

Jane Hutt AC / AM  
Y Gweinidog Cyllid a Busnes y Llywodraeth  
Minister for Finance and Government Business



Llywodraeth Cymru  
Welsh Government

Jocelyn Davies AM  
Chair, Finance Committee  
National Assembly for Wales  
Cardiff Bay  
Cardiff  
CF99 1NA

16 March 2016

*Dear Jocelyn,*

I am writing in response to the Finance Committee's report 'Future Funding for Wales', which was published yesterday.

The report is a welcome addition to the body of work that reviews and assesses how the funding of devolved public services in Wales continues to evolve, and provides thoughtful consideration of how the challenges could best be tackled.

I accept all the recommendations in the report. More detailed commentary is enclosed.

You will recognise that progressing many of the recommendations will require both the agreement of the UK Government and its active engagement. That will involve a significant change in attitude on the part of UK Government Ministers. Despite repeated requests, I have been unable to secure a meeting with the Chief Secretary to the Treasury recently to discuss the development of a fiscal framework for Wales. The UK Government has failed to arrange a Quadrilateral meeting of Finance Ministers since November 2013, and I am still waiting for the second meeting of the Joint Exchequer Committee, which was expected in Spring 2015. I note that the Chief Secretary to the Treasury was also unable to provide evidence to the Finance Committee to assist its inquiry.

There is an emerging pattern here. However I would expect the next Welsh Government to continue to play its part by taking forward the funding reform programme for Wales which will help to deliver key recommendations in your report, and by pressing the UK Government to deliver a fair fiscal framework for Wales.

*Best wishes,*

*Jane*

**Jane Hutt AC / AM**  
Y Gweinidog Cyllid a Busnes y Llywodraeth  
Minister for Finance and Government Business

Bae Caerdydd • Cardiff Bay  
Caerdydd • Cardiff  
CF99 1NA

*Wedi'i argraffu ar bapur wedi'i ailgylchu (100%)*

English Enquiry Line 0845 010 3300  
Llinell Ymholiadau Cymraeg 0845 010 4400  
Correspondence: Jane.Hutt@wales.gsi.gov.uk

*Printed on 100% recycled paper*

**Welsh Government response to the recommendations in the Finance Committee's report 'Future Funding for Wales' (March 2016)**

**Recommendation 1.** *The Committee recommends that the Welsh Government further considers creating an independent body is created to advise on a transparent system for the allocation of funding to the devolved governments, including independent assessment of how expenditure decisions for England feed into block grants.*

**Recommendation 2.** *The Committee recommends that the Welsh Government works with the UK Government to increase co-ordination and provision for discussion regarding funding arrangements among the devolved governments and with Westminster. The Committee believes these intergovernmental relations must be transparent and subject to scrutiny with a means for arbitrating and resolving disputes.*

**Recommendation 3.** *The Committee recommends that the Welsh Government works with the UK Government and the other devolved governments to ensure that changes to the Statement of Funding Policy should be agreed between the UK Government and devolved administrations wherever possible and transparently recorded.*

I accept the Committee's recommendations, although implementation is dependant on the UK Government. The Welsh Government would very much welcome a more transparent approach by the UK Government to funding devolved government, including an independent body to assess allocations, better scrutiny and an improved dispute mechanism.

These improvements should be reflected in a new Fiscal Framework for Wales that must be agreed by both governments. I would see the Statement of Funding Policy being limited to the mechanics of the Barnett formula, including the comparability factors, with the financial arrangements for each of the Devolved Administrations being set out in separate fiscal frameworks.

I was pleased to see that the Scottish Fiscal Framework, agreed recently by the Scottish and UK Governments, has an independent review process built in. This will assess the Block Grant Adjustments for Scotland before the end of 2021, and should ensure that they are calculated and applied fairly. There is also the provision for the independent arbitration of disputes between the Scottish and UK Government. I expect the same degree of independence to apply to a Welsh Fiscal Framework.

**Recommendation 4.** *The Independent Commission on Finance and Funding for Wales has shown that it is possible to generate a simple needs-based formula to replace Barnett that also retains a high degree of completeness, as such the Committee recommends that funding arrangements for Wales should be based on a formula reflecting relative needs.*

**Recommendation 5.** *Whilst recognising the necessity of a needs-based formula, should this not happen imminently, the Committee firmly believes that strengthening the commitment to a funding floor is necessary, with a secure undertaking that it will continue after the end of this UK Parliament. Furthermore, the Committee recommends that the distribution process for the block grant should have a firm statutory basis and not be a matter of ministerial discretion.*

The Welsh Government has long argued that the Barnett formula should be replaced with a needs-based formula. The Holtham Commission and a House of Lords Select Committee have shown how this could be delivered simply and fairly.

