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Finance Committee

Meeting Venue:
Committee Room 2 - Senedd

Meeting date:
18 July 2012

Meeting time:
09:15

Cynulliad Cenedlaethol Cymru
National Assembly for Wales

For further information please contact:

Gareth Price
Committee Clerk
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Agenda

Private briefing (9:15 - 9:30)

1. Introductions, apologies and substitutions (9:30 - 9:35)

2. Effectiveness of European Structural Funding in Wales - Evidence from Value Wales (9:35 - 10:30) (Pages 1 - 2)

FIN(4) 12-12 - Paper 1- Value Wales

Alison Standfast, Deputy Director Value Wales (Procurement), Value Wales
Paul Williams, Strategic Procurement Executive, Value Wales

3. Update on the work of the Commission on Devolution in Wales (10:30 - 11:15) (Pages 3 - 4)

FIN(4) 12-12 - Paper 2 - Commission on Devolution in Wales

Paul Silk, Chair, Commission on Devolution in Wales
Professor Noel Lloyd, former Vice-Chancellor, Aberystwyth University
Dyfrig John, Chairman of Principality Building Society

4. Papers to note (Pages 5 - 11)

FIN(4) 12-12 - Paper 3 - Financial implications of Public Audit (Wales) Bill
FIN(4) 11-12 - Minutes of previous meeting

5. Motion under Standing Order 17.42 to resolve to exclude the

public from the meeting for the following business:
Items 6, 7 and 8.

6. Consideration of evidence on the Effectiveness of European Structural Funding in Wales (11:15 - 11:30)

7. Response to consultation on new Scottish borrowing powers (11:30 - 11:45) (Pages 12 - 19)

8. Handling of Welsh Government Draft Budget 2013-2014 (11:45 - 12:00) (Pages 20 - 23)

Finance Committee
FIN(4) 12-12 – Paper 1

The Contribution of Value Wales to European Structural Funding in Wales

Evidence Paper provided by Alison Standfast
Deputy Director Value Wales, Welsh Government

Background

1. The Welsh European Funding Office (WEFO) is responsible for managing the delivery of European Structural Fund programmes worth just under £2 billion of EU funds over the seven-year funding period 2007–2013 to drive a total investment of over £3bn (including match funding). This includes the Convergence West Wales and the Valleys programmes and the smaller Competitiveness programmes in East Wales. Wales also participates in a number of territorial co-operation programmes, including a cross-border Ireland/Wales programme managed by the Irish Authorities.

2. The programmes are at an advanced stage of implementation. Nearly five years into the programming period, WEFO has committed £1.7 billion (91%) of the total EU funds available) to 267 projects, representing a total investment of over £3.5 billion in Wales.

3. WEFO has adopted a more strategic approach to delivery for the current programme period, with a stronger focus on objectives, outputs and outcomes to secure a more effective use of the funding and avoid waste and minimise duplication.

4. There is also a stronger emphasis on open and competitive procurement, at project level, an important tool in helping to maximise value for money and ensuring fair and open access to the benefits of EU funds by all potentially interested parties.

5. Data provided by WEFO as at 30 June 2012 shows that the total estimated amount of procurement activity in the delivery of EU approved projects is worth £1.17bn, while approved projects with completed procurement exercises have awarded contracts worth £843m to organisations. Over 1,040 contracts (worth £462m) have been awarded to the private sector, 280 contracts (worth £263m) to the public sector, and some 435 contracts (worth £118m) to the third sector.

6. WEFO published revised guidance on project delivery models and the use of procurement in October 2010. The revised guidance introduced the opportunity for projects to use competitive grants, already adopted within the WCVA Gateway project, as an alternative way of securing value for money in project delivery.

The role of Value Wales

7. Value Wales is a division of Welsh Government with the remit to improve the practice and outcomes secured from the annual £4.3 billion public procurement in Wales. Its Corporate Procurement Service (CPS) branch provides advice, guidance and assurance to Welsh Government Departments. Its Policy branch provides general guidance for the wider public sector. It also has a branch that is delivering an e-procurement programme across Wales, another that is creating and managing all-Wales agreements for common goods and services, and another that is managing the ESF funded Home-grown Talent project established to address shortfalls in public sector procurement capability.

8. Where the Welsh Government acts a project sponsor, Value Wales Corporate Procurement Services provide a full tender management service for all procurement activity.

