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**House of Commons Welsh Affairs Committee: Pre-legislative Scrutiny of draft Wales Bill**

**A Submission by:**

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

**16 January 2014**

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| **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. |

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1. **EXECUTIVE SUMMARY**
	1. CIPFA representatives have acted as advisers to the National Assembly for Wales’ Finance Committee during the 2013-14 and 2014-15 budget rounds, and also during their inquiry on borrowing powers and innovative approaches to capital financing, which was undertaken to inform the Silk Commission.
	2. CIPFA welcomes the draft Wales Bill published on 18 December 2013,[[1]](#footnote-2) and its intention to increase accountability of the Welsh devolved institutions. However, we consider that it does leave a number of questions unresolved and it is these which we wish to draw to the attention of the Committee. We also make recommendations intended to assist the Committee in improving the draft Bill.

The budget process in Wales

* 1. The draft Wales Bill contains no transfer of powers to the National Assembly for Wales over the budget process. CIPFA considers that this is a key omission, and that it runs the risk having powers over taxation and borrowing without the ability to operate an appropriate budget process through which to hold the Welsh Government to account for its financial plans.

Block grant offset

1.4 We are concerned that the mechanisms planned to offset the block grant to account for tax revenues are not indicated, either on the face of the draft Bill, or in the accompanying documentation. Thus, not allowing for scrutiny of this important element of tax devolution.

Control over capital borrowing powers

* 1. We consider that the absence of a control framework for capital borrowing powers from the draft Bill is an omission which requires further consideration. Without a prescribed control framework, scrutiny and control of borrowing and capital expenditure by the Assembly will be less effective.
1. **THE BUDGET PROCESS IN WALES**
	1. CIPFA is concerned that the draft Wales Bill makes no provision to transfer legislative powers over the Welsh budget procedures to the National Assembly for Wales (the Assembly). Given that the Bill intends to increase accountability, it seems remiss that it does not provide for an adequate budget process to allow the Assembly to hold the Welsh Government to account for its taxation and borrowing plans.
	2. The Silk Commission’s first report[[2]](#footnote-3) stated clearly that should its recommendations be implemented, the current budget process in the Assembly including the framework set by Part 5 of the *Government of Wales Act 2006[[3]](#footnote-4)* (GOWA 2006), would ‘*no longer be fit for purpose’*.
	3. The report recommended that the Assembly should be given legislative control to set and develop its own budgetary procedures, as is the case with the Scottish Parliament.
	4. The report did not suggest a specific budget process for the Assembly to adopt or copy from elsewhere. However, it was clear that any revenue raising and borrowing proposals made by a future Welsh Government should be integrated together with spending proposals into a single Finance (or Budget) Bill.
	5. The report went on to provide a general outline of how such a Bill should be scrutinised and considered by the Assembly. In particular, an Assembly Finance Bill process should involve ‘*enough time for proper scrutiny’* and ‘*the full involvement of stakeholders’.*[[4]](#footnote-5)
	6. In their response to the Silk report, the UK Government suggested with regard to the recommendation on budget procedures that the devolution of such powers could be considered in Part 2 of the Silk Commission’s work.[[5]](#footnote-6)
	7. Therefore, the draft Wales Bill contains no reference to the transfer of powers to the Assembly over the budget process.[[6]](#footnote-7) However, waiting for the second report of the Silk Commission and the UK Government’s response and subsequent legislation may not allow time for the development of an appropriate budget process for Wales, prior to the use of taxation and borrowing.
	8. New powers which would have to be incorporated into the budget process include consideration of:
	* setting Welsh tax rates for devolved taxes;
	* the adjustment to the block grant; and
	* use and sustainability of borrowing powers.
	1. Considering these, alongside the spending plans of the Welsh Government, will pose a considerable challenge to the Assembly and its committees, and will put significant emphasis on scrutiny of the overall affordability and sustainability of the Welsh Government’s financial plans.
	2. Such issues will be of considerable interest to civic society in Wales, and there will be a clear requirement for the Assembly to extend its scrutiny of the Welsh Government’s budget plans, including tax and borrowing proposals.
	3. Although the draft Bill provides that an annual report on the operation of the taxation and borrowing powers must be presented to the Assembly, this provides only for *ex ante* scrutiny.
	4. CIPFA considers that this is a key omission from the draft Wales Bill, and that it runs the risk of the Assembly having powers over taxation and borrowing without the ability to operate an appropriate budget process through which to hold the Welsh Government to account for its financial plans.

What would devolution of budget procedures entail in practice?

