element proportionate to the taxes collected.

Conclusion

Up to now the Welsh Government has not had to give any thought to taxation, just spending its block grant. It could lead on the reform of council tax, making it less regressive. It could use changes in council tax to fund a necessary reform of Stamp Duty on landed transactions. It could improve tax collection in co-operation with local authorities and could pioneer the development of a new contractual relationship between HMRC and devolved administrations.

In general, Wales has the opportunity to improve its own tax system and blaze a trail for the rest of the UK.



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The Senedd Papers

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The information in this paper is correct at the time of print.



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Ms. Jocelyn Davies, MA
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May 28, 2014

Dear Ms. Davies,

Thank you for the opportunity to contribute to your discussion of best practice budget processes. Our submission is based on the experiences of OECD Member countries and will focus on those areas where we are best able to comment.

This inquiry comes at a critical time as our OECD Working Party of Senior Budget Officials (SBO) is in the process of debating and finalizing a set of 10 (inter-related) high-level *Principles of Budgetary Governance* (see attached) to guide and inform budgetary processes and reforms. These principles are applicable to both central and sub-national governments. While recognizing that budgeting practices can vary widely across countries in light of traditional, institutional, and cultural factors, the principles draw together the lessons of a decade and more of work by the SBO and its associated Networks, as well as insights from other areas of the OECD and of the international budgeting community more generally. In particular, the principles build upon the *OECD Best Practices for Budget Transparency* which are long-established as an international point of reference for good budgeting (see attached).

The principles are:

1. Fiscal policy should be managed within clear, credible and predictable limits.
2. Top-down budgetary management should be applied to align policies with resources.
3. Budgets should be closely aligned with government-wide strategic priorities.
4. Budgets should be forward-looking, giving a clear medium-term outlook.
5. Budget documents and data should be open, transparent and accessible.
6. The budget process should be inclusive, participative and realistic.
7. Budgets should present a true, full and fair picture of the public finances.
8. Performance, evaluation and value for money should be integral to the budget process.
9. Longer-term sustainability and other fiscal risks should be identified, assessed and managed prudently.
10. The integrity and quality of budgetary forecasts, fiscal plans and budgetary implementation should be promoted through rigorous, independent quality assurance.

A discussion of each principle can be found in the attached document. Let us highlight a few points related to your inquiry here.



First, your inquiry asks about **linking budgets to outcomes**. Principle 8 posits the following, while also pointing to the use of evaluation and spending review tools:

“Performance information should be routinely presented alongside the financial allocations in the budget report. It is essential that such information should clarify, and not obscure or impede, accountability and oversight. Accordingly, performance information should be limited to a small number of relevant indicators for each policy programme; should be clear and easily understood; should allow for tracking of results against targets and for comparison with international and other benchmarks; and should make clear the link with government-wide strategic objectives.”

Traditionally, the public sector was held to account for compliance with rules and procedures, including accounting for financial appropriations. Over the past decade however, OECD countries have increasingly sought to develop a focus on the results achieved through performance budgeting. OECD (2007) identifies three broad categories of performance budgeting, with the third being highly unusual: presentational, performance-informed, and direct (or formula) performance budgeting. Arguably, a fourth type might be described as a managerial performance approach which focuses on managerial impacts and changes in organizational behaviour but may de-emphasize a strong budget linkage. Indeed, it may be more useful to think of performance budgeting types along a continuum with simple presentation of information at one end and performance-determined decisions at the other.

Despite widespread adoption of performance budgeting, countries have experienced difficulties actualizing it. While the budget provides a unique crosscutting mechanism to collect performance information, Schick (2013) notes that with few exceptions, performance budgeting has not become the government’s budget process. Rather, for most countries it is an accessory to the budget, adorning spending decisions but not fundamentally changing the way they are made. Many countries, including the United Kingdom, have gone through re-adjustment phases, re-assessing and revising their performance budgeting frameworks. There is a clear trend within OECD Member countries to move from extensive indicator sets to a few but clear objectives; towards a more focused use of performance information for management and accountability purposes rather than for allocation of resources; and towards increasing the importance of performance related-tools like programme evaluation and spending reviews, or what Schick (2013) has termed “performance budgeting extenders”.

Legislatures in particular have struggled to use performance information in the budget process in a meaningful way. Some have found that the reduction in the number of line items and higher level of aggregation in the budget documentation has diminished their control. Despite its long experience with performance budgeting, the United States Congress repeatedly chose not to give up line-item controls. In Germany, the Bundestag resisted attempts at reforms that would have reduced the number of line items arguing in part that this would diminish parliamentary influence and control. Recent reforms to the performance budgeting system in the Netherlands came about in part because budget authorisation on the basis of output targets (instead of financial inputs) was seen to have led to loss of parliamentary control and unreadable budget documentation. Indeed, the Dutch parliament increasingly perceived the almost complete lack of input information as an accountability gap (de Jong et al, 2013).

At the same time, some legislatures have pointed to problems with performance information overload (e.g. extensive indicator sets) and the difficulties parsing out that information which is most relevant and useful. As such, it is important for the legislature to be engaged early on in the process of thinking strategically about what information will be most useful for its budgetary deliberations and decisions. Sweden provides an interesting approach to improving the performance dialogue between the government and the parliament. An informal working group of approximately ten civil servants from the Ministry of Finance and parliament’s Committee on Finance was set up in 2000 and met over a period of several years. The group served as a catalyst, spreading good ideas to governmental and



parliamentary actors by identifying the types of performance information most useful to parliament in its deliberations on the budget, as well as how and when such information should be presented. Another approach of interest is to focus presentation of performance information in the budget on areas where there are changes (e.g. new programmes).

Second, let us touch upon a few lessons around **how other countries achieve devolved financial accountability while retaining central fiscal control**.

