

Funding devolved government in Wales: why not fiscal autonomy?

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Devolved Government in Wales: challenges for
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Ways of funding state or regional governments in other systems

- Own taxes – create autonomy for constituent units but can lead to huge inequalities
- Result is a vertical fiscal imbalance – the centre collects more than it needs, but states/regions collect less. The solutions to that are:
 - Conditional grants – tied, specific, centralising
 - Unconditional grants – meaning lack of control and accountability
 - Equalisation payments – unconditional grants, but compensate for extra costs of providing services, extra demand for services, or shortage of tax revenues

Understanding the impact of different instruments

Vertical axis = decentralising/centralising

Horizontal axis = active/passive state

Active/ decentralising

Equalisation

Passive/ decentralising

Own taxes

Active/ centralising

Conditional grants
(match funding)

Passive/ centralising

Unconditional grants

Comparatively speaking ...

- All federal and decentralised states combine the use of various sources of funding, though they vary in which they use and their effect
- Some examples:
 - USA: own taxes and conditional federal grants, no equalisation
 - Canada: combination of own taxes, unconditional (per capita) grants and equalisation
 - Australia: heavy reliance on equalisation and some use of own taxes (but eq'n compensates for differences in tax revenue)
 - Germany: heavy equalisation. Commitment to common living and public service standards across the country
 - Switzerland: own taxes with some equalisation.

The situation the UK now faces

- Ongoing economic crisis – limited economic growth and constrained tax revenues
- Severely stretched public finances
 - Reduced tax revenues
 - Higher demand for entitlement-based funds (social security, esp Job Seekers Allowance)
 - Very high levels of public debt, and interest payments
- Need to ‘do something’ about devolution finance
 - Scottish demands: Calman, Scottish Govt
 - English concerns about the generosity/unfairness of Barnett
 - The possibility of a bilateral deal with Scottish Govt
- What might a Conservative UK Government do?
 - Scotland is seen as the chief issue needing to be addressed
 - But Wales is promising electoral territory, both for Westminster and National Assembly

The debate so far: Scottish contributions

- The Calman Commission: devolve 10 income tax 'points', reduce block grant proportionately, devolve 3 small taxes (stamp duty land tax, aggregates levy, landfill tax); plus some borrowing powers
 - Could work for other parts of the UK
- Scottish Government: 'full fiscal autonomy' – Scottish Parliament should set and collect all taxes in Scotland and would remit a contribution to UK Govt for common UK services
 - Seen by many as tantamount to independence
 - Certainly offers nothing to any other parts of UK

The debate so far: Westminster contributions

- Commons Justice Cttee: grant should be based on need – someone else should say how
- Lords Barnett Formula Cttee: grant should be based on relative need, using small number of top-down proxy indicators (rather than very detailed needs assessment done in 1979)
 - And also institutional reform – independent commission to carry out assessment, limiting powers of HM Treasury

Options for funding devolved government in Wales

- The status quo: the Barnett formula
- Status quo plus: fix the administrative aspects, and perhaps make the grant 'fair' (needs-related)
- What the UK Govt has accepted in *Scotland's Place in the United Kingdom*: 'Calman-minus'
- 'Calman Plus' – further but still limited fiscal autonomy. But plus what?
- The 'more or less federal option': substantial fiscal autonomy, with spending and fiscal equalisation
- 'Full fiscal autonomy' (SNP policy for Scotland)

What's wrong with the status quo?

- Political contention is about treatment of Scotland not Wales
- Appears to leave Wales pretty close to where a needs assessment would (112 per cent of English spending compared to 114/115 cent per Holtham Commission) – within the margin of error?
- Mechanics of Barnett mean Wales's block grant is likely to reduce by 1.5%, not the 3.2% expected for UK public spending overall
- A constrained public spending environment means there will be minimal convergence
- What are the political pressures to deliver change?

Problems with the status quo

- The 2-3 point gap is still a lot of money
- The system doesn't satisfy political requirements of equity and fairness in distributing spending
- It doesn't recognise historic factors – whether past contributions to the UK and its economy, or the costs of tackling past poverty and deprivation
- HM Treasury retains a huge amount of discretion, which it uses in arbitrary ways to suit UK Govt interests (2012 Olympics)
 - Leaves it open to UK to adopt policies which affect the devolved govts and are outside the formula (they don't trigger consequential), but which the devolved may oppose (HE tuition fees & Scotland)

