

Rebecca Evans AS/MS

Ysgrifennydd y Cabinet dros Gyllid, y Cyfansoddiad

a Swyddfa'r Cabinet

Cabinet Secretary for Finance, Constitution & Cabinet Office



Llywodraeth Cymru
Welsh Government

Peredur Owen Griffiths MS,
Chair Finance Committee,
The Senedd,
Cardiff Bay,
Cardiff
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18 June 2024

Dear Peredur,

Thank you for your letter inviting me to attend Finance Committee on Wednesday 3 July, to discuss the Committee's Inquiry into Fiscal Intergovernmental Relations.

Ahead of my attendance, please find attached a paper addressing the Terms of Reference of the Inquiry.

I look forward to joining you to discuss these matters further.

Yours sincerely,

Rebecca Evans AS/MS

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Cabinet Secretary for Finance, Constitution & Cabinet Office

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Rydym yn croesawu derbyn gohebiaeth yn Gymraeg. Byddwn yn ateb gohebiaeth a dderbynnir yn Gymraeg yn Gymraeg ac ni fydd gohebu yn Gymraeg yn arwain at oedi.

We welcome receiving correspondence in Welsh. Any correspondence received in Welsh will be answered in Welsh and corresponding in Welsh will not lead to a delay in responding.

Welsh Government input to the Finance Committee's inquiry into Fiscal Intergovernmental Relations

Date – Wednesday 3 July 2024

Title – Fiscal Intergovernmental Relations

Overview

1. This paper provides information to the Finance Committee on fiscal Intergovernmental Relations (IGR).
2. The joint Review of Intergovernmental Relations¹ was published in January 2022. All four Nations have agreed to use the package of reforms which emerged from the Review as the basis for the conduct of IGR.
3. Following the Review, more robust machinery has been introduced, including: a Council for heads of government, chaired by the Prime Minister; two 'middle tier' Inter-Ministerial Standing Committees – one covering intergovernmental relations as a whole and one focused on finance – to consider strategic or cross-cutting issues; and Inter-Ministerial Groups (IMGs) across portfolio areas. The Review also establishes an independent IGR Secretariat, accountable to the Council.
4. There are also new mechanisms for dispute avoidance and resolution, including options for independent input.

IGR Structures.

5. The Finance Interministerial Standing Committee (F:ISC) is a central component of the new IGR structures. The Terms of Reference established meetings on a quarterly basis and ensured that arrangements for each meeting were shared equally with a rotating Chair and Secretariat for each meeting.
6. This strengthened and formalised the previous IGR arrangements whereby meetings of the UK Finance Ministers took place ad hoc, were generally held in London and always chaired by the Chief Secretary to the Treasury (CST), who also set the agenda.
7. The first meeting of the F:ISC took place on the 21 March 2022. After a promising start, with two F:ISC meetings held in March and June 2022, the change in the UK Government leadership resulted in the third F:ISC meeting being delayed, and when it did convene, in October, it was abruptly ended as a result of the then Prime Minister resigning. There were also challenges in agreeing the next meeting, which eventually took place in February 2023.

¹ [The review of intergovernmental relations | GOV.WALES](#)

8. On establishing the new IGR arrangements, it was agreed that the F:ISC Terms of Reference would be reviewed after 18 months. That work took place over the summer 2023, with a revised version agreed at the 20 September 2023 F:ISC meeting².
9. The review was a useful exercise and provided an opportunity to reflect on the first 18 months of the F:ISC operation and to ensure that both the Terms of Reference and the Secretariat Operating Protocols were working as envisaged.
10. Overall, the operation of the F:ISC has been an improvement on previous arrangements. However, the review of the Terms of Reference provided an opportunity to make some points of clarification, including changes to paragraphs 21 and 22 to clarify the process of the appointment of an independent Chair in the event of a dispute, and the timescale for a Ministerial meeting.

