Plaid Cymru: Submission to the Commission on Devolution in Wales

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1: Summary

- Plaid Cymru's approach to the issues considered by part one of the Silk Commission has four core principles:

  i. Fiscal devolution is part of an evolving process by which Wales will become more economically and democratically self-sufficient;

  ii. The Welsh Government currently has accountability over its expenditure without responsibility for its income. There are no direct linkages between taxes paid in Wales and decisions taken by the Welsh Government; decisions taken do not impact its revenue. By creating linkages, the people of Wales will be empowered over decisions that affect their wellbeing;

  iii. The economy of Wales is underperforming. We want to see a more prosperous and more equal society. Fiscal powers provide policy levers towards achieving these goals; and

  iv. The workings of government should be transparent, but current fiscal arrangements are opaque. Fiscal devolution would create greater clarity in terms of responsibility. This would enable more effective scrutiny.
• Taxation and borrowing powers play an important role in facilitating economic growth and ensuring social justice. Such powers have been proven to work at a sub-central level throughout the world, but are lacking under the current devolution arrangements in the United Kingdom.

• Significant tax revenues and powers should be transferred to the Welsh Government, including income tax, VAT, corporation tax and resource taxes. The Welsh Government should have powers to introduce and levy new taxes. Ownership and control over the Crown Estates in Wales should be transferred to the Welsh Government.

• Fiscal devolution will result in adjustments to the Welsh block grant. Mechanisms used to calculate adjustments should minimise risks to the Welsh budget. A commission should be jointly established by the Welsh and UK Governments to oversee funding, including the remaining block grant (which should be needs based to ensure fairness). Full data on funding should be made available to enable scrutiny.

• The Welsh Government should be able to borrow funds to be used for capital investment or to offset budgetary volatility. It should be free to choose the most efficient source of funding.

2: Introduction

2.1 The UK is currently moving from a highly centralised, unitary state to one with a system of asymmetric devolution. However, whilst legislative devolution to Wales has progressed, there has been no corresponding advance on fiscal matters. The Welsh Government currently has fewer tax and borrowing powers than local authorities.

2.2 This lack of fiscal devolution is a marked contrast to other countries, where substantial fiscal powers have been granted to sub-central governments (see annex). Such governments generally source significant proportions of their revenue from taxes for which they are responsible and accountable. The most commonly devolved taxes are those on income, property as well as goods and services.

2.3 Whilst a wide range of approaches to fiscal devolution has been proved to work in practice, there is no ‘one size fits all’ approach. Fiscal devolution must be tailored to fit Welsh circumstances. Plaid Cymru’s approach to the issues considered by part one of the Silk Commission has four core principles:
i. Devolution is part of an evolving process in which the nation’s capacity to take responsibility for the decisions that affect it is continually strengthened. This incorporates the transfer of both fiscal and legislative powers. Our vision is of a stronger Wales which is more economically and democratically self-sufficient. We remain committed to an independent Wales as a full member of the European Union;

ii. The Welsh Government currently has accountability over its expenditure without responsibility for its income. There are no direct linkages between taxes paid in Wales and decisions taken by the Welsh Government. The creation of linkages would empower the people of Wales, through their government, to make decisions that impact on their wellbeing. By bringing decision-making closer to the people of Wales, democratic choices could be made on the:

- Extent to which taxes could be used to strengthen the economy and enhance social justice;
- Desired relationship between tax levels and the provision of public services; and
- Extent to which society should be influenced by varying levels of taxation (such as those relating to alcohol).

iii. The economy of Wales is underperforming and the private sector is too small. We want to see prosperity grow in Wales. Such growth would transform the economic wellbeing of families and communities. This would lift people out of poverty and ensure greater social justice. In this context, fiscal powers would:

- Enable the creation of a tax system that reflects Welsh economic circumstances. Such powers would assist a Welsh Government to transform our social and business environment, helping to ensure prosperity and equality; and
- Link the funding available to the Welsh Government with the economic performance of the nation. This would incentivise the Welsh Government to develop a stronger focus on the economy, as growth would lead to increased tax revenues.
iv. We believe that the workings of government should be transparent. However, the current fiscal arrangements are opaque. Fiscal devolution would create greater clarity in terms of responsibility, allowing more detailed scrutiny. This would enhance good governance, and is in the interest of the Welsh and UK Governments.

3: Responses to core questions posed by the Commission on Devolution in Wales

What, if any, tax powers including possible new taxes and levies should be transferred to Wales?

3.1 Plaid Cymru believes that the benefits of fiscal devolution can only be fully realised through the transfer of significant revenues and powers. Such transfers should:

i. Give the Welsh Government policy levers that can be used to deliver a more prosperous society;

ii. Include a number of taxes so as to reduce the potential for over-reliance on one tax, and the corresponding risk of economic distortion;

iii. Enable the Welsh Government to raise a significant proportion of its income through taxation;

iv. Enhance the Welsh Government’s fiscal responsibility through linking accountability over expenditure with responsibility for some of its income; and

v. Link the funding available to the Welsh Government with the economic performance of the nation.

