

# Memorandum on the Economy and Transport

## Scrutiny of the Economic Action Plan and In-Year Budget 2018-19

### Economy, Infrastructure and Skills Committee – 19 September 2018

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#### 1.0 Introduction

This paper provides information on the Economic Action Plan, the policies and decisions in the 2018-19 Budget for Economy & Transport (E&T). It also provides an update on specific areas of interest to the Committee.

#### 2.0 2018-19 In Year Budget

The changes to budgets between the 2018-19 Final Budget and the 2018-19 First Supplementary Budget for the Economy and Transport MEG are summarised in **Annex A**. The additional capital allocations of £55.278m were announced by the Cabinet Secretary for Finance alongside the Wales Infrastructure and Investment Plan Mid Point Review on 1 May 2018. They cut across portfolio responsibilities which are included to illustrate the cohesive investment to deliver modern and connected infrastructure and promote and protect Wales' place in the world.

Transport connectivity at a national, regional and local level is vital to social cohesion and access to employment opportunities. The additional capital investment of £30m in the Cardiff Region will support the development of integrated transport systems which is a key driver for economic growth. Public transport improvements support our aspirations to reduce emissions by reducing car use and provide cleaner and more efficient vehicles with good outcomes for our health and our environment.

The continuation of revenue funding of £1m for free bus travel on Traws Cymru routes is also important in generating sustained passenger growth and modal shift from car to public transport on key corridors in rural areas.

In recognition of the far reaching benefits associated with greater levels of active travel and connectivity an additional allocation of £20m in 2018-19 will support our dedicated Active Travel Fund to boost delivery of active travel schemes across Wales. The total investment over the next three years is £60m. Further information on the allocations to local authorities is detailed in the Written Statement on 10 August and is available at:

<https://gov.wales/about/cabinet/cabinetstatements/2018/activetravelallocations/?lang=en>

In line with our new Economic Action Plan, Tech Valleys embeds the principles of growth, fair work and decarbonisation. The Tech Valleys £100m programme will be delivered over 10 years through a portfolio of related and complementary

technology projects, together with support for inward investment propositions. The additional funding of £25m over the next three years will support the creation of more than 1,500 jobs in Blaenau Gwent region. The Tech Valleys Strategic Plan is available on the Welsh Government's website:

<https://gov.wales/docs/det/publications/tech-valleys-strategic-plan.pdf>

### **New Rail Franchise/Metro ODP Contract**

Since my letter to the Committee, dated 20 of November 2017, I am pleased to say that Transport for Wales (TfW) has appointed their Rail Services Delivery Partner, Keolis Amey to operate the next Wales and Borders Rail Services Contract from October this year. The appointment brings significant benefits and opportunities, including a £1.9bn investment programme which supports our objectives to bring transformation to communities and people the length and breadth of Wales and its borders, by:

- Creating a network at the heart of communities, accessible to all, and 7 days a week.
- Increasing social mobility and widen access, connecting people with jobs, education, health and leisure.
- Making Wales even more attractive to business and tourists.
- Making travelling by rail enjoyable, enabling people to work and play as they travel on greener, state of the art trains which utilise next generation digital connectivity.

The budget plans for 2018-19 and 2019-20 were based on an assumed profile for the cost of the Rail Services Contract of £150m (2016-17 prices) in 2018-19 (based on six months of the current contract and six months of the new contract) and £120m (2016-17 prices) in 2019-20 (the first full year of the new contract). The expectation, which was set as the original funding envelope, was that the costs would rise in future years to reach £150m (2016-17 prices) when the full South Wales Metro services become operational from 2023-24.

The original funding envelope for the Rail Services Contract was based on a number of assumptions. During the procurement exercise some of these assumptions were adjusted to meet compliance requirements and others to enable accelerated achievement of benefits to passengers, including:

- Early investment in new and refurbished trains.
- Early investment in stations, car parks and interchange facilities.
- Early investment in additional services.
- Modernisation of maintenance and other infrastructure supporting improvement to performance and reliability.
- New ticketing and fares proposals, including contactless ticketing infrastructure.
- Economic development through employment.
- Maintaining a second safety-critical person on all heavy rail services.

