# Finance Committee Inquiry into the Implementation of the Wales Act 2014

## Evidence Paper

## Introduction

1. The Finance Committee is undertaking an inquiry into the implementation of the Wales Act 2014 and the operation of the Fiscal Framework. The inquiry will also consider public awareness of fiscal devolution and taxation in Wales.

## Context

2. The Wales Act 2014 heralded the devolution of taxes in Wales and marked an historic moment in Welsh political history. Six years on from its introduction, the last of the financial provisions in the Act have been implemented and the first year of operation of the Welsh rates of income tax has been completed. It is important to recognise the amount of work that has gone in over this period including:

    - the establishment of three Acts: the Tax Collection and Management (Wales) Act 2016; the Land Transaction Tax and Anti-avoidance of Devolved Taxes (Wales) Act 2017; and the Landfill Disposals Tax (Wales) Act 2017;

    - the creation of a new tax collection body in Wales, the Welsh Revenue Authority; and

    - the successful transition from Stamp Duty Land Tax and Landfill Tax, to the Land Transaction Tax and Landfill Disposals Tax in Wales;

    - the introduction of a Welsh Rate of Income Tax.

3. Under section 23 of the Wales Act 2014, Welsh Ministers are required to report annually on the progress made in effecting the provisions under Part 2, until the first anniversary after the final provisions have been implemented. These annual reports, published on the Welsh Government website, detail the considerable effort that has been involved over the last six years to deliver these changes on time and within budget. A link is provided here to these annual reports, https://gov.wales/welsh-taxes#WalesActreports.

4. It is also important to recognise the successful implementation of these new devolved taxes owes much to the valuable contributions provided by a wide range of stakeholders and organisations.

5. These changes has placed greater accountability at the heart of the Welsh devolution settlement and ensured the Welsh Government has more responsibility for how money is raised and spent in Wales.

6. As a consequence, around £5 billion of spending in Wales is now funded through devolved and local taxation - land transaction tax, landfill disposals tax, Welsh rates of income tax, council tax and non-domestic rates.

7. We have also embarked on the next stage of tax devolution by considering new taxes for Wales. This has the potential to make a real difference to Wales - helping us to deliver our policy priorities, whether this is by changing behaviour, raising revenue to invest in our public services, improving equity, or a combination of all.

8. For the first time, we are navigating the Wales Act process to transfer the relevant powers to Wales in relation to a new tax (a tax on land suitable for development, or a vacant land tax). The current exercise is key to testing whether we have a mechanism which will deliver further opportunities for tax policy to support our objectives.

**Tax principles**

9. The Welsh Government's principles for the development, implementation and administration of Welsh taxes were set out in the Tax Policy Framework published in 2017.

10. These are that Welsh taxes should:

    i) Raise revenue to fund public services as fairly as possible;
    ii) Deliver Welsh Government policy objectives, in particular supporting jobs and growth;
    iii) Be clear, stable and simple;
    iv) Be developed through collaboration and involvement;
    v) Contribute directly to the Well Being of Future Generations Act goal of creating a more equal Wales.

11. Guided by these principles, our tax strategy has ensured that we have developed taxes that are fair to the businesses and individuals who pay them; which are simple, with clear rules, aiming to minimise the costs of compliance and administration; that support growth and jobs, which in turn will help tackle poverty; and which provide stability and certainty for taxpayers.

12. Moving forward, the balance between investment in public services, the competitiveness of the Welsh economy and the impact on tax payers will continue to be at the forefront of decisions. As well as consideration of how best to use any new tax or further devolved tax as a lever to advance fairness and equality, enabling us to tackle social issues, ensuring justice and economic security.

**Administration of devolved taxes**

13. The measures in the Wales Act 2014 to allow for the development of devolved taxes, led to the preparation of three Welsh Tax Acts, the Tax Collection and Management (Wales) Act 2016; the Land Transaction Tax and Anti-avoidance of

Devolved Taxes (Wales) Act 2017; and the Landfill Disposals Tax (Wales) Act 2017.