9. Where the project sponsor is another public body Value Wales provides advice and guidance through its on-line procurement route-planner or through its Policy mailbox.

10. Where the project sponsor is a 3rd sector or private sector organisation the WEFO Project Development Officer (PDO) - who is responsible for over-seeing the project - is able to seek advice and guidance from the Value Wales (CPS) branch on behalf of the project sponsor. This process ensures full project governance is in place and that queries are deal with effectively. These requests can be complex and require a careful and detailed assessment of the procurement.

11. All sponsors have access to the ‘Sponsorship and Delivery’ models guidance. Value Wales assisted WEFO in its production. It contains full advice and guidance on best practice procurement. It also includes a frequently asked questions section.

12. All sponsors can also access the Value Wales Procurement Route Planner (PRP) through www.buy4wales.co.uk. This provides a range of general procurement advice and guidance and is signposted within the Sponsorship and Delivery models guidance.

13. In the early years of the EU Programmes Value Wales also provided training to WEFO staff and PDOs. More recently WEFO has commissioned training from an external training provider contracted by Value Wales. WEFO staff have attended a course on “Effective and Compliant Procurement”, as have 60 attendees from the third sector and 68 from Local Authorities.

Commission on Devolution in Wales
Comisiwn ar Ddatganoli yng Nghymru

Finance Committee
FIN(4) 12-12 - Paper 2

COMMISSION ON DEVOLUTION IN WALES

Background

1. The Commission on Devolution in Wales was announced on 11 October 2011 by the Secretary of State for Wales, following a commitment in the Coalition Agreement to "establish a process similar to the Calman Commission for the Welsh Assembly".

Terms of Reference

2. The Commission's work has been divided into two parts and the Commission is currently considering the first part of its remit.

3. Part I: financial accountability
To review the case for the devolution of fiscal powers to the National Assembly for Wales and to recommend a package of powers that would improve the financial accountability of the Assembly, which are consistent with the United Kingdom's fiscal objectives and are likely to have a wide degree of support.

4. Part II: powers of the National Assembly for Wales
To review the powers of the National Assembly for Wales in light of experience and to recommend modifications to the present constitutional arrangements that would enable the United Kingdom Parliament and the National Assembly for Wales to better serve the people of Wales.

Membership

5. The Commission has seven members, four of whom were each nominated by one of the main political parties in Wales. The other three members, including the Chairman, were appointed as independent members. The members of the Commission are:
   - Paul Silk (Chairman) – former Clerk to the National Assembly for Wales and former Clerk in the House of Commons.
   - Dyfrig John – Chair of the Principality Building Society.
   - Noel Lloyd – former Vice-Chancellor of Aberystwyth University.
   - Dr Eurfyl ap Gwilym (nominated by Plaid Cymru) – economist and economic advisor to Plaid Cymru
   - Rob Humphreys (nominated by the Welsh Liberal Democrats) – Director of the Open University in Wales.
   - Sue Essex (nominated by the Welsh Labour Party) – former member of the National Assembly for Wales and Finance Minister in the Welsh Government.

- Nick Bourne (nominated by the Welsh Conservatives) – former member of the National Assembly for Wales and leader of the Welsh Conservative Party.

Work of the Commission

6. The Commission launched its Call for Evidence on 25 November; it was issued in hard copy to over 450 stakeholders and was published on the Commission's website (commissionondevolutioninwales.independent.gov.uk). The Commission received 46 written submissions from a range of stakeholder groups including political parties, business organisations, interest groups, academics and members of the public during this period and has received a further 31 submissions since its call for evidence closed. The Commission also wrote specifically to organisations based in England near the border with Wales to gather their views.

7. The Commission held public events in every local authority area in Wales between March and May and has received a considerable amount of responses to its questionnaire from interested individuals. The Commission has also commissioned opinion poll work to look at the public opinion around fiscal powers for the National Assembly, the results of which will be published shortly.

8. The Commission has met legislators and interest groups in both Scotland and Northern Ireland to discuss the implications of on-going developments in these regions on the Commissions work.

9. The Commission has now begun to discuss its emerging conclusions and consider its package of recommendations based on the evidence it has heard. The Commission will publish its final report in late autumn.

10. A communiqué has been published on the Commission's website following each of its formal meetings to inform the public of the Commission's work.

