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Date: 05/06/20

## **Submission: Minimising and managing uncertainty with the devolved administrations during COVID-19**

### **For decision**

#### **Issue**

How to help the devolved administrations (DAs) minimise and manage the level of uncertainty in their funding from UKG ahead of Supps 2020-21.

#### **Timing**

Decision needed as soon as possible to inform our approach to potential FMQ meetings.

#### **Summary**

You have discussed at FMQs how UKG can help the DAs minimise and manage the level of uncertainty in their funding, ahead of Supps 2020-21. Our starting position has been to minimise the uncertainty they face so that they can manage this with their existing flexibilities. The DAs have publicly called for additional flexibilities (more borrowing/Reserve drawdown and CDEL-RDEL switches) but any changes should be carefully weighed against the fiscal and political risks they create for UKG. This advice sets out the two broad options that you could take of sticking to the status quo – or offering the DAs a funding guarantee and/or some more flexibilities.

#### **Recommendation**

1. We remain attracted to the status quo but judge that this is unlikely to hold, so we recommend you:

- a. Write to the DAs asking for information about their budgets and spending pressures similar to the financial information depts are providing as part of the acceleration/reprioritisation exercise; and how DA flexibilities impact UK fiscal aggregates, to help manage DA expectations about increased flexibilities.
- b. Give your steers/ red lines on the possible levers set out below, so we can develop options if we need to provide DAs with increased flexibilities.

### Introduction

1. While UKG depts and DAs were provided with substantial Covid-19 funding uplifts at Main Estimates (including c£6bn for the DAs), funding for 2020-21 will only be confirmed at Supps 2020-21. This is standard practice, but it creates significant challenges for the DAs this year for three reasons:
  - a. response to Covid-19 - DAs are having to proceed at risk when authorising large-scale but essential health and social care expenditure. We are aware of tens of billions of pressures from DHSC that are yet to be Barnetted. The longer the lag between UKG communicating its spending plans, the harder it is for us and the DAs to gauge whether their spending plans are roughly commensurate. This leaves risks for them if they overspend, and for us if they have held back spending relative to England because we did not give them sufficient comfort early enough; and
  - b. allocation - stakeholders in SW&NI are pressing for full allocation of Covid-19 Barnett consequentials, to match the response in England. The uncertainty about whether and by how much some estimated consequentials will reduce makes it difficult for the DAs to judge the level of financial risk presented by allocating in full; and
  - c. reprioritisation – like us, the DAs are undertaking reprioritisation exercises, but with unclear targets for how much they are likely to need to do so. The options for DAs to reprioritise at scale in Q3 or Q4, when Supps results are through, will be much more restricted.

2. The DAs are interested in increasing the flexibilities they have for two reasons, the tools for both of these are essentially the same but this advice only focuses on the first reason:
  - a. To be able to manage the level of uncertainty in the funding they are going to receive from UKG so they are able to plan better and not be left out of pocket, and respond in a timely manner.
  - b. Being able to deliver the response to Covid-19 they feel is necessary, including where they want to provide a more generous response than Barnett allows them to do, which they are currently constrained by doing with their current flexibilities they have. While you may want to consider above-Barnett funding later in the year (e.g. if Covid-19 hits SW&NI economies disproportionately hard) we do not think you would want to devolve further elements of fiscal policy.

### **Context**

3. The WG and NIE have said that they are stopping any new discretionary spending without further confirmation from UKG of funding.
4. There have also been increasing public calls by the DAs for further flexibility, most notably by SG and WG in their revised/supplementary budgets.
5. Before considering further flexibilities you should be aware that the SG and WG already benefit from a degree of double-funding, in as much as they get a (generous) share of UKG borrowing through the Barnett formula and their own borrowing on top. Any additional DA borrowing (or drawdown from their own Reserves) also means less funding for England within any fixed spending envelope.
6. Also, while the SG/WG signed up to their current fiscal frameworks, they were pressing for further flexibilities even before Covid-19. In the case of the SG we were already in the process of considering whether they had a legitimate case for needing greater flex given the impact of income tax forecast errors (c£200m this year and potentially as much as £500m next year). The SG will likely raise again as part of this work even though we've tried to frame narrowly as managing Barnett uncertainty in 2020-21.

7. Looking slightly further ahead, we are also due to renegotiate the SG's fiscal framework over the next two years (with a jointly commissioned independent report due by end 2021 and an HMT/SG renegotiation due by end 2022) so they will seek to bank any changes we make now as the starting point for the review. The WG's fiscal framework may also be triggered for review at the upcoming SR (if their funding falls below an agreed level relative to England) while the NIE are increasingly keen to discuss increased flexibilities through their own fiscal framework.

