

National Assembly for Wales
Finance Committee

Future Funding for Wales

March 2016

Cynulliad
Cenedlaethol
Cymru

National
Assembly for
Wales



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Finance Committee

The Committee was established on 22 June 2011. The Finance Committee's role is to carry out the functions set out in Standing Order 19. This includes consideration of the use of resources by the Assembly Commission or Welsh Ministers, and in particular reporting during the annual budget round. The Committee may also consider any other matter relating to expenditure from the Welsh Consolidated Fund.

The Finance Committee's remit also includes specific statutory powers under the Public Audit (Wales) Act 2013 relating to new responsibilities for governance oversight of the Wales Audit Office.

Current Committee membership:



Jocelyn Davies (Chair)
Plaid Cymru
South Wales East



Peter Black
Welsh Liberal Democrats
South Wales West



Christine Chapman
Welsh Labour
Cynon Valley



Mike Hedges
Welsh Labour
Swansea East



Alun Ffred Jones
Plaid Cymru
Arfon



Ann Jones
Welsh Labour
Vale of Clwyd



Julie Morgan
Welsh Labour
Cardiff North



Nick Ramsay
Welsh Conservatives
Monmouth

The following members attended as substitutes during the course of this inquiry:



Llyr Gruffydd
Plaid Cymru
North Wales



Jenny Rathbone
Welsh Labour
Cardiff Central

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Chair's Foreword

As a Committee we agreed to undertake this inquiry in May 2015, and we are pleased to be publishing this report before the Fourth Assembly is dissolved. The changing nature of devolution in the UK has meant that the evidence base for funding devolved countries is continually shifting, and this has been reflected in the time it has taken to finalise this report and in some of our recommendations. For example, when the majority of evidence was being taken there had been no decision on the adjustment to the block grant in Scotland. When finalising the report it was announced an agreement had been reached between the UK Government and the Scottish Parliament. This extended delay in reaching an agreement reflects one of our concerns regarding the adjustment to the block grant in Wales. In this regard, we have made numerous recommendations in relation to inter-parliamentary relationships; it is clear to us, for fiscal devolution to be a success in Wales, that these relationships need to improve and we hope agreement on the block grant adjustment for Wales is reached sooner than has been the case in Scotland.

Many of our recommendations relate to the need for clarity and transparency in relation to various aspects of devolved finance, such as allocations of funding to devolved government, forecasting of tax revenues and clarity over the functions of the Welsh Treasury. Additionally, we repeat previous calls for a needs based formula in relation to funding in Wales, and the creation of a Welsh Fiscal Commission.

Unfortunately, it has not been possible for the Chief Secretary to the Treasury to give evidence to the Committee. This has been very disappointing. Clearly in order to fully appraise the situation in relation to funding for Wales it is essential to have evidence from UK Ministers, particularly as a number of the recommendations in this report relate to the UK Government. I sincerely hope that consideration is given to the recommendations contained in this report by the Chief Secretary to the Treasury.

Finally, I would like to thank everyone involved in this inquiry, including those who gave written and oral evidence. I would also like to thank Gerry Holtham, who acted as an adviser to the Committee throughout our consideration of the evidence. His advice had been invaluable.



Jocelyn Davies AM
Chair

Committee Recommendations

Recommendation 1. The Committee recommends that the Welsh Government further considers creating an independent body to advise on a transparent system for the allocation of funding to the devolved governments, including independent assessment of how expenditure decisions for England feed into block grants. (Page 24)

Recommendation 2. The Committee recommends that the Welsh Government works with the UK Government to increase co-ordination and provision for discussion regarding funding arrangements among the devolved governments and with Westminster. The Committee believes these intergovernmental relations must be transparent and subject to scrutiny with a means for arbitrating and resolving disputes. (Page 24)

Recommendation 3. The Committee recommends that the Welsh Government works with the UK Government and the other devolved governments to ensure that changes to the Statement of Funding Policy should be agreed between the UK Government and devolved administrations wherever possible and transparently recorded. (Page 25)

Recommendation 4. The Independent Commission on Finance and Funding for Wales has shown that it is possible to generate a simple needs-based formula to replace Barnett that also retains a high degree of completeness, as such the Committee recommends that funding arrangements for Wales should be based on a formula reflecting relative needs. (Page 25)

Recommendation 5. Whilst recognising the necessity of a needs-based formula, should this not happen imminently, the Committee firmly believes that strengthening the commitment to a funding floor is necessary, with a secure undertaking that it will continue after the end of this UK Parliament. Furthermore, the Committee recommends that the distribution process for the block grant should have a firm statutory basis and not be a matter of ministerial discretion. (Page 25)

Recommendation 6. The Committee recommends that as a minimum, there must be a principled decision taken on how the block grant will be reduced before taxes are devolved. There is a need for a quasi-automatic procedure that is fair and allocates risk and responsibility appropriately. (Page 25)

Recommendation 7. The Committee firmly believes the relationship between the UK Government and Welsh Government needs to improve. The Committee recommends that the Welsh Government works with the Chief Secretary to the Treasury to ensure more frequent meetings and the Chief Secretary should reconsider a UK Fiscal Framework, which provides a fundamental statement of funding policy for the devolved administrations and their fiscal arrangements. (Page 30)

Recommendation 8. The Committee believes there is a need for greater end-year flexibility. The Committee recommends that once funds have been devolved to Wales, they should not be returned to Treasury if unspent at the end of the financial year. The Welsh Government should have the ability to retain surpluses and build up reserves. (Page 30)

Recommendation 9. In regard to the Welsh Government's stated intention to develop a "Welsh Treasury" the Committee considers that there is a need for greater clarity and explicitness about what that entails and recommends the Welsh Government provide this clarity. It is not simply a matter of extra staffing and technical expertise. Since government resources in future will come partly from tax revenues and borrowing, policies for these elements will have to be determined at Cabinet level and administered by the Welsh Treasury. The UK Treasury has a leading role in advising on the setting of budgets and co-ordinating expenditure decisions across all departments. The Welsh Treasury will surely have to act similarly, implying a stronger role than the Finance Department has had historically. (Page 30)

Recommendation 10. The Committee recommends that the Welsh Government works with the UK Government to review the rules in relation to introducing new taxes in Wales, to ensure the process is less onerous enabling the Welsh Government to effectively introduce new taxes. (Page 34)

Recommendation 11. The Committee believes the Welsh Government will need to forecast devolved tax revenues, including national non-domestic rates and the implications of the Block Grant adjustment, in order to inform their budgetary plans. The Committee recommends that the Welsh Government works to ensure these forecasts are high quality, transparent and in the public domain. The Welsh Government should consider whether it has the resources available to achieve this at the necessary standard. (Page 34)

Recommendation 12. Following on from a previous report, the Committee again recommends that a Welsh Fiscal Commission is set up to provide independent assessment of Welsh Government tax forecasts and assumptions. (Page 34)

Recommendation 13. The Committee notes that council tax and non-domestic rates raise over £2.5 billion a year. The Welsh Government has had a number of inquiries into non-domestic rates and the Committee believes there is a need for clarity going forward given these previous inquiries. The Committee will be recommending in its legacy report that the next Committee with responsibility for financial matters undertakes an inquiry into how valuations are kept up to date and what reforms should be considered to council tax. (Page 34)

Recommendation 14. The Committee notes the lack of published data on economic performance and tax revenues collected in Wales. The Committee recommends that information collected and published in Wales should be at least as detailed and as frequent as those that are currently produced in Scotland. (Page 34)

Recommendation 15. Whilst acknowledging that the Treasury would want to set an overall borrowing limit each year to retain control and ensure sustainability at an overall UK level, the Committee recommends that the Welsh Government's capital borrowing should be subject to a prudential borrowing regime, similar to that for local authorities. (Page 37)

1. Introduction

Terms of Reference

1. The Finance Committee (the Committee) agreed to undertake an inquiry into how Wales is funded and agreed that the inquiry would focus on:
 - the main weaknesses in the Welsh funding settlement and how these could be resolved;
 - how the agreement for a reserved-powers model for Wales, and the other St David's Day devolution proposals, could impact future funding;
 - reviewing developments on the issues of convergence, underfunding and Barnett reform highlighted in the report from the Independent Commission on Funding and Finance for Wales and the Commission on Devolution in Wales;
 - the financial and economic information which the UK and Welsh Governments need to provide to support future funding arrangements.

