



Ein cyf/Our ref : RE-249-20

Rt. Hon Rishi Sunak MP
Chancellor of the Exchequer
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

3 July 2020

Dear Rishi,

As you prepare to set out your Summer Economic Update in what are extraordinarily difficult circumstances, I thought it would be useful to describe the challenges we are facing in Wales and to remind you of some of our priorities which I mentioned when writing to you prior to your March Budget Statement.

Current Economic Conditions

In April, the UK economy was 25% smaller than it was in February. We are in the deepest recession in living memory caused by the necessity to shut down most non-essential economic activity owing to the coronavirus pandemic. While it is not yet clear to what extent GDP has decreased in Wales, we know from other data, much of it published by the Office for National Statistics, that our economy has been hit at least as hard as the UK economy on average.

While the speed and scale of the decline in GDP has been of almost unimaginable proportions, the labour market in Wales in terms of the headline indicators of employment, unemployment and inactivity has not yet materially deteriorated. The position in the UK labour market is similar. This is partly due to employment being a lagging indicator but also reflects the effectiveness of the Coronavirus Job Retention Scheme (CJRS) and the Self Employed Income Support Scheme (SEISS) in insulating the labour market from what would have been catastrophic losses in employment and increases in unemployment and inactivity. We welcome the decisive action taken in this regard.

Despite the employment support schemes, behind the headlines there is evidence of distress in the labour market. Vacancies have collapsed, hours worked have decreased at a record rate while claims for unemployment insurance have increased sharply in every local authority in Wales. News of major redundancies is now a recurrent feature of daily life, with the announcement of more than 1,400 potential redundancies at Airbus a body blow to the economy of North-East Wales and Cheshire. Alarming concerns have also been raised

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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.

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by the steel industry which is heavily concentrated in Wales as well as being of strategic significance to the UK economy as a whole.

Given the economic stress that is emerging even while the CJRS and the SEISS remain in place, we are deeply concerned that the worst is yet to come for the labour market were you to implement your plans to taper down, then close the CJRS at the end of October and end SEISS payments in August. Indeed, the Resolution Foundation estimates that one million furloughed workers could lose their jobs.

In the letter I and my colleague the Minister for the Economy and Transport wrote on 4 June (attached for ease of reference) I urged you to continue to monitor the situation, put in place active labour market measures to cope with redundancies, clarify whether you would intend to revive the JRS and SEISS if there is a second peak or local lockdowns and work with Whitehall Departments and the devolved Governments to put in place sectoral employment protection schemes for sectors which continue to be closed or very substantially impacted by Covid measures, notably hospitality and culture. The need for clarity on all these issues has only become more evident over the last month.

Fiscal Policy

Spending

I agree with the Prime Minister that the Government response to the current economic crisis must not be a further period of austerity.

The pandemic has compelled governments across the world to ramp up spending dramatically. I note that UK Government current spending was £64 billion higher in the first two months of the current financial year compared with a year earlier. I welcome the allocation of additional resources to finance new and existing programmes to deal with the crisis. It will be very important for this approach to be sustained and for the appropriate funding and tools to be in place for us to manage the recovery.

The Welsh Government has allocated more than £2.4 billion to date to COVID-19 measures. The funding is drawn from COVID-19 consequentials as well as more than £500 million which has been reprioritised within existing Welsh Government budgets and EU funds. Our forecast pressures are close to £1 billion. Pressures stem from a variety of sources. On health they cover a range of interventions including NHS workforce, testing and tracing and field hospitals.

These pressures do not include measures that will be needed to support the economic recovery and respond to further shocks, which cannot be sensibly estimated at this time. Neither do they include higher costs for Welsh Government programmes, like Free School Meals and the Council Tax Reduction Scheme, which will result from increases in unemployment and in families claiming Universal Credit.

Our spending pressure estimates are based on the assumption that no second or third waves of the pandemic materialise. So, the position could be materially worse than outlined above. Clearly additional funding is required at a scale that only the UK Government has the fiscal firepower to deliver. I urge you to use the Summer Economic Update to allocate the necessary funds to allow the Welsh Government to manage the pandemic as effectively as possible in order to protect jobs, services and living standards.

Taxation

I welcome the UK Government's use of its tax levers to respond to the pandemic. More needs to be done to prevent the losses that have already occurred in output and the seemingly imminent losses in employment from becoming permanent. Such 'scarring' would impact most on the well-being of young people, those on low pay, those with few skills, disabled groups and many from BAME backgrounds. Accordingly, the UK Government should as a matter of urgency use the tax system to incentivise companies to retain and hire workers. To this end I urge you to consider reducing employer National Insurance Contributions (NICs) or increasing the employer NICs threshold. Either would reduce labour costs for employers, encourage job creation as well as job retention and facilitate the eventual winding down of the CJRS.

As for the broader tax system, I would welcome meaningful engagement along with the other devolved administrations on future planning across the range of current and potential taxes in order to deliver our common aim of simplifying the UK tax system and making it more coherent, progressive and efficient.

Welfare

As is always the case with recessions, it is the most vulnerable and poorest groups in society who suffer most and COVID 19 has proven to have a negative impact on equality. It is already evident that a larger proportion of low-paid workers have been furloughed and are likely to be made redundant compared with those in better-paid jobs. I welcome the UK Government's decision to make the benefits system more generous and extensive in reach at the outset of the crisis. To prevent an unacceptable increase in poverty that would accompany any increase in unemployment, the benefits system must provide support that guarantees dignity for vulnerable citizens including those who stand to lose their jobs. The welfare system must reflect the enormity of the impact of this pandemic and better support those who are unemployed or economically inactive to work or to retrain and acquire new skills so that they can join or re-join the labour market as soon as possible.