14. On 1 April 2018, these Welsh Tax Acts came into force. A Tax Devolution Programme Board was established, led by HMRC. Its purpose to oversee the transition from Stamp Duty Land Tax to Land Transaction Tax, and from Landfill Tax to Landfill Disposals Tax. The Board also oversaw the Welsh Rates of Income Tax project – see paragraph 37). The Tax Devolution Programme Board provided a route for resolving project-level challenges. This board has now been formally closed.

*Land Transaction Tax*

15. The regulations to bring the rates and bands for Land Transaction Tax into effect were agreed by the National Assembly for Wales on 30 January 2018. These rates and bands have remained in place until they were amended in July 2020. The revised regulations increased the threshold for paying the main rate from £180,000 to £250,000.

*Landfill Disposal Tax*

16. The initial rates for Landfill Disposals Tax came into force on 24 January 2018. The Welsh Government committed to increase the rates of Landfill Disposals Tax in line with inflation, to maintain consistency with the UK Government's approach to Landfill Tax rates.

17. The regulations setting the Landfill Disposals Tax rates for 2020-21 were approved by the National Assembly for Wales on 28 January 2020.

*Welsh Revenue Authority*

18. Subsequent to the Wales Act 2014, the Tax Collection and Management (Wales) Act 2016 established the Welsh Revenue Authority (WRA) to administer the two fully devolved Welsh taxes – Land Transaction Tax and Landfill Disposals Tax.

19. The WRA was established in 2017 a non-ministerial department of Welsh Government. It began collecting the two devolved taxes from April 2018. A framework agreement between Welsh Government and the WRA sets out their relationship and the respective roles and responsibilities.

20. The WRA is committed to delivering a fair tax system for Wales through what it calls 'Our Approach' – a Welsh way of doing tax. This is a partnership-led approach, working with taxpayers, their representatives, and partner organisations, and is inspired by three Welsh terms: Cydweithio, Cadarnhau, Cywiro:

- Cydweithio - This literally means ‘to work together’ and carries a sense of working towards a common goal.

- Cadarnhau - This suggests a solid, robust quality that can be relied on. This is about providing certainty, being accurate and reinforcing trust.
- Cywiro - This literally means ‘returning to the truth’ and is about the way we work with you to resolve errors or concerns.

21. This approach, inspired by the WRA Charter, which consists of eight shared values, beliefs and standards, sees the WRA sharing its knowledge and insights with customers to enable them to pay the right amount of tax at the right time. There are processes in place for those who will deliberately try to avoid paying the right amount of tax.

22. The WRA has had a digital first approach to its services from the outset. Alongside dedicated customer service support this makes it easy for customers to file and pay their returns. The vast majority of WRA transactions are conducted digitally, with paper options available for those who cannot file or pay digitally.

23. The Minister for Finance and Trefnydd set out her expectations for the operation of the WRA over the period 2019-20 to 2021-22 in a remit letter. The letter set out the following priorities:

    - Ongoing development of the WRA – to build on the WRA's achievements and to look ahead over the longer term;

    - Achieving outcomes – to develop a suite of operational performance measures to identify how effectively the tax system in Wales is operating; and

    - Unauthorised Disposals – that the WRA should target resources on cases which address environmental impacts and place legitimate landfill businesses at a disadvantage.

24. The WRA's first three year corporate plan 2019-22, agreed by the Minister for Finance and Trefnydd and published in May 2019, reflects these complementary expectations, all aimed towards supporting taxpayers to pay the right amount of tax at the right time.

25. The plan is set in the context of the organisation's purpose:

    i. to design and deliver Welsh national revenue services;
    ii. to lead the better use of Welsh taxpayer data for Wales.

26. The WRA’s current strategic objectives are:

    a. Making it easier;
    b. Ensuring we are fair;
    c. Being more efficient;
    d. Enhancing our capability.

As well as two further objectives that aim to make the most out of the WRA’s role:

e. Data - Making the most of data assets for the benefit of Wales.
f. Design - Using experience and expertise to support the design of Welsh revenue services.

27. This year the WRA has led on work to consider how to make the best use of Welsh taxpayer data. While sharing information on the type of data the WRA now holds on the devolved taxes, with Welsh Government and Local Authorities, areas of common interest and possible opportunities to collaborate on improving services have been identified. The security of taxpayer data is always paramount to this work.