The Inquiry

2. The evidence for the inquiry has fallen into four main areas, which are:
 - the Block Grant;
 - new institutional arrangements within the Welsh Government;
 - possible tax revenues and reforms in the short and longer term;
 - borrowing possibilities.
3. This report provides a commentary on these four main areas, but in order to provide context for the report a brief summary of the current situation in relation to devolution across the UK is also provided. The Committee makes no recommendations or commentary in relation to the other areas of the UK but believes it is important to consider some of the issues relevant to Wales in the wider context.
4. During the course of this inquiry the Committee was keen to hear evidence from the Chief Secretary to the Treasury, and invited him to attend Committee both before and after the Autumn 2015 Spending Review. The Chief Secretary did provide written answers to some of the questions the Committee posed. However, it has proved difficult to fully appraise all of the issues in relation to funding in Wales without having the opportunity to

discuss in further detail some of the issues raised in this report with the Chief Secretary.

5. Additionally, the nature of devolution in the UK means that the landscape is continually changing. Some developments have happened after Committee evidence sessions, meaning that the Committee has been unable to pursue developing issues with all witnesses. Owing to this and in order to remain current, some of the Committee's recommendations do not flow directly from the evidence taken, but rather from its own reflections on the changing landscape.

2. Background to the current position in the UK

6. Many proposed changes to the UK devolution and funding arrangements have emerged during 2014 and 2015, and there is a growing disparity among arrangements in different parts of the UK. There is also uncertainty about the eventual impact of the new arrangements on the UK's overall fiscal arrangements and credit rating.¹

Block grant adjustment for Scotland

7. The Smith Commission² made a number of proposals that were accepted by the UK Government as the basis for further fiscal devolution to Scotland. It implied that in future the Scottish Government will control about 60 per cent of public spending in or for Scotland and will retain about 40 per cent of tax revenues in Scotland.³

8. Scotland's new fiscal powers are being implemented in two stages – stamp duty land tax and landfill tax were devolved alongside new borrowing powers from April 2015, with the full devolution of Scottish income tax following in April 2016.

9. The Barnett Formula will continue as a basis for determining the block grant in Scotland but the grant will be reduced to reflect the tax revenues that the UK Government will forego as a result of further fiscal devolution. The Scottish Government will retain the revenues from the newly devolved taxes. The grant is unaffected by business rates revenues and council tax which have long been devolved.

10. The deductions from the block grant have been agreed for the taxes being retained by Scotland from 2015 for the first financial year. Those deductions are agreed estimates of the revenue yield in the year in question. No agreement had been reached at the time of writing, however, on how these deductions will be calculated and managed in future years. The Smith Commission did not specify or agree procedures for most taxes. For income tax it was agreed that the deduction be an estimate of tax foregone in year one and that deduction be then indexed against the growth in rest-of-UK income tax base. The definition of the base and the precise form of the indexation, however, remain matters of debate.

¹ CIPFA, [Moody's warns on fiscal impact of devolution drive](#), 1 June 2015

² [The Smith Commission](#)

³ The Scottish Parliament, [3rd Report, 2015: New Powers for Scotland: An Interim Report on the Smith Commission and the UK Government's Proposals](#), May 2015

11. The Scottish Government will be able to borrow (from the National Loans Fund, commercial lenders or through issuing bonds) to fund capital expenditure. Within an overall £2.2bn cap, the Scottish Government can borrow up to an additional 10% of its capital budget each year. In 2015-16, for example, the Scottish Government can borrow around £300m. The Scottish Government can borrow short-term to finance a cyclical shortfall of revenue and it is also allowed to operate a cash reserve; it can pay up to £125 million into the reserve from existing budgets. In future any surplus of tax receipts over forecasts and expenditure can be paid into the reserve.

12. The Smith Commission set out two “no detriment” principles for the fiscal framework. The first principle is that there should be no detriment as a result of the decision to devolve further power. The Scottish and UK Governments’ budgets should be no larger or smaller simply as a result of the initial transfer of tax and/or spending powers, before considering how these are used. This means:

- (a) The initial devolution and assignment of tax receipts should be accompanied by a reduction in the block grant equivalent to the revenue forgone by the UK Government, and that future growth in the reduction to the block grant should be indexed appropriately.
- (b) Likewise, the initial devolution of further spending powers should be accompanied by an increase in the block grant equivalent to the existing level of Scottish expenditure by the UK Government, including any identified administrative savings arising to the UK Government from no longer delivering the devolved activity, and a share of the associated implementation and running costs in the policy area being devolved, sufficient to support the functions being transferred, at the point of transfer.
- (c) The future growth in the addition to the block grant should be indexed appropriately.

13. The first no detriment principle is largely uncontroversial. The Smith Commission also had a second no detriment principle that states that neither government should lose out as a result of a policy decision of the other government in a devolved area. The Smith Commission suggested there should be compensatory payments for such knock-on effects and also inferred that changes in devolved taxes in the rest of the UK should not affect overall public spending in Scotland (the “taxpayer fairness” principle). These two supposed implications of the second principle are controversial,

the first because it could be unworkable, leading to irresolvable disputes. The second is controversial because the so-called taxpayer fairness principle would eliminate elements of income-tax equalisation in the finance of public services that exist at present. It can therefore be seen as contrary to the first no-detriment principle.

14. Professor David Bell suggested to Scotland's Devolution (Further Powers) Committee (the Devolution Committee) that the double "no detriment" principle is unworkable.⁴

15. The Committee took evidence from David Phillips from the Institute for Fiscal Studies; his view was that it would not be possible to satisfy both of these principles at the time.

"... subsequently, when these powers are being used, any effect that the UK Government takes, if there are any knock-on effects for Scotland, there should be compensation and vice versa. I think that aspect is unworkable because there are always going to be knock-on effects. Trying to work out what those are and agree on what those are will lead to conflict and debate. Some work I'm doing with some colleagues in Stirling University suggests that you can't satisfy all of these principles with a single system. You know, you can satisfy some but not others."⁵

16. On 23 February 2016 it was announced agreement had been reached between the UK Government and the Scottish Government regarding deductions to the Block Grant.⁶ At the time of writing the detail of the negotiations was not available.

Developments in Northern Ireland

17. Although there is no single process for determining further devolution in Northern Ireland there have been significant developments recently:

- The Corporation Tax (Northern Ireland) Act 2015⁷ became law in March 2015, and allows the creation of a separate corporation tax rate in Northern Ireland.
- The Stormont House Agreement⁸ includes a £2 billion financial package from the UK Government, as well as flexibilities over how the

⁴ BBC News, [Scotland Bill: No detriment principle "is unworkable"](#), 21 January 2016

⁵ Finance Committee, RoP, 17 September 2015, paragraph 257

⁶ BBC News, [Fiscal framework: Scottish and UK governments agree deal](#), 23 February 2016

⁷ UK Parliament, [Corporation Tax \(Northern Ireland\) Act 2015](#)

Northern Ireland Assembly can fund the welfare system (powers which are not available to Scotland or Wales).

