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[The Finance Committee](#)

17/09/2015

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Cynulliad
Cenedlaethol
Cymru

National
Assembly for
Wales

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Cofnodir y trafodion yn yr iaith y llefarwyd hwy ynnddi 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) |
| Mike Hedges | Llafur Labour |
| 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

| | |
|----------------|--|
| Jeff Andrews | Cynghorydd polisi arbenigol â chyfrifoldeb am gyllid a materion Ewropeaidd Specialist policy adviser responsible for Finance and European matters |
| Sean Bradley | Uwch-gyfreithiwr, Llywodraeth Cymru Senior Lawyer, Welsh Government |
| Richard Clarke | Rheolwr prosiect gweinyddu trethi, Llywodraeth Cymru Tax Administration project manager, Welsh Government |
| Jane Hutt | Aelod Cynulliad, Llafur (Y Gweinidog Cyllid a Busnes y Llywodraeth) Assembly Member, Labour (The Minister for Finance and Government Business) |
| David Phillips | Uwch-economegydd Ymchwil, Sefydliad Astudiaethau Cyllidol Senior Research Economist, Institute for Fiscal |

Studies

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

| | |
|--|---|
| Richard Bettley | Y Gwasanaeth Ymchwil Research Service |
| Bethan Davies | Clerc Clerk |
| Leanne Hatcher | Ail Glerc Second Clerk |
| Yr Athro / Professor Gerald Holtham | Cynghorwr Technegol Technical Adviser |
| Lakshmi Narain | Cynghorwr Technegol Technical Adviser |
| Tanwen Summers | Dirprwy Glerc Deputy Clerk |
| Joanest Varney- Jackson | Uwch-gynghorydd Cyfreithiol Senior Legal Adviser |

Dechreuodd y cyfarfod am 08:46.

The meeting began at 08:46.

Cyflwyniad, Ymddiheuriadau a Dirprwyon Introductions, Apologies and Substitutions

[1] **Jocelyn Davies:** Welcome, everybody, to the meeting of the Finance Committee. I've had no apologies, and I know that Julie Morgan will be joining us shortly. Can I just remind you, if you've got any electronic devices, to check they're on 'silent'? You needn't switch them off, but 'silent' would be very helpful.

[2] All Members have received guidance on the changes to the rules now for making oral declarations at committee, and that starts, of course, this term. So, if anybody has any declarations, you can declare them. I won't be able to give you any advice on whether the interest actually needs to be declared, but in the spirit of the new rules, I would err on the side of caution, if I were you, but you can get advice from the registrar of Members' interests, if you've got any doubts. Any declarations? None.

08:47

Papurau i'w Nodi Papers to Note

[3] **Jocelyn Davies:** Okay, then, we'll proceed. We've got two papers to note. We've got a letter from the Presiding Officer and a letter from the Minister for Economy, Science and Transport. Are you happy to note those? Lovely.

Y Bil Casglu a Rheoli Trethi (Cymru): Sesiwn Dystiolaeth 1 Tax Collection and Management (Wales) Bill: Evidence Session 1

[4] **Jocelyn Davies:** We'll move to our first substantive item, then, which is the Tax Collection and Management (Wales) Bill. This is our first evidence session. I'm delighted that we have the Minister with us. Minister, would you like to introduce yourself and your officials, and then I think you'd like to make a short statement?

[5] **The Minister for Finance and Government Business (Jane Hutt):** Thank you very much, Chair. Can I introduce Richard Clarke, who is the tax administration project manager for the Welsh Government; Sean Bradley, who is a senior lawyer for the Welsh Government; and Jeff Andrews, specialist policy adviser for finance and European matters?

[6] So, yes, I would be grateful to say a few words this morning. Of course, this is a very important start in terms of the evidence taking on this Bill, because the devolution of tax powers is a further significant step forward for Wales and, together with new borrowing powers, they do provide an opportunity for us to develop funding arrangements that better suit Welsh circumstances and priorities. The Tax Collection and Management (Wales) Bill is the first, of course, of three proposed tax Bills for Wales, and they're going to, together, provide the legal framework for the collection of devolved taxes. So, in time, they need to be considered, of course, alongside each other.

[7] We've engaged widely across Wales, listening to the views, questions and concerns raised by the public, stakeholders and business, and, of course, you are aware of my tax advisory group and tax forum and tax expert group, which have contributed greatly to the process. I think our approach to devolved taxes has to be based on clear principles—and I've laid

those out: fairness, simplicity, supporting jobs and growth, stability and certainty—but, at its core, the Bill does represent our commitment to a self-confident, fair and prosperous Wales, and the Bill’s provisions are drawn from, and are broadly consistent with, UK and Scottish tax legislation. I think that’s an important point that will, I’m sure, be a theme in responding to questions.

[8] The Bill also provides for the establishment of the Welsh revenue authority. It includes generic provisions that relate to the devolved taxes. Subsequent legislation will provide tax-specific provisions. For example, this Bill places a duty on taxpayers to keep and preserve tax return records. However, the time frame for submitting a tax return will be included in the tax-specific legislation. So, the WRA will be responsible for tax collection and management, but it will be empowered to delegate functions and, therefore, will not necessarily undertake all aspects of tax administration itself. The committee has already considered who might collect and manage taxes, and I found that work to be very helpful before I announced preferred partners. I have suggested that Her Majesty’s Revenue and Customs is best placed to collect land transaction tax and that the WRA should undertake the collection of landfill disposals tax, but supported by Natural Resources Wales on compliance work, but discussions with both bodies on arrangements are ongoing.

[9] The cost of tax collection will be dependent on the nature of the taxes that are introduced and who undertakes their collection. Cost information is being continually updated and I will provide the committee with further advice, including the likely setting up and operating costs during the passage of the Bill. The Bill empowers the WRA to identify and collect the appropriate amount of devolved tax that’s due, and it makes provision for the conferral on WRA of civil and criminal investigation and enforcement powers with appropriate safeguards, but only after consultation on such powers. But, importantly, the Bill gives rights to taxpayers to review certain WRA decisions and to appeal to the first-tier tribunal against such decisions. I would say again that resolving disputes swiftly—and I know this has been reflected in your considerations already—is generally in everyone’s interests, and the WRA will be encouraged to use whatever approaches it considers appropriate, including the possible use of alternative dispute resolutions.

[10] So, I do believe, finally, that the Bill does provide the powers necessary to establish solid foundations for a Welsh tax regime. Powers will enable the WRA to collect and manage devolved taxes both efficiently and effectively,

and establish appropriate arrangements for the WRA's work to be scrutinised by the Assembly and others, and I hope that, by bringing forward the Bill now, it should provide sufficient time after its Assembly passage to implement tax arrangements, starting with the setting up of the WRA. I look forward, obviously, to the evidence and scrutiny session today.

[11] **Jocelyn Davies:** Thank you, Minister. I was going to ask you to summarise the purpose of the Bill, but I think you've just clearly set that out for us. So, how will you ensure that those affected by these changes will know about the changes?

[12] **Jane Hutt:** This is critical in terms of the work that we've done already to reach out and to engage people, not those who are interested in taxes, because, clearly, there are many of those in terms of tax experts, but the tax advisory group that I've set up has been a very broad base, representing views from the third sector, business, local government, as well as those tax experts, who have obviously had a clear role to play in advising us. But I think what's interesting is that those organisations like the Wales Council for Voluntary Action, the Bevan Foundation and the Confederation of British Industry then report to a much wider group of stakeholders. So, we know that the Bevan Foundation has got some funding to do work on these issues in terms of social impacts. So, actually getting the message over, as you say, is very important for those who are going to be affected by it.

[13] We've used social media to communicate key tax developments; we've published leaflets; we've got fact sheets. I think consultation's been good in terms of the ways in which people have responded, particularly when, again, they see that it's going to affect them. But we also will depend on those who have an interest in tax, or who are advising people on tax, to steer people in the right direction, to signpost to our new devolved taxes, because people have got to be ready to move from the old to the new arrangements. So, I hope that this is just the start of the communication, even though we've been engaging for many months. And I think we've also obviously got a shared interest in this evidence gathering, and the scrutiny you're embarking on will also help get the message over.

[14] **Jocelyn Davies:** Are you able to evaluate how well your messages are penetrating? Are you going to be able to do that? I mean, obviously, this isn't going to be happening, you know, next week. It's going to be some time before it takes effect, but do you plan to carry out evaluation so that you can see whether people do actually know?

[15] **Jane Hutt:** I mean, that's very important. At this point in time, we can look at the response to the consultation that we've undertaken. I think we've had over something like 360 responses to those tax-specific consultations about landfill disposals tax and land transaction tax, but also we can measure—again, measuring our web activity—. We're also looking at possibly evaluating in terms of looking at the surveys that we do about public awareness and public opinion on public services across Wales. I think that the tax exhibition that we held—and some of you may have seen it when we had it here at one point—looking at the history of Welsh taxes has actually sparked interest. But I think that we are looking at ways in which we can improve public awareness as a result of evaluation.

[16] **Jocelyn Davies:** Okay. Thank you. So, what assessment has been made of whether the Bill creates any additional compliance burdens on taxpayers?

[17] **Jane Hutt:** Well, the Bill doesn't itself create significant additional compliance for taxpayers. What's very important—and I think I made this point, I hope, clearly in my introductory remarks—is that it does retain consistency with HMRC and Revenue Scotland as far as possible on the key elements of the tax collection and management process. Obviously, there are going to be other operational compliance decisions for the WRA to make. For example, we will look at issues like how strictly to enforce late filing penalties. The approach has been about how we can be consistent. That's going to be very important for cross-border businesses as well. It is an important message that's been coming forward from people who we are consulting with that they want that consistency, and I believe that the way we've addressed it means that there won't be that additional compliance requirement.

[18] **Jocelyn Davies:** So, can we take it from that, then, that, obviously, this would have been an opportunity for new approaches that you wanted, but you felt that it was more important for things to change as little as possible?

[19] **Jane Hutt:** Well, I think it has been about looking at comparability in terms of powers with HMRC and learning from Revenue Scotland so that we can have a very consistent and comprehensive approach to tax collection and management, but also we are actually taking the opportunity to improve to clarify some of the provisions, for example, following on from the Scottish arrangements and Revenue Scotland. So, we've looked at ways we could improve the legislation. Also, we've got to look at it in terms of Welsh

priorities, in terms of what we want to achieve and the purpose of the Bill. Sometimes, improvements can be done through administrative decisions. For example, we're looking at issues around online filing and payment, for example, for landfill disposals tax. That's manual at the moment with HMRC, but we can be ahead in terms of some of those new developments, again, I think, responding to what our tax advisers say—'Well, you know, you could do better than HMRC or Revenue Scotland'—and we can move forward.

[20] **Jocelyn Davies:** And you found that, on the Scottish experience, they've been very open with you and honest with you about any ways that you could make improvements on the experience that they've had.

[21] **Jane Hutt:** It's been extremely helpful, right from the outset, at ministerial level, gaining as much advice and guidance and feedback from my counterpart, the Minister for finance, John Swinney. But also, I think our joint visit last December to Scotland and meeting members of the committee and their officials as well has been very helpful. I would say, actually, that officials, I think, at Revenue Scotland and the Welsh Government are pretty much in constant contact.

[22] **Mr Clarke:** Yes, they've been extremely helpful, actually—both HMRC and Revenue Scotland—in helping us, you know, to sort of explain, first of all, where their legislation is, how that works and, obviously, then, the operational requirements that are coming in behind it. Obviously, they're very mindful of those when the legislation is in place, so it's been extremely beneficial and we hope to maintain those strong relationships that have been forged.

09:00

[23] **Jocelyn Davies:** Lovely, thank you. Ann, shall we come to your questions?

[24] **Ann Jones:** Thanks. I was just wondering whether you'd considered whether there could have been any alternatives to new legislation to introduce this devolved tax system.

[25] **Jane Hutt:** Well, basically, the question—. There is no real alternative to legislation. If we want to raise devolved taxes in Wales, we need to legislate for it.

[26] **Nick Ramsay:** Nice try, Ann. [*Laughter.*]

[27] **Ann Jones:** Well, there we go.

[28] **Jane Hutt:** The irony is, if we didn't, we'd lose out on our money straight away.

[29] **Ann Jones:** That's fine; that's on the record.

[30] The next one, then, is: are you sure that this Bill is within the competence of the National Assembly?

[31] **Jane Hutt:** Yes. The purpose of the Bill is to provide for collection and management and there's no question about that. The Wales Act conferred new competence on the Assembly, adding devolved taxes as a new subject into Schedule 7 of the Government of Wales Act 2006, and there are no provisions of the Bill that require the consent of the UK Government. Also, the UK Government has considered the Bill and hasn't raised any concerns about competence.

[32] **Ann Jones:** Okay.

[33] **Jocelyn Davies:** Sorry, Ann. You don't expect anybody who doesn't comply with this to make a challenge that perhaps you never had the competence in the beginning. We're not so concerned about the UK Government, but it's the taxpayers who might—. This kind of thing does generate some legal cases, on occasions.

[34] **Jane Hutt:** Yes. I think that's also why it's been so important to—. I don't anticipate that. That's why it's been so important that we have had a very inclusive tax advisory group, bringing people forward who can alert us at the very outset. Again, I think that's been demonstrated. I've met with groups of lawyers, let alone tax accountants and businesses, and that, I think, has been very important work.

[35] **Jocelyn Davies:** And this question has never been raised.

[36] **Jane Hutt:** It's never been raised.

[37] **Jocelyn Davies:** Right, okay.

[38] **Jane Hutt:** I think, actually, I would say it's an assumption that this is going to happen: 'You've got the powers, get on with it', basically.

