

Rebecca Evans AC/AM
Y Gweinidog Cyllid a'r Trefnydd
Minister for Finance and Trefnydd



Llywodraeth Cymru
Welsh Government

Eich cyf/Your ref
Ein cyf/Our ref MA-RE-0709-20

Llyr Gruffydd AM
Chair
Finance Committee
National Assembly for Wales
Cardiff
CF99 1NA

28 February 2020

Dear Llyr,

**Finance Committee report: Scrutiny of the Welsh Government's Draft Budget 2020-21
(January 2020)**

In line with the commitment to respond to all Committee reports on the draft Budget no later than the day before the final Budget debate, I am pleased to enclose at Annex A the Government's response to the recommendations contained in the Finance Committee's report on its scrutiny of the Draft Budget 2020-21 (January 2020).

Once again, I would like to thank the Finance Committee for its cooperation in accommodating the changes to this year's budget timetable, including the truncated period for scrutiny.

Yours sincerely,

A handwritten signature in black ink that reads "Rebecca Evans".

Rebecca Evans AC/AM
Y Gweinidog Cyllid a'r Trefnydd
Minister for Finance and Trefnydd

Canolfan Cyswllt Cyntaf / First Point of Contact Centre:
0300 0604400

Bae Caerdydd • Cardiff Bay
Caerdydd • Cardiff
CF99 1NA

Correspondence.Rebecca.Evans@gov.wales
Gohebiaeth.Rebecca.Evans@llyw.cymru

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.

Response to Finance Committee's Recommendations on the Draft Budget 2020-21

Recommendation 1. The Committee recommends that the Welsh Government considers how a debate on spending priorities could be factored into the budget timetable, to provide an opportunity for the Assembly to influence budget priorities and allocations earlier in the process.

Response: Accept

We are committed to supporting meaningful and effective scrutiny of our budget proposals. This is demonstrated by the steps we have taken in recent years, including the move to a two-stage budget process which provides for eight weeks of scrutiny. In response to the calls made by the Finance Committee during scrutiny of the First Supplementary Budget 2019-20 for the Government to provide an early statement on spending priorities, the Minister for Finance and Trefnydd made an Oral Statement in plenary in July setting out the future outlook for public spending in Wales. We also welcomed the Finance Committee's debate on the Government's spending priorities in September. We are open to exploring with the Senedd Business and Finance Committees how a debate on spending priorities could be factored into the budget timetable.

Recommendation 2. The Committee recommends that the Welsh Government continues to press the UK Government to examine the merits of different mechanisms for overseeing application of the Statement of Funding policy, such as oversight by a body independent from government, possibly the Constitution, Democracy and Rights Commission.

Response: Accept

We welcome the Committee's acknowledgement of this important issue. Together with the Finance Ministers in Scotland and Northern Ireland, the Minister for Finance and Trefnydd has written to the new Chief Secretary to the Treasury seeking a commitment to a Finance Minister's Quadrilateral ahead of the UK Budget on 11 March. Devolved Ministers will be calling for the joint work to review and improve the Statement of Funding Policy to be completed, including putting in place effective machinery, with a credible and workable dispute avoidance and resolution mechanism, to underpin this.

Recommendation 3. The Committee recommends that the Welsh Government seeks commitments from the UK Government that UK fiscal events will normally take place by a specified date to ensure devolved administrations have sufficient time to carry out meaningful budget setting and scrutiny.

Response: Accept

The interaction between our budget timetable and that of the UK Government's is a matter that has been considered in previous years, but the awkwardness this year has been more prominent. The Committee has recommended in previous years that we should continue with the current practice of publishing the draft Budget regardless of the timing of the UK Budget. This recommendation is one we have accepted. While the timing of UK fiscal events is a matter for the UK Government, we will continue to highlight to the UK Government the importance of providing the Devolved Administrations with greater certainty and clarity in relation to the timing of UK fiscal events, given the impact this has for our respective budget procedures.

Recommendation 4. The Committee recommends that the Welsh Government continues to negotiate with the UK Government to secure more frequent and structured quadrilateral meetings of UK Finance ministers.

Response: Accept

In the recent joint letter to the Chief Secretary to the Treasury, the Devolved Finance Ministers have called on the UK Government to complete the joint work to formalise the Finance Ministers' Quadrilateral as a regular forum to discuss and resolve fiscal issues that impact on devolved governments.