The above opportunities and requirements front load some costs and consequently will require additional resource in the short term. In 2018-19 the estimated costs of the existing Arriva Trains Wales rail franchise together with the new contract is £178.8m, for which there is provision of £150.3m in the published budget. An additional allocation of £28.5m from central revenue reserves has been made.

A capital to revenue swap agreed by UK Treasury to cover the access adjustment charge of £24.89m for 2018-19 will be reflected in the Second Supplementary Budget. The end of the annual access charge rebate from 2020-21 is covered in more detail under section 3.0.

The overall cost of the Rail Services Contract over the 15 year term is within the original cost envelope defined at the outset of the procurement. It will achieve a 16% saving when compared against continuing with the existing franchise and access charge adjustment arrangements. Furthermore the revenue cost of the Rail Services Contract is two per cent (net present cost) lower than the revenue cost envelope provided at the start of the procurement exercise.

The Rail Services Contract will deliver against the commitments identified in *Taking Wales Forward, Prosperity for All: Economic Action Plan*, the priorities in *Our Valleys: Our Future*, and the goals in the *Well-being of Future Generations Act 2015*. The specific policy priorities used during the procurement exercise are published on the Welsh Government's web site.

In addition to improving our financial position over the term of the rail services contract, the winning contract exceeded the base procurement requirement that the minimum level of services is at least as good as it is presently. TfW's rail services delivery partner will deliver the following headline benefits, many of which accord to the Economic Action Plan, as part of the contract:

- Keolis Amey's UK business will move its HQ to Wales from London by 2019, and its international rail department will move to Wales from Paris by 2020, a team who provide expertise to all its rail operations around the world.
- The transformed Valley Lines will be 100 per cent non-diesel, with electricity sourced from 100 per cent renewable sources (50 per cent from within Wales).
- More trains, more services – 80 per cent more seat miles each week, including establishing a true seven-day service with new Sunday and evening services starting in December 2019 with a 22 per cent increase in Sunday mileage, and additional services to destinations across Wales with increased connectivity to border regions.
- 95 per cent of journeys will be made on brand new trains and the fleet average age will drop from 25 years now to seven by 2023.

- South Wales Metro Phase 2 transformation will provide four trains per hour from Treherbert, Aberdare and Merthyr from 2022 (currently two trains per hour), and four trains per hour from Rhymney from 2023 (currently one train per hour).
- Under 11s will go for free when travelling with an adult, and 50 per cent concessionary fares will be extended to 16-18 year olds and long-term unemployed.
- TfW's rail service delivery partner does not expect to pay dividends to its shareholders for the first 5 years, reinvesting profits to fund investment.
- Almost £200m investment in stations across the network, making them cleaner, safer and more accessible.
- 600 hundred new jobs will be created over the contract and 30 apprenticeships added per year.
- TfW rail delivery partner will support the supply chain by working with small and medium sized enterprises, as well as the third sector.

Going forward TfW will have an important role in delivering against the Economic Action Plan which indicates that we will also extend the partnership working between Welsh Government, TfW, Local Authorities and bodies such as the Development Bank of Wales to ensure a joined up approach to growing our economy and in order to capitalise on the opportunities opened up by this franchise and through Metro projects across Wales.

### **3.0 Access Charge Adjustment**

The financial implications of the agreement between Welsh Ministers and the Secretary of State for Transport regarding the existing access charge adjustment mechanism is captured within the Funding and Outputs agreement. Importantly, the Secretary of State retains the regulatory risk and opportunity for future changes to access charge payments to Network Rail resulting from regulatory reviews, which means that the Wales and Borders rail services contract will be treated in the same way as any other franchise and there will be no negative impact on fares or services levels. The Funding and Outputs Agreement has been published on the Welsh Government's website.