18. The UK Government has provided £300m of borrowing flexibility to the Northern Ireland Executive since a deal was reached to restart Stormont power-sharing in November 2015.⁹

Other developments in the UK

19. As well as announcing the Smith Commission and the St David's Day process (as detailed later in this report), the UK Government also set up a Cabinet Committee¹⁰ to consider the devolution of powers within the UK, including England. The Cabinet Committee produced an initial report on the issue of "English Votes for English Laws".¹¹ It also proposed various potential options for local authorities or new regional associations, such as retention of business rates by local authorities, or further devolution for spending responsibilities to local authorities where demand exists.

20. On 22 October 2015 the House of Commons approved the proposal for "English Votes for English Laws" by amending Parliamentary procedure for scrutinising future Bills.

21. On the 27 February 2015 the UK Government also announced the devolution of £6 billion of NHS spending to Greater Manchester.¹²

22. In response to these various developments, the Political and Constitutional Reform Committee of the House of Commons held an inquiry on "Devolution after the Referendum"¹³ which has recommended a "constitutional convention" as a mechanism to address devolution in a co-ordinated way.

23. Towards the end of the last UK Parliament, the House of Lords Constitution Committee also launched an inquiry on "Inter-governmental relations in the UK"¹⁴ which recommended changes to the framework for inter-governmental relations. The proposals included the following:

⁸ UK Government, [The Stormont House Agreement](#), December 2014

⁹ CIPFA, [Northern Ireland granted £300m borrowing flexibility](#), 15 January 2016

¹⁰ UK Government, [Cabinet Committee for devolved powers: statement on first meeting](#), 25 September 2014

¹¹ UK Government, [Implications of devolution for England](#), December 2014

¹² NHS England, [The Five-Year Forward View into action: NHS England and Greater Manchester announce shared plan for £6billion health and social care funding](#), 27 February 2015

¹³ UK Parliament, [The future of devolution after the Scottish referendum](#), March 2015

¹⁴ UK Parliament, [Inter-governmental relations in the United Kingdom](#), March 2015

- “- Whether or not it becomes a sub-committee of the Joint Ministerial Committee, the Finance Ministers’ Quadrilateral should be included as a permanent fixture in any statute setting out the framework of inter-governmental relations, with the added exposure to scrutiny that this should bring. (Paragraph 89)
- We recommend that the Government consider tasking an independent body to provide the statistics and evidence on which to base decisions about the allocation of funding to the devolved administrations. (Paragraph 91)
- The UK’s devolution settlements are of the highest constitutional significance. We are deeply concerned by the lack of central co-ordination and oversight of the devolution settlements and of the minimal consideration given to the effect of devolution in one area of the UK on other areas, and on the Union as a whole. (Paragraph 133)
- We repeat our recommendation that there should be a clear focus within Government for oversight of the constitution as a whole, beyond individual constitutional reform proposals, with a senior Cabinet minister identified as responsible for that work. (Paragraph 134).”¹⁵

24. The House of Lords Constitution Committee has also published “Proposals for the devolution of further powers to Scotland” which also emphasised that constitutional issues need to be addressed at a UK-level:

“We are astonished that the UK Government do not appear to have considered the wider implications for the United Kingdom of the proposals set out in *Scotland in the United Kingdom*. We do not consider that it is appropriate, or sustainable, to address the issue of additional powers for Scotland alone without also considering the knock-on consequences for the wider UK constitution. (Paragraph 22)

“We recommend that the Government give urgent consideration to the consequences of the Draft Clauses for the constitution of the United Kingdom as a whole. This should happen before they are passed into law. We recognise the political imperatives behind these changes but piecemeal, ad hoc changes to the Scottish devolution settlement without wider consideration of their impact could well destabilise the Union as a whole in the longer term. We question how

¹⁵ UK Parliament, [Inter-governmental relations in the United Kingdom](#), March 2015

any process that does not consider the future of the Union as a whole could provide for an ‘enduring’ settlement. (Paragraph 23).”¹⁶

25. There are a number of on-going inquiries that are looking at constitutional consequences of the changing devolution settlement in the UK. Many of these are being run by the Westminster Public Administration and Constitutional Affairs Select Committee (PACAC). PACAC inquiries of specific relevance are:

- An inquiry into the constitutional implications of “English Votes for English Laws”.¹⁷ This inquiry was started in July 2015 and has recently reported.¹⁸
- An inquiry into Inter-institutional relations in the UK was commenced in December 2015, the call for evidence closed on 29 February 2016.¹⁹
- An inquiry into the Fiscal framework for Scotland started taking evidence in January 2016.²⁰ This inquiry will determine how much the block grant will be affected by the revenue and spending powers that are being devolved under Scotland Bill. It will set out the borrowing limits for the Scottish Government and ensure that the actions of one Government will not cause financial detriment to the other.

26. A report by the Bingham Centre for the Rule of Law, “*A constitutional Crossroads: Ways forward for the United Kingdom*” (the Bingham report) has also highlighted that “the present arrangements fall short of our principles of consent and respect for the rule of law”.²¹ This report recommended redesigning devolved administrations’ funding arrangements by replacing the Barnett Formula with a system which is more transparent and objective, and which would be based on need.

27. The need for the devolution settlement to be more clearly set out in law has also been demanded for several years by the First Minister in his call for a constitutional convention.²²

¹⁶ UK Parliament, [Proposals for the devolution of further powers to Scotland](#), March 2015

¹⁷ UK Parliament, [English Votes for English Laws and the Future of the Union inquiry](#)

¹⁸ UK Parliament, [English Votes for English Laws and the Future of the Union inquiry](#)

¹⁹ UK Parliament, [Inter-institutional relations in the UK inquiry](#)

²⁰ UK Parliament, [Revising Scotland's fiscal framework inquiry](#)

²¹ Bingham Centre for the Rule of Law, [A Constitutional Crossroads: Ways Forward for the United Kingdom](#), May 2015

²² BBC News, [Carwyn Jones calls for a constitutional convention](#), 23 January 2012

English Votes for English Laws

28. The Bingham report considered the demand for “*English votes for English laws*”. The report supports the principle that bills or provisions which satisfy the McKay Commission’s test²³ of having a “separate and distinct effect” for England should be subject to consideration by English MPs alone, within the House of Commons. The problem will come with identifying what those bills are. Bills may intend to change policy only in England but if they affect public spending in England, they will *ipso facto* affect the resources available in the devolved territories via the operation of the Barnett Formula. In that case it would be inappropriate to exclude non-English MPs from voting on such measures.

29. The Bingham report suggested this made an argument for separating the way finances and policy are considered within Parliament. It is more than doubtful, however, whether such a separation is possible. If a service is abolished for example the decision on whether or not to finance it is pre-empted. Making “English votes for English laws” truly functional would require disentangling devolved finances from English policy decisions, which is not currently contemplated.