In the meantime, the Welsh Government has sought the introduction of a 'floor' to address Wales' long term funding concerns, and to prevent Barnett convergence from underfunding our devolved public services when spending again begins to grow. The temporary floor announced in the Spending Review and Autumn Statement 2015, within the relative funding range recommended by the Holtham Commission, is a step forward but, as the Committee has recognised, it falls far short of delivering long term assurance against the threat that the Barnett formula continues to hold over Wales. The Welsh Government continues to call on the UK Government to outline the details of a long term funding floor that addresses the issue of fair funding.

***Recommendation 6.*** *The Committee recommends that as a minimum, there must be a principled decision taken on how the block grant will be reduced before taxes are devolved. There is a need for a quasi-automatic procedure that is fair and allocates risk and responsibility appropriately.*

***Recommendation 7.*** *The Committee firmly believes the relationship between the UK Government and Welsh Government needs to improve. The Committee recommends that the Welsh Government works with the Chief Secretary to the Treasury to ensure more frequent meetings and the Chief Secretary should reconsider a UK Fiscal Framework, which provides a fundamental statement of funding policy for the devolved administrations and their fiscal arrangements.*

Recommendation 6 is of paramount importance. There are a range of possible approaches to how the Welsh Block Grant could be reduced in exchange for the tax revenue that will flow to Wales following tax devolution. While it will be difficult to capture all of the complex effects and interactions that could be considered, it is clear that some of the models mooted by the UK Government during negotiations on the Scottish fiscal framework would, if applied to Wales, have a grossly unfair impact on future Welsh funding. That was not the basis upon which it was agreed to devolve Stamp Duty Land Tax and Landfill Tax to Wales.

I have made clear to the UK Government that a Welsh fiscal framework needs to be agreed in advance of fiscal devolution. This should be founded on principles, in particular it should be sustainable to adapt to future decisions on tax devolution and should ensure there is no budgetary detriment to Wales simply as a result of devolving the powers. However the agreement must go further, specifying precisely and transparently how the Welsh Block Grant would be affected, and how the procedure would be independently assessed to ensure that it remains fair and fit for purpose.

The Welsh fiscal framework should reflect Wales' own responsibilities and circumstances, and it would seem sensible for this to form part of an overarching UK fiscal framework. I have written to the Chief Secretary to the Treasury on numerous occasions stressing the need to agree a fiscal framework for the Welsh Government. I continue to request meetings and would welcome more frequent meetings with the Chief Secretary to the Treasury to discuss the operation of the fiscal framework.

***Recommendation 8.*** *The Committee believes there is a need for greater end-year flexibility. The Committee recommends that once funds have been devolved to Wales,*

*they should not be returned to Treasury if unspent at the end of the financial year. The Welsh Government should have the ability to retain surpluses and build up reserves.*

I have pressed consistently for a more flexible approach to end-year budgetary arrangements. Now that the Welsh Government has a Cash Reserve in place, for future use to help manage cash-flow following tax devolution, the case is stronger than ever. The ability to retain unspent resources and manage these alongside uncertain tax revenues would be a natural next step, in keeping with our greater financial responsibility.

***Recommendation 9.*** *In regard to the Welsh Government's stated intention to develop a "Welsh Treasury" the Committee considers that there is a need for greater clarity and explicitness about what that entails and recommends the Welsh Government provide this clarity. It is not simply a matter of extra staffing and technical expertise. Since government resources in future will come partly from tax revenues and borrowing, policies for these elements will have to be determined at Cabinet level and administered by the Welsh Treasury. The UK Treasury has a leading role in advising on the setting of budgets and co-ordinating expenditure decisions across all departments. The Welsh Treasury will surely have to act similarly, implying a stronger role than the Finance Department has had historically.*

I would expect the Welsh Treasury I have established to continue to evolve to ensure it has the appropriate role within the Welsh Government and the capability needed to manage Welsh fiscal matters efficiently and effectively.

***Recommendation 10.*** *The Committee recommends that the Welsh Government works with the UK Government to review the rules in relation to introducing new taxes in Wales, to ensure the process is less onerous enabling the Welsh Government to effectively introduce new taxes.*

The ability to design new taxes is a potentially useful area for future policy development, whether primarily directed at changing behaviour or raising revenue. However any proposal for a new tax would require very careful consideration, especially when so many are struggling with the cost of living.