I also urge the UK Government to reverse the regressive welfare reform and cuts implemented over the last ten years. These changes have disproportionately affected the most vulnerable groups in society. I ask that the UK Government removes the two-child limit policy, the five week wait for the first Universal Credit payment and end the benefit cap. I also urge you to retain the temporary increases in the welfare safety net recently introduced. I also ask you to clarify that the increase in the Local Housing Allowance (LHA) to the 30th percentile will continue past 31 March 2021 and call on the UK Government to reinstate LHA rates to the 50th percentile.

In the immediate term, it will be vital to significantly increase Statutory Sick Pay for those who are required to self-isolate as a result of our Test, Trace and Protect strategy and the equivalent programmes in other parts of the UK. We already know in the context of the outbreaks of COVID in meat plants in North Wales that economic hardship is resulting for those who should self-isolate but continue to go to work for financial reasons. The relatively modest cost of preventing such hardship could help forestall the massive economic damage that would result from a second national lockdown.

Budget Flexibility

These are exceptionally uncertain times. It is now imperative that our fiscal flexibilities reflect the scale of the decisions being taken by the Welsh Government and their implications for businesses, public services and communities. I am asking for the following

budgetary and fiscal flexibilities to ensure the Welsh Government's response provides the confidence we and our partners need to manage the crisis as effectively as possible:

- Full access to the resources in the reserve this year if required, and the ability to carry forward more resource and capital in the Reserve at the end of the financial year.
- The ability to carry forward, at the end of the year, more than the overall £350m limit on the Reserve. This is because of the uncertainties about the impact of the crisis on existing programmes, the costs of new programmes, and the level of new funding from the UK Government.
- The ability to switch funding from capital to revenue budgets, and the option to deploy revenue borrowing, to provide further useful flexibilities and aid budget management.
- An increase in the annual capital borrowing limit (currently £150m) and the aggregate ceiling (currently £1bn) to enable the Welsh Government to further support its capital programmes, if necessary, and to aid the economic recovery over the longer term.
- More flexible repayment terms for Financial Transactions capital.

Whether we need to use these flexibilities will depend on how the recovery progresses, but their availability will enable us to allocate resources now, where they are needed. It would be a significant advantage if these additional flexibilities were available to the Welsh Government as a matter of course and did not require permission from the UK Government on a case by case basis. The higher limits for accessing the Reserve, carrying forward via the Reserve, and for capital borrowing should be long term arrangements, to enable efficient and effective budget management.

I very much welcome the constructive discussions I have had with the Chief Secretary over the last few months in relation to increasing flexibilities. Agreement at this time would represent a meaningful demonstration of the way in which the UK Government and the governments of the devolved administrations can work together in the shared governance of the UK, in our response to this pandemic. Supportive call for these flexibilities made by the Welsh Local Government Association, FSB Cymru, Wales TUC, the Institute of Fiscal Studies and the Senedd's Finance Committee underscore the urgency now attached to this issue in Wales.

EU Issues

Ending the Brexit transition period without a comprehensive free trade deal in place would be deeply damaging in normal circumstances, but even more so given the damage the pandemic will have inflicted on the economy by the end of the year. I urge the UK Government to negotiate a comprehensive free trade agreement with the EU. Anything less will compound pandemic damage and structurally weaken the public finances.

I remain concerned about the lack of clarity as to how the UK Government will live up to its manifesto commitments that Wales will not lose a penny of EU funding after the transition period ends, and that the devolution settlement will be fully respected. The details of the Shared Prosperity Fund allocations to the Welsh Government – which will therefore need to at least match what Wales would have received had the UK remained a member of the EU – should be shared urgently: we have already made great progress in planning for how to manage replacement funds and further UK Government delays in providing this information risk depriving Wales of crucial funds in the early years of the successor arrangements, hitting local communities and economies that are already suffering as a result of the Covid-19 pandemic. Indeed thousands of businesses supported by the Economic Resilience Fund

have benefitted from the swift action Welsh Ministers have been able to take to provide support that is tailored to the needs of the Welsh economy. Similar clarity on agriculture and rural development funding and funding Wales receives from other EU programmes is also long overdue. Your Summer Economic Update is an important opportunity to show that the UK Government has not forgotten those who currently rely on this funding.

Addressing Regional Inequality

Finally, when I wrote to you before the Budget, I emphasised that if the UK Government is serious about 'levelling up' and addressing regional inequality across the UK it will require significant investment in Wales, including in non-devolved areas such as research and development and rail. I would like to take this opportunity to stress the importance we attach to these issues. They should not be neglected in the current crisis. I will refrain from repeating all the points I made in that earlier letter, but I look forward to engaging constructively with you on this subject in more propitious times.

I am copying this letter to the Chief Secretary to the Treasury, the Secretary of State for Wales and the First Minister for Wales. I am also sharing this letter with the Chair of the Senedd Finance Committee.

Yours sincerely,

Personal Data

Rebecca Evans AS/MS

Y Gweinidog Cyllid a'r Trefnydd
Minister for Finance and Trefnydd