28. The Design objective has seen collaboration across Welsh Government and WRA to bring together a range of skills and expertise, to support early thinking on the design of any potential new revenue services. This way of working has also benefited changes to the existing two taxes.

29. The 2019-22 corporate plan includes a set of performance measures. As the WRA's approach is different, so are the nine performance measures, reflecting the new Welsh way of doing tax. The targets have been set for the end of the corporate plan period (2021-22). The WRA will report on these measures for the first time in its 2019-20 Annual Report, due to be published in Autumn 2020 – using both narrative examples and data.

30. The WRA's latest annual accounts published in July 2020 record the Authority raised £260 million through Land Transaction Tax revenues and £37 million through the landfill disposals tax revenues during 2019-20. The WRA processed just over 61,000 LTT returns, a similar volume to the previous period.

31. The WRA has been faced with particular operational challenges as a result of the flooding of its headquarters at Trefforest in February followed by the impact of the Covid-19 pandemic. The cloud based system and the primary focus on digital provision of its services has ensured the WRA has been able to maintain services with minimal disruption.

*Welsh Rates of Income Tax (WRIT)*

32. Sections 8 to 11 of the Wales Act 2014 provide for Welsh basic, higher and additional rates of income tax to be set by the Senedd by way of resolution, and further define "Welsh taxpayers".

33. The Wales Act 2014, when originally enacted, made provision for a referendum to be held in Wales about whether the income tax provisions set out in the Act should come into force. These provisions in relation to a referendum were subsequently removed by section 17 of the Wales Act 2017.

34. The Welsh Government's fiscal framework, agreed by the Welsh and UK governments in December 2016, confirmed the Welsh Government would introduce WRIT in 2019-20, subject to removal of the requirement for a referendum.

35. WRIT was introduced on 6 April 2019. For non-savings and non-dividend income, the UK Government reduced each of the three rates of income tax – basic, higher and additional rates – paid by Welsh taxpayers by 10p. On 15 January 2019, the Senedd agreed the Welsh Government's proposal to set the Rates of Income Tax for 2019-20 at 10p, ensuring the rates paid by Welsh taxpayers remained the same as those paid by English and Northern Irish counterparts.

36. HMRC retains responsibility for the collection and management of WRIT. In competence and legal terms this remains a UK tax, as are the associated arrangements for all allowances and reliefs (including the personal allowance), the tax thresholds and bands. The UK Government continues to retain the revenues from Income Tax on savings and dividend income from taxpayers in Wales.

37. Preparations for the introduction of WRIT were overseen by a cross-Government Welsh Rates of Income Tax Project Board, sitting below the Welsh Tax Devolution Programme Board, and comprising representatives of the Welsh Government, HMRC and HM Treasury.

38. As the project to implement Welsh Rates of Income Tax is now largely completed and WRIT has moved into Business as Usual operation, the project Board has transitioned to the Welsh Income Tax Board which will oversee the Business As Usual (BAU) arrangements.

39. The remaining outstanding actions in respect of the preparation of the Annual Tax Summary statement and the formal closure of the project will be managed through the new Board structure. The Board meets quarterly to monitor progress and is jointly chaired by Welsh Government and HMRC.

40. Both the Wales Audit Office and National Audit Office reviewed the preparations in the months before introduction and concluded that HMRC had appropriate delivery and governance arrangements in place to implement WRIT.

41. The outturn from the first year of income tax devolution (2019-20) will be published by HMRC in summer 2021.

42. Maintaining the accuracy of the Welsh taxpayer population is fundamental to the administration of WRIT. The Service Level Agreement (SLA) between Welsh Government and HMRC includes performance measures designed to ensure there is a continued focus on identifying and maintaining an accurate and robust record of the Welsh taxpayer population. The SLA includes a regular cycle of activity, including HMRC data scans, to ensure the accuracy of the data. One of the key requirements is for HMRC to report annually on its delivery of the agreed services.

43. The performance of WRIT is subject to audit by the Auditor General for Wales in the context of the production of the Welsh Consolidated fund and the National Audit Office. This is to ensure the adequacy of HMRC's rules and procedures put in place, in consequence of the Welsh rates provisions, for the purpose of

ensuring the proper assessment and collection of income tax charged at rates determined under those provisions.