Strengths and Weaknesses of current arrangements

Weakness

11. Instability in the UK Government in this period has resulted in a significant change in personnel. Over my time as Finance Minister, I have met with eight CSTs - four in a period of less than two months. Engagement with each of these has varied.
12. The current CST has reinstated the usual process of a call on the morning of UK fiscal events to inform me of the changes to the Welsh Government's budget and key announcements related to Wales. This has not always been observed and is dependent on who is in the CST post and whether they respect this protocol. Engagement should not be dictated by the preferences of who happens to be CST at the time.
13. There remains reluctance on the part of the UK Government to share information which impacts on Welsh Government tax and budgetary policy in advance. Successive CSTs have stated that informing me could risk affecting the markets. As well as being a highly dubious claim, the suggestion implies a lack of trust. The impact of not sharing the information in advance is detrimental to the stability of finances in Wales. For example, any changes to Stamp Duty Land Tax creates uncertainty for housing sales in Wales, as property buyers will appropriately consider delaying purchases until they understand if the Welsh Government will adjust Land Transaction Tax in response to changes announced by the UK Government. There can also be an impact from UK tax changes on our block grant. If the UK Government provided confidential information ahead of the fiscal event, the Welsh Government would be able to respond to the changes in a timelier manner, mitigating the risk of impacts on the property market in Wales.

² [Terms of Reference for the Finance Interministerial Standing Committee - GOV.UK \(www.gov.uk\)](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/115555/terms-of-reference-for-the-finance-interministerial-standing-committee.pdf)

14. There has also been a reluctance from CSTs to schedule F:ISC meetings for the year ahead, and although meeting dates are usually agreed by the Devolved Government Ministers well in advance, the CST only confirms a couple of weeks before the proposed date. This can make it difficult to plan agendas and adhere to the timescales outlined in the Interinstitutional Agreement between Senedd Cymru and the Welsh Government.

Strengths

15. The F:ISC places Finance Ministers in the various Governments in the UK on a more equal footing, with the Chair and Secretariat rotating and all agreeing to the agenda, minutes, communique etc.
16. The Devolved Governments have an equal say on topics of discussion for the agenda.
17. There is a regular rhythm of meetings, with meetings generally occurring more frequently since the establishment of the F:ISC, although it can take considerable effort to schedule these. This is important as it enables me to convey the priorities for Wales and explain the implications of UK Government decisions.
18. During meetings, Ministerial agreement is given for officials to work together outside of meetings in order to bring proposals forward at F:ISC. This has worked well in several areas such as EU funding and budgetary flexibilities.
19. We regularly discuss issues of common interest and share ideas and best practice including in relation to energy security and the need for greater investment in network infrastructure, and investment in port infrastructure to support floating offshore wind.

Communication

Engagement with other Treasury Ministers

20. As well as regular engagement with the CST, I have tried to broaden the relationship with other Treasury Ministers, namely the Financial Secretary to the Treasury (FST) who has responsibility for the UK tax system and the Exchequer Secretary to the Treasury (XST) who is responsible for growth, productivity and investment, including Investment Zones, and energy, climate and net zero transition policy and related taxes.
21. A bilateral with the FST took place on 29 November 2023, focusing primarily on the devolution of new tax powers, in particular our long-standing request for competence over a new tax on vacant land, further information is included at paragraphs 67 to 80. Topics also included the UK Building Safety Levy, tax exemption for “welfare initiatives”, and involving people with diverse characteristics in fiscal and tax policy.

22. During the meeting, I raised concerns in relation to HMRC's policy on VAT recovery for cladding remediation costs, which previously only applied to England. Following the meeting this was reviewed and expanded across the UK, meaning that developers in Wales who have pledged to fund the removal and replacement of unsafe cladding now recover the VAT they incur on this work. This was a positive outcome.
23. Following several attempts to engage with the XST, a bilateral meeting took place on 25 October 2023. Items discussed included the UK Emissions Trading Scheme, the Carbon Border Adjustment Mechanism (CBAM) and renewable energy. We secured a commitment for officials to work together on understanding the impacts on Welsh Businesses of the EU CBAM and possible UK CBAM.

Engagement with Devolved Governments

24. I also have regular engagement with my devolved counterparts, usually meeting around every two months. We primarily discuss the economic and fiscal context including spending pressures and the implications for our respective budgets. We share information on our approaches to issues of common concern including matters such as the cost-of-living crisis. We also consider opportunities to secure greater certainty of devolved funding from the UK Government including improvements to the UK Supplementary Estimates process.

Timing of Fiscal Events

25. The timing of UK fiscal events is a matter for the UK Government.
26. The timing of such events can cause Welsh Government challenges as seen with the most recent UK Spring Budget (6 March 2024) which occurred the day after our Final Budget was passed by the Senedd (5 March 2024).
27. These challenges could be mitigated by the UK Government setting dates for its fiscal events well in advance and sharing information which could impact on Welsh Government tax and budgetary policy in advance, on a confidential basis.
28. Not knowing this information in advance of our Budget impacts our preparations and limits the amount of time to formulate our own plans. I recognise it also impacts scrutiny time from the Senedd and the Finance Committee in particular.
29. Our current settlement comes to an end in March 2025. Following the General Election I will be looking to the UK Government to provide early engagement and confirmation of plans for the next UK Spending Review.

