**BACKGROUND BRIEF FOR WELSH VISITS**

**CONTENTS**

## [A] POSSIBLE QUESTIONS & ANSWERS – PART I

***Q. What is your view of reactions to your Part I report?***

**A.** It is now for the UK Government to provide its response by the spring, as stated in the Autumn Statement. But we have generally been pleased by the positive reactions, including from the Assembly, the political parties in Wales, the UK Government, independent commentators like the IWA and business.

***Q. What assurance is there that the report represents the diverse views held in Wales on these issues?***

A. As a Commission we recognised there is a great diversity of views. We heard from a wide range of people, and reflected the views expressed in our report. Occasionally our judgement differed from some of the views presented to us, but we believe we tackled areas of concern in our report and have come up with a package that will command broad support, as reflected for example in our opinion poll and the completed questionnaires we received. The Commission itself represented a very diverse range of experience.

***Q. Didn't you just engage with the 'usual suspects?' Not many people seemed to turn up to your meetings***

A. We encouraged input and gave as much opportunity to people to engage with us and present their views. We were slightly disappointed at the turnout at some of our public events, which is why we commissioned the most in-depth opinion poll on taxation matters ever held in Wales as a scientific way of seeing what people thought in the main.

***Q. What have you had to compromise on to get agreement?***

A. You will see that we have a clear set of agreed recommendations. All our recommendations have been agreed by all our Commissioners. Our balanced package of recommendations is evidence based.

***Q. Have you followed the same principles as Holtham and Calman?***

A. Our core principles are similar, although we developed a fuller set of principles than them.

**Q. *What does a "wide degree of support in Wales" mean? How can you claim this when only 39 per cent support an Assembly with tax powers and your very poor turnouts.***

A. 39 per cent favoured an Assembly with tax powers compared to 31 per cent for an Assembly without tax powers. The Commission recognises that there are difficulties in establishing public opinion on such complex questions as taxation and borrowing. And getting people to come out to talk about taxation on a wet and windy afternoon in New Tredegar was difficult! But a majority in our ICM poll favour the main proposals in our report, and our report also generally reflects most political opinion in Wales.

**Q. *How does this relate to what is happening in other UK Devolved Administrations?***

A. The Commission is obviously aware and interested in what is happening in the other Devolved Administrations of Scotland and Northern Ireland. Naturally the work of the Calman Commission and the subsequent Scotland Act was hugely relevant to our work. We visited Scotland and Northern Ireland to learn from their experience. We published research papers on them.

There is however no “one size fits all” solution to devolved financing, beyond a general principle that devolved administrations should be directly responsible for some of their budget. What works for Scotland may not necessarily be right for us in Wales – for example in Wales as we know cross-border issues are hugely significant, as a much larger proportion of our population lives within 25 miles of the border with England. We have devoted a significant amount of our report to this issue. Our report builds on the experiences elsewhere and creates solutions for Wales.

**Q. *What about cross-border impacts? What consultation did you have with bodies across the border?***

A. We wanted to ensure that the implications of our proposals are thoroughly considered on both sides of the border. Therefore we included in our Call for Evidence businesses and organisations on both sides of the border including English district councils along the Welsh border and UK wide groups such as the FSB and the IoD. We also met the IPPR to discuss their research on English attitudes on devolution. Our recommendations were drafted with the border very much in mind.

In fact we devote an Annex in our report to this subject. We recognise the importance of maintaining and developing integrated cross border economies in both North and South Wales. We ruled out devolving mobile tax bases such as corporation tax and excise duties.

***Q. Does Commission agree with Barnett reform?***

A. Barnett Reform was not part of our remit. The joint statement by the Welsh and UK Government's confirms that spending per head in Wales is currently increasing relative to England under Barnett formula. Our proposals make Wales less dependent on Barnett formula by relating some funding to tax receipts.

***Q. Why not recommend the full devolution of APD?***

A. We recommend that APD rates for long haul flights should be devolved as in Northern Ireland as a first step. We have not ruled out full devolution of APD, and recommend that this should be considered in the wider context of the development of regional airports. The Howard Davies Commission is looking at the wider issue of airport capacity in the south east and beyond and we have written to them to advise them of our report.

***Q. What about all the taxes which you rejected (fuel duty, excise duty etc)?***

A. Generally the evidence suggested no great enthusiasm for devolving these taxes. People realised the difficulties which Holtham and Calman had previously raised such as illegal cross border trade. On fuel duty, we do recommend that the UK Government should consider the possibility of extending the existing fuel duty pilot to remote rural areas of Wales in the light of experience, subject to state aid rules.

***Q. Why did you reject corporation tax devolution, given support in Northern Ireland and Scotland?***

A. If the UK Government were to devolve this in Scotland and Northern Ireland, the case for devolving in Wales would need to be considered. But, based on our evidence and principles, we do not think it should be devolved on its own. Most of the evidence we received was cautious, supporting a UK-wide system and expressing concerns about the volatility and mobility of this tax, the scope for tax avoidance and the Welsh public expenditure cost of a large tax cut. Our Terms of Reference asked us to consider the overall UK fiscal objectives: corporation tax competition within the UK would be a net loss to the UK as a whole.

What may be of greater interest for Welsh businesses is that the scope for having more Enterprise Zones in Wales eligible for enhanced capital allowances. This would require the Welsh Government to pay the additional cost beyond the normal population share and subject to state aids.

***Q. Do you agree your report was panglossian and painted too rosy a picture of income tax devolution?***

**A.** Our report made clear that tax devolution involves a transfer of risk as well as opportunity and we set out a carefully staged approach to manage those risks prudently. We provided detailed quantification of the risks in our report including an Annex devoted to the subject.

However, the key point is that, as the Holtham report recommended, the block grant adjustment should exclude risks over which the Welsh Government has no control.

***Q. On income tax, is your proposal the same as Holtham and the solution being implemented in Scotland?***

A. We have come to a similar but not identical conclusion to Holtham and to the solution being implemented in Scotland.

There is a clear exception from Holtham, who wanted to restrict the amount by which the Welsh Government could raise or lower tax rates by 3p. We have followed the Scotland Act precedent and not recommended a restriction.