Y Gwasanaeth Ymchwil
Research Service

Cynulliad Cenedlaethol Cymru
National Assembly for Wales

Committee Reference: FIN(4) 12-12 - Paper 3

Finance Committee

Financial Scrutiny of Public Audit (Wales) Bill

Paper to note: Financial Memorandum

Date of paper	**18 July 2012**

Related Information

Welsh Government, *Public Audit (Wales) Bill*, 9 July 2012

Welsh Government, *Explanatory Memorandum – Public Audit (Wales) Bill*, 9 July 2012

Welsh Government, Jane Hutt, Minister for Finance, *Public Audit (Wales) Bill*, Cabinet Written Statement, 9 July 2012

This briefing has been produced by the Research Service for use by Finance Committee.

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Research Service

1. Introduction

The Public Audit (Wales) Bill was laid before the Assembly on 9 July 2012.[1] The scrutiny of this Bill is the responsibility of the Public Accounts Committee.

Additional annual costs highlighted are around £120,000 with £20,000 set up costs.

2. Aims

The Bill aims to strengthen and improve the accountability and governance arrangements relating to the Auditor General for Wales (AGW) and the Wales Audit Office (WAO).

3. Content of Bill

Part 1 of the Bill relates to the office of the AGW, establishes arrangements for the appointment and tenure of the office and provides safeguards to ensure the AGW's independence from the Welsh Government and the Assembly. It also makes provision to make the AGW the statutory auditor of local government bodies in Wales.

Part 2 (sections 13 to 28) establishes the WAO as a body corporate consisting of seven members, five of which will be appointed by the Assembly, along with the AGW and a WAO employee recommended by the AGW for appointment.

In particular, the Bill provides the newly constituted WAO with the following responsibilities:

- to monitor and a power to advise the AGW;
- to employ the WAO's staff;
- to secure the provision of services; and
- hold property for the purposes of carrying out its functions and those of the AGW.

The Bill also requires both the AGW and WAO to prepare an annual income and expenditure estimate which must be laid before the Assembly and included in the Assembly's Annual Budget Motion.

The EM states that subject to the approval of the Bill by the Assembly, the Welsh Government intends that these new arrangements come into force by 1 April 2014.[2]

Part 3 (sections 29 to 37) includes general and consequential provisions relating to the functions of the Assembly which allows it by standing orders to make provisions regarding the functions conferred on it in relation to the AGW and WAO by the Bill.

4. Financial implications of the Bill

According to the EM, the preferred option within the Bill will give rise to transitional costs of around £20,000 and annual costs of just over £150,000.

These costs would fall on the Wales Audit Office and National Assembly for Wales.

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[1] Welsh Government, *Public Audit (Wales) Bill*, 9 July 2012 [accessed 10 July 2012]
[2] Welsh Government, *Explanatory Memorandum – Public Audit (Wales) Bill*, 9 July 2012, paragraph 35 [accessed 10 July 2012]

Transitional costs

- Advertising the posts of the WAO Chair and four board members: **£20,000** (one-off cost). This cost would fall on the Assembly;

Average annual costs

- WAO board running costs: **£155,000 a year.** This includes the remuneration, gratuities and other allowances of the Chair and the four WAO members; along with the costs of secretariat and technical support. The EM states that this cost would be borne by the WAO and would amount to 0.64% of the AGW's current budget, which is funded by a combination of the Welsh Consolidated Fund and fee income.
- **Enhanced oversight role of the Assembly:** The Assembly will need to place appropriate arrangements to undertake its enhanced oversight of the AGW and WAO. It is for the Assembly to decide whether this is achieved through an existing committee, a new committee or commission. Costs will be dependent on how the Assembly decide to achieve this.

These costs are in addition to the existing running costs associated with the AGW, which currently has an annual budget of £24.2 million.

5. Key Issues

Impact on Wales Audit Office budget

The running costs of the WAO are estimated to be around £155,000 per year. This is 0.64% of the current WAO budget. The EM does not state whether this is expected to be funded from existing funding, fee income or additional drawing from the Welsh Consolidated Fund. This reflects the independence of the WAO.

Impact on the National Assembly for Wales

There will be a one-off £20,000 cost in recruiting the chair and four board members. There will also be costs of recruitment if a board member needs to be replaced.

