



HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ

Llyr Gruffydd MS
Chair of Welsh Parliament Finance Committee
Welsh Parliament
Cardiff
CF99 1SN

23 March 2021

Dear Llyr,

WELSH GOVERNMENT'S FISCAL FRAMEWORK

1. Thank you for your letter of 25 February regarding the Welsh Government's fiscal framework.
2. The Wales Acts in 2014 and 2017 represented a significant change in the autonomy and accountability of the Welsh Government, including the devolution of new tax and borrowing powers. The jointly agreed fiscal framework put in place the financial arrangements to underpin these powers, enabling the Welsh Government to manage their devolved responsibilities within the UK's broader fiscal and economic union.
3. The benefits of this arrangement have been clear to see throughout the pandemic. Alongside substantial additional funding for the Welsh Government, the UK Government provided the majority of support directly to people and businesses in Wales. This includes 400,000 furloughed employments, 295,000 claims under the Self-Employed Income Support Scheme and 57,000 businesses supported through loan guarantee schemes. It also includes millions of life-saving vaccines that are crucial to reopening the economy.

Barnett-based funding

4. The fiscal framework sets out a funding floor mechanism to ensure the Welsh Government receives a fair level of funding relative to England. Informed by the Holtham Commission's recommendation, the inclusion of a needs-based factor in the Barnett formula provides the Welsh Government with at least £115 per person for every £100 per person of equivalent funding in England.



5. When the fiscal framework was agreed, the Welsh Government was receiving around £120 per person for every £100 per person of equivalent funding in England. This is expected to converge towards the fair level of £115 per person over time. However, the 2020 Spending Review confirmed the Welsh Government will receive £123 per person in 2021-22 for every £100 per person in England. This equates to around £1 billion more in 2021-22 than the Holtham Commission indicated – and the Welsh Government agreed - was fair for Wales relative to England.

6. It is therefore imperative that the Welsh Government uses this extra resource effectively. For example, I noted the Minister for Finance and Trefnydd suggest to your Committee that the UK Government should fund coal tip maintenance costs in Wales of £500-£600m over a decade, despite this being a devolved responsibility.

7. Her argument was that Barnett-based funding wasn't intended to cover such costs and didn't come close to doing so. However, the estimated coal tip maintenance costs average c£50-60m per year while the Welsh Government's funding is around £1 billion per annum greater than their relative needs (as identified by the independent Holtham Commission). While the Treasury stepped in to provide the Welsh Government with £31 million this year given the unexpected and severe impacts of flooding in Wales, it is evident that the Welsh Government is more than adequately funded to manage future costs as part of its normal budget planning.

Block grant adjustments for tax devolution

8. The block grant adjustment arrangements help to increase the Welsh Government's autonomy and accountability, while being shielded from UK-wide impacts. For example, if the Welsh Government wants to increase spending then it can change tax policy and spend all of the additional revenues generated. Similarly if it wants to cut taxes then it needs to manage the resulting reduction in spending.

9. However, the UK Government manages all UK-wide fluctuations in tax revenues and holds all in-year risks in relation to income tax revenues. As a result, the Welsh



Government hasn't needed to change its spending plans in 2020-21 in relation to forecast reductions in revenues from Welsh Rates of Income Tax.

Financial flexibility

10. The agreed fiscal framework provided the Welsh Government with a new £375 million Wales Reserve and the ability to borrow up to £200m per year to manage tax forecast error. However, I have provided significant additional flexibility this year recognising the challenges faced.

11. As outlined in my previous letter, I provided an unprecedented upfront funding guarantee so the Welsh Government could decide how and when to provide support in 2020-21. I also agreed the Welsh Government could carry forwards into 2021-22 any Barnett-based funding above the guaranteed £5.2 billion as well as any repayments of business rates relief – all on top of the Wales Reserve arrangements.

12. As a result the Welsh Government is carrying forwards over £650 million to spend in 2021-22. I would hope you would agree that this is rather more than a degree of flexibility, which is how the Minister for Finance and Trefnydd portrayed this to your Committee. This is also all on top of the additional £2.1 billion confirmed for 2021-22 through the Barnett formula at the 2020 Spending Review and recent UK Budget.

13. This carry forward provides the Welsh Government with substantial flexibility to support the Covid-19 response. However, as the Secretary of State for Wales alluded to in his evidence to your Committee, the UK's fiscal position is generally assessed on a financial year basis. The UK's spending framework is therefore designed to enable the UK Government to manage spending on a financial year basis, including the impact of Welsh Government spending.



Capital borrowing

14. The Welsh Government also has significant capital borrowing powers. While I note your report recommends that the limits are increased, it is important to recognise that the Welsh Government already receives a share of UK Government borrowing through the Barnett formula.

15. Historic borrowing by the Welsh Government also demonstrates that the annual limit of £150 million provides sufficient flexibility, with borrowing yet to reach this limit in any of the financial years that the fiscal framework has been in place. In particular, the Welsh Government borrowed £65 million in 2018-19, did not borrow in 2019-20, and even in 2020-21 only plans to borrow £125 million.

16. Looking forwards to 2021-22, on top of the £150 million of available borrowing, the Welsh Government has a £2.4 billion capital block grant and a further £160 million of capital funding as part of the wider £650 million carry forward set out above. It is also worth noting that the Welsh Government has complete flexibility to spend as much of its overall resources on capital investment as it chooses to.

17. I am copying this letter to the Minister for Finance and Trefnydd as well as the Secretary of State for Wales, and look forward to continuing to work closely for the benefit of Wales in the future.

Best wishes,

A handwritten signature in black ink that reads 'Steve Barclay'.

RT HON STEVE BARCLAY MP