

# Budget Series 1: Funding Welsh devolution

Quick Guide

June 2013

## Devolution funding

Responsibility for fiscal policy and the allocation of public expenditure across the UK lies with HM Treasury. Funding for the devolved administrations is determined within spending reviews, alongside that for UK Government departments.<sup>1</sup> This takes the form of a grant<sup>2</sup> from the relevant Secretary of State which is voted by the UK Parliament.

The budgets of the devolved administrations are not exclusively funded by grant from the UK; further elements of financing include local taxation (non-domestic rates and council tax), European funding and borrowing by local authorities for capital investment. Following the passage of the *Scotland Act 2012*,<sup>3</sup> the Scottish Government will also have control over additional devolved taxes from 1 April 2015; the revenues received from these taxes will be deducted from the Scottish block grant.<sup>4</sup>

## Categories and limitations of funding

The grant made available to the Welsh Government comprises two separate categories of expenditure:

- **Departmental expenditure limits (DEL)** – normally set over three or four years as part of the UK Government's spending review process, this is the multi-year budget limit for the Welsh Government. Most of the DEL is unhypothecated (the assigned budget) and allows the Welsh Government full discretion over its spending priorities. Changes in provision for these items are determined by the Barnett formula. Some elements of DEL however, are ring-fenced and can only be used for specified purposes (the non-assigned budget).
- **Annually managed expenditure (AME)** – covers spend which is generally demand-led and therefore provision cannot reasonably be subject to multi-year limits, (for example, the issue of student loans). This is reviewed and set twice a year by HM Treasury. AME can only be allocated to the purpose for which it is assigned; therefore the Welsh Government has no discretion over its allocation. Further AME can be drawn from HM Treasury if required, while any unspent AME must be returned.

<sup>1</sup> HM Treasury set out arrangements for funding the devolved administrations in *Funding the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly: Statement of Funding Policy*, October 2010. [accessed 15 May 2013]

<sup>2</sup> Funding for the Wales Office and other direct charges are top-sliced from the grant prior to it being released. Also funded from within the grant, but outside of the Welsh Government's available budget, are funding for the direct funded bodies (ie National Assembly Commission, the Auditor General and the Public Services Ombudsman).

<sup>3</sup> *Scotland Act 2012* [accessed 15 May 2013]

<sup>4</sup> The *Scotland Act 2012* transfers new powers to the Scottish Parliament relating to taxation and borrowing. From April 2015, stamp duty land tax and landfill tax will be fully devolved to Scotland. From April 2016, the Scottish Parliament will be asked to set a Scottish rate of income tax, to replace a 10p reduction from each band of income tax.

The Welsh Government is free to allocate the 'assigned' element of their budgets as they see fit, provided their plans comply with UK Government fiscal policy.<sup>5</sup> In reality, the scope for allocation is limited by existing demands and commitments.

## The Barnett formula

The non-statutory Barnett formula determines changes to planned spending within the assigned budget but does not determine its overall size. When the UK Government reviews its spending plans,<sup>6</sup> the Welsh block receives a population-based proportion of the changes in planned spending on comparable government services in England. Three factors are considered when calculating changes to the Welsh block grant using the Barnett formula:

- The **amount of change in planned spending** to UK Government departmental programmes;
- The **comparability percentage** – this describes the extent to which services delivered by the UK Government departments correspond to services for which the Welsh Government has responsibility. For example, the comparability percentage for health is 99.1 %, as the vast majority of health related spend is devolved to the Welsh Government; whereas the comparability percentage for transport is 73.1%, as the UK Government retains responsibility for several areas of transport spend.<sup>7</sup>
- The **population proportion** – this is Wales' population as a proportion of the population of England. Figures used reflect the annual mid-year estimates of population. The 2010 Spending Review used the 2009 mid-year estimates of population, giving a population proportion of 5.79% for Wales.