30. These difficulties are exacerbated if votes on rates of English income tax are considered as English laws. Alan Trench has pointed out some of the practical difficulties around an “English rate of income tax”. The English rate of income tax actually relates to Wales and Northern Ireland as well, so isn’t an England-only issue. Even in the case of Scotland the English rate of income tax will affect the block-grant adjustment mechanism referred to earlier and so will influence the total resources available to Scotland.²⁴

²³ The McKay Commission, [Report of the Commission on the Consequences of Devolution for the House of Commons](#), March 2013

²⁴ Alan Trench, [An “English rate of income tax”: six questions in search of an answer](#), 25 April 2015

3. The Block Grant

The current situation in Wales

Wales Act 2014

31. From 2018, the Wales Act 2014 will devolve similar tax and borrowing powers to those contained in the Scotland Act 2012. The Committee has considered the impact of these powers and will also review the associated tax legislation as it is drafted over the coming years.

32. There is currently no agreement between the UK and Welsh governments over how the block grant will be adjusted to take account of the new taxes.

St David's Day Agreement

33. On 27 February 2015 the UK Government announced the St David's Day Agreement²⁵ on the devolution of further powers to Wales. The command paper "Powers for a Purpose: Towards a lasting devolution settlement for Wales" includes several important financial elements:

- Agreement to move from a "conferred-powers" model (where specific areas are devolved to Wales) to a "reserved-powers" model (where everything is devolved to Wales, unless specifically reserved by Westminster) for Wales. Any additional funding associated with transfers of powers will be dealt with through existing mechanisms, including those in the HM Treasury's Statement of Funding Policy.
- Chapter 4 states that it has considered which of the Smith Commission recommendations for fiscal devolution in Scotland might be appropriate for Wales. However, there is no further discussion in the command paper on the welfare powers and tax powers devolved to Scotland under the Smith Commission. Chapter 5, "*Looking ahead*", adds that the UK Government may consider which of the recommendations made by the Smith Commission may be appropriate for Wales, although no timetable or process is described for doing so.²⁶
- The UK Government has agreed to introduce a funding floor in the level of relative funding it provides to the Welsh Government. The Spending Review in November 2015 specified a floor for the Welsh

²⁵ UK Government, [Welsh devolution – St David's Day Agreement: Prime Minister's speech](#), 27 February 2015

²⁶ The content of these two chapters seem to contradict each other

Departmental Expenditure limits at 115 per cent of expenditure per head of equivalent English expenditures. This commitment, however, only extended to the current spending round in the present Parliament, after which it is to be “reviewed”. No detailed mechanism for implementing the floor was announced.²⁷

34. The Welsh Government’s new borrowing powers under the Wales Act 2014 will be extended to allow the issuing of bonds to borrow for capital expenditure, this will need to be enacted before the capital borrowing powers become available in April 2018.²⁸

35. The UK Government has said it will consider the case for devolving Air Passenger Duty (APD) to the Welsh Government. Most recently it stated “the Government is considering devolving APD to Wales in parallel to a review of options to support regional airports from the impacts of APD devolution”.²⁹

The Sustainability of the Barnett Formula

36. The Barnett Formula has long been criticised for its arbitrary nature and lack of attention to relative need. Most recently the Bingham report concluded that the Barnett Formula does not deliver equity between the various parts of the UK and should not continue. It stated:

“The Barnett Formula needs to be replaced, both as a way of distributing resources to devolved governments and because of the amount of resources it allocates. It should be replaced by a grant calculated on the basis of relative needs, reflecting principles common to federal and decentralised countries. The criteria for the grant need to be clear and determined in advance, reviewed every five to seven years, and administered impartially.

“While administrative arrangements and the structure of a new grant should come in straight away, adjustments to the amounts paid to devolved governments which reduce their grant should be phased in over a number of years.”³⁰

37. Apart from issues of current equity, the Independent Commission on Funding and Finance for Wales (the Holtham Commission) highlighted that as

²⁷ UK Government, [Powers for a purpose: Towards a lasting devolution settlement for Wales](#), February 2015

²⁸ Finance Committee, [FIN\(4\)-02-16 Paper 1](#), 20 January 2016, para 34

²⁹ The Guardian, [Bristol airport warns against devolved air passenger duty powers](#), 11 February 2016

³⁰ Bingham Centre for the Rule of Law, [A Constitutional Crossroads: Ways Forward for the United Kingdom](#), May 2015

public expenditure increases the Barnett Formula would lead to “convergence” between the amount spent per head in Wales and that in England.³¹ Yet Welsh needs resembled those of the poorest English regions (which were not subject to the same squeeze) and were above those of England on average. It has been noted that as public expenditure is falling the “Barnett squeeze” has reversed but that it will re-emerge as an issue when expenditure increases in the future.³²

38. The Bingham report notes that further devolution of taxes will lead to new difficulties with the formula. The block grant will become increasingly opaque as adjustments are made to allow for devolved tax capacity, to pay for devolved welfare functions in Scotland, and by application of the “no detriment” rule intended to prevent tax policy decisions by either devolved or UK governments having adverse effects on the other. The concern about increasing complexity is echoed in a forthright criticism by the Scottish Parliament’s Devolution Committee. Its report says this “multiple black box” approach will become a source of nothing but disagreement and intergovernmental tension.³³

39. The Bingham report also noted that the way devolution was being proposed within England, e.g. to Manchester, differs from the way that it was extended to devolved administrations. The report says this raises questions over whether any consistent principles are being followed by UK Government and how sustainable the Barnett Formula is in the long term given devolution to English regions.³⁴

40. Those issues of equity, convergence, growing complexity and the claims of English regions were covered in evidence to the Committee.

41. The UK Government’s calculations are that Wales receives 116 percent of UK average funding per head for devolved functions, which is within the range that the Holtham Commission calculated would obtain if Wales were funded as an English region. In evidence to the Finance Committee, Alan Trench noted that the Welsh Government has not challenged this figure. He added that the UK Government’s policy of sheltering spending on health and

³¹ Independent Commission on Funding & Finance for Wales, [Fairness and accountability: a new funding settlement for Wales](#), July 2010

³² BBC News, [Barnett bailouts](#), 12 August 2014

³³ The Scottish Parliament, [New Powers for Scotland: An Interim Report on the Smith Commission and the UK Government's Proposals](#), May 2015

³⁴ Bingham Centre for the Rule of Law, [A Constitutional Crossroads: Ways Forward for the United Kingdom](#), May 2015

schools in England against cuts in public expenditure “has the effect of significantly sheltering devolved budgets”.³⁵

42. While the indications were that Wales was reasonably fairly funded by the system at present, evidence presented to the Committee was that the Barnett Formula was not sustainable in the longer term, especially with increased fiscal devolution. Alan Trench was of that view and Jane Hutt AM, Minister for Finance and Government Business (the Minister) agreed. She said that the Barnett Formula does not provide or deliver equity within the UK and is not appropriate for a decentralised constitution.³⁶ The Minister referred to the Holtham Commission, which found “the Barnett Formula lacks any objective justification”.³⁷

43. The Minister said moreover that the current approach leads to disputes, particularly regarding consequential funding arrangements, and cited the example of “regeneration expenditure associated with the Olympics” which did not result in any additional funding to Wales as a consequence of the spend in England.³⁸

44. CIPFA agreed that “funding through the mechanism of the Barnett Formula is inconsistent with a position of further devolution of tax powers to devolved administrations”. Furthermore, CIPFA said it advocated “a position where further resource allocation across the UK should be principles-based, transparent, accountable and should seek to address relative need as well as promotion of equity”.³⁹

45. CIPFA also noted that the combination of the Barnett Formula and ring fencing of education and health spending in England had been helpful to Wales. It said “As far as Barnett funding goes ... that’s probably protected you a little bit ... from perhaps some of the more severe cuts”.⁴⁰