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

[40] **Ann Jones:** You said this is the first of three Bills relating to the devolution of taxes. I wonder if you could just give the committee some brief outline of how you've ensured that the provision in this current Bill that we're looking at now will take into account anything from the later two tax-specific Bills.

[41] **Jane Hutt:** Yes, it is the first of the three anticipated Bills that we need to establish our devolved arrangements. Of course, in terms of the provisions of this Bill, it's about having a common approach to the proposed Welsh taxes. The provisions provide flexibility so that we can respond to future needs and opportunities, but it's an overarching structure. Now, the later two Bills, of course, may need to adjust and adapt this framework that's directly relevant to them, so the Bill provides, for example, that the WRA may delegate some of its functions, as you know, to different bodies. In a similar way, issues about the number of WRA members may be amended. But I think it is important that this provides that overarching structure.

[42] **Ann Jones:** Okay. So, you said it's likely to require amendments when the later two Bills—

[43] **Jane Hutt:** I think, obviously, as we develop a Welsh tax legislative programme, there will be an opportunity and they will need to be considered in terms of the provisions of this Bill, as part of that development. That would be anticipated, I think, in any circumstance when you're starting on the overarching Bill.

[44] **Ann Jones:** Okay. And, just finally from me, what evidence led you to introduce the Tax Collection and Management (Wales) Bill before rather than after the introduction of the tax-specific Bills? I believe that happened in Scotland and you said that Scotland have been very helpful.

[45] **Jane Hutt:** Yes. I think this was—. It is partly to—. The importance of this is to ensure that we have got that overarching framework for introducing the tax-specific Bills, and we want to make sure that we've established the Welsh revenue authority and that it is competent and capable of collecting and managing the devolved Welsh taxes that are coming forward. But, I

think, of course, it does mean that we have to look at the fact that the new, specific taxes that we're going to bring forward—we need to also recognise that they're going to have a bearing in the future. Those Bills for those taxes will, of course, come in the next Assembly. But it is important that we've consulted already on those tax-specific Bills and, in fact, I issued my written statements on Tuesday about the consultation.

[46] Scotland said to us, I think, in some of the conversations, 'Oh, we wish we'd been able to do this first—get the tax collection and management and then go into specifics.' There are pros and cons to this. I think we've tried to do as much alongside this in terms of identifying issues, haven't we?

[47] **Mr Clarke:** We have, and I think the key point here, of course, is having sufficient time then to set up the arrangements. What this first piece of legislation will enable us to do is to make sure we've got the Welsh revenue authority fully up and functioning by the time then that the taxes are developed. There's a clear advantage in doing that early on.

[48] **Ann Jones:** Thanks, Chair.

[49] **Jocelyn Davies:** Okay. Thank you. Chris.

[50] **Christine Chapman:** Thanks. In the White Paper, it talks about the need for a general anti-abuse rule; this hasn't been dealt with in the Bill. I just wonder, Minister, how you think that this would be legislated for. How do you plan that this would be legislated for?

[51] **Jane Hutt:** I mentioned the written statements that I published on Tuesday, following a consultation on the Welsh land transaction tax and landfill disposals tax. In those statements, I did confirm my commitment to the development of a Welsh tax avoidance rule, following on from the White Paper. It is important that I make it very clear again that tackling the avoidance of devolved taxes is a top priority. I intend to have robust anti-avoidance arrangements and that they should be established. I think, as a result of the consultations that we've undertaken, it's very clear that that is also understood from the feedback.

[52] **Christine Chapman:** Thank you. Now, obviously, you've talked previously about the four key principles that will underpin the new Welsh tax system. Do you think that any of these principles should be fairly clear—you know, should they be reflected in the Bill?

[53] **Jane Hutt:** Well, I think that the Bill does enshrine the Welsh Government's key principles and, you know, I've already mentioned, I think it's—. In fact, those principles have really shaped the content of the Bill and I think that that is very clear in terms of the ways in which I've developed the Bill, as a result of consultation, of course, and feedback, but also those key principles. They're embedded, I believe, in the Bill.

[54] **Jocelyn Davies:** Before you move on, Chris, was it on this point you wanted to come—?

[55] **Mike Hedges:** It was on the general anti-abuse rule—

[56] **Jocelyn Davies:** Okay, we'll take that now then.

[57] **Mike Hedges:** —I wanted to raise—. What are you doing to co-ordinate especially with England and especially relating to the landfill tax? I mean, as you know, the border is porous and also there's quite a lot of landfills either side. If either gets it wrong and it becomes easy to avoid in one or the other, then you're going to have an awful lot of through traffic.

[58] **Jane Hutt:** Right, well, I think I might ask Sean to answer that from a legal perspective in terms of the ways in which we'd approach this. From a policy perspective, as you know, Mike, we're suggesting Natural Resources Wales should be the key body to deal with compliance, which is what we're talking—you know, to prevent this happening. Already, that's what they're doing, and they're doing it with across-the-border issues with the Environment Agency as well. So, in terms of the legal issues that you raised, I don't know if there's anything else to add, really.

[59] **Mr Bradley:** I suppose, just to say that this is something that's still being considered carefully; we've had the consultation responses. Obviously, there's a lot of work going on on the specific Bills for land transaction tax and landfill disposals tax, and this is a key issue that we're looking at. There is a difference of approach between Scotland and the current UK landfill, and the UK general anti-abuse rule doesn't apply, at the moment, to landfill. So, it's something that we need to think about carefully, because of consistency, the border, and so on. So, it's very much something that we're alive to.

[60] **Mike Hedges:** I won't push it much further, but I don't think anybody living up in Connah's Quay is going to take their landfill up to Scotland. They

may well take it into Cheshire. If England gets it wrong, or we get it wrong, then it's going to have an effect on an awful lot of movement with regard to the environment, and an awful lot of tax being not paid. So, can I just flag up I think it's really important that this is co-ordinated with England, much more than Scotland? Because I don't think anybody's going to drive to Scotland to avoid landfill tax.

[61] **Jane Hutt:** It does go back to those key principles about comparability and consistency, particularly relating to cross-border. Talking to businesses, in north-east Wales particularly—and obviously that's where you're most likely to have that cross-border issue—we've taken that very much into account.

[62] **Jocelyn Davies:** Chris, shall we come back to your questions?

[63] **Christine Chapman:** Just finally, Minister, I just wondered: have you got a view on whether it should be a legal requirement for any new taxes to recover the costs they incur in collection?

[64] **Jane Hutt:** Well, my understanding is a legal requirement isn't necessary. Of course, based on previous years, I've mentioned the fact that, in terms of the sums of money that we would be seeking to raise, it would be anticipated that it's about £200 million, and the cost of collection's likely to be in the region of £4 million to £5 million. That's using Revenue Scotland as a benchmark, but it isn't necessary to have a legal requirement.

[65] **Jocelyn Davies:** Nick, shall we come to your questions?

[66] **Nick Ramsay:** Thanks, Chair. Morning, Minister.

[67] **Jane Hutt:** Morning.

[68] **Nick Ramsay:** Please can you explain how the Bill allows the Welsh revenue authority to delegate functions to other bodies while retaining accountability for tax collection?

[69] **Jane Hutt:** Section 13 is what we need to look at for the answer to this question. In that section, the Bill provides that the

[70] 'WRA may delegate any of its functions to any person prescribed by regulations made by the Welsh Ministers'

[71] but that delegation won't affect WRA's ability to exercise the function or its responsibility for the exercise of the function. I think the key point about this, and I'm sure the key point to your question, is that the WRA retains legal responsibility for the exercise of its functions, and the discretion over whether to delegate, for how long, and to what extent. So, it's crucial that it's the WRA who hold that legal responsibility.

[72] **Nick Ramsay:** Thanks. Is there a risk that the delegated tax collection body might not perform?

[73] **Jane Hutt:** This is where we have to look very carefully at ensuring that, in terms of that delegation, the WRA again is being responsible—that it is responsible for effective and efficient execution of its legal functions, and also that it can direct the delegation in terms of how it expects those functions to be exercised. Also, it would be expected to publish information about these delegations, and that means that that will come through, I think, in terms of scrutiny, and the Assembly has a role in this in terms of delivery of those delegations. There would be a lot of information that would have to be provided in terms of that, about the agreement in terms of delegations, length of delegation, criteria for monitoring, and conditions under which delegation could be revoked. Those key issues would also have to be very clear and transparent.

[74] **Nick Ramsay:** What's the thinking behind section 12? Section 12 allows the Welsh revenue authority to delegate any of its functions to staff. In the interests of good governance, would it be better for certain key functions to be reserved for approval by the WRA itself—things like approval of accounts?

[75] **Jane Hutt:** Well it is a matter for the WRA, as I've said, as to which functions they would delegate. Again, if the accounts or publication of a tax statement are delegated, WRA has to retain and will still retain overall responsibility for them. This is very consistent, again, going back to lessons learnt and sharing, with the provisions that underpin Revenue Scotland and HMRC.

09:15

[76] **Nick Ramsay:** It just seems that the delegation, as allowed for by the Bill—. It's got the words in brackets '(to any extent)'; it does seem that you're giving the new authority almost a blank cheque to do what it wants in terms

of delegating internally. That might be the right thing to do, and I'm sure it is happening with Revenue Scotland, but it just does seem to be quite a wide remit.

[77] **Jane Hutt:** Well, of course, I have listed ways in which they have got to account for this delegation, which would be very clear. Obviously, that has to be open for public accountability. You've mentioned the issue about delivery and poor performance, and there would have to be very robust performance management in terms of the delegations and arrangements with those bodies. I can see that these will be issues that will be under scrutiny and questioned, of course, by the Assembly and other elected members across elected bodies to make sure that if there are any issues about performance, they come forward. I think one of the issues that—

[78] **Jocelyn Davies:** But, Minister, why does the legislation need to say '(to any extent)'? If '(to any extent)' wasn't there—. Is this because of some case that's happened in the past? Mr Bradley, are you able to help us? Has there been a challenge of, 'Yes, you've got the power to delegate'? Why do you need to put '(to any extent)' in?

[79] **Mr Bradley:** I think it's just a matter of clarity in the drafting, putting it beyond doubt that there aren't any restrictions on any of the things that WRA cannot delegate internally. So, I think it's just a drafting technique. We can look at that.

[80] **Jocelyn Davies:** It's a certain style, is it?

[81] **Mr Bradley:** Yes; style.

[82] **Jocelyn Davies:** We don't like to see things in brackets normally, in legislation, because it sounds like a little bit of an afterthought. [*Laughter.*] Mr Clarke, did you have—.

[83] **Mr Clarke:** The only point I was going to add is this is very much to enable the WRA to do the day-to-day business and to give them the flexibility from day to day. I suppose, with all organisations, like the Welsh Government, there are delegations, but it doesn't change who is ultimately responsible for undertaking those sorts of functions and delivering against them. So, that doesn't change. I suppose, as to how that might be carved up, I don't think anyone would anticipate that such key documents, perhaps like a corporate plan or annual report, wouldn't still be signed off at the

appropriate level. So, it's just an internal arrangement by which they can have the flexibility to do the day-to-day business.

[84] **Jane Hutt:** But I think the issue is that we're not suggesting—. In terms of other equivalent legislation in terms of Revenue Scotland and provisions for HMRC, this is reflecting what we have learnt.

[85] **Mr Bradley:** Yes; I don't think there's anything particularly unusual in what we're doing here, it's just allowing that flexibility to WRA to run itself as it sees fit. Ultimately, it'll be the chief executive of WRA and the board who will be accountable for how it operates and how it's functioning.

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

[87] **Nick Ramsay:** Thanks. Minister, I think you've suggested that HMRC are likely to be the preferred provider to collect devolved taxes. What's your reasoning behind this? Is it a cost issue? Obviously, they've been doing this up to now. When will you make a final decision as to who will collect the taxes?

[88] **Jane Hutt:** Well, yes, as you know, I mentioned this in my introductory remarks. I have indicated that we think HMRC would be likely to be the preferred provider. We've got a very constructive relationship with HMRC. I think they've come before this committee and given evidence. They sit on our tax experts group, and they've been very helpful and proactive in providing us with information. They are our preferred partner for the transactional and routine compliance functions in terms of land transaction tax—it is their extensive knowledge and experience of operating UK taxes, which would aid the development of our Welsh tax arrangements. And, actually, also, of course, in terms of the consultation feedback, the approach of this proposal has been welcomed by the land transaction tax key partners.

[89] Just in terms of timelining, we're consulting and discussing with HMRC about their capability. We want to be very clear that they can take this on and be thoroughly engaged with us, and that they've got the capacity and they're going to be flexible in responding to the needs of Wales. So, that's ongoing. And in terms of the detail, I want to confirm this as soon as I can. Of course, it would be for the next Welsh Government to confirm whether HMRC is the final choice of partner to deliver functions, so that would not be until next year—a decision to be made within 2016. You know, in terms of progress on this, I'd want to report back as soon as possible.

[90] **Nick Ramsay:** Should HMRC be asked to provide regular performance reports to help understand whether their standard approach is suitable for the Welsh context?

[91] **Jane Hutt:** Well, this goes back to the earlier question about the responsibility that the Welsh revenue authority then has for delegations. The WRA will, of course, be required to annually prepare and publish an annual report and lay that copy before the National Assembly, as well as regular reports to the WRA from HMRC regarding performance management. We'd expect that the annual report would include information about performance from HMRC and NRW partners on the collection and management of Welsh taxes. Of course, that then does mean the Assembly has the opportunity to scrutinise the entire operation of WRA, including the delivery by HMRC.

