

FINANCE COMMITTEE – INQUIRY INTO BEST PRACTICE BUDGET PROCESSES - PART 2

Evidence from the Minister for Finance and Government Business

Introduction

1. This paper provides evidence to inform the Finance Committee's inquiry into Best Practice Budget Processes – Part 2.
2. This part of the inquiry is considering the planning and implementing of new budget procedures. The Committee has requested views on:
 - * Tax and borrowing issues;
 - * Managing budgetary risk;
 - * Transparent and understandable budget processes;
 - * UK budget planning; and
 - * Implementation

Background

3. The Wales Bill, which is currently being considered by the UK Parliament, includes a range of financial reform measures which would give Wales:
 - powers to introduce Welsh taxes that would replace UK stamp duty land tax and UK landfill tax;
 - powers to create new devolved taxes on a case by case basis;
 - partial devolution of income tax, if supported by the people of Wales in a referendum;
 - borrowing powers for capital investment of up to £500 million in total; and
 - borrowing powers (also of £500 million) to manage short term budgetary fluctuations arising from tax devolution.
4. The Wales Bill will also enable the Assembly to set its own budgetary procedures.
5. The Wales Bill recently completed Report Stage in the House of Lords, and is expected to receive Royal Assent before the end of the current Parliament (i.e. before the end of March 2015).
6. Alongside the Wales Bill, the UK Government published a Command Paper - 'Wales Bill: Financial Empowerment and Accountability' - which indicates that the new Welsh taxes to replace UK stamp duty land tax and UK landfill tax should be introduced in April 2018.

Evidence

Tax and borrowing issues

7. On 19th November, the Welsh Government published the Treasury Paper 'Tax powers, purpose, principles and priorities' including some key facts about taxes¹.
8. Alongside the devolution of new tax powers, the block grant will need to be adjusted to reflect the reduced revenues flowing to the UK Exchequer. These offsets to the block grant should be calculated in a fair and transparent manner which takes into account the properties of the relevant tax base.
9. The Welsh Government's Holtham Commission proposed the so-called 'Holtham offset' as a fair way of combining devolved tax revenues with continued block grant funding. That mechanism has been agreed for Scotland in relation to income tax and would be the expected approach for Wales, were a Welsh rate of income tax to be introduced in the future.
10. The offset mechanism for the smaller taxes in Scotland, which will take effect from 1st April 2015, is still to be agreed between the Scottish Government and HM Treasury.
11. A Joint Exchequer Committee (JEC), including the Chief Secretary to the Treasury, the Secretary of State for Wales, the Financial Secretary to the Treasury and myself, has been established to oversee the transfer to Wales of the new financial powers included in the Wales Bill. In its first meeting (20 October), the principles that should underlie the block grant adjustments were agreed. These will seek to achieve fairness to both the UK and Welsh Governments by minimising the risks from funding transfers to both the UK and Welsh Governments, including policy 'spillover' and tax avoidance, and ensure that mechanisms are consistent with Azores criteria and State Aid principles.
12. The unanimously agreed cross-Party Motion on the 'Future of devolution for Wales' (20 October 2014) has established the immediate priorities for Wales in respect of further fiscal devolution (above and beyond that within the Wales Bill), including: devolution of direct long-haul air passenger duty and, subject to what is agreed for the other Devolved Administrations, possible devolution of corporation tax. These, and the other priorities, should be underpinned by resolution of the 'fair funding' issue through implementation of a funding floor.
13. The Welsh Government's new capital borrowing powers will be introduced alongside the Welsh taxes to replace UK stamp duty land tax and UK landfill tax, in April 2018. In advance of this date, the UK Government has enabled 'early access' to borrowing to contribute to the enhancement of

¹ [Treasury Paper - Tax powers, purpose, principles and priorities](#)

the M4 in south-east Wales if it is required. The Welsh Government is committed to using the full new borrowing powers, alongside the capital budget and innovative funding measures, to benefit all parts of Wales.

