



# **Cynulliad Cenedlaethol Cymru** **The National Assembly for Wales**

## **Y Pwyllgor Cyllid** **The Finance Committee**

**Dydd Mercher, 17 Mehefin 2015**  
**Wednesday, 17 June 2015**

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Cofnodir y trafodion yn yr iaith y llefarwyd hwy ynddi yn y pwyllgor. Yn ogystal, cynhwysir trawsgrifiad o'r cyfieithu ar y pryd.

The proceedings are reported in the language in which they were spoken in the committee. In addition, a transcription of the simultaneous interpretation is included.

### **Aelodau'r pwyllgor yn bresennol** **Committee members in attendance**

Peter Black

Democratiaid Rhyddfrydol Cymru  
Welsh Liberal Democrats

Christine Chapman

Llafur

	Labour
Jocelyn Davies	Plaid Cymru (Cadeirydd y Pwyllgor) The Party of Wales (Committee Chair)
Alun Ffred Jones	Plaid Cymru The Party of Wales
Ann Jones	Llafur Labour
Julie Morgan	Llafur Labour
Nick Ramsay	Ceidwadwyr Cymreig Welsh Conservatives

**Eraill yn bresennol  
Others in attendance**

Alistair Brown	Cyfarwyddwr Strategaeth Ariannol, Llywodraeth yr Alban Director of Financial Strategy, Scottish Government
Yr Athro/Professor Gerald Holtham	Cynghorwr Arbenigol Expert Adviser
Sean Neill	Dirprwy Gyfarwyddwr Cyfrifoldeb Ariannol, Llywodraeth yr Alban Deputy Director Fiscal Responsibility, Scottish Government
Yr Athro/Professor Alan Trench	Arbenigwr ar ddatganoli ac aelod o Gomisiwn Adolygu Canolfan Bingham ar gyfer Trefn y Gyfraith Devolution expert and member of the Bingham Centre for the Rule of Law Review Commission

**Swyddogion Cynulliad Cenedlaethol Cymru yn bresennol  
National Assembly for Wales officials in attendance**

Richard Bettley	Gwasanaeth Ymchwil Research Service
Bethan Davies	Clerc Clerk
Tanwen Summers	Dirprwy Glerc Deputy Clerk
Joanest Varney-Jackson	Uwch-gynghorydd Cyfreithiol Senior Legal Adviser

*Dechreuodd rhan gyhoeddus y cyfarfod am 10:00.  
The public part of the meeting began at 10:00.*

**Cyflwyniad, Ymddiheuriadau a Dirprwyon  
Introductions, Apologies and Substitutions**

[1] **Jocelyn Davies:** Welcome, everybody, to a meeting of the Finance Committee. Can I remind everybody, if you've got a mobile device, please put it on 'silent'? I think that would be very useful, but you needn't switch them off. I've got one apology this morning from Mike Hedges, as he's attending another committee this morning.

**Ariannu yn y Dyfodol: Sesiwn Dystiolaeth 2**  
**Future Funding: Evidence Session 2**

[2] **Jocelyn Davies:** I think we can go straight to item 4, which is evidence session number 2 on our review. We are very lucky to have officials from the Scottish Government with us this morning, via video-conference. I hope the technology doesn't let us down. Would it be okay with you, after you've introduced yourselves, if we just go straight to questions?

[3] **Mr Brown:** Yes, that's fine.

[4] **Jocelyn Davies:** So, if you'd introduce yourselves for the record.

[5] **Mr Brown:** My name is Alistair Brown, and I'm the director of financial strategy in the finance directorate in the Scottish Government.

[6] **Mr Neill:** My name is Sean Neill, I'm the deputy director for the fiscal responsibility division in the Scottish Government.

[7] **Jocelyn Davies:** Lovely, thank you. In general, do you think that the current mechanisms for financing the devolved administrations in the UK are sustainable in the long term?

[8] **Mr Brown:** Well, I'll offer a response to that as best I can. I think there are two points to make in response to that question. On the current mechanisms—by which I take it you refer to the Barnett formula as a means of adjusting the block grant for the devolved administrations each year and the UK's spending review processes that feed through into the devolved administrations' block grant—the first point to make is that that's been running largely unchanged for pretty much 40 years now. So, it has a track record of being sustainable. Clearly, we're at a point of change in these mechanisms and arrangements. Our mechanisms in Scotland have already changed. With respect to 2015-16, we have some modifications to the funding mechanism in respect of devolved taxes and also in respect of borrowing. So, looking forward, are they sustainable? We can divide that up into two. Are they financially sustainable? I guess, as much as anything, that's a question for the UK Government, but I would have thought that the answer is 'yes', because Barnett is designed to peg movements in your block grant and in ours to movements in comparable UK spending. So, it seems to me that the answer to the question 'Are the mechanisms financially sustainable?' is 'Yes, they are'. 'Are they politically sustainable?' is a question probably that's not really for civil servants to answer, but I think that is probably the big question: are they politically sustainable, given the trends that we're seeing and the views being expressed by devolved administrations, including, obviously, our own?

[9] **Jocelyn Davies:** Okay, thank you.

[10] **Mr Neill:** I suppose the only one thing I would add to that is, as we look forward to, as Alistair was mentioning, the fact that there will be further devolution in Scotland, as set out by the Smith Commission recommendations, one of the overarching design principles around a revised fiscal framework is around the sustainability of that, and that is one of the underpinning principles of design—whenever we look forward in the negotiations with Treasury, it has sustainability in mind and long-term sustainability.

[11] **Jocelyn Davies:** Thank you. The recent period of austerity, has that highlighted any particular problems over the way that you're funded?

[12] **Mr Brown:** I'll attempt some comment in response to that, too. I think the austerity

period, or fiscal consolidation, has certainly put strains on the funding system, in that it's meant reductions in real terms in the block grants for the devolved administrations, but I haven't seen any comment to the effect that the degree of consolidation or of austerity being applied to the block grants is greater than the degree of austerity being applied to UK public spending generally. So, I don't think that that problem has arisen. I think what we have seen in our end of the UK is our Ministers expressing a desire to have more autonomy of decision making over fiscal issues. An example of that would be our Ministers would like to see greater choice being devolved to them over the timing of movements in public spending, and also greater discretion over borrowing, so that they could decide to change or adjust the time and shape of their investment in infrastructure. Is it the period of austerity that has brought these questions uppermost? I think that these questions would be in the minds of our Ministers and would be raised with the UK Government whether or not we were in times of austerity, but the background of austerity has certainly sharpened them and brought them to the fore, would be my comment.

[13] **Jocelyn Davies:** Okay, thank you. Talking about additional powers that the Scottish Government would want, what additional powers would they want next?

[14] **Mr Neill:** I think, over the weekend, the Scottish Government set out proposals for further control over business taxes and minimum wage to try and get a kind of coherent package around supporting the Government economic strategy and the overall purpose of delivering sustainable economic growth. Scottish Ministers have set out their view that they would like to move towards full fiscal autonomy in a phased approach, and, as part of that, they would see implementation of Smith, followed by further control of business taxes and responsibility for employment law—so it's kind of framed around employability and helping drive sustainable economic growth through enhanced powers.

[15] **Mr Brown:** I was just going to add, for the committee's benefit, that there is a press release on our website quoting Mr Swinney on that, dated Monday, the fifteenth, if people wanted to look at the specifics.

[16] **Jocelyn Davies:** Yes, certainly, we'll look at that. Julie, shall we come to your questions?

[17] **Julie Morgan:** In order to make the devolved funding arrangements more open and transparent and consistent, what legislative changes do you think are required by the UK Government?

[18] **Mr Brown:** That's an interesting question. One general point to make is that the funding arrangements between the UK Government and the devolved administrations are really not legislative at all at the moment. Obviously, you'll find no reference to the Barnett formula, for example, in any legislation. The nearest we get to the rules being written down and published is in the statement of funding policy, which the Treasury produces normally at every spending review, although the current version has not been updated since 2010 by my recollection.

[19] Now, the statement of funding policy is an interesting document. It's published by the Treasury with the agreement of the Secretaries of State for the devolved areas, but not with the agreement of the devolved administrations—neither the Northern Ireland Executive nor the Welsh Government nor the Scottish Government. We're consulted and you're consulted, but our agreement is not required. So, one point our Ministers would make, and they have made it, is that they believe that the statement of funding policy, setting out the funding arrangements, should be agreed between the Treasury on the one hand—or the UK Government on the one hand—and each of the three devolved administrations on the other. But, to stick to the text of the question you've asked, that's not a legislative change, but it

would be quite a significant change and it's one that our Ministers have sought in the past. I think the key point on legislative change that our Ministers would make is that they want to see significant material borrowing powers for Scotland in statute. We have borrowing powers in the Scotland Act 2012 and our Ministers are strong supporters of what the Smith Commission said in its recommendation about borrowing, which was that consideration should be given to a prudential borrowing regime. That is, I think, definitely a step towards transparency and consistency. Our Ministers would like to see that enshrined in the Scotland Bill that is currently before the Parliament.

[20] **Julie Morgan:** Thank you very much. Do you think that there should be more consistency in terms of the funding arrangements of the different parts of the UK?

[21] **Mr Brown:** I'm not sure if we have a view about that. As Sean has said, Scottish Ministers have got pretty strong views about the direction of travel on funding for Scotland, with a greater degree of autonomy, particularly in relation to revenue raising and also in relation to employment legislation and programmes. As far as I'm aware, our Government has not expressed a view on whether it thinks there should be greater consistency among the three devolved administrations. I think the view that Mr Swinney would take is that he has an agenda to pursue that flows from his party's, his Government's and his administration's programme, and he would wish his colleagues in Cardiff and in Belfast all success with the programmes that they are pursuing.

[22] **Mr Neill:** I suppose the only thing that I would add to that is that one of the key elements of the Smith Commission recommendations, obviously, was that the Barnett formula will continue to be used to determine the remaining block grant. Obviously, that was with reference to Scotland. However, all political parties that were on the Smith Commission actually signed up to that; that is one of the underpinning funding mechanisms for Scotland going forward.

[23] **Julie Morgan:** Obviously, the different parts of the UK are developing in different ways; the devolution settlements are different in each area. So, I don't know how there can be fairness and consistency with that happening, when one part may feel that another part is doing better financially. You know, Wales may think Scotland is getting a better deal. How do you think that ought to be dealt with in a fair way? I suppose, really, your previous answer has covered that a bit.

[24] **Jocelyn Davies:** Can you still hear us?

[25] **Mr Brown:** Sorry, the sound faded out there, I think.

[26] **Jocelyn Davies:** Oh, I see. Well, I think that Julie's last point was about fairness and consistency, but I think we can take from the answer you gave earlier that perhaps it's not your top priority.

[27] **Mr Brown:** Well, I think our Ministers would say that they want funding to be fair and consistent, but they would stop short of expressing any view about whether funding for Wales or Northern Ireland was fair and consistent. We understand the point that was being alluded to there as to public spending per head in the different areas of the devolved administrations, but we wouldn't want to go beyond the position that our Ministers take, which is essentially not to comment on funding for devolved administrations other than their own.

[28] **Jocelyn Davies:** That's fair enough. Ffred, shall we come to your questions?

[29] **Alun Ffred Jones:** I'll be asking in Welsh.

[30] **Jocelyn Davies:** Have they got translation?

[31] **Alun Ffred Jones:** A ydy'r cyfieithu yn gweithio? **Alun Ffred Jones:** Is the translation working?