* 1. The Assembly’s current budgetary procedures are prescribed in Part of the *GOWA 2006*,[[7]](#footnote-8) and cannot be altered by the Assembly. Powers over the Assembly’s current budgetary provisions could be devolved through one of two ways:
* A new Bill introduced at Westminster (e.g. a new Wales Bill); or
* An Order in Council made under Section 109 of the *GOWA 2006*.[[8]](#footnote-9)
	1. These powers could be devolved in practice by adding control over the Assembly’s budgetary procedures to Subject 13 in Schedule 7,[[9]](#footnote-10) and extending the scope of paragraph 5(2) of Part 2 to Schedule 7 to allow an Assembly Act to modify most (but not all) of the provisions contained in Part 5 of the *GOWA 2006*.
	2. This would in turn allow the Assembly to pass an Act to replace or modify Part 5 of the *GOWA 2006* which deals with finance and budgetary matters (e.g. Section 125 to 128[[10]](#footnote-11)) to establish a budget process which links taxation, spending and borrowing, and provides sufficient time for proper scrutiny and stakeholder involvement as recommended by the Silk Commission.
	3. Westminster legislation would need to contain general provisions in relation to the Welsh Consolidated Fund (WCF) and other basic financial safeguards, as is the case with the *Scotland Act 1998*. The draft Wales Bill could be modified to provide for such measures, as well as to specify the minimum inclusions in Welsh legislation.
	4. The draft Wales Bill already provides for setting taxation rates and borrowing limits, however it could also deal with how taxation/borrowing receipts are to be handled. For example: taxation receipts and borrowings to be paid into the Welsh Consolidated Fund, repayments of borrowings to be a direct charge on the Fund and provision for the Assembly to authorise tax rates and borrowing limits.
	5. Subject to any financial provisions contained in the draft Wales Bill, if granted such powers the Assembly could pass a Bill (similar to the *Public Finance and Accountability (Scotland) Act 2000[[11]](#footnote-12)*) which could repeal and replace previous financial provisions to set budgets, provide for the preparation of audit and accounts and accountability arrangements.
	6. Such an Assembly Bill could incorporate: requirements for taxation, spending and borrowing plans to be linked, provisions for operation of the Welsh Consolidated Fund and detailed provisions for accounts and audit. Standing Orders of the Assembly could make special provision for the handling of Budget Bills including a requirement that they can only be introduced by a Welsh Minister.

What are the likely timescales involved?

* 1. In terms of timescales, the introduction of a Wales Bill during the current Parliament suggests that new powers will be devolved to the Assembly in time for the beginning of the fifth Assembly in May 2016.
	2. In practice therefore, it seems likely that the 2017-2018 budget will be the first to take advantage of new borrowing, landfill tax and stamp duty land tax powers. The 2017-18 budget which would be considered in detail by the Assembly six months earlier, in October 2016.
	3. This suggests that any devolution and subsequent changes to the budget process to make it fit for purpose to incorporate borrowing and taxation powers would have to be in place prior to this time, in order to enable the Welsh Government to prepare, and the Assembly to scrutinise, the 2017-18 budget adequately.
	4. It is worth noting that in Scotland, where the Parliament already had legislative control over budgetary procedures prior to the *Scotland Act 2012*, the Finance Committee is still contemplating how the budget process will operate as part of its consideration of implementation of the *Scotland Act 2012*.[[12]](#footnote-13) Much of the issues raised will also be applicable in Wales.

**Recommendations**

* 1. CIPFA recommends that:
* Legislative control over budgetary procedures for Wales should be transferred to the Assembly, as recommended by the Silk Commission.
* Given the likely timescales involved, together with the requirement for subsequent Welsh legislation, such provision should be made as soon as possible and thus should be incorporated into the draft Wales Bill.
* The draft Wales Bill should amend Schedule 7 to the *GOWA 2006* to add this power and should incorporate the financial safeguards which are appropriate to be retained by Westminster, without being too prescriptive, as described above.

**3. BLOCK GRANT OFFSET**

3.1 The draft Bill devolves powers over taxation; but makes no mention of how the Barnett-determined block grant from the UK Government will be reduced to compensate for these revenues.

3.2 The first report of the Silk Commission made recommendations on which mechanisms[[13]](#footnote-14) should be used to offset the block grant for each tax. It recommended that:

* SDLT and landfill tax – offset by fixed deduction;[[14]](#footnote-15)
* Income tax – offset by indexed deduction;[[15]](#footnote-16) and
* New taxes – no corresponding reduction to block grant.[[16]](#footnote-17)

3.3 In the UK Government’s response to the recommendations on SDLT and landfill tax it states that corresponding reductions to the block grant should be agreed with the Welsh Government, and in relation to income tax, makes no mention of the calculation of the corresponding offset.