Transparency of funding announcements by the UK Government

30. I have raised with successive CSTs the need for greater clarity and more timely information on the implications of UK Government funding announcements for the Welsh Government Budget at the time such announcements are made.

31. We generally do not receive advance notice of allocations that the UK Government intends to make in England and any subsequent consequential funding that might flow to Wales. This emphasises the importance of having the budgetary flexibility to manage this uncertainty.
32. UK Government funding announcements are not always as clear as they should be and as we would like them to be. There are many examples of this, for example, we did not know how the UK Government intended to fund public sector pay offers in England announced in May 2023, and whether any consequential funding would arise, until nine months later at the UK Supplementary Estimates in February 2024. Also, in the latest UK Budget, UK Government announced an additional £500m for the Household Support Fund in England in 2024-25. At the time of the announcement, we did not know whether we would receive a consequential. This information only became available after the event, and we were originally informed it would be transferred at UK Mains Estimates. However, we have recently been informed the funding will be provided at UK Supplementary Estimates in February 2025 instead. No explanation has been provided for the delay.
33. The UK Government's Block Grant Transparency document³, published annually, presents the total changes arising from spending review settlements at UK department level. We are not provided with any detail of individual UK programme changes at spending reviews. Between spending reviews, the Barnett formula consequentials from individual UK Government measures are identified, although it can initially be unclear whether these will be funded with new money or through savings or reprioritisation by Whitehall departments. The final decision on funding may not take place until very late in the financial year at UK Supplementary Estimates, although the additional funding might have been in place in England for much of the year as illustrated in the examples above.
34. The delay in providing clarity has impacts for our own spending choices and makes it difficult to plan effectively given the uncertainty about the exact size of the funding envelope available.

UK Supplementary Estimates

35. Our experience of supplementary estimates this year illustrates the points we have been making about the need for further improvements to the in-year processes and the importance of additional flexibility for Devolved Governments.
36. Provisional estimates were provided to us on 18 January. Final figures for the 2023-24 supplementary estimates were received on 7 February.
37. On 13 February, HM Treasury advised the final figures contained errors and revised final figures were provided.

³ [Block Grant Transparency: July 2023 - GOV.UK \(www.gov.uk\)](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/115443/Block_Grant_Transparency_July_2023.pdf)

38. The revised figures resulted in an additional £70m of resource and an increase to our capital budget of nearly £3m compared to the figures provided the week before.
39. The overall changes to the Welsh Government budget in 2023-24 included an additional £231m in resource, £8m in general capital and a reduction of £38m to Financial Transactions capital. These changes were confirmed 7 weeks before the end of the Financial Year.
40. Last summer we carried out an extensive re-prioritisation of our budgets in light of very significant pressures and unpalatable decisions were made, some of which could have been avoided, had we known how much additional funding was going to be provided during the year.
41. Together with the other devolved Finance Ministers, I have led discussions on improving the supplementary estimates process to support effective budget planning at the F:ISC.
42. The outcome of these discussions to date have resulted in Devolved Governments being permitted to automatically manage outside their existing Reserve arrangements any funding changes at UK Supplementary Estimates that differs by more than 10% from the provisional estimates provided in January.
43. Whilst any agreement which provides support to manage the risk of uncertainty is welcome, this mechanism is insufficient when material changes are notified in the last quarter of the financial year. This year, the combined resource changes represented more than half the total value of the Wales Reserve.
44. Agreement was reached at the F:ISC meeting in March 2024 for officials to re-visit work to develop proposals for improving in-year funding processes including consideration of capital to resource switches, to be discussed during a future F:ISC meeting.
45. The support of the Finance Committee in continuing to raise these issues with the UK Government is welcomed.

Budgetary Flexibilities

46. Welsh Government Ministers have continued to make representations to the UK Government for additional fiscal flexibilities through the appropriate channels, including the F:ISC and through bilateral meetings and correspondence with the CST and the Chancellor of the Exchequer.
47. The fiscal levers currently available to the Welsh Government limit its ability to respond quickly to emerging needs, leaving it dependent on decisions made by the UK Government, which fail to recognise the impact on its budgets and the scrutiny provided by the Senedd. The current UK financial arrangements do not offer the predictability and funding certainty required to support Welsh Government budget planning and that of its partner organisations.