As noted in Principle 1 of the draft OECD Principles for Budgetary Governance:

- A sound fiscal policy is one which avoids the build-up of large, unsustainable debts, and which uses favourable economic times to build up resilience and buffers against more difficult times. However, there are a range of political and other factors that can impede governments from effecting such counter-cyclical, or even cyclically neutral, policies.
- At minimum, governments should have a stated commitment to pursue a sound and sustainable fiscal policy. The credibility of this commitment can be enhanced through clear and verifiable fiscal rules or policy guidelines which make it easier for people to understand and to anticipate the government's fiscal policy course throughout the economic cycle, and through other institutional mechanisms (see also Principle 10) to provide an independent perspective in this regard.

The main challenge when designing monitoring mechanisms for sub-national governments (SNGs) is to set up a mechanism which ensures economic stability and sound fiscal management while allowing sufficient flexibility to cope with unforeseen events and financial capacity for delivering public services and financing public investment. Such monitoring mechanisms should also avoid inducing pro-cyclical policies by SNGs. Currently there is a great diversity of practices in monitoring SNG debt across OECD countries, ranging from pure reliance on market mechanisms (arguably the most risky practice as markets tend to expect a bailout), to direct controls (e.g. authorisation from central government to issue debt, again with potential risk regarding bailouts), to sophisticated fiscal rules (with states/regions typically responsible for setting fiscal rules and monitoring local governments' finances). Just as with central governments, rules may include budget balance rules, expenditure and expenditure growth limits, and debt and debt service restrictions. Partly as a result of the crisis, we have seen a tightening of enforcement mechanisms and sanctions for non-compliance with the rules in OECD countries in recent years.

The OECD has identified several key challenges in monitoring SNG debts that should be addressed:

- *Lack of information about SNG budgeting practices.* In some countries, each SNG has its own budget practices and accounting standards. This makes comparison and monitoring very difficult. Ideally, information should be made available on how economic assumptions are set; whether and how SNGs carry out sensitivity analysis of economic assumptions; availability of contingency reserve funds; medium term perspective; and performance and results.
- *Lack of appropriate and timely information about SNG financial and debt situation.* According to principle 5 of the draft OECD Principles for Budgetary Governance, budget documents and data should be open, transparent, and accessible. Both for central government (but also for the legislature) transparency is essential to monitor SNG budgets and policies, track funds, and answer ex post questions about policy implementation. But financial information reported by SNGs often comes with a time lag and may be incomplete. In some cases information is not compiled, and in countries where SNGs use different accounting standards, it may not be comparable even when it exists. This hinders accountability and prevents central governments from taking timely corrective measures.



- *Lack of comparability of SNG data.*
- *Ensuring that SNG budgets present a true, full and fair picture of the public finances.* Off-budget funds and local public enterprises or agencies may hide debt and fiscal risks and must be closely monitored (OECD, 2013b).

Related to this last bullet point Principle 7 of the draft OECD Principles for Budgetary Governance gives the following guidance for providing a true, full and fair picture of the public finances:

- As a contract of trust between citizens and the state, it is expected that the budget document should account truly and faithfully for all expenditures and revenues of the national government, and that no figures should be omitted or hidden (although limited restrictions may apply for certain national security purposes). To underpin trust, this expectation should be made explicit through formal laws, rules or declarations that ensure budget sincerity and constrain the use of “off-budget” fiscal mechanisms.
- Control of the national budget is the responsibility of the central government, and the degree of co-ordination and co-operation with subnational levels of government naturally varies from country to country. The budget documentation should present a full national overview of the public finances – encompassing central and subnational levels of government – as an essential context for a debate on budgetary choices.
- Budget accounting should show the full financial costs and benefits of budget decisions, including the impact upon financial assets and liabilities. Accruals budgeting and reporting, which correspond broadly with private sector accounting norms, routinely show these costs and benefits; where traditional cash budgeting is used, supplementary information is needed. Where accruals methodology is used, a cash statement should also be prepared to show how the national government operations will be funded from year to year.
- Public programmes that are funded through non-traditional means – e.g. PPPs – should be included and explained in the budget reports, even where (for accounting reasons) they may not directly affect the public finances within the time frame of the budget document.

Regarding **how the new budget processes can be made transparent and understandable to all**, discussion of Principle 6 of the draft OECD Principles for Budgetary Governance on achieving an inclusive, participative and realistic budgeting process notes that:

- As well as having access to budget documents and data, parliament and citizens should be able to understand and influence the discussion about budgetary policy options, according to their democratic mandate, competencies and perspectives.
- Detailed and technical information should be presented in a simple manner, and the impact of budget measures – whether to do with tax or expenditure – should be clearly explained. A “citizen’s budget” or budget summary, in a standard and user-friendly format, is one way of achieving this.
- The national parliament has a fundamental role in authorising budget decisions and in holding governments to account. The parliament and its committees should have the opportunity to engage with the budget process at all stages of the budget cycle. The clear setting-out of medium-term budgetary envelopes (see also Principle 4) should help the parliament to participate in the annual process of budget formulation ex ante as well as ex post.
- Since governments have finite resources at their disposal, budgeting is concerned with identifying priorities, assessing value for money and making decisions. Parliaments, citizens and civil society organisations can contribute usefully to the budget process when they become engaged in the debate about difficult trade-offs, opportunity costs and value for money. Governments should facilitate this



useful engagement by making clear the relative costs and benefits of the wide range of public expenditure programmes and tax expenditures.

Principle 6 highlights the role of the legislature in the budget process. A well-functioning parliamentary scrutiny process serves to increase budget transparency and accountability, while openness on the part of parliament itself can lead to greater public participation in the law-making and policy-making processes. The new powers devolved to Wales imply a potentially greater scrutiny role for the National Assembly. As such, it may be of interest to look at some of the trends we are seeing around legislative scrutiny in OECD member countries.