The Committee will recall that it was previously reported that the Welsh Government had been required to pay the UK Government in excess of £1bn over the course of the next 15 years of the Wales and Borders Rail Services contract. This has now been successfully re-negotiated, and the Funding and Outputs Agreement sets out how the new mechanism will work.

During a transitional period, which is designed to account for the way the Welsh Government is funded and HM Treasury's Spending Review assumptions (2017 – 2020), the Welsh Government will make two payments to the Department of Transport of £24.89m in 2018-19 and £71.8m in 2019-20. These costs will be accommodated within existing Welsh Government budgets. From 2020-21 the current Access Charge Adjustment mechanism will end.

A new arrangement, baselined to the forecast access charges in our new Wales and Borders Rail Services contract (and therefore included in the overall cost base for the contract), will be in place. This means that future adjustment payments resulting from regulatory reviews, between the Welsh Government and the Department for Transport or between the Department for Transport and the Welsh Government, will be determined by comparing actual access charges paid to Network Rail to the payments in our rail services contract. If the actual access charges match the level in our contract there will be no requirement for an adjustment either way.

Concurrently the UK Government will pay the Welsh Government a sum of £2m in 2018-19 and £4.4m for 2019-20 to operate the England only services part of the contract. For subsequent years, the England only services funding will be indexed using the same methodology that applies to equivalent franchise payments.

Within the Funding and Outputs agreement the Secretary of State has reconfirmed his commitment to provide £125m (2014 prices) towards the cost of the South Wales Metro, which will be drawn down in line with expenditure.

#### **4.0 Brexit**

The UK Government cannot fulfil its responsibilities for ensuring the UK as a whole is prepared without working with the Devolved Governments – with our extensive responsibilities for transport, economic development, agriculture, health, energy and environment – all of which will be hugely impacted by Brexit.

Despite the backdrop of uncertainty, we took action immediately after the referendum to mobilise resources and to build capability across government to respond to Brexit. This has ensured that we have engaged extensively with stakeholders' right from the start to understand their concerns and priorities and to be active in setting out coherent policy positions to influence the UK Government's approach to exit negotiations and prepare for the multiple possible outcomes. We have produced detailed, evidence based policy proposals on how the right kind of Brexit can protect jobs and put forward proposals on trade, immigration, the future of the UK and a range of other issues once we are out of the EU.

We are providing help to organisations across Wales to get ready for Brexit with a dedicated £50m fund. This fund (announced Jan 2018) will help business, public services and other partner organisations in Wales plan for and prepare for the impacts of Brexit.

Alongside internal Welsh Government actions including establishing Ministerial coordination structures to oversee Brexit activity in all Welsh Government departments and setting up a dedicated European Transition Team to coordinate all Welsh Government Brexit activity, the Welsh Government has sought to engage widely.

Externally we have set up a range of structures to engage with organisations across Wales, covering the private, public and third sectors, so we can have frank conversations on the impact of Brexit, get intelligence on their experiences and work together to prepare for the many practical implications of leaving the EU. These include:

- European Advisory Group, bringing together business leaders, representatives from universities, trade unions, agriculture, public services, politicians and the third sector to advise us on the implications for Wales of Brexit.
- Higher Education Brexit Working Group – with senior representatives from HE and FE sectors - to provide advice on the implications of Brexit for the higher education sector in Wales.
- Council for Economic Development EU Working Group with senior business leaders and organisations chaired by the Economy Secretary. The Economy Secretary has also help Brexit trade related events to hear from businesses.
- Environment and Rural Affairs Brexit Roundtable Stakeholder Group set up after the referendum, as a forum for engagement and collaboration between the Welsh Government and the food, fisheries, farming, forestry and the environment sectors.
- In health we engage with key health and care stakeholders through the main representative bodies: Welsh NHS Confederation and Social Care Wales. We are also working directly with specific groups and organisations such as Public Health Wales, Royal College of Nursing, Association of British Pharmaceutical Industry and NHS medical directors.
- We also engage through the Workforce Partnership Council, Faith Forum and the Third Sector Partnership Council.

