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Llywodraeth Cymru
Welsh Government

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22 July 2015

Dear Jocelyn,

Thank you for your letter following the meeting of 25 June 2015. I hope the Committee found the session helpful as you undertake your inquiry into Future Funding.

As I highlighted to the Committee, the joint statement on funding reform in 2012 represented an important step forward in negotiating a fair funding settlement for Wales. The UK Government, for the first time, recognised that there had been convergence in relative funding in Wales and that convergence is very likely to reassert itself once spending starts to increase. I have attached a copy of the joint statement. I have called on the UK Government to agree a new joint statement ahead of the UK Spending Review that outlines the details of a fair funding floor for Wales.

In addition to a fair funding floor, I have also been pressing the UK Government to introduce a number of specific changes to our budgetary arrangements that would provide useful additional flexibility. As part of the St. David's Day process I requested:

- a change to the budget exchange system to ensure that the Welsh Government would not be subject to any restrictions in carrying forward either planned or unplanned underspends;
- the ability to draw forward capital budgets, including borrowing, across the period of a Spending Review, to provide a smoother capital budget profile and allow capital investment in excess of the arbitrary allocation via the Barnett formula;
- being able to switch between capital and revenue budgets; and
- like Northern Ireland, the public sector in Wales would benefit from capitalising the costs of reorganisation, including any Voluntary Exit Schemes, were such schemes to be taken forward.

I will again be making the case for greater budgetary flexibility as part of wider changes to our funding arrangements in an updated Statement of Funding Policy to be published alongside the UK Spending Review.

With the new devolved taxes becoming active in Wales from April 2018 there will need to be changes to the fiscal framework to account for the new revenue stream from those taxes. The issue of block grant offsets is a very important aspect of how the financial settlement will operate in the future. The detailed arrangements for the block grant offsets have not yet been agreed with the UK Government. However, it is important to ensure that offsets to the block grant are calculated in a fair and transparent manner which takes into account the properties of the relevant tax base. I am thankful to the Holtham Commission for the detailed analysis on the block grant offset mechanisms. Their work will form the starting point in my negotiations with the UK Government.

I look forward to reading the findings of the Committee's inquiry and I have provided responses to the additional questions from the Committee in Annex A.

Bert Hisher,



Jane Hutt AC / AM

Y Gweinidog Cyllid a Busnes y Llywodraeth
Minister for Finance and Government Business

Annex A – Finance Committee additional Questions

City Deal

The UK Government has stated that it is interested in negotiating individual City Deal's, including potentially a deal with Cardiff. How would funding for a City Deal operate in relation to the block grant?

Given that economic development is a devolved issue, should HM Treasury be encouraged to provide all funding for city deals through the block grant for allocation by the National Assembly?

The City Deal for Glasgow and Clyde Valley attracted new investment from the UK Government and I expect this to also to be the case for the potential Cardiff Capital Region City Deal. The Glasgow and Clyde Valley City Deal included funding from the UK Government in areas that are not devolved to the Scottish Government. It is my expectation that any funding from the UK Government to support a City Deal proposal for Cardiff Capital Region would, therefore be additional to, and sit outside of the block grant.

Funding arrangements for local government

Should the devolution of funding from central government to local government which is happening in England also occur in Wales?

The vast majority of the funding provided by the Welsh Government to local authorities in Wales is unhypothecated, enabling authorities to allocate resources according to local needs and priorities, taking account of their statutory duties and functions. The White Paper, Reforming Local Government: Power to Local People, set out the Welsh Government's plans for reviewing the local government finance framework for Wales.

How should the borrowing and taxes raised by local authorities be managed within the wider Welsh borrowing and tax system?

There are long-standing frameworks in place to govern the borrowing and taxation arrangements of local authorities in Wales. The devolution of tax and borrowing powers to the Welsh Government will not impact on those arrangements. However, there may be opportunities to look at the system of taxation and borrowing across Wales as a whole to make the most effective use of the powers that are available.

Public sector balance sheet

The Committee has heard that Wales is the only devolved administration which doesn't publish information on the balance between its revenues and spending. How important is it to calculate and forecast the overall fiscal position of the Welsh public sector?

The Welsh Government already publishes data relating to its own finances and those of local authorities in Wales. These will be developed to take account of devolved taxes. The UK Government publishes estimates of public spending in Wales and UK taxes raised in Wales.

The Welsh Government does not publish an estimate of Wales' overall fiscal position as this is a hypothetical construct. Wales is integrated into the tax and expenditure regime of the UK, most of which is non-devolved. There would be little point in putting resources into such an exercise; we have no plans for Wales to become independent or to adopt full fiscal autonomy.

Do you believe that a public sector balance sheet should be produced for Wales?

The preparation of a balance sheet for the public sector in Wales is complex given that there is currently no mechanism for consolidating the information made available by public sector bodies in Wales. Such an exercise will require the co-operation of all parts of the public sector in Wales.

As it is unclear what the purpose for a public sector balance sheet for Wales is I am happy to consider whether there are more appropriate alternative methods to producing any specific information that the Committee is seeking.

Greater certainty over funding

How can the UK Government give devolved administrations greater certainty of their likely future funding?

In times of falling budgets, it is more important than ever that we have maximum certainty on likely future funding. As long as the majority of our funding comes from the UK Government, we will continue to be dependent on their timescales for their decisions. In the evidence session on 25 June, I said that even with the tax varying powers that are recommended by the Silk Commission, the block grant would still account for 80 per cent of our budget which is why it is important that we continue to press for fair funding. However, as I highlighted in the debate on the First Supplementary Budget on 14 June, the successive reductions to our Budget over this Spending Review period, including the in-year incremental cuts we have received this year, make proper financial planning, and the ability to invest strategically, harder.

Within the limitations of the current fiscal framework, providing greater financial flexibilities for Wales is, of course, one way in which the UK Government can help us to manage our budgets in the future so we maximise the funding we have available to deliver our priorities for Wales.



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.