



Cynulliad  
Cenedlaethol  
Cymru

National  
Assembly for  
Wales

# Cofnod y Trafodion The Record of Proceedings

[Y Pwyllgor Cyllid](#)

[The Finance Committee](#)

15/03/2017

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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. Where contributors have supplied corrections to their evidence, these are noted in the transcript.

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

Mike Hedges <a href="#">Bywgraffiad</a>   <a href="#">Biography</a>	Llafur Labour
Steffan Lewis <a href="#">Bywgraffiad</a>   <a href="#">Biography</a>	Plaid Cymru The Party of Wales
Eluned Morgan <a href="#">Bywgraffiad</a>   <a href="#">Biography</a>	Llafur Labour
Nick Ramsay <a href="#">Bywgraffiad</a>   <a href="#">Biography</a>	Ceidwadwyr Cymreig Welsh Conservatives
Mark Reckless <a href="#">Bywgraffiad</a>   <a href="#">Biography</a>	UKIP Cymru UKIP Wales
David Rees <a href="#">Bywgraffiad</a>   <a href="#">Biography</a>	Llafur Labour
Simon Thomas <a href="#">Bywgraffiad</a>   <a href="#">Biography</a>	Plaid Cymru (Cadeirydd y Pwyllgor) The Party of Wales (Committee Chair)

**Eraill yn bresennol**  
**Others in attendance**

Anthony Barrett	Archwilydd Cyffredinol Cynorthwyol a Phennaeth Ymarfer Archwilio Ariannol, Swyddfa Archwilio Cymru Assistant Auditor General and Head of Financial Audit Practice, Wales Audit Office
Robert Chote	Cadeirydd, Y Swyddfa Cyfrifoldeb Cyllidebol Chairman, Office for Budget Responsibility
Martin Peters	Rheolwr Moeseg a'r Gyfraith, Swyddfa Archwilio Cymru Law and Ethics Manager, Wales Audit Office

Huw Vaughan Thomas Archwilydd Cyffredinol Cymru  
Auditor General for Wales

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

Bethan Davies	Clerc Clerk
Gemma Gifford	Dirprwy Glerc Deputy Clerk
Christian Tipples	Y Gwasanaeth Ymchwil The Research Service
Katie Wyatt	Cynghorydd Cyfreithiol Legal Adviser

*Dechreuodd y cyfarfod am 09:00.*  
*The meeting began at 09:00.*

**Cyflwyniad, Ymddiheuriadau, Dirprwyon a Datgan Buddiannau**  
**Introductions, Apologies, Substitutions and Declarations of Interest**

[1] **Simon Thomas:** Bore da. **Simon Thomas:** Good morning. I call Galwaf y Pwyllgor Cyllid i drefn. the Finance Committee to order. I Croeso i Aelodau a phawb. Gwnaf welcome Members and everyone else. atgoffa pawb bod clustffonau ar gael I remind everyone that headsets are ar gyfer cyfieithu—cyfieithu ar sianel available for interpretation on 1, lefel y sain ar sianel 0. Os caf i channel 1 and amplification on ofyn i'r Aelodau daweli unrhyw channel 0. Can I remind Members to ddyfais electronig fel nad yw'n ensure that any electronic devices are amharu ar y pwyllgor—. on silent, so they don't affect the committee's proceedings?

**Papurau i'w Nodi**  
**Papers to Note**

[2] **Simon Thomas:** Hefyd, a gaf i **Simon Thomas:** Can I also ask ofyn i aelodau'r pwyllgor, yn y lle Members, in the first place, to note

cyntaf, i nodi'r papurau yr ŷm ni wedi'u derbyn? Mae llythyr gan Weinidog y Gymraeg a Dysgu Gydol Oes—mwy o fanylion am y Bil Anghenion Dysgu Ychwanegol a'r Tribiwnlys Addysg (Cymru)—a hefyd llythyr gan Weinidog Iechyd y Cyhoedd a Gwasanaethau Cymdeithasol, ei hymateb hithau i'n hadroddiad ni ar Fil Iechyd y Cyhoedd (Cymru), wedyn dau set o gofnodion o ddau gyfarfod diwethaf y pwyllgor.

the papers that we've received? There's a letter from the Minister for Lifelong Learning and Welsh Language—more details about the Additional Learning Needs and Educational Tribunal (Wales) Bill—and a letter from the Minister for Social Services and Public Health, with her response to our report on the Public Health (Wales) Bill, then two sets of minutes of the last two committee meetings. Is everyone content?

[3] **Mike Hedges:** Hapus.

**Mike Hedges:** Content.

[4] **Simon Thomas:** Hapus. Pawb yn hapus i nodi hynny. Diolch yn fawr.

**Simon Thomas:** Everyone's content to note that. Thank you very much.

9:01

**Archwilydd Cyffredinol Cymru: Cyfrifon Blynyddol Cyfoeth Naturiol  
Cymru 2015–16**  
**Auditor General Wales: Natural Resources Wales Annual Accounts  
2015–16**

[5] **Simon Thomas:** A gaf i droi, felly, at yr archwilydd cyffredinol a'i swyddogion? Croeso i chi a diolch am ddod at y pwyllgor. Cyn i fi agor y drafodaeth a'r cwestiynau, fel petai, hoffwn i jest roi ar gofnod pam rŷm ni'n cynnal y sesiwn yma. Diben y sesiwn yw deall yn gyhoeddus y broses a arweiniodd yr archwilydd cyffredinol i osod cyfrifon Cyfoeth Naturiol Cymru ar ôl y dyddiad cau statudol. Bydd y Pwyllgor Cyfrifon Cyhoeddus yn cynnal sesiwn yn edrych ar y materion penodol yn y

**Simon Thomas:** We turn now to the Auditor General for Wales and his officials. Welcome to you and thank you for attending the committee this morning. Before I open the discussion and the questions, I'd like to put on record why we're having this session today. The purpose of the session is to understand publicly the process that led to the auditor general laying Natural Resources Wales's accounts after the statutory deadline. The Public Accounts Committee will have a session

cyfrifon hynny, rydw i'n deall, ar 28 Mawrth. Rŷm ni wedi derbyn gohebiaeth, wrth gwrs, gennych chi yn ystod y cyfnod hwnnw, ac roeddem ni yn awyddus bod yna sesiwn gyhoeddus lle rŷm ni'n gallu deall y broses a dysgu rhyw wersi o'r broses yma. Os caf i atgoffa aelodau'r pwyllgor, a hefyd unrhyw un sydd am wyllo'r pwyllgor, neu edrych ar y trawsgrifiad, nad ydym ni yma—bod gennych chi fel archwilydd, wrth gwrs, disgrisiwn yn y gwaith yr ŷch chi'n ei wneud, a'n bod ni'n cymryd diddordeb yn rôl a threfniadau llywodraethu'r swyddfa archwilio, a diben y sesiwn heddiw yw deall y gwrthdaro rhwng y Gorchymyn sefydlu, Deddf Archwilio Cyhoeddus (Cymru) 2013, a'r cod ymarfer sydd gyda chi hefyd fel archwilydd cyffredinol.

looking at the specific issues in those accounts, I understand, on 28 March. We have had correspondence from you during that period, and we were eager that there be a public session where we could understand the process and learn any lessons from it. If I could remind Members, and anyone who wants to watch the committee, or look at the transcript, that we're not here—that you as auditor general have discretion in the work that you do, and we take an interest in the role and the governance arrangements of the audit office, and the purpose of the session today is to understand the conflict between the establishment Order, the Public Audit (Wales) Act 2013, and the code of practice that you have as auditor general.

[6] Felly, diolch i chi yn fawr iawn am ddod atom ni y bore yma. Os caf i ofyn i chi a'i swyddogion jest datgan enwau a chyfrifoldebau ar gyfer y cofnod, os gwelwch yn dda—.

So, I thank you very much for attending this morning. If I could ask you and your officials just to state your names and roles for the record, please—.

[7] **Mr Thomas:** Gwnaf—fel sy'n hysbys, Huw Vaughan Thomas, Archwilydd Cyffredinol Cymru.

**Mr Thomas:** Yes—Huw Vaughan Thomas, Auditor General for Wales.

[8] **Mr Barrett:** Anthony Barrett, assistant auditor general and head of practice for financial audit.

[9] **Mr Peters:** Martin Peters, head of law and ethics.

[10] **Simon Thomas:** Diolch yn fawr. Os felly, gan ein bod ni wedi derbyn gohebiaeth yn y gorffennol, ac wrth

**Simon Thomas:** Thank you very much. Given that we've received correspondence and seen the

gwrs wedi gweld y cyfrifon oedd accounts that were laid last week, if wedi'u gosod wythnos diwethaf, os you're happy, we will now proceed ydych chi'n hapus, gwnawn ni fwrw with some questions that we have as ymlaen gyda'r cwestiynau sydd a committee. gennym ni fel pwyllgor.

[11] A fedrwch chi jest amlinellu yn Could you just outline very briefly fyr iawn pam rŷch chi wedi dod i'r why you have come to the conclusion casgliad yn y lle cyntaf nad oedd in the first place that it wasn't modd i chi fodloni'r amser statudol possible for you to meet the statutory ar gyfer adrodd ar gyfrifon Cyfoeth deadline for reporting on the NRW Naturiol Cymru, a hefyd os oes gyda accounts, and also whether you have, chi, yn benodol ar ddechrau'r sesiwn, specifically at the outset of the gwersi yr ŷch chi am i'r pwyllgor eu session, any lessons that you want deall o'r profiad yna? the committee to understand or learn from that experience?

[12] **Mr Thomas:** Diolch, Simon. **Mr Thomas:** Thank you, Simon. I will Byddaf i'n ateb yn Saesneg, os caf i. be replying in English, if I may.

[13] I think that we need first to remember that this is a blue moon type of occasion in terms of the public sector bodies. The last time that accounts were audited, in a sense, late, was Education and Learning Wales, with John Bourn, and I don't think that there is anyone here who was sitting in the Assembly at that time.

[14] **Simon Thomas:** Or even remembers ELWa.

[15] **Mr Thomas:** Well, yes. They were in—the process took about 10 months. Of course, at that stage, and this gets into the heart of it, there was no four-month requirement, and, indeed, there is still no four-month requirement on a number of public sector bodies in Wales. That gradually crept in in the 1990s—with various establishment Orders, four months started to be placed. It is a very crucial distinction. If I were sitting in Westminster, I could have sought an Order to be made by Treasury under the Government Resources and Accounts Act 2000, which can be done very quickly—a matter of days—and has the effect of delaying such time limits in order to allow an audit to be concluded. In Wales, I have no such provision. You could have sought an Order under section 13 of the Public Bodies Act 2011, but for that to actually happen I would have needed to have known four months before—at least four months before—the cut-off date that,

actually, I was going to qualify the accounts, and I was not in that position. I was not in that position for two reasons: (1) I needed to seek additional papers from the NRW, and, indeed, the last lot of papers didn't actually arrive until early February. Then there was a dispute about legal opinion. NRW sought its own legal opinion; I needed eventually to seek counsel opinion. I do that because there is no—. If I set out the reasons for amending or qualifying accounts, that can only really be challenged in the courts. It is therefore appropriate that I take account of court case law and, as I mentioned in my letter to you, it's that of Doody that is the relevant one in this case, which says that, basically, in carrying out administrative law requirements, you must not forget the principles of natural justice, allowing others to comment, and so on. So, there was a clash, and there is a clash, under our audit legislation, and, as I've said, it is the fact that we have no means of very quickly delaying cut-off dates.