Thus, the Barnett formula operates an incremental system, in that the allocation in one year is based on that in the previous year. The changes to the block grant are therefore calculated by:

$$\boxed{\text{Change to UK department's DEL}} \times \boxed{\text{Comparability percentage}} \times \boxed{\text{Population proportion}}$$

For example, if the UK Government decided to increase its spend on Transport by £100 million, (which has an overall comparability percentage of 73.1%), then the calculation would be as follows: £100 million x 0.731 x 0.0579 = £4.23 million. Thus, the Barnett consequential would be an additional £4.23 million on top of the overall baseline. This calculation would be conducted for each UK Government department with a change to planned spending, and the sum of these represents the net change to the Welsh block grant.

<sup>5</sup> Note that the Welsh Government has **no** discretion over the total level of the assigned DEL.

<sup>6</sup> Generally through spending reviews although other spending announcements, such as those made by the Chancellor of the Exchequer in his Budget and Autumn Statement, also impact on allocations to the Welsh block.

<sup>7</sup> Details of comparability percentages can be found in Annex B of HM Treasury's *Funding the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly: Statement of Funding Policy*, October 2010. [accessed 15 May 2013]

## Formula by-pass

Although the majority of funding for the devolved administrations is determined by the Barnett formula, there are a number of exceptions where the population-based approach is not appropriate. This is often referred to as formula by-pass. These include some programmes within DEL, all of AME, and other expenditure outside DEL.

DEL items within the 'non-assigned' budget will be determined separately between the devolved administration, the relevant Secretary of State, HM Treasury and the relevant UK Government department.

The arrangements for funding the devolved administrations are set out in the Statement of Funding Policy.<sup>8</sup>

## Funding reform

In October 2012 the Welsh and UK Governments published a joint statement on funding reform, which resulted from a year long process of bilateral talks between the two governments. This process aimed to address the issue of fair funding and convergence as a result of the Barnett formula, which was raised during the work of the Holtham Commission, as well as the potential for borrowing powers to fund capital investment.<sup>9</sup>

The statement recognises that there has been convergence in Welsh funding since devolution, but on the basis of current UK Government spending plans this is unlikely to continue (as a result of spending cuts). However, should spending levels increase in the future, convergence would resume. The statement makes the commitment to conduct a joint review of the pattern of convergence in advance of each spending review, and if this forecasts convergence over the spending period, then the two governments will '*enter into discussions on options to address the issue*'.<sup>10</sup> No detail is provided on what such options may be.

In relation to the potential for the Welsh Government to borrow to finance capital investment:

In principle, the UK Government accepts the case for the Welsh Government to have access to borrowing powers in order to finance infrastructure projects, subject to an appropriate independent stream of revenue being in place to support it.

Decisions on the devolution of taxes – which could provide an appropriate revenue stream – will be made after the Silk Commission reports.

It has been agreed that the UK Government and Welsh Government should continue to explore the options for financing specific infrastructure projects, including the case for early access to borrowing powers in anticipation of a future independent revenue stream.<sup>11</sup>

Again, the detail of how such access to borrowing powers for specific projects would be gained, or the nature of projects for which this would be considered, are not provided.

<sup>8</sup> HM Treasury, *Funding the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly: Statement of Funding Policy*, October 2010. [accessed 15 May 2013]

<sup>9</sup> For further information regarding the fair funding issue and convergence as a consequence of the Barnett formula see Research Paper: *The Barnett formula and the changing face of devolution funding*, June 2011

<sup>10</sup> Welsh Government, Jane Hutt (Minister for Finance), *Funding Reform*, Written Cabinet Statement, 24 October 2012

<sup>11</sup> Welsh Government, Jane Hutt (Minister for Finance), *Funding Reform*, Written Cabinet Statement, 24 October 2012