[32] Mae cytundeb Dydd Gŵyl Dewi wedi ymrwymo i ddisodli'r model rhoi pwerau presennol yng Nghymru a chyflwyno model pwerau wedi'u cadw, tebyg i'r hyn sydd yn yr Alban. Ar sail profiad yr Alban o weithredu'r model yma, a oes gennych chi unrhyw sylwadau o ran unrhyw effaith ariannol wrth gyflwyno'r newid yma yng Nghymru? The St David's Day agreement commits to replacing the current conferred powers model in Wales with a reserved powers model, similar to that which exists in Scotland. Based on the Scottish experience of operating a reserved powers model, do you have any observations on whether the transition in Wales could have any financial impacts?

[33] **Mr Brown:** That's perfectly understandable here, thank you. We've obviously been operating a reserved powers model now since 1999. The comment I would offer is that we put a huge amount of effort, back in 1997 and 1998, into understanding what the reserved powers model meant, and exactly what Executive and legislative competence and what spending responsibilities were coming to Scotland, and what would stay with the UK Government under reserved powers. So, a great deal of effort went into that, and a huge amount of detail, in understanding the intricacies of all the relevant spending programmes. And, since then, it's worked well, would be my observation, with minimal uncertainty, and that's both in terms of Executive and legislative competence and in terms of the spending responsibilities that flow from that. So, as you move into that model, I think the observation that I would offer is that time invested in understanding exactly what it means in terms of Welsh Government and Welsh Assembly responsibilities will be well spent. And, in a sense, the devil's in the detail, and it's worth investing the time in getting right to the bottom of that. I hope that's of some use.

[34] **Alun Ffred Jones:** Iawn. Diolch yn fawr iawn. Wrth weithredu'r model pwerau wedi'u cadw hefyd, a ydyw'n anochel yn galw am awdurdodaeth gyfreithiol unigryw, fel sy'n bodoli yn yr Alban, ond sydd ddim, wrth gwrs, yn weithredol yma yng Nghymru? **Alun Ffred Jones:** Okay. Thank you very much for that. In implementing the reserved powers model, does that require a distinctive legal jurisdiction, as exists in Scotland, but not yet, of course, in Wales?

[35] **Mr Brown:** I'm not a lawyer, so the answer that I'll give is more of an observation from an administrative civil servant, and I think the answer would be: no, it doesn't require a distinctive legal administration, because the issue is really: what is the applicable legislation? And for us, it's been a mixture of UK and Scottish legislation. For you in Wales, I think the same would apply. Clearly, under some circumstances, the law in Scotland has distinctive application or distinctive meaning, and that's taken into account in the work that we do, but it's not a necessary feature of a reserved powers model.

[36] **Alun Ffred Jones:** Iawn, diolch yn fawr. A chwestiwn arall: mae'r cytundeb Dydd Gŵyl Dewi wedi addo cyflwyno cyllid gwaelodol, sef llawr Barnett—a fydd cyflwyno'r cyllid gwaelodol i Gymru, ond nid i wledydd eraill, yn arwain at heriau newydd o ran sicrhau cysondeb fformiwla Barnett? **Alun Ffred Jones:** Okay, thank you. And another question: the St David's Day agreement has promised that a funding floor, namely a Barnett floor, would be introduced—will the introduction of a funding floor for Wales, but not for other countries, lead to new challenges in ensuring the consistency of the Barnett formula?

[37] **Mr Brown:** Well, we know about the St David's Day proposals and the funding floor proposition. Our view is that that will not, or should not, affect funding from the UK Government for devolved programmes in Scotland. I think that the observation that I would make is that it illustrates the basic flexibility of the Barnett formula—that, with agreement, elements can be added to it and adjustments can be made to it, and the example of the funding floor, I think, illustrates that, in that Barnett can continue to operate, but were it to produce a result that touched the floor, the floor would operate to ensure that no further reduction in spending per head took place. But I think that that can be accommodated within the overall structure of which the Barnett formula forms a part, without raising any fundamental questions of funding. And, certainly, we don't see the funding floor proposition raising any fundamental issues for funding in Scotland.

[38] **Alun Ffred Jones:** Iawn, diolch yn fawr. Rwy'n credu fy mod i'n deall eich safbwynt chi'n iawn. Mae'r cwestiwn arall a oedd gen i wedi cael ei ateb yn barod. **Alun Ffred Jones:** Thank you. I think I understand your position clearly. The other question that I had has been answered already.

[39] **Jocelyn Davies:** Okay, thank you. Peter, shall we come to yours?

[40] **Peter Black:** How can the current weaknesses in block grant funding between different parts of the UK be addressed if the Barnett formula were to be retained?

[41] **Mr Brown:** Well, I think it rather begs the question about what these weaknesses are. Our position—and I think I need to revert to the stated position of Scottish Ministers on this, which Sean has already referred to—is that Barnett should be retained as the means of annually adjusting. Sometimes, it's more than annually with the Barnett formula: obviously, it operates at each fiscal event, so the budget and the autumn statement and, indeed, at Mansion House statements that the Chancellor might make. Subject to that, our Ministers' view is that the Barnett formula should be retained. As Sean has said, that was confirmed by all of the parties to the Smith Commission last November, and Smith says in his conclusions that the block grant from the UK Government to Scotland will continue to be determined via the operation of the Barnett formula.

[42] So, our Ministers see that as pretty much at the heart of the whole funding construct. They have said publicly that the circumstances in which the Barnett formula would no longer operate in Scotland are the circumstances of full fiscal autonomy. They've also said that there would be a significant period of adjustment between the current funding model—which is entirely dependent for movement in the baseline on the operation of the Barnett formula—and full fiscal autonomy. That would have to be managed over a period of time, with the Barnett formula gradually being phased out. So, that's the position of our Ministers on the question.

[43] **Peter Black:** I think we've identified the weaknesses that the Barnett formula is crude, doesn't reflect need, and overfunds Scotland compared to other—[*Laughter.*] Well, it funds Scotland more generously per head, perhaps, than Wales, rather than overfunds you. You're talking about phasing it out over a period of time. Do you think that is a mechanism that could actually address some of those issues to the satisfaction of all parties?

[44] **Mr Brown:** Well, the reference to the Barnett formula being phased out over time is purely and entirely in the context of a move to full fiscal autonomy for Scotland, which is a policy of the Scottish Government. It's not, as far as we know, a policy that the UK Government is prepared to support. So, you would have to see the comment I've just made in that context. In the event of full fiscal autonomy for Scotland, balanced by the phasing out of the Barnett formula, what happens to funding for other devolved areas, devolved administrations, in the UK, would be a matter for debate, but that is not a question to which our Ministers have addressed themselves, nor have they offered views.

[45] **Peter Black:** So, is there a means of reforming the Barnett formula, do you think, that would be satisfying to all parties or that would make some progress on that path?

[46] **Mr Brown:** You're inviting me to offer a personal view, I think, because the Scottish Government doesn't have a policy on reform of Barnett. One thing to bear in mind about the Barnett formula is that it operates on the margins. So, it's the change in comparable England and England-and-Wales spending programmes that is picked up by the Barnett formula, and a proportion of that change is then added to or subtracted from the Welsh block grant in your case, or the Scottish block grant in our case, and the proportion reflects relative population. So, ours is 9.9 per cent of England-only and 9.3 per cent of England-and-Wales programmes, if I've got that right. It's all set out in the statement of funding policy.

[47] Then, over time, the accumulation of Barnett changes, Barnett consequentials, affects the baseline—it moves the baseline up or, if there was a cut, it moves the baseline down. What it doesn't do is re-base the baseline. So, Barnett never touches the fundamental starting point of the baseline. The fundamental starting point of the baseline is lost in the mists of mid-twentieth century British political and economic history, I guess. Our baseline dates back to the beginning of the Barnett formula in 1974 or 1975, whenever it was. So, you could envisage changing the baseline by agreement between one of the devolved administrations and the UK Government, and start it again from a new baseline that reflected a different view of relative spending priorities. Then, Barnett could continue to operate on the new baseline. I'm making these comments simply as an illustration of the fact that the Barnett formula works on the margin and doesn't dictate the underlying baseline itself. As far as I can see, the UK Government could enter into discussions with any of the devolved administrations about that without needing to fundamentally reform the Barnett formula. I should make absolutely clear that what I'm speaking about here is just an illustration of what Barnett is and how it works. It's not at all a comment on the position that the Scottish Government takes or that our Ministers have articulated. I hope that's clear.

[48] **Peter Black:** That is clear, and I accept that point of view. Thank you for that. Obviously, both Wales and Scotland are facing changes in terms of our devolved spending in tax arrangements. What other governmental arrangements could we adopt to negotiate and manage that framework better?

[49] **Mr Brown:** I think that's a very interesting point. Do you want to comment on that, Sean?

[50] **Mr Neill:** Yes. So, obviously, we've been through a process of further devolution with the original Scotland Act 2012, which devolved land and buildings transactions tax and Scottish landfill tax. We have taken the opportunity to review the inter-governmental working in light of progress made on the implementation of that, so what operated really well and what areas we could maybe look to improve upon. I think what we're doing now is putting in place a framework, which is still based on the original governance structures set out in the command paper for the Scotland Act 2012, which stays with ministerial bilateral discussions, and that will take forward some of the political and detailed negotiations around the operation of the fiscal framework and support through the Joint Exchequer Committee. Then, alongside that, there is senior official-level support to try to facilitate constructive agreement between Ministers. So, the phasing of this is that we're trying to get officials to have a detailed and constructive discussion to put options to Ministers, which are jointly agreed, and which Ministers can then take a view on and come to some sort of political agreement—or ask more officials to undertake further work.

[51] **Mr Brown:** Could I also add that I think there are arrangement whereby Welsh, Northern Irish and Scottish Ministers meet together—the finance Ministers meet from time to



time informally. I think that's been helpful. More formally, there are finance Ministers' quadrilateral meetings, involving the Chancellor or the Chief Secretary to the Treasury as well as the finance Ministers in Cardiff, Belfast and Edinburgh. These are formal. There are minutes of the meetings, and there's generally an agreed statement given to the media afterwards. My observation is that they've been helpful, but I would also observe that they don't take place very often. I think the last finance quadrilateral meeting would've been in the early part of 2014, or possibly even in 2013. So, one thought there is that it would probably be helpful to have a more formal and regular meeting of the four finance Ministers. That's a personal observation, but I don't think Mr Swinney here would disagree with it. He's an enthusiast for the devolved administrations getting together with the Treasury in that way.

[52] **Mr Neill:** I think that the only other point to note was that this working, this inter-governmental machinery, did take up quite a bit of Smith's recommendations. His view was that the current machinery between Scottish and UK Governments, including joint ministerial committees, needs to be reformed as a matter of urgency and scaled up significantly to reflect the scope of agreement arrived at by the parties.

10:30

[53] So, you get a sense there that there is general agreement that inter-governmental working and the way we operate probably need a bit of significant reform to take into account the further devolution of powers across the whole of the UK.

[54] **Peter Black:** Do you think there's a case for an independent body to oversee devolved funding? I know we've had disputes in the past, as to whether various items of UK Government expenditure should be Barnettised, such as the Olympics or HS2. Would an independent body act as an arbitrator in that situation and be able to oversee that? Would that be a case for that?

[55] **Mr Brown:** I think that's an interesting possibility. These questions, as far as I recall, ended up being discussed—I'll not say the word, 'agreed', but they were discussed—and a conclusion was reached in the joint ministerial committee, which is the formal overarching mechanism or framework in which both the UK Government and the three devolved administrations meet to, if necessary, settle disagreements. That's chaired by the Prime Minister, and the First Ministers of the three devolved administrations attend and are part of the JMC machinery.