[16] I think that brings me to the last of the points I'd make by way of introduction. Welsh audit legislation—indeed, Welsh audit and accounting legislation—is spread over a range of statutes, often with conflicting requirements, or at least incompatible requirements one with the other. So, there is, particularly now that we are having extra powers given to Wales, I think, a need to consolidate and really bring together that range of legislation. I should mention that when the 2013 Act, which is now in force in terms of the Wales Audit Office, was introduced, it was the Government's intention at that stage to actually have a part 2. The part 2 would have done the consolidation of audit legislation, but, for various reasons, I understand that consent was not possible from Westminster for that to take place. But it can be done, and I would think that the conclusions I would draw from the experience that we've gone through with the NRW accounts is (1), as I said, it's a rare event, but, secondly, that we need to have the mechanism that the Government Resources and Accounts Act provides for my counterparts in terms of dealing with this kind of event, even though probably another one won't arise for at least 10 years.

[17] **Simon Thomas:** Is four months, which is in the establishment Order for Natural Resources Wales—and, as you say, it's in lots of other places as well relating to public bodies, but not in all of them—but would that usually be seen, in terms of international accounting standards, as being a good or a decent period of time for this process to take place?

[18] **Mr Thomas:** It's a decent period of time, assuming that there are no fundamental difficulties. And if you think of the reasons why I tend to qualify



accounts—. I qualified accounts in terms of local health boards, for example, but that's fairly straightforward. They're spending—what they did at the time, I qualified. They were spending in excess of their ambit. Everybody accepted that; I have to qualify. And that four-month period is absolutely okay for that. When it gets to irregularity and you're needing to pursue issues, that's when it becomes more complex. Anthony.

[19] **Mr Barrett:** Yes, and, certainly, if you look at some of the other sectors as well, three to four months would be the norm. We've seen local government coming forward in recent years, and it will come forward again. As the auditor general said, that is fine unless we hit problems or issues that can—. And, invariably, those issues crystallise towards the end of the audit process, and that then can lead to delays in other sectors as well.

[20] **Mr Thomas:** But, of course, the local government audits are under a slightly different set of statutory requirements. The nearest one I can think of is, as Mike Hedges would recall, the audit we did of the drainage boards. That was prolonged before we were able to actually give an opinion, which was again a qualified opinion.

[21] **Simon Thomas:** As you've outlined, you couldn't know at the start of the four-month period that you would not have time to take legal advice, for natural justice, as you call it, for the third party to be able to be a part of this. Where in that process did it become clear to you that you couldn't complete within the four months, and where did you feel that that necessitated, or would have necessitated if there had been one available, a trigger to extend the period or to consult with various committees, or whatever it might be, in that sort of scenario?

[22] **Mr Thomas:** I think that, in this, the other issue that we have is clearly the slightly—. The expectation that I've had throughout is that it was the Public Accounts Committee that I needed to keep informed, and I have done so. It was when I copied to Mark Reckless the letter I sent to Nick Ramsay that that became the case. But to answer your questions, I think it was only really about mid December that I came firmly to the view that I was not going to reach that deadline. My hope was, throughout that period, that further documentation that we'd requested would actually clarify one way or the other, and we'd got legal advice, we had the challenge to that legal advice, and therefore it became clear that we were not going to meet that deadline.

[23] **Simon Thomas:** And how important was it, that the challenge to the

legal advice that you just mentioned—that was NRW; their alternative legal advice, if you like—in terms of your decision making around not being able to do this within the four-month period?

[24] **Mr Thomas:** Well, it clearly got—. Whilst I rely on my own legal advisers, the process of considering the advice, and indeed the process of taking account of comments that had been received from the third party, meant that, inevitably, I couldn't just simply dismiss them and say, 'Well, that's it, I'm carrying on.' I had actually to consider them, had actually to seek legal advice on that, and that inevitably means that you're going to miss the deadline.

[25] **Simon Thomas:** David Rees.

[26] **David Rees:** Thank you, Chair. Obviously, you've started clarifying a little bit as to the conflict that exists between the establishment Order and your own codes of practice. But can I just go back to your point? You said that about mid December you recognised that you would not meet the target. The target was 23 December. That's rather late to identify that you're not going to hit the target within probably one, two weeks.

[27] **Mr Thomas:** That depends. Missing the target means that I'm signing the accounts; I'm signing the accounts with a qualified opinion. In fact, if we're being technical, if you noticed, the accounts weren't actually resubmitted to me until 2 March. So, in this process, when do you reach the point that you're saying, 'I am definitely going to qualify'? I was minded to qualify at that point, but I could not reach a firm view until I'd allowed the process of other people's responses to come back to me, and I'd considered those. And, as I said, we then received, in early February, additional documentation from NRW, which, again, I'd had to consider. So, the point is: at what point am I actually saying, 'This is clear, I am going to qualify these accounts, and I'm going to do it in a way that means that any challenge to me that is robust can be withstood'? So, it is the case that, yes, it became clear at that point that there was no alternative other than not being able to meet one administrative requirement in order to adhere to the requirements of audit legislation more generally.

[28] **David Rees:** Can I ask you: you said that additional information came to you in February from there; was that information requested or was that as part of the response to your seeking clarification on the points, as you highlighted in your letter, about the case law relating to Doody, to ensure

fairness applies?

[29] **Mr Thomas:** Well, NRW felt that they needed to bring certain other correspondence to my attention.

[30] **David Rees:** Were you aware that would be happening?

[31] **Mr Thomas:** No, I wasn't.

[32] **David Rees:** Okay. So, the situation is that you reached a point where you felt you hadn't had sufficient responses to be able to sign off, effectively, and then you felt that you had to inform others that you wouldn't meet the targets. I understand that. Perhaps you can just clarify, in your legal advice, what was it that said that fairness and case law took precedence over the establishment Order?

09:15

[33] **Mr Thomas:** I'm going to ask Martin to expand on this, but when it came to the point that I clearly couldn't meet it, the issue that I had is that I had conflict between two bits of legislation: which assumes precedence for that purpose? It's that one that I referred to in my letter to Simon on 22 December—it is the case law of R v. the Home Secretary on the part of Doody. Martin.

[34] **Mr Peters:** Yes, our solicitors quite clearly told us that with this kind of clash, in resolving it, there was a need to consider whether individual rights were affected. Those would be prioritised and that's what we did. I think this is set out in the letter.

[35] **David Rees:** It is set out; it does set out the priorities about Doody, but I suppose, in a sense—[*Inaudible.*—]—understand is, as you say, there's conflict around this decision as to which one wins that conflict, effectively.

[36] **Mr Peters:** But it is quite clear that that's the right thing to do.

[37] **Mr Thomas:** And that is because, again, the only place that my audit opinion can be challenged is in the courts, and it is important, therefore, that I withstand any kind of judicial review by indicating that I have applied issues of natural justice and fairness.

[38] **David Rees:** In that sense then, you just said, in an earlier response this morning, that you do not believe that this will happen maybe for another 10 years, for example, but it could happen next year, for example. What is necessary to avoid this happening again—to allow you to actually ensure that natural justice and fairness are applied, whilst still meeting, if possible, legal obligations under other aspects?

[39] **Mr Thomas:** It's about meeting the administrative obligations under the establishment Order. We need, in Wales, the same kind of mechanism that the Government Resources and Accounts Act 2000 gives to the NAO in England. In that case, even though it was mid December, I could have sought an Order, the Treasury could have laid it a couple of days later, and the deadline would have been extended.

[40] **David Rees:** And is there any belief that you have that you could actually perhaps have spotted this earlier than mid December, because you just had that feeling, you had an indication, because information was not coming in, that you were unlikely to meet that target?

[41] **Mr Thomas:** But the only mechanism—. If I could have spotted it already—hindsight is a wonderful thing, but the only mechanism is an Order to amend the establishment Order. That mechanism requires public consultation, it requires all the procedures, hence four months. So, I needed to know four months beforehand that I was going to qualify. Yes, I had doubts about the issues of regularity, but you have actually to check the evidence and you have actually to reach a view, based on the evidence, based on natural justice, having allowed NRW and the third party an opportunity to comment. So, the mechanism of amending the establishment Order isn't a practical one.

[42] **David Rees:** And, therefore, is it your view that the only solution to any future possible conflicts is some form of Order that allows you to actually come to us quickly?

[43] **Mr Thomas:** Yes. At the heart of it, yes. We need to be able to say, 'Look, these accounts, they are doubted and, for various reasons, I cannot audit [correction: complete my audit]. I will need to seek a separate Order to amend.' But that, I think, has to be done—. The danger is to do it and say, 'We'll just do it as a one-off.' I think that it ought to be done as part of a more general review of audit legislation. I think I mentioned before that we have the oddity that Sport Wales doesn't have any kind of requirement to

have its accounts audited. That seems to have slipped through the royal charter process of establishing that body. So, there are areas that do need to be tidied up and this one, yes, it was spotted.

[44] **Simon Thomas:** Mark Reckless.

[45] **Mark Reckless:** When did you first become minded to qualify the NRW accounts?

[46] **Mr Thomas:** We obviously sought advice on the kinds of issues that were there. We started probing and asking questions in September. We sought legal advice in November, and it's at about that point, at the end of November, that it became clear that I thought I was definitely going to qualify the accounts.

[47] **Mark Reckless:** How long was there between your receiving that legal advice that led you to the firm view you would be qualifying and the deadline for the accounts? What was that period?

[48] **Mr Thomas:** The deadline would have been about three to four weeks, but the point is that, at that stage, we then obtained—. Sorry, we then got a separate legal response from NRW's lawyers, which we again needed to take into account.

[49] **Mark Reckless:** How long did it take you to consider and take into account that legal view from NRW?

[50] **Mr Thomas:** I'd sought legal advice from others. That came through in December, about mid December, which I shared again with NRW, and I also at that stage started drafting the report that you now see in its final form on the accounts.

[51] **Mark Reckless:** Why couldn't you have been drafting that report simultaneously with the further legal advice being taken?

[52] **Mr Thomas:** Well, clearly, one does. One does a whole series of things in parallel. I think at the heart of your question is: could I have produced my audit opinion earlier? And I think that I'd stay very clearly with the fact that I do not believe that I could have done it in a way that complied with the Doody principles. And, indeed, that was the advice. The challenges that we received from NRW had required, in the end, early in the new year, for me to

seek counsel opinion as well.

[53] **Mark Reckless:** You referred to the Doody case. I wonder if there is an analogy with the Maxwellisation process for public inquiries. I understand that when you'd taken legal advice, you then had a contrary legal view for NRW, and, in respect of NRW's rights, you needed to take further legal advice in light of what they had presented. However, when you got that advice back, isn't there an argument that that should have been it, rather than you then going through a further iteration of sharing your second advice with NRW and allowing them yet another chance to raise issues and delay?