There is an enhanced oversight role for the Assembly. Now cost estimate is provided, as it is up to the Assembly to consider whether this is function should be part of an existing committee, new committee or commission.

The Public Accounts Committee currently has responsibility for scrutinising the AGW estimate. This Bill gives the Assembly the ability to pass this responsibility to another committee.

Finance Committee

Meeting Venue:	**Committee Room 2 – Senedd**
Meeting date:	**Wednesday, 4 July 2012**
Meeting time:	**09:00 – 11:00**

Cynulliad Cenedlaethol Cymru
National Assembly for Wales

This meeting can be viewed on Senedd TV at:
http://www.senedd.tv/archiveplayer.jsf?v=en_300000_04_07_2012&t=0&l=en

Concise Minutes:

Assembly Members:

Jocelyn Davies (Chair)
Peter Black
Christine Chapman
Paul Davies
Mike Hedges
Julie Morgan
Ieuan Wyn Jones
Jenny Rathbone

Witnesses:

Jane Hutt, Minister for Finance and Leader of the House
Jeff Andrews, Welsh Government
Margaret Davies, Welsh Government
Matthew Denham-Jones, Welsh Government

Committee Staff:

Gareth Price (Clerk)
Daniel Collier (Deputy Clerk)
Martin Jennings (Researcher)
Eleanor Roy (Researcher)
Joanest Jackson (Legal Advisor)

1. Introductions, apologies and substitutions

1.1 The Chair welcomed Members and members of the public to the meeting.

1.2 Apologies had been received from Ann Jones, for whom Jenny Rathbone was substituting.

2. Welsh Government Supplementary Budget 2012-2013 (Summer 2012)

2.1 The Chair welcomed Jane Hutt AM, Minister for Finance; Jeff Andrews, Specialist Policy Adviser; Margaret Davies, Head of Budget Policy; and Matthew Denham Jones, Head of Budgetary Control and Reporting.

2.2 Members scrutinised the Minister.

Action points:

The Welsh Government agreed to:

- Publish details of projects receiving funding from round 6 of Invest-to-Save, including how much each project received, the projected savings, details of the pay-back profile, and details of the forthcoming evaluation of Invest-to-Save;
- Provide clarification on the £1million investment in the Single Environmental Body, which was raised by the Environment and Sustainability Committee at its meeting on 27 June 2012;
- Confirm when the Committee will receive a year-end report detailing variations between actual spend and the last supplementary budget of the year.

3. Papers to note

3.1 The Committee noted the correspondence from HM Treasury on the consultation on new Scottish borrowing powers. The Committee agreed to respond to the consultation, outlining the findings of the inquiry into Prudential Borrowing and Innovative Approaches to Capital Funding.

3.2 The Committee noted the correspondence on its inquiry into Devolved Funding: Borrowing Powers and Innovative Approaches to Capital Funding.

3.3 The Committee noted the correspondence from the Minister for Health and Social Services regarding the Supplementary Budget 2011-2012 (Spring 2012), which would inform its scrutiny of the Supplementary Budget 2012-2013.

3.4 The Committee ratified the minutes of the previous meeting.

4. Motion under Standing Order 17.42 to resolve to exclude the public from the meeting for the following business:

Items 5 and 6.

5. Welsh Government Supplementary Budget 2012-2013 (Summer 2012) - Consideration of evidence

5.1 The Committee discussed the evidence on Welsh Government Supplementary Budget 2012-2013 (Summer 2012)

6. Welsh Government Draft Budget 2013-2014 - Options for appointing an expert adviser

6.1 The Committee agreed to appoint a technical advisor to assist with its scrutiny of the Welsh Government budget 2013-2014.

Transcript

Y Pwyllgor Cyllid
Finance Committee

Tom Dodd
Debt and Reserves Management Team
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

19 July 2012

Dear Tom

The Finance Committee of the National Assembly for Wales recently undertook an inquiry into borrowing powers and innovative approaches to capital funding. While the outcomes of our inquiry naturally focused on arrangements in Wales, we took evidence regarding arrangements, current and upcoming, in the rest of the UK. We have responded below to the questions raised in the consultation document on which we have taken relevant evidence.

