

Funding reform: joint statement of progress

Introduction

The UK Government and Welsh Government have jointly agreed the next steps following inter-governmental talks on funding reform. These cover devolved funding, borrowing powers and wider reform.

Devolved funding

The Welsh Government strongly believes that there is no case for further convergence in Welsh relative funding. The UK Government recognises that there has been convergence in Welsh relative funding since the start of devolution, and that this is a significant concern in Wales.

Both Governments accept that, on the basis of present UK Government spending plans, there is unlikely to be further convergence over the current budgetary planning horizon. A small amount of divergence is likely to occur over the remainder of this spending review period, but the overall trend of convergence is very likely to reassert itself once spending starts to increase.

In future, in advance of each spending review there will be a joint review of the pattern of convergence by the two Governments. If convergence is forecast to occur over the course of the spending review period, both Governments will then enter into discussions on options to address the issue, based on a shared understanding of all the evidence available at that time.

Both Governments commit to negotiating to achieve a sustainable arrangement for Welsh devolved funding and the UK public finances, that each can accept as being fair and affordable.

The Welsh Government believes that a mutually acceptable outcome to those discussions is an essential precondition for any significant devolution of taxes and the UK Government will only implement such changes with the consent of the National Assembly for Wales.

Borrowing powers

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.

Both Governments agree that any borrowing powers should operate within the UK Government's responsibility for delivering its fiscal mandate.

Wider reform

The Silk Commission is currently considering the case for devolving additional fiscal powers to Wales, including the options for the devolution of certain tax-varying powers.

Both Governments commit to giving the Commission's proposals serious consideration, with a view to agreeing jointly a package of reforms that delivers fair and accountable funding for Wales and that commands a broad consensus.

Intergovernmental talks on funding reform: Technical annex agreed jointly by the UK Government and Welsh Government

Introduction

1. This paper provides technical information that supports the joint statement on funding reform that has been agreed jointly by the UK Government and Welsh Government.

Convergence and the Barnett formula

2. In spending areas that are fully devolved, an increase in spending per head in England leads to an equivalent per head cash increase to the Welsh block grant. Since block grant-funded spending per head in Wales is currently above the English average, this means that in percentage terms the increase to the block grant in Wales is less than the increase in England.
3. When public spending in England on functions devolved to Wales is increasing in cash terms, and holding other factors constant (see para. 5), the Barnett formula causes relative per capita funding of devolved public services in Wales to converge on the average per capita level for England.
4. When public spending in England on functions devolved to Wales is decreasing in cash terms, and holding other factors constant, the Barnett formula causes relative per capita funding of devolved public services in Wales to diverge from the all-England average.

Factors that influence convergence

5. The factors that influence the rate of convergence are:
 - **Changes in relative population:** if the Welsh population increases relative to England, the rate of convergence increases. If the Welsh population decreases relative to England, the rate of convergence decreases.
 - **Spending growth:** higher spending growth increases the rate of convergence. Lower spending growth reduces the rate of convergence. This nominal spending growth may be driven by real changes in expenditure or by inflation. Cash decreases in spending causes divergence.

- **Reprofiling:** if the Welsh Government or a UK Government spending department changes the profile of spending subsequent to a spending review exercise, relative funding levels will be temporarily affected, but there is no long-term impact on the trajectory of convergence. Over the last decade, such reprofiling resulted from the build up and draw down of End-Year Flexibility amounts by individual departments.

Historic convergence: 1999 - present

6. Convergence in Welsh relative funding occurred from 1999-00 to 2009-10 (see chart).
7. The factors listed at para.5 influenced the pattern of convergence during the period 1999-2011 in the following ways:
 - **Changes in relative population:** The Welsh population share declined over this time period from 5.9 to 5.8 per cent, and somewhat reduced the rate of convergence compared to what would have happened if population relativities had remained constant.
 - **Spending growth:** Spending consistently increased over the last decade, causing steady convergence through most of the period.
 - **Re-profiling:** The different forms of re-profiling have led to localised peaks and troughs in the pattern of relative spending since devolution against the overall background of convergence.

Modelling future convergence

8. It is impossible to forecast with certainty the future trajectory of relative funding, given uncertainty over future population relativities and future levels of funding.
9. The main factors influencing the rate of future convergence are changes in spending on devolved activities and movements in relative population.
10. Based on plans for the current spending review period and the population projections published by the Office for National Statistics, there is likely to be a small amount of divergence in relative funding over the period to 2014-15. Department-level budgets have not been decided beyond 2014-15.

Wales' relative expenditure per head on programmes covered by the Barnett formula (England=100)