It is important to remember that the part played by the legislature is impacted by a variety of factors such as whether parliament has a role in approving ex ante fiscal frameworks, the comprehensiveness of budget documentation, amendment powers, time available for debate, committee organization, and staffing and analytical capacity. Other factors include constitutional division of responsibilities, party systems, and mandatory spending – among others.

One of the most significant changes for just over a third of OECD legislatures is their involvement in reviewing and approving overarching fiscal frameworks and targets – in complement to their traditional roles in enacting detailed appropriations. This parallels the growth of top-down budgetary frameworks in many OECD countries (see Principle 2 of the draft OECD Principles for Budgetary Governance for a discussion of top-down budgetary management) and can help reinforce broad political commitment to fiscal discipline. However, while the legislature gains new influence in setting and approving macro targets, for some there may be a trade-off in terms of freedom to amend appropriations later on.

Legislative influence (and the ability of the legislature to seek out meaningful public input) is also affected by the time available to consider key budget documents. The OECD Best Practices for Budget Transparency recommend that the government's draft budget be submitted to parliament far enough in advance to allow parliament to review it properly – at least three months prior to the start of the fiscal year – and that the budget be approved by parliament prior to the start of the fiscal year.

The most important budget scrutiny happens in committee. There is a trend in OECD countries towards having a dominant Budget/Finance Committee responsible for budget review which coordinates varying levels of input from sectoral committees. Ideally a strong Budget/Finance Committee promotes coordination and consistency in legislative budget action and facilitates fiscal discipline, while involving sectoral committees allows the legislature to draw on their specific expertise. Some Budget/Finance Committees, for example Germany, also use a rapporteur system by which members are assigned responsibility for specific portfolios (departmental budgets) allowing them to develop significant expertise on these departments budgetary allocations and the rationale behind them. Committee deliberation is likely to be more effective if committee members serve on the committee for the full term of parliament, again because it allows them to gain the expertise necessary to challenge executive officials.

By far the most important trend we are seeing in OECD countries is a marked increase in the analytical capacity for legislatures. For many legislatures resources traditionally were limited to committee staff (which often performed more clerical type tasks) and library and research services staffed by generalists covering many areas rather than budget specialists. Today we are seeing more and more budget specialist units established within parliaments such as the UK Scrutiny Unit, Israel Budgetary Control Unit, and the Polish parliament's Department of Social and Economic Research.

There has also been growth in the number of independent parliamentary budget offices (e.g. United States, Mexico, Korea, Australia and Canada). The province of Ontario has also established a Financial



Accountability Office). These have highly specialised staff and typically are given special access to government information necessary to carry out their mandates. Other countries have chosen a fiscal council model. Both models can provide critical independent analysis by undertaking real time surveillance of public finances and fiscal policy, thus promoting quality and integrity in budgeting. The National Assembly for Wales will have the benefit of access to independent forecasts from the UK Office for Budget Responsibility (OBR), as well as other analysis that the OBR produces.

The Committee may be interested to note that the OECD Council recently adopted the *Council Recommendation on Principles for Independent Fiscal Institutions* (February, 2014) which provide guidance on issues to consider when establishing an independent parliamentary budget office or fiscal council (see attached).

Again, the above messages are based on OECD analysis of our Member country experiences. We would be pleased to elaborate on any of these points, as well as other modern budgeting reforms that are covered in the draft Principles of Budgetary Governance, including providing specific country examples.

Again, thank you for the opportunity to provide this submission to the Finance Committee.

Sincerely yours,

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Public Governance and Territorial Development Directorate
OECD Senior Budget Officials (SBO)

Draft Principles of Budgetary Governance





Draft PRINCIPLES OF BUDGETARY GOVERNANCE
First orientations for a set of core standards and principles

Initial consultation draft
November 2013

Introductory note

The objective of these draft Principles is to draw together the lessons of a decade and more of work by the OECD Senior Budget Officials (SBO) Working Party and its associated Networks, along with the contributions and insights from other areas of the OECD and of the international budgeting community more generally. The draft Principles provide a concise overview of good practices across the full spectrum of budget activity, taking account in particular of the lessons of the recent economic crisis, and aim to give practical guidance for designing, implementing and improving budget systems to meet the challenges of the future. The overall intention is to provide a useful reference tool for policy-makers and practitioners around the world, and help ensure that public resources are planned, managed and used effectively to make a positive impact on citizens' lives.

As a draft document, these Principles are a work in progress and will benefit from the constructive input and improvements from interested parties around the world, before they are considered and adopted as a formal instrument of the OECD in the future.

For further information or to provide feedback, please contact:

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Draft PRINCIPLES OF BUDGETARY GOVERNANCE

First orientations for a set of core standards and principles

Introduction: The fundamental national role of the budget and the budgeting process

The budget is a central policy document of government, showing how it will achieve its annual and multi-annual objectives. Apart from financing new and existing programmes, the budget is the primary instrument for implementing fiscal policy. Alongside other instruments of government policy – such as laws, regulation and joint action with other actors in society – the budget aims to turn plans and aspirations into reality. More than this, the budget is a contract between citizens and state, showing how resources are raised and allocated for the delivery of public services. Such a document must be clear, transparent and credible if it is to command trust, and to serve as a basis of accountability.

External stakeholders also look to the quality of the budget document, and of the budgeting process, in assessing the soundness and reliability of a state. The process of shaping the budget is typically led by the Treasury/Ministry of Finance (“central budget authority” or CBA), and draws together the contributions from ministers, parliamentarians, public officials and other trusted advisers, civil society organisations and advocacy groups and, increasingly, from citizens themselves. An *effective* budgetary process is one that takes these contributions, weighs and considers them, and transforms them into a set of proposals for action for the betterment of society. A *sound* budgeting system is one which engenders trust among citizens that the government is listening to their concerns, has a plan for achieving worthwhile objectives, and will use the available resources effectively, efficiently and in a sustainable manner in doing so.