On 23 August the UK Government published the first of its "technical notices" which include advice for businesses, citizens and public bodies on what to do if the UK leaves the EU without agreement ( a 'no deal' Brexit). It is the view of Welsh Ministers that a 'No deal' outcome would be a catastrophic failure of the UK Government that would cause huge disruption and serious, long-lasting economic and social damage to all parts of the UK. If the UK Government had adopted the blueprint to negotiations the Welsh Government set out over 18 months ago, they could have made substantial progress on the future partnership with the EU. They also could have avoided the situation we face today where our biggest employers are considering leaving the UK with the loss of thousands of jobs causing disruption to our economy, our universities are at

risk of losing out on vital research and our hospitals are warning of staff shortages putting patients at risk.

Wales welcomes the efforts made by the UK Government to spell out some of the practical issues likely to arise if there is a no deal outcome to the current negotiations. These notices demonstrate a simple truth - a 'no deal' Brexit would lead to huge disruption, hitting our economy, jobs, trade, services and a range of other sectors hard.

The Welsh Government welcomes the UK Government's increase in engagement with the devolved Administrations on the development of the notices and wider contingency planning around a 'no deal', but there is still much further that the UK could go in working collaboratively with us on all elements of EU exit negotiations and preparations. We have repeatedly and strenuously raised the need for the UK Government to properly share information on the steps they have taken to prepare. We are glad that this is beginning to happen but there is a need to increase the flow of information further. The reality is our ability to plan is limited by what the UK Government shares with us.

Whatever the form of Brexit, the UK leaving the EU will cause disruption. That is why as, as a responsible government, we will continue to plan for all possible outcomes. It is imperative that all the administrations across the UK work collaboratively to plan how to mitigate the most serious effects of a breakdown in the negotiations between the UK and the EU27 - the Welsh Government is strongly committed to doing this.

In the meantime Welsh Government is pursuing additional sources of funding including £150m of Industrial Challenge funding approved this year with a further £150m of pipeline applications pending.

## **5.0 Ministerial Advisory Board**

Good quality, relevant and timely advice from external sources is essential to informing effective policy-making and the new Ministerial Advisory Board strengthens that capacity for sound and challenging external advice. Establishing the new Board builds on the theme of simplification and transparency, because it is accompanied by a phasing out of a number of sector panels, groups and boards. This new Board has a broad remit across the whole of industry and advise on the creation of a sustainable economy of the future for Wales.

Due to this streamlining, a number of my advisory panels and boards have been wound up or merged. In terms of sector panels, those in respect of energy and environment, financial and professional services, ICT, and construction have been wound up. The Creative Industries sector panel will be replaced by a board for Creative Wales. We have started the Public Appointments process and expect it to be in place for early 2019. The roles of the Life Sciences Sector Panel and Advanced Manufacturing and Materials sector panel having already been superseded by the Life Sciences Hub and Industry Wales respectively.

I have also wound up the Enterprise Zone Boards for Central Cardiff Enterprise Zone, the St Athan Enterprise Zone. The Ebbw Vale Enterprise Zone Board will also cease with relevant functions represented and continued by the Technology Park Board. I have also announced a timetable for transition toward the merger of the Snowdonia and Anglesey Enterprise Zones and the ceasing of the Deeside Board as it transitions into the Advanced Manufacturing Research Institute Board.

It is important to recognise what is in scope in these considerations. We need to distinguish between those bodies that provide a statutory function and those that do not. We also need to be clear on what we mean by an 'advisory board'. In particular, recognising that there is a very clear difference between bodies that provide advice to Welsh Government and Welsh Government advisory bodies i.e. those groups, panels and boards established and appointed by Welsh Ministers with the purpose of providing advice on economic development and transport matters.

When the often-quoted figure of 48 advisory boards is unpicked, it becomes evident that it includes bodies that provide statutory functions like the Council for Economic Development, the Welsh Industrial Development Advisory Board as well as bodies that sit outside of the direct control of Welsh Government. My focus has been on streamlining those groups that we have direct responsibility for – like the sector panels and enterprise zone boards. As the Ministerial Advisory Board develops and matures, we will consider further opportunities for streamlining.