1. **What does the theory of fiscal decentralisation tell us about the merits and demerits of Scottish bond issuances, including, and beyond, the issues covered in this document?**

There are risks associated with fiscal decentralisation if it takes place in the absence of a suitable agreed framework for control. Such risks include moral hazard and a lack of accountability for the impact of sub-national borrowing on the national fiscal and macroeconomic position. However, in our inquiry we took evidence “that it is perfectly proper for national Governments to seek to place reasonable constraints on sub-national or regional Governments’ ability to borrow, and it is a matter of agreeing on the appropriate limits.”[1]

[1] Record of Proceedings [para 42], 16 May 2012, Finance Committee

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Fiscal decentralisation gives sub-sovereign administrations greater flexibility over the way in which the resources available to them are used. This requires longer term financial planning, and robust assessment of investment requirements, which, if properly carried out, can contribute to the achievement of better value for public money. As a Committee, our view is that to deliver their capital programmes and use investment as an important economic lever, devolved administrations should be given maximum flexibility to manage their resources according to local priorities, within the parameters of an agreed control framework. The particular features of such a control framework are a matter for negotiation between national and sub-national governments.

2. What insights do UK precedents for sub-sovereign bond issuance provide for Scotland?

The Local Government Association and Welsh Local Government Association have explored the potential for local authorities to make use of their powers to issue bonds. More detail about this is given in answer to question 4 below.

3. What are the implications of central governments providing, or not providing, explicit guarantees for the borrowing of a sub-sovereign?

The Scottish Futures Trust, on 2 May 2012, told us that the National Housing Trust in Scotland was funded through a combination of local authority borrowing and private equity. The Scottish Government had provided a guarantee for the local authority borrowing element.[2] The Scottish Futures Trust told us that "the guarantee is provided by Scottish Ministers with its value reflected in budget and accounts on a probability call multiplied by value if called basis".[3] If there were to be an explicit guarantee of Scottish borrowing by the UK Government, it would score against central budgets, and might impact on central borrowing.

[2] Record of Proceedings, [para 55], 2 May 2012, Finance Committee
[3] Finance Committee, FIN(4)-09-12 Paper 1, *Written evidence from the Scottish Futures Trust*, 30 May 2012

4. **How relevant to Scotland's situation are the interest rate premia that are observed in countries that issue sub-sovereign bonds?**

Our report recommended that, should the Welsh Government be granted borrowing powers, the Minister for Finance should include an expected maximum borrowing level in the annual budget motion.[4] Use of borrowing would therefore be subject to scrutiny by the National Assembly as part of the usual budget process. The Minister would be responsible for demonstrating the prudence and affordability of any proposed borrowing from any proposed source. This would require the Minister to undertake robust value for money assessments of the source of financing. We assume that similar arrangements would be put in place in Scotland in respect of borrowing powers or the issuance of bonds.

The evidence we received is that currently, local authorities in England and Wales undertaken the majority of their borrowing, approximately 75-80 per cent, from the Public Works Loan Board.[5] Our understanding is that this is largely on the basis of cost. The Holtham Commission's final report stated that the Welsh Government, if given the ability to borrow, would be likely to borrow from the Public Works Loan Board, also on the grounds of cost.[6]

The Local Government Association told us on 16 May 2012 that following the increase in the Public Works Loan Board rate by 1 per cent in 2010, the Local Government Association and Welsh Local Government Association undertook work to explore alternative sources of financing. The conclusion of this work was that if local authorities collaborated to borrow from the market, "the market would charge a premium of around 0.75% over the gilt rate". The Local Government Association said that this estimate was supported by evidence from the Transport for London bond issuance, which "got off at around that premium over the gilt rate".[7]

The Scottish Government would need, in considering whether to issue bonds as a product of debt, to take into account the costs of the various borrowing options open to them, and to make use of the option which offered the best value for money. In its evidence to us on 2 May 2012, the Scottish Futures Trust told us that:

[4] Finance Committee, *Borrowing powers and innovative approaches to capital funding*, July 2012
[5] Department for Communities and Local Government, Statistical Release, *Local authority borrowing and investments – 2010-11*, December 2011
[6] Independent Commission on Funding and Finance for Wales, *Fairness and accountability: a new funding settlement for Wales*, July 2010
[7] Record of Proceedings, [para 176], 16 May 2012, Finance Committee

"For all of the work that we are involved in with [local authorities], we will probably use the Public Works Loan Board, because that seems to be the cheapest finance out there at the minute for local authorities. We have looked at other options with them, for example, local authority bonds, which I know have been talked about, but they seem at the minute to be likely to be more expensive".[8]