[54] **Mr Thomas:** I think the point you're making about the Maxwellisation process is a good one, in the sense that there's always a point where there is a dispute between a third party, say, and the kinds of reports we produce. And at some point, as with my value-for-money studies, I have to reach a decision, but we do allow enough time for people to express a view and respond. If I can ask Anthony just to illustrate how that matches the kind of process that other audit offices go through—.

[55] **Mr Barrett:** Yes, if you look at the general processes, you have to give an organisation an opportunity to respond, and there's a difference between responding to legal advice and responding to the draft report when you see it in all its detail. So, there's the process of sharing the advice, further information coming in from various parties, that being assessed, further legal advice if necessary, and then any changes being made to a draft report to reflect any of the representations made, and, invariably, there are one or two changes. They tend to be relatively minor, but, for factual accuracy, we need to get that right. And then there's a process of clearance, of providing the draft report to the relevant parties to enable them to see the totality of the information and the evidence and the conclusions that the auditor general is making, and to be able to comment on those, and that in itself takes some time as well.

[56] **Mark Reckless:** Thank you.

[57] **Simon Thomas:** Mike Hedges.

[58] **Mike Hedges:** Moving on slightly, this has taken a lot longer than is traditional, so what resource and cost implications are there to the additional activities required by this audit, and who's going to pay them?

[59] **Mr Thomas:** The charge goes to NRW. Very roughly, the costs have taken us about another 12 per cent, compared to the normal amount of time we would have spent on the NRW audit.

[60] **Simon Thomas:** Sorry—is it on this point, David?

[61] **David Rees:** Just on that, is the cost of your counsel advice also included in that?

[62] **Mr Peters:** Not in the 12 per cent, but it's in our additional costs, yes.

[63] **David Rees:** To NRW.

[64] **Mr Peters:** Yes, it will be in the charge.

[65] **Mike Hedges:** Will we, at some stage, in some set of accounts, see these charges, either in yours or in NRW's?

[66] **Mr Thomas:** Yes, because it appears as our fee to NRW.

[67] **Mike Hedges:** Okay. My last question: we understand that there is no provision in legislation for the extension of the four-month deadline. Should there be a procedure by which, if you think you're going to breach the four-month deadline, you bring it to the attention of the committee at as early a stage as possible?

[68] **Mr Thomas:** I think that I need a bit of clarity as to the new role that, clearly, the Finance Committee is assuming in this regard. Clearly, it's a matter for the Assembly to place those kinds of rules on me. But I had been keeping the Chair of the Public Accounts Committee informed throughout on the progress of this audit, because it is PAC that, as you mentioned at the start, is going to actually have to receive the formal report and, therefore, take evidence—that's on the twenty-eighth. So, I thought I had been keeping the relevant committee informed. Now, clearly, if change has taken place, that's fine—we'll know that in future. But the procedure—I would just reiterate that we need, in Wales, a parallel to the Westminster arrangements.

[69] **Simon Thomas:** We are interested, as you can tell. There's been no change as such, but, as you pointed out in your earlier evidence, this has not arisen since the Public Audit (Wales) Act 2013, since we've had the Natural Resources Body for Wales (Establishment) Order 2012 nor since we've had

this proper process in place. As I pointed out myself, PAC will look at the accounts themselves, but we are the committee, however, charged by the Assembly to look at the process behind that, and that's why we were keen to understand it a little more.

[70] Just one or two questions, if I may, following on from what's already been asked: my understanding as well, from the correspondence we've had and also looking at the accounts, which were laid on Friday, is that you felt there was a lack of proper records to allow you to make some key decisions. So, it's not simply that there was a third party and iterations around legislation; you also question whether the record-keeping around the awarding of contracts was sufficient for you to come to a conclusion. Would that not usually mean that you would qualify the accounts within the four-month period and then, perhaps, there would be a future reiteration of this discussion, as it were?

[71] **Mr Thomas:** No, we can't do that in terms of, if you like, 'Yes, accounts qualified—reasoning will follow'. Anthony.

[72] **Mr Barrett:** Basically, once the auditor general has provided—certainly in the case of NRW—the opinion on the accounts, the audit is closed. He is—I think the technical term is *functus officio*. He is without any legal authority to do any audit work on that year of accounts. We have a slightly different situation in local government, for example, where you can and we do issue an opinion on the accounts but we keep the audit open, because they've separated the audit opinion from the certification of completion of the accounts [correction: audit]. Once we've certified completion of local government, it's the same process—the audit is finished. So, in local government, we can hold them open and we can give the opinion, if we don't think it's likely to be a material issue, whilst we're dealing with some correspondence or a formal objection. Once that's been dealt with and we've considered the impact on the organisation, we can then certify the audit as complete. But, in the case of the central Government bodies, invariably, there is no separation, there is no separate certification of completion and the giving of the opinion renders the audit closed. So, if we wanted to do further work, we'd have to keep the audit open by not giving the opinion.

[73] **Simon Thomas:** Thank you for that explanation—it explains the difference between the two audit regimes to a certain extent and why some people might have formed an impression that something could have happened in this circumstance that clearly is not possible. But, within the



overall process, within that, usually, four-month period for most bodies, what role do third parties normally play within that? How much time do you have within that process to take account of their concerns, or questions they raise or whatever it may be?

09:30

[74] **Mr Thomas:** Audit, in its best form, is not something that we do after we are suddenly presented with the final accounts. We will have been doing work beforehand, and hence a number of Assembly Members bring issues to our attention in the course of the year; we will make sure that we try to cover that in our accounts. So, there's always some element of correspondence that we have received that we will use in terms of doing the audit of the accounts. In this case, we received directly correspondence from a third party, which, we would, in the normal course of events, have actually tested out, but we were unable, for the reasons that I have set out in my opinion, to find, among other things, the necessary evidence base in terms of the way in which the contracts had been awarded. We started asking questions about the nature of that audit process [correction: that process], and, again, without going into the detail, we recorded it in the opinion. Of course, there will be a fuller report going to the Public Accounts Committee—not just the accounts themselves.

[75] **Simon Thomas:** Thank you for that. I'm just trying to understand, really—. You made the earlier point around the process by which, if this were to arise again, you would need to extend the period in the way that it was, de facto, extended on this occasion. I just wondered within that, in line with the principles you mentioned earlier—the Doody case—how much time you felt you would need to allow within that. In this case, in effect, it's taken, I think, seven months to reach a conclusion. Is that the kind of time that we would expect this iterative process to go on with third parties if it were to arise again, or is this not only once in a blue moon but even further ahead than that, if you like?

[76] **Mr Thomas:** Well, as I said, the last time that anything similar arose was in respect of John Bourn's period as auditor general in looking at the ELWa accounts. It hasn't arisen since then. That's possibly one reason why we haven't had the kind of mechanism that Westminster's had.

[77] **Simon Thomas:** Okay. Steffan Lewis.

[78] **Steffan Lewis:** In terms of the qualified regularity opinion for Natural Resources Wales, can you explain the impact of that and any potential way forward for the organisation?

[79] **Mr Thomas:** There are two. One is that, because it is a public body, any account that is qualified has to appear before the PAC. The PAC will need to take evidence, reach a conclusion and, doubtless, make some kind of recommendation for the Assembly to consider. There's also the kind of immediate response that we've received from NRW, which is in terms of tightening up the procedures they have for the awarding of contracts, and I'm sure that they will learn some lessons from that. The impact of qualified accounts is that I am telling you, as an Assembly, that I have significant uncertainty that the funds that you voted to NRW have been correctly applied. So, it is, if you like, back to the Assembly to say, 'Having heard what the auditor general has said, having taken evidence, this is the recommendation'. So, in a sense, it is in your hands.

[80] **Steffan Lewis:** That's heard loudly and clearly. What would be your role and the role of your office following the certification of the annual report and accounts?

[81] **Mr Thomas:** We will clearly be—. The next time that we do an audit of NRW, there will be certain things that have been flagged up by this process that we will check have been put in place.

[82] **Steffan Lewis:** The contract in question was awarded in May 2014. Was that apparent in the 2014–15 accounts?

[83] **Mr Thomas:** No, it wasn't, and I deal with that in the report I'm providing to the PAC. Basically, when I do an audit—. If I answer it in a more general sense, if I do an audit of any organisation, I can't certify that every single transaction is valid. But, when evidence is brought, then we can start digging. In this case, we hadn't discovered it from the previous one, but it was brought to our attention, therefore we started looking in this audit.

[84] **Steffan Lewis:** Will it affect your opinion of those accounts in any way?

[85] **Mr Thomas:** No, because we qualified on this account.

[86] **Steffan Lewis:** Why was the issue brought to light by a third party rather the audit team? I suppose you've just touched on that a little in your

previous answer.

[87] **Mr Thomas:** We can sample, and perhaps a sample might have given it, but it didn't in the previous one. Because it was brought to light we looked at it.

[88] **Simon Thomas:** You've—. Oh, sorry. Mike Hedges.

[89] **Mike Hedges:** I'm not sure if I ought to be asking this in a fortnight's time or here, but surely large contracts should be amongst those that are sampled, because they have positions that are the greatest potential cause. So, in the process, don't you give priority to larger contracts?

[90] **Mr Thomas:** Yes, we do, if it had appeared as a large contract, and that's, I think, a matter that the PAC may wish to look at.

[91] **Simon Thomas:** Clearly, as you've earlier pointed out and as has just been reinforced, there are issues for Assembly committees to look at here, not just the PAC—one or two other committees might be interested as well, and the Assembly as a whole. Can I just ask at this stage, however: would you share my concern, reading the laid accounts and audit report as we saw them laid last week from Natural Resources Wales, that I can't discern in those any sense from the chief executive or the chair of Natural Resources Wales as to any lessons that they have learned from this audit process and anything that they might be trying to do to change their record keeping, the way that they procure and the way that they would be responding to questions like this in the future?

[92] **Mr Thomas:** I think that, in terms of the accounts themselves, it records the accounts and my qualification. I think, from some of the comments that have been made in the media, that NRW is actually recognising that there are issues that they need to address, and, doubtless, the PAC will be pressing on those issues.

[93] **Simon Thomas:** You have previously said, in your report on the development of Natural Resources Wales, that you felt their procurement functions were non-conforming. Is that something that has a relevance to your finding on this occasion as well?

[94] **Mr Thomas:** I think NRW had a very difficult task in terms of putting together the various bodies. Indeed, if you like, there's a commonality

between the issues on which ELWa was qualified and NRW. Both were organisations that were called into being, which brought together individual organisations, and both did it against a very tight timetable. In the case of ELWa, they didn't prioritise—if memory serves me right—getting the procedures in place. In the case of NRW, they certainly had looked at lessons and did things to tighten up arrangements, and we commented on those in a separate value-for-money study. But this was a contract that was at the point in which the new body came into being, and whilst I believe that, again, the PAC will want to look at that, it's again an issue that arises when organisations are brought together. I think that there are lessons here that we need to reflect on when setting up large organisations like this in Wales.