44. Following an audit of the HMRC accounts, an extract covering all matters relating to WRIT will be made available to the Senedd. This is currently planned for January 2021.

**The approach to taxation in Wales**

45. Our annual tax work plan sets out how we are taking forward the development of tax policy in Wales. The latest published version relates to 2019. The 2020 Work Plan has been delayed due to the impact of the Covid-19 pandemic.

46. The issues addressed through the annual tax work plans can be grouped into the following three themes:

    - Develop tax policy as fairly as possible, aligned with Welsh Government policy priorities, and in collaboration with stakeholders.
    - Operate Welsh taxes within a UK context.
    - Increase knowledge and understanding about taxes in Wales.

47. The balance between investment in public services, the competitiveness of the Welsh economy and the impact on tax payers will be at the forefront of decisions, just as we use taxes as a lever to advance fairness and equality, enabling us to tackle social issues, including justice and economic security.

48. In particular we are continuing to pursue the devolution of a new tax (a vacant land tax) to Wales, testing the mechanism and the requirements of the process for the first time.

**Mechanism for devolving powers**

49. Continuing to build the capacity and capability required for the development and administration of the devolved taxes continues to be a key priority.

50. We are continuing to work with the UK Government to secure the devolvement of tax competence in respect of vacant land. A written statement was issued on w/c 7 September updating the Senedd Cymru on the latest position. I also wrote separately to the Chairs of the Legislation, Justice and Constitution and Finance Committees on this.

51. Alongside this, we are currently consulting on further legislation in Wales which will ensure Welsh Ministers can make changes to the “Welsh Tax Acts” at short notice in the following circumstances:

- to stop avoidance or evasion of the devolved Welsh taxes;
- to comply with international obligations;

- in situations of exceptional need (such as in response to a tribunal or higher courts decision);
- in specific circumstances where Welsh Ministers consider it in the public interest to do so; and
- in particular, in response to tax policy changes made by the UK government.

**Fiscal framework**

52. The framework underpinning the Welsh Government's funding arrangements is set out in two key documents: the statement of funding policy and the Welsh Government's fiscal framework agreement.

53. The statement of funding policy describes the detailed workings of the Barnett formula and how this is used to determine changes to the block grants for each of the devolved administrations. It also details a number of other elements of devolved finance arrangements. It was last published in 2015 alongside the comprehensive spending review in that year. The UK Government is planning to publish an updated version this year to accompany the forthcoming spending review.

54. The fiscal framework agreement was published in December 2016. It enabled the implementation of the tax and borrowing powers included in the Wales Acts 2014 and 2017. The agreement also introduced changes to the way the Barnett formula operates in Wales.

55. The following sections address various aspects of the fiscal framework. The fully devolved taxes, land transaction tax and landfill disposals tax, were introduced in April 2018 and the Welsh rates of income tax in April 2019. It is therefore still early to assess the performance of the fiscal framework in relation to the implementation of the devolved taxes. However, the sections below include some preliminary consideration of performance so far.

<u>Block grant / Barnett formula</u>

56. The Welsh Government is largely funded through a single unhypothecated block grant. Changes to the block grant are determined by the Barnett formula. Under this formula, the block grant in any given year is equal to the block grant in the previous year plus a population share of changes in UK Government spending on areas which are devolved to the Welsh Government.

57. At the time of a spending review this process involves a degree of approximation. UK Government plans for future years are only initially available at a departmental level. As some UK departments cover both devolved and non-devolved functions, it is not possible to say precisely what the change in funding for areas which are devolved will be.  To address this, the percentage split

between devolved and non-devolved spending from a base year is applied to the overall change in each UK department's budget over the period covered by the spending review.

58. These department-level percentages or comparability factors are calculated by assessing whether each individual spending programme is devolved or not. The spending on programmes which are deemed to be devolved is added up for the base year (usually the year prior to the period covered by the spending review) and divided by that department's overall budget. The comparability factors are calculated by the UK Government in the run up to a spending review and published in the statement of funding policy. The Devolved Administrations are consulted as part of this process.