However, we heard evidence that the 2010 Spending Review increased the rate of Public Works Loan Board funds significantly, which had a noticeable impact on the levels of English and Welsh local authority borrowing from the Public Works Loan Board.[9] While subsequently the rate has been lowered, in return for the provision of more robust financial information by local authorities, if the rate were to increase to a level in excess of the interest rate premium attached to the issuance of sub-sovereign bonds, or there was to be further uncertainty about the Public Works Loan Board rate, a situation could arise when bond issuance represented better value for money, even taking into account any sub-sovereign bond interest rate premium. Our report recommended that greater certainty about the Public Works Loan Board was required.

5. What are the key risks and benefits to Scotland of bond issuance by Scottish Ministers?

Borrowing, from whatever source, gives governments, local or central, greater flexibility about when and how they make use of resources. The result is that it can become possible, even taking account of the costs associated with borrowing, to finance assets or projects which might not otherwise be affordable from ordinary budgets, particularly in this time of budget constraints, and therefore allow investment in infrastructure to further boost the economy. This represents not an increase in financial settlement, rather an increase in financial autonomy.

The Local Government Association ("LGA") told us that local government's ability to undertake prudential borrowing had increased the flexibility for local authorities to take greater advantage of potential opportunities, and to work in partnership with other funders to make possible capital investment which otherwise could not go forward, for example in relation to proactive road maintenance or housing.[10] Similarly, in its response to our consultation, Carmarthenshire County Council told us that: "Without [prudential

[8] Record of Proceedings, [para 28], 2 May 2012, Finance Committee
[9] Finance Committee, FIN(4)-07-12 Paper 2, *Written evidence from the Local Government Association*, 16 May 2012
[10] Ibid

borrowing], we would not have been able to build so many new schools nor refurbish many more. […] We would not have been able to retain and improve our Council housing stock."[11] The power to issue bonds, in addition to other sources of borrowing for capital purposes, would increase the flexibility available to the Scottish Government in the way it accessed borrowing to enable it to take forward its capital investment programme.

We heard evidence from local government directors of finance in Scotland that "the main issue around bond issuance is economies of scale – that is, the size that the bond issue would need to be to make it cost-effective". The directors told us that if local authorities were to collaborate, they could envisage a situation where it could be cost-effective to raise finances through bond issuance.[12]

The Scottish local government directors of finance also told us that local authorities considering bond issuance would need to be mindful of capacity for administration and management of the financial arrangements.[13] The Scottish Government would need to ensure that sufficient capacity and capability was available to ensure robust governance arrangements. The Scottish Futures Trust, an independent body which has a role in assisting the public sector in Scotland to access financing and acts as a centre for expertise, might have a role in this respect.

6. What is the potential source, scale and depth of demand for Scottish bonds?

Our inquiry did not take any evidence in this regard.

7. What would be the size of any yield premium that potential investors would require to invest in Scottish bonds (as a spread to the yield on UK gilts)?

We did not take any evidence in respect of a yield premium for potential Scottish bonds, but as noted above in answer to question 4, we heard evidence that if local government in England and Wales were to issue bonds under normal market conditions, the market would be likely to charge a premium of around 0.75 per cent over the gilt rate.[14]

[11] Finance Committee, *Borrowing powers and innovative approaches to capital funding*, Consultation response from Carmarthenshire County Council, FIN(4)-DF08
[12] Record of Proceedings, [para 53], 24 May 2012, Finance Committee
[13] Ibid [para 53]
[14] Record of Proceedings, [para 176], 16 May 2012, Finance Committee

8. How significant are the potential benefits and risks of bond issuance by Scottish Ministers to the rest of the UK, including to the UK gilt market?

We did not take any evidence in this respect.

9. Are there any other issues and risks that could impact on the rest of the UK in giving Scottish Ministers the power to issue bonds? If so, how might any such risks be managed?

