Welsh Conservatives’ submission to the Silk Commission
February 2012

- Welsh Conservatives believe that consideration should be given to the devolution of some aspects of income tax, because this could make the National Assembly more accountable to the people it represents for the money it spends. We believe that there is considerable merit in exploring this policy.
- We note the potential benefits of devolving corporation tax to the National Assembly, but are not yet persuaded that these exceed the potential costs. Welsh Conservatives believe that more work needs to be done before a viable case can be made for the devolution of corporation tax to the National Assembly.
- Welsh Conservatives strongly support the conclusion reached by the Holtham Commission that the Welsh Government should acquire limited borrowing powers to finance capital spending.

1. The National Assembly is now an established feature of the Welsh political landscape, and enjoys growing support, particularly amongst young people (All Wales Convention, November 2009). The Assembly is an important, accessible and democratic forum for the people of Wales.

2. Public spending is higher per head in Wales than in most other parts of the United Kingdom, but taxes collected are not, meaning that Wales continues to benefit enormously from economic and social union within the United Kingdom (House of Commons Library, January 2012; Independent Commission on Funding and Finance for Wales, July 2010).

3. Welsh Conservatives believe that whilst the premise of devolution has now been anchored – bringing political representation closer to the people and allowing Wales to pursue policies more closely aligned with her economic and social needs – the promise of devolution has yet to be realised. More than a decade on from the onset of devolution, Wales faces continued challenges, particularly in raising the educational achievements and economic prosperity of its people. Wales remains the poorest part of the United Kingdom (ONS, December 2011). Unemployment has fallen (ONS, December 2009). Unemployment is higher in Wales than in other UK nations and higher than the British average (ONS, January 2012). One in three children in Wales is growing up in poverty, and one in five in a household in which no one works (DWP, May 2011; ONS, January 2011).

4. Bold action is required to turn the Welsh economy around, reduce Wales’ dependence on the public sector and allow for the provision of equitable and modern public services. How far taxation has a role to play in this is the subject of considerable debate. This is not only the case in Wales but elsewhere in the United Kingdom. The work of the Silk Commission can be read in the context of the Varney Review of Tax Policy in Northern Ireland, the Independent Commission on Funding and Finance for Wales (‘Holtham Commission’), the Commission on Scottish Devolution (‘Calman Commission’) and HM Treasury’s consultation on Rebalancing the Northern Ireland economy.

5. Welsh Conservatives note the terms of reference relating to Part 1 of the Silk Commission:

    To review the case for the devolution of fiscal powers to the National Assembly for Wales and to recommend a package of powers that would improve the financial accountability of the Assembly, which are consistent with the United Kingdom’s fiscal objectives and are likely to have a wide degree of support.

We shall take each of these points in turn.
6. Just as the Calman Commission held for the Scottish Parliament that ‘it does not have to take responsibility for raising the money it spends through taxation, and is not able to use tax to influence behaviour’ (2009:76), so too the National Assembly lacks responsibility for raising the money it spends in Wales. As presently framed, devolution in Wales falls short of established thinking in public finance theory according to which bodies that spend public money should have a role in extracting it from them (Independent Commission on Funding and Finance for Wales, July 2010). The Holtham Commission argued persuasively that ‘Welsh discussion about issues of priority in public services would be more developed if everyone knew that there was a choice about paying more or less tax for more or less service, rather than simply blaming Westminster for inadequate resources’ (2010:13).

7. We note, and support, the comments from Secretary of State for Wales Cheryl Gillan MP, who has called for ‘the argument, for once, to move away from whether there is enough money to how it is spent and whether it is spent effectively. It is true to say that a Government who take from Peter and give to Paul can always rely on the support of Paul. [The Government] is asking the commission to see whether Paul can also make a contribution’ (Hansard, 3 November 2011).

8. The fact that the performance of the Welsh economy has no impact on the devolved budget is a further significant weakness of the current funding regime. There is presently little incentive for the devolved administration to act in a way that enhances economic development. Senior Labour figures admit the party has been ‘reluctant to engage’ with the private sector (Western Mail, 21 October 2011). Such antipathy to business and wealth creation has come at little cost to the Welsh Labour Government. As Holtham noted (2010:13), ‘the absence of clear linkages between Welsh taxpayers, the Welsh economy and the resources available to the [Welsh] Government is a major weakness of the current funding regime.’

9. The Holtham Commission concluded that ‘some devolution of powers over taxes would greatly enhance the accountability of the current settlement’ (2010:15). Calman held that ‘if the Scottish Parliament is to be fully financially accountable to the Scottish people, it should be dependent for a significant proportion of its revenues on tax decisions which it is obliged to make’ (2009:104). We find this argument to be a compelling one, and believe that the policy of devolving, in part, power over the setting of income tax to the National Assembly is worthy of particular consideration.