3.4 Given that this has been the focus of much discussion during the scrutiny of the *Scotland Act 2012* in the Scottish Parliament, we consider that the Wales Office could have learnt from this experience and provided an indication either on the face of the draft Bill, or in the accompanying documentation, as to how such deductions would be conducted to allow for scrutiny of this important element of tax devolution.

**Recommendations**

* 1. CIPFA recommends that the draft Bill, or accompanying documentation is amended to:
* clearly set out the intended mechanism of offsetting the block grant for each tax over which powers are being devolved.
* reflect the Silk Commission’s recommendation that there will be no block grant offset in respect of new taxes.

**4. CONTROL OVER CAPITAL BORROWING POWERS**

4.1 The draft Bill allows the Welsh Ministers to borrow up to £500 million to fund capital expenditure. Such borrowing must be from the National Loans Fund (NLF) or commercial lenders. The impact assessment supporting the draft Bill states that this borrowing is to be supported by the revenues of the devolved taxes (SDLT and landfill tax), and could be raised in the event of income tax devolution.[[17]](#footnote-18)

Sources of borrowing

4.2 The draft Bill anticipates that borrowing could be from the NLF and also from commercial lenders.

4.3 Access to the NLF provides a more privileged, higher status and cheaper form of loan than is available to local authorities, the Northern Ireland Executive and the other bodies which are channelled into the Public Works Loan Board (PWLB) as their public lender.[[18]](#footnote-19)

* 1. At the moment the draft Bill does not set any restrictions on the types of debt product which can be accessed from commercial lenders.

Local Government and the Prudential Framework

4.5 Borrowing and capital expenditure in local government is controlled by the prudential framework. This encompasses primary legislation, underlying regulation in the form of a statutory instrument, a professional code of practice – CIPFA’s Prudential Code for Capital Finance in Local Authorities[[19]](#footnote-20) and the requirement for elected members to approve capital expenditure plans and associated borrowing and investment decisions.

4.6 The objectives of the Prudential Code are to ensure that:

* capital expenditure plans are affordable;
* external borrowing and other long term liabilities are within prudent and sustainable levels; and
* treasury management decisions are taken in accordance with good professional practice.

4.7 The code is supported by a suite of prescribed prudential indicators which are designed to allow the council to test the affordability and sustainability of the proposed debt and to be assured that treasury management decisions are in accordance with good practice. The prudential indicators are in the public domain and require to be approved by elected members as part of the plans for capital expenditure.

4.8 In submitting evidence to the Commission on Scottish Devolution[[20]](#footnote-21) and to the Scottish Parliament’s Scotland Bill Committee[[21]](#footnote-22) we recommended that a robust control mechanism was necessary to ensure effective Parliamentary scrutiny.

4.9 In its report on borrowing powers and innovative approaches to capital funding, the Assembly’s Finance Committee adopted the principles of the Prudential Code in their recommendation that:

*If the Welsh Government were granted borrowing powers, proposals for upper limits for its borrowing requirements, demonstrating affordability, sustainability and prudence, should be presented to the Assembly within the budget motion.[[22]](#footnote-23)*

4.10 This recommendation was accepted in principle by the Welsh Government:

*The Welsh Government accepts that borrowing should be affordable, sustainable and prudent, and that the Assembly should be able to exercise its oversight and scrutiny roles in relation to borrowing as it does with other financial activities of the Welsh Government through the budget process and other mechanisms.[[23]](#footnote-24)*

4.11 However, the draft Bill appears to contain no provision requiring that the Assembly have oversight of the Welsh Government’s borrowing powers by requiring approval or authorisation of their plans to borrow. Again, there is a requirement to report to the Assembly *ex ante*, however this does not allow the Assembly the appropriate consideration of the Welsh Government’s borrowing plans and whether these are affordable and sustainable in the long term.

4.12 The absence of a control framework from the draft Bill is an omission which requires further consideration. Without a prescribed control framework, scrutiny and control of borrowing and capital expenditure by the Assembly will be less effective.

Affordability of borrowing

4.13 The fundamental objective of affordability is to ensure that capital investment remains within sustainable limits and to consider the impact upon the budget and on local tax.

* 1. The ability of local government to fund the revenue consequences arising from lending comes principally from grant paid by the Welsh Government and from the power to raise local taxation in the form of council tax.
	2. The consequences of capital expenditure funded by borrowing are the repayment of the borrowing itself and the repayment of interest. Local government statute dictates that liabilities from external borrowing have ‘first call’ on revenues, before any other type of expenditure.
	3. The decision to undertake capital expenditure and subsequently pay interest and to repay external debt will represent a significant opportunity cost for the Welsh Government. Clearly, this will come at the expense of revenue expenditure on services. Unlike the clarity with the local government legislation, the draft Bill is not clear which income source the borrowing by the Welsh Government will be secured upon.