[95] **Simon Thomas:** Thank you for that. Could you just say, in that regard, just a little more about why you feel—without going where PAC will want to go in a couple of weeks' time—that the fact that this contract did not emerge at the earlier stage in terms of a sampling or looking at the large contracts, or just the audit team thinking, 'Well, that looks quite big and unusual over 10 years, let's have a look at it', why that might be something that you would want the PAC to look at in particular?

[96] **Mr Thomas:** The contract didn't appear as a single contract, but as separate contracts.

[97] **Simon Thomas:** I understand, thank you.

[98] **Mr Barrett:** A number of smaller contracts, rather than one large contract.

[99] **Simon Thomas:** But treated as a single contract.

[100] **Mr Thomas:** No, treated as separate contracts.

[101] **Simon Thomas:** Ah. Okay, well that probably does take us into PAC territory, which I'm sure they will want to examine. I don't know if—I don't know if it's on that or other things, but I'll go to Mr Reckless first.

[102] **Mark Reckless:** It's a separate point, if anyone wants to come in on that issue first.

[103] **David Rees:** It's on a separate issue.

[104] **Simon Thomas:** A separate issue—so, over to you.

[105] **Mark Reckless:** Chair, I was keen just to follow up on the 25 January letter from the auditor general to you about the code of practice. I recognise, there, the Doody principle, and the way you've resolved—or, at least, dealt with—conflicting legislative requirements. However, on the requirement on you to produce that code of practice, you do have at, I think, paragraph 31(d):

[106] 'After concluding fieldwork, auditors must...offer audited bodies and relevant third parties the opportunity to comment on the factual accuracy of the findings, as appropriate.'

[107] And then you go on in (f) to say, also, that they must

[108] 'Produce outputs that comply with statutory and professional reporting requirements'.

[109] So, you have in your own code of practice an apparent conflict between the timeliness and the statutory requirement. Would you give consideration to revising that code of practice to put in an appropriate requirement, were principles within that code itself to clash?

[110] **Mr Thomas:** I was going to ask Anthony to explain the process that we go through in looking at the code of practice and continually updating it in light of Financial Reporting Council guidance. But can I just make the point that, at the heart of this, I am convinced that had we had the kind of mechanism that Westminster has, we would not be having this meeting today? We'd have exercised the powers under the particular bit of legislation. But as regards to the code of practice—.

[111] **Mr Barrett:** The code, yes. We carry out an annual review of the code and take a view as to whether or not it needs updating. We're currently going through that process at the moment, and identified some changes that need to be made in relation to the Well-being of Future Generations (Wales) Act 2015 and things like that, and we'll certainly be looking at the outputs from this matter to see if any particular changes need to be made. As Huw was indicating, it wouldn't change the contradiction that exists between natural justice of giving third parties [correction: giving third parties the opportunity to comment], and complying with administrative duties in terms of the timetables. But it is certainly something we will look at in this context.

[112] **Simon Thomas:** The current code, or certainly the current code that I have in front of me, is dated April 2014. Does that mean it hasn't been updated since then, or don't you—?

[113] **Mr Barrett:** It has been reviewed, but it hasn't been updated.

[114] **Simon Thomas:** So, it hasn't changed as a result of reviews.

[115] **Mr Barrett:** No.

[116] **Simon Thomas:** Okay, I understand. David Rees.

[117] **David Rees:** I just want to come back. I appreciate that we're not here to review the accounts; that's the Public Accounts Committee's job. But several times this morning you've strongly said that if you'd had the same powers as in Westminster, you wouldn't be here, basically. But we are. The question I want to ask is: one of the reasons identified is this allowing of fairness—the Doody case law is showing that. How much time do you give for third parties to respond to you, so that that fairness can happen? What are the expected timescales?

[118] **Mr Peters:** It depends on the circumstances. I mean, if you've got a large volume of very complex issues, you've got to give longer than if you've got one single simple issue. But as a general rule of thumb, nothing less than two weeks is going to be really fair.

[119] **David Rees:** Looking at your letter to the Chair of the Public Accounts Committee of 14 December, and the subsequent letter to the Chair of this committee, it's quite clear that there was a substantial amount of information that you were working through as a consequence. So, what would you expect as a timescale for that?

[120] **Mr Thomas:** Again, particularly as an audit process goes on, and we, in a sense, are going through iterations, the amount of time will decrease. For example, we had a draft report that went to NRW, the Welsh Government and a third party—I think just before Christmas. Well, clearly we had to allow for the Christmas and the new year period. So, getting responses back mid January was actually quite a reasonable one. We revised, sought further legal advice and then, as I just said earlier, some further information arrived, which we had to consider. So, could I have done it faster? Well, without that

additional information I might have done it a couple of weeks faster, but at the heart of it is the complexity of the issues that were there, and the fact that we weren't able to find all the necessary information that we needed from NRW, immediately to hand. They had to do searches themselves. So, I think that we have progressively given less time, because it is an iterative process, and that is normal. We're clearing up a particular value-for-money report at present where we've given a reasonable length of time on the first one, we're revising the draft now, it will enter clearance, and it will be a shorter time period for clearance because people have had an opportunity to comment beforehand.

09:45

[121] So, I do try to avoid the Maxwellisation that Mark Reckless referred to. I do try and avoid that, just continually going on and on.

[122] **David Rees:** I appreciate that. In your letter, you indicate that you took legal advice on 28 November, but you didn't write to the Public Accounts Committee until 14 December. I just want to try and work out why, if you had legal advice on 28 November—what was the difference between then and 14 December? When you spotted—

[123] **Mr Peters:** Was it not 28 November?

[124] **David Rees:** I said 28 November.

[125] **Mr Peters:** Yes, 28 November. Then we had to get the—. Well, NRW had a contrary view. We shared that legal advice with them, the same day or the next day. They said that they had a contrary view. We had to give them time to provide that contrary view.

[126] **David Rees:** So, even at that point it was likely you were not going to hit the target, effectively.

[127] **Mr Thomas:** That we weren't going to meet it at that stage.

[128] **Mr Peters:** Well, it took time—

[129] **David Rees:** Can I ask, if that's the case: did you forewarn, for any reason, not on 14 December but beforehand, through the chair of PAC: 'Look, it's unlikely we'll hit this target. I'll write to inform you, but it's

unlikely'—were they aware of that beforehand?

[130] **Mr Thomas:** Yes.

[131] **David Rees:** Okay.

[132] **Simon Thomas:** We've talked about the need for a possible change here, and to understand how this might be dealt with in the future. In terms of the impact on your own office, dealing with this and the obviously quite intense iterations that sometimes had to happen, by the sound of it, was there anything that impacted on your own office in terms of capacity or your ability to deal with this, and which would arise again in a different circumstance?

[133] **Mr Thomas:** In terms of work pressure, no. I think it is, in the end, a matter for my judgment. I'm informed—I have to consider, obviously, the advice I receive. I've got to read the papers and reach a view. But there is no-one else who can do that. It's vested in my office.

[134] **Simon Thomas:** Indeed. And you have that discretion.

[135] **Mr Thomas:** Yes. Well, it's not so much discretion—it is my duty to actually consider that.

[136] **Simon Thomas:** Any further questions, committee? Do you have anything further that you think we need to listen to or understand, as it were?

[137] **Mr Thomas:** No, but I would like to just say that I've said, on previous occasions when I've been here, that there's a need to try to tidy up the legislation more generally. It may be useful if actually I were to write to you setting out some of those areas, because I do genuinely feel that the new auditor general, next year, when they take over, would benefit from seeing a better consolidation of accounts and audit legislation.

[138] **Simon Thomas:** The committee would be very pleased to receive that. As you know, we have a general view on other issues that you've raised in terms of the fees scheme in the past, and other things that are set in legislation that are perhaps not helpful for current circumstances. So indeed, that would be very useful. Thank you for that.



[139] **Mr Thomas:** In relation to the fee scheme, I expect to be publishing a consultation document next month.

[140] **Simon Thomas:** Okay. Thank you.

[141] In which case, we'll bring this session to a close. Thank you very much for your assistance this morning. Diolch yn fawr iawn.

[142] **Mr Thomas:** Diolch.

09:49

**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 eitemau 5 a 7 exclude the public from items 5 and  
y cyfarfod yn unol â Rheol Sefydlog 7 of the meeting in accordance with  
17.42(vi). Standing Order 17.42(vi).*

*Cynigiwyd y cynnig.*

*Motion moved.*

[143] **Simon Thomas:** A ydy'r **Simon Thomas:** Is the committee  
pwyllgor yn hapus i fynd i sesiwn happy to go into private session?  
preifat?

[144] Are you happy to go into private session under 17.42 for items 5 and  
7 of today's meeting? Diolch yn fawr.

*Derbyniwyd y cynnig.*

*Motion agreed.*

*Daeth rhan gyhoeddus y cyfarfod i ben am 09:49.  
The public part of the meeting ended at 09:49.*

*Ailymgynullodd y pwyllgor yn gyhoeddus am 10:30.  
The committee reconvened in public at 10:30.*

## **Datganoli Pwerau Cyllidol i Gymru: Briffio ar Ragolwg Trethi Cymru Devolution of Fiscal Powers to Wales: Welsh Tax Forecast Briefing**

[145] **Simon Thomas:** Can I call the Finance Committee back to order and welcome everyone back to the public session with Robert Chote? I hope that you can hear us clearly, and we can see and hear you.

[146] **Mr Chote:** Yes, I can. Thank you very much.

[147] **Simon Thomas:** Thank you. Can I welcome you back to the Finance Committee? But just for the record, if you can state your name and post so that we have that for the record, please.

[148] **Mr Chote:** I'm Robert Chote, and I'm chairman of the Office for Budget Responsibility.

[149] **Simon Thomas:** Thank you for joining us this morning. As you know, we want to understand the role of the Office for Budget Responsibility around devolved taxes in Wales and the information you provide as a basis for tax forecasting, and then decisions made by the Welsh Government and approved, hopefully, by the National Assembly. Could you just, at the outset therefore, remind us and give us an overview of your role in the Office for Budget Responsibility, and how you operate—and particularly your role—in forecasting the Welsh devolved taxes landscape?

[150] **Mr Chote:** Yes, certainly. As you may know, we were created back in 2010, and we were given four main tasks at that stage, one of which was to produce, twice a year, five-year-ahead forecasts for the economy and the public finances for the United Kingdom as a whole; a second role to use those to judge the Government's progress against its fiscal targets; a third role to scrutinise the costing of individual tax and spending measures that appear in budgets and autumn statements; and a fourth role to look at the long-term outlook for the public finances and the public sector balance sheet. We were then given, as the devolution process got under way, an additional responsibility to produce forecasts for those taxes that were to be devolved to the nations. Obviously, as we will continue to have a responsibility for producing a forecast for the United Kingdom public finances as a whole, we continue to have to forecast those tax receipts once

they are fully devolved, as they still form part of the overall UK public finances. The way the process works, in effect, is that, in the run-up to a budget or an autumn statement—. Sorry, I got a bit of feedback coming back. Sorry about that.

[151] **Simon Thomas:** It's okay. We can hear you clearly.

