

National Assembly for Wales Finance Committee

Inquiry into *Future Funding*

MEMORANDUM BY ALAN TRENCH

1. This memorandum is intended to assist the Committee in relation to my oral evidence on 17 June 2015. In it I shall briefly address issues that I understand are of particular concern to the committee. More detail on these matters can be found in my January 2013 paper *Funding Devo More*, and in the report *A Constitutional Crossroads: Ways forward for the United Kingdom* published in May 2015 by the Bingham Centre for the Rule of Law, for which I acted as adviser.¹
2. Both these reports discuss in some detail the need for a changed approach to administrative arrangements to make fiscal devolution work. These concerns apply even to the very limited degree of fiscal devolution to Wales that is presently underway. What is needed includes an independent expert body to 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. It also includes an independent body to resolve any disagreements or disputes that arise between governments (not necessarily only financial ones, but the need is particularly acute when it comes to financial matters.² There also need to be clearer arrangements for accountability of any UK Government agency that collects devolved taxes on behalf of a devolved government. As part of a wider reconstruction of financial arrangements, the present system by which the block grant is paid to the Secretary of State, who remits funds to the Welsh Consolidated Fund after deducting the costs of running his or her office, should also cease. Grant should be paid directly to the Welsh Government, and the costs of running the Wales Office borne by the UK Government rather than the funding of devolved public services.

The main weaknesses in the Welsh funding settlement and how these could be resolved

3. It is hard to see how issues of Welsh ‘under-funding’ relative to need are pressing at present. The evidence suggests that ‘under-funding’ was never very great, and has largely ceased to apply.³ The reasons for this are not altogether clear, but the protection

¹ *Funding Devo More* can be found at www.ippr.org/publications/funding-devo-more-fiscal-options-for-strengthening-the-union. *A Constitutional Crossroads* can be found at <http://www.biicl.org/ingham-centre/devolution>

² As regards intergovernmental co-ordination, see also my paper for the ‘UK’s Changing Union’ project: A. Trench *Intergovernmental Relations and Better Devolution*, December 2014, available at <http://sites.cardiff.ac.uk/wgc/files/2014/12/INTERGOVERNMENTAL-RELATIONS-AND-BETTER-DEVOLUTION-FINAL-Dec-2014.pdf>. See also my blog post ‘Better intergovernmental relations for better devolution’, *ClickonWales* 15 December 2014, <http://www.clickonwales.org/2014/12/better-intergovernmental-relations-for-better-devolution/>

³ In evidence to the Commons Welsh Affairs Committee in March 2015, the Parliamentary Under-secretary of

of health and schools spending in England under the Conservative-Lib Dem Coalition government until May 2015, and similar commitments made by the Conservatives, has played a significant part in this.

4. The issues that will affect Wales are therefore two-fold. First is the possible impact of convergence, if public spending should increase. This is, in reality, only a limited prospect given the new Government's commitments to fiscal austerity, although maintaining real-terms funding for the NHS and schools in England will produce nominal increases that, other things being equal, will lead to convergence. Second, there is the question of what room for manoeuvre the Welsh Government and National Assembly might have in the light of austerity; if the UK Government prefers to limit spending on public services generally, the working of the Barnett formula will mean the National Assembly has largely to follow likewise, or make cuts in some areas to protect funding in others. Securing funding at the level of 'relative need' ensures Wales gets an appropriate share of the 'cake' of public spending, but is of little use if decisions made for England mean that the cake shrinks. Wales may still get its 'fair share', but have less money to spend overall.
5. What Wales faces is the problem that arises from the way the Barnett formula works. By allocating changes in spending to devolved governments following changes in spending on 'comparable functions' in England, it implicitly assumes that devolved governments will have a similar model of public services to those in England. While devolved governments are free to move (vire) money between functions within the block grant, the overall amount of the block grant assumes an 'English' model of services and, if the English model of services changes, devolved governments will either have to follow suit or make cuts in one area to continue to maintain funding for another. Wales receives the worst of this because it is funded at about the level of relative need; Scotland and Northern Ireland, which are both funded above that level, are under less immediate pressure to follow an English policy choice.
6. It is hard to think of ways to resolve this problem. The only option that offers greater leeway, though to a limited extent, is greater fiscal devolution provided that this is accompanied by an effective equalisation mechanism. Increased reliance on own-source tax revenues increases the scope to have a different approach to public policy compared to reliance on a grant that is driven by English policy choices.
7. It is worth noting that the new UK Government's plans for 'English votes for English laws' may make this problem all the more acute. Much depends on exactly how this applied, but if Welsh MPs are unable to vote on matters that affect devolved funding Wales will find itself dragged along by English policy choices without any of its elected

State claimed that Wales currently receives 116 per cent of UK average funding for devolved functions. This is in line with earlier forecasts made by the UK Government. See House of Commons Welsh Affairs Committee *Oral evidence: Responsibilities of the Secretary of State for Wales*, HC 400, Tuesday 17 March 2015, Q. 93. The Welsh Government has not, to my knowledge, challenged this figure.