[56] The question of whether some element of independence should be brought in I think is a big question. It's a big constitutional question. As far as I'm aware, it's not a question on which our Ministers have expressed a view. What I would say is that there is a degree of dissatisfaction with the rather extended timescales involved in joint ministerial committee, JMC, machinery. So, I think the fact that all the devolved administrations are involved in the machinery is welcomed, but the fact that it can take rather a long time to resolve issues, especially financial issues, is seen as a weakness. As I say, I'm not aware that our Ministers have expressed any view on the merits or otherwise of an independent element in the machinery.

[57] **Mr Neill:** I suppose the only bit I would maybe add to that—maybe to bring a little bit of recent experience of how we've used the role of the Scottish Fiscal Commission and also the role of the Office for Budget Responsibility in helping to come to some sort of shared understanding of the block grant adjustment associated with land and buildings transaction tax and Scottish landfill tax—is that, obviously, for the 2015-16 budget, we had to adjust the block grant to take into account the devolution of these further tax powers, and the Scottish Fiscal Commission and the OBR both had a positive role to play in trying to set out what they thought the forecast would've been for 2015-16 to help Ministers develop a shared

understanding.

[58] I think there was constructive work that went on to help understand the methodologies that underpinned each of the forecasts, and that process enabled Ministers to come to some sort of agreement for one year, which set the block grant for the Scottish Government. So, there was a positive role for independent scrutiny in some of this work.

[59] **Peter Black:** Okay, thank you. That's helpful.

[60] **Jocelyn Davies:** Okay, thank you. Ann?

[61] **Ann Jones:** Does the Scottish Government have any concerns over the financial consequences for the rest of the UK of further devolution within England?

[62] **Mr Brown:** This is an interesting question. One comment would be that we haven't seen any kind of detailed proposals for further devolution. I know that they're being talked about, devolution to cities and so on, but I think we would need to see something pretty detailed before we had a view about whether there might be any implications for funding in the rest of the UK—for us or for you.

[63] I think the key point would be that, provided the underlying principles of the Barnett formula are maintained, subject to whatever adjustments there would be as a result of the St David's Day agreement, then there shouldn't be any detriment, to use Smith's language, to funding for Scotland. I think it would be reasonable for the devolved administrations to expect there to be no detriment to their funding as a result of changes to the arrangements within England, either in terms of devolution of powers to cities, or in terms of voting arrangements in the House of Commons.

[64] **Ann Jones:** Okay; thank you. How is your Scottish Government proposing to devolve more powers to local government?

[65] **Mr Brown:** We have not, as far as I'm aware, published any proposals on further devolution to Scottish local government. The background to our Government's relationship with local government goes back to 2007 and 2008, when a minority SNP administration first took office in Edinburgh, and some very interesting things were done at that point. Previously, the Scottish Government had funded local authorities through a whole series of grants, which were added together, and the total was talked about as rate support grant, but within that, there were numerous ring-fenced grants that went out to local government and they had to spend them on specified objectives. What the incoming administration did in 2007 was to say, 'Look, we'll scrap all of that; we'll remove ring-fencing; there will be one block grant, as it were, to each local authority'. In return for what was a very significant increase in local authorities' financial freedoms, we looked to Scottish local authorities to enter into what was referred to as 'a single outcome agreement'. We also wanted local authorities to commit themselves to achieving the overall, broad objectives of Government, which were all set out in terms of positive impact on the people of Scotland. So, there was a considerable amount of increased delegation, or devolution, to local authorities at that stage. That's stood the test of time: we still operate under a no ring-fencing, single outcome agreement regime here.

[66] Where our Ministers might want to go next in terms of the economy or delegation to local government they haven't yet made clear, but it is relevant to note that Scottish Ministers have set up the Commission on Local Tax Reform. That has a website, and it is worth, possibly, someone having a look at that. The local tax commission is a joint Scottish local government and Scottish Government investigation of the options for local taxation in Scotland, looking particularly at options for the future modification or replacement of the council tax. I hope that gives a picture of where we are in terms of Scottish Government-local

government relations.

[67] **Jocelyn Davies:** Yes, thank you; that's very clear. Chris, shall we come to your questions?

[68] **Christine Chapman:** We know that the UK Government has said that it wants to negotiate individual city deals, including potentially a deal with Cardiff. I wonder if you could tell me how the Scottish Government was involved in the Glasgow and Clyde valley city deal, which was announced in 2014.

[69] **Mr Brown:** Yes. Well, I should first of all say that I'm not an expert on city deal, and if the committee wanted to take that a little further, we could provide a note from colleagues here who are closer to the action on that than I am. So, please say if the committee would like that.

[70] My knowledge and understanding is that we were aware of the outline of the city deal proposal being developed by the UK Government, and obviously there was a set of city deals being prepared. There was one in particular being prepared in relation to Glasgow. We were aware of it, and we were involved pretty closely as soon as the outline of the deal was announced by the UK Government, and it has not been a matter of conflict between the two Governments. I suppose if you asked us whether we could have had a little bit more information a little earlier, then the answer is probably 'yes', but now that we've got the city deal in place, I think there's good collaboration between UK Government, Scottish Government and Glasgow City Council to make it a success, and now Ministers are supporters of the concept of cities as places where co-ordinated planning and investment activity can take place and can make a difference. So, to summarise it, we think that they're proving to be a pretty good idea.

[71] **Christine Chapman:** Okay. I think the committee would appreciate some further information; that would be very helpful, I think.

[72] **Mr Brown:** We'll write on that.

[73] **Christine Chapman:** That'll be great. Bearing in mind what you said, in the future do you think devolved parliaments should have a say in the city deals? Obviously, this is about additional funding outside of the block grant. Do you think you could have learned lessons from the way it was done with Glasgow and Clyde valley city deal? For the future, do you think there should be a more formal arrangement with devolved parliaments on this?

[74] **Mr Brown:** As I say, I'm not aware that the funding arrangements have led to particular difficulties or friction. My understanding is that we were satisfied that the additional spending going into the Glasgow city deal, directly from the UK Government, was not at the expense of the Scottish block. So, that was a potential source of difficulty that didn't arise. But what I would offer to do, if it's all right with the committee, is ask colleagues who are directly involved with the city deal policy and implementation to attempt to give an answer to that second question in the further information that we provide.

[75] **Christine Chapman:** Okay, that would be helpful; thank you.

[76] **Jocelyn Davies:** So, just to be clear, the Scottish Government had no say in which city received the city deal.

[77] **Mr Brown:** As far as I understand, that's correct. In fact, it is correct.

[78] **Jocelyn Davies:** Okay. Nick, shall we come to your questions?

[79] **Nick Ramsay:** Thanks, Chair. Good morning, both. The committee has received evidence on the importance of clear reporting of the public spending and liabilities. How does the Scottish Government calculate and forecast the overall fiscal position of both the Government and the wider Scottish public sector?

[80] **Mr Brown:** I think that question, to my mind, leads us into issues around what's referred to as 'whole of Government accounts'. It's a bit of a specialist area and I hope I know enough about it to answer the question satisfactorily.

[81] The UK Government produces whole of Government accounts for the UK, and that's where they denominate some of the figures in trillions of pounds. They look at major, major financial issues, such as the overall liability of the public sector represented by pensions, and things like that. So, you wouldn't find any of that in any individual sector accounts, but you do find it in the whole of Government accounts. Our audit body, Audit Scotland, has been saying for some time now that there is a need for greater clarity—I don't know quite what the word would be—in the reporting of the financial circumstances of the Scottish public sector as a whole, which embraces all the different aspects of the Scottish public sector. So, we're talking here about the devolved public sector—so, Scottish Government, the health boards, the non-departmental public bodies and Scottish local authorities. That's been a consistent theme of Audit Scotland for a couple of years now. Our Minister has accepted, certainly in principle, that it would be good to produce Scottish level whole of Government accounts and work is under way to explore how that might be done. So, I think that's part of the answer to the question.

[82] In terms of how we forecast and track and report on the financial circumstances of the wider Scottish public sector, we don't do that in one place at the moment. There is a lot of the public sector included within the Scottish Government's accounting boundary, so our own accounts, for example, consolidate the accounts for the NHS in Scotland and for non-departmental public bodies, but they don't consolidate the accounts of Scottish local authorities and that is what we'd get in addition, if one were to produce whole of Government accounts for Scotland. I should stop there and check that I'm actually answering the question, or is the questioner after something a bit different?

10:45

[83] **Nick Ramsay:** No, I think that you're answering the question very well.

[84] **Mr Brown:** Okay, thank you. I think, in terms of forecasting the overall fiscal position, our forecasting activity to date has very largely been about forecasting spending in the context of spending reviews—so looking, typically, three years ahead. What we haven't done until very recently is to forecast funding, other than through reading carefully what the OBR has to say about the UK's position on funding. But what we're starting to do, as you can understand, for the first time now, is to look at our own future receipts—forecast receipts—for the devolved taxes that are under our hands. That's a new experience. We produced forecasts for the two wholly devolved taxes for the first time last September or October, at the time of the draft Scottish budget. We modified these in the light of the Chancellor's autumn statement on 4 December last year. What we're now doing is thinking about further-ahead forecasts, which is a new challenge for us, but one that we're working on in collaboration with the body that Sean mentioned, which is the Scottish Fiscal Commission. It was set up essentially to provide assurance on fiscal forecasts for Scotland, mainly on tax receipt forecasts.

[85] **Mr Neill:** So, primarily, the work of the fiscal commission has been—. To date, they've taken a one-year view, which matched to the overall spending review period. But,

obviously, as we go into the next spending review, we'll need to look further ahead. As Alistair was saying, right now, we're just moving to put the Scottish Fiscal Commission on a statutory footing and we've set out a view of what the fiscal commission could comment on, and that's out to consultation until the end of June, where we've assessed what the role of the fiscal commission could be. We're very clear in the draft consultation that the fiscal commission won't actually produce their own forecast; it'll be for the Scottish Government to produce a fiscal forecast and it's for the Scottish Fiscal Commission to challenge and test and provide assurance around the reasonableness of those forecasts. However, that's, as I say, out to consultation at the moment and we'll review that position in light of feedback in the consultation. The intention is to move forward and put the fiscal commission on a statutory footing in year five of this Scottish parliamentary term, which will start in September. So, we will be bringing forward draft legislation for that. As part of that, we will try, as much as we can, to futureproof the role of the fiscal commission to reflect the additional tax powers and additional responsibilities that will come along once Smith is implemented.

[86] **Nick Ramsay:** Okay, thanks. How are the borrowing and taxes raised by local authorities managed within the wider Scottish borrowing and tax system?

[87] **Mr Brown:** That's an interesting one as well. I'll ask Sean to come in in a moment. Scottish local authorities get their receipts from five sources. The biggest is the—I still call it the rate support grant, but I think it's probably called something else now. Something like 55 per cent of all local authority funding in Scotland is through the support grant from Scottish Government, and then between 15 per cent and 20 per cent comes from council tax, so that's the domestic element of rates; another 15 per cent to 20 per cent—about £2 billion—comes from non-domestic rates, and then something a little larger than that, probably about £2.5 billion to £3 billion, comes from fees and charges. Local authorities get a lot of income from fees and charges and the remainder is income from the Department for Work and Pensions, which is then dispersed by local authorities in housing benefit, which is quite a significant part of their work. I'm afraid I'm not familiar with the exact responsibilities or funding arrangements of local authorities in Wales, but that's how funding for local authorities up here splits.