[152] **Mr Chote:** In the run-up to a budget or an autumn statement we produce a draft forecast for the economy, which then is sent off to officials in Her Majesty's Revenue and Customs, the Department for Work and Pensions et cetera, and they bring back to us a set of forecasts for individual tax receipts and flows of welfare spending, debt interest spending et cetera, which we then scrutinise and change them if we think that's necessary. That gives us a forecast for the public finances. That goes through four iterations in the run-up to a budget or an autumn statement. The first three iterations are essentially looking at the forecast if the Chancellor of the Exchequer sits on his hands and does nothing in the budget or the autumn statement. It's what we call a pre-measures forecast. Then in the final iteration—the fourth one—that we produce close to publication, you add on the effect of the measures that are being announced in the budget.

[153] As part of the process of producing the pre-measures forecast, in addition to forecasting the receipts for the UK taxes, we look at the receipts specifically for the devolved taxes. So, in a similar way to the rest of the forecast, officials from revenue and customs and OBR staff together will produce draft forecasts for the devolved taxes on a pre-measures basis; i.e. not including anything that the Chancellor is intending to announce. We have meetings with people, either physically or like this—present on video conference or telephone—at which officials from the Welsh Government, the Scottish Government and the Scottish Fiscal Commission can join with us in questioning and scrutinising the numbers and asking questions of revenue and customs. Then, obviously, at the end of the day we have to go away and make decisions about those.

[154] That's a very useful meeting, because it's an opportunity for us to ask, in particular, officials in Scotland and Wales whether there is any local or nation-specific information, data or trends that we ought to be aware of in setting up those forecasts, which are generally based on the outlook for the UK as a whole, and making adjustments as appropriate for those institutions. So, once that's done, we will then agree ourselves a forecast at the end of the day. The published forecast will also include any impact of measures that the

Chancellor of the Exchequer announces in the budget or the autumn statement. Now, those measures, obviously, have to remain confidential up until the point at which he announces them, so those and the potential effect of those on Wales and Scotland, we cannot discuss at those meetings because it's too early in the process. So, we have to have that discussion at the level of pre-measures forecast, then add it in at the end, and then we produce, alongside the budget, this publication on the devolved taxes forecast. And the aim there is to explain the methodology, what's changed in the most recent forecast, and the impact of the measures that we've had to put on the end after the period of when we're able to consult with the Government. So, I hope that's useful by way of introduction. I'm obviously very happy to pick up or expand on any of that as you wish.

[155] **Simon Thomas:** Yes, thank you for that. And thank you for setting out the process and the various situations that you go through. Clearly, we've now had the budget, so we can start to look at the impact on Welsh tax forecasts. One of the things that's clear from the budget is the impact of the personal allowance and changing the personal allowance—particularly in the Welsh context, as I understand it, there's a particular impact. Are you able at all to give us an outline of how that decision has impacted on your forecast for potential Welsh tax receipts?

[156] **Mr Chote:** Yes, I think it's an interesting—. This is a pattern that's worth looking at over a number of these sorts of statements, where you have seen on the income tax side a tendency for the UK Government to raise revenue from people relatively high up the income distribution, but at the same time to increase over time the personal allowance more quickly than average earnings have gone up. So, in a sense, what that has meant is that you're ending up getting more of the pot of income tax receipts from higher up the income distribution. Now, one consequence of that for Wales in particular—Scotland as well, to a degree—is that the distribution of income in Wales is different from the rest of the UK, in the sense that you have a higher proportion of incomes from lower down the income distribution, and a smaller proportion in particular at the very top, and that's partly a 'London versus everywhere else' effect as distinct from a 'Wales versus the rest of United Kingdom' effect.

[157] So, that trend over time has tended to reduce the overall share of the United Kingdom tax receipts accounted for by Scotland and Wales, because of the nature of the policy changes and the way that they've affected things. What we tend to do in producing a forecast for Welsh income tax, and

Scottish income tax to a degree, is to get information on what share of the total receipts—the relevant pool of receipts: non-savings, non-dividend income-based receipts—comes from Scotland and Wales. For that, we use something called the survey of personal income, which is a survey of a small-ish but not insignificant proportion of taxpayer information, and you derive a share and then you look and say, ‘Are there any particular reasons to expect the Welsh share to rise or fall over time relative to where you’re starting?’ The sorts of things you would look at include any policy measures like that, so that you would expect to have a proportionately different effect in Wales from the rest of the country. There might be other things that you want to take into account as well, and also, as the data become more up-to-date, you may discover that the share that Wales accounted for when you actually have the outturn data is slightly different from what you assumed it was going to be when you were producing earlier forecasts, so you may need to adjust the starting point, as well as taking into account anything that you think might move the share in the future.

[158] **Simon Thomas:** Just on that, just to concentrate on income tax, or personal taxation at the moment, are those data that you have robust and up-to-date enough for your purposes from the point of view of Welsh taxation, or potential Welsh tax devolution?

[159] **Mr Chote:** The notion of having to rely on this survey means that there’s inevitably something of a lag involved there. It’s not necessarily hugely problematic. We discovered, I think, that the Welsh share, when we had a new year’s-worth of the survey of personal income, data showed that the Welsh share was 1.26 per cent of income tax, and previously we’d assumed it was 1.27 per cent, so not a huge difference in that case. But there’s always the possibility that this survey will have—. Because it’s not the whole taxpayer population, you can end up with differences between what that survey is telling you and what the whole population is telling you. So, there will be movement around this.

[160] Over time—I mean, we’re seeing this, obviously, more pertinently with Scotland, given where they are in the process. The Revenue and Customs is flagging individual taxpayers as being, in their case, obviously, a Scottish or a non-Scottish taxpayer, and then you’re less reliant on the survey to work out what the shares are and how that is moving, and you’ve got more timely data directly based on HMRC now having to ask this question, whereas, previously, they didn’t have to.

[161] **Simon Thomas:** Indeed. Thank you. Eluned Morgan.

[162] **Eluned Morgan:** Can I ask you about the forecasting of Welsh devolved taxes? You state that in Scotland there are less macroeconomic data for you to rely on, and therefore the accuracy of your forecasts probably can't be as relied upon as that for England. Presumably, that's also true for Wales. Can you tell us how accurate were you? How far out were you in terms of—? You've had a bit of time in Scotland: what did it look like in reality—your forecast against the reality?

[163] **Mr Chote:** It's an interesting question on whether you—. It's certainly true, as we've said, that we produce a macroeconomic forecast at a United Kingdom-wide level. The difficulty with producing one for the nations is fundamentally one of timeliness, the availability of the information and the lag with which it comes through. I think it's an interesting question and it's by no means a given that, if we did try to, or somebody tried to do a nation-specific macroeconomic forecast, that would necessarily improve the accuracy of the underlying data, because, obviously, you're introducing an additional degree of uncertainty about how accurate the macro forecast is relative to the other one. So, I think we've taken some reassurance from the fact that the tax shares do tend to be relatively stable. And so I think there would be an interesting question of—and it's one, obviously, now that with the Scottish Fiscal Commission having to do forecasts of its own for itself—to what extent doing a full all-bells-and-whistles macroeconomic forecast would actually help that or whether doing something more rough and ready would be a better cost-benefit analysis approach to that.

[164] I think what you find in terms of the forecasting record over time is that it does differ for different reasons, depending on the different taxes, and an error in the Scottish or the Welsh tax forecast can arise at least as much as from an error in the UK forecast as it can from an error in your forecast of what share would be accounted for by the individual nations. So, to take the example of income tax, we have tended, over recent years, to overestimate that, to a degree, for a variety of reasons that may be common, to a degree, across the UK, notably that earnings growth has tended to be weaker than we and most other forecasters have expected, but employment growth has tended to be stronger. In addition, of employment growth, more of that has tended to be self-employment than people had anticipated, and there has also been a growing tendency for people to decide to incorporate—to become, effectively, companies—and therefore paying tax on profit, rather than being employees or self-employed people.

10:45

[165] So, for a whole variety of reasons, the effective tax rate, the amount of tax you get out of every pound of labour income—. The income that people earn has been overestimated, but that's not necessarily for specifically Welsh or Scottish reasons—it's a UK-wide story that probably dominates the other areas. If you go to the property transactions taxes, there's a particular issue there that, if you're looking at the trends in these things, the idea that Scotland looks very different from Wales, looks very different from England, in a UK story, is kind of missing the point, when the big difference is the performance of London and the south-east versus the rest of the country, and it can go in both directions. So, when the 'top high-value properties' are being transacted more frequently than those in the rest of the countries, then, obviously, receipts are relatively buoyant and there's a big gearing effect there. If, as in the more recent period, they're relatively weak, then that can have a disproportionate effect. So, one thing we try to do when producing these forecasts, and, indeed, when producing a forecast for stamp duty in the UK as a whole, is to have an eye on what you can tell, if anything, about the trends for London and the south-east, and try to make some sort of adjustment for that.

[166] **Simon Thomas:** Mike Hedges.

[167] **Mike Hedges:** Two questions. The first one is: looking at the Welsh tax forecasts, you seem to be expecting it to be virtually a linear continuation for land transaction and income tax, the two cyclical taxes. That'll be 13 years without another recession, which I think would be very interesting. Do you just take a straight, linear view that it'll continue as it is now, or do you have a more robust means of calculating it?

[168] **Mr Chote:** Well, that's a very good point. What we do is, essentially, that the forecast is predicated on the assumption that the Bank of England sets interest rates and sets monetary policy more broadly to stabilise the inflation rate at the target that it has been given, and then, effectively, to keep the amount of activity in the economy, the amount of spending, output and income in the economy at the sort of goldilocks level—neither too hot nor too cold—that is consistent with keeping inflation stable. So, to that extent, when you're producing a forecast, you are assuming that, in the future, you don't get swings up and down: you have a starting point, and you have to judge whether the economy is performing below potential or above

potential, and you get them back there.

[169] So, in the central forecast and over a five-year horizon, we don't plug in another recession simply on the grounds that, on average, over a given number of years, you're likely to have one. That is something, though, that we think about carefully when we're looking at fiscal risks, and so we might use our scenario analysis, which we did in this economic and fiscal outlook, to look, for example, at what would happen if you had a mini boom or bust in the behaviour of consumer spending. One feature of the UK economy over 2016 is that it has ended the year with more momentum than most people had expected, but that being driven by consumer spending and a sharp fall in savings. So, we thought one useful thing to do would be to look at what happened if that continued and consumer spending remained strong, pushing the economy into the up phase of an economic cycle because people continue to run down the savings, and an alternative where it goes in the other direction, because consumers tighten their belts and retrench a bit. So, you're right in the sense that you would want to be alert to the possibility of economic cycles, and history shows that you don't go for that long without having upswings and downswings, but, basically, we have to deal with that as analysis of risk and of sensitivity, rather than basically saying, 'Let us make the assumption that, in year 4, the Bank of England takes its eye off the ball and we have either a boom or a bust.'

[170] **Mike Hedges:** Growth in the last year—some economists, and I tend to agree with them, put a lot of it down to the fact we've had a 17 per cent devaluation. Are you assuming a 17 per cent devaluation year on year that would give you that level of growth, or do you think, at some stage, we will stop devaluing, and currency devaluation will come to an end, and the Bank of England may well have to step in then and increase interest rates in order to protect the pound? You may not agree with this, but I would like your view on it: I don't believe the Bank of England will let the pound drop below parity to the dollar.