Need for capital investment

* 1. Borrowing is intended to fund capital investment and it is therefore essential that the need for borrowing is underpinned by a clear asset management strategy. Simplistically, asset management planning considers future service delivery need. That need then influences investment decisions which drive the need for borrowing. This can be contrasted with the practice under the previous control framework where the financial cap, rather than service need, dictated investment.
	2. The Prudential Code prescribes that, in making its capital investment decisions, the authority must have explicit regard to option appraisal, asset management planning, strategic planning for the authority and achievability of the forward plan.
	3. The prescription that investment decisions (and therefore borrowing decisions) must have explicit regard to asset management is not evident in the draft Bill.

Comparison with the *Scotland Act 2012*

4.20 The *Scotland Act 2012* gives the Scottish Ministers the power to borrow for capital investment, limited to 10% of the Scottish Government’s capital DEL each year within a statutory total of £2.2 billion.[[24]](#footnote-25) There appears to be no similar annual profile of borrowing set out for Wales in the draft Bill.

4.21 If the Welsh Government were given powers on the same basis as Scotland, i.e. 10% of the capital DEL in each year, then the limit on borrowing for the 2014-15 financial year would be around £142 million.[[25]](#footnote-26) Such an annual profile on borrowing could prevent the situation where the entire borrowing limit is utilised at an early stage.

4.22 The *Scotland Act 2012* also sets out that loans for capital purposes will generally be for a maximum of 10 years, with the option of this being extended in line with the life of the asset in question. The draft Bill appears to state no time limits on the life of the debt of the Welsh Government, thus providing no safeguard for debt extending far into the future and potentially creating a burden on future generations.