[88] Now, we control the rate support grant. It's a matter that is discussed between Ministers on the one hand and council leaders on the other, every year, in the context of the Scottish draft budget—a very important bit of negotiation and agreement—and that's worth something like £8 billion annually. Council tax, which is the domestic element of rates, is in an interesting situation. Local authorities statutorily have the freedom to set their own rate, but, for the last seven years, there has been a voluntary council tax freeze in place in Scotland, and the Government make sure that Scottish local authorities aren't worse off as a result of that by giving an extra payment every year that basically makes up for the effect of inflation on the frozen council tax income. Then, on non-domestic rates, the Scottish Government does control the rate, the poundage that is charged. So, I suppose I'm painting a picture where the Scottish Government controls the three major elements of funding.

[89] DWP obviously controls funding for housing benefit, and that's a different set of arrangements in which we have no part. There's a direct relationship between DWP and local authorities there. Then finally, on local fees and charges and whatnot, I think most of these are parking fines, some of which I have to pay, but that's entirely up to local authorities. So, if they want to achieve growth in funding, and therefore growth in spending that's beyond the growth implicit in our payments to them, grant payments, then it's to the fees and charges element that they look. So, there's a high degree of interest and quite a lot of control there.

[90] In terms of local authority borrowing, it's a remarkably significant sum. Local authorities in Scotland have outstanding debt of about £15 billion, which is, to my mind, quite a lot. [*Laughter.*] It's about 10 per cent of Scottish GDP, to put it in scale. That is left to local

authorities under the prudential code and, certainly, as I understand it, a similar prudential code is in place in respect of English and Welsh local authorities. What I would say there is that we would like a prudential code of the kind that our local authorities are subject to in terms of the control of their borrowing. Local authorities in Scotland borrow largely from the UK national loans fund, they're responsible to themselves and their auditors for operating the prudential code and keeping their borrowing affordable, and it's a system that appears to us to work well. Now, can I just check that I have answered the question?

[91] **Nick Ramsay:** Yes, that was very comprehensive. You even included the reliance on parking fines of local authorities in there, so, yes thanks for that. A couple more questions from me. First of all, I take from what you said a couple of questions ago that you believe that a public sector balance sheet should be produced for Scotland. Secondly, how can the UK Government give devolved administrations such as the Scottish Parliament, the Scottish Executive, greater certainty of their likely future funding?

[92] **Mr Brown:** Just on the first point, on a balance sheet for Scotland, I think what I would say is that we're examining ways in which appropriate information could be provided. I think it'd be fair to say that Audit Scotland think that we should be providing something in the nature of a balance sheet for Scotland, but I think we've stopped short of saying that that's exactly what we'll do. We're working towards reporting that would convey the information that Audit Scotland have referred to.

[93] Then, to refer to the substantive part of your question as to the UK Government giving devolved administrations greater certainty, I think my view as an official is that the UK Government actually manages to give quite a lot of certainty, certainly to the Scottish administration, Scottish Government, in terms of future funding. The mechanism through which they do that is the spending review. So, every two or three years, they have a forward look on UK spending, which the Barnett formula then translates into a series of adjustments for the Scottish baseline, which gives us, effectively to the nearest £1 million, how much we'll have to spend two or three years out. Subsequently, what happens, of course, is that the Chancellor runs annual budgets and he runs annual autumn statements, and if he changes the level of comparable UK spending—so, on health, schools, transport and whatnot—our block grant is adjusted as well. Clearly, at the point of the spending review, one doesn't know what future decisions might be made in budgets and in autumn statements, so there is that degree of uncertainty.

[94] What I would observe is that it's not particularly helpful—to us, I mean—when consequential changes to our budgets flow from UK Government decisions outside the programme, or the normal mechanism of budgets and autumn statements. We had the Chancellor at the Mansion House the week before last announcing changes to some UK spending totals, and a day or two later we got the news through that there would be a total reduction in the Scottish budget—Scottish funding this year, in the year that we're embarked on—of £107 million. Now, that's the result of the operation of the Barnett formula. The observation is that that's quite difficult, because we're already in-year. It would've been less difficult if it had been an increase in spending, rather than a reduction. To be fair to the UK Government, they offered us the option of either absorbing the whole of that reduction of £107 million in the current year, or absorbing none of it this year and all of it next year, or splitting it between the two years. So, they've done what they could, I guess, to make the bitter pill as palatable as possible.

[95] I'm rambling on a bit, but our view would be that there is reasonable certainty, at least up to the horizon provided by spending reviews, of our spending in the future. However—and this is stating the blindingly obvious—in the point in time that we're at now, where 2015-16 is the last year covered by the previous spending review, and the UK Government is planning to run a spending review and hasn't done so yet, so we don't know

what our spending aggregates are for 2016-17 or the years beyond, and neither does the Welsh Assembly Government, that does mean that we're on very, very short planning horizons now. But the same could be said of UK departments—the Ministry of Defence, and the Home Office and whatnot. They don't have any further-ahead view than we do of their spending totals. I hope that's of some use.

[96] **Nick Ramsay:** Great, thanks for that. Just very finally from me, if I may, Chair, just going back to an answer that you gave to I think it was Alun Ffred Jones earlier, you said one way around the problems with the Barnett formula may be to, rather than adjust the formula, adjust the historic amount—

[97] **Jocelyn Davies:** The baseline.

[98] **Nick Ramsay:** Yes, the baseline that was in operation up until the mid-1970s. That would certainly be one way of giving additional funding, say, to Welsh Government or Scotland, but that wouldn't deal with the issue of the Barnett squeeze, would it? Okay, you'd get more money additionally, but then as time goes on you'd be back to groundhog day where the squeeze would come back into operation.

[99] **Mr Brown:** By Barnett squeeze, I guess you're referring to the convergence on spend per capita—

[100] **Nick Ramsay:** Yes. I don't think you experience it in quite the same way in Scotland.

[101] **Mr Brown:** Yes, well, it's an interesting issue, the convergence on per-capita public spending. It's something that the arithmetic of Barnett says should happen, but actually, when you look at what does happen, the squeeze seems remarkably slow. Maybe that's a bit like being grabbed by a boa constrictor, or something like that. Our observation is that, at a time of low spending growth, which we've had for the last five years, then the squeeze hardly works. If there is zero spending growth, the convergence, or the squeeze, doesn't work at all.

11:00

[102] Obviously, if we reverted to a time of more rapid spending growth, which we can only dream about, I think, at the moment, but were that to happen, then the effect of convergence would be stronger. The other effect that's at work here is relative population movements. In Scotland, our population is growing, but it's not growing as fast as in the UK as a whole, and the result of that, arithmetically, is that the Barnett squeeze isn't working. We're not seeing a reduction in spend per head in Scotland as compared to spend per head in the UK as a whole. We would've done back in the noughties when, under Chancellor Brown, public spending was growing. We would've seen some convergence, but, as far as I'm aware, since 2010, there has been no material convergence in spend per head. Now, obviously, as I say, once spending growth returns, that will be an issue again, and my understanding is that that was the point of the proposition on the floor for public spending per head for Wales.

[103] **Nick Ramsay:** Great, thanks.

[104] **Jocelyn Davies:** Just one or two questions to finish off. In this idea of renegotiating the baseline, were you suggesting there that perhaps the different devolved administrations could have different baselines?

[105] **Mr Brown:** Well, we do have different baselines now.

[106] **Jocelyn Davies:** Right, I see. So it would be up to each administration to negotiate separately in terms of the baseline, of updating that baseline.

[107] **Mr Brown:** Yes. The point I was seeking to make—and it was a personal point rather than reflecting any view of the Scottish Government—was that the Barnett formula only operates at the margin of the baseline, so reforming the Barnett formula doesn't change the baseline. That's the point I was making. If a devolved administration felt that the baseline itself was unsupportable or deeply flawed, then the way to get at that would not be to adjust the formula, because by definition, the formula keeps the existing baseline; the way to get at deep dissatisfaction with the baseline itself would be to seek to negotiate some change to it.

[108] **Jocelyn Davies:** Then that wouldn't impact on the way the formula currently works for the other administrations.

[109] **Mr Brown:** Yes, that would be my view. Indeed, it wouldn't impact on the way the formula works for Wales. It would continue to look at comparable spending programmes in England, and when they moved, it would take a Welsh population share of that movement and apply it to the Welsh baseline. So, the Barnett formula itself would continue to operate, but what I'm saying is that, if there were to be agreement that the baseline should be something different, the formula would operate on that different baseline.

[110] **Jocelyn Davies:** Okay. There was something that also you mentioned earlier in relation to Barnett, and that's that you've agreed this one-year deduction from the block grant on the basis of the forecast for tax revenues, but you've not agreed a mechanism for future deductions. So, if the tax rates change, what will happen then? How does the Barnett formula work then, when larger deductions are required? How are you going to have that ability to preserve conformity?

[111] **Mr Neill:** I'll maybe save Alistair just on this one. You're right in saying that we've only reached an agreement for a one-year deal for the block grant adjustment. Just to clarify, the block grant will always work in Scotland, regardless of what happens through the devolution of additional powers. It's just the adjustment to the block grant will get larger and larger. So, at the moment, we have an adjustment that is just under £500 million to take into account the devolution of the two devolved taxes. However, once we get further fiscal powers, we'll be looking at adjustments that are well over £15 billion to the block grant, but the block grant, within itself, will just keep operating. As opposed to the actual question around what it looks like going forward, that has been put into the work in the Smith Commission. We have a challenge to come up with a revised fiscal framework for Scotland, and part of that work will look at not only the taxes within the Scotland Act 2012, but also two further devolved taxes that the Smith Commission recommended to put forward, which are aggregates levy and air passenger duty. We'll take these as a collective and have a look at both the initial adjustment and how that's going to be indexed going forward, and how all that work will fit with the principles, which are set out in the Smith Commission, of economic responsibility, where you take full accountability for the decisions and your choices in relation to the policy of the taxes, but also how it would fit with Smith's principle of no detriment. So, that's looking to make sure that no Government is any better or worse off at the point of devolution, and that indexation is working going forward.

[112] **Jocelyn Davies:** Okay. Thanks for explaining that. Well, we've run out of time. We've got one or two questions left, but perhaps we'll send those to you, because we've got our next witness waiting. I think we found that very, very helpful indeed. We'll also send you a transcript; so if you could look at that and check it for factual accuracy, then we'll be able to publish it. So, thank you very much for your time this morning.

[113] **Mr Neill:** Thank you.

[114] **Mr Brown:** Thank you.



[115] **Jocelyn Davies:** Okay, shall we move straight on to the next item on our agenda, as we've got our witness waiting?

[116] **Julie Morgan:** Can we make sure they send the information on city deals?

[117] **Jocelyn Davies:** Yes, on city deals—we'll make sure that we get that. And there was a note on something else as well, I think.

11:06

### **Ariannu yn y Dyfodol: Sesiwn Dystiolaeth 3 Future Funding: Evidence Session 3**

[118] **Jocelyn Davies:** So, this is item 5 on our agenda, which is the future funding evidence session number 3. I'm delighted that we have Alan Trench with us this morning. I usually ask witnesses to introduce themselves, but there's probably no need for you. But, if you've got one or two words to say, we'll go straight to questions then.

[119] **Professor Trench:** I'm very happy to go straight to questions, Chair.

[120] **Jocelyn Davies:** Okay, then. I'll start. In general, do you believe that the current mechanism for financing the UK devolved administrations is sustainable in the long term?

[121] **Professor Trench:** No.

[122] **Jocelyn Davies:** I very often look at your blog, so I knew the answer you were going to give to that, but it is worth us having that on the record. Thank you.

[123] Ann, shall we come to your questions?

[124] **Ann Jones:** Has the recent period of austerity highlighted any particular problems for how devolved administrations are funded?