Managing budgetary risk

14. The devolution of taxes will bring a new dimension to planning and modelling within the Welsh Government which will require the development of new forecasting and modelling processes. The capacity requirements of these increased fiscal responsibilities are being considered and addressed.
15. The OBR will forecast Welsh receipts for stamp duty land tax, landfill tax, aggregates levy and Welsh income tax receipts, for the first time, as part of the fiscal forecasts accompanying the Autumn Statement on 3 December 2014. The Welsh Government will forecast revenues from the replacement taxes for stamp duty land tax and landfill tax, once the arrangements for these taxes are sufficiently clear.
16. The OBR already publishes forecasts of Scottish receipts for those taxes that will be devolved to the Scottish Government under the terms of the Scotland Act.
17. To manage the volatility in respect of tax devolution, the Wales Bill provides for short-term revenue borrowing powers of up to £500m. Alongside this, the Command Paper describes the cash reserve which will enable the Welsh Government to save tax receipts when they are in excess of forecasts, and to draw on those savings to maintain spending levels in times when tax receipts are below forecast.
18. The mechanism for managing any volatility arising from the devolution of non-domestic rates is currently under discussion with the Treasury.

Transparent and understandable budget processes

19. Steps have been taken in recent years to review the presentation and transparency of the Welsh Government's spending plans to support increased scrutiny. The Budget Protocol, which was endorsed by the Assembly back in 2012, was another important milestone in the continual programme of work to consider the transparency of budget proposals and how the Welsh Government can support the Assembly in its scrutiny. As part of this work, a commitment was made to provide a written report on final outturn to the Finance Committee – a clear demonstration of the commitment to working openly and transparently.
20. There is no single budget format which can meet all information requirements. It is also important to understand that while strategic decisions are taken in the autumn, the operational detail of budget plans will continue to develop up to the beginning of the financial year. A

balance is required between the commitment to providing information with the need for that information to remain meaningful.

21. The Welsh Government has consistently demonstrated commitment to engage with, and listen to, frontline staff who deliver vital public services across Wales. This engagement has been more important than ever in recent years, to work collaboratively with delivery partners to maintain high quality service provision in the face of very significant budget reductions. This is the context in which the Minister for Finance and Government Business engaged with a broad range of people through the Budget Tour 2014, in preparation for the Draft Budget 2015- 16 in September 2014.
22. There is a commitment to continuing this collaborative and consultative approach in the context of future budgets in order to ensure that the Welsh Government's budget documentation is open, transparent and accessible. There is a need to keep this under review as we develop the future budget in the light of the Wales Bill.

UK budget planning

23. The Wales Bill Command Paper confirmed the establishment of a Joint Exchequer Committee for Welsh Ministers and UK Ministers to oversee the transfer of the new financial powers. The first meeting of the JEC was on 20 October 2014.
24. Given that the bulk of the Welsh Government's funding will continue to come from the UK Government via the Welsh block, there will be a need to continue to work within the constraints of their processes and timescales.
25. There are also issues to address in terms of how the requirements of the scrutiny process can be balanced with the need to provide certainty to delivery partners and the need to allow the Government flexibility to respond to changing circumstances.
26. New fiscal powers provided by the Wales Bill presents the opportunity to consider the best budgetary procedure fundamentally and design a process that is both effective and proportionate, whilst acknowledging the constraints under which we operate.

Implementation

27. At this stage, it should be recognised that much of the detail relating to the implementation of the Wales Bill is under discussion with the UK Government. Therefore, there are likely to be changes at the operational level as this work develops.

28. Implementation of new fiscal responsibilities under the Wales Bill will require changes to the budgetary procedures of the National Assembly for Wales. The Wales Bill provides the opportunity to consider any changes within both statutory and non-statutory frameworks. It also provides a flexible timescale within which changes to the statutory provision could take place.
29. As a minimum, the changes to the budgetary procedures need to include the receipt and subsequent expenditure of revenues raised from devolved taxes and the receipt, expenditure and repayment of funds accessed under increased borrowing powers.
30. These changes could be implemented using the existing legal framework within the Government of Wales Act 2006. This would be a flexible approach within which to consider the ongoing implementation of new fiscal powers under the Wales Bill, together with the developments for further fiscal devolution.
31. To implement the necessary changes, there would be a requirement for the revision of the Standing Orders of the National Assembly for Wales and/or the Budget Protocol agreed between the Welsh Government and the Finance Committee to set out clearly the additional information to be provided to ensure transparency and effective scrutiny of the new fiscal powers. The Annual and Supplementary Budget Motions would be retained as a means of legally approving the budget.
32. In Scotland, implementation of the same fiscal powers were undertaken on a non-statutory basis. The Written Agreement between the Scottish Government and the Finance Committee was amended to detail the information that the Scottish Government would provide in relation to devolved taxes and borrowing in its 2015-16 Draft Budget documentation.
33. The Wales Bill also provides the opportunity to consider wider changes to the budgetary procedures. Some of these have been identified already within the Committee's inquiry such as outcome based budgets, medium to long-term planning and alignment of budgets and accounts.