59. The fiscal framework agreement introduced a new element to the Barnett formula in Wales. Changes to the Welsh Government's block grant are multiplied by a needs based factor. This is intended to address the convergent property of the Barnett formula which, if unreformed, would mean relative funding per person in Wales would fall towards the level in England. The needs based factor will be set at 115%, based on the range of relative need recommended by the Holtham Commission and the funding floor implemented in the 2015 Spending Review. For a transitional period, while relative block grant funding per person in Wales is above 115% of equivalent funding per person in England, the factor is set at 105%.

60. The needs based factor has been applied to changes in the Welsh Government's block grant since 2018-19, compared to a 2017-18 baseline. It has delivered a total of around £360 million additional funding to date, with about half of that in relation to coronavirus funding in 2020-21.

61. The Welsh Government's long term aim is for a needs based funding system which operates consistently across the UK. This is set out in the 2018 paper *Reforming UK funding and fiscal arrangements after Brexit: Securing Wales' Future* and summarised in the finance section of *Reforming our Union: Shared Governance in the UK.* In the meantime, the addition of a specific needs based factor means that for the first time relative funding in Wales takes account of Wales' relative need to fund devolved public services. Its introduction goes some way to delivering a fairer funding system for Wales.

Governance arrangements and specific funding allocations outside Barnett

62. The papers referenced above set out the Welsh Government's views on how devolved finance arrangements should be reformed. As noted in those papers, the current arrangements in the statement of funding policy are imposed by the UK Government. There is little meaningful consultation with the devolved governments and the arrangements are not jointly agreed. As a result, those

processes have been brought into dispute. For example, in 2017 the Welsh and Scottish Governments jointly raised a disagreement following the UK Government's decision to allocate an additional £1bn to Northern Ireland as part of the confidence and supply agreement between the Conservative Party and the Democratic Unionist Party following the 2017 General Election.

63. The current system should be replaced by jointly-agreed funding arrangements based on consent and cooperative working. This should operate with the UK Government and all of the devolved administrations, ending bilateral deals and agreements to bring consistency and clarity to the fiscal arrangements within the UK.

64. As noted earlier, the statement of funding policy will be revised in the run up to the spending review in the current year. The Welsh Government will be consulted as part of the process, however it will remain a UK Government document and revisions are unlikely to address the issues raised here.

Block grant adjustments

65. The fiscal framework agreement includes details of the block grant adjustments introduced alongside the devolved taxes. The adjustments reduce the Welsh Government's block grant, reflecting the fact that devolved tax revenues now go directly to the Welsh Government rather than the UK Exchequer.

66. The adjustments for the two fully-devolved taxes work from a baseline which reflects tax collected under the predecessor UK tax in Wales in the year prior to devolution (2017-18). The annual block grant adjustments (BGAs) are grown from this baseline reflecting changes in the equivalent UK Government tax in England and Northern Ireland.

67. The BGA accompanying the introduction of the Welsh rates of income tax in 2019-20 included a transitional arrangement, as the baseline position for the tax base at the point of devolution was not known. In the first year the adjustment was set at the expected level of revenues collected in Wales from 10p of tax in each band (applied to non-savings non-dividend income). With the Welsh Government setting the devolved tax rates at 10p in each band, the block grant adjustment was the same as the devolved revenues in 2019-20. As a result, there was no net impact on the Welsh Government budget from income tax devolution in the first year. From 2020-21 onwards the block grant adjustment for each band will increase or decrease reflecting growth in 10p's worth of income tax (from non-savings non-dividend income) in England and Northern Ireland.

68. The precise mechanism used to calculate the BGAs is known as the comparable model and is set out in detail in the fiscal framework agreement. The BGAs are

based on the Office for Budget Responsibility's (OBR) forecasts of UK Government tax revenues.

69. For the Welsh rates of income tax, the BGA is fixed before the beginning of the year in question, using the previous autumn's Economic and Fiscal Outlook (EFO). The BGAs for the fully devolved taxes are also set using the previous autumn's EFO but are revised in-year using the following autumn's EFO.