[125] **Professor Trench:** It certainly highlights problems. It also highlights, perhaps, some of the advantages of the present system, notwithstanding that I've just said that I don't think the system is sustainable. One of the curious things that has occurred since 2010 is that, because the coalition and now the Conservative Government have been committed to sheltering spending on health and schools in England—and those are the largest elements of devolved discretionary spending for all three devolved Governments—that has the effect of significantly sheltering devolved budgets. That has a further knock-on effect, which is that, because of the way that devolved Governments have made their decisions—all three of them—they have ended up sheltering local government services, and running local government services in what, I think I would say, is a more sensible way than has been the case in England, where a very large amount of the austerity that has happened so far has been visited upon local government services, and local government budgets have been dramatically reduced as a result.

[126] Going beyond that, I'd say two things: the first is that we are clearly in a period of trying to implement fiscal devolution, and to change the way that our financing system works. How effectively we'll do that remains to be seen, but doing so at a time of austerity and spending restraint is very difficult. We have now become very fond of quoting the phrase in public life, 'You fix the roof when the sun is shining', but this was an archetypal case where the roof could and should have been fixed when the sun was shining, and that was in the early noughties, when tax receipts were buoyant and public spending was increasing significantly.

Doing so now, particularly, I suspect, in relation to Scotland, given the political and constitutional situation there, is going to be very difficult.

[127] The second point is that it's a necessary consequence of the way that we have approached finance and devolution that UK Government decisions, which, themselves, are driven, first and foremost, by considerations about England, are going to be visited upon devolved Governments. The Barnett formula is, to a large extent, a transmission mechanism. It has worked in a slightly odd-gearred way because of the protection of health and school spending, but it is essentially a transmission mechanism. So long as we have a system that, on the one hand, means that all decisions in relation to that grant are matters not merely for the UK Government, but for the Treasury, and, on the other, that we have very limited degrees of fiscal devolution, that, I'm afraid, is going to remain the case.

[128] **Ann Jones:** Okay, thank you. Would you summarise the main recommendations of the recent Bingham Centre report, which are relevant to the question of devolved funding, please?

[129] **Professor Trench:** Well, I think that the first consideration is to say that there's one big choice that needs to be made and we, as a commission, were unable to make it. All we could do was say that it needed to be made—to advise others to make it. That is, that there needs to be a major debate about the nature of solidarity across the United Kingdom. We have reached a position where we haven't had any meaningful discussions about that, probably for 60 or 80 years, while the arrangements for allocating money across the UK have changed dramatically during that time—

[130] **Alun Ffred Jones:** Sorry. Can I intervene? What do you mean by 'solidarity'?

[131] **Professor Trench:** Well, I mean the nature of what it is that the UK level will assure its citizens, wherever they may live, and then the means by which you allocate the money to ensure that that is the case. The UK need not deliver those assurances itself. In some cases, it does through mechanisms like the old-age pension and benefits, like what we still call jobseeker's allowance and employment support allowance.

[132] In other cases, we have a principle that there should be a national health service that will provide universal care, free at the point of use. As it happens, the NHS is wholly devolved, and the welfare system is, at present, wholly reserved. All devolved Governments have signed up to the principle of an NHS providing universal care, free at the point of use, but that's nowhere committed to any sort of binding document. So, it's something that we happen to do—that all parts of the UK happen to do, and that all parts happen to believe in. But there's nothing that actually codifies that. It seems to me that carrying on with the system that we have, which has created very divergent arrangements, is quite dangerous. The commission took the view that there needs to be a much more substantive debate about solidarity. That has, logically, to come first because that drives a number of the much more technical issues.

[133] The second question is that we think that the grant element of devolved funding needs to relate much more clearly to issues of equity rather than to simply being where you happen to be at the time. Effectively, we have a pass-the-parcel system: the music stops and the parcel happens to be in certain places at the time that the music stops. That, again, is simply inappropriate, but the choice about how you do that system itself depends on your wider considerations about solidarity across the UK, and where the locus of that solidarity should be—whether, in relation to devolved governments, it's in devolved parts of the UK or it's at the UK level.

[134] Third, we think that the machinery of administering devolution funding needs a

substantial overhaul. In particular, I think we would highlight the need for two new sets of institutions. One would be something that one might call a UK finance commission or funding commission to advise on how funds should be allocated in a non-political independent way. The second is a much more robust, impartial approach to resolving disputes and disagreements when they occur. One would expect that, if there were a more robust mechanism for doing that, there might actually be fewer rather than more disputes.

[135] I think that's as far as we go in the commission. I have views that aren't necessarily part of the commission's report that would extend to issues like fiscal devolution. The one key thing we do say, in relation to fiscal devolution, is that the arrangements that are being proposed by the UK Government for implementing the Smith recommendations for Scotland will not work. In particular, the reference to the use of the no-detriment principle that's set out in the UK Government's command paper, 'Scotland in the United Kingdom: An enduring settlement', simply emphasises that principle far too much and it will not work in that form. It will be a recipe for political tension and disagreement; it will not be a recipe for applying fiscal decentralisation in an effective way.

[136] **Jocelyn Davies:** Before you move on, did you have a question, Nick, on this point?

[137] **Nick Ramsay:** Yes, it was just on the issue of solidarity that you clarified earlier. It sounds wonderful stuff, but I just think, how on earth are you going to get Scotland to buy into it, because they're going to lose money?

[138] **Professor Trench:** Well, the question is not simply whether Scotland buys into it, but what the UK as a whole, and in particular the UK Government, wishes to commit itself to. It may be that when Scotland looks at that, Scotland will take a view that that's not a choice it wants, but it's a choice that needs to be had, rather than to be allowed to proceed by default, because what we have at present is, bluntly, a system that is generous to Scotland and not very generous to a number of other parts of the UK. It also happens to be pretty generous to Northern Ireland; it's not particularly generous to Wales, and it's fairly miserly to several large parts of England. That is not a recipe for equity and it's not a recipe or a system that anyone ever consciously chose. It is certainly not a system that I think anyone would ever consciously choose.

[139] **Jocelyn Davies:** Ann.

[140] **Ann Jones:** Can I just ask then, what legislative changes do you think are required by the UK Government to improve the consistency and the transparency of the devolved funding arrangement?

[141] **Professor Trench:** Well, this brings us back, I think, perhaps, to another one of the big recommendations that the Bingham commission makes and that is the idea of an overarching charter of the union, which would articulate some of these principles in a general way, and indeed other principles in a general way. The means by which that would be framed and adopted, I think, are major questions for discussion.

[142] The other change that very clearly needs to be made—. You would certainly want a statutory framework for both those two new institutions that I've mentioned: the finance commission and the dispute resolution body. And I think that, more generally, the Barnett formula and these arrangements need to be put on a statutory footing. At the moment, as you all know, they rest on the Treasury's statement of funding policy, which was last issued in 2010. Presumably, there will be a new edition this autumn, following the spending review—the custom has been to issue a new one after each spending review—but that's simply a statement of Treasury policy and it's adopted unilaterally; it's not even formally agreed by devolved Governments.

[143] The Treasury is subject to no statutory constraints whatever in relation to this. The funding that is then out-produced, is then calculated, is put in the hands of devolved governments by a very complicated mechanism that involves, first of all, its appropriation through the mechanism of the supply and appropriation Act at Westminster, which, in fact, allocates the money, not to the National Assembly or to the Welsh Government, but to the Secretary of State for Wales, and it's the Secretary of State for Wales who then pays the money into the Welsh consolidated fund, which is administered by the Welsh Government. It seems to me that that's a strange and inappropriate mechanism that is designed partly out of tradition and small 'c' conservatism and partly out of an administrative convenience, and partly to reflect a constitutional fiction about the accountability of Ministers to the UK Parliament for the spending of public money.

[144] **Ann Jones:** Okay, thanks. Are there any potential financial impacts, or what financial impacts could there be, on devolved administrations of a move to an English rate of income tax, or English votes for English laws?

[145] **Professor Trench:** An 'English rate of income tax' is a term that was used in the run-up to the election campaign and particularly in the election campaign. As I said in a post on my blog, 'Devolution Matters', it appears to make no sense whatever and, indeed, it appeared to be extracting a lively headline out of an old story. To the extent it makes sense, I'm not really sure I understand. I think what it would actually mean—although it has been badged as an English rate of income tax—would be an English, Welsh and Northern Irish rate of income tax; in other words, a non-Scottish rate of income tax, on the basis that income tax would be devolved to Scotland under the Smith Commission recommendations. Now, even that is over-egging the pudding rather, because what is devolved under the Smith recommendations are all the revenues of income tax, the power to set the various rates and the threshold between the rates, therefore the bands that income tax is charged at. That's not the same as devolving the whole of income tax because the personal allowance will continue to be set at Westminster for the UK as a whole, the collection arrangements will continue to be UK-wide and the accountability of HMRC will be first and foremost to Westminster, rather than to Scottish Parliament as well. There are some questions about accountability of HMRC as a tax collection agency, both in relation to the Scottish rate of income tax, which comes into effect next May, as well as this wider devolution of income tax. The UK will still be responsible under the Smith proposals for income tax on savings and dividends income, and I think it's regrettable in the Scottish context that the debate about savings and dividends has been forgotten. If one goes back in time, the proposal from Calman was to assign a chunk of those in 2009, and that was dropped and everyone stopped talking about it. But, actually, that makes really quite a lot of sense—there were some very difficult issues in relation to savings and dividends income. They're much harder to allocate than earned income—PAYE income—because you don't know the tax residence of the payee or the payer of the tax; the payer of the saving, the interest income or the dividend. You don't know the tax status of the person to whom they're paying it.

[146] So, all those decisions are going to remain UK-wide decisions. The decision about the English rate of income tax, or the English/Welsh/Northern Ireland rate of income tax is going to relate only to the actual rates of taxation itself. And quite apart from anything else, this is going to make for a parliamentary ballet of some intricacy. I would not want to be responsible for the choreography of that.

[147] **Christine Chapman:** Okay. Julie.

[148] **Julie Morgan:** My question is to ask you whether there should be—[Inaudible.]—that you think it should be. Do you want to carry on?

[149] **Professor Trench:** I think that that's a desirable objective; getting there is the difficult bit.

[150] **Julie Morgan:** Yes, and I think you did say earlier that you thought the divergence arrangements were dangerous.

[151] **Professor Trench:** The—?

[152] **Julie Morgan:** The different ways that things were happening were dangerous. I wondered what you meant by that.

[153] **Professor Trench:** Well, I think where we have got to, as I say, means that it becomes increasingly hard to say what it is that citizens of the UK as a whole have in common, because your experience of life is increasingly different whether you live in Scotland, Wales, Northern Ireland or in England. I think that you start to need to work out what it is that have you in common, as well as what it is that you do differently, and how and why that is the case.

[154] **Julie Morgan:** And this is your solidarity.

[155] **Professor Trench:** This brings us back to the issue of solidarity, and then we can start to think more clearly about the mechanisms by which that's delivered.

[156] **Julie Morgan:** Right. And what about other countries? Could you give us an example of a federal-style country where this is operating successfully?

[157] **Professor Trench:** Most countries—. We have a number of examples. The two that I find always particularly interesting and useful are Canada and Australia, both of which are common law federal systems with parliamentary systems, so very different to the United States with a presidential system. And that institutional difference has quite an impact in all sorts of respects. And both have differing ways of approaching questions of social solidarity. The Australians have an institution called the Commonwealth Grants Commission, which institutionally, I think, is a very interesting model—and indeed one I would recommend, I think, and we discussed that in the Bingham report—that advises the federal treasurer, as he's called—the equivalent of the Chancellor of the Exchequer—about the allocation of funding by grant to the states.