[92] **Nick Ramsay:** Thanks. Section 14 allows Welsh Ministers to give the Welsh revenue authority directions of a general nature. Can you tell us what those directions are likely to include?

[93] **Jane Hutt:** Well, if we look at, perhaps, examples of what that power could include in terms of, for example, setting out an annual remit for WRA to specify tax policy priorities—I mean, that's, you know, the way in which we would envisage the power being used. But there may be exceptional circumstances, of course, where the Welsh Government might want to direct the WRA where they think that an intervention might be necessary to improve efficient and effective collection and management of taxes. But, importantly, as you see from section 14, the Bill requires Welsh Ministers to publish any direction that they've given unless they think it could prejudice the effective exercise of WRA functions. But I think the fact is clear that that has to be transparent on the face of the Bill, but Welsh Ministers aren't going to be involved in any of the direct arrangements in terms of taxpayers' affairs or operational decisions.

[94] **Nick Ramsay:** The Scottish legislation contains similar provisions to this, but it does guarantee Revenue Scotland's operational independence. That doesn't seem to be in this Bill. Is that deliberate?

[95] **Jane Hutt:** We're looking carefully at how Revenue Scotland's going to deliver this. It is too early to evaluate their legislative provisions that's underpinning Revenue Scotland. We've looked at this very carefully in terms of the approach they've taken in Scotland, and we've concluded—and this is

about, again, your earlier question about, you know, whether we can actually improve on Scottish legislation—that Welsh Ministers need to have sufficient powers to further tax policy in Wales to ensure that Welsh tax arrangements are efficient and effective. And we do feel that the direction-making power is both necessary and proportionate. If you look at the tax collection and management Bill, it does mirror UK Government in relation to HMRC, but I think one of the differences is that, actually, any directions that are made by Treasury to HMRC don't have to be published. We're making it very clear that any direction would have to be published. So, I think it is important also to look again at the Scottish arrangements. The Scottish Bill, the Scottish legislation, requires Revenue Scotland to have regard to any guidance given by the Scottish Ministers. So, that's the way they're managing it. But in terms of—

[96] **Nick Ramsay:** I know it's not your responsibility—Scottish affairs—but do I get the impression that you think there are areas where the Scottish legislation could have flaws and you don't want to see those same mistakes happen here?

[97] **Jane Hutt:** I think, as I said, it's a bit early to evaluate the direction that Scotland has taken as far as this is concerned, but lawyers and experts have told us that we could improve on it. I don't know if either Sean or Richard want to say anything because they've been heavily involved in this.

[98] **Jocelyn Davies:** Giving a direction and having regard to guidance—you're in two very different places, aren't you? I think the point that Nick is making is that in Scotland the authority is guaranteed operational independence. Nobody could question it, but here you could issue directions.

[99] **Mr Clarke:** Can I just make a few points? Yes, this is a consistent power to what HMRC actually has. So, there's no departure from that. Yes, there is a difference to the Scottish approach. We don't know yet how that will pan out. But I think the starting point of the question was around the operational independence, and where we have a consistency is that we're looking to adopt a non-ministerial department, which is the standard model used by HMRC and Revenue Scotland. And that, in itself, draws a line that Ministers are not involved in day-to-day operations; they don't have access to taxpayers' affairs, which is the important part of it. It was recognised when we did research at an international level that that's not where Ministers are involved.

[100] Where we have improved on the HMRC's standard power, or we think we have, is on that need to actually publish where the direction has been made. There is a caveat there, in the case of where it has an impact on the operational aspects of the WRA, but it goes further. So, we found a midway between the two arrangements that exist currently.

[101] **Nick Ramsay:** So, if I send my annual tax return to the Minister, it'll be returned unopened—*[Laughter.]*—with a post-it note. *[Laughter.]*

[102] **Jocelyn Davies:** Tell me something, then, in terms of the directions that are issued by—. Is it the Treasury that would issue those directions? Does it ever do it? You said it's not published, but are you aware of—? Is this something that we can expect frequently to see, or very rarely, or exceptionally, or—?

[103] **Mr Clarke:** There's an annual remit letter that the Treasury issues to HMRC and that is published, so that's—

[104] **Jocelyn Davies:** But that's not a direction, then, is it?

[105] **Mr Clarke:** No, it's not a direction and we have looked at what the occasions are that the Treasury—. And we've tried to explore that and we're not aware of any. These are exceptional circumstances, and we anticipate the necessity. But it is a potential safeguard to ensure that there is revenue collected for the benefit of Wales. But it's exceptional to go from beyond the standard remit letter.

[106] **Jocelyn Davies:** I can see that Peter and Nick now are—

[107] **Peter Black:** Does this happen in Scotland as well?

[108] **Mr Clarke:** Obviously, Revenue Scotland started from 1 April this year.

[109] **Peter Black:** But does the annual remit letter have the same sort of set-up in Scotland, even though they have guaranteed independence? Does the same thing happen in Scotland?

[110] **Mr Clarke:** I'm not sure if they're issuing a remit letter, but they are providing guidance.

[111] **Nick Ramsay:** I think what the committee is trying to be clear on, and

forgive us for labouring this point, is the extent to which that operational independence is what it says on the tin—the extent to which it is independent. Now, from what you’ve said, you intend it to be exceptional circumstances where there would be a direction or an intervention. But I think we’re just trying to be sure that the Bill does indeed safeguard that operational independence.

09:30

[112] **Jocelyn Davies:** And it doesn’t say ‘in exceptional circumstances’ in this section, does it?

[113] **Nick Ramsay:** Chair, I think Jane wanted to come in.

[114] **Jocelyn Davies:** Sorry.

[115] **Jane Hutt:** This is very helpful because this is where there are differences in terms of the Welsh approach, so I think it’s very valuable to have this scrutiny. Sean, did you want to—

[116] **Mr Bradley:** Thank you. So, the question is about the operational independence and one of the key differences is that, in Scotland, the Revenue Scotland and Tax Powers Act 2014 says that Revenue Scotland is operationally independent and the point that’s being raised is that we don’t have similar wording in this Bill. The reason why is that it is not necessary. All of the substance of the Bill, Parts 3, 4 and 8—all of these big chunky technical parts of the Bill—are effectively the mechanics for the operational independence of WRA. So, it sets out very clearly what powers WRA has. It sets out what it can do in certain circumstances, how it makes decisions and it includes very comprehensive and extensive review and appeal rights for taxpayers.

[117] All of those decisions are decisions that would be subject to public law principles: they have to be reasonable; they have to be based on policy and have to be in accordance with the law. So, the operational independence is there. The direction-making power now is something that is intended really, as Richard has alluded to, as an exceptional measure for circumstances where something might not be going quite right. The wording in section 4 is about general directions—directions of a general nature. So, the Welsh Ministers will not have powers to issue specific direction—

[118] **Nick Ramsay:** Sorry, do you mean section 14?

[119] **Mr Bradley:** Section 14—sorry. So, the Welsh Ministers will not be able to issue directions that are case specific to individual taxpayers and so they will not be able to get involved in and interfere in individual taxpayers' affairs. So, I think that if that's your concern—

[120] **Jocelyn Davies:** That's what you mean by 'a general nature'.

[121] **Mr Bradley:** Yes. So, a remit letter has been mentioned. That could be an example, you know: 'Your priorities for this year are addressing tax avoidance' or—. So, it's that kind of thing rather than—

[122] **Jocelyn Davies:** We expect the remit letter to be something that's routine and that will be annual. That doesn't sound to be in exceptional circumstances. In this bit, 'general directions', even though it's of a general nature and I understand that, it doesn't say here, 'in exceptional circumstances'. Right, Peter.

[123] **Peter Black:** Section 14 has a specific exception in relation to directions given under sections 28 and 29, so the Minister may issue directions except under sections 28 and 29:

[124] 'may not relate to the exercise of the functions in sections 28 or 29.'

[125] Why just those two sections? For example, if you look at section 32, could the Minister give directions in relation to the exercise of functions of the accounting officer?

[126] **Jocelyn Davies:** Perhaps you could send us a note on that.

[127] **Mr Bradley:** Yes.

[128] **Jocelyn Davies:** Perhaps you'll send a note on that. Minister, I think what we're saying relates to the reading of it. To us, you're saying that it's in exceptional circumstances, but it doesn't look, from the reading of it, that it might be in exceptional circumstances. I think that's as far as we can take that. Nick, do you want to carry on?

[129] **Jane Hutt:** I think that's very helpful and we can reflect on and feedback to you on that.

[130] **Jocelyn Davies:** This is why the first session is always very useful in terms of setting the—

[131] **Jane Hutt:** Yes, absolutely.

[132] **Jocelyn Davies:** Nick, back to you.

[133] **Nick Ramsay:** Thanks, Chair. I have a couple more questions now on, firstly, the governance of the new WRA. It's going to be a mixture of non-executive and executive members. That differs from HMRC. Can you tell us why you came to that decision?

[134] **Jane Hutt:** Yes. As we've already said, and Sean and Richard have said, this is going to be a Welsh non-ministerial department. In fact, the first Welsh non-ministerial department. We have looked at both the HMRC model and the Revenue Scotland model as well. Revenue Scotland is a separate corporate body. With HMRC, there are civil service commissioners who are appointed by the Queen. We prefer to go along the corporate body mode, which is along the lines of Revenue Scotland. But, obviously, there are differences from Revenue Scotland in terms of the fact that they have got solely non-executive members. But we think that it's important that the WRA board structure does include a mix of non-executive and executive board members.

[135] **Nick Ramsay:** Thank you, Minister. There's nothing in section 5 about the length of appointment or whether retired members could be reappointed. Do you think there should be?

[136] **Jane Hutt:** This is for future Ministers to determine. It's very consistent with what the arrangements are in Revenue Scotland, but these are issues that the committee will, I'm sure, have views on, so it's helpful to get your views on these issues.

[137] **Jocelyn Davies:** Yes, but if the legislation is silent on it, a Minister in the future could decide for themselves how long people would serve for and so on.

[138] **Jane Hutt:** That is the way in which it—. And it's reflected in existing legislation—

[139] **Mr Clarke:** Yes, it is.

[140] **Jane Hutt:** But, I think it's still useful to have views from committee about whether we need to be more specific and prescribing.

[141] **Mr Clarke:** As drafted, it is for Ministers to decide the terms and conditions, but the policy consideration is that it's consistent with other non-executive appointments that the Welsh Government currently makes.

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

[143] **Nick Ramsay:** Okay, moving on to section 7; that allows the WRA to establish its own committees and sub-committees. What comparisons to HMRC and other organisations have been made in determining this ability?

[144] **Jane Hutt:** HMRC has an executive committee that acts as its board. I understand that that also has different elements—a performance committee, audit, a transformation committee. So, we've looked at their range, but, again, we've also looked at what Revenue Scotland's got. They've got an audit and risk committee, and they're going to have a staff and equalities committee. I think that that's similar to the people matters sub-committee on HMRC. Obviously, audit and risk committee and the staffing committee are key committees, and they are reflected in both HMRC and Revenue Scotland. It's important we learn from what they've set up.

[145] **Nick Ramsay:** And learn from the mistakes as well, I think you're indicating.

[146] **Jane Hutt:** Absolutely.

[147] **Nick Ramsay:** Okay, and, finally from me, section 3(1) states that one or two members of staff will be nominated to the board by the new authority. Would it not be clearer to require the two staff members to be nominated by the chief executive for approval by the board?

[148] **Jane Hutt:** I think this, again, is an area, at this stage, where we'd be very interested in your views on this, because the Bill does provide for WRA to nominate executive members and, you know, it's important that we do reflect, as you say, the importance of who's on the executive front representation and whether that would be helpful. But I think that your views would be useful on this.

[149] **Jocelyn Davies:** Well, we saw an example in the—*[Interruption.]* Sorry, Mike, I know—

[150] **Mike Hedges:** You carry on with what you're saying, because I forgot what I was going to say.

[151] **Jocelyn Davies:** We've had recent legislation, haven't we? The Wales Audit Office is an example where, I think, the members were elected by the staff. So, maybe we've got an experience there that maybe we could look at.

[152] **Mike Hedges:** Can I just carry on from what you said?

[153] **Jocelyn Davies:** Yes.

[154] **Mike Hedges:** Is there an argument for consistency with what we've done with the auditor general and the Wales Audit Office in terms of length of service and the length of time people can be there, and the election of people, so that there's some level of consistency, if only across the finance part of the public sector in Wales?

[155] **Jane Hutt:** I just think it might be helpful if we did a note to committee on the current arrangements that we've got in terms of all those appointments.

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

[157] **Peter Black:** Yes. Section 9 of the Bill—another in parenthesis thing—allows the WRA to decide its own quorum for board meetings. To ensure proper oversight of WRA activity, should there be a requirement in this section for a majority of non-executive members?

[158] **Jane Hutt:** Well, it's this section, as you are aware, that does provide for the Welsh revenue authority to regulate its own procedure, and that would include quorums in terms of any committee or sub-committee, you know, according to what they think is appropriate. So, we need to look at this in terms of, for example, committees and sub-committees that will be important to them. I think these procedures would all have to be published as a matter of good practice, and it's important that that would reflect in terms of use of quorums.

[159] **Peter Black:** I understand that, Minister. I think the role of non-executive members has to be fairly clear and quite important here. I'm just saying: would it not make sense to say that as those non-executive members form the important oversight role, any quorum should be specified to include a certain number of those, or a majority of those, to ensure that oversight carries on?

[160] **Jane Hutt:** At the moment, the Bill does make it very clear that membership of the WRA will consist of predominantly non-executive members anyway.

[161] **Peter Black:** It doesn't specify that in the quorum, does it?

[162] **Jane Hutt:** That, again, is something that we need to reflect on. Richard.