Unlike the Scotland Act, we think that the Welsh Government should be able to vary all income tax rates by different amounts. We think, as Holtham did, that this is important because it allows the Welsh Government more flexibility in being able to manage potential cross border movements of tax payers. This is not such an issue for the Scotland/England border. But we make no recommendation about whether the Welsh Government should use this flexibility in practice.

***Q. Does this mean that the Welsh Government could set very high or much lower rates for higher rate taxpayers?***

A. The Welsh Government could not introduce a new tax band but it could vary the existing rates. In practice, however, it is unlikely to set very different rates from the rest of the UK.

If the Welsh Government chose to increase the top rate this could lead to a possible reduction in Welsh taxes as a lot of people could choose to leave Wales. If it made a significant reduction in the top rate then it would make the tax system more regressive than the rest of the UK. These options seem unlikely to be attractive to a future Welsh Government.

***Q. Why should the block grant be reduced? Would Wales lose because of its weak tax base?***

A. The Welsh Government would be able to spend Welsh tax receipts so as Holtham recognised it is only fair that the block grant should be reduced. We recommend the same adjustment mechanism as Holtham.

What matters is not the low level of tax receipts but the growth in this level over time.

Income tax receipts in Wales have actually tended to grow somewhat faster than the UK average because of growth in the employment rate. The employment rate in Wales is lower than in England but the gap has been closing in recent years and this generates more income tax receipts. But we do recognise there is some risk here, although manageable. That is why we recommend a phased approach over time, with the initial phase based on riskless assignment of income tax.

***Q. If income tax devolution does not go ahead, how much devolved spending would be financed by devolved taxes?***

A. The figure would fall from 25 per cent to 13 per cent, of which most would be council tax and business rates.

***Q. What would happen if the Welsh Government reduced the higher rate of income tax to attract taxpayers across the border to increase Welsh income tax receipts?***

A. It would be quite difficult to identify how many people move for this reason although it would be reflected in overall Welsh tax receipts. But we do set out a general no detriment principle that tax changes should not be at the detriment of either Government. It would be for the two Governments to agree how to apply this principle. In any event this is a hypothetical and politically unlikely scenario.

**Q. What percentage of income tax would be devolved?**
A. Total income tax in Wales is about £4.8 billion and we are devolving about £2bn i.e. over 40 per cent.

***Q. Would taxes go up?***
A. Not necessarily. The Welsh Government could decide to reduce income tax or make a flatter structure to create a more enterprising culture. The First Minister has indicated that he would reduce taxes.

***Q. Have you effectively kicked income tax devolution into the long grass?***
**A.** We make it conditional on a referendum and a mutually agreed resolution of fair funding, which it will be for the two Governments to take forward. We ourselves do not take a view on fair funding, which is outside our remit. We set out a realistic timetable up to 2020.

***Q. Are borrowing powers dependent on tax devolution?***
A. We are proposing a package which contains both tax and borrowing powers. The Welsh Government would become similar to local authorities in this respect.

***Q. Why don't you say what the borrowing limits should be? What happens if income tax devolution does not go ahead?***
A. We propose a limit of £500m for borrowing for current expenditure. For capital spending we recommend at least proportionate to Scotland, given that we are recommending similar tax powers to Scotland, which would imply a limit of about £1.3 billion or over £100m a year. If income tax devolution did not go ahead, the analogy with the size of the Scotland limit would not be so strong as less tax would be devolved in Wales than Scotland, although as we point out in our report, Wales has fewer PFI payment commitments than Scotland so in that sense has more capacity to repay debt.

***Q. When could borrowing start? How much?***

A. We say in the report that new borrowing powers could be used in April 2016 if the legislation is enacted; and that if agreed by the UK Government, existing borrowing powers might be used earlier than this in anticipation. The amount, and whether income tax assignment would "count" as a revenue stream, would be matters for the two Governments to agree.

***Q. Why another referendum? Is there any chance of a majority in favour? When would it be?***

A. We set out the arguments for and against but on balance favour a referendum on the basis of the evidence we have received. But this is a matter for the two Governments. On the basis of the ICM poll a majority is favour of income tax devolution, but we can't predict what the outcome would be at this stage.

We envisage it might be in 2017 but this would be a matter for the two Governments.

***Q. Has the Welsh Government and Assembly got sufficient capacity? Can they be trusted with tax and borrowing powers?***

A. We see no reason why in principle they should not deliver successful Welsh fiscal policies but we do recommend cost effective strengthening of capacity. They have successfully managed their budget to date.

***Q. Slippery slope to the end of the Union?***

A. No. We are not recommending fiscal autonomy, which would mean an end to the existing fiscal transfers, vital to a successful economic Union.

***Q. Will Wales be better or worse off than now?***

A. This is about improving financial accountability. The fair funding issue is being addressed separately. We would argue that Wales would be better off in the sense of having more fiscal choices and levers available to it. And our package has been carefully designed to avoid big fiscal risks to either the UK or Welsh Governments.

***Q. Will this be overtaken by events in Scotland? Or by Part 2?***

A. We do not think so although obviously the financial settlement in Wales should be kept under review in the light of both the referendum and Part 2.

***Q. How exactly would your proposals strengthen the Welsh economy and business?***

A. In three main ways:

First, it would incentivise growth by providing the Welsh Government with a share of increasing tax receipts. This is only fair – if the Welsh economy does relatively well including as a result of successful Welsh Government economic policies (such as the ReAct and ProAct employment grants for businesses which it introduced a few years ago), Wales should get more resources, including through for example rising income tax and business rates.

Second, it would provide the Welsh Government with a new set of fiscal policy tax levers.

Third, it would enable the Welsh Government to borrow to increase economically worthwhile investment such as transport, strengthening the economy and tax base for the future.