**Recommendations**

* 1. CIPFA recommends that:
* The draft Bill is modified to incorporate the requirement for a governance and control framework for borrowing, which clearly sets out the responsibilities of the Welsh Government and the Assembly. The framework could be based on CIPFA’s Prudential Code for Capital Finance in Local Authorities, but should ensure:
	+ a sufficient degree of Assembly time is applied to the annual scrutiny of government’s borrowing plans, with a particular consideration of the affordability and long term impact of the borrowing on future revenue budgets;
	+ the relative priority of debt repayment is clarified:
	+ it drives asset management planning and that any plans for borrowing presented to the Assembly should be accompanied by a transparent and robust asset management plan
* At the very least the draft Bill should be modified to incorporate:
	+ a requirement for the Assembly to approve or authorise the Welsh Government’s borrowing plans. This could be achieved by linking the spending, taxation and borrowing plans through the budget process (see section above).
	+ annual limits on capital borrowing and to set a time limit on borrowing for capital purposes similar to that provided for in the *Scotland Act 2012*.
1. Wales Office, [*Draft Wales Bill*](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/266782/Draft_Wales_Bill.pdf) [↑](#footnote-ref-2)
2. Commission on Devolution in Wales, [*Empowerment and Responsibility: Financial Powers to Strengthen Wales*](http://commissionondevolutioninwales.independent.gov.uk/files/2012/11/English-WEB-main-report.pdf), November 2012 [↑](#footnote-ref-3)
3. [Part 5](http://www.legislation.gov.uk/ukpga/2006/32/part/5) to the *Government of Wales Act 2006* [↑](#footnote-ref-4)
4. Commission on Devolution in Wales, [*Empowerment and Responsibility: Financial Powers to Strengthen Wales*](http://commissionondevolutioninwales.independent.gov.uk/files/2012/11/English-WEB-main-report.pdf), November 2012 [↑](#footnote-ref-5)
5. HM Government, [*Empowerment and Responsibility: devolving financial powers to Wales*](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/259359/empowerment_and_responsibility_181113.pdf), 18 November 2013 [↑](#footnote-ref-6)
6. Wales Office, [*Draft Wales Bill*](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/266782/Draft_Wales_Bill.pdf) [↑](#footnote-ref-7)
7. [Part 5](http://www.legislation.gov.uk/ukpga/2006/32/part/5) to the *Government of Wales Act 2006* [↑](#footnote-ref-8)
8. [Section 109](http://www.legislation.gov.uk/ukpga/2006/32/section/109) to the *Government of Wales Act 2006* [↑](#footnote-ref-9)
9. [Schedule 7](http://www.legislation.gov.uk/ukpga/2006/32/schedule/7) to the *Government of Wales Act 2006* [↑](#footnote-ref-10)
10. [Sections 125-128](http://www.legislation.gov.uk/ukpga/2006/32/part/5/crossheading/expenditure) to the *Government of Wales Act 2006* [↑](#footnote-ref-11)
11. [*Public Finance and Accountability (Scotland) Act 2000*](http://www.legislation.gov.uk/asp/2000/1/contents) [↑](#footnote-ref-12)
12. Scottish Parliament, Finance Committee, [*Implementation of the Scotland Act 2012*](http://www.scottish.parliament.uk/parliamentarybusiness/CurrentCommittees/49234.aspx). See particularly the paper on the [*Scottish Budget Process*](http://www.scottish.parliament.uk/S4_FinanceCommittee/Reports/Budget_Adviser_paper_on_budget_process.pdf) by the Committee’s Expert Adviser [↑](#footnote-ref-13)
13. A summary of the four types of deduction can be found in a paper presented to the Scottish Parliament’s Finance Committee in support of their consideration of the implementation of the Scotland Act 2012: Block ***grant adjustment mechanism in relation to the Scottish rate of Income Tax***: [*Submissions from Professor Gerald Holtham, Professor David Bell and the David Hume Institute*](http://www.scottish.parliament.uk/S4_FinanceCommittee/Scotland_Act_12.pdf) , April 2013 [↑](#footnote-ref-14)
14. Commission on Devolution in Wales, [*Empowerment and Responsibility: Financial Powers to Strengthen Wales*](http://commissionondevolutioninwales.independent.gov.uk/files/2012/11/English-WEB-main-report.pdf), November 2012 (Recommendations 3 and 4) [↑](#footnote-ref-15)
15. Commission on Devolution in Wales, [*Empowerment and Responsibility: Financial Powers to Strengthen Wales*](http://commissionondevolutioninwales.independent.gov.uk/files/2012/11/English-WEB-main-report.pdf), November 2012 (Recommendation 16) [↑](#footnote-ref-16)
16. Commission on Devolution in Wales, [*Empowerment and Responsibility: Financial Powers to Strengthen Wales*](http://commissionondevolutioninwales.independent.gov.uk/files/2012/11/English-WEB-main-report.pdf), November 2012 (Recommendation 11) [↑](#footnote-ref-17)
17. Wales Office, [*Draft Wales Bill*](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/266782/Draft_Wales_Bill.pdf) Impact Assessment [↑](#footnote-ref-18)
18. [↑](#footnote-ref-19)
19. 18 [CIPFA submission to Scottish Parliament Scotland Bill Committee](http://www.scottish.parliament.uk/S4_ScotlandBillCommittee/Inquiries/Chartered_Institute_of_Public_Finance_and_Accountancy.pdf), September 2011 CIPFA, The Prudential Code for Capital Finance in Local Authorities [↑](#footnote-ref-20)
20. [CIPFA submission to the Commission on Scottish Devolution](http://www.google.co.uk/url?sa=t&rct=j&q=&esrc=s&source=web&cd=2&cad=rja&ved=0CDcQFjAB&url=http%3A%2F%2Fwww.cipfa.org%2F-%2Fmedia%2Ffiles%2Fpolicy%2520and%2520guidance%2Fresponses%2520to%2520consultations%2Fscottish_devolution_submission_20080908.pdf&ei=_-), 2008. [↑](#footnote-ref-21)
21. [CIPFA submission to Scottish Parliament Scotland Bill Committee](http://www.scottish.parliament.uk/S4_ScotlandBillCommittee/Inquiries/Chartered_Institute_of_Public_Finance_and_Accountancy.pdf), September 2011 [↑](#footnote-ref-22)
22. National Assembly for Wales, Finance Committee, [Borrowing powers and innovative approaches to capital funding](http://www.senedd.assemblywales.org/documents/s8907/Borrowing%20powers%20and%20innovative%20approaches%20to%20capital%20funding%20-%20Report%20-%20July%202012.pdf), July 2012 [↑](#footnote-ref-23)
23. [Welsh Government Response to Finance Committee Report, Borrowing Powers and innovative approaches to capital finance](http://www.senedd.assemblywales.org/documents/s10049/%20Welsh%20Government%20response.pdf), August 2012 [↑](#footnote-ref-24)
24. [*Scotland Act 2012*](http://www.legislation.gov.uk/ukpga/2012/11/contents) [↑](#footnote-ref-25)
25. Based on a capital DEL budget of £1.42 billion as detailed in the Welsh Government’s [Final Budget 2014-15](http://wales.gov.uk/funding/budget/final-budget-2014-2015/?lang=en), December 2013. [↑](#footnote-ref-26)