[163] **Mr Clarke:** Yes. I have two points, I suppose. First of all is that, as drafted, it sets out quite clearly that the non-executives on the board would be a higher percentage. But it doesn't reflect that in the quorum, as you quite rightly point out. And, of course, there is also a scope for regulations on the number and formation of the board, effectively the WRA board, to be amended by Ministers. So, simply—

[164] **Peter Black:** So, you could use regulation to do that, could you?

[165] **Mr Clarke:** The regulation power that's proposed here is for the Minister then to revisit the number of members. That could obviously be then the executive—

[166] **Peter Black:** The regulation doesn't give the Minister the power to specify how the quorum could be made up.

[167] **Mr Clarke:** It doesn't specifically say that, but that could be something that could be considered.

[168] **Jane Hutt:** That would be helpful for us to look at.

[169] **Peter Black:** I'm sure we'll come back to that in a later scrutiny session. Section 25 of the Bill requires the WRA to produce a charter of standards and values to summarise how it will interact with taxpayers, but neither the Bill nor the explanatory memorandum prescribe the content of

that charter. Why is that?

[170] **Jane Hutt:** In terms of the charter, which is provided, as you say, in section 25, this is crucial in terms of the culture that we want the WRA to set and it is good practice. What I intend to do is actually move towards consultation on a charter in the new year because, although it will be for the WRA in terms of their responsibility to establish a charter, I think it would be good for us to instigate discussions and consultation on the charter. It is a duty on WRA to prepare this charter, to consult on, publish, review and lay the charter before the Assembly, and also give an assessment of progress against the charter in its annual report.

[171] **Peter Black:** But you don't think—

[172] **Jocelyn Davies:** Nick, was it on this specific point or can you come in after Peter's finished?

[173] **Nick Ramsay:** Afterwards.

[174] **Jocelyn Davies:** Right. Peter.

[175] **Peter Black:** You don't think it's right that you should say, either in the Bill or in regulation, what the charter should address.

[176] **Jane Hutt:** As I said, I think we're certainly at the starting point of wanting to consult about this, but I don't think that it's appropriate for us to prescribe the content of the charter on the face of the Bill. It's clear that it has to be that a charter will be produced on how it will interact with taxpayers, but, certainly, what we need to do now is open up the public awareness and consultation on that.

[177] **Peter Black:** I'm just wondering why you feel it necessary to duplicate what's already in the Bill. The Bill clearly says the WRA must publish the charter and review it. It must also consult and it must lay it before the Assembly. So, why are you doing their work for them and then they'll do the same thing again? What happens if you get different results?

[178] **Jane Hutt:** I think we're not doing the work for them, but I think we're—. Going back to the first question, it's about how we're raising public awareness and understanding and preparing, and also having a policy input from the public, taxpayers and users into what a charter could consist of and

how important it will be. I think it will be very worthwhile for us to consult on this.

[179] **Peter Black:** I'm just throwing this in as a suggestion before I pass on to Nick: would it not make more sense to have a regulation power whereby you could specify what the charter should address and you should then consult on what that regulation should—. So, you're asking members of the public what the WRA should address in their charter and then you could put that in regulation for them to actually form the charter from that, as opposed to consulting on your own charter.

[180] **Jane Hutt:** All we are doing is paving the way in terms of what a charter could look like and, in doing that, engaging with the public fully, and stakeholders and partners, in how that charter could particularly relate to Welsh needs and circumstances. I think that's something that we should do prior to the Welsh revenue authority being set up, but, obviously, it is up to them then to take account of it. But I don't know, in terms of preparing this point—

09:45

[181] **Mr Clarke:** Yes, perhaps I could make a couple of points. The approach that's proposed, Chair, is consistent with Scotland and with HMRC, as to the charter, and not actually saying what the content will necessarily be, other than, obviously, to establish the right relationship between the revenue authority and the taxpayer. In preparing the ground in readiness, of course, in the wider policy view, I think it's probably reasonable to look at the level of engagement that goes on with the individual taxpayer and to take a broad view. It's absolutely right that it's the responsibility of the Welsh revenue authority to ultimately publish the charter, and they have the responsibility for that. But, in getting a broad view as to what that content might be and helping them to be in a state of readiness, I think it's very important that the consultation will help them to achieve that, and to make sure that—. I think the key is around timing here as well. We are talking of 1 April 2018. That's not a huge amount of time to prepare for this. So, the more things that are ready, so that the charter is there at the outset from when devolved taxes take effect, that's very important. So, the more that can be done beforehand would be very helpful.

[182] **Jane Hutt:** Just to confirm: there's consistency with what's happening with Revenue Scotland and HMRC. But also, I think it is important that the

principles that I've laid out and mentioned in my opening remarks—you know, that we do go forward, being very clear about those principles to pave the way for that charter.

[183] **Peter Black:** It does sound like the exercise is chipping away at the WRA's independence here but, you know, we will leave that for now.

[184] **Jocelyn Davies:** Nick, did you have a point on this?

[185] **Nick Ramsay:** Yes, building on from Peter's point, I appreciate it's simply paving the way, but in section 25, where it says,

[186] 'review the Charter from time to time',

[187] I think something along the lines of a regular timetable being established at some point would be better than 'time to time', which seems a bit vague to me.

[188] **Jocelyn Davies:** [*Inaudible.*] Peter, did you have any more questions on—

[189] **Peter Black:** Yes, just one more on section 27, which states that the WRA annual report must be produced as 'soon as is reasonably practicable' after the financial year end. Would it not make more sense to amend that to 'no later than 31 August' so that the annual report is submitted alongside the annual accounts?

[190] **Jane Hutt:** Well, we would of course expect the annual accounts to be submitted and audited well in advance of that date. I mean, lawyers tell me it's not necessary to have the legal provision for the annual report in the Bill, but I expect that copy of the annual report to be produced in the same time frame as the accounts.

[191] **Peter Black:** I'm just trying to avoid a situation that we have in Finance Wales, where it is very difficult to get hold of virtually anything in terms of the annual reports and annual accounts. So, I think it's important—

[192] **Jane Hutt:** It's not a non-ministerial Government department, Finance Wales.

[193] **Peter Black:** I understand that but I think—. You expect them to be

published at the same time, then.

[194] **Jane Hutt:** Yes.

[195] **Jocelyn Davies:** So, you're saying the date isn't in there because there's not a need to for it to be in there, but it could be in there if you so wished. There's no reason for it not being in there, other than you don't need it. Mr Bradley?

[196] **Mr Bradley:** I think there's a bit of a theme through some of the recent points that we've discussed. It's about striking a balance between allowing a certain degree of flexibility to WRA and proceeding in anticipation that things are going to work and that there won't be problems, and—

[197] **Jane Hutt:** And independence.

[198] **Mr Bradley:** —and independence, and over-regulating in the Bill and being too descriptive about what we want WRA to do. If we turn one way, we can be criticised for being too prescriptive and chipping away at independence. If we go another way, we can be criticised for not setting out enough detail on the face of the Bill. So, I think it's about trying to strike a balance. We think we've got a balance that should work. If experience shows that things are not working, then we'd look at it again, I expect.

[199] **Mr Clarke:** Can I make an additional point, if I might? I suppose that that date, and why it exists anyway in relation to the accounts and the statement, is because the auditor general has a very important role in looking at those particular documents. You know, there's a duty on the auditor general, looking at assurance. That doesn't apply in the case of the annual report, but the important consideration is: when are these published and when are they laid before the Assembly so that the Assembly has the opportunity for scrutiny? Clearly, there's an advantage for both the annual report and the statement, as well as the accounts, to be available at the same time. That would be the aspiration here; that is what we'd look to achieve. So, it's not necessarily 31 August. That's there, I think, very much in case the other two enable the Auditor General for Wales to have sufficient time to do their work—four months. Ultimately, though, what we're looking for is to make sure that the annual report is there and that it's available for scrutiny alongside those documents when the auditor general has completed their work.

[200] **Jocelyn Davies:** Okay. Thank you for that, Mr Clarke. Okay, Peter?

[201] **Peter Black:** Yes. Fine.

[202] **Jocelyn Davies:** Julie, shall we come to your questions?

[203] **Julie Morgan:** Mine are about the costs of establishing the WRA. I think we've already touched on some of those questions, but have you got an estimate of the costs of establishing the WRA?

[204] **Jane Hutt:** I think setting the definitive costs is crucial, but it is difficult to get those definitive costs at this stage. It's going to be very important, of course, that the Assembly will be able to scrutinise the WRA's budget and expenditure, but in terms of the ways in which we need to look at those costs, we have looked again at Revenue Scotland costings for setting up Revenue Scotland—£4 million to £5 million, and £3 million annual running costs. I think that this is the issue that we need to—. We're learning from them and also looking at HMRC costs, but it is ensuring that we've got value for money and, you know, we've got the flexibility to adapt, perhaps, to new devolved taxes, if they arise, in looking at those costings.

[205] **Julie Morgan:** Is it not possible to look at the different scale of activities between Scotland and Wales to have an estimate about, you know, what it would be in Wales?

[206] **Jane Hutt:** Yes, there is—. We have looked at the different scales of activity. I think that the set-up costs are inevitably pretty much the same in terms of—. And there are comparators in terms of IT provision—fixed costs of IT provision. Also, again, just looking at Revenue Scotland, I think there are opportunities. They've got different ways in which they're going to arrange the way that Revenue Scotland collects their taxes in terms of looking at tax evasion et cetera and compliance and avoidance. So, there are differences but some are pretty fixed, like set-up costs. However, I do expect, Chair, to bring clearer set-up cost estimates to this committee during the scrutiny stage. So, we should get much more clarity on this.

[207] **Julie Morgan:** So, will that include the sort of costs of contracting with HMRC to collect the devolved taxes?

[208] **Jane Hutt:** Yes.

[209] **Julie Morgan:** And do you know what proportion of the revenue raised by devolved taxes would be taken up by collection costs?

[210] **Jane Hutt:** Well, the collection costs—and, you know, that's the WRA carrying out its functions—will be met by Welsh Ministers. The Bill provides for this in section 22. It will be separate from the tax revenue, of course, collected by WRA. That's paid into the Welsh consolidated fund. They will be separate—these will be accounted for separately. Again, looking at the costings, as I've mentioned already, in terms of Revenue Scotland and the proportions, they're talking about £3 million annual running costs. That's a sort of benchmark for us, but I think that the important thing is that we will account for these separately and that we will be responsible for those collection costs. But, again, I hope that we'll be able to give you more clarity on these points in terms of costs in due course.

[211] **Julie Morgan:** That's fine.

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

[213] **Alun Ffred Jones:** Rwy'n meddwl efallai eich bod chi wedi ateb y cwestiwn yma, ond fe wnafei ofyn beth bynnag: ar wahân i gostau gweinyddu'r WRA, pa fathau eraill o gostau a fydd yn dod yn sgil y Bil?

Alun Ffred Jones: I think perhaps you've answered this question, but I will ask it anyway: apart from the administrative costs of the WRA, what other types of costs will arise as a result of the Bill?

[214] **Jane Hutt:** Well, I've mentioned set-up costs, running costs, and costs of audit as well, of course, are important.

[215] **Alun Ffred Jones:** Mae adran 22 yn caniatáu i Weinidogion gyllido costau gweinyddu'n uniongyrchol. A fyddai'n well cyllido'r WRA fel llinell wahanol yn y gyllideb flynyddol, fel sy'n digwydd gyda'r HMRC?

Alun Ffred Jones: Section 22 provides for Ministers to fund WRA's operational costs directly. Would it be more appropriate to fund WRA as a separate line in the annual budget, as happens with HMRC?

[216] **Jane Hutt:** Well, the WRA, of course, will be undertaking a function for the Welsh Government and, therefore, it will, as I've said, be funded through the Welsh Government budget. That means that the WRA's budget will be set by Welsh Ministers, it will be scrutinised and it will be part of the budget process. It will be scrutinised and voted on by the Assembly, as part of the

wider Welsh Government budget. So, it would be very clearly a separate line.

[217] **Alun Ffred Jones:** Iawn. A obvious question to end: clearly, if outside bodies collect taxes, will they have to show or keep those tax receipts separately from their other accounts?

[218] **Jane Hutt:** Absolutely. Clearly, yes: an essential requirement. And that will be very clearly identifiable and available for people to scrutinise and see.

[219] **Jocelyn Davies:** Okay. Mike, shall we come to yours?

[220] **Mike Hedges:** Investigation and enforcement: to what degree has the text of the relevant legislation governing HMRC's equivalent powers been transferred directly into the Bill?

[221] **Jane Hutt:** Two powers of the Bill include powers of investigation and enforcement, but Part 4 relates to civil powers of investigation and enforcement and, of course, those powers allow WRA to obtain the information they need to determine a person's liability to tax or to penalties. Part 9 is relevant to the investigation and enforcement of criminal offences.

[222] **Mike Hedges:** So, just to be clear, are all the powers currently held by HMRC being copied across?

[223] **Jane Hutt:** We've looked very carefully again at the differences and the similarities. If you look at Part 4, civil investigation and enforcement powers, there's a high degree of consistency with HMRC and Revenue Scotland. So, it's broadly the same. But I think one of the points earlier on is that we actually feel that we've been able to improve on arrangements and some of the detail about how the powers operate and more safeguards for taxpayers. There are some differences—and I don't know if you want examples—that we feel that we've improved upon.

[224] **Mike Hedges:** Would you expect HMRC to be copying anything across from us and also, if HMRC make alterations in the future, will you be looking to see if that's relevant to Wales?