Recommendation 5. The Committee recommends that an update is provided as soon as possible after the UK budget detailing any impact of the UK macroeconomic forecasts, particularly any impact on devolved tax revenues and the associated block grant adjustments.

Response: Accept

In the debate on the draft Budget, the Minister for Finance and Trefnydd committed to providing an update as soon as possible following the UK Budget on the implications for the Welsh Government's Budget. This will cover the impact of any spending announcements via the Barnett formula, and also how the new macroeconomic forecasts are likely to affect devolved tax revenues and the associated block grant adjustments.

Recommendation 6. The Committee recommends that the Welsh Government recommences talks on new taxes with the UK Government as soon as possible in order to test the process, and provide an update to the Committee in due course.

Response: Accept

The Welsh Government is making progress with the UK Government to secure powers for a vacant land tax in Wales. A Joint Exchequer Committee to discuss the proposal has now taken place, and we have sent a formal request for new tax

powers to the UK Government. The UK Government is currently considering this request.

Recommendation 7. The Committee recommends that the Welsh Government keeps under review new and emerging data sources, such as the Office for National Statistics Welsh Gross Domestic data, to improve the accuracy of Welsh economic and devolved tax forecasts.

Response: Accept

The forecasting models underpinning the Office for Budget Responsibility's forecasts for the fully devolved taxes are maintained by Welsh Government analysts and are reviewed regularly. The quality assurance procedures ensure those models make use of the best available data sources. Welsh Government analysts also liaise with OBR and HMRC analysts regarding income tax forecasts and take part in challenge sessions during each forecasting exercise.

The new ONS publication of quarterly GDP growth for the countries and regions of the UK is a welcome addition to the economic evidence base. It should however be noted that these statistics are experimental and are still being developed and tested with users. Early indications are that the series are volatile and subject to quite large revision. If they eventually prove to be a useful indicator of tax revenue growth, there will be a good case for taking them into account in the tax forecasts. They are most likely to be of use in relation to income tax forecasts, where there are long lags before outturn information is available. The OBR will be interested in any data source which can improve its assessment of the current revenue position.

As detailed in its Welsh Taxes Outlook publication, the OBR has considered the value of a full macroeconomic forecast for Wales. Due to the similarities in historic growth rates between Wales and the rest of the UK, when expressed on a "per head" basis and issues relating to data availability and reliability, it concludes that there is more value in monitoring the convergence or divergence between Wales and the UK in specific economic variables of relevance to the taxes.

Recommendation 8. The Committee notes the significant level of coding errors reported in relation to Welsh Taxpayers by HMRC and recommends that the error rate continues to be monitored by the Welsh Government and an update is provided to the Committee following the next scan.

Response: Accept

C codes were introduced to the UK tax system for the first time last April. Around 97% of C codes are now operating correctly. The Welsh Government is in regular contact with HMRC, which has an ongoing programme of compliance work to further increase the percentage of C codes being used properly. Following the latest scan, the coding errors have reduced again and are expected to reduce further when we receive data in April. We will provide an update to the Committee once data from the next scan is available.

Overall, the problems with C code operation broadly match the experience of the introduction of S codes for Scottish taxpayers, where currently only 1.5% of S codes are not being used properly. S codes were introduced into the UK tax system in April 2016. The Welsh Government monitors the situation through governance meetings with HMRC, which usually take place on a monthly basis.

Recommendation 9. The Committee recommends that the Welsh Government considers ways in which it can improve the integration of well-being goals in the presentation of future budgets to demonstrate more consistently how the Wellbeing of Future Generations Act is embedded in its decision making processes throughout departments and that this is reflected in the budget process.

Recommendation 10. The Committee recommends that the Welsh Government works with the Future Generations Commissioner and stakeholders to develop the Budget Improvement Plan.

Response: Accept

The purpose of the Budget Improvement Plan, which was published for the first time as part of the 2020-21 draft Budget, is to set out how we will use the Well-being of Future Generations Act and the five ways of working to drive continuous improvement in the budget process. As part the Plan we will explore how the presentation of future annual budgets can more clearly demonstrate how the Act and our well-being objectives have influenced our strategic spending priorities. Engagement is a key element of the Plan, which includes actions to develop how we engage with stakeholders, including the Future Generations Commissioner and her office, about the Plan's delivery.

Recommendation 11. The Committee recommends that the Welsh Government lengthens the period of time covered in the Budget Improvement Plan to reflect the spirit of the Well-being of Future Generation Act and longer term transformational change.