***Q. What are the overall costs?***

A. On a pro rata basis with Scotland the start up cost might be around £20m and the ongoing costs might be around £2m a year. But the Welsh Government could gain around £6m a year from the more buoyant income tax base if the past favourable employment trends continue, although this is not guaranteed. All these figures are small compared to the £15bn annual Welsh DEL budget.

There is unlikely to be a large net cost for replacing the smaller taxes.

The cost of a stronger Treasury function and Assembly scrutiny can be contained within existing running costs.

There would be strict limits on increased borrowing.

There would be no net increase in borrowing from raising or lowering tax and spending.

So fiscal impacts would be limited.

***Q. Would Wales be less attractive to inward investment?***

A. We think that the Welsh Government could use fiscal powers to make Wales more attractive. But we ruled out corporation tax because of the importance of a unified UK regime.

***Q. What about using existing borrowing powers to finance the M4 relief road? What about transferring the Severn Crossing tolls to the Welsh Government in 2018?***

A. The issue of the use of the existing borrowing powers and whether tolls should be transferred from the UK Government to the Welsh Government in 2018 are matters for the UK Government and the Welsh Government.

The issue of whether the Welsh Government would use a new borrowing power to help fund an M4 relief road if this power is recommended by the Silk Commission and enacted by the UK Government would be a matter for the Welsh Government to decide.

# [B] GENERAL LINES – PART I

## B1 Work Programme & Stakeholder Engagement

- The Commission had a challenging and complex remit with Part I looking at financial accountability and Part II reviewing the powers of the National Assembly for Wales.

- The Commission has delivered Part I of our remit by publishing our findings on financial accountability on 19 November 2012.

- We placed great importance during Part I to gather evidence and hear the views of as many people as possible.

- We made 28 visits in Wales, we received written and oral evidence, we commissioned an ICM opinion poll, we issued a questionnaire, we produced an explanatory leaflet, we published minutes of our monthly meetings in transparent fashion, we visited Scotland and Wales, we reviewed the international evidence, we briefed MPs, AMs, and Peers, we met Assembly and Parliament Committees, there were debates in the Commons and Lords, we met UK and Welsh Government Ministers and officials.

- The Commission used its monthly meetings to meet key stakeholders e.g. it met all the members of the Holtham Commission.

- We have published all of our agendas, minutes, evidence and six research papers on our website.

- We actively engaged with the Welsh media to promote interest in our work and encourage evidence.

## [C] POSSIBLE QUESTIONS & ANSWERS – PART II

***Q. What assurance is there that the Commission represent the diverse views held in Wales on the issues at which we are looking?***

**A.** As a Commission we recognise there is a great diversity of views. We have been clear from the start of this project that our door is always open, and we are keen to meet any organisations or individuals that wish to express their views.

***Q. What was the process for appointing new Commissioners?***

A. Jane, Helen and Trefor were appointed by the Secretary of State and bring a wealth of experience from the public, private and voluntary sectors.

***Q. What are your reflections on the meetings of the new Commission so far?***

**A.** The new Commission is working well together and I am hopeful that we can continue to work consensually as we did in Part I. We are aware of the complexity of the questions before us, which are not amenable to easy answers. At our first Commission meeting, all of us were in agreement that the recommendations we make will be for the benefit of Wales and the UK as a whole.

***Q. Can you reassure us of your independence?***

**A.** We are a fully independent Commission and are determined to deliver the best recommendations for Wales. The Commission is not beholden to anyone - though our political members may well speak to their party colleagues, they will not be beholden to them either.

***Q. What are your plans for consultation in Part II? How do you engage with as wide a group as possible?***

**A.** The Commission launched its Call for Evidence on 29 November on our website, which was also sent out to over 700 individuals and organisations including Assembly Members, Members of Parliament, Peers, businesses, local councils, minority groups, and other interested parties.

Our Call for Evidence closed on 1 March and we encouraged as many as possible to submit evidence to us. We received over 100 responses and we are still open to receiving written evidence.

The Commission is running public consultation events and meetings with experts across Wales as our work progresses, we aim to allow as many people as we can to get involved and attend an event.

And as in Part I we are commissioning an opinion poll.

***Q. What does a "wide degree of support in Wales" mean?***

**A.** The Commission recognises that there are difficulties in establishing public opinion on such complex questions. As a Commission we will therefore strive to gain a wide range of support from political parties and key stakeholders, as well as generating interest, understanding and appreciation from the wider general public.

***Q. What lessons have you learned from other UK Devolved Administrations?***

**A.** As a Commission, we are determined to come up with a package of recommendations which will benefit Wales. However, we will be looking at Scotland's and Northern Ireland's devolution experience with interest and have already visited these countries.

There is however no "one size fits all" solution. What works for Scotland and Northern Ireland may not necessarily be right for us in Wales. There are also other experiences of devolution internationally, and we are reviewing the evidence from abroad.

***Q. What about cross-border impacts? What consultation are you having with bodies across the border?***

**A.** We want to ensure that the implications of our work are thoroughly considered on both sides of the border. Therefore we included in our Call for Evidence businesses and organisations on both sides of the border including English district councils along the Welsh border and UK wide groups such as the FSB and the Institute of Directors.

***Q. Will you be looking at specific issues such devolution of policing, courts and prisons, the reserved powers model, a devolved legal system? What is meant by "modifications" to the settlement?***

A. At the moment we have an open mind. We are not, at this stage, ruling anything in or out although we will of course respect our terms of reference. The written evidence we have received so far suggests that most people do not want to return powers to London, although some do. Some are broadly content with the status quo. Others want to devolve more powers in areas such as policing and justice, transport, energy and the environment, natural resources, broadcasting and others. Some want a reserved powers model. And some want the two Governments to work more effectively together.

***Q. In Part II are you just going to look at tweaks as the Secretary of State has said?***

A. We will look at possible modifications as our remit requires and we have invited people to put forward their views in our call for evidence published on 29 November. We have not ruled anything in or out, but we hope as many people and organisations will respond with their views on how devolution can work better for Wales.

***Q. Will you consider repatriating powers to Westminster?***

**A.** That is not ruled out by our terms of reference, but there is unlikely to be widespread support for a wholesale repatriation of powers. We will however consider all evidence submitted to us.