[225] **Jane Hutt:** Clearly, in terms of the delegation for collection, they will

be very clear on the terms of that delegation, but this is clearly embedded in our legislation for the Welsh revenue authority. They might like to learn from the differences and the improvements that we're making in terms of the way HMRC operates, but this will be clear in terms of the enforcement, as opposed to the ways in which they operate at this point. Do you want to clarify that, Richard?

[226] **Mr Clarke:** Well, I was just going to add that, clearly, tax legislation is changing; it's constantly changing and as it changes, it will be very important for Wales in the future to take account of changes elsewhere and to reflect on those to see if they have relevance in Wales. So, yes, that will need to be kept very closely under review as we progress.

[227] **Jocelyn Davies:** You said you could give us some examples of some extra safeguards for taxpayers. Do you want to give us just a flavour of what you mean by that?

10:00

[228] **Jane Hutt:** Thank you for that. Under section 84, for example, WRA can only issue taxpayer notices requesting information with tribunal approval; HMRC and Revenue Scotland don't need tribunal authorisation to do that. Under section 101, WRA can carry out an inspection of business premises in certain circumstances, but it can only do that with the agreement of the occupier of the premises or with the approval of the tribunal. In some circumstances, Revenue Scotland and HMRC can carry out those inspections without needing the occupier's agreement and without the approval of the tribunal. Just finally, sections 92 and 106 in the Bill provide that, where the tribunal authorises the use of any powers under Part 4 to require information or inspect premises, that authorisation is valid for a maximum of three months. There's no equivalent deadline in UK or Scottish legislation.

[229] **Jocelyn Davies:** Thank you. Are all Members happy? Thank you, Minister, for that session. As normal, we'll produce a transcript; if you would check it to make sure it's accurate, then we'll be able to publish it.

10:11

**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 that the committee resolves to
gwahardd y cyhoedd o'r cyfarfod ar exclude the public from the meeting
gyfer eitem 5 yn unol â Rheol for item 5 in accordance with
Sefydlog 17.42(vi). Standing Order 17.42(vi).*

Cynigiwyd y cynnig.

Motion moved.

[230] **Jocelyn Davies:** So, I now move a motion under Standing Order 17.42 that we go into private session. Everybody content? Thank you.

Derbyniwyd y cynnig.

Motion agreed.

Daeth rhan gyhoeddus y cyfarfod i ben am 10:01.

The public part of the meeting ended at 10:01.

Ailymgynullodd y pwyllgor yn gyhoeddus am 10:46.

The committee reconvened in public at 10:46.

**Ariannu yn y Dyfodol: Sesiwn Dystiolaeth 5
Future Funding: Evidence Session 5**

[231] **Jocelyn Davies:** Okay, well welcome back, everybody, to a meeting of the Finance Committee. We're now on agenda item 6, which is our inquiry into future funding, and this is evidence session 5. We have with us for this session David Phillips. David, would you like to introduce yourself and your title for the record? Then, if it's okay with you, we'll go straight into questions.

[232] **Mr Phillips:** That's fine. My name is David Phillips. I'm a senior research economist at the Institute for Fiscal Studies, and I analyse issues around devolved government finance and local government finance, amongst

other things.

[233] **Jocelyn Davies:** Lovely, thank you. So, in general, then, do you believe that the current mechanisms for financing the UK's devolved administrations are sustainable in the long term?

[234] **Mr Phillips:** Well, I think that's a question that has a few different answers. First of all, it's worth noting that one of the key components, the Barnett formula, has lasted for a long time already. It has some benefits: it's simple; it's relatively transparent, at least in how it's meant to operate, although there are some elements about what goes into the Barnett formula that are not quite so transparent; and it has strong political support in Scotland, which is likely to be driving the constitutional agenda in the UK over the next few years. So, at least in the short term, politically, one of the main elements seems to have quite strong political support behind it, both from the UK Government and from the Scottish Government. But I think, in the longer term, maybe it's not so stable. There are problems with the system. The Barnett formula itself, you know, there's no rational basis for the Barnett formula. Over time it implies some form of convergence for the different countries, especially in Wales, where already the funding levels are, if anything, a little bit below that needs basis. I think that suggests that, in the longer term, there could be political pressure to change it, and there could be instability. This is all being added to by the ad hoc way in which the system is being amended in different part of the UK. So, different deals for Scotland, different deals for Northern Ireland, and now the huge array of different deals within England as well, with local devolution.

[235] **Jocelyn Davies:** So, the different deals, then, do they mean that—. One of the first things you said in favour of it was that it was kind of clear and people understood it, but if there are different deals, does that make that cloudier? Does that mean that it can't be understood and that it's not so clear?

[236] **Mr Phillips:** Well I think 'yes'. With the different deals being made for different parts of the UK, for different parts of England, it makes what was an imperfect but relatively straightforward system more complicated, less easy to understand and less stable, because each area will look at the deals that other parts are getting and try to cherry pick the bits that they think they will also benefit from, and it can unravel.

[237] **Jocelyn Davies:** Okay, thank you. So, I was going to say: what about

austerity, then? Because currently we're going through this period of austerity, has that highlighted any particular problems? Because I don't think you mentioned that earlier on.

[238] **Mr Phillips:** No, I didn't. I guess I'm going to make two points on this. First of all, on the way the Barnett formula works in terms of convergence, that operates when spending is growing. So, in terms of the relative funding position of the devolved Governments, if anything, that would have improved slightly in the case of Wales during the austerity period. It's still difficult to make the cuts in Wales, but if anything, those cuts have to be slightly smaller than the equivalent cuts in England.

[239] It did highlight one problem, though, and that's the way that the Barnett formula treats business rates, non-domestic rates, and the interaction of business rates and the cuts they made to local government spending in England. The way the Barnett formula works insulated Scotland and Northern Ireland from those cuts. We did some work in the IFS that suggested that Scotland received cuts of about £600 million a year less than it would have if the Barnett formula had interacted correctly. They've now devolved business rates fully to Wales, so, over the next few years, Wales will benefit from this flaw if they continue to cut the Department for Communities and Local Government budget in England.

[240] However, I'd make two points. You might think, 'Well, it's a flaw, but we're benefiting from it; great'. Two points: one, this could go into reverse. If the spending patterns change in England, if they start increasing the DCLG budget, this flaw actually starts hurting Wales, Scotland and Northern Ireland. Secondly, on benefiting from a flaw in a formula, well, if it's known to be flawed and it's known to be unfair to different parts—to England relative to Scotland, Wales and Northern Ireland—then that would undermine support for the whole system of redistribution across the UK, in England. So, I think, rather than trying to benefit from flaws, it's better to try to get a fundamental reform to the system that you think—

[241] **Jocelyn Davies:** When you say 'flaw', you don't mean the Barnett floor, you mean the Barnett flaw.

[242] **Mr Phillips:** I mean a Barnett flaw; a flaw in the formula, rather than a floor. [*Laughter.*] I know you can't record body movements, but I mean an error in the formula.

[243] **Jocelyn Davies:** Right; okay. Thank you for that. Julie, shall we come to your questions?

[244] **Julie Morgan:** Yes. You talked about the different deals that are happening for the different devolved nations and areas, and obviously the Scotland Bill is coming through and Northern Ireland is getting additional powers, in particular corporation tax. What do you think the impact on Wales will be by these powers being given to the other countries?

[245] **Mr Phillips:** I think there are two different kinds of impact. The first is the impact of the use, or potential use, of these powers. So, in particular, you mentioned Northern Ireland's power over corporation tax. In Northern Ireland, if they sort out the political difficulties there and that power is actually handed to them and they choose to use it to reduce the corporation tax rate to match the Republic, we will have two rates in the UK: 12.5 and 20. It'll be 20 in Wales and 12.5 in Northern Ireland and that will give them a significant competitive advantage. I must say, I've never bought the argument that Northern Ireland's a special case on this, that just because it shares a land border with Ireland it's in a particularly difficult situation: business competition is international now. So, I think there could be impacts there. There could be impacts at the top of the income distribution if Scotland decided to cut the top rate of tax, for instance for those earning over £150,000; that could have an impact on Wales if it caused people to move between different parts of the UK.

[246] But, the other type of impact, I think, is not so much the powers that have been devolved, but the precedents that are being set in the negotiations, particularly in Scotland, with how the fiscal framework will work. So, the issues around the borrowing powers that'll be granted and the issues about how the block grant will be adjusted when these tax powers are being devolved. All of these different decisions that are being made on the fiscal framework will have big impacts on the kind of incentives, the risks and the equalisation that takes place under tax devolution, and I think there could be precedents set. If a certain deal is done for Scotland, the UK Government could say, 'Well, Wales should have the same deal', but Wales hasn't been in a position to negotiate over what it thinks the fiscal framework should look like. So, I think there's a risk that a precedent is set in Scotland or in Northern Ireland, and that Wales has to adopt that without being involved in the negotiations that define these things.

[247] **Julie Morgan:** Right. So, do you actually think that there should be a

uniform form of devolution?

[248] **Mr Phillips:** I don't necessarily think there should be a uniform form of devolution with exactly the same powers devolved to the different countries, but I would say that it would seem to make sense, rather than doing these ad hoc bilateral deals, to kind of sit down together and think, 'What should the system look like? What types of risks should be shared across the UK? What should be borne by the devolved Assemblies?'—and that could differ in different circumstances—'What kind of incentives should they face?' and 'What kind of form of funding should it be—should it be on a needs basis, should it be on a resource basis or should it be just on a population basis?' I think that, whilst the deals might differ, the fact that, you know, they've been done in ad hoc ways and Scotland to an extent is driving it means that Wales could be disadvantaged if the system that's designed doesn't reflect, kind of, what's good for the—

[249] **Julie Morgan:** How could that be done in the stage we're at at the moment?

[250] **Mr Phillips:** I don't know. I'm not a—

[251] **Julie Morgan:** Maybe we need a sort of constitutional convention looking at fiscal—

[252] **Mr Phillips:** I'm aware that's kind of the proposal from the First Minister here in Wales. I have a great deal of sympathy for that. I know others say that it would become a talking shop and that it would be seen as a betrayal of Scotland and it would cause political problems. I'm not a politician; I'm not sure what the right answer is here. But, as an economist looking at this, I worry that the kind of ad hoc deals that are being done could just make the system unwieldy and complicated. As we'll come on to later perhaps, the system that's been designed for Scotland—potentially, elements of it are unworkable, and I think that, actually, having a sit down and a more rational think from first principles about how this should work would be a good thing.

[253] **Jocelyn Davies:** Hang on, Julie, before you go on; Mike, did you have a question on this particular point?

[254] **Mike Hedges:** On corporation tax, if that's okay.

[255] **Jocelyn Davies:** All right, okay, we'll let Julie finish and then we'll come back to you.

[256] **Julie Morgan:** I'm just interested in which bits you think are unworkable.

[257] **Mr Phillips:** Okay, so the Smith commission set out a range of principles that it thought the new fiscal framework for Scotland should satisfy—that the Barnett formula should be kept, that the UK Government should bear the risks that affect the whole of the UK, that Scotland should have the full cost or benefit of its own policy decisions, and then there are the so-called no-detriment principles, whereby there should be no detriment just from the act of devolving the power. So, you could devolve a power and neither party should win or lose from that. Then, subsequently, when these powers are being used, any effect that the UK Government takes, if there are any knock-on effects for Scotland, there should be compensation and vice versa. I think that aspect is unworkable because there are always going to be knock-on effects. Trying to work out what those are and agree on what those are will lead to conflict and debate. Some work I'm doing with some colleagues in Stirling university suggests that you can't satisfy all of these principles with a single system. You know, you can satisfy some but not others. I think that's because, again, the process in which these principles were decided was not taking a step back and saying, 'What risks and what incentives and what rewards should be devolved?' It was very much, 'Let's do this quickly; let's look at the status quo and reform from that', rather than actually taking a more first-principles-based approach to it. So, I think there are lots of potential problems.

[258] **Julie Morgan:** Thank you. And then my final question really was to ask what you think would be the implications of the move to an English rate of income tax and English votes for English laws.

[259] **Mr Phillips:** Do you mean if income tax is devolved to Wales as well as to Scotland?

[260] **Julie Morgan:** Yes.

[261] **Mr Phillips:** It's interesting. As I understand it, the proposal for English votes for English laws is almost like English veto for English laws. It couldn't be the case that the English MPs could force through a change to English tax rates, but they could veto a change to the income tax rates in England. So, I

think some of the most dire warnings of the fact that, you know, England could force through a cut to income tax in England, cut public spending and that it would have knock-on effects via the Barnett formula to Wales—. I'm not sure that is true, because Wales can always say, you know, the vote at the end is always a whole of the United Kingdom vote and Wales can always intervene at that stage. But it still, clearly, does have implications.

11:00

[262] Because English taxes do have knock-on effects for the rest of the UK, you might say that it's not fair for England to be able to veto that, in a way that Wales can't veto that. So, it's not quite as dire as some make out, but there are still definitely issues there.

[263] **Jocelyn Davies:** Thank you. Mike, what was the point that you wanted to make?

[264] **Mike Hedges:** A point on corporation tax. For many multinationals, corporation tax is virtually an optional tax, with their ability to move money away et cetera. You talk about Ireland doing it, but the double Irish has been removed hasn't it, so some of the advantages Ireland had have disappeared. Wouldn't Northern Ireland be picked up by the Azores judgment that, if they did cut corporation tax, the UK Government could not make up their shortfall?