46. David Phillips, while not defending the Barnett Formula, noted drawbacks of a needs-based alternative, as it:

“... would blunt the incentive the Welsh Government has to take action to reduce relative needs and to boost economic performance. Depending on whether the needs based formula also took into

³⁵ Finance Committee, RoP, 17 June 2015, paragraph 125

³⁶ Finance Committee, RoP, 25 June 2015, paragraph 6

³⁷ [FF05, written evidence](#)

³⁸ [FF05, written evidence](#)

³⁹ [FF03, written evidence](#)

⁴⁰ Finance Committee, RoP, 11 June 2015, paragraph 12

account revenue-raising capacity, it could also blunt incentives to boost revenue growth from devolved taxes.”⁴¹

The Funding Floor

47. In November 2015 the UK Government announced a funding floor at 115 percent but only for this Parliament, saying the floor will be reviewed after this Parliament.⁴²

48. The Minister said while funding was provided through the Barnett Formula a funding floor was needed, which would result in Wales receiving “the same percentage change in spending in devolved areas of responsibility as England”. The Minister said a specific mechanism needed to be agreed to implement the floor if the UK Government’s commitment was to be satisfactory.⁴³

49. The idea of a funding floor was commented on by other witnesses; for example, CIPFA said that whilst it would support the withdrawal of the Barnett Formula, it could be “tinkered” with, by having a floor based on a needs based measure.⁴⁴

An independent body

50. The Minister said that legislation would be helpful to ensure clarity of funding arrangements, as currently HM Treasury is “judge, jury and executioner in terms of our fiscal arrangements”⁴⁵ and suggested that in the longer term a “body independent of Government should undertake a needs assessment to determine the level of funding for the devolved governments”.⁴⁶

51. Alan Trench agreed that an independent body should be created “to advise on how funds should be allocated in a non-political independent way”.⁴⁷ It would “carry out the technical work necessary to understand devolution finance, including calculations of grant and changes to it, and the impact of fiscal devolution where that takes place”.⁴⁸

⁴¹ [FF06, written evidence](#)

⁴² HM Treasury, [Spending review and autumn statement 2015](#), November 2015

⁴³ [FF05, written evidence](#)

⁴⁴ Finance Committee, RoP, 11 June 2015, paragraph 66

⁴⁵ Finance Committee, RoP, 25 June 2015, paragraph 13

⁴⁶ Finance Committee, [FIN\(4\)-14-15 Paper 1](#), 25 June 2015

⁴⁷ Finance Committee, RoP, 17 June 2015, paragraph 134

⁴⁸ [FF08, written evidence](#)

52. Alan Trench continued that an independent body could be created to provide “a much more robust, impartial approach to resolving disputes and disagreements”.⁴⁹

53. The Bingham report said:

“The machinery for administering devolution finance can no longer be left to the sole discretion of HM Treasury, with some consultation with devolved governments. These arrangements must not only balance the interests of both devolved and UK Government, but also be adequately transparent and rule-driven to ensure that autonomy, accountability democracy and the rule of law are respected.”⁵⁰

54. The Bingham report continued to say that an independent, impartial body is needed to advise on financial matters and calculations. The report further said that there also needs to be an effective way of resolving disagreements and disputes when they arise, rather than ones that leave the initiative in the hands of the UK Government as at present.⁵¹

55. CIPFA agreed that an independent body was needed to ensure an appropriate level of funding to Wales:

“We think that the issue of regional funding and devolved funding across the UK probably should be put into the hands of an independent body rather than Treasury...an independent body that you have, or that you can feed into, helps make that decision and has a process for arbitration or whatever.”⁵²

56. David Phillips also said an independent institution could act as an arbiter in the case of disputes around the Barnett Formula. He said:

“the Barnett Formula (or any replacement formula) and associated Statement of Funding Policy could be managed by an independent body, rather than the Treasury.”⁵³

57. Despite the universal approval of witnesses of the proposal for an independent body the Chief Secretary to the Treasury said:

⁴⁹ Finance Committee, RoP, 17 June 2015, paragraph 134

⁵⁰ Bingham Centre for the Rule of Law, [A Constitutional Crossroads: Ways Forward for the United Kingdom](#), May 2015

⁵¹ Bingham Centre for the Rule of Law, [A Constitutional Crossroads: Ways Forward for the United Kingdom](#), May 2015

⁵² Finance Committee, RoP, 11 June 2015, paragraph 76

⁵³ [FF06, written evidence](#)

“The UK Government is not currently considering the option of introducing an independent body to monitor the application of the Barnett Formula.”⁵⁴

Committee view

58. The Committee recognises that the arguments for fair funding in Wales are long standing, well evidenced and supported by the Assembly.⁵⁵

59. The Committee recognises the points raised by David Phillips that any needs-based funding reduces the incentives of the Welsh Government to address needs and boost revenue. Nonetheless it does not consider these points outweigh the case for fairness.

60. The Committee’s “*Best Practice Budget Process*” report recommended that an independent arbitration mechanism would be an appropriate route if the Welsh Government and the Treasury fail to agree the amount of block grant adjustment.⁵⁶

61. The issue of a funding floor has been frequently raised to ensure Wales’ funding levels does not fall below a broadly fair level. The announcement of a funding floor in the most recent spending review sets a welcome precedent but the Committee notes with concern the time-limited nature of the commitment, which means it applies to a period when a floor mechanism will probably not be needed while only a “review” is promised for later when a floor may be required.

The Committee recommends that the Welsh Government further considers creating an independent body to advise on a transparent system for the allocation of funding to the devolved governments, including independent assessment of how expenditure decisions for England feed into block grants.

The Committee recommends that the Welsh Government works with the UK Government to increase co-ordination and provision for discussion regarding funding arrangements among the devolved governments and with Westminster. The Committee believes these intergovernmental

⁵⁴ HM Treasury, [Letter from the Chief Secretary to the Treasury to the Chair of the Finance Committee](#), 19 August 2015

⁵⁵ National Assembly for Wales, [Plenary, 13 May 2015](#)

⁵⁶ Finance Committee, [Best Practice Budget Process Part 2 – Planning and implementing new budget procedures](#), March 2015

relations must be transparent and subject to scrutiny with a means for arbitrating and resolving disputes.

The Committee recommends that the Welsh Government works with the UK Government and the other devolved governments to ensure that changes to the Statement of Funding Policy should be agreed between the UK Government and devolved administrations wherever possible and transparently recorded.

The Independent Commission on Finance and Funding for Wales has shown that it is possible to generate a simple needs-based formula to replace Barnett that also retains a high degree of completeness,⁵⁷ as such the Committee recommends that funding arrangements for Wales should be based on a formula reflecting relative needs.

Whilst recognising the necessity of a needs-based formula, should this not happen imminently, the Committee firmly believes that strengthening the commitment to a funding floor is necessary, with a secure undertaking that it will continue after the end of this UK Parliament. Furthermore, the Committee recommends that the distribution process for the block grant should have a firm statutory basis and not be a matter of ministerial discretion.

The Committee recommends that as a minimum, there must be a principled decision taken on how the block grant will be reduced before taxes are devolved. There is a need for a quasi-automatic procedure that is fair and allocates risk and responsibility appropriately.