Our inquiry recognised that HM Treasury retains responsibility for UK fiscal and macroeconomic policy. We therefore considered some of the risks that might be involved in the granting of borrowing powers to the Welsh Government. As part of this consideration we discussed appropriate controls which might be agreed to ensure that sub-national borrowing did not place national macroeconomic parameters at risk. We were aware that the ability of regional governments to borrow, and, particularly, the ability for sub-national bond issuance, had been discussed at an EU level following the recent Eurozone crisis. The Welsh Government told us that while in some European countries, Spain for example, central governments had not placed restrictions on the borrowing undertaken by sub-national governments:

"The Welsh Government's position is that it is perfectly proper for national Governments to seek to place reasonable constraints on sub-national or regional Governments' ability to borrow, and it is a matter of agreeing on the appropriate limits."[15]

There are a number of different models which can be used to control the borrowing of sub-national governments, although our understanding is that there is no consensus on whether any particular model produces consistently better outcomes. According to the evidence submitted by the Independent Expert Group to the Commission on Scottish Devolution, the control framework models can be summarised as:

- *Market discipline*
  No limits set on sub-national borrowing. Local government is free to decide how much to borrow, from whom to borrow and what to spend borrowed money on. Financial markets enforce discipline and ensure sound borrowing practices through increases in borrowing costs or limiting access to financing;

[15] Ibid [para 42]

- *Rules-based controls*
  Variety of forms, including restrictions on overall budget deficits, operating budget deficits, indicators of debt servicing capacity, levels of accumulated sub-national debt or levels of spending. Alternatively, rules can limit the purposes for which borrowing can be undertaken;

- *Administrative approach*
  Direct control by central government over sub-national borrowing, including by setting temporal limits on overall debt, reviewing and authorising individual borrowing operations or the centralisation of all government borrowing with on-lending to sub-national governments; and

- *Cooperative approach*
  Negotiated process between central and sub-national government to design sub-national borrowing controls.[16]

In relation to borrowing powers in Scotland and Northern Ireland, we understand that national limits on maximum borrowing levels apply. This is in contrast to the more flexible arrangements in place for local authorities under the prudential code.

The prudential borrowing regime which applies to local government in the UK is a hybrid of the control models set out above. There is no statutory limit on the level of local authority borrowing, meaning that, in theory, local government is free to decide how much to borrow and what to spend that borrowing on. However, there are restrictions preventing local authorities from running budget deficits. Additionally, as a high proportion of local authority borrowing is undertaken through the Public Works Loan Board, the operation of local government borrowing is effectively controlled by central government through the lending rates.

Further to this, HM Treasury retained a ‘backstop’ to allow it to set a limit on local government borrowing, should the macroeconomic circumstances require it. Arrangements for this reserved ability are set out in an established protocol which was negotiated by local and central government in Scotland, and in a draft protocol negotiated by the Welsh Government and Welsh local authorities.[17]

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[16] Independent Expert Group, *Evidence from the Independent Expert Group to the Commission on Scottish Devolution: Should Scottish Ministers be Able to Borrow?*, June 2009
[17] Finance Committee, FIN(4)-08-12 Paper 1 *Written evidence from CIPFA Directors of Finance Section*, 24 May 2012

We asked local government representatives for their views on the control central government retained over local authority borrowing. The Scottish Local Government Directors of Finance told us that:

"One of the key learning points from the practical operation of the prudential regime is that against that background of local responsibility, government has retained power to impose limits on capital expenditure. Local authorities therefore require to be prepared in the event of any limit being imposed."[18]

This suggested to us that, while the protocol to impose a national limit on borrowing has never been required, local authorities take account of the potential for it to be used in their borrowing considerations. It is therefore a key component of the self-regulation which characterises the prudential borrowing framework.

We believe that it is reasonable for such a 'backstop' to be in place in order to enable HM Treasury to fulfil its fiscal and macroeconomic responsibilities whilst maintaining flexibility and the principle of self-regulation.

As a Committee, we are persuaded that, subject to an agreed framework of controls mitigating against the risk of a negative effect on total UK borrowing or undermining the overall UK fiscal position, the provision in the Scotland Act 2012 which gives HM Treasury Minister the ability to grant Scottish Ministers the flexibility to borrow by way of bonds, if it can be demonstrated to be cost effective and prudent to do so, is sensible. This is a provision which we would want to see replicated in any legislation which granted borrowing powers to the Welsh Government.

If you would like any further information, or have any queries, please contact the Committee's Clerk, Gareth Price, on 029 2089 8409 or at Gareth.Price@wales.gov.uk.

Yours sincerely

Jocelyn Davies AC
Jocelyn Davies AM

[18] Ibid

By virtue of paragraph(s) vi of Standing Order 17.42

Document is Restricted