[265] **Mr Phillips:** Indeed, yes. So, if Northern Ireland was to cut corporation tax, they would have to bear the revenue costs of that on their own budget. But I guess the issue is that, as a country with a relatively small amount of corporate tax base at the moment, they'd only lose a relatively small amount of money. And then, if lots of money shifted into Northern Ireland to take advantage of the lower tax rates, through profit shifting, transfer pricing, that could actually more than outweigh. In the same way as Ireland thinks it gains from having a low corporation tax rate, it could be the case that Northern Ireland gains as well. So, there could still be an incentive for them to cut rates.

[266] **Mike Hedges:** But the major Irish benefit of the double Irish has now stopped, hasn't it?

[267] **Mr Phillips:** I think that in some—. There are still certain tax advantages to being in Ireland. Some of the main ones about how they can

get—. Sorry, I know some American companies could avoid being taxed at all, and that may have ended; I'm not sure about that—

[268] **Mike Hedges:** Yes, it has.

[269] **Mr Phillips:** But, still, the lower rate in Ireland still proves attractive to many companies.

[270] **Mike Hedges:** But why is it more attractive than using the British Virgin Islands or the Cayman Islands to hold your money, where you—

[271] **Alun Ffred Jones:** Because it's nearer.

[272] **Mike Hedges:** No, but you could just have an office with a sign there.

[273] **Jocelyn Davies:** Shall we ask a question to the witness rather than have a conversation around the table? I should have warned you about Mike before I called him in. [*Laughter.*] Do you have a question?

[274] **Mike Hedges:** I thought I had asked one actually. Why would they use Northern Ireland's reduced corporation tax as compared to using the Cayman Islands, British Virgin Islands, or other places with zero taxation, or even Jersey and Guernsey?

[275] **Mr Phillips:** It's because there are rules around transfer pricing, which are the prices that are charged between companies within the same group. And if HMRC thinks that those are being abused, it can say, 'We think this is being abused and we'll not allow you to shift your profits overseas.' Now, being in Northern Ireland, rather than just having a plaque on the door, they might have some operations there, some call centres or some back-office staff, so it's easier to actually—. It will be harder for HMRC to say, 'No, these profits aren't here; it's just a brass plate on the door.' So, it will be easier for them to shift profits to somewhere where they actually have more operations, and it's the same legal jurisdiction; they're still in Europe. It's just easier for them to do this being closer and having a similar legal system et cetera.

[276] **Jocelyn Davies:** Peter, shall we come to your question?

[277] **Peter Black:** Yes, sure. It looks like we're stuck with the Barnett formula for some time to come. How can the current weaknesses in block

grant funding between different parts of the UK be addressed, given that we are stuck with that formula for at least the medium term?

[278] **Mr Phillips:** I think that there are a number of weaknesses, some of which are kind of independent of the Barnett formula and some of which are part of the Barnett formula. The weaknesses that are developing in the system going forwards are this ad hoc approach to making deals with particular areas; an asymmetric system whereby the allocations are driven by spending decisions in England and what happens for England, without thinking about the system as a whole; and, again, this developing potential for conflict between the different Governments around things like the no-detriment principles and around things like inclusion of what spending gets included in the Barnett formula.

[279] I think that there are two things that can be done there. First of all, if possible, we should have this more inclusive approach to setting out what we think the system should look like, what risks, what incentives should be devolved, involving all the countries in there to decide that, rather than doing bilateral deals. And, secondly, I think actually just publishing more information about how it works, so that it's available for scrutiny and available for analysis. So, for instance, with the Barnett formula, every year the Treasury produces a spreadsheet to go alongside each budget, which says how much Wales gets because of all the decisions it's making and which areas of spending it's included in its calculations of the Barnett formula and the ones where it said, 'No, that's not comparable.' That's not published. That should be published so that people can scrutinise and critique it. I managed to get hold of this by talking to people in the Treasury and I've got the spreadsheets in my office. These should be made available online. I think the Welsh Government probably gets given these to confirm—. If the Treasury doesn't publish them, the Welsh Government should publish them.

[280] Secondly, perhaps there's a role for taking the power out of the Treasury's hands on this. At the moment, the Treasury is judge, juror and executioner, when it comes to the Barnett formula. Is there a case for setting up an independent body that makes recommendations on how it runs the Barnett formula system and makes recommendations on how the block grant, for instance, should be calculated et cetera? I guess, ultimately, decisions have to remain in the hands of politicians, but having an independent body making recommendations could make the system more transparent and more accountable.

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

[282] **Nick Ramsay:** Yes, exactly on this. I'm intrigued by this notion of an online Barnett formula spreadsheet. I'm just wondering what sort of people— . Mike Hedges would be on there straight away, I think. I approve of the transparency, but—

[283] **Jocelyn Davies:** I think your point is that, if something is published, even if a small number of people who are particularly interested in this are looking at it, then it does tend to be more justifiable.

[284] **Mr Phillips:** Yes, I think so. I think it would be a very small minority of people in here—two people here; maybe three in this room would want to look at it or maybe more.

[285] **Nick Ramsay:** You could have an app on the phone—[*Laughter.*]*—so that we could see, at any moment, how much money is coming to Wales through consequentials.*

[286] **Mr Phillips:** I just think that the idea behind this is not that it would be something that everyone looks at but just that, by making this publicly available, it's available to people like the Institute for Fiscal Studies and to people in Welsh universities and the Welsh public sector and the Assembly to critique and to hold Treasury and hold the Welsh Government to account over. It's straightforward to do. The House of Lords committee on Barnett reform in 2009 recommended this and it wasn't acted upon.

[287] **Peter Black:** Do you think that there's a particular weakness in scrutiny at Westminster in terms of these particular issues?

[288] **Mr Phillips:** I'm not an expert in parliamentary processes in Westminster, but I think the fact that it's presented as, 'Here is the block grant addition we're making and the changes to the block grant', rather than 'Here is the calculation, here's what we included and here's what we didn't include. Let's debate this.' I think that it is a weakness of—

[289] **Peter Black:** Do they even debate it?

[290] **Mr Phillips:** It's part of the finance Bill—

[291] **Peter Black:** Yes, I know.

[292] **Mr Phillips:** —but I'm not sure if it gets debated or whether they just sign it off. But the fact that there's no information about how it is calculated and that it's just like, 'Here's the number'—I think that is a weakness.

[293] **Peter Black:** Okay. Obviously, given that we are stuck with the Barnett formula for a bit, is there any way that the Barnett formula can be tweaked to incorporate relative needs in different parts of the UK? Is there anything in particular we should be looking at?

[294] **Mr Phillips:** I think there are ways in which the Barnett formula could be changed to introduce some element of a floor to the Barnett formula. And this time I mean a 'floor', as in—

[295] **Peter Black:** Yes, I've got you.

[296] **Mr Phillips:** —not an error. I'm not sure that it's by the ways that have been suggested so far to the committee. I think that two ways have been suggested to the committee so far in evidence given by other witnesses. One was that, at the moment, say you say the relative spending of the Welsh should be 112 per cent of spending in England, two ways have been suggested in order to do that. One said, once you're at that level, going forwards, say that Wales gets 112 per cent of the consequential they would otherwise get through the Barnett formula. Another way was saying that the Barnett formula should be switched from being a pound-per-person adjustment to being a percentage adjustment. So, if England gets a 3 per cent increase in its budget, Wales should get a 3 per cent increase in its budget. Now, that wouldn't actually give you a floor at 112 per cent because of differential population growth. If you set 112 per cent as your factor, or you increase it in line with aggregate spending growth in England, you will need to be overshooting the floor; you will converge some way above the floor.

[297] **Peter Black:** We're okay with that. [*Laughter.*]

[298] **Mr Phillips:** But the way you should do it is to do it on population, so that percentage spending growth per capita in Wales should be the same as percentage spending growth per capita in England. So, I think it can be done, but the systems that have been suggested by the Welsh Government would need to be tweaked. Otherwise, you could overshoot the floor.

[299] **Peter Black:** Maybe that's why they suggested it.

[300] **Mr Phillips:** Maybe that's why they suggested it, but, again, I'd highlight the point that—

[301] **Jocelyn Davies:** I can see the development of a 'Phillips formula' here. [*Laughter.*] Mike, did you have one on this point, before Peter comes to his next question?

[302] **Mike Hedges:** On this point, I think the issue that I've got with population is population changes all the time, and Scotland's done very well per head because they went for a long time when their population was going down, whereas the Welsh population was going in the opposite direction, and there was a drag, wasn't there? I don't know how long they are behind, but at one time, they were almost a decade behind, weren't they? I don't know how far behind they are now on population, but that can have a huge effect. Are you aware of anything being done to deal with that population drag?

[303] **Mr Phillips:** As far as I'm aware, there are no plans by the UK Government to reform the Barnett formula in such a way that it accounts for a differential population growth. If it did account for differential population growth, the Barnett formula would lead to convergence more rapidly. Without making other changes to it, it wouldn't be in Wales's interest, or in Scotland's interest, to do this, to account for differential population growth, to deal with this—you know, the population issue.

[304] **Mike Hedges:** Don't they deal with population growth now? One part of the formula is: change in population, change in expenditure. It's just a drag on the population.

[305] **Mr Phillips:** So, the formula isn't 'change in population'; it's the relative population, and that is used to—. The increments are calculated based on the Welsh population x the comparability factor x the cash change in England. The reason that doesn't account for differential population growth is that, whilst the increments are based on population growth, the base level of spending isn't adjusted to population, and that means that, whilst you update the population year to year for the increments, you're not actually adjusting the base level of spending, and that means, as you say, if population growth had been the same in England and Scotland, Scotland would have had quite rapid convergence during the 2000s to, you know, similar levels of spending in England, and so would Wales, but because the

English population has been growing much, much quicker than Scotland's, and a bit quicker than Wales's, that's why that convergence didn't happen.

[306] **Peter Black:** So, if you adjusted the base across all the nations, you would effectively be going back on the UK Government's promise to Scotland to leave them alone.

[307] **Mr Phillips:** Yes.

[308] **Peter Black:** But we could try and adjust it for Wales.

[309] **Mr Phillips:** I don't know how politicians at Westminster would consider having different versions of the formula for different parts of the country. What they've said is that they'd be happy to have a floor in the Welsh formula. I'm not sure how they're thinking about implementing that. But the promises made to Scotland put some constraint on the formula. However, I would say that the formula is not constant. The Barnett formula has changed significantly over time. You know, when they devolved business rates to Scotland, they changed how the Barnett formula worked.

[310] **Peter Black:** And that's the point: they've actually done changes to the base for different nations at different times and for different things, which is why Scotland has such an advantage.

[311] **Mr Phillips:** Yes.

[312] **Peter Black:** Yes.

[313] **Nick Ramsay:** So, there's potentially a flaw in the floor. [*Laughter.*]

[314] **Jocelyn Davies:** Ffred, did you have a question on this particular point?

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

[316] **Jocelyn Davies:** Leave it, is it? Okay, then. Peter, I think you have—

[317] **Peter Black:** Yes. Your consultation response suggests that basing funding on relative need could introduce new risks, which could be balanced against potential benefits. Can you summarise your concerns relating to a needs-based approach? What are those risks?

[318] **Mr Phillips:** Again, I'm going to say there are two kinds of risks with this—I know I keep saying this now. So, the first risk is one of implementing such a system. Now, Gerry Holtham did some great work, showing that you could actually do a very good approximation of a very complicated formula for a needs-based assessment with just five or six core elements of a formula, and if these systems were being designed by economists and agreed by economists, that's what we would do. Unfortunately, the world isn't run by economists, its run by politicians. [*Laughter.*]

11:15

[319] **Jocelyn Davies:** Mr Phillips, we've been very nice to you.

[320] **Mr Phillips:** I'm only joking—kind of.

[321] **Jocelyn Davies:** Well, economists don't have to take political decisions.

[322] **Mr Phillips:** They haven't got to take political considerations into effect. I think the politics does make this difficult, because politicians are there to represent the interests of their constituents. If they think their constituents would benefit from adding certain things to this formula or taking certain things off the formula, it can very quickly become a game in the system to get different things added in. That is what you saw under the local government funding formulae in England in particular. I'm not sure about the case in Wales. Having said that, I think it is worthwhile thinking about this system. It would be much more rational and fairer to have a needs-based system. However, in the context of things like devolving taxes, I think it opens up the trade-off between providing incentives to devolved Governments to grow their own economies and equalisation to ensure that they don't face the cost of relative economic decline.

[323] So, under the Barnett formula, when you devolve income tax to Scotland or Wales, the way it works is that, from then on, if the income tax revenues do relatively well in Wales and they grow better than they do in England, Wales benefits from the devolution of income tax. If income tax does relatively badly compared to England, Wales would lose out from the devolution of income tax. What that means is that it gives the Welsh Government incentives to grow revenues and grow the economy; it's accountable for its revenue growth. If you then switch from the Barnett system to one of needs-based equalisation, what happens then? How these systems work—it's the same with local government—is you have an

assessment of the revenue-raising capacity of the country and an assessment of the needs. As your revenue-raising capacity falls, because you're getting poorer and your needs go up, you offset all the incentive effects from the income tax side. So, I think what this opens up is this trade-off between providing incentives for growth and providing needs-based equalisation. That's why I say we need this kind of first-principles-based assessment. How much risk sharing should there be? How much needs equalisation? How much incentives and risk? Because, just looking at these things in isolation, and doing quick and dirty deals, you don't think about how all these bits interact with each other.

[324] **Peter Black:** I'm sure an economist could come up with an answer to that.

[325] **Jocelyn Davies:** Nick, on this point?

[326] **Nick Ramsay:** So, are you saying that, if you go to a needs-based formula, together with devolving taxes, the danger is that, if you get poorer, and you get more money from the centre because your need is growing, the Welsh Government could actually get caught in almost like a spiral of decline where there's no incentive for them to then try and lift the economy out of the doldrums?

