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Ymateb gan Y Sefydliad Siartredig Cyllid Cyhoeddus a Chyfrifyddiaeth  
Response From The Chartered Institute of Public Finance & Accountancy

**June 2015**

**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](http://www.cipfa.org)

## **1. Executive Summary**

1.1 Reflecting on the focus of the Committees inquiry into future funding considerations, this submission will concentrate on the following areas:

- The key weaknesses and limitations (*see appendix 1*) in the current Welsh funding settlement and how these should be addressed
- What type of financial information is needed by the Welsh Government to provide appropriate support for and scrutiny of future funding arrangements
- The relevance of the Barnett Formula funding arrangements and;
- The principles that should be adopted to underpin further devolution of fiscal powers to Wales

1.2 CIPFA would make the following conclusions and recommendations to the Committee for consideration in its inquiry.

- The current funding settlement for Wales sets out prescribed borrowing limits set by the UK Government.<sup>1</sup> These limits are already significantly lower than levels of affordable borrowing in Local Government in Wales. A prescribed level of borrowing sets limits on the fiscal levers available to the Welsh Government.

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<sup>1</sup> Wales Act 2014, Section 20 'Borrowing'

- CIPFA would support the implementation of borrowing supported by a prudential management regime as recommended by the Smith Commission in Scotland.<sup>2</sup>
- CIPFA believes that the funding through the mechanism of the Barnett Formula is inconsistent with a position of further devolution of tax powers to devolved administrations.
- CIPFA advocates a position where further resource allocation across the UK should be principles based, transparent, accountable and should seek to address relative need as well as promotion of equity.<sup>3</sup>
- In order to support the devolved financial powers and enhanced accountability of the Welsh Government, there needs to be an appropriate robust system of financial reporting at a whole of Wales public sector level. This would include a balance sheet for Wales to assess the state of public finances in Wales and underpin enhanced scrutiny arrangements.<sup>4</sup>
- The Welsh Government should plan for a robust system of public financial management that includes an enhanced fiscal framework, independent scrutiny of Welsh Government tax and spending forecasts, all of which is support by legislative arrangements.

## **2. Borrowing and Prudential Management**

- 2.1 The current financial settlement includes borrowing powers of up to £500m for current revenue spending shortfalls, which remains unchanged from the Government of Wales Act 2006.<sup>5</sup> Capital borrowing powers providing a borrowing limit of £500m have been introduced in the Wales Act 2014.<sup>1</sup>
- 2.2 The limits are set taking account of the ratio between devolved tax revenues and borrowing. Taking account of this, it is put forward by the UK Government that the current settlement for Wales is more generous than that proposed for Scotland.<sup>6</sup>

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<sup>2</sup> The Smith Commission Report, paragraph 95 (5) (b) [http://www.smith-commission.scot/wp-content/uploads/2014/11/The\\_Smith\\_Commission\\_Report-1.pdf](http://www.smith-commission.scot/wp-content/uploads/2014/11/The_Smith_Commission_Report-1.pdf)

<sup>3</sup> CIPFA Briefing – Funding Devolved Government - <http://www.cipfa.org/cipfa-thinks/briefings>

<sup>4</sup> CIPFA Manifesto – things can only get worse, A call for sustainable public finance - <http://www.cipfa.org/cipfa-thinks/manifesto2015>

<sup>5</sup> Government of Wales Act 2006, Section 122 (2)

<sup>6</sup> HM Government, Wales Bill: Financial Empowerment and Accountability, para 88-90 - [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/294421/Wales\\_Bill\\_Command\\_Paper\\_-\\_English.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/294421/Wales_Bill_Command_Paper_-_English.pdf)

- 2.3 CIPFA would support the approach taken by the Smith Commission in Scotland.<sup>2</sup> This would mean that the Welsh Government should also have sufficient borrowing powers to support capital investment, consistent with a sustainable overall UK fiscal framework. The Welsh and UK Governments would need to consider the merits of undertaking such capital borrowing via a prudential borrowing regime, similar to Local Government,<sup>7</sup> and consistent with a sustainable overall UK framework.
- 2.4 We believe that this approach would facilitate a greater focus on medium to long term planning for Wales in its approach to Capital Investment. It would provide for greater accountability and transparency to the Welsh Assembly and Welsh Electorate, given that supporting prudential indicators are agreed, reviewed and published, and it would place the significant fiscal lever of borrowing for investment fully within the hands of the Welsh Government.
- 2.5 Within Local Government in Wales a similar prudential regime has been successfully in place for a number of years. A key element of the prudential regime is that Local Authorities set their authorised borrowing limit annually. Essentially this limit is the maximum that the elected members will allow executive officers to borrow and it is set in the context of its affordability on local taxation.
- 2.6 For an indication of the scale of borrowing in Local Government; in the 2010/11 financial year the total authorised limit across local government in Wales was over £5.0bn,<sup>8</sup> significantly greater than the limit being imposed by the UK Government on Capital Borrowing for the Welsh Government. As at the 31<sup>st</sup> March 2013, outstanding loan debt on the balance sheets of Local Authorities in Wales stood at £2.4bn.<sup>9</sup>
- 2.7 In order to fully support this approach, CIPFA advocates putting in place the following:
- A formal updated fiscal framework for Wales, supported in legislation
  - An agreed set of Prudential Indicators, measuring affordability, sustainability and prudence of the medium term to longer term investment decisions of the Welsh Government
  - An agreed method for Independent Scrutiny of the revenue and spending forecasts of the Welsh Government