***Q. Will you consider the case for a bigger Assembly?***

**A.** The structure of the Assembly is outside our remit, but in Part I we did comment on the capacity of the Assembly to handle an increased workload and the possible case for more support e.g. research.

***Q. Are you just looking at changes in powers?***

**A.** We are happy to consider any evidence about how we can make devolution work better for Wales e.g. by more effective working between institutions, although it is of course for the Welsh Assembly and Government to decide how to run their own devolved policies.

***Q. Is now the right time to be looking at more powers for the National Assembly for Wales? The National Assembly received substantial further powers following the referendum last year.***

**A.** The referendum was on a separate issue to the one the Commission is looking at here. The referendum last year granted the Assembly with primary law making powers in the twenty areas defined by the original settlement. We are looking at what new areas of responsibility could be devolved to the Assembly that would allow them to better serve the people of Wales.

**Q.** ***Do you agree that setting up the Silk Commission was inconsistent with the Government's assurances at the time of the March 2011 referendum? A slippery slope to devo max?***

**A.** The decision to set up the Silk Commission was taken by HMG with the support of the main political parties in Wales. It is not a foregone conclusion that there will be more devolution of powers. We will listen to what everyone has to say and recommend what we think is in the best interest of Wales and the UK.

***Q. What are your resources and budget?***

A. The Commission is supported by a small secretariat of five officials made up from the Wales Office, HM Treasury and the Welsh Government.

The UK Government has given us a budget of approximately £1 million for us to complete our work on both Part 1 and Part 2 of our remit over the two and a half years. None of the Commissioners are receiving remuneration for our work except for expenses to cover travel and subsistence costs incurred whilst undertaken Commission activities. We are on track to meet our timetable and budget.

As a Commission we are committed to delivering the best value for money possible.

## [D] GENERAL LINES AND SPECIFIC ISSUES – PART II

### D1 Call for Evidence /Public Engagement

- We placed great importance during Part I to gather evidence and hear the views of as many people as possible.

- We are determined to build on this for Part II and have been considering ways of engaging with stakeholders and the general public extensively.

- On 29 November 2012 we launched our Call for Evidence for Part II of our work, on the non-financial aspects of the current devolution settlement.

- We invited submissions until 1 March 2013 from any interested party, whether an individual, government, business or other organisation that wished to share their experience of devolution and help us in our considerations of how the devolution settlement could be modified to better serve the people of Wales.

- We would strongly encourage as many as possible, collectively or individually, to give us their views on the current constitutional arrangements – both the current division of responsibilities and also the way that devolution is administered.

- We have asked for suggestions to help identify any areas that the Commission should consider in particular, as well as specific ideas for how the devolution settlement should be modified to better serve the people of Wales.

- We are seeking views on how the current settlement works in practice, and where improvements could be made to the way it works such as, for example, better cooperation in certain areas which might benefit the people of Wales.

- We are also considering ways of engaging with stakeholders and the general public extensively. We are holding a series of public events to hear people's views. Further details are on our website including a questionnaire.

## D2 Specific issues

**Q. How will you achieve consensus when the two Governments' evidence is so far apart?**

A. Their evidence has been very valuable to us. Not necessarily looking for short term solutions but looking at how devolution should evolve over time.

**Q. What are the pros and cons of devolving policing?**

A. Other major public services devolved; and good fit with tackling causes of crime. But need to consider in wider context of rest of criminal justice system. And cross border.

**Q. And criminal justice system?**

A. Devolving courts, prison, legal aid, criminal justice policies would raise a lot of issues. On the other hand seems to work well in Scotland and Northern Ireland.

**Q. Separate jurisdiction?**

A. Scotland and Northern Ireland have separate jurisdictions and Wales has own laws. So worth considering. But very different history.

**Q. More powers in transport, broadcasting, water, large windfarms? Social security and economy?**

A. Many of these are worth looking at and nothing ruled out. Can learn from Scotland although need to pay attention to Welsh circumstances. Most people not calling for big changes on social security and economy.

**Q. Reserved powers model better?**

A. Some people say so but not a panacea, still jagged edges.

**Q. Welsh Government should use existing powers better?**

A. Not our role to assess Welsh Government, but we take this argument seriously. Not saying how devolved powers should be used.

**Q. Views of business?**

A. Helpful evidence from FSB Wales but in general would like to hear more from business.

- ## E1 Terms of Reference

An independent Commission will be established to review the present financial and constitutional arrangements in Wales. It will carry out its work in two parts:

Part I: financial accountability

**To review the case for the devolution of fiscal powers to the National Assembly for Wales and to recommend a package of powers that would improve the financial accountability of the Assembly, which are consistent with the United Kingdom's fiscal objectives and are likely to have a wide degree of support.**

Part II: powers of the National Assembly for Wales

**To review the powers of the National Assembly for Wales in the light of experience and to recommend modifications to the present constitutional arrangements that would enable the United Kingdom Parliament and the National Assembly for Wales to better serve the people of Wales.**

In undertaking Part I, the Commission should:

- provide independent advice on the case for improving the financial accountability of the National Assembly for Wales consistent with the fiscal and constitutional framework of the United Kingdom;
- consult widely on a package of fiscal powers which would improve the financial accountability of the National Assembly for Wales;
- make recommendations on whether a package of fiscal powers could be devolved to the National Assembly for Wales which are likely to have a wide degree of support; and
- consider and make recommendations on how best to resolve the legal and practical implementation issues from devolving a package of fiscal powers, including consistency within the United Kingdom.

Part I will be completed before work on Part II begins.

In undertaking Part II, the Commission should:

- examine the powers of the National Assembly for Wales, and in particular:
  - the boundary between what is devolved and non-devolved;
  - whether modifications to the boundary should be made at this stage; and
  - any cross-border implications of such modifications;
- consult widely on any proposed modifications to the current boundary;
- make recommendations on any modifications to the settlement likely to have a wide degree of support; and
- consider and make recommendations on how best to resolve the legal and practical implementation issues from those modifications.