Response: Accept in principle

We accept the spirit of this recommendation which is about providing longer-term transformational change which is why the Plan seeks to demonstrate the journey we have been on, and the journey ahead, to improve the budget process over the course of a number of years. This is the first time we have published a Budget Improvement Plan which is intended to be developmental in nature as every time it is published, it will take a five-year horizon and be a rolling programme of improvements, demonstrating how the Act is being embedded. This approach is intended to strike the balance between being ambitious but also realistic about the time it will take to deliver the actions contained within the plan to maximise their impact and reflect meaningfully the nature of the change outlined in the plan. We will work with stakeholders, including the Future Generations Commissioner, to understand how we might improve the plan and expand its scope for future years.

Recommendation 12. The Committee recommends that the Strategic Integrated Impact Assessment accompanying the 2021-22, and future budgets, provide a transparent account of the negative as well as the positive impact of budget allocations, including the evidence base on which they draw.

Response: Accept

In line with previous evidence and feedback, the Strategic Integrated Impact Assessment of the draft Budget sets out the detail of the evidence, statistics and supporting information which underpins the spending proposals, a step acknowledged by the Committee. We recognise that impact assessments must consider both negative and positive impacts in order to mitigate negative impacts and to explore opportunities to promote a more positive approach.

The 2020-21 Budget has provided real terms increases for all portfolios. This has meant that we have been able to sustain the majority of budgets at 2019-20 levels and make a number of targeted investments in line with our cross-cutting priorities. This is reflected in the narrative of the Strategic Integrated Impact Assessment.

In line with our ongoing commitment to improve the way we assess the impact of our spending decisions the Budget Improvement Plan identifies a range of actions to further strengthen Welsh Government's approach.

Recommendation 13. The Committee recommends that the Welsh Government provides an update on the outcome of its discussions with the Scottish Government on the role of its Equality Budget Advisory Group and any changes in approach that may arise following these considerations.

Recommendation 14. The Committee urges the Welsh Government to use evidence and best practice from work undertaken elsewhere as a basis for a gender sensitive budgeting approach, in order to mainstream a gender dimension into all aspects of the budget cycle without delay.

Response: Accept

Initial discussions have been held with the Chair of Scotland's Equality Budget Advisory Group about the Group's approach in Scotland as part of discussions during the Gender Equality Review.

We are also pursuing discussions with Scottish Government as we establish our relationship with the Well-being Economy Government (WEGo) network.

In November, Welsh Government officials also held a workshop with the existing members of the Budget Advisory Group for Equality (BAGE) and wider stakeholders to consider how this group can evolve to continue to provide insight into the impact of our budget decisions, across all the impact considerations, including equality.

We will consider carefully the feedback from these sessions to frame our future approach to BAGE and how we engage more widely with stakeholders. We will update the Finance Committee in due course about any changes in our approach.

As part of the 2020-21 budget preparations we are exploring a gender budgeting approach as part of the Personal Learning Account pilot to assess how a gender budgeting approach might help identify and understand potential different impacts, including unintended impacts, to improve how we prioritise and allocate resources. The Budget Improvement Plan sets out our ambitions to test and integrate gender, exploring and developing a gender budgeting approach in our budgeting considerations. As part of this, we will be using evidence and best practice from a range of sources to inform our ongoing work.

Recommendation 15. The Committee recommends that the Welsh Government provides more detail in future years on how allocations and programmes will progress towards the commitment to be carbon neutral by 2050 and over what timescale this will be achieved.

Recommendation 16. The Committee recommends that the Welsh Government develops an understanding of the carbon impact of the budget and its spending decisions, and looks at how it can meaningfully demonstrate the carbon impact of future budgets.

Recommendation 17. The Committee encourages the Welsh Government to support the work being taken forward by the Future Generations Commissioner in relation to the development of a carbon impact account and explore other ways in which the Commissioner's office, with its degree of independence, can provide further advice and support to help the Welsh Government achieve its decarbonisation ambitions and well-being objectives.

Response: Accept

Alongside the draft Budget, the Minister for Finance and Trefnydd published the Budget Improvement Plan, which sets out further steps to explore how the assessment of the carbon impact of our spending programmes can be embedded more firmly in the budget process.

The carbon impact assessment of spending programmes is a cross cutting responsibility of all Ministers and should inform the funding decisions Ministers take in setting detailed MEG spending plans.