I would welcome a simpler process for creating new devolved Welsh taxes - one that places more control with the Welsh Government and the Assembly, rather than with the UK Government and Parliament, but that would not lessen our responsibility to assess the immediate and wider impacts of any proposal thoroughly and sensibly.

***Recommendation 11.*** *The Committee believes the Welsh Government will need to forecast devolved tax revenues, including national non-domestic rates and the implications of the Block Grant adjustment, in order to inform their budgetary plans. The Committee recommends that the Welsh Government works to ensure these forecasts are high quality, transparent and in the public domain. The Welsh Government should consider whether it has the resources available to achieve this at the necessary standard.*

The Welsh Government will need to generate a forecast of tax revenues from the two new devolved taxes - Landfill Disposals Tax and Land Transaction Tax - from 2018-19. The first forecast will be included with the draft budget in Autumn 2017, and will comprise a forecast for the year ahead and indicative estimates for future years.

The Welsh Government has the advantage of some expertise already in place on this. Following the work of the Holtham Commission, Ministers took the decision to retain the team that had supported the Commission in order to lead on the work that led to the joint statement of funding reform, and to advise on the first Silk report and the Wales Bill.

The forecasting model which the Welsh Government is developing for Land Transaction Tax adopts a similar approach to those of the Office for Budget Responsibility (OBR) and Scottish Government. That for Landfill Disposals Tax has some features similar to those of both the OBR and Scottish Government models.

***Recommendation 12.*** *Following on from a previous report, the Committee again recommends that a Welsh Fiscal Commission is set up to provide independent assessment of Welsh Government tax forecasts and assumptions.*

Independent scrutiny of tax forecasts will be an important element of future budgetary arrangements. The decision on whether this role should be carried out by a Welsh Fiscal Commission will rest with a future Welsh Government. In the meantime, the Welsh Treasury has developed a good working relationship with the Office for Budget Responsibility.

***Recommendation 13.*** *The Committee notes that council tax and nondomestic rates raise over £2.5 billion a year. The Welsh Government has had a number of inquiries into non-domestic rates and the Committee believes there is a need for clarity going forward given these previous inquiries. The Committee will be recommending in its legacy report that the next Committee with responsibility for financial matters undertakes an inquiry into how valuations are kept up to date and what reforms should be considered to council tax.*

Local taxes represent an important source of revenue in Wales, providing vital resources to help finance public services and ensuring there is local accountability in key decisions about the prioritisation of funding. I am sure that a future Welsh Government would value input from the relevant Assembly Committee on policy and administrative matters relating to those taxes as a contribution to considerations about how the local funding system as a whole might be developed to provide a sustainable basis for funding local services in the future.

***Recommendation 14.*** *The Committee notes the lack of published data on economic performance and tax revenues collected in Wales. The Committee recommends that information collected and published in Wales should be at least as detailed and as frequent as those that are currently produced in Scotland.*

The Welsh Government and the Office for National Statistics (ONS) both publish a wide range of indicators relating to the Welsh economy. In addition, statistics on UK and local taxes are published by HM Revenue and Customs and the Welsh Government respectively. However there is always scope to improve the range, timeliness and frequency of statistical information. The ONS has plans to improve the scope and frequency of economic statistics for the UK Countries and English regions over the next few years and is also consulting on the possible development of public finance statistics at the same level of geography. Together with the Welsh Revenue Authority, a future Welsh Government will also need to consider what statistics should be developed in relation to devolved taxes in Wales.

**Recommendation 15.** *Whilst acknowledging that the Treasury would want to set an overall borrowing limit each year to retain control and ensure sustainability at an overall UK level, the Committee recommends that the Welsh Government's capital borrowing should be subject to a prudential borrowing regime, similar to that for local authorities.*

I agree that a prudential borrowing regime, as part of a sustainable UK framework, offers a sensible alternative to the current approach to capital borrowing. Borrowing should be subject to the ability to repay.

Even in the absence of a prudential borrowing arrangement, based on the existing capital borrowing limit applied to Scotland (which currently has a similar level of devolved responsibilities to Wales), I believe that the Welsh Government's capital borrowing limit could be increased - arguably to around £1.3 billion. The borrowing ceiling should also rise significantly in the event of the introduction of Welsh Rates of Income Tax.