[171] **Mr Chote:** Well, you have to ask the Bank of England what their policy is as regards the exchange rate. As I understand it, they're aiming for the inflation target, and there's no implicit or explicit target there. What we do, which is a very conventional assumption for economic forecasters, is to assume that the future path of the exchange rate reflects the differences between interest rates and expected interest rates in this country and other places, and that the exchange rate moves, essentially, to ensure that the returns you would get investing in each place would broadly equalise.



[172] The impact of the fall in the exchange rate that we've seen does show up in sort of buoying the short-term export performance, so you do get some boost there, but if you go back a year to the forecast that we were producing back in March of last year, you essentially have a weaker picture for business investment, and business investment did indeed fall in 2016 relative to the previous year. Weaker consumption, particularly coming into the middle part of this year, because the fall in the exchange rate pushes up prices and pushes up inflation, which squeezes household budgets. That effect, we assume, will feed through probably from the second quarter of this year onwards; you wouldn't expect it to come in straight away. And then the exchange rate effect on exports is a partial offset; roughly speaking, it offsets about half the impact going in the other direction from the changes you make to business investment and consumer spending.

[173] Clearly, if you believe that the exchange rate has fallen because financial markets have concluded that, in the future, the economy is going to be poorer and/or the trade position is going to be weaker, then while it's true that the fall in exchange rate provides a cushion, it's a bit odd to describe it as being a net stimulus if the reason for it coming about in the first place is because of that change in expectations about future income.

[174] **Mike Hedges:** I could continue this for an hour, but I'll be quiet, Chair.

[175] **Simon Thomas:** Thank you. I turn to Nick Ramsay, please.

[176] **Nick Ramsay:** Diolch. Good morning. Can I ask you about the use of Welsh-specific data? And, in terms of this budget, how have Welsh Government officials fed into and influenced your forecasts, if at all?

[177] **Mr Chote:** As I say, we've had two meetings—one basically on income tax and one on the other taxes, which is an opportunity to feed in information. One area that, for example, we did on this occasion is that we made a methodological change in the income tax forecasts that is based on future population trends, and the expectation in the ONS's population projections is that you would have slower population growth in Wales and Scotland relative to the rest of the UK. So, that's obviously something we did want to talk to officials about.

[178] An example of information being fed in of local and national significance would be on landfill, where the trends for the rest of the UK—for

England, in particular—show changes in recycling and an end to the period of greater recycling. We had evidence from Welsh colleagues saying that that pattern was not the same in Wales, and so therefore we've made an adjustment to the forecasts specifically on that basis. We don't do those forecasts on the basis of simply assuming that any Government in Wales or anywhere else will hit the targets that they have set themselves, but in terms of outturn data, that was a useful input which has meant that we've not just pushed the Welsh forecast in the same direction as all the others.

[179] **Nick Ramsay:** That's really helpful, particularly the example you provided. You mention that the expansion of the Scottish Fiscal Commission forecasting remit may speed up improvements in forecasting. Will the lack of a fiscal commission in Wales mean that progress here is slower?

[180] **Mr Chote:** I think it will be a 'suck it and see' exercise as far as the Scottish commission goes. It will obviously depend on what additional information they are able to provide and the additional resources that they're able to bring to that. As you know, the original plan was that the Scottish Fiscal Commission would provide independent scrutiny of the forecasts being produced by the Scottish Government. That has now, after subsequent discussion, moved to a more similar model to the OBR in the Westminster context. In other words, the Scottish Fiscal Commission will do the forecasts itself. That's not started yet, but it will move to that model. So, obviously, given the resources they have, they will be able to invest some time and effort in, presumably, getting more information, and being able to put more analytical resources into that than we would be able to do from London, on the basis of the resources that we're able to allocate to this from the total. How useful that turns out to be, whether it does result in very different forecasts, I don't know, but my hope is, certainly, that their work will provide us with more information and insight and analysis that we can draw upon. So, if Wales had a similar thing, then maybe one would hope for similar contributions. Whether that would pass the cost-benefit test of whether it's worth having a fiscal commission is in the eye of the beholder, and obviously has much broader issues around it than just whether it makes our job easier or not.

[181] **Nick Ramsay:** So, a Welsh fiscal commission is something we shouldn't necessarily shut the door on, but it would have to pass some criteria as to whether it was worth having cost-benefit wise in the medium term.

[182] **Mr Chote:** Yes, and I think that would, because it has with Scotland—.

It depends a bit on where you think you're going to end up in the range of not just tax, but also potential spending flows that are devolved. If it's a relatively small one, then presumably the justification for a whole apparatus, a quango to do that, is harder to justify, but that's obviously something that I presume you will keep under review.

[183] **Nick Ramsay:** Great. And, finally from me, will a methodology note for forecasting Welsh tax receipts be published similar to Scotland?

[184] **Mr Chote:** I don't think so. We started off doing the Scottish note, as it were, before we embarked upon this process, and we wanted to set out, before we started it, the methodology that we would be using. And, obviously, we were highlighting, at that stage, things like that there's not the availability of a Scottish macro forecast, and therefore the use of shares. What I think we've essentially done is we now use the devolved taxes publication, which is a lot longer than it used to be, to discuss the methodology in brief and, in particular, to highlight changes in methodology over time. So, I think, if we were to do one, all it would end up doing is recycling the information that is now available in this publication here anyway. So, there's not an intention to do something different. If you feel that this publication doesn't give you enough information on particular aspects of methodology that you'd like us to incorporate, then that's something we'd obviously be very happy to hear about.

[185] Over time, obviously, as more things are devolved in more places, we're going to have to look at how wieldy this document is, and think about how we present all this information and the ability to do it in as timely a fashion as we do at the moment. And that's something, if we end up thinking we need to do something very different, we'll obviously want to talk to the Governments, the fiscal commission, and to yourselves and your Scottish counterparts about, in terms of whether we're providing you with the information you need.

[186] **Nick Ramsay:** You've clearly got a growing body of work there over the years to come as the devolution of taxes increases. But, thanks, that's been really helpful.

[187] **Mr Chote:** Thank you.

[188] **Simon Thomas:** If I could just come in on this point around information, and the growing body, as Nick Ramsay just said. Of course, we

don't have a fiscal commission at the moment in Wales. That's not proposed. I don't know if you're aware that the Welsh Government has, however, contracted with a unit in Bangor University to give them, from time to time, independent advice and fiscal advice. And I just wondered, first of all, if you're aware of that, and secondly whether that information, or the work of that unit, would be something that you'd be looking at within the OBR as well.

[189] **Mr Chote:** Well, we've not had any contact with them yet, but it would be very interesting to do so. So, if it's possible, I'll ask the clerks for contact information and we can get in touch with them. It would certainly be very—. It's always a good idea to have another set of eyes over these sorts of issues, and obviously it's not our job to provide policy advice at any of the national or UK levels, but anything that they're doing on the substance of the forecast, we'd be very interested to look at and help them with their work if we can.

[190] **Simon Thomas:** Well, thank you for that. As I understand it, it's not necessarily policy advice, it is information and fiscal information, but it's within the last several days, certainly within the last week, that that relationship has been built up. So, we will certainly share that with you in that regard. Mike Hedges, do you want to come in?

[191] **Mike Hedges:** May I return to income tax? Two questions. The first one is: you're going to use HMRC data to forecast Welsh income tax receipts; how accurate do you think that will be? There are an awful lot of people who work in England, live in Wales and vice versa. There are also people moving back and forth across the border, certainly in the north-east of Wales. So, how accurate do you think those HMRC data will be?

11:00

[192] **Mr Chote:** As I say, you can see that there are bits of variation in the share that you get out of the survey of personal income, and you do, every time you move to a new vintage of that, need to make an adjustment. So, obviously, there will be a sampling error in these sorts of things and whether the new number you're going to is the accurate one or the old one was the accurate one, or whether the accurate one lies somewhere between the two, this is an evolving process.

[193] I think a general point to make here, which obviously we start to see in

Scotland, comes back to—. You're mentioning the potential mobility of either the individuals or the tax base across the border, for example. That obviously becomes more of an issue for the forecast, the greater the degree to which the Welsh Government chooses to exploit the powers it has to end up with a different structure of rates from that which prevails in the rest of the UK. There would then be some behavioural response to that.

[194] So, what we're seeing with Scotland—with the, pretty much, full devolution, bar the size of the personal allowance of income tax there—is a decision to basically have the higher rate kicking in a bit earlier and the personal allowance a bit higher. So, you've not seen big changes in the rates, but you are beginning to see the tax schedules in Scotland and the rest of the UK moving a little bit apart from each other. The further apart they move, the more you would expect that to create financial incentives for people to move money or themselves in one direction or another. We have not assumed in the Scottish example that there's a huge rush of people across the border in either direction in response to this, but as I say, the more you move to a world in which there are quite big differences in rates and allowances or thresholds, if that is devolved, then the more you need to worry about the impact of that on the forecast, not only in the nation that makes those changes, but also the knock-on effect elsewhere.

[195] **Mike Hedges:** Of course, you haven't got a lot of population living alongside the border, whereas in Wales, you have, certainly in north-east Wales—you've got conurbations such as Chester and Wrexham, which are effectively one conurbation in terms of movement and employment. But the other question I've got is on—

[196] **Mr Chote:** On that point, HMRC at the moment is based on main residence, so the judgment as to where you fall in terms of this. Now that, obviously, is a grey definition to some degree and it will be interesting to see how fluid that proves.

[197] **Mike Hedges:** Thank you. I've read the Scottish devolution of income tax and I read the command paper. It's awfully complicated, or I found it awfully complicated in terms of defining a Scottish taxpayer. It says things like MPs, even though they might spend the majority of their time in London, would still count as Scottish taxpayers. Do you think there's a danger of people choosing a residence that gets a different rate of tax? It doesn't matter at the moment where it is identical whether you decide your main residence is in one place or another, but if the tax rates are different, isn't

there a danger of people deciding that their main residence is somewhere else?

[198] **Mr Chote:** Yes. Inevitably, you create that sort of incentive. I guess the issue is whether the difference in tax rates and allowances and thresholds is large enough for it to be worth the cost of—. Clearly, it's a very different issue if you decide to physically move yourself from one side of a border to another or if you have a property in both places and the nature of those properties is such that you can plausibly claim either of them to be a main residence and, therefore, you're pretty free to choose at relatively low cost. I think, basically, it will be interesting to see in practice how this works: how many occasions there will be when the taxpayer status that people claim for themselves is challenged by HMRC or, indeed, whether HMRC challenges in the other direction. I think, you know—as I say, it comes back to the point that the bigger the difference in the tax systems, the greater the incentive and the greater the possible benefit that would make it worth while bearing some cost to do this. But, at this stage, we've not assumed that the differences between the Scottish rate schedule and the rest of the UK rate schedule are large enough to make a really big difference either to their numbers or to the rest of the UK numbers.

[199] **Simon Thomas:** Eluned Morgan.