70. For 2020-21 the BGAs for all taxes have been set using the March 2020 EFO, because there wasn't an EFO in autumn 2019. The final BGAs for 2018-19 and 2019-20 and the current BGAs for 2020-21 are shown in table 1.

**Table 1: Block Grant Adjustments**

| | | | £ million |
|---|---|---|---|
| | 2018-19[1] | 2019-20[2] | 2020-21[3] |
| Land Transaction Tax | 241.8 | 234.8 | 260.9 |
| Landfill Disposals Tax | 26.5 | 24.9 | 24.7 |
| Welsh Rates of Income Tax | | 2,059.4 | 2,156.3 |
| Of which: Basic rate | | 1,778.4 | 1,854.3 |
| Higher rate | | 237.3 | 248.9 |
| Additional rate | | 43.6 | 53.2 |

1. Based on OBR autumn 2018 Economic and Fiscal Outlook
2. LTT and LDT based on OBR December 2019 Welsh Taxes Outlook
   WRIT based on autumn 2018 Economic and Fiscal Outlook
3. All based on OBR March 2020 Economic and Fiscal Outlook

71. The revenue outturns and current year forecasts for the fully devolved taxes and the current forecasts for WRIT are shown in Table 2. The coronavirus pandemic will affect revenues in 2020-21 across the devolved taxes. For budgetary purposes, the WRIT revenues in the current year are now fixed. The difference between the figures in table 2 and the eventual outturn will be taken into account in a reconciliation exercise. This will be combined with any change to the BGA shown in table 1, in the light of England and Northern Ireland outturn. The relevant income tax outturn information for 2020-21 will be available in the summer of 2022. The overall reconciliation adjustment will then be applied to the Welsh Government's block grant for 2023-24.

72. The OBR revenue forecasts for the fully devolved taxes in 2020-21 will be revised in the autumn, alongside the associated BGAs.

**Table 2: Devolved tax revenues**

| | | | £ million |
|---|---|---|---|
| | 2018-19[1] | 2019-20[1] | 2020-21[2] |
| Land Transaction Tax[3] | 227.9 | 260.3 | 254.0 |
| Landfill Disposals Tax | 44.4 | 36.9 | 34.2 |
| | | | |
| Welsh Rates of Income Tax | | 2,059.4 | 2,169.7 |
| Of which: Basic rate | | 1,778.4 | 1,864.2 |
| Higher rate | | 237.3 | 251.3 |
| Additional rate | | 43.6 | 54.1 |

1. Outturn for LDT and LTT from Welsh Revenue Authority annual accounts
WRIT for 2019-20 from OBR autumn 2018 Economic and Fiscal Outlook
2. All forecasts from OBR March 2020 Economic and Fiscal Outlook
3. 2019-20 LTT outturn affected by £28.2m tax liability associated with Transport for Wales purchase of Core Valleys Lines from Network Rail, with no overall net resource benefit to Welsh Government.

73. With just two years of outturn information for the fully devolved taxes and none yet for the Welsh rates of income tax, it is early to judge how well the budgetary treatment of devolved taxation is performing. In aggregate, the revenues from land transaction tax and landfill disposals tax over the two years for which there is outturn are a little higher than the associated BGAs. This will reflect a number of factors, including: tax policy choices, tax administration performance, the property market and wider economic conditions.

74. The delay before outturn information is available for income tax revenues means that this element of the fiscal framework cannot be properly assessed for Wales at the moment. The long lag before reconciliation adjustments are applied can clearly lead to budgetary issues in future years, as has recently been observed in Scotland.

75. The differences between income tax devolution in Wales and Scotland are likely to mean that reconciliation issues are less severe in Wales. In Scotland, all income tax on non-savings non-dividend income is devolved. With just 10p of each tax rate devolved in Wales, the Welsh Government has less exposure to the risks associated with differential income tax revenue growth. The separate BGAs for each income tax band in Wales should also help to reduce this risk, by weighting the overall BGA in a way that more closely resembles the Welsh income tax base. Scotland has a single BGA for income tax.

76. The Welsh Government will continue to monitor the arrangements carefully across all the devolved taxes and will raise any concerns with the UK Government.