[158] The way it does that is, I think, not anything like as useful or appropriate. It uses something like over 90 indicators and an extremely complex set of formulae that eat up data to address the so-called 'fiscal handicaps', which I think is the terms that is used, or fiscal disabilities, of each of the various parts of Australia—the various states and territories. And that's a highly solidaristic approach in what actually is a pretty equal country. You have two or three really big outliers in Australia, but the difference between, as it were, the somewhat less prosperous parts of Australia, like South Australia, or even Tasmania, and the more prosperous parts like Victoria and New South Wales, is fairly limited. Your big differences in Australia relate to the Northern Territory and Western Australia. The Northern Territory is large and poor, and also has a very large aboriginal population, and that imposes a particular cost in delivering public services. Western Australia has been through a resource boom, and at the moment is richer than richer than Croesus. That creates some significant strains there.

[159] The Canadian system does not address spending issues in the way that the Australian system does—the question of the cost of providing services. It simply addresses the differences in tax base across the different parts of Canada. It does that by a formula that is run and administered by the federal Government's department of finance, not on the advice of any outside body, let alone any independent body. It's therefore a mechanism where there is

less political confidence on the part of the provinces, on the whole. Equally, it does seem to be reasonably fairly run and managed, even if it is run definitely in the interests of the federal Government.

[160] **Julie Morgan:** So there's not much challenge to either of these systems.

[161] **Professor Trench:** Oh, there's endless argument. The nature of these processes is that there is endless argument, because you are talking about money. You're talking about the allocation of public money, and that is always going to be contentious in every country that you find. But these are federal systems that have dealt with these problems of a balance between the autonomy of sub-state governance and state-wide solidarity in ways that reflect their own distinctive histories, cultures, values and institutions. That is the process I think that the UK needs to go down.

[162] **Jocelyn Davies:** Have you got any examples where you've got this arrangement where there are different countries, because, obviously, Canada's one country and Australia's one country; we're talking about the UK, which has different countries or nations within—

[163] **Professor Trench:** Canada, of course, is a multinational state, and you have the question of national identity and possible secession and independence, which has been a very live issue for Quebec for a very long time. That's one of the reasons why I would be hesitant about Australia as a parallel—because Australia is not a multinational system. Canada is, and Spain is. Spain manages these things in a remarkably strange and dysfunctional way that doesn't even obey the usual rule of Spanish public life, which is that it's politically gamed. Spain actually makes no sense whatever to me. I've been reading quite a lot about Spain lately and the more I read, the less sense it makes.

[164] The other systems we often look at are those in Germany and Belgium. Germany is very peculiar for a number of reasons. One is that it's not a very good parallel because, again, it's not a multinational state. It also operates a remarkably complex, very egalitarian system of allocating funding, but operates horizontally, not vertically. In other words, all the countries we've been talking about so far have the federal Government raising funds that are then allocated to the constituent units, to sub-state Governments, to address the differences in their economic position or social factors that affect the cost of providing services there. In Germany, it operates directly between the different land Governments. The landtag of Baden-Württemberg makes a monthly transfer to the Government of Saxony-Anhalt or Saxony, and they're the poorer länder, because those are the recipient länder, and it's the agency that collects the revenues in accordance with federal legislation. So, it's very hard to categorise in those terms.

[165] Belgium is again a peculiar country that is, in fact, despite the ongoing debates about both constitution and fiscal issues in Belgium, actually remarkably still centralised. Fiscal decentralisation in Belgium doesn't go very much beyond what the Calman proposals or the Silk proposals would have delivered for Scotland or Wales respectively, despite a lot of debate about further decentralisation there.

[166] **Jocelyn Davies:** So Canada is the best example. Julie, do you have any—

[167] **Julie Morgan:** That's fine, thank you.

[168] **Jocelyn Davies:** Ffred, shall we come to your questions?

[169] **Alun Ffred Jones:** Iawn. Gwnaf **Alun Ffred Jones:** Okay. I will speak in siarad yn Gymraeg. Welsh.

[170] Rwy'n meddwl fy mod i'n iawn i ddweud nad ydych chi'n credu y bydd y newid i fodel cadw pwerau i Gymru yn cael unrhyw effaith ariannol. I think I'm correct in saying that you don't believe that the change to the reserved powers model for Wales will have any financial impact.

11:30

[171] **Professor Trench:** Directly, I don't see that it does. Indirectly it might, but I think the question about funding relates to the substantive functions for which the Welsh Government and the National Assembly are responsible. It is perhaps worth noting that the very useful fundamental recommendations and advice of your adviser in the commission he chaired a few years ago were designed for a Welsh Government, whatever its powers might have been, without any change in its functions. So, even with the very limited powers of the 1998 Assembly, it would have been an appropriate solution for it.

[172] **Alun Ffred Jones:** Diolch yn fawr. Ydych chi'n credu y bydd gweithredu model o bwerau wedi eu cadw hefyd yn gofyn am greu awdurdodaeth gyfreithiol unigryw, fel sy'n bodoli yn yr Alban? **Alun Ffred Jones:** Thank you. Do you believe that the operation of the reserved powers model would also require the creation of a distinctive legal jurisdiction as exists in Scotland?

[173] **Professor Trench:** My own view is that it would be extremely difficult to establish a reserved powers model without a legal jurisdiction as well. I said so in my evidence to part 2 of the Silk commission's inquiry. What that means in terms of spending is another question, because, No. 1: a legal jurisdiction, in principle at least, ought to be pretty much a zero-sum game. There is no inherent reason why—even if you were to go down the path of having separate Welsh courts, legal system, professions, judges, et cetera—that necessarily involves any significant extra costs beyond those that are already incurred by having a law-making National Assembly, and courts that are run on an England and Wales basis. Second: as I said in my evidence, there's no particular necessity to have separate Welsh courts as part of a Welsh legal jurisdiction. You need to have distinct Welsh courts, but that doesn't necessarily mean separate. So, you could well have, for example—. One option would be that, while you have a Welsh legal jurisdiction, which, as it were, draws a line around both a geographical unit and a body of law, the court system and so forth remain reserved matters for Westminster. The decisions about the funding and running of those courts remain matters for Westminster and the judges who sit in the courts of Wales are the judges who are presently entitled to sit in the courts of England and Wales. So, I'm not saying it needs to be done in that way, but that is an option at one end of a very long continuum of choices about what a legal jurisdiction means.

[174] **Alun Ffred Jones:** Diolch yn fawr. A chwestiwn ar fenthyca: mae Deddf Cymru 2014 yn caniatáu i Lywodraeth Cymru fenthyca i ryw raddau hyd at derfynau penodedig mympwyol. A ddylai pwerau benthyca, yn hytrach, fod yn gysylltiedig â chynlluniau treth a gwariant, drwy system fenthyca ddarbodus? **Alun Ffred Jones:** Thank you. And a question on borrowing: the Wales Act 2014 allows the Welsh Government limited borrowing up to arbitrary fixed limits. Should borrowing powers, instead, be linked to tax and spending plans through a system of prudential borrowing?

[175] **Professor Trench:** Yes, but I think you need to 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—the making of decisions about those and the exposure to the risk that your receipts don't match your expectations for those receipts. The UK's financial difficulties—overall public finance difficulties—at root, are because tax receipts in 2008-9

went off a cliff and public spending didn't. That's the root of the deficit. You can argue about whether spending was too high or not, whether these changes should've been foreseen, but that is why you have the large deficit that we have at the present time. The same applies to any authority that collects taxes, whether it's a local authority or a sub-state Government in federal and decentralised countries, and it's worth noting that the sub-state Government in all these countries we've been talking about have extensive borrowing powers and some of them have created significant problems, both form themselves and central Government, as a result of the way that they've used them—Germany being a particular case in point. So much for German fiscal prudence.

[176] **Alun Ffred Jones:** Y cwestiwn olaf: **Alun Ffred Jones:** And the final question: a gaf i gyfeirio at baragraff 10 o'ch may I refer to paragraph 10 of your memorandwm chi, ac mae'r frawddeg gyntaf memorandum, and the first sentence says: yn dweud:

[177] 'In reality, the point of a "Barnett floor" is highly questionable, since the current level of funding is probably about right.'

[178] Could you explain that? The next sentence is:

[179] 'What is needed is a mechanism to address the issue of convergence.'

[180] I'd always assumed that the Barnett floor was to address convergence. Perhaps you will explain.

[181] **Professor Trench:** Yes. The Barnett floor is designed to prevent—. It has never been specified in any way I've seen published that makes an awful lot of sense and that says what it means. It usually appears to mean some way of adjusting the baseline of funding, rather than the increment of funding, to ensure that it doesn't fall below a particular level. But it occurs to me that, actually, you can do that by adjusting the formula to deal with the issue of convergence, rather than by some probably rather complicated and perhaps arbitrary mechanism of varying the baseline. Now, again, your adviser has already answered this question. His report sets out the mechanism by which you do so once you have dealt with the baseline issue. As it happens, it looks like the baseline issue has been more or less resolved so far, because no-one has yet, at least as far as I'm aware, challenged the UK Government's figure that Wales is now at about 116 per cent of comparable funding for devolved services. As I said in the note to my paper—I think the footnote is there; yes, it's in footnote 7 on page 2—the UK Government predicted, on the basis of its spending estimates some years ago, that, by this year, Wales would be at about 115.9 per cent. I think that's what the published figure was. In his evidence to the Welsh Affairs Committee just before the election, the Parliamentary Under-Secretary of State said the figure was 116 per cent, and I've not seen anyone question that. So, it looks as though that is actually right.

[182] **Alun Ffred Jones:** How do we know that is right?

[183] **Professor Trench:** Well, I've privately invited Welsh Government to challenge that and they've not. I would hope your committee's asked them that question; if not, I would suggest you do so, because it seems to me this is information that Welsh Government should have and should certainly be willing to give your committee. But, assuming that that's right, that certainly puts it pretty much in the middle of the range of relative need that the Holtham commission suggested back in 2009. Maybe that figure ought to be looked at again, but their figures were between 114 per cent and 117 per cent, if memory serves, of English per capita spending. And, if you're at 116 per cent, you're where you need to be, pretty much. So, the question is: how do you address the issue of convergence? Now, No. 1, the issue of convergence is unlikely to be a very significant one in the foreseeable future, given what's



going on in public spending, but it's likely to be a factor. Of course, because you're relatively close to the level of relative need, this is a meaningful factor for you in a way it is not for Scotland. The way you could address that is by a very, very simple factor, which is to add a needs-weighted figure to the formula for the Barnett formula. The Barnett formula has three elements—the actual mechanism of the Barnett formula. It is to take the amount of change in comparable spending in England, to apply to that first of all a comparability percentage, which varies from department to department—so, it's 100 per cent for education, it's 99.1 per cent for health, and it varies for other departments. You first multiply the change in spending for England by that figure, and then you multiply it by a population figure. If you add to that formula—. That implicitly assumes that you get 100 per cent of the comparable change made for England. Well, if the Welsh relative needs are at, let us say, 115 per cent, why not multiply that figure by 115 per cent? This is laid out in the Holtham commission's report; it's not a novel or, indeed, I'm afraid to say it, original insight, but it is the way to address the problem in a very practical way without the necessity of the very extensive, complex, messy negotiations that things like baseline reviews would necessarily involve.

[184] **Jocelyn Davies:** As we heard earlier—I think you were in the room when we heard the evidence from the Scottish officials.

[185] **Professor Trench:** Indeed, yes.

[186] **Jocelyn Davies:** Any further questions?

[187] **Alun Ffred Jones:** No.

[188] **Jocelyn Davies:** Peter, shall we come to your questions?

[189] **Peter Black:** I'm not sure if you haven't just answered the first question, actually, which is: 'how can the current weaknesses in block grant funding between different parts of the UK be addressed if the Barnett formula were to be retained?' I think you've just answered that question, unless you have anything you want to add to that.