[200] **Eluned Morgan:** Can I just check something with you? I've been carrying this around on my phone since last autumn. The tweet that I found suggested that there was a difference in terms of your forecasting from March to November in terms of employment income tax receipts of £90 billion. Can you tell me: is that correct?

[201] **Mr Chote:** I don't know which number that is. It may be one that you add up over a number of years, in which case, the more years you add, the larger the number gets. As I say, we were certainly, in the changes that we made between the March forecast—. If this tweet came out in response to the previous forecast back in November of last year, rather than—

[202] **Eluned Morgan:** Yes.

[203] **Mr Chote:**—well, obviously, rather than this one—

[204] **Eluned Morgan:** Yes, this November.

[205] **Mr Chote:**—then, there obviously was—. There was quite a big change in the forecast between March of last year and November. That would have included a weaker path for productivity growth, which would imply a weaker path for earnings growth, and that can lead to—particularly if you take the annual number and then just add an increasing number of years to it, you can get to big round numbers out of that. So, I suspect that that’s what it’s related to. If you want me to have a look offline at the precise number and see whether I can recognise where it’s come from, then, obviously, I’m happy to do so.

[206] **Eluned Morgan:** But, I mean, if that’s true, and I’ve got the table in front of me, it’s £90 billion. That’s quite a difference over a six-month period, isn’t it? So, are any of these forecasts worth bothering with? Because that could pay for the whole of the NHS for a year.

[207] **Mr Chote:** Yes, as I say, but, you know, if it was a £90 billion a year change, then that really would be quite something. So, it does depend over which period, and how you’re adding them up, it looks. In general, the average change in the overall forecast for the UK budget deficit from one fiscal event to another is about 0.5 per cent of GDP, which would be about £10 billion. So, you have some forecast changes that are relatively large, particularly if you make a big judgment about the future rate of productivity growth, because that will have an impact on earnings growth right the way through the forecast and make quite a big difference, or you can have, as we did between the November forecast and this one, a relatively small change. This is one of the smallest pre-measures forecast changes over that period, obviously partly reflecting the fact that we’ve only had three or four months, whereas, previously, you’d had closer to nine months and the referendum in the middle of it, which obviously necessitated some fairly large judgments at that stage about the impact on trade, inward migration, et cetera—very broad-brush judgments, because, obviously, we don’t know where the negotiations are going to end up, but we’ve made some adjustment for that, which we’ll have to come back to in the future. But that would explain why the movement between March of last year and November was a relatively large forecast change in comparison with, for example, the one we’ve just done.

[208] **Eluned Morgan:** Thanks.

[209] **Simon Thomas:** Could I just ask, specifically on the Welsh forecasting: is what you’ve just set out also the reason why the change in income tax—

well, we don't have income tax devolution yet, but the change in forecast that you've made around that also showed a significant decline in income tax receipts that would have been accrued in Wales?

[210] **Mr Chote:** Yes, well, in terms of the decline in the Welsh forecast for income tax between November and March, actually, on that occasion, it is more to do with the sort of specifics of the Welsh and, indeed, the Scottish forecasts, rather than the UK forecast more broadly. So, if you have this document, the devolved taxes document, to hand, you can see the table on page 30. The largest single factor reducing the Welsh income tax forecast since November is the methodological adjustment we've made to relative population growth, therefore assuming that you end up with a smaller Welsh population share towards the end. In addition, the latest vintage of the survey of personal income suggests that the Welsh share at the beginning of the forecast was smaller than it was. Compare that to the other forecast changes that we've made, looking at incorporating the other changes to the income tax forecast on this occasion—those have been relatively small. I would say that, from memory, most of these changes from forecast to forecast in the Welsh forecast probably owe more to what's going on in the UK-wide forecast than they do to the devolved nations. So, this one is a bit of an outlier in that respect.

[211] **Simon Thomas:** There were specific reasons in the most recent forecast that were Welsh-related reasons, if you like.

[212] **Mr Chote:** Yes, as I say, whether you—. The fact that we decided to make an adjustment, which as I say we discussed with everybody at the pre-forecast meeting, to take into account the fact that the ONS assumes, in its population projections, slower growth in the population of Wales and Scotland than in the rest of the UK. So, it's not as if it were Welsh specific—there's a similar adjustment in Scotland—but it's basically looking at the differential population growth rates.

[213] **Simon Thomas:** This does underline the importance of the fiscal agreement between the Welsh Government and the UK Government, which, of course, is nothing to do with the OBR, but it does underline it nevertheless. Mark Reckless.

[214] **Mark Reckless:** Why did you forecast such a fall-off in consumer spending after a referendum where most people got the result they voted for?



[215] **Mr Chote:** It's interesting. The forecast on consumer spending that we made back in November was essentially to say that the real value of consumer spending would be squeezed by higher inflation as a consequence of the weaker pound. That is an effect that we still assume will come in, basically in the second quarter of this year and a little bit further. The profile of inflation through this year has slightly changed because the pound has picked up a bit, but the Government has also taken some policy decisions that push up inflation in the near term, for example, on insurance premiums.

[216] One of the reasons why, back in November, our forecasts for the economy were more optimistic than the average of the outside forecasts was that we didn't assume that there would be a consumer-confidence-related squeeze on the cash amount of consumer spending that people did. Some of the more gloomy forecasts, including some of those that were published prior to the referendum—we didn't do a forecast of what would happen under a leave vote prior to the referendum—did assume that there would be a consumer-confidence effect that would just mean that people spent less money, not merely that that money wouldn't go as far as it otherwise would have done.

[217] What's been striking in the way things have actually turned out is, as I say, the squeeze on inflation is coming through the pipeline, and you assume that'll be there, but actually consumers have spent more. We've seen a strong growth in consumer spending, considerably stronger than income growth. So, you've seen the saving ratio falling really very sharply during the second half of last year.

[218] At one level, you look at that and say, 'My gosh, this really isn't sustainable; you can't have real consumer spending going at 3 while incomes are flat.' That can't go on forever, and indeed we don't assume that it will. One slight area of caution, I would say, is I think incomes are being slightly depressed at the moment, particularly on dividend and pension elements, not just on labour income. So maybe this dramatic movement in the saving ratio, which helps explain the momentum of the economy towards the end of the year, is not quite as, on the face of it, unsustainable as it looks.

[219] **Mark Reckless:** You sound surprised by some of that strength or that consumers would respond, for most of them, to winning that vote and expecting a better future outside the European Union, by reducing their spending. Is the March forecast—is the assumption from that that this

unexpected strength, to you, that's come through in the economy is only a one-off and doesn't really help the public finances, except in the short term, because you assume it's all going to go worse for those consumers in future, even though you and so many other forecasters were overly pessimistic about the second half of 2016?

11:15

[220] **Mr Chote:** On the saving ratio, in particular, we don't assume—. Its having dropped so sharply, we don't assume a 'v' pattern in which that zooms back to where it started. What we assume is, essentially, that it stabilises. So, over time, as I say, if you look at what's happened to real consumer spending, it has grown by a little over 3 per cent in the year to the fourth quarter. Real household disposable income has been flat over that period. That clearly cannot be sustained indefinitely. The saving ratio would go down and down and down, and would be completely implausible. So, the forecast, basically, if you look over the next five years, you get to a position where both of them are growing by about 2 per cent a year, and that stabilises the saving ratio.

[221] In terms of its impact on the overall path of the economy, we've assumed that the recent momentum at the end of last year continues reasonably firmly into the first quarter of this year. We are assuming about 0.6 per cent growth in the first quarter of this year. The purchasing managers' index numbers that have come out more recently might suggest something weaker, but I'm not sure I would place, at this stage, too much weight on that as one isolated area. We then assume that the pace of growth slows into the later parts of this year, as this inflation squeeze starts to hit.

[222] What we've not done in this forecast is changed our overall view of how much the economy—or by very little—can grow over the full five years, if the Bank of England is pursuing inflation. I.e., the potential level of GDP in five years' time is very, very little different from what it was back in November. One consequence of that is that, if you have more rapid growth at the beginning of the forecast—in the most recent outturn data in the early quarters of the forecast—there is then less scope for it later on. So, growth in 2016 as a whole was weaker than expected, 2017 we have pushed up, 2018 and 2019 we have pushed down. That's not because we think there's a new reason to be pessimistic about 2018 and 2019; it is that you have had more of the good news early, as it were. So, if you end up in roughly the same place, you get a bit weaker growth in the subsequent quarters.

[223] **Mark Reckless:** Good news on the consumer is judged to be temporary. Then, the other two big changes that you had in your November forecast—and Eluned Morgan said there was £90 billion overall over the horizon—were assuming that productivity would be less good because we were leaving the EU, and also that trade, overall, would be less because we were leaving the EU. Are both those assumptions still there, and what does that say about what you're expecting to happen in terms of so-called soft Brexit versus hard Brexit?

[224] **Mr Chote:** Yes, you are right. Those underlying judgments haven't changed. We said back in November, and we stick to the view now, that it is impossible—. There is no firm basis for us to predict precisely what the outcome of the negotiation is going to be. Nailing the forecast to any particular prediction of exactly what sort of deal it will be would be unrealistic. So, we made a set of broad judgments. As you say, that includes a weaker path for productivity growth, primarily because of weaker business investment, and, indeed, it has fallen during 2016.

[225] Other people will point to a relationship between trade growth and innovation and productivity as well over the long term. We placed less emphasis on that back in November. You then have, in addition, an assumption that net inward migration would be somewhat weaker than it otherwise would have been. The latest outturn data appear to be in line with the current set of ONS projections that we're using, but it is early days yet, so—. There was no reason to change it this time, but that's something you'll want to keep under review. But, as I say, for the time being, we have not made any judgments at this forecast or at the last one as to where on the spectrum of hard to soft—or what the impact or what difference it would make if it were hard or soft—. It is much more of a broad-brush exercise than that. The other thing on that subject that we haven't included is any estimate of a 'divorce bill', if there were to be one. Again, we don't think there's enough evidence upon which to put in a number just because you've no idea, if there would be one, what it would be and, which matters just as much to the forecast, when it would be payable.

[226] **Mark Reckless:** If we were to move to WTO terms at the end of the process, would your forecast then allow for a lot more import substitution as people sought to avoid paying tariffs on importing goods into the UK and would therefore produce more here? And would you also expect to see a further decline in the selling exchange rate, boosting net trade still further?

[227] **Mr Chote:** We haven't looked at that or done any analysis of that at this stage. I think there would be an interesting question on the specifics of the exchange rate: whether we would make a specific adjustment or if that was the way in which things were going, then presumably the exchange rate would be responding to that in whichever way it feels appropriate as you went along there. So, whether we would need to make any additional adjustment beyond what the markets had concluded from that, I think, you know, is not the necessarily the case. But, as I say, we haven't attempted to do any scenario analysis of that sort at this stage. We're basically going to wait until we see how things turn out.

[228] **Mark Reckless:** Thank you very much for sharing your thoughts on that issue. Can I turn briefly to land transaction tax? We've just got the changes set out before us from March 2016 through November 2016 and March 2017 and what happened for landfill tax forecasts for Wales, or at least as the proportion of the SDLT. Broadly, between March and November, for most years we slipped a few million, but quite a small overall change. But then from November through to March 2017, we saw £20 million to £30 million increases in the projection for LTT. Could you describe to us why those changes were made? Obviously, this is going to be a very significant matter for Wales.