[327] **Mr Phillips:** Yes. What I'm saying is that one of the concerns with the current system is that, with no tax devolution, there's few incentives to grow the economy because you don't get any benefit from that. You'd get that benefit if you devolve tax revenues under the Barnett formula. But, if you overlay that with a needs-based system, unless you think very carefully about how that system works, the standard systems that are used will again completely negate the incentives, because you're just compensating them with more block grant when you lose your tax revenues.

[328] **Nick Ramsay:** It's obvious isn't it?

[329] **Jocelyn Davies:** Peter?

[330] **Peter Black:** That was my last question. Mike's question—I've finished.

[331] **Jocelyn Davies:** Okay, Mike, we'll come to you then.

[332] **Mike Hedges:** The question I've got down here has been answered, but

that doesn't stop me having two others.

[333] **Jocelyn Davies:** No, it doesn't.

[334] **Mike Hedges:** Do you really think a Government would not want to grow the economy because it doesn't get any financial benefits from it? Because I would think a Government under any hue anywhere would want to grow their economy if only for the benefit it'll have in electoral terms for them.

[335] **Mr Phillips:** That's an interesting point. I think that you're right. It is not only for increasing revenues that the Government wants to increase economic growth. There are other innate reasons and there are political reasons to do it. The idea behind devolving some of the risk, but also the incentive to lower levels of government, is that it provides an additional incentive. It also, perhaps, counteracts maybe not political, but bureaucratic tendencies. In a system where you have no incentive to grow the economy and you have a needs-based system, you get poorer and you get more money to spend. Now, the bureaucratic tendency could be that, actually that's a good thing because you can then do—. You know, the bureaucrats involved in managing the system get more power and get more responsibility. So, I think it's not just the politicians. There is some concern about the bureaucratic side of things as well.

[336] **Mike Hedges:** Can I add a final point on this? If we look, historically, at Wales in the 1980s, there was a huge loss of employment in steel and coal, for example, which happened for economic reasons. If we had had a Welsh Assembly at that time—and a Welsh Government at that time—it would have had no power to stop those closures taking place, but it would have had the tax hit from it. Isn't there the danger that things beyond the control of Government can have a serious effect on the income tax it has in? Just look at the last time we went into recession, in 2008. Welsh income tax, according to Mr Holtham, fell by about £400 million.

[337] **Mr Phillips:** Yes. So, I'll make two points on this. First, you are absolutely correct that the factors driving differential performance between Wales and the rest of the UK are not only down to Government policy in Wales. They could be down to Government policy at the UK level, if they make policies that are, you know, more harmful or more beneficial to Wales. Or, they can be down to other economic factors. Now, design a system that allows you to let the Welsh Government gain and lose from its own policy

decisions, but insulate it from the other factors affecting the market performance of the Welsh economy—designing such a system is almost impossible because you have to separate out what’s going on: what is the impact of policy and what is the impact of non-policy factors on the Welsh economy? Again, that’s why I raised the point earlier about trying to think what the balance of equalisation of risk should be. There are, potentially, systems where you’d have some equalisation and some risk. But we are not having this debate at the moment; we are having a debate about what power should be devolved and how we should do this adjustment—not this first principle about what these risks should be. So, I think it’s very important that you are raising these questions about risk.

[338] The second point I’d raise on this £400 million revenue loss that you mentioned is that, under a system of tax devolution, if it’s done in the way that Mr Holtham suggests, it’s not the absolute decline in revenues that matters to the Welsh Government budget; it’s the relative decline in the Welsh Government budget. So, if Welsh tax revenues fall by £400 million, but that’s only equivalent to the Welsh population share of the overall fall in tax revenues, the method that Gerry suggests would insulate Wales from that because the block grant would go up to compensate, provided that your fall in tax revenues wasn’t bigger than the fall in the rest of the UK. So, it’s the relative risks, not the absolute risks, that you face in recessions.

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

[340] **Nick Ramsay:** Yes. Thanks, Chair. If I can ask you about the block grant and how we adjust that to take account of new tax powers, the Smith Commission suggested that when a new tax is devolved to Scotland, the block grant should be adjusted to ensure that there was no detriment to either Government’s finances as a result of that decision. Could you explain the practical problems that have been encountered in applying this principle, and would they be relevant to Wales?

[341] **Mr Phillips:** Yes, I can definitely do that. So, again, there are two problems with this. The first problem is actually what you do in the first year. In principle, how you do this in the first year is conceptually straightforward. You make a forecast of how much you think would have been raised from that tax—from Scotland or from Wales—and you subtract that from the block grant that you give to Scotland or Wales. So, you forecast that you are going to take £4 billion in income tax in Scotland, and you take £4 billion off the block grant: conceptually straightforward. But it is practically difficult,

because in making forecasts, there is an element of judgment involved and different people will come up with different forecasts. This happened in Scotland with devolving stamp duty. The Scottish Government, and, I guess, HMRC, both forecast what they thought would be raised from stamp duty in Scotland and they came up with a number 15 per cent or 20 per cent different from each other.

[342] **Nick Ramsay:** No small amount.

[343] **Mr Phillips:** No small amount. Then, both estimates were signed off. The HMRC one was signed off by the Office for Budget Responsibility as being, you know, sensible, and the Scottish one has been signed off by the Scottish Fiscal Commission as being sensible. So, just having independent oversight doesn't necessarily mean you get kind of one consensus answer, that shows. In the end, there was a typical fudge—they split difference, did it in the middle. So, there were difficulties in year 1. I think where the difficulties have become even more difficult is what happens in subsequent years, because the Smith Commission says that this block grant should be indexed appropriately, full stop, and doesn't elaborate on what that appropriate index issue should be. Now, the principles that the Smith Commission talks about—no detriment, risk-sharing, full responsibility for Scotland's decisions being borne by Scotland—imply certain features for the system. It actually rules out a needs-basis system for Scotland for funding. So, these principles are there but there are multiple different ways you can adjust the block grant that don't perfectly meet these principles but kind of get close, but they will have different effects in different circumstances depending on what's happening to Scotland's population growth, what's happening to economic growth, the relative level of the taxes in England and Scotland to start with, et cetera.

[344] **Nick Ramsay:** After the decision's been made as to how much you cut the block grant, et cetera, how quickly would we have the figures of actually how much tax had been raised so we could see whether the appropriate reduction had been made?

[345] **Mr Phillips:** Within a few months of the end of the year, I imagine. Now, the idea is that, if there are inaccuracies made, what happens is that an adjustment is made going forward. If you took off too much, you'd give them a bit more the next year. If you took off too little, you'd take a little bit more off subsequently. It would probably happen in a year lag. So, if you made a mistake in year 1, you'd find out in year 2 and you'd make the adjustment in

year 3. But, you know, there is room for mistakes. That's why you need borrowing powers to kind of smooth these errors and smooth the risks that go with the cycle.

[346] **Nick Ramsay:** Okay. You've just said there that the first year of adjustments to the block grant should be more straightforward than the subsequent adjustment because we've had no system decided yet and the subsequent adjustments will be made. Talking about the first-year adjustments; how do you think those should be made?

[347] **Mr Phillips:** As I said, with the first-year adjustments you have a forecast for what you think would have been raised if the UK tax had still been in place in that country and that—

[348] **Nick Ramsay:** Do you think that that is the only way that that could be done? I mean, do you think that that is the preferable model of doing it, then compensating afterwards if there's an error—a flaw? I won't use the word 'flaw' anymore; an error.

[349] **Mr Phillips:** I think that is the only way that kind of—. I buy the first no-detriment principle. There should be no detriment, if at all possible, in the first year of devolution, and that is a way in which you meet that principle. I can't see a logical or rational way of doing it otherwise apart from trying to forecast what you would have raised in year 1. Yes, I just can't see what other method you would use.

[350] **Nick Ramsay:** You couldn't, just for the sake of argument, devolve the tax and somehow, then, when you know exactly what the amount is, make an adjustment afterwards?

[351] **Mr Phillips:** You would then need to—. If the devolved government was getting the entire block grant and its tax revenues, either there would need to be some kind of constraint that said, you know, 'We're going to stop you spending a certain part of that because we don't want you to spend more than your budget', in which case it's almost like taking it off straight away.

[352] **Nick Ramsay:** So, there might be a speed to spend the money, so that when the Government comes back, 'Oh sorry; it's gone'.

11:30

[353] **Mr Phillips:** Yes. Or you'd give the Government discretion and it would be the risk that devolved Governments would spend that money. I just wouldn't think that's feasible—politically or practically.

[354] **Jocelyn Davies:** Okay. Are you finished, Nick?

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

[356] **Jocelyn Davies:** Okay. Ffred.

[357] **Alun Ffred Jones:** Well, I think the questions have been addressed. I'm not sure they've been answered, or perhaps I haven't understood the answers. You talk about three possible mechanisms to adjusting the block grant. Which method do you think is preferable, or do you think that there should be another way to address this problem?

[358] **Mr Phillips:** Okay. Out of the three that I listed in my written evidence, I think the one that makes most sense is: after year 1, once you've got the initial block grant adjustment, say you have £4 billion, my favoured way is to say, 'Well, what happens to the equivalent tax revenues in England? How much do they grow in percentage terms?' So, if the revenues go up by 10 per cent in England—or, sorry, you forecast revenues to go up by 10 per cent in England—in the next year, you say, 'Well, let's increase this £4 billion and next year, we'll take off £4.4 billion from the block grant'. What that means is, if Welsh revenues grow by more than 10 per cent, the Welsh Government gains from the tax devolution, because your revenues will go up to £4.5 billion, £4.6 billion, and they're only taking £4.4 billion off, so you've got an extra £100 million or £200 million, but, if your revenues go up by less, you'd lose out—Wales would lose out from the system.

[359] Now, I think that approach works well, because, effectively, if the Welsh revenues are keeping up with English revenues, you win; if they're not, you lose. It provides the correct incentives to the Welsh Government to grow the economy, and it kind of says, 'Well, we'll define performance against what's happening in the rest of the UK'.

[360] There's a question about whether you do that in revenue growth per person, or revenue growth in total, because of differential population growth between the different countries. So, if the Welsh population is growing more slowly, you might think, 'Well, of course our revenue's not going to grow as fast as in England, because we've got fewer people', so you can have a

debate about whether to do it in revenue growth per person, or revenue growth in total. But I think that approach works very well.

[361] The other two approaches, as I said in my written evidence, I think have drawbacks.

[362] **Jocelyn Davies:** Before you move on to that, how did England become the rest of the UK?

[363] **Mr Phillips:** Sorry. I guess, in this case, if income tax has been devolved to Wales and to Scotland, it's England and Northern Ireland. That becomes the—

[364] **Jocelyn Davies:** Okay. So, you would do some sort of calculation that combined those two, would you, if you were doing—

[365] **Mr Phillips:** Yes.

[366] **Jocelyn Davies:** Oh, right, so it wouldn't just be—

[367] **Mr Phillips:** The reason you take out Scotland is because Scotland might have different tax policies and the reason you do England and Northern Ireland is because the Barnett formula, which gives your spending—

[368] **Jocelyn Davies:** Because that's what's left.

[369] **Mr Phillips:** Yes, that's what left in the kind of UK system.

[370] **Jocelyn Davies:** Okay. Go on to your second point, because I interrupted you, sorry.

[371] **Mr Phillips:** All I was going to say was that the other systems have drawbacks. So, one simple system would be to say, 'Look, we've taken the equivalent of 20 per cent off the block grant in year 1; let's just reduce the block grant by 20 per cent going forwards'. But that doesn't give as much risk sharing, because what would happen then—. You know, the point you raised about tax revenues falling by £400 million during the recession—under the system where you made a fixed deduction from the block grant, Wales would have to bear the risk of these booms and busts. It would have to borrow and save to do that, and I think that would be putting a pretty big risk on the Welsh Government's budget, given the potential for fairly limited

borrowing powers, and the fact that it probably costs the Welsh Government more to borrow than it would for the UK Government; they're in a better position to smooth.

[372] The other method I suggest I think would lead to Wales losing out, because Welsh revenues have to grow more quickly than in England to keep up with England, given that they start from a lower base. So, indexing to the percentage growth rates of revenues in England and Northern Ireland, I think would be the most appropriate way and it's very similar to what Gerry Holtham suggested in the index deduction approach for income tax.

[373] **Jocelyn Davies:** Ann, shall we come to your questions?

[374] **Ann Jones:** Yes, thanks. Should a Welsh fiscal commission be created to independently forecast tax, borrowing and spending?

[375] **Mr Phillips:** Yes.

[376] **Ann Jones:** Okay, thank you. How can the UK Government give devolved administrations greater certainty of likely future funding?

[377] **Mr Phillips:** Again, first, we could have a proper rational debate about what the system as a whole should look like, rather than having these small, ad hoc deals done in a reactive manner, because I think—you know, the UK Government is not having a proactive debate about this; it's reacting to events, and events happen, and that causes instability and uncertainty for the devolved Governments: how will this change? Five years down the line, will Wales have to have another change because the UK Government decides that it wants Wales to have similar powers to what Scotland has?

[378] I think there's also an issue about, you know—. The main settlements that Wales gets get announced in the spending review, but then this can be done in-year via changes that are made in, for example, the emergency budget. The emergency budget announced changes to budgets in England back in July. That has in-year effects for Wales—

[379] **Ann Jones:** £50 million.

[380] **Mr Phillips:** Yes. Perhaps you could say that, you know, there should be flexibility around when that's spent. I think, actually, in the 2010 review there was flexibility about when the devolved Government had to make the

changes. I'm not sure there was in 2015.

[381] **Ann Jones:** No, I don't think so.

