

PAPER TO THE FINANCE COMMITTEE FUTURE FUNDING

Introduction

1. The purpose of this paper is to set out written evidence on future funding in Wales for the Finance Committee.
2. The Welsh Government welcomes the opportunity to submit evidence to the Committee to highlight the weaknesses of the current funding arrangements for devolved public services in Wales, specifically the weaknesses of the Barnett formula.
3. The Welsh Government will continue to press for a funding settlement for Wales that is fair and that halts future convergence.
4. The Welsh Government welcomes the new fiscal powers introduced in the Wales Act 2014. Powers to replace Stamp Duty Land Tax and Landfill Tax in Wales will provide useful additional levers to achieve policy aims in Wales. The Welsh Government also welcomes new borrowing powers to help fund infrastructure investment but believes the borrowing limit in the Wales Act 2014 constrains our ability to invest in the infrastructure Wales needs.

Weakness of the Welsh funding settlement

5. There have been a number of studies that have looked at the allocation of funding to the Welsh Government with most looking at the mechanism for calculating the block grant, the Barnett formula¹. Those studies agree that the Barnett formula does Wales no favours and should be replaced by a mechanism that distributes resources based on need.
6. The Welsh Government set up the Independent Commission on Funding and Finance for Wales in 2008 to look at the pros and cons of the formula-based approach to the distribution of public expenditure resources to the Welsh Government and to identify possible alternative funding mechanisms².
7. The conclusion from the Commission's authoritative reports is clear - the Barnett formula lacks any objective justification. As a direct result of the Barnett formula, relative funding per head for devolved services in Wales has converged towards the average level of funding per head in England. If the Barnett formula remains in place, funding per head in Wales will converge towards the average for England, regardless of the higher relative need to spend on devolved services in Wales.

¹ These include: The House of Lords Select Committee on the Barnett Formula; The House of Commons Justice Committee; and numerous academic studies (See Bristow, G (2008) The Barnett Formula and its Consequences for Wales: A Literature Review for a summary)

² The Commission's full terms of reference were to:

- Look at the pros and cons of the present formula-based approach to the distribution of public expenditure resources to the Welsh Assembly Government; and
- Identify possible alternative funding mechanisms including the scope for the Welsh Assembly Government to have tax varying powers as well as greater powers to borrow.

**PAPER TO THE FINANCE COMMITTEE
FUTURE FUNDING**

8. The Welsh Government agrees with the recommendations of the Independent Commission on Funding and Finance for Wales that the funding arrangements for Wales should be based on need. There is no basis for Welsh relative funding per head of the population to converge towards the average for England.

9. There continues to be unanimous support within the National Assembly for Wales for the Welsh Government to be fairly funded. On 13 May 2015, there was unanimous support for the motion that:

the National Assembly for Wales recognises that the Barnett funding formula is not in the best interests of Wales, notes that repeated studies have found that Wales is underfunded relative to need, and calls on the UK Government to ensure that Wales is funded fairly by implementing a funding floor that has cross-party support.

10. The Welsh Government will continue to call on the UK Government to implement a funding floor that is fair and that halts future convergence.

11. The Welsh Government believes that the most straightforward way to implement a funding floor is to ensure that, once spending starts to increase, Wales receives the same percentage change in spending on devolved areas of responsibility as England. This requires only a small adjustment to the Barnett formula. This would be easy to understand and easy for HM Treasury to implement. If there was a 3 per cent increase in spending in England on functions that have been devolved to Wales, then there would also be a 3 per cent rise in Wales.

12. In the longer term, the Welsh Government believes that a body that is independent of government should undertake a needs assessment to determine the level of funding for the devolved governments. At present the UK Treasury undertakes the operation of the Barnett formula without any agreement with the devolved administrations. This has led to disputes as to whether the devolved administrations should receive consequential funding from spend in England. A recent example includes the regeneration expenditure associated with the Olympics, where the Welsh Government did not receive any Barnett funding from this expenditure in England. As the Independent Commission of the Bingham Centre for the Rule of Law recently concluded: "the present arrangements fall short of our principles of consent and respect for the rule of law".