48. In *Reforming our Union: Shared governance in the UK (June 2021)*⁴, the Welsh Government set out the need for a new principles-based approach to UK funding underpinned by a jointly agreed needs-based funding system which operates on a consistent basis across the UK and is overseen by an independent body.
49. The Institute for Fiscal Studies (IFS) has previously highlighted the case for enhanced reserve powers in Wales and for drawdown limits to be increased, if not abolished⁵. It is the view of the IFS that the existing limits on the total amount that can be held in reserves should, at the very least, be indexed in some way to account for growth in devolved spending and tax revenues.
50. The final report of the Independent Commission on the Constitutional Future of Wales⁶ noted that the budget restrictions applied by HM Treasury undermine the Welsh Government's ability to manage its budget and plan for the long term. The report argues that the financial flexibilities that the Welsh Government continues to seek from HM Treasury are reasonable, and that it should either accept them or explain its reasoning.
51. Although this recommendation is for the UK Government to take forward, I welcome it. We have, for some time, been pressing for additional flexibility alongside making the case for a review of the process for devolving new tax powers. The removal of constraints is essential to enable greater predictability of our funding and support effective budget management for both us and partner organisations including local authorities.
52. On 27 February, all parties in the Senedd jointly tabled a motion and voted unanimously for the UK Government to provide Wales with additional fiscal flexibilities.
53. This year (2024-25) the Welsh Government's borrowing and reserve limits will be worth almost a quarter (23%) less in real terms than when they were introduced in 2018-19. Welsh Government Ministers have repeatedly made the case for Welsh Government borrowing and reserve limits to be indexed to inflation and for the limits on its Reserve draw-down to be abolished. These flexibilities were provided to the Scottish Government last August and are equally applicable to Wales.
54. In addition, the increase in the level of capital borrowing flexibility offered by the UK Government to Northern Ireland to support the restoration of the Executive starkly contrasts with the absence of increase to the Welsh Government's borrowing limits.
55. The Welsh Government's general capital budget in 2024-25 is worth up to 8% less in real terms than when it was set at the time of the 2021 Spending Review. There must be fairness and consistency applied in the operation of the UK funding arrangements across all parts of the UK.

⁴ [Reforming our Union: Shared governance in the UK June 2021 \[HTML\] | GOV.WALES](#)

⁵ [Options for reforming the devolved fiscal frameworks post-pandemic | Institute for Fiscal Studies \(ifs.org.uk\)](#)

⁶ [Independent Commission on the Constitutional Future of Wales: final report | GOV.WALES](#)

56. On top of the increases to borrowing and draw-down limits, along with the other devolved Finance Ministers, I continue to make the case for the UK Government to establish a principle that funding announced after an Autumn fiscal event should come with full flexibility outside the normal year end arrangements. This would provide Devolved Governments with a greater degree of certainty to plan effective public services. This flexibility has previously been provided by the CST on request. Devolved Governments wish to formalise this arrangement. Alternatively, increased Reserve limits would provide flexibility to enable Devolved Governments to more easily manage late changes to their budgets.

Interparliamentary Committee

57. I welcome the establishment of the Interparliamentary Committee and was pleased to attend to provide evidence. These relationships can help ensure that all elected representatives with an interest in issues which affect the proper functioning of the United Kingdom have an opportunity to share and come together.

58. I believe there is a role for the Committee in strengthening relationships with the Welsh Affairs Committee and other relevant Parliamentary Committees, in order to exchange information and encourage them to be engaging, listening and constructively challenging the Westminster Parliament on IGR relationships from their end.

Dispute Resolution

59. The joint Review of Intergovernmental Relations established structures and processes to enable meaningful engagement, and a mechanism that affirms each government's right to refer and escalate a dispute.

60. Our approach to date has been to work with the UK Government constructively and pragmatically on any issues that arise as part of what should be routine intergovernmental engagement. However, if we cannot reach agreement through these arrangements, the dispute resolution processes are operational and open to us.

61. The mechanisms remove some of the former barriers to raising disputes and require independent chairing and secretariat arrangements. They include a presumption of independent input, through either advice or mediation, and increased transparency to aid legislatures' scrutiny and stakeholder engagement.

62. Annex C Terms of Reference for the F:ISC⁷ para 12 to 26 sets out the process for raising financial disputes. This outlines that no member of the F:ISC can reject the decision of another to raise a dispute as well as establishes that a F:ISC in 'dispute setting' will be chaired by an independent chair, which all parties to the dispute must agree to.