Budgeting is no longer the preserve of central governments: it is a process that encompasses all levels of government, national and subnational. Budget systems and procedures should be coordinated, coherent and consistent across levels of government. These budget principles are therefore relevant, and should be applied as appropriate, to all levels of government.

Moreover, budgeting is not a standalone process, removed from the other channels of government action. Good budgeting is supported by, and in turn supports, the various pillars of modern public governance: integrity, openness, participation, accountability and a strategic approach to planning and achieving national objectives. In this way, budgeting is an essential keystone in the architecture of trust between states and their citizens.

Budgeting practices can vary widely across countries in light of traditional, institutional and cultural factors. However, based on the experience of the Senior Budget Officials (SBO) and the extensive analysis of various aspects of budgeting conducted by the SBO and its networks over recent years and related studies across the OECD (see Bibliography), the common elements of modern budgeting practice can be presented as high-level principles to guide and inform budgetary processes and reforms. Countries that organise their budgetary affairs on the basis of these governance principles are best-placed to meet citizens’ expectations for sound, stable and effective public governance.

These principles deal with the various phases of the budget process, the attributes of the budget document, as well as the wider context within which budgets are formed. The OECD has developed, and is developing, more detailed principles and recommendations for further guidance on specific elements of the overall budgeting framework.

1. Fiscal policy should be managed within clear, credible and predictable limits.

- A sound fiscal policy is one which avoids the build-up of large, unsustainable debts, and which uses favourable economic times to build up resilience and buffers against more difficult times. However, there are a range of political and other factors that can impede governments from effecting such counter-cyclical, or even cyclically neutral, policies.
- At minimum, governments should have a stated commitment to pursue a sound and sustainable fiscal policy. The credibility of this commitment can be enhanced through clear and verifiable fiscal rules or policy guidelines which make it easier for people to understand and to anticipate the government's fiscal policy course throughout the economic cycle, and through other institutional mechanisms (see point 10 below) to provide an independent perspective in this regard.

2. Top-down budgetary management should be applied to align policies with resources.

- The starting point for budgetary management should be the setting of overall budget targets by the CBA which will achieve fiscal policy objectives for each year of a medium-term fiscal horizon. These targets should then be used to ensure that all elements of revenue, expenditure and broader economic policy are consistent and are managed in line with the available resources.
- The accuracy of economic forecasting, and of tax and expenditure baseline projections, is of central importance if top-down budgeting is to be planned and implemented effectively (see also points 4 and 10 below).

3. Budgets should be closely aligned with government-wide strategic priorities.

- To promote alignment with the (multi-year) planning, prioritisation and goal-setting functions of government, the (annual) budgeting process should (a) develop a medium-term perspective, beyond the traditional annual cycle (see point 4 below); and (b) organise and structure the budget allocations in a way that corresponds readily with national objectives.
- The CBA should have a close working relationship with the centre of government (i.e. prime minister's office or cabinet office), given the inter-dependencies between the budget process and the achievement of government-wide policies.
- From time to time, governments may need to revisit or realign their fundamental priorities to take account of developments in the economy or in society. A periodic, comprehensive review of expenditure (see point 9 below) is a useful tool for ensuring that budgetary expectations are managed in line with government-wide developments.

4. Budgets should be forward-looking, giving a clear medium-term outlook.

- A medium-term dimension to budgeting is essential both for managing fiscal policy effectively and for resourcing government plans and priorities (see points 1, 2 and 3 above). Moreover, many structural reform measures – whether relating to expenditure or revenue – take several years to yield their expected benefits, and these effects should be planned and budgeted for across the multi-year horizon.
- A medium-term expenditure framework (MTEF) is accordingly of fundamental importance in setting a basis for the annual budget. To be effective, an MTEF should have real force in setting boundaries for the main categories of expenditure, for each year of the medium-term horizon; should be fully aligned with the top-down budgetary constraints agreed by government; should be grounded upon realistic forecasts for baseline expenditure (i.e. using existing policies), including a clear outline of key assumptions used; should show the correspondence with expenditure objectives and deliverables from national strategic plans; and should include

sufficient institutional incentives and flexibility to ensure that expenditure boundaries are respected.

- Capital investment plans, which by their nature have an impact beyond the annual budget, should be grounded in objective appraisal of economic capacity gaps, infrastructural development needs and sectoral/social priorities. The budgeting process should require a prudent assessment of the costs and benefits of such investments; affordability for users over the long term, including in light of recurrent costs; relative priority among various projects; and of overall value for money. Investment decisions should be evaluated independently of the specific financing mechanism i.e. whether through traditional capital procurement or a private financing model such as public-private partnership (PPP).

5. Budget documents and data should be open, transparent and accessible.

- Clear budget reports should be available to inform all stages of policy formulation, consideration and debate, as well as implementation and review. The annual budget document itself, which shows the allocations for each public service area and revenue policy measures under each tax heading, is of central importance. Budgetary information should also be presented in comparable format in advance of the final budget providing enough time for effective discussion and debate on policy choices (e.g. a draft budget or a pre-budget report), during the implementation phase (e.g. a mid-year budget report) and after the end of the budget year (an end-year report) to promote effective decision making, accountability and oversight.
- All budget reports should be published fully, immediately and routinely, and in a way that is accessible to citizens. In the modern context, “accessibility” requires that budget documents be available on-line, and that all budget data be presented in open data formats which can be readily downloaded, analysed, used and re-presented by citizens, civil society organisations and other stakeholders.
- The budgeting process brings together all financial inflows and outflows of government; the use of open, standardised data sets should therefore allow for the budgeting process to facilitate and support other important government objectives such as open government, integrity and programme evaluation.