The Commission will not consider, in part I, the Holtham Commission's proposals for funding reform in Wales, including Welsh Ministers' existing borrowing powers, which are being dealt with through a separate bilateral process between the United Kingdom Government and the Welsh Government; and, in part II, the structure of the National Assembly for Wales, including issues relating to the election of Assembly Members.

## E2 Principles

A set of principles devised by the Commissioners for Part I. Part II principles are not yet published, and we are receiving evidence on them.

• ***Accountability*** **–** the level of spending by the sub-national government should be affected by the sub-national government's taxation choices. The sub-national government should have the responsibility for raising some of the money that it spends. The impact of decisions on taxation made by the sub-national government should be clear to taxpayers, and taxation and spending choices should be offered to the electorate in sub-national government elections;

• ***Autonomy*** **–** sub-national governments should have some freedom to decide the level of spending and how it is spent. This is also related to the principle of subsidiarity;

• ***Cooperation and constructive engagement between the central and sub-national governments*** **–** the two governments should engage with each other in a spirit of negotiation, agreement and mutual consent;

• ***Economic incentivisation*** **–** the sub-national government should have sufficient incentives to grow the economy;

• ***Efficiency*** **–** the funding system should ensure that sub-national governments can manage their resources in the most efficient way and promote economic growth. It may be more efficient for a sub-national government to set a different taxation and spending arrangement from that at the central level so as to better meet the preferences of its citizens in line with principles of subsidiarity. Different taxation arrangements should minimise administration and compliance costs, economic distortions and tax avoidance;

• ***Empowerment*** **–** the funding system should enable the sub-national government to use fiscal powers as tools to achieve desired outcomes in areas of policy under its control. The sub-national government should have the powers to be able to implement policies which are different from those of the central government to better meet its perception of the needs of its citizens. With empowerment comes responsibility for delivering successful fiscal policies;

• ***Equity*** **–** resources should be allocated in a way that makes it possible for a standard level of public services to be made available in all parts of the state, subject to variation to reflect sub-national policy preferences. Equalisation payments can be used as a method of achieving equity by making payments to areas with a lower capacity to generate tax revenue or areas with a higher cost of providing a standard level of public services due to higher need. Those payments are essential to address the underlying issues that generate higher need, and should therefore have the effect of reducing this need in the future. Tax systems should also promote fairness between taxpayers;

• ***Fiscal discipline* –** the financing arrangements of a sub-national government should not undermine the macro-economic stability objectives of the central government;

• ***Simplicity* –** the funding system should be designed to minimise complexity in its administration and in its compliance arrangements for individuals and businesses. The devolution of fiscal powers almost inevitably increases complexity: the goal, therefore, is to assess the potential benefits against the potential costs associated with a more complex system;

• ***Stability, predictability and sustainability* –** the funding system should minimise volatility to enable public spending to be managed properly and be predictable in its operation. The funding system should also meet the needs of the present and those of future generations; and

• ***Transparency* –** taxation and spending decisions should be readily understood and the justification for them made evident.

Our draft vision for Part II is as follows:

*We believe that the people of Wales will be best served by:*

- *a clear, well-founded devolution settlement that allows coherent political decisions to be made in a democratic and accountable manner, and*
- *political institutions that operate effectively and work together in the interests of the people they serve.*

*Devolution of power to Wales should benefit Wales and the whole of the United Kingdom.*

## E3 Part I Recommendations

R.1. The current funding arrangements for the Welsh Government do not meet the requirements of a mature democracy and are anomalous in an international context. The funding model of a block grant and some devolved taxes best meets sound principles for funding the Welsh Government. We therefore recommend that part of the budget for the Welsh Government should be funded from devolved taxation under its control.

R.2. Business rates should be fully devolved, subject to the Welsh and UK Governments agreeing the details and assessing any risks involved.

R.3. Stamp Duty Land Tax should be devolved to the Welsh Government with Welsh Ministers given control over all aspects of the tax in Wales. A fixed deduction should be made to the block grant with the value of this agreed between the Welsh and UK Governments taking due consideration of the volatility of receipts.

R.4. Landfill tax should be devolved to the Welsh Government with Welsh Ministers given control over all aspects of the tax in Wales. A fixed deduction should be made to the block grant with the value of this agreed between the Welsh and UK Governments taking due consideration of the declining taxable base.

R.5. Subject to the outcome of discussions between the UK Government and the EU Commission on state aid issues, aggregates levy should be devolved to the Welsh Government, with Welsh Ministers given control over all aspects of the tax in Wales. A fixed deduction should be made to the block grant with the value of this agreed between the Welsh and UK Governments taking due consideration of the declining taxable base.

R.6. We recommend that APD should be devolved for direct long haul flights initially and recommend that devolving all rates for APD to Wales should be part of the UK Government's future work on aviation taxation, which should include considering the wider case for regional differentiation for APD or airport congestion charging. We recommend that this issue should be considered in the context of the Davies review and any developments in Scotland and Northern Ireland. A fixed deduction should be made to the block grant with the value of this agreed between the Welsh and UK Governments taking due consideration of the forecast tax revenues in Wales.

R.7. We do not recommend that fuel duty should be devolved. We recommend that in the light of experience of the fuel rebate pilot scheme, the UK Government should assess the extension of the scheme to some rural and remote areas in Wales, subject to EU agreement.

R.8. We recommend that the following taxes should not be devolved:

- alcohol and excise duties;
- Vehicle Excise Duty;
- Capital Gains Tax;
- Insurance Premium Tax;
- stamp duty on shares;

- Inheritance Tax;
- betting and gaming duties; and
- Climate Change Levy.

R.9. We recommend that when the UK Government is considering introducing new taxes in devolved areas of policy, there should be a presumption in favour of devolving powers over the tax to the Welsh Government.