However, the assessment of the specific carbon impact of individual investments is not always a straightforward process. For example, the carbon reduction impact of the Welsh Government's investment in electric charging infrastructure is likely to be highly dependent on the regulatory decisions that the UK Government makes regarding fossil fuel vehicles. Where it is appropriate and meaningful, we will consider the incremental impact of Welsh Government spending, as well as the wider impact that policy implementation has on carbon emissions.

Additionally, the development of the next Low Carbon Delivery plan will set out the detail of how key policies will allow us to meet our carbon budget, providing clarity and certainty to businesses and individuals. We are already developing the policies and proposals that will allow us to implement a plan to meet our second carbon budget. We recognise that the increased ambition will mean an increased scale and rate of the policy effort required to meet our new target.

Next year, we will be receiving further Welsh-specific advice and recommendations from the UKCCC, including recommendations on changing our pathway through our 2030 and 2040 targets and our second carbon budget. We will also receive a progress report on our first carbon budget, and HM Treasury will be undertaking a review of how the transition to net zero would be funded and where the costs would fall. These are all key pieces of evidence we will need to review in evolving how we assess the impact of our budget decisions.

A workshop was held in September with officials from the Future Generations Commissioner's office, the New Economics Foundation and Welsh Government senior policy officials to reflect on the 10 point plan. This included discussion on the work the Commissioner is intending to take forward on carbon impacts.

We welcome the Commissioner's intention to undertake work in relation to the development of a carbon impact account and will look forward to considering its conclusions in due course.

Recommendation 18. The Committee recommends that the Welsh Government clearly sets out in future budget documentation how it is applying its own definition of prevention to expenditure and provides as much information as possible on the outcomes it is aiming to deliver through its preventative strategies.

Response: Accept

We are committed to supporting a continued shift in investment towards preventative activities as part of our Budget Improvement Plan. We will consider how we can set out more clearly the improvements we are making within future budget documentation, including how we take forward our definition of prevention.

Recommendation 19. The Committee recommends that the Welsh Government provides an analysis of preventative spend within the budget and accelerates actions relating to prevention in its Budget Improvement Plan.

Response: Accept in principle

We remain committed to providing greater detail about the investment we are making in preventative activity in the annual Budget. In recognising this to be a complex area, we are keen to ensure any such analysis is robust, meaningful and serves a clear purpose in improving budget allocations. Through delivery of our

Budget Improvement Plan we will consider how we might accelerate the current activities set out in the plan.

Recommendation 20. The Committee recommends that the Welsh Government engages with stakeholders to find better ways to evidence and communicate the process for identifying priorities and making budget decisions.

Response: Accept

As part of preparations for the 2020-21 draft Budget, the Minister for Finance and Trefnydd met with a range of stakeholders including each of our four statutory Commissioners and the Equality and Human Rights Commission to hear their views on priority areas for the Budget. Such engagement is a key element of our Budget Improvement Plan, which sets out our continuous ambitions to engage meaningfully with key stakeholders to shape improvements to spending and taxation proposals. These plans include using feedback from our recent workshop with the Budget Advisory Group for Equality (BAGE) and wider stakeholders to develop an enhanced approach to engaging about budget considerations in the future.

Recommendation 21. The Committee recommends that the Welsh Government develops a definition of poverty in a Welsh context and clearly sets out its vision for tackling poverty in Wales, including: distributional impacts, the intended outcomes of targeted poverty interventions, and steps to respond to the impact of UK Government decisions.

Response: Accept in principle

The Welsh Government has already adopted a definition of poverty which is broader than an income measure. This is set out in our Child Poverty Strategy.

We realise that standard measures such as basing a definition purely on income alone does not capture the multidimensional nature of poverty. The Welsh Government has already adopted one alternative model in the Wales Index of Multiple Deprivation which is used for programmes such as Flying Start. We are also exploring the feasibility of improving the precision and scope for breakdowns of Welsh poverty estimates derived from the Department for Work and Pensions' Family Resources Survey data.

It is important to recognise that measures of poverty are relative so we need to take care in applying certain definitions too rigidly. We need to recognise, as far as possible, the differences in people's circumstances and try to tailor our assistance accordingly so we maximise the impact of our investment. We are working with the Department for Work and Pensions and Social Metrics Commission on alternative measures of poverty.

Our vision of reducing poverty as far as it is possible relies on immediate measures to put additional money into people's pockets but also implementing longer term

measures in education, training and employment which will lead to a skilled and well paid workforce.