6. The budget process should be inclusive, participative and realistic.

- As well as having access to budget documents and data, parliament and citizens should be able to understand and influence the discussion about budgetary policy options, according to their democratic mandate, competencies and perspectives.
- Detailed and technical information should be presented in a simple manner, and the impact of budget measures – whether to do with tax or expenditure – should be clearly explained. A “citizen’s budget” or budget summary, in a standard and user-friendly format, is one way of achieving this.
- The national parliament has a fundamental role in authorising budget decisions and in holding governments to account. The parliament and its committees should have the opportunity to engage with the budget process at all stages of the budget cycle. The clear setting-out of medium-term budgetary envelopes (see point 4 above) should help the parliament to participate in the annual process of budget formulation *ex ante* as well as *ex post*.
- Since governments have finite resources at their disposal, budgeting is concerned with identifying priorities, assessing value for money and making decisions. Parliaments, citizens and civil society organisations can contribute usefully to the budget process when they become engaged in the debate about difficult trade-offs, opportunity costs and value for money. Governments should facilitate this useful engagement by making clear the relative costs and benefits of the wide range of public expenditure programmes and tax expenditures.

7. Budgets should present a true, full and fair picture of the public finances.

- As a contract of trust between citizens and the state, it is expected that the budget document should account truly and faithfully for all expenditures and revenues of the national government, and that no figures should be omitted or hidden (although limited restrictions may apply for certain national security purposes). To underpin trust, this expectation should be made explicit through formal laws, rules or declarations that ensure budget sincerity and constrain the use of “off-budget” fiscal mechanisms.
- Control of the national budget is the responsibility of the central government, and the degree of co-ordination and co-operation with subnational levels of government naturally varies from country to country. The budget documentation should present a full national overview of the public finances – encompassing central and subnational levels of government – as an essential context for a debate on budgetary choices.
- Budget accounting should show the full financial costs and benefits of budget decisions, including the impact upon financial assets and liabilities. Accruals budgeting and reporting, which correspond broadly with private sector accounting norms, routinely show these costs and benefits; where traditional cash budgeting is used, supplementary information is needed. Where accruals methodology is used, a cash statement should also be prepared to show how the national government operations will be funded from year to year.
- Public programmes that are funded through non-traditional means – e.g. PPPs – should be included and explained in the budget reports, even where (for accounting reasons) they may not directly affect the public finances within the time frame of the budget document.

8. Performance, evaluation and value for money should be integral to the budget process

- Parliament and citizens need to understand not just what is being *spent*, but what is being *bought* on behalf of citizens – i.e. what public services are actually being delivered, to what standards of quality and with what levels of efficiency.
- Performance information should be routinely presented alongside the financial allocations in the budget report. It is essential that such information should clarify, and not obscure or impede, accountability and oversight. Accordingly, performance information should be limited to a small number of relevant indicators for each policy programme; should be clear and easily understood; should allow for tracking of results against targets and for comparison with international and other benchmarks; and should make clear the link with government-wide strategic objectives.
- Expenditure programmes (including tax expenditures) should be routinely and regularly subject to objective evaluation and review, to inform resource allocation and re-prioritisation both within line ministries and across government as a whole. High-quality performance and evaluation information should be available to facilitate an evidence-based review.
- In particular, all new policy proposals should be routinely and openly evaluated *ex ante* to assess coherence with national priorities, clarity of objectives, and anticipated costs and benefits.
- Periodically, governments should take stock of overall expenditure and reassess its alignment with fiscal objectives and national priorities, taking account of the results of evaluations. For such a comprehensive review to be effective, it must be aligned with political demand.

9. Longer-term sustainability and other fiscal risks should be identified, assessed and managed prudently

- To promote a stable development of public finances, mechanisms should be applied to promote the resilience of budgetary plans and to mitigate the potential impact of fiscal risks.

- Fiscal risks, including contingent liabilities, should be clearly identified, explained and classified by type: e.g. forecasting assumptions; national and international economic risks and scenarios, including uncertainties relating to the economic cycle and internal and external economic imbalances; liabilities and guarantees in the public sector, including public enterprises; potential liabilities in the broader economy, including any implicit support for strategic industries or private-sector pension schemes; risk-sharing and joint financing arrangements with the private sector, including PPPs; implicit guarantees for sub-national debt; risks from natural disasters and other unpredictable events; and longer-term sustainability risks, including those related to publicly-funded pensions and any implicit support for private-sector pensions.
- Fiscal risks should also be quantified as far as possible, and the mechanisms for managing these risks should be made explicit and reported alongside the annual budget. Such mechanisms should include, as appropriate: adoption of a prudent fiscal stance; adequate fiscal buffers against cyclical volatility; charging market-based fees for the implicit costs associated with liabilities and guarantees; credible repudiation by the government of any perceived responsibility for risks that belong in the private sector; and protected reserve funds for unforeseen events and for longer-term budgetary challenges.
- Longer-term demographic changes and other factors can also give rise to major pressures and challenges for budgetary policy: issues such as social security, health care, care for older people, education, energy policy and the structure of the tax base should be considered under this heading. A report on long-term sustainability of the public finances should be published regularly (at least once every 3 years), and its policy messages – both near-term and longer-term – should be presented and considered in the budgetary context.

10. The integrity and quality of budgetary forecasts, fiscal plans and budgetary implementation should be promoted through rigorous, independent quality assurance.

