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Jocelyn Davies AM
Chair, Finance Committee
National Assembly for Wales
Cardiff Bay
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Ref: 33SOS14

14 February 2014

Dear Jocelyn,

Thank you for your 7 February letter setting out the views of the National Assembly for Wales's Finance Committee on the draft Wales Bill. I am pleased that the Committee welcomes much of the content of the draft Bill, particularly its main provisions to make the devolved institutions in Wales more accountable for the money they spend through the devolution of tax on land transactions and tax on disposals to landfill and (subject to a referendum) a portion of income tax.

In relation to the devolution of these powers, you asked for more detail on how the subsequent reduction in the block grant would be administered. The UK and Scottish Governments are currently discussing the most appropriate block grant adjustment mechanism in relation to stamp duty land tax and landfill tax in Scotland. The Scotland Bill Command Paper indicated that this would be a one-off adjustment, but the precise nature of that adjustment is still to be agreed. The UK Government has now opened similar discussions with the Welsh Government, with the intention is that the same mechanism can be agreed for both Wales and Scotland.

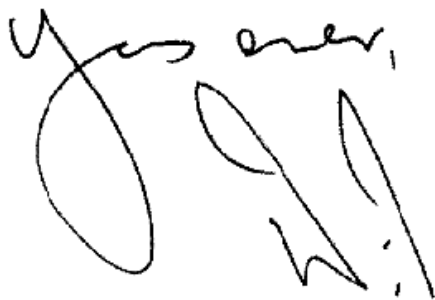
As regards income tax, we have accepted the Silk Commission recommendation that following the devolution of a portion of income tax the block grant should be adjusted using the 'indexed deduction' method. This method manages a certain amount of the risk that is transferred by devolving taxation while ensuring the Welsh Government has a clear incentive to increase tax revenues through economic growth. This mechanism also increases accountability by linking the Welsh Government budget to economic performance in Wales, while shielding the Welsh Government from UK-wide impacts that the UK Government is better placed to manage.

Turning to your comments on the borrowing powers, the £500m capital borrowing limit is a generous, but affordable, limit commensurate with the revenue streams derived from the two taxes we are devolving. It could be increased if the people of Wales support the devolution of income tax in a referendum, and we are content that the mechanism set out in Bill to do so by order provides sufficient flexibility to ensure the limit remains commensurate with the revenue streams available.

As regards the "lockstep" mechanism for the devolution of income tax, we believe that this is the right system for Wales. The system applies in Scotland, with a single devolved rate for all bands, and would work equally well in Wales. The lockstep delivers on two key principles that underpin the Government's approach to devolving income tax: firstly, that the UK maintains a progressive tax system and secondly, that fiscal devolution does not benefit one part of the UK at the expense of another.

Finally, in your letter you also highlight the importance of ensuring the devolution boundary is in the right place in regard to Assembly budgetary procedures. You will be aware that the Silk Commission recommended that the Assembly should be given control over its budgetary procedures, and the issue has been raised several times during the Bill's pre-legislative scrutiny. My officials have also discussed the matter recently with colleagues in the Welsh Government.

We are giving careful thought to the Commission's recommendation and to the need for appropriate provision in the Wales Bill. I will write to you again when this has progressed to let you know how we intend to proceed.

A handwritten signature in black ink, appearing to read "Yes ever," followed by a stylized signature that includes a large loop and a vertical stroke.

Rt. Hon. / Y Gwir Anrh. David Jones MP / AS
Secretary of State for Wales
Ysgrifennydd Gwladol Cymru