10. Devolving responsibility for setting the level of income tax over and above a Westminster ‘base’ whilst subtracting a concomitant reduction from the block grant would preserve the advantages of stability and predictability that characterise the present funding regime.

11. The Calman Commission cautions that measures taken to inject greater accountability to the devolved settlement in Scotland could come at the expense of introducing economic and administrative inefficiencies and inequalities of need. Holtham concluded that these would likely be negligible in the case of the devolution of income tax to the Assembly, and that differences in the basic rates of income tax between England and Wales could be sustained without inducing harmful behavioural or migration impacts.

12. However, the potential for introducing economic and administrative inefficiencies through the devolution of corporation tax is significant.
13. The Government has consulted on whether to devolve the power to vary the level of corporation tax to the Northern Ireland Executive (Rebalancing the Northern Ireland Economy, March 2011). The consultation addresses a number of potential risks, including the risk of profit shifting – or ‘brass plating’ – wherein ‘companies artificially manipulate transactions so that their taxable profits arise in low tax jurisdictions, while the activities generating those profits remain in a high tax jurisdiction,’ as well as further losses that would be incurred as a result of Tax Motivated Incorporation (2011:27).

14. The devolution of corporation tax to a devolved assembly could result in ‘the creation of compliance costs for businesses operating on either side of [a] border, as well as the increased collection costs for the Government’ (David Gauke MP, Hansard, 21 June 2011).

15. It would introduce ‘substantial unwelcome volatility into the Welsh budget’ (Independent Commission on Funding and Finance for Wales, 2010:78).

16. ‘Differential tax rates may cause businesses or other tax payers to take decisions based only on tax considerations’ and not economic motives (Commission on Scottish Devolution, 2009:79). This could lead to economic distortions within the UK’s single market.

17. Devolving corporation tax to the National Assembly could also reduce the total tax take available to HM Treasury. Professor Jim Gallagher has referred to this as the ‘cannibalisation’ of British tax revenue. Devolving corporation tax to the Scottish Parliament, he argues, would provide a ‘strong incentive for companies not to change their actual economic behaviour but to change their corporate structures so that their book their profits in Edinburgh and pay less tax. The net effect of that is that the UK as a whole gets less tax and we have simply cannibalised our own tax income’ (Scottish Affairs Committee – Fourth Report, March 2011).

18. However, the Treasury’s consultation paper also highlights a number of advantages that could accrue to Northern Ireland as a result of a lower corporation tax regime. Crucially, these include additional investment by internal and external firms, the potential for increased economic growth and a revitalised private sector, which collectively would help to rebalance the Northern Ireland economy (2011:34). It argued: ‘A lower corporation tax would, on its own, be likely to have a positive effect on local private sector investment and foreign direct investment (FDI) by increasing the return on capital to investors’ (2011:20). And it concluded: ‘Reducing the corporation tax rate in Northern Ireland would have a positive impact on both domestic investment and FDI, which could lead to increased economic growth and a stronger private sector’ (2011:51).

19. Consultees in Northern Ireland said that lower rates of tax would ‘improve the viability of their business or allow them to undertake additional activity.’ In particular, it would ‘increase general business confidence to invest, for example, on product or premises development or in increasing employment.’ Increased FDI would also lead to spillover and supply chain effects (Rebalancing the Northern Ireland economy: a summary of consultation responses, December 2011).

20. Welsh Conservatives have long campaigned in support of policy interventions that would free up entrepreneurs and businesses in Wales to invest more of their own profits on new staff, new premises or new, responsible market capitalisation. We campaigned strongly in support of greater business rate relief in Wales for example in the 2011 National Assembly election.
21. We believe that the UK Government’s National Insurance relief for the first ten employees taken on by start-up companies outside the South East has set an important precedent for the setting of multiple-level business taxes within the same tax jurisdiction.

22. Further, we have carefully considered the relative success that a reduced rate of corporation tax has had as a lever for economic growth in the Republic of Ireland. Between 1980 and 1993, 116,000 jobs were created in the Irish Republic, compared to just 13,000 in Northern Ireland (Financial Times, 22 March 1999). In the last five years, twenty-one companies interested in investing in Northern Ireland instead went south (Belfast Telegraph, 2 July 2010). Many claim to have been attracted by Ireland’s 12.5 per cent rate of corporation tax. Former Irish Taoiseach Bertie Ahern suggests that a lower corporation tax was the ‘cornerstone of [Ireland’s] success’ (BBC News, 31 March 2006). Secretary of State for Northern Ireland Owen Paterson MP has argued that the devolution of corporation tax to Stormont would be a ‘game changer’ (Derry Journal, 20 June 2011).