- The CBA needs to command the confidence of a broad range of stakeholders – across government, within parliament and the public, and internationally – in the quality and integrity of its budgetary forecasts and fiscal plans and in its ability to manage budgetary implementation and delivery.
- In the first instance, governments should invest continually in the skills and capacity of staff to perform their roles effectively – whether in the CBA, line ministries or other institutions – including by reference to current international standards and norms.
- The credibility of national budgeting – including economic forecasting, adherence to fiscal rules, longer-term sustainability and handling of fiscal risks – can also be enhanced through independent fiscal institutions or other structured, institutional processes for allowing objective scrutiny of, and input to, government budgeting. An open, transparent and participative approach to budgeting (see points 4 and 5 above) also promotes the credibility and quality of the budgetary process.
- Independent internal audit is an essential safeguard for the quality of integrity of budget processes and financial management, both within the CBA and within line ministries.
- The supreme audit institution (SAI) has a fundamental role, as a guardian of the public trust, in ensuring that budgeted resources are used properly. A well-functioning SAI should deal authoritatively with all aspects of financial accountability. As regards efficiency and value for money, both the internal and external control systems should have a role in auditing the cost-effectiveness of individual programmes and in assessing the quality of performance accountability and governance frameworks more generally.

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OECD Best Practices for Budget Transparency

Note from the Editors

The relationship between good governance and better economic and social outcomes is increasingly acknowledged. Transparency – openness about policy intentions, formulation and implementation – is a key element of good governance. The budget is the single most important policy document of governments, where policy objectives are reconciled and implemented in concrete terms. Budget transparency is defined as the full disclosure of all relevant fiscal information in a timely and systematic manner.

OECD Member countries are at the forefront of budget transparency practices. At its 1999 annual meeting, the OECD Working Party of Senior Budget Officials asked the Secretariat to draw together a set of Best Practices in this area based on Member countries' experiences.

The Best Practices are in three parts. Part 1 lists the principal budget reports that governments should produce and their general content. Part 2 describes specific disclosures to be contained in the reports. This includes both financial and non-financial performance information. Part 3 highlights practices for ensuring the quality and integrity of the reports.

The Best Practices are designed as a reference tool for Member and non-member countries to use in order to increase the degree of budget transparency in their respective countries. The Best Practices are organised around specific reports for presentational reasons only. It is recognised that different countries will have different reporting regimes and may have different areas of emphasis for transparency. The Best Practices are based on different Member countries' experiences in each area. It should be stressed that the Best Practices are not meant to constitute a formal "standard" for budget transparency.

1. Budget reports

1.1. *The budget*

- The budget is the government's* key policy document. It should be comprehensive, encompassing all government revenue and expenditure, so that the necessary trade-offs between different policy options can be assessed.
- The government's draft budget should be submitted to Parliament far enough in advance to allow Parliament to review it properly. In no case should this be less than three months prior to the start of the fiscal year. The budget should be approved by Parliament prior to the start of the fiscal year.
- The budget, or related documents, should include a detailed commentary on each revenue and expenditure programme.
- Non-financial performance data, including performance targets, should be presented for expenditure programmes where practicable.
- The budget should include a medium-term perspective illustrating how revenue and expenditure will develop during, at least, the two years beyond the next fiscal year. Similarly, the current budget proposal should be reconciled with forecasts contained in earlier fiscal reports for the same period; all significant deviations should be explained.
- Comparative information on actual revenue and expenditure during the past year and an updated forecast for the current year should be provided for each programme. Similar comparative information should be shown for any non-financial performance data.
- If revenue and expenditures are authorised in permanent legislation, the amounts of such revenue and expenditures should nonetheless be shown in the budget for information purposes along with other revenue and expenditure.
- Expenditures should be presented in gross terms. Ear-marked revenue and user charges should be clearly accounted for separately. This should be done regardless of whether particular incentive and control systems provide for the retention of some or all of the receipts by the collecting agency.

* The Best Practices define "government" in line with the System of National Accounts (SNA). This definition encompasses the non-commercial activities of government. Specifically, the activities of state-owned enterprises are excluded from this definition. Although the SNA definition focuses on general government, *i.e.* consolidating all levels of government, these Best Practices should be seen to apply to the national government.

- Expenditures should be classified by administrative unit (*e.g.* ministry, agency). Supplementary information classifying expenditure by economic and functional categories should also be presented.
- The economic assumptions underlying the report should be made in accordance with Best Practice 2.1 (below).
- The budget should include a discussion of tax expenditures in accordance with Best Practice 2.2 (below).
- The budget should contain a comprehensive discussion of the government's financial assets and liabilities, non-financial assets, employee pension obligations and contingent liabilities in accordance with Best Practices 2.3-2.6 (below).

1.2. *Pre-budget report*

- A pre-budget report serves to encourage debate on the budget aggregates and how they interact with the economy. As such, it also serves to create appropriate expectations for the budget itself. It should be released no later than one month prior to the introduction of the budget proposal.
- The report should state explicitly the government's long-term economic and fiscal policy objectives and the government's economic and fiscal policy intentions for the forthcoming budget and, at least, the following two fiscal years. It should highlight the total level of revenue, expenditure, deficit or surplus, and debt.
- The economic assumptions underlying the report should be made in accordance with Best Practice 2.1 (see below).

1.3. *Monthly reports*

- Monthly reports show progress in implementing the budget. They should be released within four weeks of the end of each month.
- They should contain the amount of revenue and expenditure in each month and year-to-date. A comparison should be made with the forecast amounts of monthly revenue and expenditure for the same period. Any in-year adjustments to the original forecast should be shown separately.
- A brief commentary should accompany the numerical data. If a significant divergence between actual and forecast amounts occurs, an explanation should be made.
- Expenditures should be classified by major administrative units (*e.g.*, ministry, agency). Supplementary information classifying expenditure by economic and functional categories should also be presented.

- The reports, or related documents, should also contain information on the government's borrowing activity (see Best Practice 2.3 below).