[229] **Mr Chote:** Well, the landfill tax—the main issue that we've had is, obviously, looking at the most recent outturn data. So, you can see the in-year receipts, if you have page 50, for the UK. The Welsh forecast is not moving very much differently from the UK forecast as a whole. You've had, on the UK side, weaker receipts, which is pushing through the forecast. Then, as I say, we've made an adjustment at a UK level on the assumption that there's a lower recycling trend, which pushes up the forecast receipts. The evidence that we have from the Welsh Government is that there's less of that here.

[230] **Simon Thomas:** Sorry, just to clarify: I think the question was on the land transaction tax rather than the landfill tax.

[231] **Mr Chote:** Sorry, I thought you turned to landfill halfway through.

[232] **Mark Reckless:** Sorry, no, LTT.

[233] **Simon Thomas:** I think with the land transaction tax, there is a more

significant difference in the forecast.

[234] **Mr Chote:** Yes, hold on, let me—. Yes, on the SDLT, the land transactions one, again the outturn data is the most significant driver of the change since November. So now we're on page 44. On the residential side, the changes to the house price and property transactions numbers: they're a bit stronger than they otherwise would have been, and that's a UK-wide effect, but not an enormous amount of change there, relative to the fact that the within-year numbers have so far been coming out relatively strongly. There's a small change in terms of the re-costing of the additional properties issue. There's an interesting one with the additional properties element of tax—and we're finding this, I think, across the UK as a feature of the Scottish LBTT as well—it's knowing how much of this will be refunded. So, it's paid initially, but then if it turns out not be an additional property, there's a window of opportunity in which people can come back. And knowing where that is going to settle down in terms of the proportion of the receipts that have come in that end up having to be refunded—evidence in Scotland is relatively high, less so I think here, but it's perhaps an additional uncertainty over these numbers more generally.

[235] **Mark Reckless:** We had a table, I think from the same publication, where between March and November 2016 there was a modelling change to the SDLT forecasts, and I think that the impact on Wales was somewhere between £30 million and £40 million negative for each future year, but the overall figures only moved a few million. So, am I right to think there was a sort of news element of transactions coming in better than expected, but that was offset by a sort of modelling change, which was about the same magnitude? Why did you do that modelling—?

[236] **Mr Chote:** So, this was between two earlier—

[237] **Mark Reckless:** We're just in the table that says—

[238] **Mr Chote:** So, this wasn't between the last forecast and this one, it was—

[239] **Mark Reckless:** Between March 2016 to November 2016. We have a table: 'Changes in SDLT forecasts from March 2016 to November 2016 resulting from modelling changes'. And the overall changes were only, perhaps, about £3 million, one way or the other, but the modelling changes were between £30 million and £40 million.

[240] **Mr Chote:** Well, I'm afraid I've only got the November 2016 to March 2017 numbers in front of me. If you could send me a copy of that table, I'd be happy to clarify that with you offline.

[241] **Mark Reckless:** We'll ask our clerks to do that. Finally, can I just say, on the land transactions tax: I know there are several other taxes in a Scottish context, but previously you've been putting a certain amount of resource into every tax, and no doubt there are forecasting errors, and if you put in more resource into a particular thing you might be able to do a bit better on forecasting that particular tax, but a lot of those errors would sort of come out in the wash, perhaps, at the overall level. For Wales, in particular, once this tax bests in the Assembly, it's going to become a matter of great importance for us, and I just wonder—will you be putting more resource into your SDLT or LTT for Wales modelling, given that the implication of an error is much greater in the forecast, because it changes the amount of real resource that is available to Wales?

[242] **Mr Chote:** Well, I mean, we try to do the best job that we can with these forecasts on the basis of the available information. It's certainly an area where we've looked at the methodology over time, and obviously, the move away from a slab structure to a slice structure has necessitated coming back and looking at these methodologies again, and thinking about them, and we've made some judgments on that. I think one thing to bear in mind with this is that, obviously, because the revenue is affected both by changes in price and by changes in the level of transactions, you have to live with the fact that this is a relatively volatile and hard-to-predict set of receipts. And often—I think this will be one of the interesting issues, and we've had this discussion with the Scottish forecasters—in judging where you take two different methodological approaches, you need a very long period of data to work out whether the difference in forecasting performance of that is a matter of, you know, the fact that one model or one approach is a better one than another one, and whether the judgments that you made, in particular about the level of transactions, are going with you or against you.

[243] So, as I say, North sea oil is worse, but in terms of something that is moved not simply by a relatively smooth path of consumer spending or a slightly less smooth part of income, but when you've got something that is driven both by transactions—where you assume you're moving to some steady state that is, in a way, hard to define on its own—and the movements in property prices, I think the lesson I would say for policy makers with this is

obviously that it's important for us, and we will do the best job that we can, but you need to be prepared for the volatility in this, and planning on that basis.

[244] **Mark Reckless:** Thank you.

[245] **Simon Thomas:** Thank you. Steffan Lewis.

[246] **Steffan Lewis:** Just one brief question. On SDLT models, there's an assumption that Welsh property prices grow in line with the UK. I just wondered how you take into account the insanity of the London city-state's property market in those models.

[247] **Mr Chote:** Well, as I mentioned earlier, it is something where we always take into account the fact that that movement can be different, and it can be movement in either direction, so it can be a period of relative strength or a period of relative weakness. It's an issue that we have to confront at the level of the UK forecast, in any event. Over a lengthier period of time, whether there is a bias in the degree of the additional London/south-east effect, our view is that it still makes sense to assume that the Welsh thing rises on average with the UK as a whole, but there may be particular periods in which you need to aim off for that in one direction or another. It's also, of course, an area where, if you have locally available information that the Welsh Government et cetera are able to bring that you can draw on with that, then that's obviously something that you can look at each time you do it.

11:30

[248] **Simon Thomas:** Just on this point, Mike Hedges.

[249] **Mike Hedges:** London, of course, is an international city and a lot of the purchases in London are being made by people who are using dollars and euros as opposed to pounds. The 17 per cent reduction in the pound means that unless prices have gone up by 17 per cent, people are getting their properties cheaper. Isn't there a danger, if the pound keeps reducing, that prices in London will be driven by the fact that it's actually costing less in dollar and euro terms?

[250] **Mr Chote:** It can certainly be an influence. I think you'd find that there were things moving in other directions as well at the same time, but it's certainly one of the reasons why you might want to be wary, particularly at

the very top of the market. Also, investment purchases as well, as people are deciding where they want to be resident, may be an issue there. So, for example, if you think there are particular outcomes for the prospects for the financial sector, that may have a different effect on parts of relatively high-priced bits of the housing market than overseas investor purchases. But it's certainly something to keep an eye on.

[251] **Simon Thomas:** Finally, we do now turn to the landfill disposals tax, I think, with David Rees.

[252] **David Rees:** Thank you, Chair. A very quick one. The November figures were actually based on more recent data, compared to the March figures, which were based on the 2013–14 figures. As we move closer to the point at which the tax is devolved, are you confident that you are going to have the more relevant up-to-date, accurate data to provide a forecast that is going to be very close to, actually, the figures that will be transferred?

[253] **Mr Chote:** I think this is an area where you can always do—and it's good to have more timely and more local information where that is available. With the landfill, we've tended to have to fall back pretty much on the DEFRA analysis overall for the major trends that underpin the long-term judgments, but if you can get more on that, then that's a good idea. Now, I think the difficulty—. You know, you need to take into account things like trends in recycling, whether there are new incineration facilities coming into play as well—that's something that I think we've assumed has had an impact on the starting share for Wales, to begin with, because of the capacity in Cardiff et cetera. So, it's an area where any more data that becomes available is welcome, and it's one of the reasons why it's important that we discuss these with officials in the governments and any other interested bodies so that we can get all the information that we can. So, I would encourage anybody who has more up-to-date information on that to make sure that we're able to get it.

[254] **David Rees:** In terms of governments, I assume that you are in discussions with the Welsh Government as well to provide that information.

[255] **Mr Chote:** Yes. As I say, when we have our discussion on all the pre-measures forecasts, we go through them in turn, and then it's basically asking each administration whether there's any particular local information or new data that they think we should be aware of, particularly anything that suggests—assuming the trends that we have—that those trends are not



representative of the particular nation in question. As I say, there was the specific case here of information brought to us suggesting that the halt in the rise in recycling was not the same in Wales as it was elsewhere, and we've taken that on board. So, that sort of information is very helpful.

[256] **David Rees:** Can I ask one other separate question?

[257] **Simon Thomas:** One final question; yes, indeed.

[258] **David Rees:** I appreciate your time, because I know that we've kept you longer than we should have. But one final question: Mark Reckless identified some questions on Brexit—

[259] **Mr Chote:** I'm slightly concerned that the camera is going to go off, but keep going.

[260] **David Rees:** Mark Reckless raised the issue on Brexit. I just want to clarify a couple of points on how you forecast, because it's important for the tax receipts from Wales. We've understood that Wales certainly gets a surplus in its exports compared to imports, therefore there's no deficit within the Welsh economy. Is that taken into consideration, when you do analysis, as to how that may impact, or may not impact, in your forecasts for tax receipts from Wales? Because, obviously, if there's a bigger hit in Wales as a consequence of any possible tariffs that may or may not be applied, that may have more of an impact, perhaps, percentage wise upon the income tax revenues because it may have a bigger impact on employment. Do you take those issues into consideration when you do the analysis?

[261] **Mr Chote:** No, that's not something that we've looked at yet. Partly—as I was saying in response to Mr Reckless, we've not based the forecast on any particular assumption about where exactly the negotiations will end up in terms of new trade regime, new migration regime. We've made some broad-brush adjustments that are consistent with a variety of external studies looking at a variety of possible outturns, and they are at a very high level of less import and export growth overall, but offsetting each other, so no net effect on the path of the economy, weaker productivity growth, weaker net inward migration, but we haven't gone down to those sorts of distributional-level questions, and I think you'd need to be much clearer about where you were turning up. I think that would be quite—. Judging those sorts of effects at the UK level is going to be difficult enough; doing it differentially, I suspect, will be even more of a challenge, but, obviously, it's

something that we, if it seems sensible, will look at as time goes by.

[262] **Simon Thomas:** Very grateful for your time this morning, and also for giving us an extra five minutes of Alex Ferguson time, as it were—thank you for that. We've had a wide-ranging discussion; I know it has been macro as well as micro, but I think it's important for the committee to understand some of the overall views you take on forecasting, as well as some of the specifics around the Welsh tax devolution. I very much appreciate your time with us, and I'm sure we'll have this session, or something similar, again as you produce further figures. Diolch yn fawr iawn. Thank you very much.

[263] **Mr Chote:** Thank you very much—very nice to see you.

[264] **Simon Thomas:** We return to private session, as we were earlier.

*Daeth rhan gyhoeddus y cyfarfod i ben am 11:37.*

*The public part of the meeting ended at 11:37.*