R.10. Where UK-wide taxes and reliefs are not devolved, we recommend that:

a. the UK Government should keep under review the scope for introducing tax reliefs which would help to support the Welsh economy in an affordable and cost effective way subject to EU state aid constraints; and

b. if the UK Government changes the thresholds and allowances or rates for a tax that is not devolved, which includes an element of geographical targeting (for example, capital allowances in Enterprise Zones in selected areas), then an assessment should be made in consultation with the Welsh Government as to whether the Welsh Government should be able to fund additional coverage.

R.11. The National Assembly for Wales should be given a power to legislate with the agreement of the UK Government on a case by case basis to introduce specified taxes and any associated tax credits in Wales. The Welsh Government should retain the revenue from these without a deduction to the block grant. The UK Government should adopt a flexible approach to any proposal for these taxes from the Welsh Government.

R.12. We do not recommend devolving corporation tax to Wales. However, if the UK Government were to agree to devolve corporation tax to both Scotland and Northern Ireland, we recommend that the same powers should be given to Wales.

R.13. We recommend that the enhanced capital allowances should be able to be offered within more enterprise zones in Wales subject to state aid rules and provided the Welsh Government pays the incremental cost.

R.14. Variation of VAT rates within a member state is prohibited by EU law. We therefore have no option but to rule out the devolution of VAT, although we recognise that there are also other arguments against the devolution of VAT. To make devolved budget adjustments when those adjustments are not the result of the actions of the Welsh Government could be regarded as the opposite of improved accountability. As a result we do not recommend assigning VAT.

R.15. We do not recommend that NICs in their current form should be devolved. There is an intrinsic link between contributions and the National Insurance Fund which funds social security benefits. We recommend that the UK Government should give further consideration to regionally differentiated adjustments, such as the employers NICs holiday, to support the labour market within state aid rules. The Welsh Government should be able to fund extra such geographically differentiated adjustments within Wales, if compatible with EU commitments and the UK social security system.

R.16. We recommend that the UK and Welsh Governments should share the yield of income tax. The Welsh Government should have responsibility for setting income tax rates in Wales and we recommend the following package:

a. income tax on savings and distributions should not be devolved to the Welsh Government;

b. there should be new Welsh rates of income tax, collected by HMRC, which should apply to the basic and higher and additional rates of income tax;

c. the basic, higher and additional rates of income tax levied by the UK Government in Wales should be reduced initially by 10 pence in the pound. Over time the Welsh Government's share could increase if there is political consensus;

d. the Welsh Government should be able to vary the basic, higher and additional rates of tax independently;

e. the Welsh Government should not be restricted in its rate setting above the reduced UK rates;

f. the block grant adjustment mechanism should be based on the indexed deduction method as advocated by the Holtham Commission and being implemented in Scotland, which automatically incorporates the principle of 'no detriment'; and

g. there should be transitional arrangements following the introduction of income tax devolution, in particular to help manage the transfer of risk.

R.17. We recommend that the Office for Budgetary Responsibility (OBR) should produce Welsh income tax forecasts in a similar way to Scotland and the amounts forecast should be assigned to the Welsh Government prior to the introduction of legislation, without any impact on the Welsh Government's spending power.

R.18. We recommend that the transfer of income tax powers to the Welsh Government should be conditional upon resolving the issue of fair funding in a way that is agreed by both the Welsh and UK Governments.

R.19. We recommend that Welsh Ministers should be given an additional power to borrow to increase capital investment above the Welsh Government DEL budget. There should be an overall limit to such borrowing, at least proportionate to that in Scotland, whilst taking into consideration the relative lack of exposure to PFI in Wales. The agreed annual profile should provide some flexibility and be subject to review in each spending review. Borrowing should be from the National Loans Fund and commercial sources. We also believe that the Welsh Government should be able to issue its own bonds.

R.20. We recommend that new powers for Welsh Ministers to borrow for short term purposes should be introduced to manage cash flow and volatility in taxes when devolved taxes are in place, similar to those in the Scotland Act 2012.

R.21. We recommend that the Welsh and UK Governments should work together to promote increased investment in Wales through the variety of funding mechanisms available.

R.22. There is opportunity for improving the availability of information to increase financial accountability, public understanding and transparency, and we recommend the following, subject to a detailed assessment of the costs and benefits involved by the UK Government and Welsh Government as appropriate:

a. estimates of spending in England on services which are devolved in the case of Wales should be made available to help inform the debate on public finances in Wales;

b. consideration should be given to whether the ONS United Kingdom accounts should include a 'sub-national' tier of government spending;

c. figures on the amount of tax collected in Wales should be produced. Such figures should also include estimates of the Welsh fiscal balance. This country and regional analysis should be done on a consistent basis across the United Kingdom;

d. we encourage the UK Government and the devolved administrations to publish annually key comparative statistics in devolved and non-devolved areas; and

e. the Welsh Government should consider whether more information could be published on the economy in Wales including on Welsh GVA or other income measures, as well as on economic forecasting.

R.23. The following institutional changes should be made to improve financial accountability:

a. consideration should be given to the OBR or another body having a wider role in either producing or validating information on public finances and the economies of Wales, Scotland and Northern Ireland; and reviewing and auditing technical aspects of the devolved funding system where appropriate;

b. changes to the Statement of Funding Policy should be agreed between the UK Government and devolved administrations wherever possible and transparently recorded;

c. the current finance ministers' meetings should be formalised;

d. the present arrangement whereby the Chief Secretary to the Treasury has attended the National Assembly's Finance Committee to answer questions on the UK Budget should be formalised; and

e. more information should be made available on the current scrutiny and accountability of public spending in Wales.

R.24. The Welsh Government should be allowed to switch spending from capital to resource spending within the terms of a concordat agreed with HM Treasury, in the light of the Welsh Government's record on budget management and provided the UK Government's fiscal targets are not put at risk.

R.25. The UK and Welsh Governments and other devolved administrations should review experience of the devolved budget exchange scheme in the next spending review and agree appropriate flexibility provided the UK Government's fiscal targets are not put at risk.

R.26. Devolution of income tax should be subject to a referendum in Wales. Provision for such a referendum should be contained in the Act which introduces tax and borrowing powers.