13. Both the Independent Commission on Funding and Finance for Wales and the UK Government's Commission on Devolution in Wales (the Silk Commission) concluded that the financial accountability of the Welsh Government could be enhanced by having a proportion of the money available to spend on public services generated from devolved taxes under its control.

14. The Wales Act 2014 implemented most of the recommendations of the first report from the Silk Commission. The Welsh Government welcomes the measures included in the Wales Act 2014 and is already preparing for the

PAPER TO THE FINANCE COMMITTEE FUTURE FUNDING

replacements for Stamp Duty Land Tax and Landfill Tax in Wales from 2018. The Welsh Government will not consider the devolution of income tax until the block grant is put on a fair and sustainable footing through the implementation of a funding floor.

15. The Welsh Government also welcomes 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.
16. There needs to be greater flexibility in the funding arrangements to manage budgetary volatility and to better manage the 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.

Developments on convergence, underfunding and Barnett reform

17. In a joint statement with the Welsh Government in 2012, the UK Government recognised for the very first time that there has been convergence in Welsh funding since devolution and that convergence is a significant concern in Wales.
18. As agreed by the terms of that joint statement, the Welsh Government and UK Government completed a joint review of the direction of convergence in Welsh relative funding in advance of the 2015-16 spending round.
19. In the run up to the spending round, Welsh Government and UK Treasury officials tested alternative spending scenarios for 2015-16, which were then assessed for their impact on Welsh relative funding levels. Based on this analysis, both Governments were able to conclude that no convergence was forecast during the 2015-16 spending period. The Details of this analysis including trends are published on the Welsh Government's web-site (<http://gov.wales/about/cabinet/cabinetstatements/2013/relativefunding201516/?lang=en>)
20. In the 2012 joint statement, the UK Government recognised that there is very likely to be further convergence in the future as soon as funding increases again.
21. The UK Government's St. David's Day announcement included the introduction of a floor in the level of relative funding it provides to the Welsh Government - with the precise level of the floor and the mechanism to deliver to be agreed alongside the next UK Spending Review. Following the UK general election, the Secretary of State for Wales said that "we are absolutely committed to following through on this historic commitment to bring fair funding to Wales".
22. Agreeing the detailed arrangements for the funding floor is a priority of the Welsh Government, and discussions are ongoing. The Welsh Government will be

PAPER TO THE FINANCE COMMITTEE FUTURE FUNDING

negotiating for a funding floor that is fair to Wales – and to the rest of the UK – and prevents any further convergence.

Future devolution proposals

23. The Queen's Speech on 27 May 2015 announced that a Wales Bill will be introduced in the current parliamentary term. This will introduce legislation to devolve new powers to the Welsh Government in areas including transport, energy and electoral arrangements. The Wales Bill will also legislate for a reserved powers model for Wales.
24. The Welsh Government will continue to press for the devolution of Air Passenger Duty (as recommended by both the Holtham and Silk Commission) to be included in the Wales Bill.
25. The devolution of new powers will have financial implications as the Welsh Government will be responsible for a wider range of policy areas. All transfers of responsibilities from the UK Government to the Welsh Government should be accompanied by full budgetary transfers, subject to independent scrutiny and with the possibility of independent arbitration to handle unresolved disagreements about the size of appropriate transfers.

Future Funding arrangements

26. The Welsh Government believes that future funding and fiscal arrangements should be agreed jointly with the UK Government. A Joint Exchequer Committee (JEC) has been established by the Welsh and UK Governments to provide Ministerial oversight of this collaborative work, providing a biannual forum to discuss and agree the details of fiscal devolution.
27. The agreements that were reached on the block grant off-set for the full devolution of Non-Domestic Rates and the ability for the Welsh Government to issue bonds demonstrate the progress that the JEC has made since inception. The Welsh Government is keen that this joint working continues to consider the outstanding fiscal matters in Wales, including fair funding and the devolution of Air Passenger Duty.
28. While there are differences in the devolution of fiscal powers to Wales, Scotland and Northern Ireland, the Welsh Government sees great merit in agreeing the financial arrangements associated with the devolution of fiscal powers in a co-ordinated way where possible. However, the Welsh Government will only agree arrangements that are in the best interests of Wales.

**PAPER TO THE FINANCE COMMITTEE
FUTURE FUNDING**