[190] **Professor Trench:** I'd like to elaborate on one aspect of that, which is this: what we have had since 1999 is an approach from Treasury that has said that the arrangements for funding devolution have to be symmetric; they've got to be the same for everyone. Nothing else about devolution has been the same, except the attempt by the Treasury to say that the mechanism that is used should be the same, including, of course, the main output of what the Treasury said should be the same, which is the funding allocations, which, as we know, are generous to Scotland, generous to Northern Ireland and not generous to Wales. I can't see the logic of insisting on symmetry in that one respect. Either one seeks to have a wider and more substantial degree of symmetry, or one actually says, 'We have to remedy this immediate injustice here, particularly since it doesn't create other injustices elsewhere, and we can then address wider problems, subsequently'—in other words, not letting the best be the enemy of the good.

[191] **Peter Black:** Okay. I think you just answered my second question. [*Laughter.*]

[192] **Professor Trench:** So, if you invite that one, I might answer your third. [*Laughter.*]

[193] **Peter Black:** Moving on from that, then, in terms of the intergovernmental arrangements. What intergovernmental arrangements could be adopted to negotiate and manage the framework of devolved spending and tax arrangements?

[194] **Professor Trench:** Well, I think I have already answered that, but I think I answered that right at the beginning when talking about the need for two wider new institutions both to

advise on allocations and provide wider expert advice and, indeed, possibly an audit role, as well, and then to act as a dispute resolution mechanism.

[195] I think there is another question, which is where these discussions should be held. Now, at the moment, of course, we have the so-called joint exchequer committee that's been set up between the UK and Welsh Government to deal with the tax devolution that's already on the table, so stamp duty land tax and landfill tax, and, to the extent it's on the table and relevant, the proposed Welsh rate of income tax. We also now have an agreement in principle, but no action on a Welsh intergovernmental committee, building on the recommendations of the Silk commission's part 1 report, and agreed in the 'Powers for a purpose' command paper.

[196] I think that committee, whatever form it may actually take, is also capable of playing a very useful role in dealing with these issues, particularly if they are, indeed, going to be allowed to continue bilaterally, rather than operate in the more multilateral way I think would make sense.

[197] **Peter Black:** There's still the issue of arbitration on issues where there is no agreement to resolve them quickly, because it's just Barnett-ing expenditure like HS2, for example.

[198] **Professor Trench:** Yes. If we take HS2 as an example—and that's a good example—HS2 is going to be one of those questions that will—. How that is Barnett-ised, as you put it, is going to be an issue that's going to be up for consideration in the revision of the statement of funding policy that will be under way in the run up to the autumn spending review, presumably. As it happens, HS2 funding, because it doesn't have a separate budget line, has triggered consequential for Wales, although on fairly limited amounts. There's a genuine consideration to be had about whether HS2 is for the benefit simply of England, or for the UK as a whole, and this is a discussion that's been ongoing in relation to major transport schemes for a long time. The very first discussion of this was in relation to London Transport, which, in the 1999 statement of funding policy, was categorised as being for the benefit of the UK as a whole and was then re-categorised with effect from 2003.

[199] There's been a similar debate in relation to Crossrail, and HS2 will trigger it. And one can see—. I mean, I think the arguments in relation to both Crossrail and London Transport were particularly feeble. These were very clearly issues for the benefit of London and Londoners and not for the benefit of the UK as a whole, except on those occasions when you happen to go to London, but they're no more for the benefit of people from Wales than they are for the benefit of people from France.

[200] So, there is a debate to be had about that. At the moment, of course, that would entirely be held behind closed doors. No doubt, the Welsh Government will make representations, but it won't be directly engaged in any of those discussions. To the extent there is a representation of Welsh interests, it'll be by the Wales Office. The key decision maker in these processes is first and foremost going to be HM Treasury—possibly, to a degree, the Department for Transport. The Department for Transport will have an interest because if it is told that the Welsh consequential, effectively, comes off the Department for Transport block, the Department for Transport is going to want to see that no further reduction is made from its spending. That would appear to be the explanation for the mess that was created out of the consequentials for the 2012 London Olympics: that a Minister was told that there were going to be Barnett consequentials on this, and there were going to be hundreds of millions, and he decided to save the hundreds of millions by simply writing the budget line to relate to non-devolved spending rather than devolved spending, even though it was the regeneration of a large chunk of east London. That's the reason for a different way of making the process for—and for a statutory basis for the Barnett formula, rather than the statement of Treasury policy.

11:45

[201] **Jocelyn Davies:** Can I just ask you, as an aside, really—. We often refer to and talk about Treasury as if it's a separate thing from the UK Government—[*Laughter.*]—as if there's no Minister in control or there's no ministerial decision-making, as if there's a kind of—. Why is that? Why has it got this status that puts it, really, equal to or even above the UK Government in terms of money?

[202] **Professor Trench:** Well, it is because it is so overwhelmingly the most important department for economic and spending matters, which includes most domestic matters.

[203] **Jocelyn Davies:** Isn't it ministerial decision making that goes on there? Isn't it a person making a decision rather than these mysterious individuals that make up the Treasury?

[204] **Professor Trench:** Obviously, the key Ministers—. The Treasury, like all UK Government departments, has a ministerial team. It has quite a large ministerial team, and it's headed by two Cabinet Ministers which, in itself, indicates its importance. It is, I think, the only department of state that has two Cabinet Ministers more or less as of right. There are a number of other departments that have a Minister of State invited to attend Cabinet. The Chief Secretary—

[205] **Jocelyn Davies:** But it does seem that the decisions of Treasury are depersonalised from ministerial decision making by referring constantly to 'the Treasury'.

[206] **Professor Trench:** As an observer I would say that, with Treasury much more than other Whitehall departments, there's also a tendency for there to be an identity on the part of officials with Ministers and Ministers with officials. In other words there is a corporate identity that will adjust itself to the preferences and views of a particular Chancellor, but nonetheless it has a corporate identity as well that is, I think, stronger than most other Whitehall departments.

[207] **Jocelyn Davies:** Okay. It seems to me that the officials have the final say—I don't know—rather than the Ministers, but I could be wrong. Peter, have you finished your questions? Chris, shall we come to yours?

[208] **Christine Chapman:** Yes, okay. Thank you. Do you have any concerns over the financial consequences for the rest of the UK of further devolution to English regions and local authorities?

[209] **Professor Trench:** I have two concerns. One is that there has not been enough, and the other is that there's been too much. The respect in which there has not been enough is that much of the devolution that appears to be on the table is about spending devolution and not about fiscal devolution to go with it. Now, fiscal devolution is not straightforward. It never is. We have two local taxes, of course—non-domestic rates, which, in reality, has been set at an England-wide level or an England-wide way, and council tax, which is subject to a pretty strict limitation regime because, if increases exceed a particular amount, it's now required that you have a referendum locally on that, which means that no-one will ever have a tax increase that exceeds that amount, because you've very unlikely to recover enough money to make it worth trying to hold a referendum, let alone win it. On the other hand, what has happened with local spending in England is that extra revenues for both NDR and council tax that are generated by authorities can now be retained by the authorities that generate them. This means that it becomes harder and harder to map what the distribution of public spending is across England. So, we paradoxically have both too much and too little devolution in the one package. We have a third problem as well. The third problem is the means by which these

changes are accomplished, which has the advantage of being demand-driven and the disadvantage of being ad hoc and reactive and lacking any wider structural plan. That means that it's very unclear what you have to do in order to secure a city deal or one of the sort of super packages like the so-called devo Manc package, other than reach a private bargain with the Chancellor. That's not a particularly good way of running a country.

[210] **Christine Chapman:** Okay. I wanted to move, actually, onto the city deals. These are questions I did put to the previous witnesses. The UK Government has said that it wants to negotiate an individual city deal, and obviously the one with Cardiff. Do you think there should be a greater say, or a say from the devolved parliaments, in these city deals, given that this is additional funding outside the block grant? Do you think it's about right?

[211] **Professor Trench:** I'm not sure that I've thought about that enough to have a view. There are arguments both ways, so it depends to what extent the city deal is about additional funding that relates to devolved or non-devolved matters, because of course there are significant non-devolved matters that affect local authorities, particularly, as well. I'm afraid I can't say much more than it's a difficult question.

[212] **Christine Chapman:** Okay, thank you.

[213] **Jocelyn Davies:** It did seem, from the evidence we took earlier, that the Scottish Government didn't even have a say as to which city that might be.

[214] **Professor Trench:** It is for the UK Government to make a decision about who it's going to talk to and whether it's in its interest to have these things. I mean, the UK Government will naturally, for example, have a major interest in what happens in Aberdeen, because Aberdeen is the centre of the oil industry and, quite apart from servicing north sea oil fields, it has also developed considerable expertise, of considerable importance, as a centre for oil engineering on a global scale. It's one of the places that people would look to after Houston now, for knowledge of how you get oil out, particularly of oil fields under the water.

[215] **Jocelyn Davies:** Ffred, was it on this point that you wanted to—?

[216] **Alun Ffred Jones:** Yes. The city deal for Glasgow is the most generous of all city deals in the UK. Do you think that that had any relation to the Scottish referendum?

[217] **Professor Trench:** I have no information.

[218] **Jocelyn Davies:** Do you have any suspicions? [*Laughter.*] I'm pulling your leg. Nick, shall we come to your questions? You had finished, Chris, hadn't you?

[219] **Christine Chapman:** Yes.

[220] **Nick Ramsay:** How important is it to calculate and forecast the overall fiscal position of the Welsh public sector?

[221] **Professor Trench:** I have to ask you a question before I try to answer that.

[222] **Nick Ramsay:** I feared you might.

[223] **Professor Trench:** Bearing in mind what I heard of your discussion with your previous witness, when you were talking about a balance sheet in relation to Scotland, are you talking about a balance sheet or a profit and loss?

[224] **Jocelyn Davies:** Well, the auditor general has also made the same point, I think, as

has been made in Scotland by their auditors, that this overall, sort of, balance sheet of the entire public sector would be a useful thing.

[225] **Nick Ramsay:** I was certainly talking about a balance sheet to the previous witness. They said it didn't have to be a carbon-copy balance sheet of the UK balance sheet.

[226] **Professor Trench:** There are a number of difficulties with the balance sheet, not least the valuation of all your assets. I think that that would make me hesitant about endorsing the idea of a balance sheet, because you're going to have to work out the value of all assets held by the public sector, and, frankly, it will not know some of the assets it holds. Valuing many of these assets is going to be hugely difficult, because you have things like heritage property; you have unsaleable heritage property like art works; you have highly sensitive heritage real property in the form of publicly owned lands for heritage purposes; and a very, very complex set of issues there.

[227] What you most certainly need and do not have in Wales—and Wales is the only one of the devolved Governments that doesn't do this—is a version of a profit and loss. It's been a long-standing concern of mine that there is no Welsh equivalent of the GERS survey—Government Expenditure and Revenue Scotland. There are, without question, a number of significant flaws and problems in GERS, but it is a clear and useful depiction of some really important data. Indeed, I think I touched on this toward the end of my memorandum.

[228] **Nick Ramsay:** Just on that, should we give up on the idea of this mirror of a balance sheet, such as we have across the whole of the UK? Is that so difficult to achieve that, actually, what you've just said about profit and loss would be a more sensible way?