1.4. Mid-year report

- The mid-year report provides a comprehensive update on the implementation of the budget, including an updated forecast of the budget outcome for the current fiscal year and, at least, the following two fiscal years. The report should be released within six weeks of the end of the mid-year period.
- The economic assumptions underlying the budget should be reviewed and the impact of any changes on the budget disclosed (see Best Practice 2.1 below).
- The mid-year should contain a comprehensive discussion of the government's financial assets and liabilities, non-financial assets, employee pension obligations and contingent liabilities in accordance with Best Practices 2.3-2.6 (below).
- The impact of any other government decisions, or other circumstances, that may have a material effect on the budget should be disclosed.

1.5. Year-end report

- The year-end report is the government's key accountability document. It should be audited by the Supreme Audit Institution, in accordance with Best Practice 3.3 (below) and be released within six months of the end of the fiscal year.
- The year-end report shows compliance with the level of revenue and expenditures authorised by Parliament in the budget. Any in-year adjustments to the original budget should be shown separately. The presentation format of the year-end report should mirror the presentation format of the budget.
- The year-end report, or related documents, should include non-financial performance information, including a comparison of performance targets and actual results achieved where practicable.
- Comparative information on the level of revenue and expenditure during the preceding year should also be provided. Similar comparative information should be shown for any non-financial performance data.
- Expenditure should be presented in gross terms. Ear-marked revenue and user charges should be clearly accounted for separately.

- Expenditure should be classified by administrative unit (*e.g.* ministry, agency). Supplementary information classifying expenditure by economic and functional categories should also be presented.
- The year-end report should contain a comprehensive discussion of the government's financial assets and financial liabilities, non-financial assets, employee pension obligations and contingent liabilities in accordance with Best Practices 2.3-2.6 (below).

1.6. Pre-election report

- A pre-election report serves to illuminate the general state of government finances immediately before an election. This fosters a more informed electorate and serves to stimulate public debate.
- The feasibility of producing this report may depend on constitutional provisions and electoral practices. Optimally, it should be released no later than two weeks prior to elections.
- The report should contain the same information as the mid-year report.
- Special care needs to be taken to assure the integrity of such reports, in accordance with Best Practice 3.2 (below).

1.7. Long-term report

- The long-term report assesses the long-term sustainability of current government policies. It should be released at least every five years, or when major changes are made in substantive revenue or expenditure programmes.
- The report should assess the budgetary implications of demographic change, such as population ageing and other potential developments over the long-term (10-40 years).
- All key assumptions underlying the projections contained in the report should be made explicit and a range of plausible scenarios presented.

2. Specific disclosures

2.1. Economic assumptions

- Deviations from the forecast of the key economic assumptions underlying the budget are the government's key fiscal risk.
- All key economic assumptions should be disclosed explicitly. This includes the forecast for GDP growth, the composition of GDP growth, the rate of employment and unemployment, the current account, inflation and interest rates (monetary policy).

- A sensitivity analysis should be made of what impact changes in the key economic assumptions would have on the budget.

2.2. Tax expenditures

- Tax expenditures are the estimated costs to the tax revenue of preferential treatment for specific activities.
- The estimated cost of key tax expenditures should be disclosed as supplementary information in the budget. To the extent practicable, a discussion of tax expenditures for specific functional areas should be incorporated into the discussion of general expenditures for those areas in order to inform budgetary choices.

2.3. Financial liabilities and financial assets

- All financial liabilities and financial assets should be disclosed in the budget, the mid-year report, and the year-end report. Monthly borrowing activity should be disclosed in the monthly reports, or related documents.
- Borrowings should be classified by the currency denomination of the debt, the maturity profile of the debt, whether the debt carries a fixed or variable rate of interest, and whether it is callable.
- Financial assets should be classified by major type, including cash, marketable securities, investments in enterprises and loans advanced to other entities. Investments in enterprises should be listed individually. Loans advanced to other entities should be listed by major category reflecting their nature; historical information on defaults for each category should be disclosed where available. Financial assets should be valued at market value.
- Debt management instruments, such as forward contracts and swaps, should be disclosed.
- In the budget, a sensitivity analysis should be made showing what impact changes in interest rates and foreign exchange rates would have on financing costs.

2.4. Non-financial assets

- Non-financial assets, including real property and equipment, should be disclosed.
- Non-financial assets will be recognised under full accrual-based accounting and budgeting. This will require the valuation of such assets and the selec-

tion of appropriate depreciation schedules. The valuation and depreciation methods should be fully disclosed.

- Where full accrual basis is not adopted, a register of assets should be maintained and summary information from this register provided in the budget, the mid-year report and the year-end report.

2.5. Employee pension obligations

- Employee pension obligations should be disclosed in the budget, the mid-year report and the year-end report. Employee pension obligations are the difference between accrued benefits arising from past service and the contributions that the government has made towards those benefits.
- Key actuarial assumptions underlying the calculation of employee pension obligations should be disclosed. Any assets belonging to employee pension plans should be valued at market value.

2.6. Contingent liabilities

- Contingent liabilities are liabilities whose budgetary impact is dependent on future events which may or may not occur. Common examples include government loan guarantees, government insurance programmes, and legal claims against the government.
- All significant contingent liabilities should be disclosed in the budget, the mid-year report and the annual financial statements.
- Where feasible, the total amount of contingent liabilities should be disclosed and classified by major category reflecting their nature; historical information on defaults for each category should be disclosed where available. In cases where contingent liabilities cannot be quantified, they should be listed and described.

3. Integrity, control and accountability

3.1. Accounting policies

- A summary of relevant accounting policies should accompany all reports. These should describe the basis of accounting applied (*e.g.* cash, accrual) in preparing the reports and disclose any deviations from generally accepted accounting practices.
- The same accounting policies should be used for all fiscal reports.
- If a change in accounting policies is required, then the nature of the change and the reasons for the change should be fully disclosed. Information for

previous reporting periods should be adjusted, as practicable, to allow comparisons to be made between reporting periods.