## **6.0 Economic Action Plan**

### Economic Action Plan Implementation

Following publication of the Economic Action Plan in December 2017, we have made considerable progress over the first half of this year to implement and embed key elements of the Plan. At the front and centre of this work has been the development and introduction of the new operating model (Economic Contract, the Calls to Action and the Economy Futures Fund). This is the centrepiece of the Plan and now frames our relationship with business.

Alongside the new operating model, we have also taken steps to streamline and strengthen the way in which advice is provided so that it is strategic, joined-up, and effective. We have achieved this through the establishment of a new Ministerial Advisory Board (external advice) and a Cross Government Delivery Board (internal advice).

Our focus now is on implementing other key aspects of the Plan. These include regional economic development and foundation sectors.

### New operating Model (Economic Contract, Calls to Action, Economy Futures Fund)



### *Economic Contract*

The early and good progress we have made in embedding the Economic Contract is important because it is at the bedrock of our new operating model, to changing the way we deliver and to the inclusive growth ambitions of the Economic Action Plan.

To date (August 2018) we have completed 44 Economic Contracts with businesses. These cover a good spread of businesses of different sizes, in different sectors and different parts of Wales. They provide lots of learning that we are capturing so that we use it in disseminating good practice.

### *Calls to Action*

From the outset, we have been clear that we would not apply the Calls to Action retrospectively to cases where we were already in detailed discussions with a business about an investment proposal. Naturally, there is a time-lag between the implementation of the Calls to Action and the receipt of new business investment proposals that align to them. However, we are now beginning to see a flow of such proposals and 67 are at an advanced stage.

The Calls to Action are very much about future proofing and represent the areas where we want to work with business. Each Call to Action encapsulates, at a high level, the outputs we are seeking to secure, but we are working to develop more detailed metrics and guidelines to support value for money assessments. This is an iterative process and is being informed by the learning we are capturing from our experience of the Calls to Action.

### *Economy Futures Fund*

The Economy Futures Fund provides the financial underpinning to our new operating model. It provides businesses with a clearer line of sight to direct Welsh Government funding that can support the Calls to Action. We have consolidated six funds into the Economy Futures Fund. They are:

- Capital Investment and aid for job creation.
- Research, Development and Innovation (including SMART Cymru).
- Environmental Protection Scheme (EPS).
- Tourism Investment Support Scheme (TISS).
- Creative Production Funding.
- Repayable Fund for SMEs.

We have said we will consolidate as much of the direct funding we offer as is possible and practicable into the Economy Futures Fund. This has to be part of a managed transition and it will take time. We want to see how the Economy Futures Fund operates first, incorporate learning and see what businesses are telling us before we take the further step of consolidating further funding streams. In 2018-19 the capital budget supporting business is £50m and the innovation

budget is £3.8m. Welsh Government leverages its core funding alongside European Structural funding for the benefit of the economy, particularly in the infrastructure, training, skills and innovation priority areas.

Clearly, because we have consolidated a number of existing funds, it is inevitable that the Economy Futures Fund contains forward commitments agreed before the new operating model came into existence. It is important that we honour those commitments and so for some time, the Economy Futures Fund will support legacy projects agreed prior to the Economic Action Plan.

However, over time, we will see a gradual tapering in those legacy projects and an increase in the proportion of support we deliver to new projects agreed under the new operating model of Economic Contract, Calls to Action and Economy Futures Fund. Since the launch of the Economy Futures Fund in May, we have given a commitment of just over £6.2 million in financial support to 29 businesses.

Budgets will continue to be realigned and reprioritised during the transition to the new operating model. The budget presentation will be revised for the 2019-20 Draft Budget.

### Regional Economic Development

The Plan is a plan for all of Wales and I want to enable all parts of Wales to develop their strengths and opportunities, so that they not only make a bigger contribution to wealth and well-being, but also benefit more from it. That is why developing our approach to Regional Economic Development is at the front and centre of this next phase of delivering the Economic Action Plan.