⁵⁷ Independent Commission on Funding and Finance for Wales, [Fairness and accountability: a new funding settlement for Wales](#), July 2010

4. New institutional arrangements within the Welsh Government and intergovernmental arrangements

Background

62. A key difference between the command paper for Wales and the one for Scotland is that there is no description of a new fiscal framework for Wales. There are several proposals on “Intergovernmental Relations” although these do not appear to include funding issues:

- The Welsh and UK governments should establish a Welsh Intergovernmental Committee, to resolve disagreements on cross-border issues;
- There should be an arbitration mechanism in relation to legislative competence;
- The two governments should collaborate to produce comparative data and analysis on public service and economic outcomes.⁵⁸

63. The Committee’s *Best Practice Budget Process* report recommended:

“...that an independent arbitration mechanism would be an appropriate route if the Welsh Government and the Treasury failed to agree the amount of any block grant adjustment. The Welsh Government should keep the Committee informed of any agreements on the block grant adjustment which are reached with the UK Government.”⁵⁹

64. Since the passing of the Wales Act 2014 the Welsh Government has been making arrangements for the devolution of tax raising powers. The Welsh Government has introduced a Bill to put in place arrangements for tax collection and management, and has undertaken consultations in relation to landfill disposal tax and land transaction tax.

Intergovernmental relations

65. Evidence from Universities Wales referred to the formal mechanisms governing arrangements between the UK Government and the devolved

⁵⁸ UK Government, [Powers for a purpose: Towards a lasting devolution settlement for Wales](#), February 2015

⁵⁹ Finance Committee, [Best Practice Budget Process](#), July 2014

parliaments, but states “the UK Government’s policy making process often considers devolved concerns late, or not at all”.⁶⁰

66. In order to help the devolved administrations with their long term planning CIPFA believed that a Spending Review should cover the life a Parliament.⁶¹ The most recent spending review in November 2015 covered the next four years.

67. In the context of intergovernmental relations, the issue of an independent body to administer aspects of devolution finance recurred. David Phillips noted that calculating the adjustment to the block grant following tax devolution would be complicated. He concluded:

“It would be preferable if the UK Government and Welsh Government agree on a methodology, and publish detailed information on the calculations.”⁶²

68. David Phillips said that these calculations should be assessed and, if appropriate, signed off by the Office of Budgetary Responsibility (OBR) and an equivalent Welsh fiscal commission.⁶³

69. In addressing the calculations of block-grant reduction to offset tax revenues devolved, the Chief Secretary to the Treasury merely restated the current position:

“The outcome of the application of the Barnett Formula to UK Government departmental allocations is announced both at Spending Reviews and at individual fiscal events. These figures are then represented in Estimates laid before Parliament. HM Treasury’s *Statement of Funding Policy* contains the relevant details on the factors used when the Barnett Formula is applied.”⁶⁴

70. Specifically in relation to the arrangements for adjustment to the block grant for taxes, the Chief Secretary to the Treasury said:

⁶⁰ [FF02, written evidence](#)

⁶¹ Finance Committee, RoP, 11 June 2015, paragraph 121

⁶² [FF06, written evidence](#)

⁶³ [FF06, written evidence](#)

⁶⁴ HM Treasury, [Letter from the Chief Secretary to the Treasury to the Chair of the Finance Committee](#), 19 August 2015

“We will be taking forward discussions with the Welsh Government on block grants adjustments related to devolved Welsh taxes in due course.”⁶⁵

71. In relation to intergovernmental relations the Minister said a quadrilateral meeting between the devolved Finance Ministers and the Treasury hadn’t taken place since 2013 but individual Ministers from the devolved parliaments had met with the Chief Secretary to the Treasury individually. The Minister said she had called for the Chief Secretary to reconsider a UK Fiscal Framework, which provides a fundamental statement of funding policy for the devolved administrations and their fiscal arrangements.⁶⁶

72. The Bingham report identifies that the piecemeal, ad hoc approach to devolution taken so far cannot continue due to the constitutional difficulties that have been created. The report’s recommendation to address that is a *Charter of the Union*, to be passed as a Westminster statute with consent from the devolved legislatures, and setting out key principles for the working of a devolved union.

73. The Bingham report also includes a major set of recommendations relating to the UK Government, and particularly Whitehall. It said:

“Whitehall needs to pay much more attention to devolution concerns; it needs to ensure that the machinery of intergovernmental co-ordination actually works; and it needs to reinforce ministerial capacity.”⁶⁷

74. The Bingham report said the block grant arrangements need to be put on a statutory basis rather than resting on a Treasury “Statement of Funding Policy”, and be subject to external scrutiny and audit.

75. Alan Trench agreed that funding needed to be put on a statutory footing⁶⁸ and called for action on:

“a Welsh intergovernmental committee, building on the recommendations of the Silk Commission’s part 1 report, and agreed

⁶⁵ HM Treasury, [Letter from the Chief Secretary to the Treasury to the Chair of the Finance Committee](#), 19 August 2015

⁶⁶ Finance Committee, RoP, 25 June 2015, paragraph 134

⁶⁷ Bingham Centre for the Rule of Law, [A Constitutional Crossroads: Ways Forward for the United Kingdom](#), May 2015

⁶⁸ Finance Committee, RoP, 17 June 2015, paragraph 142

in the ‘Powers for a purpose’ command paper ... capable of playing a very useful role in dealing with these issues.”⁶⁹

Holding reserves and Welsh Government institutional arrangements

76. The Minister welcomed the fiscal devolution measures within the Wales Act 2014, and said preparation were taking place for the replacements for Stamp Duty Land Tax and Landfill Tax in Wales from 2018. However, at the time the Welsh Government would “not consider the devolution of income tax until the block grant is put on a fair and sustainable footing”.⁷⁰

77. The Wales Act 2014 gives the Welsh Government borrowing powers to invest in capital projects from 2018. Ministers will be able to borrow to invest in any devolved area of responsibility, up to a total limit of £500m. Early access to borrowing powers has been granted to help finance an enhancement to the M4. The Wales Act 2014 also provides for up to £500m of borrowing to support revenue spending to help manage budgetary fluctuations that may occur as a result of tax devolution.⁷¹ This is covered further in Chapter 6.

78. The Minister said “there was a need for greater flexibility in the funding arrangements to manage budgetary volatility and to better manage funding of public services from year to year. The Welsh Government believes there should be greater flexibility on the use of unspent resources and greater flexibility between our capital and resource budgets”.⁷²

79. CIPFA agreed the issues of end year flexibility around cash reserves was something to be considered⁷³ to facilitate longer-term planning.⁷⁴

80. Alan Trench also said consideration must be given to the Welsh Government holding reserves.⁷⁵

Committee view

81. The Committee is concerned by the Minister’s evidence in relation to the infrequency of the meetings which take place between the various governments within the UK, and is disappointed that these meetings do not

⁶⁹ Finance Committee, RoP, 17 June 2015, paragraphs 195-196

⁷⁰ [FF05, written evidence](#)

⁷¹ Welsh Government, [Financial reform and tax policy: Funding arrangements for the Welsh Government are changing](#), 17 December 2014

⁷² [FF05, written evidence](#)

⁷³ Finance Committee, RoP, 11 June 2015, paragraph 128

⁷⁴ Finance Committee, RoP, 11 June 2015, paragraph 130

⁷⁵ Finance Committee, RoP, 17 June 2015, paragraph 254

happen more frequently. The Committee believes that in the current devolution climate intergovernmental relations should be a high priority.

The Committee firmly believes the relationship between the UK Government and Welsh Government needs to improve. The Committee recommends that the Welsh Government works with the Chief Secretary to the Treasury to ensure more frequent meetings and the Chief Secretary should reconsider a UK Fiscal Framework, which provides a fundamental statement of funding policy for the devolved administrations and their fiscal arrangements.