representatives – whether in Parliament or the National Assembly – being able to take part in decisions about that.⁴

How the agreement for a reserved-powers model for Wales, and the other St David's Day devolution proposals, could impact future funding

8. It is hard to see how a 'reserved powers' model, as such, would affect the funding of the National Assembly and Welsh Government. This would be a legal change that would affect the constitutional structure of Welsh devolution but not the functions devolved. What would affect future funding would be the adequacy (or not) of changes made to the block grant in respect of further substantively-devolved functions. The Welsh Government's position – that 'it will be crucial for the two Governments to negotiate a fair budget transfer of both running costs and programme budgets to go with these new responsibilities' – is entirely understandable, and to be endorsed.⁵ Questions about the costs of providing an existing package of services are not straightforward and the difficulties they have presented in the past (over such issues as student support) emphasise the problems they present. This accentuates the need for the sort of independent mechanisms to advise on technical matters and to resolve disputes discussed in paragraph 2 above.

Reviewing developments on the issues of convergence, underfunding and Barnett reform highlighted in the Holtham and Silk reports

9. The St David's Day Agreement contains an assurance in relation to convergence and 'fair funding' by means of a 'Barnett floor'.⁶ This commitment is rather vague – indeed, rather vaguer than those previously given by the Coalition in October 2012 and by the Labour UK Government in November 2009.⁷
10. In reality, the point of a 'Barnett floor' is highly questionable, since the current level of funding is probably about right. What is needed is a mechanism to address the issue of convergence. That is rather more straightforward, and indeed would be simple to introduce administratively by a modest change to the formula used to apply the Barnett formula to Wales.

⁴ This issue is discussed further in chapter 5 of the Bingham Centre report, *A Constitutional Crossroads*. See particularly section 5.2.

⁵ Welsh Government, *Devolution, Democracy and Delivery. Powers to achieve our aspirations for Wales* WG 22188, July 2014, paragraph 29.

⁶ HM Government, *Powers For A Purpose: Towards a lasting devolution settlement for Wales* Cm 9020, February 2015, paragraph

⁷ For discussion, see my blog posts on *Devolution Matters*: 'The UK-Welsh Government agreement on borrowing powers and Barnett convergence', 25 October 2012, <https://devolutionmatters.wordpress.com/2012/10/25/the-uk-welsh-government-agreement-on-borrowing-powers-and-barnett-convergence/> and 'Financing devolution by grants: Calman, Holtham and Barnett', 29 November 2009, <https://devolutionmatters.wordpress.com/2009/11/29/financing-devolution-calman-holtham-and-barnett/>

11. However, it is worth noting that even a commitment to a Barnett floor (or a convergence-avoiding mechanism) involves an agreement about the level of relative needs in Wales between the UK and Welsh Governments. That means even a rather nebulous commitment may raise the technical and political issues of a needs assessment, and all the difficulties and delay that may cause.

The financial and economic information which the UK and Welsh Governments need to provide to support future funding arrangements

12. Any future funding arrangements will require much better data about public finances than we have at present. The UK Government's annual *Public Expenditure Statistical Analyses* publication includes information about spending on key functions, and now also tells us about whether (for Scotland, Wales and Northern Ireland) spending is by the UK or devolved government. (In *PESA 2014*, this was table 9.21, 'Identifiable expenditure on services for Scotland, Wales and Northern Ireland in 2012-13'.) This is however a comparatively recent development. We still have only limited information about changes to the block grant triggered by changes in spending on 'comparable functions' in England. (This is presented in the Wales Office Annual Report, and remains sufficiently broad it is hard to verify.) All this information is in the hands of the Welsh Government, but they choose not to publish it themselves.
13. When it comes to tax revenues, information is much more scarce. The Welsh Government – unlike its Scottish and Northern Ireland counterparts – makes no effort to publish estimated tax receipts from Wales. (The Scottish Government has an annual publication, *Government Expenditures and Revenues Scotland*, also known as *GERS*. The Department for Finance and Personnel Northern Ireland publishes an annual 'Net Fiscal Balance Report' from time to time, most recently for 2011-12.) HM Revenue & Customs has embarked on an 'experimental' series of territorially-disaggregated statistics, most recently published for 2013-14, calculated on a different basis to *GERS* and the Northern Ireland Net Fiscal Balance reports.⁸
14. It is nothing short of deplorable that the Welsh Government has not sought to help clarify the debate by producing its own figures similar to *GERS*, but has left it to other, UK Government, agencies to do so – and to let this be done in an inconsistent way that is also hard for those interested to find. Publishing accurate, verifiable figures would be one role a 'UK Finance Commission' might undertake. The Welsh Government's failure to take any action regarding this means it has little ground to complain about unfairnesses in the system, however, as it has left these to be matters of assertion rather than verifiable data.

Alan Trench
14 June 2015

⁸ The most recent data are at <https://www.gov.uk/government/statistics/disaggregation-of-hmrc-tax-receipts>