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<sup>7</sup> CIPFA, The Prudential Code for Capital Finance in Local Authorities (2011 Edition)

<sup>8</sup> Prudential Borrowing and innovative approaches to capital funding Welsh Local Government Association – 2 March 2012 – paper to the Finance Committee of the National Assembly for Wales

<sup>9</sup> Capital and Treasury Management Statistics 2013/14, CIPFA.

### 3. Barnett Formula Funding

- 3.1 CIPFA believes that continuation of the use of the Barnett Formula to deal with further devolution is not feasible. Further, we believe that the Barnett Formula in its current form should be withdrawn.
- 3.2 A way forward was outlined by the Steele Commission<sup>10</sup> which drew attention to the arrangements put in place when Australia introduced a major package of reform to its fiscal system in 1999. The changes came with a guarantee that each state would not be worse off during the transitional period than it would have been had the changes not been implemented. The transition period was approximately 8 years and during this time states whose income fell below the guaranteed level were given non ring fenced grants to maintain overall revenue levels.
- 3.3 CIPFA believes that any future funding solution would have to consider relative public service needs. For example, a recent report on fiscal devolution concluded: 'for a system of fiscal devolution to balance equalisation and incentives it has to start with an assessment of need and resources; have a mechanism for reallocating disproportionate tax yield growth and include periodic reassessments'.<sup>11</sup> Any solution would also need to factor in the extent of local control over taxation including for example over non-domestic and domestic rates.
- 3.4 A clear case for a principles based approach to funding devolved government across the UK emerges from CIPFA's assessment of reviews of the Barnett Formula and consideration of International evidence. CIPFA has proposed four simple principles which would underpin the funding for all devolved government across the UK:<sup>3</sup>
- **Need** – the relative need and assessment of the socio-economic circumstances of each of the devolved government areas should be assessed;
  - **Equity** – this would be the cornerstone principle promoting equalisation across the nations of the UK.
  - **Accountability** – the devolved administrations should have some powers over taxation to provide a direct relationship between services provided and taxes paid, this making them more directly accountable, and

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<sup>10</sup> Moving to federalism – A New settlement for Scotland March 2006

<sup>11</sup> House of Commons, Communities and Local Government Committee Report, Devolution in England: the case for Local Government, June 2014

- **Transparency** – any funding mechanism should be transparent in its operation and should be the responsibility of a body independent of government.

3.5 We note that the UK Government has committed to establishing a process to review relative levels of funding within the block grant with the potential of introducing a floor in funding.<sup>12</sup> This will provide a Wales with a method to alleviate the process of future funding convergence under the Barnett Formula arrangements.

3.6 Placing a floor into the relative funding mechanism under Barnett for Wales does however raise the question of the funding position for the other devolved regions funded under Barnett Formula arrangements. This would put the regions on a different funding basis, if not implemented elsewhere, and further undermine the relevance of the current funding mechanism.

3.7 CIPFA supports the view taken by the UK Government which has stated that they will work with the Welsh Government to develop sustainable long-term funding arrangements within a robust fiscal framework that reflect the changes made.<sup>13</sup>

#### **4. Financial Information to Support Future Funding Arrangements**

4.1 An important component of supporting further devolution of powers to Wales is the quality of state level financial information and governance. Without good financial information and advice, policy makers and managers of public services fail to make sound decisions, leading to poor use of public money.

4.2 Robust financial reporting at a state level will be important for Wales for a number of reasons:

- To provide markets with an understanding of the state of public finances in Wales, supporting any move by the Welsh Government to raise finance through commercial markets.
- To provide transparency which helps inform voters and other stakeholders about the financial stewardship of the Welsh Government.

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<sup>12</sup> UK Government: Powers for a Purpose: Towards a Lasting Settlement for Wales, (Chapter 4, para 4.9), February 2015,

<sup>13</sup> UK Government: Powers for a Purpose: Towards a Lasting Settlement for Wales, (Chapter 4, para 4.11), February 2015,

- To underpin sound decision making and scrutiny arrangements under any revised fiscal framework and;
  - To enable medium to longer-term planning
- 4.3 CIPFA would advocate the development and use of projected combined Welsh public sector level balance sheets<sup>14</sup> as an integral part of the Welsh Governments fiscal and budgetary frameworks.