Budget management tools

77. The fiscal framework agreement included the creation of a Wales Reserve. The Welsh Government can save surplus revenues and unused block grant funding in

the Wales Reserve, up to a limit of £350m. The Reserve started operating at the end of 2017-18, with the Welsh Government able to save underspends to support tax devolution and manage other budget pressures in the following year. It can draw down up to £125m of resource and £50m of capital in any year.

78. Table 3 shows the starting position for the Reserve in each of the years that tax devolution has been in operation. The overall £350m limit on the Reserve and the annual drawdown limit, combined with late changes to the Welsh Government's block grant via the UK Supplementary Estimates process, have made the management of the Welsh Government's end year position very challenging over the last two years. This part of the budgetary process would be smoother and more effective if the limits were increased.

**Table 3: Wales Reserve position at the start of each year**

| | 2018-19 | 2019-20 | £ million 2020-21[1] |
|---|---|---|---|
| Resource | 270 | 304 | 232 |
| Traditional Capital | 53 | 8 | 39 |
| Financial Transactions Capital | 1 | 14 | 66 |
| **Total** | **325** | **326** | **337** |

1. Provisional

79. The Welsh Government can borrow up to £200m each year for resource purposes, within an overall cap of £500m, if tax revenues are lower than forecast. Repayments must be within 5 years.

80. The Welsh Government has not made use of this facility yet. The Scottish Government has used its equivalent facility to cover the 2017-18 income tax reconciliation payment in the current year.

81. Given the challenges with the current Reserve limits noted above, there are particular concerns that the available budget management tools will not be sufficient to deal with the additional uncertainty associated with the coronavirus pandemic in the current year, and potentially in future years. The Welsh Government has been provided with an additional £4bn to finance its response to the pandemic this year. The scale of this additional in-year funding, combined with disruption to existing expenditure programmes and the potential impact on tax revenues means that the Government is facing unprecedented levels of uncertainty.

82. Discussions with the UK Government have led to the guaranteed £4bn additional funding, ahead of associated spending announcements in England, which provides some reassurance regarding one aspect of in-year budget management. However, there could still be substantial changes later in the year.

As noted in the fiscal framework agreement, Welsh Ministers can request additional flexibility in exceptional circumstances. The situation in the current year is exceptional and the Welsh Government is making the case for additional flexibilities this year, as well as longer term changes to the limits.

Capital Borrowing

83. The Welsh Government can borrow up to £150m a year for capital purposes, with an overall limit of £1bn. It borrowed £65m in 2018-19 but did not require the facility in 2019-20 due to the UK Government providing additional capital spending in-year, which to use at short notice meant the planned capital borrowing for that year was no longer required. The 2020-21 budget plans assume £125m of capital borrowing.

84. Capital spending will form a vital element of the Welsh Government's plans for reconstruction in the wake of the coronavirus pandemic. We do not yet know the level of capital funding that will come via the block grant next year and beyond. However, it is quite possible that the Welsh Government will need to make the case for increased capital borrowing limits in order to effectively support the economic recovery.

Spill-over effects

85. The treatment of tax-related spill-over effects and mechanisms to deal with them were agreed by the Welsh Government as part of the overall fiscal framework agreement. More general spill-over effects are treated in the statement of funding policy and have been the cause of disagreement in the past. This section only discusses the arrangements in the fiscal framework agreement.

86. One of the most likely UK Government policy changes to impact on Welsh Government revenues would be changes to the income tax personal allowance. The income distribution is more concentrated at the lower end in Wales than in England. This means that changes to the personal allowance have a greater relative impact on revenues in Wales. The BGA arrangement provides a mechanism to deal with this particular spill-over effect. As noted above, the separate BGAs for each tax band mean that the combined BGA behaves more like the Welsh tax base than would be the case with a single, unweighted BGA. As a result, the effect of personal allowance changes on the separate BGAs is more like that on Welsh tax revenues, helping to take account of the asymmetric revenue impact.

87. There has been no specific application yet of the other arrangements to deal with spill-over effects set out in the fiscal framework agreement.

International comparisons

88. The paper *Reforming UK funding and fiscal arrangements after Brexit: Securing Wales' Future* referenced earlier includes some examples at Annex 1 of fiscal decentralisation in other countries.