[382] **Mr Phillips:** So, I think if you are going to do in-year cuts in England, give the flexibility to the devolved Governments to say, 'Well, we'll do it this year' or 'We'll delay it to next year.'

[383] **Ann Jones:** All right, thanks. Thanks, Chair.

[384] **Jocelyn Davies:** Chris.

[385] **Christine Chapman:** Thanks. What additional financial freedoms could be given by the UK Government to help with multi-year planning beyond the current budget exchange system?

[386] **Mr Phillips:** One potential would be make that arrangement more flexible. So, rather than having a very prescribed limit about how much is carried over in multi-year flexibility, give the Welsh Government kind of full freedom to decide how much to carry over. I guess the issue is about bringing forward; if the Welsh Government wants to bring forward spending, that's more tricky. Potentially, the UK Government would think that there's a timing consistency problem with that. So, the Welsh Government wants to bring forward a big bit of money and then, subsequently, it finds out it hasn't got enough money the next year to pay for its services. The UK Government could be worried about having to bail out the Welsh Government in those kinds of circumstances. So, maybe, giving the Welsh Government not only budget exchange, but also borrowing powers that are more flexible than they are at the moment—.

[387] As I understand it, at the moment, the Welsh Government only has capital borrowing powers, not borrowing powers for current spending. If income tax is devolved in part to Wales, there will be some current borrowing powers, but, if they operate as in Scotland, those borrowing powers could only be used to deal with forecast errors. So, if you forecast that your revenue's going to be, you know, £4 billion, but it comes out as £3.9 billion, you can use that borrowing to make up that gap. But if you forecast £3.9 billion, you can't say, 'Well we actually think, you know, that we want to borrow a bit of money and pay it back later to get us up to £4 billion.' I think, actually, giving that extra flexibility to say, 'We're borrowing not only for the errors in forecasts, but also more generally to give us flexibility about

how we spend money over time to deal with the economic cycle or to deal with just, you know, our priorities' would be a good step forward.

[388] **Christine Chapman:** Obviously, reserves—do you think it is essential the Welsh Government could hold reserves so that they can effectively manage their own funding, then?

[389] **Mr Phillips:** I would say it would make sense for the Welsh Government to be able to hold reserves. Local authorities can hold reserves—

[390] **Christine Chapman:** Essential? Would that—.

[391] **Mr Phillips:** Not necessarily essential if you have sufficient borrowing powers. So, reserves and borrowing powers, to some extent, could be seen as interchangeable. If you don't have reserves, then you need to have greater ability to borrow money to smooth these shocks that will occur when you have devolved tax powers.

[392] **Christine Chapman:** Thank you.

[393] **Jocelyn Davies:** Mike.

[394] **Mike Hedges:** Two points: isn't it cheaper, though, to use reserves than to borrow? The second point is: if the Welsh Government does build reserves, shouldn't it be allowed to invest them like a local authority does, rather than just leave them to sit with the Treasury?

[395] **Mr Phillips:** So, using reserves is cheaper, however, it means you have to, kind of—you build up the reserves, so you have to, you know, not spend some money in order that you can build up the reserves. I'm not saying that that's a bad thing, but, potentially, giving the Welsh Government the option of either using reserves or borrowing allows the Welsh Government to decide whether it wants to pay the cost to borrow money or pay the upfront cost of having to hold back some spending to put into reserves. About whether it's put into investments as opposed to just being held by the treasury, again, I think local government has the power to do that—to hold money in investments. I can't see a strong reason for the Welsh Government not to be able to do that, although, again, it does impose risks, of course.

[396] **Mike Hedges:** Can I just finish on this, because we've started talking about local government? Do you see any reason why the Welsh Government

shouldn't have the same powers that local government has in terms of borrowing and in terms of investing?

[397] **Mr Phillips:** So, you mean prudential borrowing powers?

[398] **Mike Hedges:** No, the whole—. I don't mean just prudential powers, but I mean the whole set of powers that exist.

[399] **Mr Phillips:** I must admit I'm not an expert on the full system of local government finance. The area that I've been looking at with this has been prudential borrowing, and I think the issue is quite tricky, and I'll tell you why: I think, actually, it could be asymmetric in the UK because of political reasons. So, why does prudential borrowing work for local government? Why hasn't local government run up large amounts of debt and gone bankrupt? Well, first of all, I think, because there's no political incentive for them to do that. They need to get votes from their voters. They understand the UK Government can intervene and say, 'No, we're going to cap', and they're going to stop them borrowing. And the UK Government, if, you know—. The system is stable because, if the UK Government really had to, it probably could bail out. Now, my concern with a system like this for devolved governments is that, in Scotland, I think the political institutions—. The political situation in Scotland is not one that favours stability in such a system. The Scottish Government has a policy of independence. To some extent, that gives an incentive to the Scottish Government for this system not to work that well, so that it can argue that there are potentially benefits in becoming independent: 'The current system's not working, so we need to be independent'. What this could mean is that the Scottish Government has an incentive to borrow money in an effort to use that borrowed money to fund better spending, to fund more things, and it's: 'Look, we're better at managing the economy than the UK Government is. Look how much more we could do under independence'. Then, the UK Government might want to cap those borrowing powers, but the political ramifications of capping Scotland would be huge. You've given Scotland the powers and now you're capping them and you're going against the Scottish will. And, again, the bail-out implications—the UK Government wouldn't be in a position to bail out Scotland because of the implications in England.

[400] So, I think politically, the UK Government will not want to give prudential borrowing powers to Scotland because of the significant political difficulties of that, and then giving the powers to Wales but not Scotland again could be politically difficult. So, actually, in Wales's case, I could see

how a system could operate and be stable, but because of the political situation in Scotland, I think it would be challenging for the UK Government to operate a prudential system of borrowing for the devolved governments without creating the scope for further conflict between Scotland and Westminster. I think that is something they're trying to avoid. Now, maybe it's worth while doing that to get a system that works, but politically I think there would be difficulties that might make Westminster balk at this, and if they're concerned about the stability of the UK, they might want to be a bit wary of doing this.

[401] **Jocelyn Davies:** So, Wales can't have prudential borrowing powers because the UK Government doesn't trust the SNP? Well, that's what you said.

[402] **Mr Phillips:** So, what I'm saying is that, if there's a system—. I can see reasons why the UK Government would be politically wary of doing this. I'm not saying that it's economically right or it's fair that this is what would happen, but I see difficulties in doing this given the political economy of the UK at the moment.

[403] **Mike Hedges:** Can I come in on this point?

[404] **Jocelyn Davies:** Yes, because I know that Gerry wants to ask some questions as well.

[405] **Mike Hedges:** The revenue implications of capital would fall on the Scottish Government, so they could do it as prudential borrowing, and they could run up £1 billion or £2 billion a year in payments, but they'd have to find those payments from their own revenue. So, I can see why the Westminster Government would have to bail them out: 'This is your position. This is what you've borrowed. This is what you've got to do'. That's why local authorities haven't engaged in substantial prudential borrowing—because of the revenue implications. Why would Scotland or Wales, as national Governments, be different to the local authorities in that?

11:45

[406] **Mr Phillips:** I think the system is more likely to work when each of the players in the system wants to remain part of the system. Local authorities are not in a position where they want to declare independence from the UK—at least, not since the 1980s—but, with Scotland, there's a situation where one of the countries does want to declare independence. I'm not saying that

necessarily they would run up debts in order to destabilise the system and to offer additional spending to the Scots in the short term to prove their capabilities, at the risk of long-term instability, but I think that's a risk that would be there—although there, it's less prevalent for local authorities—and I was just raising that.

[407] **Jocelyn Davies:** Okay, well, it's an interesting theory, certainly. I think you had one or two questions, because I know you've got a train to get, David, haven't you?

[408] **Mr Phillips:** Yes.

[409] **Professor Holtham:** Thank you, Chair. One question was to do with the interaction of the floor and population, because I think this is one of the things that's been coming up in discussions between the Welsh Government and the Treasury. Is there any problem—? What's wrong with simply saying, that, at the beginning of the three-year expenditure cycle, the block grant was this, but now, before we even apply Barnett, or Barnett with the floor, or Barnett with a few needs factors, before we do any of that, we're just going to take that block grant and adjust it—the whole block now, not the increment—for the relative population change? So, we do a one-off fix on the level at the beginning of the three-year period and then we can apply the Barnett formula with the floor, i.e. the percentage change, or something. What's wrong with just doing the population fix on the level, and then applying the Barnett formula?

[410] **Mr Phillips:** I guess that would work if, in the subsequent period, the population didn't start to diverge again. Let me clarify that—

[411] **Professor Holtham:** You just do it, say, every three years. The population divergences are not that rapid; you don't need to do it every year, but if you put the fix in—. Say you do it every three or four years, or whatever the convenient period is, it's probably going to lead to a reduction or an increase in the block grant of 1 or 2 per cent tops, which isn't the end of the world, and then you can apply the formula.

[412] **Mr Phillips:** I think that is a way of doing things. An alternative way of doing things would be to, year by year, use the population projections to index the block grant in percentage growth per capita. So, comparable spending is going up by 2 per cent per head in England, we'll do the block grant by 2 per cent a head in Wales. I think both of those should work. Your

way has the benefit of using actual population figures at a point in time, but then allowing some divergence over the subsequent period, which you then adjust. My way—

[413] **Professor Holtham:** The point is that the errors in population projection are probably quite large relative to the change in population if you're doing it year to year. So, you get into a bit of a muddle.

[414] **Mr Phillips:** Errors in population projections do have faults in them, that's true. Maybe it's worth while looking at where the changes will be bigger. So, are the errors larger in the forecasts, or are the differential growth rates more different? That could be worth while looking into, to see which way will give you the smoother path of Welsh Government spending. I completely agree with that.

[415] **Professor Holtham:** Thank you. My other question was to do with your work on non-domestic rates and the flaw in the system.

[416] **Jocelyn Davies:** Shall we call it 'the fault'?

[417] **Professor Holtham:** The fault in the system, yes. In your written submission, you have a couple of suggested fixes where, instead of allocating non-domestic rates to the expenditure of one department, you apply them across a number of departments and change the consequentials for a number of departments, to sort of smooth things and get rid of that fault. You also say there's actually a more radical solution, which is just to not do any of that. You work the initial block grant out purely on the expenditure side, and then at the end you take off whatever you want to take off for the tax bases that have been devolved, and you just put NDR in there with income tax and the other devolved taxes and take it off at the end. Isn't that actually a cleaner way of doing it than trying to adjust a whole series of consequentials within the formula?

[418] **Mr Phillips:** So, it depends upon the types of risks you want to devolve when you're devolving the taxes. I've talked to the architects of this system for non-domestic rates, and they said that they were aware of the methods—I suggested where you kind of do the expenditure side separately and then make an adjustment akin to the income tax at the end. They said they were aware of those methods when designing the system for the devolution of NDR to Scotland, but those systems—the Holtham method where you index this change then to what happens to the base or the revenues in England—

only devolve the relative risk of business rates growth in Scotland compared to England. But they wanted to devolve the absolute risk of business rates to Scotland, so that if business rates fell in Scotland and they fell in the UK, Scotland would still bear that cost. Now, for me, that doesn't really make sense, but the context of the report I wrote was that the system that they implemented to do what they wanted to do had a fault in it. So, the reason I suggested that one method to remove this particular fault would be to move towards, rather than making just an adjustment to the Department for Communities and Local Government comparable factor, just a small adjustment of all the comparable factors across departments, because it would remove that particular fault but still deliver a system where Scotland bears the absolute risk of its business rates revenues. But I agree with you that it doesn't make sense to devolve the absolute risk of any individual tax to a devolved Government because, just imagine, you know, you devolved the absolute risk of North sea oil to Scotland. Well, everyone knows that's going down and Scotland hasn't got the kind of mechanisms to make up that in other areas. It could be the same with business rates; business rates could be in a trend down if there's more and more online and more and more homeworking, which means that business rates could be on a downward trend. So, I agree it would make more sense to move to a system of relative risk, which you'd get if you did the solution that you suggest.

[419] **Jocelyn Davies:** I think we should finish on the point where two economists just agreed. [*Laughter.*] And I know you've got your train to catch. Thank you, David; I think that was an excellent session. And thank you for explaining your answers with such clarity to those of us who are not research economists.

[420] **Mr Phillips:** And I really hope you're aware that I was only joking with my politicians jibe. [*Laughter.*]

[421] **Jocelyn Davies:** Do you know, I thought you redeemed yourself beautifully, actually, from that? [*Laughter.*] We'll send you a transcript. We'd be very grateful if you'd check it, especially the 'flaws' and the 'floors', just to make sure that it reflects what you wanted to say. And then we'll be able to publish it.

[422] **Mr Phillips:** Okay.

[423] **Jocelyn Davies:** Lovely; thanks very much.

[424] **Nick Ramsay:** One thing we can assure you is that we're not thinned. [*Laughter.*]

[425] **Jocelyn Davies:** Yes, we're not.

[426] **Mr Phillips:** Diolch yn fawr.

[427] **Jocelyn Davies:** Thank you.

11:54

**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 that the committee resolves to
gwahardd y cyhoedd o weddill y exclude the public from the
cyfarfod yn unol â Rheol Sefydlog remainder of the meeting in
17.42(vi).*

*accordance with Standing Order
17.42(vi).*

Cynigiwyd y cynnig.

Motion moved.

[428] **Jocelyn Davies:** I move that somebody vote that we go into private session now. How's that?

Derbyniwyd y cynnig.

Motion agreed.

Daeth rhan gyhoeddus y cyfarfod i ben am 11:54.

The public part of the meeting ended at 11:54.