The Committee believes there is a need for greater end-year flexibility. The Committee recommends that once funds have been devolved to Wales, they should not be returned to Treasury if unspent at the end of the financial year. The Welsh Government should have the ability to retain surpluses and build up reserves.

In regard to the Welsh Government's stated intention to develop a "Welsh Treasury"⁷⁶ the Committee considers that there is a need for greater clarity and explicitness about what that entails and recommends the Welsh Government provide this clarity. It is not simply a matter of extra staffing and technical expertise. Since government resources in future will come partly from tax revenues and borrowing, policies for these elements will have to be determined at Cabinet level and administered by the Welsh Treasury. The UK Treasury has a leading role in advising on the setting of budgets and co-ordinating expenditure decisions across all departments. The Welsh Treasury will surely have to act similarly, implying a stronger role than the Finance Department has had historically.

⁷⁶ Finance Committee, RoP, 25 June 2015, paragraph 34-37

5. Possible tax revenues and reforms in the short and longer term

Background

82. The Committee, during its Best Practice Budget Process inquiry, recommended that the Welsh Government should consider providing further financial economic data. This would provide evidence to support policy development and external scrutiny. Additionally, the Committee's report recommended that the Welsh Government should give further consideration to creating an independent body similar to the Scottish Fiscal Commission.

83. The Committee recommended that the Welsh Government should take account of the outcomes from the business rates review of Professor Brian Morgan during its Devolved Funding: Borrowing Powers and Capital report in 2012.⁷⁷

84. During the Spending Review in November 2015 the UK Government announced that it will legislate to remove the need for a referendum to introduce Welsh Rates of Income Tax.

Tax forecasts

85. The Minister referred to the preparations taking place for the replacements for Stamp Duty Land Tax and Landfill Tax in Wales from 2018. In relation to tax forecast the Minister said the Welsh Government was looking at "the prospects of establishing our own fiscal commission",⁷⁸ but was currently working with the OBR to ensure confidence in the tax forecast it produces⁷⁹ and that the Welsh Government does "challenge and check the OBR forecasts".⁸⁰ The Minister said:

"We've got to be able to validate and scrutinise tax forecasts, you know, because this is all about informing our budgetary plans."⁸¹

86. CIPFA believed that forecasting should be done by an independent body⁸² and advocated the role of a fiscal commission in Wales and referred to the approach in Scotland, specifically the independent role of the Scottish Fiscal Commission in reviewing Scotland's forecasts and "overseeing and

⁷⁷ Finance Committee, [Devolved Funding: Borrowing Powers and Capital](#), July 2012

⁷⁸ Finance Committee, RoP, 25 June 2015, paragraph 98

⁷⁹ Finance Committee, RoP, 25 June 2015, paragraph 109

⁸⁰ Finance Committee, RoP, 25 June 2015, paragraph 129

⁸¹ Finance Committee, RoP, 25 June 2015, paragraph 98

⁸² Finance Committee, RoP, 11 June 2015, paragraph 26

advising the Scottish Government on whether the funding settlement is appropriate or not”.⁸³

87. David Phillips supported the publication of forecasts of devolved taxes, and data relating to the operation of the Barnett Formula.⁸⁴

Further new taxes

88. In relation to the approval process for new taxes the Chief Secretary to the Treasury said:

“The Command Paper, published in March 2014, set out a clear list of the criteria against which any proposals for new taxes from the Welsh Government would be assessed by the UK Government. The paper set out that the criteria would include the extent to which the new tax:

- affects UK macro-economic or fiscal policy and/or the single market;
- may be non-compliant with EU legislation;
- increases tax avoidance risks; or
- creates additional compliance burdens for businesses and/or individuals;
- is aligned with devolved responsibilities,
- Consistent with the process set out alongside the Scotland Bill, any proposal from the Welsh Government for a new tax would need to include full details on the following:
 - the tax base (i.e. taxable activity);
 - estimated revenue and economic impact;
 - estimated impact on UK revenue or interaction with UK-wide taxes;
 - expected impacts on business and individuals (including a distributional impact);
 - assessment against all relevant legislation and directives, including the
 - Human Rights Act, EU State Aid rules, Equality Act etc; and
 - collection and compliance plans,

⁸³ Finance Committee, RoP, 11 June 2015, paragraph 72

⁸⁴ [FF06, written evidence](#)

The UK Government will work with the Welsh Government to assess any such proposals in a timely manner. If at the end of that process the UK Government decides not to grant powers to the Assembly to create a new devolved tax, it will explain its reasoning.”⁸⁵

89. When asked whether the Welsh Government had given any thought to the creation of new taxes in Wales the Minister said:

“Apart from what is already under way in terms of consultation in terms of land transaction tax and landfill disposal tax, we still await, for example, the devolution of the aggregates levy that, in fact, has been held up in Scotland, in terms of the devolution, as well as in Wales. But, we will have the powers within the 2014 Act to look at new tax opportunities, and that is obviously something now that, as a Welsh Government, we are beginning to see what could be ahead of us in terms of opportunities. My absolute focus at the moment really is on the funding—securing the funding floor and securing what we asked for in terms of the St David’s Day process. That was the funding floor and APD, very much reflecting what came from the Silk commission.”⁸⁶

90. The Minister continued:

“Where I’m taking it at this stage is to raise the question with colleagues in the Welsh Government and officials and say, ‘In terms of future prospects, we need to start scoping for new taxes in terms of policy needs’.”⁸⁷

Committee view

91. The ability to be able to forecast revenues from taxes is clearly important and the Committee would reinforce its view from the Best Practice Budget Process inquiry that consideration should be given to the creation of a Welsh Fiscal Commission. The Committee firmly believe not doing so has clear implications for future Welsh fiscal planning as it will be important not to introduce borrowing, spending or tax policies in the short-term which lead to unaffordable long-term commitments.

⁸⁵ HM Treasury, [Letter from the Chief Secretary to the Treasury to the Chair of the Finance Committee](#), 19 August 2015

⁸⁶ Finance Committee, RoP, 25 June 2015, paragraph 21

⁸⁷ Finance Committee, RoP, 25 June 2015, paragraph 25

92. In relation to the creation of new taxes the Committee believes that the process for introducing a new tax is too onerous and should be reviewed.

The Committee recommends that the Welsh Government works with the UK Government to review the rules in relation to introducing new taxes in Wales, to ensure the process is less onerous enabling the Welsh Government to effectively introduce new taxes.

The Committee believes the Welsh Government will need to forecast devolved tax revenues, including national non-domestic rates and the implications of the Block Grant adjustment, in order to inform their budgetary plans. The Committee recommends that the Welsh Government works to ensure these forecasts are high quality, transparent and in the public domain. The Welsh Government should consider whether it has the resources available to achieve this at the necessary standard.

Following on from a previous report, the Committee again recommends that a Welsh Fiscal Commission is set up to provide independent assessment of Welsh Government tax forecasts and assumptions.

The Committee notes that council tax and non-domestic rates raise over £2.5 billion a year. The Welsh Government has had a number of inquiries into non-domestic rates and the Committee believes there is a need for clarity going forward given these previous inquiries. The Committee will be recommending in its legacy report that the next Committee with responsibility for financial matters undertakes an inquiry into how valuations are kept up to date and what reforms should be considered to council tax.

The Committee notes the lack of published data on economic performance and tax revenues collected in Wales. The Committee recommends that information collected and published in Wales should be at least as detailed and as frequent as those that are currently produced in Scotland.