We will continuously assess the effectiveness of the policies which support our vision and will adapt them as necessary to ensure their impact is maximised and support our ambitions to reduce the levels of poverty in Wales. We also recognise that the policy levers affecting the headline poverty figure sit firmly with the UK Government and we are implementing measures aimed at alleviating the effects of these policies.

Recommendation 22. The Committee recommends that the Welsh Government develops new strategies to improve the education, skills and employment opportunities of the most disadvantaged members of society.

Response: Accept in principle

We have prioritised skills and employability in Prosperity for All, our National Strategy, recognising the positive impact that education, training and upskilling can have on employment prospects which is good for individuals and good for the economy. We have set out our strategic approach in the Employability Plan, Economic Action Plan and 'Education in Wales - Our National Mission'. These strategies guide how we tackle education, skills and employment levels in Wales and deliver opportunity, equality and prosperity for all. They also deliver the operational framework to guide cross government policy development, implementation and monitoring.

Recommendation 23. The Committee recommends that the Welsh Government considers ways to actively promote the real living wage to employers, particularly within the private sector, across Wales.

Response: Accept

The Welsh Government has a range of ways in which it can promote fair work, such as the Code of Practice of Ethical Employment in Supply Chains. We are working with relevant teams to scope how the real living wage and other elements of fair work can be promoted within the public and private sector, across Wales.

Recommendation 24. The Committee recommends that the Welsh Government provides evidence and additional details on how programmes aimed at improving the economy provide value for money whilst balancing investment to increase productivity and earnings, and to get people into employment.

Response: Accept in principle

All spending programmes are expected to demonstrate value for money based on sound evidence of what works, with ongoing performance assessed using key metrics and robust evaluation. We will explore what additional details we can provide in future budgets as part of the Ministerial evidence to Committees.

Recommendation 25. The Committee recommends that the Welsh Government reviews its strategy for bus services, ensuring that available resources are effectively targeted to better connect those who rely on this method of transport to ensure inclusive economic growth.

Response: Accept

The Buses (Wales) Bill is a key element of a wider process of reform we are undertaking in relation to the planning and delivery of bus services in Wales, which will contribute to our ambition of a high quality, low carbon, multi-modal and integrated public transport network, which meets the needs of the travelling public. The changes proposed in the Bill by the Minister for Economy, Transport and North Wales will seek to address some of the negative impacts of de-regulation on users, operators and local authorities by creating a number of tools which would enable local authorities to intervene should they choose to do so.

Recommendation 26. The Committee recommends that future Welsh Government Budgets should include flexibility and specific scenario planning to respond to economic shocks or uncertainty. Draft budgets should detail the response to negative effects or potential opportunities for different sectors of the Welsh economy.

Response: Accept in principle

The Chief Economist's Report, published alongside the draft Budget, provides a number of scenarios for the future prospects for the Welsh Government's finances and considers a range of fiscal risks. These scenarios will be adapted in future publications to reflect particular macroeconomic or fiscal concerns and emerging risks which are relevant at the time. The draft Budget includes an unallocated DEL provision which provides in-year flexibility to address unexpected changes which impact on the Welsh Government's finances. The cash reserve and borrowing powers provide further budgetary tools to enable the Welsh Government to manage its finances in as effective a manner as possible. The Minister for Finance and Trefnydd signalled to the previous Chief Secretary to the Treasury that, as part of the next Spending Review, we would be seeking a permanent increase in the maximum size of the Wales Reserve and in the annual drawdown limits, as well as an increase in the Welsh Government's annual and aggregate borrowing limits. These changes will ensure that the fiscal framework within which we operate enables the Welsh Government to manage its resources more effectively and deliver better value for money. Greater flexibility will be an important issue for discussion with the new Chief Secretary. In addition, the Budget Improvement Plan sets out the Welsh Government's intentions to explore the integration of scenario modelling into future budget planning.

Recommendation 27. The Committee recommends that the Welsh Government provides confirmation that it has obtained assurance from the UK Government on the financial support available to the agricultural industry in Wales for every year of the Parliament.

Response: Accept in principle

The UK Government has provided confirmation of funding for the Basic Payment Scheme in 2020. It has said it will seek to provide further information on funding for future years at the Comprehensive Spending Review planned for later this year. Until we receive such clarity, we are unable to provide confirmation. We will however continue to press the UK Government to end the uncertainty and confirm replacement of all European funding which currently comes to Wales without delay.