Status quo plus

A set of sticking plasters to redress most pressing problems

- Leave the block grant intact, or adjust it ad hoc to relate to 'needs' (the Hain position)
- Fix administrative problems: some impartial body to decide on how Barnett formula should work – whether a change in spending in England triggers a consequential, what 'comparable functions' are, etc
- Easy to implement, though Treasury appears unhappy about loss of control
- And won't do much to ensure UK-wide equity or redress historic problems

A 'fair grant'

Means a needs assessment to relate amounts paid by grant to needs affecting the services provided

- Two main sorts of need:
 - Demand for services (e.g. more for care for elderly depending on aged population)
 - Costs of providing services (e.g. more for providing services in sparsely populated areas)
 - Plus a 'catching up' fund?
- Historic resistance to this from HM Treasury, and Whitehall more generally
 - Cost and complexity of the undertaking
 - Loss of discretion?
- And from politicians, particularly in Labour
 - Because it imposes a lot of pain in Scotland for little gain anywhere, even in Wales
 - The grievance it does address from SE England is intermittent and not hugely salient

A Welsh version of Calman

- Constitutionally, Wales and Scotland aren't actually that far apart – despite the lack of primary legislative powers
 - Executive powers confer much practical responsibility (which is also the working assumption underpinning how Barnett works)
 - And the models of devolution given extensive autonomy over a broad but constrained range of powers (no economic powers)
- Calman's argument for limited fiscal autonomy was rooted in the need to make the Scottish Parliament accountable financially as well as electorally – essentially a political/constitutional argument, not an economic one
 - That it appears to work is recognition of the fact that Scotland is in or close to 'fiscal balance' – Scottish tax revenues largely cover the cost of services provided there, notwithstanding Scotland's 'Barnett bonus'
 - Concerns about the economic implications – not supplying adequate levers to tackle the revenue risks
- Why shouldn't that argument apply in principle to Wales too?

Implementing a Welsh version of Calman

- Applying this model in practice is trickier; the key problem is that it needs some form of fiscal equalisation too
- Not difficult technically – at simplest, the difference between a ‘UK standard’ penny rate of income tax and what is generated in Wales
- But serious data problems in working out what that might be (no Welsh version of *Government Revenues and Expenditures in Scotland*, flawed though the revenue data are in that)
- Alternative approach would be to devolve 10 points of personal income tax, but avoid some of the data and transparency issues by reducing the block grant simply by what that yields, not some standard rate
 - Problem with that – doesn’t enable system to respond to changes in relative economic performance across UK
 - But it does create strong incentives to improve Wales’s economic performance

Implementing a Welsh version of Calman II

- The big political problem: the present situation depends on non-transparent fiscal equalisation.
- Making that transparent risks a political backlash especially in SE England – it would be ‘brave’.
- Which political party has an interest in doing so? Unattractive to both Labour and Conservatives, who need votes from SE England to win Westminster elections
- What about a referendum? The Scottish precedent (from 1997) suggests one is needed. If it must be held, ideally it should be at the same time as one on Part 4 of GWA 2006 – so that there is a ‘constitutional resettlement’ offered to the electorate, and to minimise the dangers of a ‘neverendum’
 - But time is very tight for that to happen in autumn 2010

More extensive forms of fiscal autonomy

- More extensive forms of fiscal autonomy offer the prospect of greater scope to shape the Welsh economy, as well as greater accountability because voters don't just receive services from governments but also pay for those services through their taxes
- Most federal systems operate with high levels of fiscal autonomy for constituent units: in countries like Switzerland or Canada, cantons and provinces raise on average 70-80 per cent of their own spending.
- All the various forms of such approaches pose the same fundamental problem: that Wales is in serious fiscal deficit (though we don't know by how much), so an equalisation system would be necessary to prevent serious harm being done to public services in Wales
 - Such systems are often technically complex and not very transparent,
 - Even limited transparency could be expected to cause political problems

Some conclusions

- Now is a very difficult time to revisit the financing of devolution, whether in terms of economics, public finance, or politics
- Wales is unlikely to benefit from a continued pattern of ad hoc bilateral deals (driven by Scottish concerns)
- The arguments advanced by Calman for a measure of fiscal autonomy in Scotland are very substantially applicable in Wales too
- Fiscal autonomy could work for Wales, but would need a system of fiscal (as well as spending) equalisation
- That sort of system would be politically difficult to put in place
- The data especially on revenues are gravely defective. We need better data to understand the nature of the problems we face.
- Politically, it is likely to be particularly **unattractive** to a Conservative UK Government – though conceivably might happen if there's a minority one

Read more on the ‘Devolution Matters’ blog

<http://devolutionmatters.wordpress.com/>