6. Borrowing possibilities

Background

93. The current financial settlement includes borrowing powers of up to £500m for current revenue spending shortfalls, which remains unchanged from the Government of Wales Act 2006 (GOWA). This will be able to be used to support revenue spending to help manage budgetary fluctuations that may occur as a result of tax devolution. The Wales Act 2014 gave the Welsh Government borrowing powers to invest in capital projects from 2018. Ministers will be able to borrow to invest in any devolved area of responsibility, up to a total limit of £500m. Early access to these capital borrowing powers has been granted to help finance an enhancement to the M4.

94. In its 2012 report on Devolved Funding: Borrowing Powers and Capital⁸⁸ the Committee recommended that if the Welsh Government was granted borrowing powers, the system should be flexible. Borrowing proposals should be accepted if they demonstrated affordability, sustainability and prudence, as is the case with local government prudential borrowing.

Evidence

95. In relation to borrowing in Wales, CIPFA said:

“The current funding settlement for Wales sets out prescribed borrowing limits set by the UK Government. These limits are already significantly lower than levels of affordable borrowing in Local Government in Wales.”⁸⁹

96. When questioned further CIPFA added:

“... your borrowing powers are kind of limited at the moment, so we would advocate moving that fiscal framework towards that prudential-type regime.”⁹⁰

97. For an indication of the scale of borrowing in local government; in the 2010-11 financial year the total authorised limit across local government in Wales was over £5.0bn,⁹¹ significantly greater than the limit being imposed

⁸⁸ Finance Committee, [Devolved Funding: Borrowing Powers and Capital](#), July 2012

⁸⁹ [FF03, written evidence](#)

⁹⁰ Finance Committee, RoP, 11 June 2015, paragraph 26

⁹¹ Welsh Local Government Association, [Prudential Borrowing and innovative approaches to capital funding Welsh Local Government Association](#), March 2012

by the UK Government on Capital Borrowing for the Welsh Government. As at the 31 March 2013, outstanding loan debt on the balance sheets of Local Authorities in Wales stood at £2.4bn.⁹²

98. Furthermore, CIPFA supports the “implementation of borrowing supported by a prudential management regime”.⁹³ CIPFA said it would support the approach taken by the Smith Commission in Scotland, “which would mean that the Welsh Government should also have sufficient borrowing powers to support capital investment, consistent with a sustainable overall UK fiscal framework”.⁹⁴

99. CIPFA advocated putting in place the following:

- A formal updated fiscal framework for Wales, supported in legislation;
- An agreed set of Prudential Indicators, measuring affordability, sustainability and prudence of the medium term to longer term investment decisions of the Welsh Government;
- An agreed method for Independent Scrutiny of the revenue and spending forecasts of the Welsh Government.⁹⁵

100. When asked about prudential borrowing CIPFA said:

“...it’s linked to the revenue that’s not only raised, but also any other kind of revenue – your total revenue, if you like. So, you begin to look at the affordability of what you’re borrowing and what you’re paying in terms of that debt, in terms of its impact on that revenue. Are you spending 20 per cent of that cake financing your debt or whatever it happens to be? So the Assembly itself decides what is affordable in that sense. So, it’s not a limit on the amount of debt that you can have; it’s your judgement about what’s affordable in terms of the impact on the revenue streams that you have. So, there is a relationship with taxes raised, but I’m talking about the totality of the revenue.

“... there’d be a legislative requirement for the Assembly to say what’s an affordable limit, effectively, that you couldn’t go above. I think that would probably fit in quite nicely with Treasury’s framework, give them some comfort. But, having that kind of fiscal approach, if you ever got to the stage of say, raising bonds for

⁹² Capital and Treasury Management Statistics 2013/14, CIPFA.

⁹³ [FF03, written evidence](#)

⁹⁴ [FF03, written evidence](#)

⁹⁵ [FF03, written evidence](#)

finance or anything like that for them to be able say, ‘Yes, the Welsh Assembly are creditworthy,’ or whatever, and therefore that would impact on the interest rates you could attract and things like that.”⁹⁶

101. The written evidence from the Minister said:

“The Welsh Government welcomed the devolution of borrowing powers to invest in capital infrastructure. The Welsh Government believes that the borrowing limits in the Wales Act 2014 should be increased to enable the Welsh Government to invest in the infrastructure Wales needs to support growth and jobs.”⁹⁷

102. The Minister said a prudential borrowing system would work well for the Welsh Government and called for the Welsh Government’s borrowing ceiling to be increased to £1.5 billion, and the annual limit on capital borrowing should be £250 million. The Minister said this would “put us in accord with the Scottish borrowing limits”.⁹⁸

103. Alan Trench believed that borrowing powers should:

“...go beyond a system of prudential borrowing as well, once you have fiscal devolution. I can’t see how you can effectively manage meaningful fiscal devolution that involves control of a particular set of taxes- tax base or set of tax bases – making the decisions about those and the exposure to the risk that your receipts don’t match your expectations for those receipts.”⁹⁹

Committee view

104. The Committee is concerned that the Welsh Government does not have the same borrowing powers as local authorities.

Whilst acknowledging that the Treasury would want to set an overall borrowing limit each year to retain control and ensure sustainability at an overall UK level, the Committee recommends that the Welsh Government’s capital borrowing should be subject to a prudential borrowing regime, similar to that for local authorities.

⁹⁶ Finance Committee, RoP, 11 June 2015, paragraph 59-61

⁹⁷ [FF05, written evidence](#)

⁹⁸ Finance Committee, RoP, 25 June 2015, paragraph 84

⁹⁹ Finance Committee, RoP, 17 June 2015, paragraph 175

Witnesses

The following witnesses provided oral evidence to the Committee on the dates noted below. Transcripts of all oral evidence sessions can be viewed in full at www.senedd.assembly.wales/mgIssueHistoryHome.aspx?Ild=1243

Name	Organisation
<i>Thursday 11 June 2015</i>	
Alan Bermingham	The Chartered Institute of Public Finance and Accountancy (CIPFA)
<i>Wednesday 17 June 2015</i>	
Alistair Brown	Director of Financial Strategy, Scottish Government
Sean Neill	Deputy Director, Fiscal Responsibility, Scottish Government
Alan Trench	Devolution expert and member of the Bingham Centre for the Rule of Law Review Commission
<i>Thursday 25 June 2015</i>	
Jane Hutt AM	Minister for Finance and Government Business
Andrew Jeffreys	Director Treasury, Finance and Corporate Services, Welsh Government
Ed Sherriff	Head of Fiscal Strategy, Welsh Government
Jeff Andrews	Specialist Policy Adviser Welsh Government
<i>Thursday 17 September 2015</i>	
David Phillips	Senior Research Economist, Institute for Fiscal Studies

List of written evidence

The following people and organisations provided written evidence to the Committee. All written evidence can be viewed in full at

www.senedd.assembly.wales/mgConsultationDisplay.aspx?ID=175

Copies of the correspondence considered in the course of this inquiry can be accessed at

www.senedd.assembly.wales/mgIssueHistoryHome.aspx?IId=12550

Organisation	Reference
Federation of Small Businesses Wales	FIN(4) FF01
Universities Wales	FIN(4) FF02
The Chartered Institute of Public Finance and Accountancy	FIN(4) FF03
NEA Cymru	FIN(4) FF04
Ministerial Response	FIN(4) FF05
Institute for Fiscal Studies	FIN(4) FF06
Scottish Government	FIN(4) FF07
Alan Trench	FIN(4) FF08