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Llywodraeth Cymru
Welsh Government

Eich cyf/Your ref
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Jocelyn Davies AM,
Chair, Finance Committee,
The National Assembly for Wales,
Cardiff Bay,
Cardiff
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25 June 2013

Dear Jocelyn,

I am writing to provide you with a short note on a number of technical issues associated with the Spending Round, in advance of the UK Government's announcement tomorrow.

Welsh Government Baseline

Firstly, I thought it would be helpful for me to provide some clarity on the approach used by HM Treasury to define the Wales DEL baseline in advance of a Spending Review. The baseline used by HM Treasury to calculate changes is not the same as the budget we have available to use in 2014-15. In preparing for a Spending Review, HM Treasury makes adjustments to our baseline to remove additions over the previous Spending Review period, which are deemed to be non-recurrent.

For example, in terms of tomorrow's Spending Round, this means that the additional capital received over the current Spending Review has been removed from the baseline. As a result, whilst any additional capital announced for 2015-16 would in effect be in addition to the Wales Capital DEL baseline, it would not necessarily increase our available budget in comparison to the available budget in 2014-15. Conversely, we are expecting the reductions to our Resource DEL, which have been announced in successive Autumn Statements and Budgets since 2010, to be treated as recurrent reductions and form part of the baseline.

I attach a short technical note explaining these movements in more detail at Annex 1.

Barnett Formula

Having established the baseline, the Spending Round will announce any changes to reflect decisions made in relation to UK Departments. For each Department, the Barnett Formula will calculate a consequential that can be positive or negative. These consequentials are individually calculated on the basis of an assessment of comparability and a population proportion. These individual consequentials are summed to arrive at a net adjustment to the Welsh baseline.

Financial Transactions

In recent Budgets, the UK Government has made capital allocations known as Financial Transactions. These are not traditional capital grants and have some significant restrictions attached. Financial Transactions can only be used for loans and equity and a proportion of the funding will have to be repaid to the Exchequer.

In total, we received additional capital of £63.2m in 2013-14 and £97.6m in 2014-15 in the UK Government's March Budget. Of this, £62.8m in 2013-14 and £90.7m in 2014-15 was earmarked for Financial Transactions. Work is underway to consider how we can best utilise the funding for financial transactions and I hope to make further announcements on this in the Draft Budget 2014-15.

In the meantime, there could be further capital consequentials, earmarked for Financial Transactions in the Spending Round tomorrow. Again, we will need to consider carefully how we use this funding effectively.

Convergence

Last October, the Welsh Government and UK Government issued a joint statement of progress on funding reform. That statement included, for the first time, recognition by the UK Government that there had been convergence in Welsh relative funding since the start of devolution. It also contained a commitment that, in advance of future spending reviews, there would be a joint review of the pattern of convergence by the two Governments. If convergence was forecast to occur over the course of the spending review period, both Governments would then enter into discussions on the options to address the issue.

I am pleased to confirm that a joint review has been undertaken in preparation for this Spending Round, and I will provide further detail on the outcome of this work later in the week.

I hope this is helpful in advance of tomorrow's Spending Round.

Best wishes,

Jane

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Wales 2014-15 Budget and Baseline for the UK Government's Spending Round 2013

1. The UK Government is due to announce the outcome of its Spending Round exercise, setting out the resource and capital Departmental Expenditure Limits (DELs) for UK Government Departments and for the Devolved Administrations for 2015-16 on 26 June.

2. The Spending Round documentation will include comparisons to show how the 2015-16 budgets relate to a baseline level of expenditure. It is important to note that the baseline is not the same as the DEL for the previous financial year, 2014-15. As a result, the change from baseline, in cash or percentage terms, is not the same as the year-on-year change in expenditure.

3. The table below compares the Wales budget for 2014-15 with the Wales baseline for the Spending Round. The Resource DEL baseline is £50 million or 0.4 per cent lower than the 2014-15 budget, while the Capital DEL baseline is £325 million or 23 per cent lower than the budget.

Wales 2014-15 Budget and baseline for 2015-16 Spending Round (£ million)

	2014-15 Budget	Baseline for 2015-16 Spending Round	Difference between baseline and 2014-15 budget
Fiscal Resource Departmental Expenditure Limit (DEL)	13,690	13,640	-50
Ring-fenced non-cash items	506	506	0
Total Resource DEL	14,196	14,146	-50
Capital DEL	1,431	1,106	-325
Total DEL (excluding non-cash items)	15,121	14,746	-375

4. The baselines are lower than the actual DELs for 2014-15 because increases announced since the 2010 Spending Review, particularly to capital DELs, have been treated as time-limited and have been removed for the next spending round period. (By contrast, reductions to resource DELs, which have been announced in successive Autumn Statements and Budgets since 2010, have been treated as recurrent reductions and therefore maintained in the baseline.)

5. As a result of the above, any reductions from baseline announced in the Spending Round will be smaller and any increases will be bigger than the actual year-on-year changes in expenditure that the 2015-16 settlement will represent, particularly in relation to capital. For example, a Wales capital DEL in 2015-16 of £1,300 million would be around £200 million or 18 per cent higher than baseline, but over £100 million or 9 per cent lower than the 2014-15 budget.