10 November 2016

Dear Finance Committee

**Welsh Government’s draft budget for 2017–18**

On 3 November 2016 the Economy, Infrastructure and Skills Committee questioned the Cabinet Secretary for Infrastructure and Skills and the Minister for Skills and Science, as part of our scrutiny of the Welsh Government’s draft budget for 2017–18.

I am writing to draw a number of headline issues to your attention.

**Inflation**

We heard from the Deputy Permanent Secretary that assumptions for inflation in the budget had been based around 2–3%. The National Institute for Economic and Social Research published a forecast on Thursday 3 November suggesting that inflation could rise to 4% by the end of 2017. And while 4% is the headline forecast, it is normal that different sectors will have different, and potentially higher, rates of inflation within each sector.

The infrastructure portfolio contains a number of large-scale, multi-year investment projects – most notably the M4 Relief Road and the South Wales Metro – whose costs could rise considerably, were inflation to rise sharply after a lengthy period at historically low levels.
While an increase in inflation of 1–2% within the financial year 2017–18 is likely to be uncomfortable but manageable within the Economy and Infrastructure portfolio, higher rises in future years could have a significant and negative impact on the cost of long-term multi-million pound projects. It is crucial that the government acknowledges the risk posed by rising inflation not just to the budget, but all its policy goals.

We note too that higher inflation rates would not just impact on portfolios within our remit area, but are a potential risk across all areas of Government activity in the coming years.

We would welcome further details of how the department is modelling the potential impact of higher levels of inflation.

Budget process
In July 2016 the Finance Committee recommended that in future the Welsh Government should publish "greater evidence setting out the rationale behind budget allocations... including details of the anticipated economic impact." The Welsh Government accepted this recommendation.

However, within this year's Strategic Impact Assessment, which covers 10 pages for the whole of the budget, the only reference to enterprise zones states that "research has shown that area based initiatives, like enterprise zones, can have positive impacts on employment and regional GDP." This is one of a number of references to the economy and infrastructure portfolio which lack any of that evidence-based rationale requested by Finance Committee, and agreed by the Government. In response to our questions, the Minister noted that measurement of economic outputs was not an exact science – which is clearly true. But in order for others to assess whether the priorities chosen are reasonable, and whether the anticipated outputs represent value for the public money invested, it is vital that greater effort is put in to sharing the thinking and evidence which underpins the government's spending decisions. That thinking can sometimes be found in other places (we were given an example in the Finance Wales annual report), so should be included in the budget narrative.
Measuring outputs and outcomes
There is also work to be done in ensuring outputs and outcomes are measurable and meaningful. In the current economy, where employment is at record levels, 'jobs created' is not always necessarily the most effective measure of success, nor is it always necessarily the most desirable, particularly if those jobs are not ones which are attractive to, or a good skills match with, the local workforce. Equally, it may be the case that businesses are seeking support from the Welsh Government to increase their productivity and raise their output but without wishing to create jobs and take on additional staff in the process.

The realities of the current economy should always be reflected in both the support available from the Welsh Government and the indicators used to measure success.

In our discussion with the Minister for Skills and Science she noted that her budget lines for innovation, for example, required a longer term view to judge return on investment than a simple grant for job creation.

It is vital that the ongoing work to develop a new economic strategy includes some effort to ensure that outcomes which arise as a result of Welsh Government investment can be more effectively predicted in advance, and measured afterwards. In this way it would be possible to provide truly effective scrutiny of the decisions behind budget allocations, and the net impact of that investment. This will not only allow make it clearer where schemes are unsuccessful,

Cross-cutting themes

The new government has set a high priority on the cross-cutting nature of government portfolios and responsibilities. This move away from silo-ed working which has characterised government at every level is welcome.

However, the current budget is not especially well-presented to capture the impact of these cross-cutting themes. Nor where multiple-departmental budgets feed in to aspirations (eg Active Travel, where spending in the health, local government or economy and infrastructure portfolios could all contribute to the successful implementation of the Active Travel Act.)
Within its own budget, we could not easily identify the total Welsh Government spend on the skills of its own staff, for example. Nor could we say how much is spent on R&D.

**Wellbeing and Future Generations**

While both Ministers have clearly stated in their responses to the committee that the principles of the Future Generations have been embedded in all their decision making, it was not clear to us how this was having an impact on budget decisions, nor what – if anything – had changed as a result. When asked for a specific example, the Cabinet Secretary for the economy and infrastructure cited maintaining funding for the Bus Services Support Grant (BSSG) at £25m. This fund has been fixed at £25m since 2013–14 – long before the WFG Act passed into law.

While the Future Generations Commissioner has indicated she expects the impact of the Act on public bodies – including Welsh Government – to grow over time, it is not clear at present if the new framework is being used to challenge the status quo, or merely to justify decisions that have previously been taken.

Our discussion raised a number of other specific issues, which we will raise and monitor with the relevant Ministers in our regular scrutiny throughout the year.

Yours sincerely

Russell George AM
Chair
Economy, Infrastructure and Skills Committee