### How to proceed

8. There are two broad options for how to proceed with the DAs:
9. Stick to the status quo – use information sharing and regular updates to give our best assessment of final levels of 2020-21 funding such that the uncertainty can be minimised to a point whereby it can be managed within the DAs current flexibilities.
  - a. This is our current approach and is working to some extent at the moment. I.e. it has enabled the DAs to respond to the immediate health and business support pressures. It also protects HMT interests in not moving away from the current funding agreements and not increasing fiscal risks.
  - b. However, the DAs have publicly criticised UKG for not giving them more certainty, we are conscious that there is a lot of uncertainty in dept numbers that could increase DA funding significantly, and politically it is difficult to ignore the DA calls for further flex.
10. Go beyond current funding arrangement by either giving the DAs a block grant funding guarantee and/or more flex – there are 5 main levers that you could use to do this as set out in Table 1 below. In order of our emerging preference the levers are:
  - a. **CDEL to RDEL switches** – currently requires HMT approval and only in exceptional circumstances. In practice it is equivalent to a surrender of a CDEL underspend and an RDEL Reserve Claim, which has implications for current budget/capital targets. UKG depts have been told you won't entertain CDEL-RDEL switches this year and will treat as a CDEL surrender and RDEL Reserve Claim.

- b. **Provide a guaranteed level of Barnett-based block grant funding for 20-21** – this could be set at the level of their combined c£6bn Mains funding / the latest position of over £7bn for all three DAs / or HMT shares a figure incrementally through the year that we're confident won't go down. This gives the DAs certainty over their funding position, but could mean HMT plugging a gap in 20-21 from the UKG Reserve (thereby increasing PSNB/PSND) if Barnett consequential end up being lower than what we've guaranteed (which you would need to decide whether to recover from the DAs in future years).
  - c. **Increase to Reserve drawdown for SG and WG, and Budget Exchange limits for NIE** – politically it is hard to reject a request for SG and WG to access their own funding but this will hit PSND/PSNB and it will be hard to make this a one-off change.
  - d. **Increase to capital borrowing limits** – the annual limits can be increased without legislation, but would hit PSND/PSNB when the DAs spent what they have borrowed. However, this combined with CDEL-RDEL switches could give the DAs the outcome they desire of additional RDEL flex.
  - e. **Increase the scope of resource borrowing powers** – this is the flexibility the DAs are most in favour of but would hit PSNB/PSND and is the most difficult long term for HMT. It would also require primary legislation as DAs can currently only borrow resource if they repay in-year, not across years, or (for the SG/WG) to cover tax/welfare forecast errors.
11. These all therefore come with risks to HMT:
- fiscal risks - an increase to PSNB/PSND in 20-21 and possibly beyond.
  - political risk - that this sets the new baseline for future negotiations e.g. WG and SG fiscal framework reviews and would be hard to unwind post Covid-19.
12. There are various combinations that you could pursue, and it is likely that each of the DAs would want a different combination.

### **Next steps / approach with the DAs**

13. We have been discussing at official level what data DAs can share to give you a better understanding of their budget pressures. We will

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draft a letter for you to send formalising this request for further information.

We will then assess this against the DAs' expected Barnett-based funding (using latest information from UKG depts), and see a) if we think the DAs need more flex and b) if so, what that this flex could look like. This will inform a paper for you to table at the next FMQ.

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**Table 1 - Levers to minimise and/or manage uncertainty**

	<b>Current position</b>	<b>Risks / gains</b>	<b>DA position</b>
<b>CDEL to RDEL switches</b>	With HMT approval in exceptional circumstances	<ul style="list-style-type: none"> <li>• Economic risk</li> <li>• Fiscally neutral (but has implications for current budget/capital targets)</li> <li>• Could undermine line with UKG depts</li> </ul>	<ul style="list-style-type: none"> <li>• Doesn't reduce uncertainty</li> <li>• Doesn't increase spending power</li> <li>• Increases flex to manage uncertainty</li> </ul>
<b>Provide a guaranteed level of Barnett-based block grant funding for 20-21</b>	Barnett applied to new DEL funding. Confirmed at Supps.	<ul style="list-style-type: none"> <li>• Call on the UKG Reserve</li> <li>• Undermines Barnett</li> </ul>	<ul style="list-style-type: none"> <li>• Gives certainty</li> <li>• Doesn't increase flex</li> </ul>
<b>Increase to Reserve drawdown (and Budget Exchange limits for NIE)</b>	SG: £250m RDEL WG: £125m RDEL NIE: 0.6% of RDEL budget	<ul style="list-style-type: none"> <li>• Fiscal risk</li> <li>• Precedent – lead to political calls that this becomes permanent</li> <li>• Undermines WG and SG fiscal frameworks</li> <li>• DAs don't need to wait for UKG to spend</li> </ul>	<ul style="list-style-type: none"> <li>• Doesn't reduce uncertainty</li> <li>• Increases flex to manage uncertainty</li> </ul>
<b>Increase to capital borrowing limits</b>	SG: £450m pa WG: £150m pa NIE: £200m pa	<ul style="list-style-type: none"> <li>• Fiscal risk (call on UKG Reserve)</li> <li>• Precedent – lead to political calls that this becomes permanent</li> <li>• Undermines WG and SG fiscal frameworks</li> <li>• Fairness to England</li> <li>• DAs don't need to wait for UKG to spend</li> </ul>	
<b>Increase the scope of resource borrowing powers</b>	Only for tax/welfare forecast error: SG: £300m pa WG: £150m pa		

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