3.2. Systems and responsibility

- A dynamic system of internal financial controls, including internal audit, should be in place to assure the integrity of information provided in the reports.
- Each report should contain a statement of responsibility by the finance minister and the senior official responsible for producing the report. The minister certifies that all government decisions with a fiscal impact have been included in the report. The senior official certifies that the Finance Ministry has used its best professional judgement in producing the report.

3.3. Audit

- The year-end report should be audited by the Supreme Audit Institution in accordance with generally accepted auditing practices.
- Audit reports prepared by the Supreme Audit Institution should be scrutinised by Parliament.

3.4. Public and parliamentary scrutiny

- Parliament should have the opportunity and the resources to effectively examine any fiscal report that it deems necessary.
- All fiscal reports referred to in these Best Practices should be made publicly available. This includes the availability of all reports free of charge on the Internet.
- The Finance Ministry should actively promote an understanding of the budget process by individual citizens and non-governmental organisations.

Provision of Economic Data and Modelling in Wales

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Introduction

The use of economic modelling is a critical component for the assessment of economic policy for any Government. Robust models are a necessity for any legislative body considering alterations to taxation. To date, there have been limits on the extent to which economic models of Wales have been used to inform policy. This contrasts with the situation in Scotland where for well over two decades there has been significant economic data gathering and interrogation done, first by academics but then by the Scottish Government, to inform both basic and more complex models of the Scottish economy. Scotland benefits from better details of the economic links between regional industries, government and households, and has official Input-Output tables (see below) detailing these links. Added to this is the significant economic modelling work conducted at Strathclyde and Heriot Watt Universities, where sophisticated macroeconomic models for Scotland have utilised this data, delivering unique policy insights.

For Wales there has been a conflation of two problems, the first is having greater **Data** and the second is the ability to produce and run **Economic Models**. Each of these are inherently important for Wales but having one without the other will be of little use. What is required is a fundamental change with which “economic intelligence” is gathered, analysed and disseminated.

Data

The biggest challenge presently is the collection and provision of disaggregated Welsh economic data. There are two primary blocks of data required to build an economic model capable of analysing tax changes. First micro or agent level information including i) Consumption, ii) Labour Market Composition and well as Dynamics and iii) Earning, Saving and Investment information. Second, macro including aggregate regional accounts of output and inputs.

Presently there is little (agent level) data collected specifically for Wales, the National Survey for Wales is run by the Welsh Government and contains a great deal of information of which some would support development of economic models for Wales. However with few adjustments a specific economic behaviour module could be included cheaply and efficiently improving the usefulness of this source for modelling purposes. Another important source is the Integrated Household Survey conducted at a UK level. With a Welsh booster this would be a particularly valuable resource for developing agent level data for use in economic models of Wales.

Macro data would include: i) Trade Flows ii) Aggregate Tax Receipts iii) Project Government Expenditure. This macro/aggregate data presents somewhat more of a challenge. To this point there exists no formal Welsh accounting programme whereby components of supply and demand are decomposed into inputs and outputs. This macroeconomic information provides the backbone of understanding how Wales's economy works.

The simplest accounting mechanism that could be adopted quickly would be an official Input Output (IO) account formed from a supply and use matrix as well as the detailed information on the components of final demand.

Although not official an IO account for Wales has been in existence since 1995 constructed by the Welsh Economy Research Unit (WERU) at Cardiff University. But this accounting data has only been updated incrementally through projects supported by agencies and Government Departments in Wales. The monetary cost of producing official input-output tables for Wales would not be high, and the supporting statistical framework is already in place. Development could be achieved quickly and efficiently. Looking at both micro and macro data requirements, existing surveys and work in Wales already provides the base for more in-depth information to be collected. The Welsh Government might recognise that investing in the foundation capacity through which to develop more complex economic models, could reap dividends when tax changes are debated in the future.

Economic Modelling

Economic modelling builds a framework for applying logic, statistics as well as mathematics to independently assess and test the consequences of changes to economic outcomes. Economic models do not give definitive answers but can provide likely outcomes of changes in policy. This in turn provides powerful tools for critique of changes before they are actually implemented. Models usually fall into two classes **Impact**, to assess short run changes or a set of specific individual actions and **Forecast** for understanding trends across time particularly in aggregate data. Whichever class of model is used the output is very much limited by the accuracy and quantity of its initial input data.

Likely Models suitable for Wales for assessing tax changes are an i) Econometric Input Output (EIO) and ii) Computable General Equilibrium (CGE) model. To date there have been some attempts to build and run models for Wales however these have been limited by the quality of data available.

Led by a team in Scotland utilising the AMOS (A Macroeconomic of Scotland) framework, a CGE model for Wales has been developed and has been used to assess the economic and environmental consequences of industrial change. Dr Andrew Crawley from WERU has been leading a European-funded project, INTERIM¹ (Integrating Regional Economics Impact Models) the goal of which is to develop new approaches to the development of economic impact models. Working with a world-class team in the United States, one of the test regions will be Wales. The output from this research will be a new Wales Econometric Input Output model.

Both of these examples show how modelling has been utilised for Wales but both of which are academic in nature and have been constrained by limited information. Similar to the discussion of data in the previous section the examples of existing models provide a useful starting point for developing robust tools for the assessment of tax changes as well as other policy assessments.

Importance for Wales

If any tax raising powers were to be devolved, there would need to be sufficient economic models and data available in Wales to inform the debate over the consequences of such actions. There is currently no official disaggregated macroeconomic model for Wales, and estimates of tax change consequences will at this stage likely have to be sought from the UK Treasury based upon UK models.

Having an independent Welsh model(s) provides the ability to construct policy scenarios using robust methods explicitly built for understanding Welsh specific consequences.

¹ <http://business.cardiff.ac.uk/research/projects/integrating-economic-regional-impact-models>