⁷ [Terms of Reference for the Finance: Interministerial Standing Committee - GOV.UK \(www.gov.uk\)](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/684442/Annex_C_Terms_of_Reference_for_the_FISC.pdf)

63. The inclusion of independence in the dispute process is something Devolved Governments successfully negotiated, alongside placing a timeframe around managing disputes to ensure their timely resolution.
64. In reviewing the F:ISC Terms of Reference we strengthened the dispute mechanism, clarifying the process of the appointment of an independent chair in the event of a dispute and timescale for a Ministerial meeting, to ensure disputes are addressed in a timely manner.
65. The first stage in raising a dispute is demonstrating that all steps have been taken to exhaust pragmatic resolution. These are outlined in paragraphs 17 a to d. We must be able to evidence we have met these criteria to the independent IGR Secretariat to demonstrate we have grounds for raising a dispute.
66. The independent IGR Secretariat have a role in facilitating the process of dispute resolution. This includes assessing whether the appropriate steps have been followed to resolve a disagreement and decide whether it should be escalated as a dispute through the formal process.

Devolution of Taxes

67. In March 2014, the UK Government set out the principles by which devolved taxes would be created in its Wales Bill Command Paper⁸ (sections 72-74).
68. The process to devolve powers for a vacant land tax, started six years ago, with the intergovernmental process for devolving competence for new taxes agreed with the UK Government in January 2018. Following two years of work to ensure the UK Government had the information required to proceed, we submitted a formal request for the transfer of powers in March 2020.
69. Prior to making the formal request, I met and discussed the proposal with the then FST and he was agreeable to receiving the request based on the information provided. However, by August 2020 the FST had written to insist that further information was required.
70. The UK Government has agreed the principle that it is for the Welsh Government to make policy decisions about how any new devolved tax would operate, and for the Senedd to decide whether to pass any new tax into law. However, they continue to seek further information on the potential operation of such a tax rather than its suitability for devolution.
71. Despite successive attempts over several months and multiple FST's to discuss the issue of the powers for the vacant land tax. I finally met the current FST in November 2023 where I raised this issue. During the meeting, the FST committed to set out the additional information the UK Government is seeking in relation to the proposal to introduce a vacant land tax in Wales.

⁸ [Microsoft Word - Wales Bill Command Paper - Cover English FINAL FOR TSO.DOC \(publishing.service.gov.uk\)](#)

72. Since the meeting, I have written (4 March 2024) to the FST and requested an update on the additional information they are seeking. I received a response (5 March 2024) from the FST apologising for the delay and advising that his officials have been looking again at what additional information is required. The FST advised that they would be in touch within the next few weeks to clarify. In May 2024, Treasury officials clarified the information is that which was requested back in 2020, so we are no further forward.
73. Our experience in seeking devolution of powers for a vacant land tax makes it clear that the process for the devolution of new tax powers is not fit for purpose.
74. We have pursued the devolution of powers for a vacant land tax because of the potential of such a tax to help deliver our housing and regeneration ambitions. In doing so we have also had the opportunity to test the mechanism for devolving new tax powers under the Wales Act (2014).
75. Vacant land tax is also a helpful test case for the mechanisms agreed - it is a narrow tax, very clearly aligned to devolved responsibilities. It would apply only to land in Wales and would not reasonably be expected to have a material impact outside of Wales. This makes it a clear candidate for devolution.
76. It is intended to influence behaviours rather than being primarily to raise revenues. If we are not able to secure the powers for this tax, it is very difficult to believe the process, as currently provided for, can deliver any new tax powers for Wales.
77. Our ambitions for tax powers are not limited to a vacant land tax, which is why it is so important we ensure the process works and we set appropriate precedents for how it operates in future.
78. We have always been clear, we agree that the UK Government has a legitimate interest in whether the powers are suitable for devolution, but it is for this Senedd, not the UK Government, to be concerned about how those powers are used once they are devolved.
79. It is also important to contrast the experience with another Devolved Government. The Scottish Government has been able to work with the UK Government to devolve competence for tax powers for a new Scottish Building Safety Levy (BSL), similar to the Levy being developed in England. The joint UK Government/Scottish Government consultation paper on the BSL, published on 8 January, shows that in this case UK Government is willing to devolve competence in advance of policy development when it suits them to do so.
80. The next UK Government should review and reform the process for agreeing new devolved tax powers.