[229] **Professor Trench:** Profit and loss, particularly if you've got a profit and loss that gives you a number of years' data—and, as with all these things, it's not worth doing them for one year; you want to have them over a period of time so you can see how things change over time—would make things much easier to understand. We have difficulties, I think, in a number of areas. The first is assessing exactly what Wales's fiscal position is—what the tax revenues attributable to Wales are. Now, even Northern Ireland, which runs a significant fiscal deficit as well, publishes a document that estimates its fiscal revenues. The GERS estimates are problematic. There's an attempt by HMRC to come up with a different, experimental series of data that is its own attempt to address a similar problem in a different way. But we could really do with an attempt to put that together for Wales on the GERS basis, not least because that's comparable to Scotland and Northern Ireland as well.

[230] **Jocelyn Davies:** So, what does that actually contain? You wouldn't be valuing all the assets owned by the—

[231] **Professor Trench:** This is revenues. This is tax revenues.

[232] **Jocelyn Davies:** And what's owed, what's borrowed—the debt.

[233] **Professor Trench:** What GERS tells us, first of all, is revenues. Second, there's an attempt to understand the nature of debt, of which hardly any, none, is Scottish Government debt at present. It's either debt assumed by local authorities in Scotland, or it's an apportioned share of UK public debt that is attributable on whatever basis you choose—whether it's GDP per capita, et cetera—to Scotland. So, it's not a balance sheet in that sense. But you can say, with a bit more confidence, for example, what the interest charges are that are attributable to Scotland—they would have to know the debt that underpins that in order to work that out—as part of your year's spending, your profit and loss chart. Equally, that's setting out then in some detail the allocation of public spending for Scotland. GERS is not as clear as it might be about the balance of that between Scottish Government and UK Government. So, it gives a

single aggregated figure for public spending across the various statistical headings that are used. You have to dig in to find where that breaks down between the different Governments that spend this. Those data are clearly collected, because they are then, ironically, published by the UK Government in the document called PESA, the public expenditure statistical analyses.

[234] **Jocelyn Davies:** So, they trust those figures.

[235] **Professor Trench:** Oh, yes.

[236] **Jocelyn Davies:** And how long have they been collected?

[237] **Professor Trench:** Well, GERS's origins go back to the late 1980s, certainly the early 1990s.

[238] **Jocelyn Davies:** And that has been developed and refined over time.

[239] **Professor Trench:** It started as probably a rather propagandistic exercise on the part of a Conservative Secretary of State, but it's a series that's continued. Its data quality have improved very considerably over time and, for as long as I've been using it, since devolution, it's been national statistics, so it satisfies the quality criteria of the Office for National Statistics. So, it's as good as we get, and it's put together, particularly on the spending side, as part of the process of supplying information to Treasury to put together the PESA data. So, these processes are closely linked. That makes life a great deal easier, as I say—having the information about what public spending is, and how that relates to overall tax figures. The Northern Ireland data, I may say, tell us a great deal about overall fiscal balance or imbalance, which is not a particularly favourable figure for Northern Ireland. They're very bad at telling us which Government spends on what. They're really quite exceptionally bad at that.

[240] **Jocelyn Davies:** How long have they been collecting that information?

[241] **Professor Trench:** Northern Ireland has been publishing for about five or six years now, so for a much less long time, but eventually they decided that this information needed to be collected and published. What we also don't have, or have very imperfectly, is any indication of the evidence of what changes are made to devolved spending in response to programme changes in relation to England. In other words, what triggers a Barnett consequential, and how much is that Barnett consequential? Now, that has been done, again, for about five or six years, I think partly after we made a fuss about this in the Lords' Barnett Formula Select Committee report. For Wales, that now appears as a schedule at the back of the Wales Office annual report, of all places, which is not a particularly good place for it. I would like to see HM Treasury—or, indeed, a potential UK finance commission—publishing a much more systematic devolution finance report that tries to make sense of these things, but this is, I think, chapters 8 and 9, or 9 and 10, of PESA, and those are very useful data, but they're scattered across a number of publications and, as I say, the bases on which they're calculated are somewhat inconsistent.

12:00

[242] **Nick Ramsay:** Okay; the same question I asked to the Scottish witnesses earlier: how should the borrowing and taxes raised by local authorities be managed within the wider Welsh borrowing and tax system?

[243] **Professor Trench:** I think, again, I would have to duck that. I think that if one understands local authorities as being constitutionally fundamentally creatures of the National Assembly and the Welsh Government, then that implies that they should be accounted for as

part of the wider Welsh public sector, and that's obviously going to have consequences for how one might understand a borrowing regime. It might also suggest that, actually, Welsh local authorities should be having their direct relationship with Welsh Government in relation to the exercise of borrowing functions, rather than—. I don't know how that works at present. So, the Public Works Loan Board or the national loans board is the mechanism by which they borrow money, rather than having any meaningful control over it.

[244] **Nick Ramsay:** Okay; thanks. You've answered the question about balance sheet versus profit and loss. How can the UK Government give devolved administrations greater certainty on their likely future funding? Can they?

[245] **Professor Trench:** This is one respect in which, actually, you would not want to move away from the Barnett formula. For all the difficulties that we were hearing about in relation to Scotland—and I'm sure Wales has had similar ones—when changes are announced in the middle of a financial year by the Chancellor that have knock-on effects for the block grant through the Barnett formula, the Barnett formula is good at delivering stability and predictability in public finances. That is one thing that it is good at. That is something that's desirable to maintain, although it's not the only thing that one would want to have or to maintain in the system.

[246] I think that, as it were, one of the things that is going to have to happen in this wave of constitutional reform and institutional reform is going to be an adjustment in the way these decisions are made at UK level. Apart from anything else, I think there's going to have to be much greater and more careful differentiation in Westminster and Whitehall about decisions that relate to England and those that relate to the UK as a whole. That, to come back to an earlier question asked by Ms Jones, is something that also bears on English votes for English laws. There's a very direct consequence. If you're going to treat England as a distinct unit, that can't simply be for a couple of stages of parliamentary process. In order for that to work effectively and properly, it's got to relate to how England functions within the devolved union more generally.

[247] The other side of that is these decisions are going to have to take longer. Again, I suspect it will be unpopular in Westminster, if not in Whitehall, to be told that the price of English votes for English laws is that, suddenly, you're not going to be able to pass an Act of Parliament in six months and that, actually, you'll have got to go through a process that is going to mean it takes much, much longer. I remember trying to explain the difficulties of the old legislative competence regime, of which I'm sure few of you need a reminder—

[248] **Nick Ramsay:** Those were the days. [*Laughter.*]

[249] **Professor Trench:** —to a Swiss civil servant. I explained how this meant that the legislative cycle moved from being nine to 12 months, which was what we were used to in the UK, to at least, on average, 24 months, and sometimes longer—at least as far as Wales was concerned. He said, 'That would be a very quick Act here'. The nature of running a very consensus-oriented system like Switzerland means that formulating and framing legislation is a very deliberative process and, actually, I suspect that's one of the necessary changes for making a devolved union work more thoroughly as well.

[250] **Nick Ramsay:** Thanks.

[251] **Jocelyn Davies:** Okay; I've got some questions that Mike was going to put to you, but he wasn't able to be with us today, and those were about what additional financial freedoms would be necessary for multi-year planning beyond end-of-year flexibility, if you've got a view on that, and if you've got any views on flexibility around reserves.

[252] **Professor Trench:** Let's take the second part first: the question on reserves. I take it the question's referring to the UK reserve rather than to maintaining it—

[253] **Jocelyn Davies:** No, for the Welsh Government to be able to manage its own resources properly—the ability to hold reserves without constraints.

[254] **Professor Trench:** It certainly needs examining. It's something that we haven't talked about very much in the last few years, which is interesting. But, of course, in the early years of devolution, the question of calling on the UK reserve for emergencies that occurred in devolved parts of the UK was a difficult and, politically, a very charged one. And there were cases of things like foot and mouth disease, which obviously triggered a call on the reserve, where there wasn't much question about it, because Wales was suffering from the disease, perhaps more acutely than other parts of the UK, but it was a UK-wide problem, while things like localised outbreaks of flooding became much more contentious and much more problematic. And the decision making regarding that, I think, is something that might need to be revisited. As I say, it's perhaps fortunate that we haven't had the sort of natural emergencies that have made that a pressing issue lately.

[255] On the question of end-year flexibility, I am forgetting what the new term that is used officially—

[256] **Jocelyn Davies:** Yes, there is a new term—

[257] **Professor Trench:**—to describe the phenomenon.

[258] **Nick Ramsay:** End-of-year flexibility?

[259] **Jocelyn Davies:** No, that's the old term, but, anyway, regardless of the term—

[260] **Professor Trench:** Yes. It's again something that is problematic, and it seems to me that this comes out of the origin of treating the devolved administrations as not merely successors to, but standing pretty much in the shoes of, the old devolved departments—the old Welsh Office and Scottish Office, and so on. That, again, is not appropriate. Once funds are allocated to Wales, it needs to be able to decide how they're going to be spent, and, if there are balances that are left over, those can't be arbitrarily removed, but, in fact, provide an element of flexibility for devolved finance Ministers, and—

[261] **Jocelyn Davies:** Without needing permission from—

[262] **Professor Trench:** Yes. I think it's worth mentioning one other thing that is sort of in that context, and it's the provision that's in the Wales Act 2014 that mirrors something that was in the Scotland Act 2012, which creates a power to create new taxes, to introduce new taxes. It strikes me that that's a very interesting and a very useful new power. The criteria that have been set out by Treasury in a Welsh context are particularly vague. Those that were set out in a Scottish context were also pretty vague, but had more words in them. I think that Treasury, again, could usefully rethink those criteria, and, indeed, more work ought to be done on that. But, equally, the idea of the introduction of new taxes, not necessarily as ways of generating significant amounts of revenue—it's very hard to see that they would—but as a way perhaps of raising some revenue at the margin, and also of shaping behaviour, is something that is worth bearing in mind. It's notable that Wales was the first part of the UK to introduce a charge for disposable bags—single-use bags. Equally, it did it as a charge, not as a tax, and at least one of the other Governments that has followed suit has done it as a tax. I happen to think that that's a particularly silly decision to make because, of course, the Welsh experience is that you're essentially not going to generate any revenue from this. The success of the tax, or the charge, is that you lose the revenue—you deter the behaviour that creates the



revenue. But that is, itself, a useful effect, and having the power to introduce new taxes, as ways of shaping behaviour, may be a very useful tool that Wales now has.

[263] **Jocelyn Davies:** Okay. Have we got any other questions?

[264] **Nick Ramsay:** It's 'budget exchange'; we got there in the end.

[265] **Jocelyn Davies:** Budget exchange; thank you. Did we Google that?

[266] **Nick Ramsay:** Yes.

[267] **Jocelyn Davies:** Right. Other search engines are available. [*Laughter.*] Thank you very much; you were very useful and entertaining as always, so we're very grateful for your time today. As usual, we'll send you a transcript and, if you could check that for accuracy, we'll be able to publish it. Thank you.

12:09

**Cynnig o dan Reol Sefydlog 17.42 i Benderfynu Gwahardd y Cyhoedd o'r  
Cyfarfod  
Motion under Standing Order 17.42 to Resolve to Exclude the Public from the  
Meeting**

*Cynnig:*

*Motion:*

*bod y pwyllgor yn penderfynu gwahardd y cyhoedd o weddill y cyfarfod, yn unol â Rheol Sefydlog 17.42(vi).*

*that the committee resolves to exclude the public from the remainder of the meeting, in accordance with Standing Order 17.42(vi).*

*Cynigiwyd y cynnig.  
Motion moved.*

[268] **Jocelyn Davies:** I'll now move the relevant motion so that we can go into private session. Everybody agreed? Lovely; thank you.

*Derbyniwyd y cynnig.  
Motion agreed.*

*Daeth rhan gyhoeddus y cyfarfod i ben am 12:09.  
The public part of the meeting ended at 12:09.*