The production of regional plans is not the totality of regional economic development, but they are a critical part of it. This is because regional economic development is a huge agenda, with many moving parts, not least the future of regional investment in a post-Brexit landscape. In this context, the regional plans are critical to clarifying priorities and creating a unity of purpose around those priorities.

We have established four key principles that are guiding our work on the development of regional plans. They are:

- Regional Plans must add value and not duplicate other regional plans such as City and Growth Deals.
- They must balance ambition with deliverability – recognising opportunities, but also constraints.
- They need to be rooted in our strategic vision, agenda and obligations as set out in the Economic Action Plan, Prosperity for All and the Well-being of Future Generations Act.

- They should not be a top-down imposition, but created and developed with our partners in the regions.

The Chief Regional Officers are continuing to engage with a range of partners in each region to help inform the approach. Because regional economic development has to be a shared endeavour across Government, we have also made this agenda the key focus of the Cross Government Delivery Board. We have already had a good discussion at the Board covering a range of issues, including the scope of the regional plans. This work will intensify over the autumn, when I expect to take this issue to Cabinet with a view to making an announcement before the end of the year.

### Foundation Sectors

We have identified four foundation sectors (food; retail; care and tourism) where we think there is scope to work more effectively across Government and with the sectors to maximise benefits. In doing so, we think we can help to:

- Improve the quality, sustainability, and prospects of these sectors.
- Change perceptions of work in these sectors to aid recruitment, retention, and progression.
- Maximise the impact of these sectors on place-based and regional economic development.

The development of an enabling plan is important in that context because it will guide cross-government activity and help the sectors themselves address common approaches to tackling common issues.

We are working across Government and with the sectors to identify common themes, opportunities and challenges and potential responses to these as the basis for a single, strategic and integrated foundation sector enabling plan. We expect to be in a position to publish a draft plan for further consultation in December of this year.

## Annex A – 2018-19 Plan – Overview of Budget Changes

Economy & Transport MEG - In Year Budget Changes		Resource £'000	Capital £'000	Total £'000
<b>2018-19 Final Budget</b>		<b>654,625</b>	<b>412,601</b>	<b>1,067,226</b>
<b>Allocations from Central Reserves</b>				
Bus Support	Funding for TrawsCymru will support free bus travel for strategically important public transport connections on key routes not served by the rail network.	1,000	-	1,000
Tech Valleys	The investment supports a £100m project to provide new manufacturing space with a focus on new technologies. It supports the "Our Valleys Our Future" programme. <i>The total allocation is £25m (2019-20 £10m and 2020-21 £10m)</i>	-	5,000	5,000
Next Generation Broadband – <b>Leader of the House and Chief Whip portfolio</b>	The investment supports Next Generation Access Broadband Phase 2 to deliver fast, reliable broadband to those areas in Wales not served by the market. <i>Total investment is £31.5m (2019-20 £16m and 2020-21 £6.5m)</i>	-	9,000	9,000
Transport Developments	The allocation from the financial transactions capital reserve will support integrated public transport network developments in the Cardiff capital region.	-	30,000	30,000
Sustainable Travel, Walking & Cycling	The investment will accelerate active travel routes to connect residential areas with key employment and educational sites and services. <i>Total investment is £60m (2019-20 £20m and 2020-21 £30m)</i>	-	10,000	10,000
Cadw visitor experience - <b>Minister for Culture, Tourism and Sport portfolio</b>	The investment supports the Cadw visitor experience including major projects for Caerphilly Castle, Flint Castle, Tretower Court, Caernarfon Castle and Porth Mawr. <i>Total investment is £10m (2019-20 £3.8m and 2020-21 £4.5m)</i>	-	1,278	1,278
<b>Total Additional Allocations</b>		<b>1,000</b>	<b>55,278</b>	<b>56,278</b>
<b>2018-19 First Supplementary Budget</b>		<b>655,625</b>	<b>467,879</b>	<b>1,123,504</b>