## **5. Reserved Powers Model**

- 5.1 CIPFA, having taken note of the available research,<sup>15</sup> supports the view that the Reserved Powers Model offers a number of advantages over the Conferred Powers Model that is contained within the Government of Wales Act 2006.
- 5.2 The key advantage is to provide legal clarity over what powers the Welsh Assembly has and to remove any uncertainty in areas where it may be difficult under the Conferred Powers Model to specifically define all the areas of responsibility that the Welsh Government should have. The Reserve Powers Model has been previously proposed by the Richard Commission 2004,<sup>16</sup> based on the Scottish Model of legislative powers.
- 5.3 Adoption of a Reserved Powers Model in Wales will also bring an element of consistency in approach to devolution across the regions of the UK. CIPFA does not expect full co-ordination of devolution settlements across the regions as it would be expected that regions will move at different paces and the appetite for devolved powers within the electorate in each regions may well differ. However, we do believe that it would be appropriate and fair if the model for devolution settlements had a degree of consistency.

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<sup>14</sup> CIPFA Manifesto 2015, section 6, page 18

<sup>15</sup> Scottish Law Commission, Comments on White Paper 'Our Changing Democracy: Devolution to Scotland and Wales' Memorandum no. 32, June 1976

<sup>16</sup> Report of the Commission on the Powers and Electoral Arrangements of the National Assembly for Wales <http://researchbriefings.files.parliament.uk/documents/SN03018/SN03018.pdf>

## APPENDIX 1 – Summary of Limitations in the current funding system

<p>Block grant calculated by Barnett formula</p>	<p>The Welsh Government has no control over the level of funding available and must ensure public services are affordable within the funding envelope provided. Some control can be exercised over levels of local taxation and other funding sources; the block grant provides the majority of income for the Welsh Government.</p> <p>The Wales Act 2014 provides that a referendum can be held to give Welsh Ministers the power to vary income tax, and gives the Welsh Government control of stamp duty land tax and landfill tax. These measures may provide some additional funding depending on the choices made.</p>
<p>Limitations on how block grant can be spent</p>	<p>As the UK Government retains control over fiscal policy, HM Treasury imposes controls on the block grant. Under a reserve powers model the Welsh Government has discretion over how to spend the majority of the block grant in relation to devolved areas.<sup>17</sup></p> <p>Some more volatile elements of expenditure are restricted.<sup>18</sup> Spending in these areas is not within the discretion of the Welsh Ministers, and this funding must be used for the purpose for which it is provided, or returned to HM Treasury. Although this provides the Welsh Government's funding with an element of protection from the risks associated with such volatile, demand-led elements of spending, it also removes an element of control over the totality of their available funding.</p>
<p>Inability to hold reserves</p>	<p>Funding received in the block grant cannot be held in 'reserve' to be carried over into future financial years.<sup>19</sup> Any unspent grant must be returned to the Treasury at the end of the financial year.</p> <p>There is a system by which the Welsh Government can ask to carry forward any unspent grant, the budget exchange mechanism.<sup>20</sup> However, this is subject to limits, and is designed to avoid the 'use it or lose it' effect where money is spent merely to avoid being lost,</p>

<sup>17</sup> The departmental expenditure limits (DEL).

<sup>18</sup> Included in the annually managed expenditure (AME).

<sup>19</sup> It should be noted that local government in Wales can hold reserves.

<sup>20</sup> As detailed in HM Treasury's [Consolidated Budgeting Guidance](#).

	<p>rather than to manage financial pressures across years. This does not enable the funds to be held in a 'reserve' but rather allows access to the agreed amount in the next financial year.</p>
<p>Inability to borrow over the long term</p>	<p>Local government in Wales can borrow money, as long as this is affordable and prudent.<sup>21</sup> This enables authorities to spread the cost of capital investment in schools, roads and other infrastructure, over a number of years.</p> <p>Under the current settlement, the Welsh Government has only limited ability to borrow money, with the power to borrow up to £500m to cover temporary shortfalls in revenue spending and £500m for Capital Investment<sup>1</sup></p>
<p>Limited information on future funding levels</p>	<p>In terms of financial planning for the future, the Welsh Government has only restricted information on its future level of funding. Although the block grant does provide a level of certainty, the amount of grant to be received is indicated as part of the UK Government's Spending Review process, which intends to provide figures for three financial years, to enable financial planning.<sup>22</sup></p> <p>The timing and lengths of Spending Review periods have varied, with the Spending Round 2013 providing figures for only two years (2014-15 and 2015-16), with no forecasts for financial years beyond the UK general election.</p> <p>Spending Reviews provide an indication of what the block grant is likely to be, these plans are often altered by decisions in UK Government Budgets and Autumn Statements, and therefore the block grant figures are subject to change, in either direction. These issues of timing and changes to the level of grant present difficulties in the ability of the Welsh Government to establish medium or long term financial plans.</p>

<sup>21</sup> Local Government Act 2003, Chapter 1 Capital Finance, sections 1 - 6

<sup>22</sup> Three year plans apply to the bulk of the grant, the departmental expenditure limit (DEL). However, the more volatile annually managed expenditure (AME) is planned for on an annual basis.