23. Welsh Conservatives note that the Varney Review of Tax Policy in Northern Ireland (December 2007), the Commission on Scottish Devolution (June 2009), CBI Scotland’s response to the Scottish Government’s consultation (September 2011) and the Scottish Parliament’s Scotland Bill Committee (March 2011) have all rejected the devolution of corporation tax to the Northern Ireland Executive and Scottish Parliament respectively. ‘Tax avoidance may be profitable for companies but it is not a productive activity,’ concluded the Scottish Parliament Committee, ‘nor would it attract jobs and growth to Scotland’ (2011:52).

24. We note the potential benefits of devolving corporation tax to the National Assembly, but are not yet persuaded that these exceed the potential costs. On this topic we therefore keep an open mind. Welsh Conservatives believe that more work needs to be done before a viable case can be made for the devolution of corporation tax to the National Assembly.

Consistency with the United Kingdom’s fiscal objectives

25. The Calman Commission argued in the case of Scotland: ‘if [the Scottish Government] is to be accountable for its spending decisions it should be able to influence the total of its capital spending in any one year as well. So we recommend that the Scottish Government has the capacity to borrow for capital investment on a Prudential basis’ (2009:13), similar to that used by local authorities.

26. Calman ruled out, however, extending borrowing powers to the Scottish Government in order to fund revenue expenditure (2011:107). ‘This is because the continuing contribution of the block grant to the Scottish budget includes a component of borrowing by the UK Government to counter the economic cycle’ and decisions on counter-cyclical borrowing ‘relate to macro economic policy management’ and should rest with the UK Government. The Commission therefore concluded that there would be a case for borrowing powers ‘to extend beyond finance for cash flow management and capital expenditure’ (2009:107). ‘There should ideally be no net borrowing over the economic cycle to finance current or revenue expenditure.’

27. The Welsh Government currently has the power to borrow up to £500 million from the Secretary of State in order to meet ‘a temporary excess of sums paid out of the Welsh Consolidated Fund’ (Government of Wales Act 2006). However, unlike local authorities, the Welsh Government currently has no powers to borrow from the Public Works Loan Board in order to finance capital spending. We believe this situation to be anomalous. We strongly support the conclusion reached by the Holtham Commission that the Welsh Government ‘should acquire limited borrowing powers to finance capital
spending’ (2010:111). The Welsh Government should be able to borrow via the Public Works Loan Fund, and a ceiling should be placed on the total debt it is able to carry at any one time.

28. Whilst we understand the Commission is focusing on taxation and borrowing, we see some merit in considering the current operation of the Housing Revenue Accounts Subsidy scheme.

29. The UK Government, as the Treasury’s consultation makes clear, is ‘seeking a balance. It wants to ensure the empowerment of all devolved institutions. At the same time, it must maintain the success of the shared economy on which all countries of the UK depend’ (2011:5).

30. Welsh Conservatives strongly endorse the UK Government’s efforts to rebalance the British economy. Indeed, as a Welsh party, proudly unionist in its outlook, it is a matter of considerable pride for us that this policy is being taken seriously.

31. Nonetheless we do not underestimate the difficult and sometimes competing decisions that the Government now faces over economic and social reform. The potential for economic and administrative inefficiencies that could result from the devolution of select taxation powers jars with the Government’s commitment to simplify the UK tax system. Cannibalisation of the UK tax base would undermine the principles of economic and social union which underpin the United Kingdom. The Government’s commitment to eliminate the bulk of the structural deficit within this parliament necessitates the reduction in the rise of public spending, yet the devolution of corporation tax in particular would, at least to begin with, reduce the budget of the National Assembly further. As an indication, the devolution of corporation tax to the Northern Ireland Executive has been estimated to cost an annual £350 million (HM Treasury summary of consultation responses, December 2011).

32. Good government is about taking difficult decisions. But Welsh Conservatives believe in this case that any steps to alter the fiscal arrangements of the National Assembly must also carry the full support of the people of Wales.

Securing a wide degree of support

33. Devolution now enters a critical phase. Support for the National Assembly is growing (All Wales Convention, November 2009), but turnout remains far too low at Assembly elections. With forty per cent of a forty-one per cent turnout, the executive in Wales has the support of fewer than one in six voters (Members Research Service, May 2011). This is detrimental to the Welsh democratic process.

34. If voters are to be empowered with the fundamental political choice of paying more or less tax for more or less service, then so too must they be empowered with the final decision over whether to accept responsibility for making this choice in the first place.

35. In 1997, Scotland’s referendum on devolution included a referendum on the principles of tax-varying powers. We see this as an important constitutional precedent.

36. Welsh Conservatives therefore accept the sentiment expressed by the Holtham Commission, that ‘devolution of powers over income tax would [likely] take place only after a referendum’ and that ‘without that, devolving income tax may be too big a change to make without public endorsement’ (2010:121). We believe that any alteration in the fiscal governance of the Assembly should be achieved through a referendum and with the consent and support of a majority of people in Wales.