R.27. A new Wales Bill should be introduced in this Parliament to devolve tax and borrowing powers. A bill to devolve tax and borrowing powers should not wait until the completion of Part II of our work. Changes which do not require legislation should be introduced as soon as possible.

R.28. The Welsh Government should set up a Welsh Treasury to manage the new powers we are recommending.

R.29. The new funding system will require a strengthening of the institutional arrangements to deal with finance:

a. a joint Intergovernmental Bilateral Committee on Welsh Fiscal Devolution should be established to meet at least twice a year following the OBR's biannual forecasts to discuss taxation and macroeconomic policy;

b. the relationship between HMRC, the Department for Work and Pensions, and the Welsh Government on income tax should be set out in a Memorandum of Understanding, which should be published in advance of implementation;

c. for the National Assembly for Wales and Welsh Government, the lines of accountability of HMRC in relation to the Welsh rate of income tax should be similar to those of HMRC to the UK Parliament and Government. An HMRC Additional Accounting Officer should be made specifically accountable for the collection of the Welsh rate of income tax;

d. the Wales Bill should enable the National Assembly for Wales to compensate HMRC for the net additional costs associated with implementing and maintaining the Welsh rate of income tax. For the taxes that are to be wholly devolved (SDLT and Landfill Tax) and any new taxes, the Assembly will need to agree formal arrangements, for example a contract or accompanying service level agreement, with the body, either new or existing, which they decide to administer the taxes;

e. where a varying tax rate could lead to an increase or decrease in liabilities for the UK Government, the principle which is set out in the Statement of Funding policy that 'the body whose decision leads to the additional cost will meet that cost' should be adhered to;

f. the UK Government should make sure that the Welsh funding system is as transparent as possible with the key components either verified independently or dependent on independent sources. The OBR should be responsible for forecasting Welsh tax receipts, based on data that will include information provided by the Welsh Government. A memorandum of understanding between the OBR, HMRC and HM Treasury should be published in the lead up to implementation alongside more detail on the forecasting methodology. The ‘no detriment’ principle should apply as in Scotland; and

g. the UK Government should invite the Comptroller and Auditor General as head of the NAO to prepare a report to the National Assembly for Wales on HMRC’s administration of the Welsh rate of income tax. If the Welsh Government decides to approach HMRC to administer the smaller taxes, and HMRC agree, then it will be up to the Welsh Government to decide how any audit arrangement should work.

R.30. The Welsh Government and UK Government should work closely together to use both devolved and non-devolved economic powers to strengthen the Welsh tax base.

R.31. These changes should be introduced in a phased way to manage the risks of instability in public finances and of windfall gains or adverse shocks to the Welsh Budget.

R.32. The National Assembly for Wales should have legislative control of its own budgetary procedures.

R.33. The National Assembly Commission may need to consider modest building-up of capacity for financial scrutiny.

## E4 Part I Key Facts

Key findings of ICM opinion poll

- Up to two in three people think the Welsh Government should be able to vary major UK wide taxes in Wales
- 64 per cent favoured income tax devolution
- 67 per cent favoured devolution of 'buying a house' tax (SDLT)
- 72 per cent favoured a power to introduce new taxes to change behaviour
- 80 per cent favoured a power to borrow
- 81 per cent favoured a referendum on income tax powers
- Two in three people believed the Welsh economy would be stronger and similarly the delivery of public services would be enhanced if tax and borrowing powers were devolved
- Majority (56%) convinced that the Welsh Government would be held more accountable for its decisions if it took some responsibility for tax powers.

How Welsh public finances would be affected by our recommendations

- Existing annual Welsh devolved spending (Welsh government and local authorities): £18 billion;
- Of this Welsh devolved spending, amount currently determined by Welsh tax receipts i.e. council tax funded spending: £1.3 billion;
- Welsh devolved spending determined by Welsh tax receipts under our proposals, including council tax, business rates, a 10p share of income tax and smaller taxes (stamp duty land tax, landfill tax, aggregates levy, long haul APD): £4.4 billion i.e. about one quarter of total devolved spending;
- annual amount which the Welsh Government could borrow for increased capital investment if set at at least 10 per cent of existing Welsh Government capital budget as proposed in Scotland: over £100 million a year. Limit on total cumulative amount of capital borrowing over a period of years (i.e. total debt) if set at least proportionate to the proposed Scottish: about £1.3 billion; and
- Annual amount of borrowing for current spending if set proportionate to Scotland: around £100 million. Limit on cumulative amount of borrowing for current spending (i.e. total debt) over a period of years: £500m.

# E5 UK Government and Welsh Government - Funding reform: Joint statement of progress

<u>Introduction</u>
The UK Government and Welsh Government have jointly agreed the next steps following inter-governmental talks on funding reform. These cover devolved funding, borrowing powers and wider reform.

<u>Devolved funding</u>
The Welsh Government strongly believes that there is no case for further convergence in Welsh relative funding. The UK Government recognises that there has been convergence in Welsh relative funding since the start of devolution, and that this is a significant concern in Wales.

Both Governments accept that, on the basis of present UK Government spending plans, there is unlikely to be further convergence over the current budgetary planning horizon. A small amount of divergence is likely to occur over the remainder of this spending review period, but the overall trend of convergence is very likely to reassert itself once spending starts to increase.

In future, in advance of each spending review there will be a joint review of the pattern of convergence by the two Governments. If convergence is forecast to occur over the course of the spending review period, both Governments will then enter into discussions on options to address the issue, based on a shared understanding of all the evidence available at that time.

Both Governments commit to negotiating to achieve a sustainable arrangement for Welsh devolved funding and the UK public finances, that each can accept as being fair and affordable.

The Welsh Government believes that a mutually acceptable outcome to those discussions is an essential precondition for any significant devolution of taxes and the UK Government will only implement such changes with the consent of the National Assembly for Wales.

<u>Borrowing powers</u>
In principle, the UK Government accepts the case for the Welsh Government to have access to borrowing powers in order to finance infrastructure projects, subject to an appropriate independent stream of revenue being in place to support it.