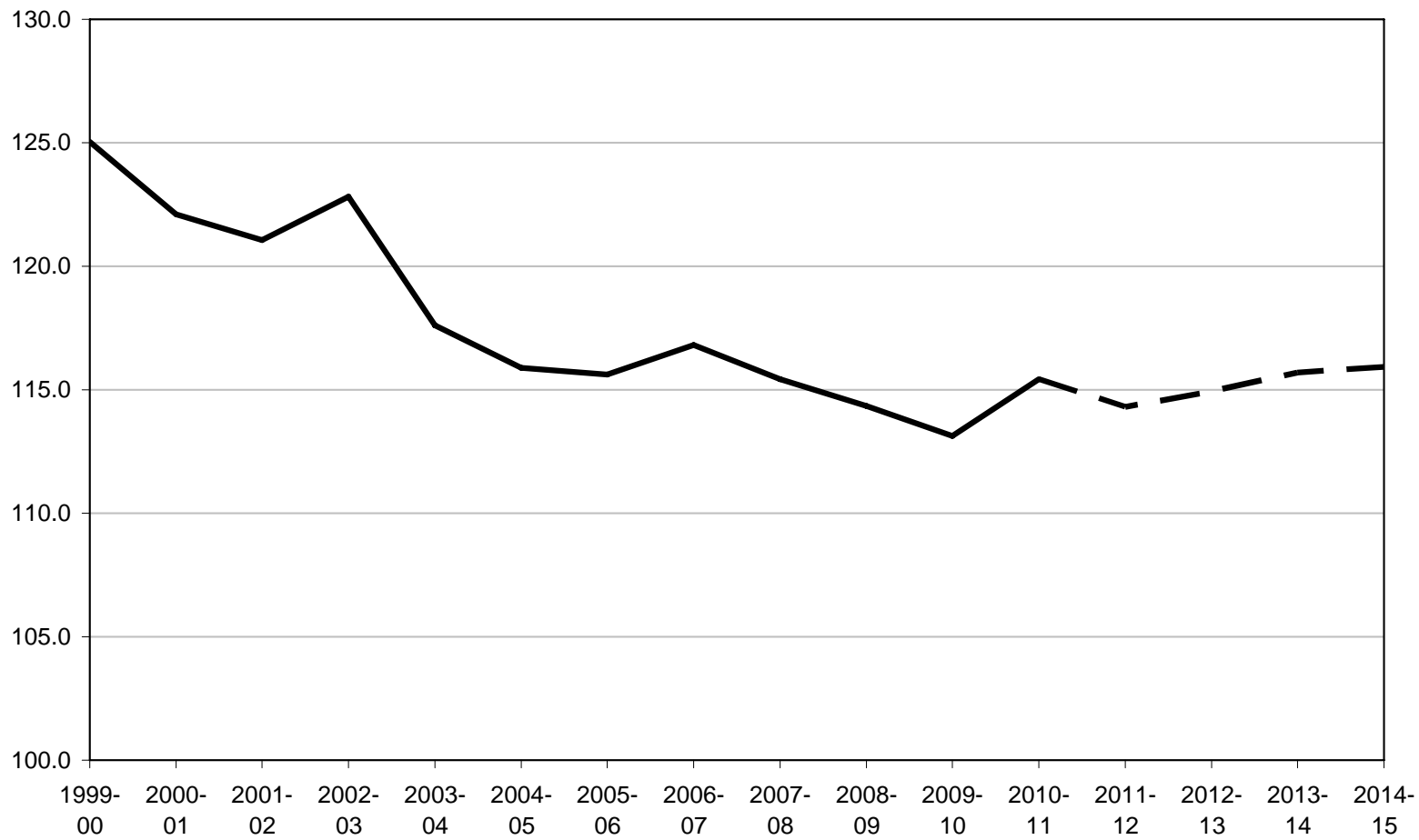


Table of Wales' relative expenditure per head on programmes covered by the Barnett formula (England = 100)

Historic

1999-00	125.0
2000-01	122.1
2001-02	121.1
2002-03	122.8
2003-04	117.6
2004-05	115.9
2005-06	115.6
2006-07	116.8
2007-08	115.4
2008-09	114.3
2009-10	113.1
2010-11	115.4

2010 Spending Review period

2011-12	114.3
2012-13	114.9
2013-14	115.7
2014-15	115.9

Methodological note: derivation of relative expenditure figures

11. The table on the previous page shows the relative funding position in Wales in each year since devolution. This note sets out the methodology behind these figures and the assumptions made to generate the estimates for the current spending review period. (The expenditure and population data used here are those available at the time the evidence was discussed and agreed in the intergovernmental talks.)

Relative funding since devolution

12. Expenditure in Wales covered by the Barnett formula is defined as the total Wales Departmental Expenditure Limit (DEL). Comparable spending in England was calculated by applying the comparability factors published in the Statement of Funding Policy to the Departmental Expenditure Limits of each UK Government department. The expenditure figures are taken from *Public Expenditure Statistical Analyses* (PESA). Funding per head was calculated by dividing the expenditure figures by the mid-year population estimates published by the Office for National Statistics (ONS). These were updated using the indicative estimates published by the ONS in October 2011, taking account of the new migration allocation methodology.
13. The latest set of comparability factors was published in the Statement of Funding Policy accompanying the 2010 Spending Review. These factors were applied to the DELs published in PESA 2011, providing estimates of comparable spending back to 2005-06. Estimates for earlier years were derived from earlier editions of PESA. For each edition of PESA the most recent comparability factors available at the time were used. There is a substantial overlap in the years covered by successive editions of PESA. To compile time series going back before 2005-06, the most recent available estimate for each year was used. The overlap period was used to adjust data from earlier editions to allow for classification changes between PESA editions.

Relative funding over the 2010 Spending Review Period

14. The same methodology as above was used to produce the relative funding figures for 2011-12 to 2014-15. The expenditure figures were taken from PESA 2011 adjusted to include the additional allocations announced in the 2011 Autumn Statement. The population denominators used to produce the per head estimates were the 2010-based projections published by the Office for National Statistics.