## Silk Commission Part 1 Report

The Silk Commission reported on Part 1 of their work in November 2012, in relation to the potential for further fiscal powers for Wales.<sup>12</sup> They concluded that the best model for Wales would be a combination of block grant with some tax devolution. The Commission's remit did not include consideration of funding reform as proposed by Holtham, but they did recommend that *'the transfer of income tax powers to the Welsh Government should be conditional upon resolving the issue of fair funding in a way that is agreed by both the Welsh and UK Governments.'*<sup>13</sup>

At the time of writing, the UK Government response to their recommendations is expected soon. The joint statement above sets out that both the Welsh and UK Governments are *'committed to giving the Commission's proposals serious consideration, with a view to agreeing jointly a package of reforms that delivers fair an accountable funding for Wales.'*<sup>14</sup>

## Accessing the Welsh block grant – the Welsh Consolidated Fund

The *Government of Wales Act 2006* created the Welsh Consolidated Fund (WCF). This is a neutral bank account held by the Paymaster General.<sup>15</sup> The Act sets out arrangements for payments to be made into the WCF, including the grant received from the Secretary of State.<sup>16</sup>

The Auditor General must grant approvals to draw cash from the WCF.<sup>17</sup> The Auditor General must be satisfied that there is valid statutory authority to allow the amounts requested to be issued. In general, amounts may only be issued from the WCF if the National Assembly has passed a budget motion to that effect, although there are exceptions to this: sums may be 'charged on' the WCF by legislation;<sup>18</sup> when payment is deemed to have been authorised by a budget resolution under section 127 and 128 of the *Government of Wales Act 2006*;<sup>19</sup> and sums paid into the WCF by mistake.<sup>20</sup>

This means that the National Assembly has firm control over the use of resources. HM Treasury has 'administrative' control over the budget, whereas the limits on the use of resources and drawing of cash from the WCF as set by budget motions are 'statutory' controls. The use of resources in excess of the amounts permitted in a budget motion would be deemed irregular and result in an adverse audit opinion by the Auditor General.<sup>21</sup>

<sup>12</sup> Commission on Devolution in Wales, *Empowerment and Responsibility: Financial Powers to Strengthen Wales*, November 2012

<sup>13</sup> Commission on Devolution in Wales, *Empowerment and Responsibility: Financial Powers to Strengthen Wales*, November 2012 [Recommendation R.18, Chapter 5]

<sup>14</sup> Welsh Government, Jane Hutt (Minister for Finance), *Funding Reform*, Written Cabinet Statement, 24 October 2012

<sup>15</sup> **Section 117**, *Government of Wales Act 2006*. The Paymaster General is a UK Government Minister who has statutory responsibility for the Government accounts held in his/her name at the Bank of England.

<sup>16</sup> **Sections 118 to 120**, *Government of Wales Act 2006*

<sup>17</sup> As provided for in **Section 129** of the *Government of Wales Act 2006*

<sup>18</sup> **Section 20(5)** of the *Government of Wales Act 2006* provides an example of this: sums required for the making of payments for the remuneration of a person who holds or has held the office of Presiding Officer or Deputy Presiding Officer are to be charged on the WCF. [accessed 18 April 2011]

<sup>19</sup> **Section 127** deals with a situation where no budget resolution has been adopted by the National Assembly by the beginning of the relevant financial year. **Section 128** is aimed at emergency situations where it is not practicable to put down a budget motion for reasons of urgency. [accessed 18 April 2011]

<sup>20</sup> **Section 130**, *Government of Wales Act 2006*

<sup>21</sup> HM Treasury may also impose financial penalties for breaches of the DEL.

## Further information

For further information on the/about **devolution funding arrangements, budgets and the Barnett formula**, please contact **Dr Eleanor Roy** ([eleanor.roy@Wales.gov.uk](mailto:eleanor.roy@Wales.gov.uk)), Research Service.

**See also:**

- **Budget Series 2: The budget process in Wales**
- **Budget Series 3: Scrutiny of the budget**
- **Budget Series 4: Budget glossary**
- **Welsh Government, Budgets**

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