Decisions on the devolution of taxes – which could provide an appropriate revenue stream – will be made after the Silk Commission reports.

It has been agreed that the UK Government and Welsh Government should continue to explore the options for financing specific infrastructure projects, including the case for early access to borrowing powers in anticipation of a future independent revenue stream.

Both Governments agree that any borrowing powers should operate within the UK Government's responsibility for delivering its fiscal mandate.

Wider reform

The Silk Commission is currently considering the case for devolving additional fiscal powers to Wales, including the options for the devolution of certain tax-varying powers.

Both Governments commit to giving the Commission's proposals serious consideration, with a view to agreeing jointly a package of reforms that delivers fair and accountable funding for Wales and that commands a broad consensus.

## E6 Current Devolution Settlement

The system of devolution in Wales is based on the “conferred powers” model. The UK Parliament has transferred competence to the National Assembly for Wales to make laws, or Assembly Acts, in 20 subject areas. The 20 areas of transferred powers are listed under Schedule 7 to the Government of Wales Act 2006. These are in line with the executive responsibilities of the Welsh Government.

Through these 20 areas the National Assembly for Wales has responsibility for the majority of domestic policies, and since the 2011 referendum the National Assembly for Wales has also had enhanced legislative powers – which are called “primary powers”. However, there are exceptions within the devolved areas where the UK Parliament retains the power to legislate over some areas of domestic policy.

The areas where the National Assembly currently has whole or partial powers to legislate upon are:

1. **Agriculture, Fisheries, Forestry and Rural Development** (exceptions include hunting with dogs, regulation of sea fishing outside the Welsh zone, regulation of scientific or other experimental procedures on animals)
2. **Ancient monuments and Historic buildings**
3. **Culture** (exceptions include public lending rights and broadcasting)
4. **Economic development** (exceptions include National Insurance Contributions, fiscal, economic and monetary policy and regulation of international trade, financial services including investment business, banking and deposit taking, collective investment schemes and insurance, and competition policy)
5. **Education and training** (exceptions include pay and conditions of teachers and research councils)
6. **Environment**
7. **Fire and rescue services and promotion of fire safety**
8. **Food**
9. **Health and health services** (exceptions include abortion, xenotransplantation, regulation of health professionals and poisons)
10. **Highways and transport** (exceptions include road traffic offences, driver licensing, driving instruction and insurance of motor vehicles, aviation policy, shipping services, Network Rail and rail regulation)
11. **Housing**
12. **Local government** (exceptions include local government franchise, electoral registration and administration, registration of births, deaths, marriages and civil partnerships)
13. **National Assembly for Wales**

14. **Public administration** (with the exception of regulation of the profession of auditors)

15. **Social Welfare** (exceptions include child support, social security, child benefit and guardian's allowance)

16. **Sport and recreation** (exceptions include betting, gaming and lotteries)

17. **Tourism**

18. **Town and country planning**

19. **Water and flood defences** (exceptions include appointments of water infrastructure companies or sewerage infrastructure companies for any area most of which is in England and licensing of Water suppliers )

20. **Welsh language** (with the exception of use of the Welsh language in the courts)

Schedule 7 can be amended by what is known as an Order in Council. This effectively means a proposal from the United Kingdom Government that is approved by the Assembly and by both Houses of Parliament.

There are a number of areas where the National Assembly for Wales cannot legislate at all. There are some general restrictions and exceptions, but fundamentally any area that is not listed as a devolved power under Schedule 7 of the Government of Wales Act cannot be legislated upon by the National Assembly. There is no comprehensive list of these areas. However some of the main areas that are non-devolved are: foreign affairs, defence, macro-economic policy, the tax and welfare system, energy policy, broadcasting and policing and justice.

Within the United Kingdom, the UK Parliament is sovereign and could, in theory, pass laws in any areas for which it has transferred responsibility to the National Assembly. However, in practice, whenever the UK Parliament has legislated in an area that relates to or affects a devolved responsibility, the UK Parliament has sought the consent of the National Assembly. For example, when passing legislation for the recently- established non-devolved Police and Crime Commissioner Scrutiny Panels, the consent of the National Assembly was sought as the Scrutiny Panels related to local government, a devolved responsibility.

In effect, devolution in Wales is currently in its third phase. In the second phase, prior to the 2011 referendum, the National Assembly for Wales had only some primary law-making powers. These were transferred incrementally as part of the Government of Wales Act 2006, which enabled the National Assembly to make primary laws (or Assembly Measures) on some subjects within devolved areas, set out in Schedule 5 of the Act. New primary legislative powers required the approval by the UK Parliament of Legislative Consent Orders; if the National Assembly wanted to make a law on a subject within a devolved area that was not listed in Schedule 5, it had to seek the permission of the UK Parliament. The 2006 Act also set the arrangements for the referendum held in 2011 and the current devolution settlement which followed the referendum.

Between its establishment in 1999 and 2006, the first phase of devolution, the National Assembly for Wales had powers only to make secondary legislation. These were in “conferred areas”, areas that broadly corresponded to the responsibility of UK Ministers, usually the Secretary of State for Wales, which had been accumulated over time prior to devolution.

Finally it is worth noting the scope of devolution or “conferred areas” has been expanded incrementally since 1998.This has meant that the extent of the Welsh devolution settlement has expanded in a number of specific areas, such as fire and rescue services, some aspects of rail policy and animal health. The Order in Council procedure referred to earlier allows this process to continue.

## E7 Cost Comparisons with other Commissions

| COMMISSION | COST | TIMEFRAME | INCLUDED IN BUDGET |
|---|---|---|---|
| Silk | Est. £1 million | 27 months | Commissioners unpaid;<br>No Salary costs for Secretariat. |
| Holtham | £500k per year | 23 months | Commissioners pay;<br>Some salary costs for Secretariat. |
| Calman | £614,000 | 15 months | Commissioners unpaid;<br>Salary costs for Secretariat. |
| All Wales Convention | £1.5 million | 17 months | Unknown |