3.2 Transfers should take place as follows:

i. **Income tax:** The transfer of income tax revenues and powers would enable the creation of a system tailored to Welsh circumstances. Each UK income tax rate applicable in Wales should be reduced by at least half. Revenue associated with the balance would be retained by the UK Government. The Welsh Government should have the power to set Welsh income tax rates without restriction. These would be additional to the remaining UK rates. However, this involves the risk that changes at a UK level (such as to personal allowances and bands) would negatively impact on Welsh revenues. The UK
ii. **VAT:** Transfer of VAT revenues as part as a package of fiscal devolution would link a significant proportion of the Welsh Government’s budget to taxes raised in Wales. As variation of VAT within European Union member states is constrained by tax harmonisation rules, at least half the imputed VAT revenues in Wales should be transferred to the Welsh Government.

iii. **Corporation tax:** Whilst a range of factors apart from taxation contribute to economic growth, corporation tax offers a powerful tool to facilitate increased performance. All corporation tax revenues should be transferred, as should the power to set rates. It would also be desirable to transfer powers over structural elements of corporation tax, such as the definition of taxable profit.

iv. **Resource taxes:** Wales should be able sustainably to exploit its natural resources for the greatest environmental, social and economic gain. All powers and revenues associated with existing resource taxes such as landfill tax and aggregates levy (subject to EU approval) should be transferred. Wales should have the power to create and levy new taxes on all aspects of resource exploitation, including water and renewable energy.

v. **Other taxes:** There should be the greatest possible devolution of taxation powers and revenues when permitted by European law. In relation to some specific taxes, powers and revenues relating to taxes on property and land (such as stamp duty land tax and capital gains tax on property and land) should be transferred to Wales, as should air passenger duty. We would also support devolution in relation to alcohol and tobacco excise duties. However, the potential for economic distortion and tax avoidance would need to be taken into account when formulating the most appropriate approach.

3.3 The Welsh Government should have powers to introduce and levy new taxes, except where taxes are specifically reserved to Westminster.

3.4 The part of HM Revenue and Customs (HMRC) responsible for raising taxes in Wales (payable to the Welsh Government) must be accountable to the National Assembly for Wales. Before
3.5 National Insurance Contributions (NICs) should not be devolved as these are notionally hypothecated to fund social protection services. These services are reserved to the UK Government and are needs related with common treatment of citizens across the UK. The lack of a devolved benefits system rules out devolution of NICs at present. However, Plaid Cymru would want a transfer in the longer term. In addition, the reservation to central government of social protection is a common feature of fiscal devolution.

What, if any, borrowing powers should be devolved to Wales?

3.6 Borrowing has a vital role when seeking to fund large capital projects that will increase economic capacity, as well as in offsetting any budgetary volatility arising from tax devolution.

3.7 Borrowing for capital expenditure is particularly important at present, given that:

i. Changes to the Welsh Government's capital budgets reflect Barnett consequentials, not its own requirements;

ii. Budget cuts announced by the UK Government will have a devastating impact on the ability of the Welsh Government to fund large capital projects over the coming years; and

iii. The current realities of subdued economic growth and rising unemployment means that there is a pressing need for government to intervene to support growth and job creation.

3.8 Local authorities can borrow within the prudential borrowing framework. The proposed Scotland Bill contains measures that would enhance the Scottish Government's borrowing powers. It is unreasonable to exclude the Welsh Government from public bodies that have, or are likely to have, substantial borrowing powers.

3.9 Significant borrowing powers should be devolved to the Welsh Government. Borrowing limits should be based on an assessment of sustainability and affordability. The Welsh Government should be entitled to set an annual borrowing limit for itself, which it considers affordable and
3.10 The Welsh Government should be free to issue bonds or obtain commercial funding, as well as using the services of HM Treasury’s Debt Management Office (DMO). This will enable the Welsh Government to decide which borrowing mechanism best suits its requirements. In many cases, it may make sense to borrow via the DMO. However, this might not always be the best option. For example, local authorities have generally borrowed funds from the DMO’s Public Works Loan Board (PWLB) instead of issuing bonds in recent years. Such debt has tended to be cheaper than alternative mechanisms. However, the UK Government has now increased the cost of this debt. Some local authorities are now exploring re-entering the bond markets as a consequence.

3.11 Such borrowing powers would complement the implementation of initiatives such as our ‘Build for Wales’ proposal. That proposal would establish a not-for-distributable-profit company to generate investment in transport, schools, hospitals, new homes, and the wider world-class infrastructure required for economic growth. ‘Build for Wales’ would be funded via bonds, whilst it would be structured as a body similar to Glas Cymru.

Do you have any other proposals for improving the financial accountability and empowerment of the Welsh Government?

3.12 **Transparency:** Consideration of fiscal devolution is hindered by the opaque nature of the current arrangements. It is difficult accurately to identify trends over time. In line with the recommendations made by the Allsopp Review sponsored by HM Treasury, publicly available data covering current and future funding arrangements should include those identifying:

i. Expenditure by Whitehall departments on services in England that are devolved to Wales; and

ii. The amount of tax collected in Wales.

3.13 **Funding arrangements:** The transfer of tax revenues will lead to corresponding adjustments to the block grant. A number of methodologies could be used to calculate these, each of which has advantages and disadvantages. Given the budgetary risks involved, we believe that:
i. Careful consideration must be given to the way in which adjustments are to be calculated. Significant work will be needed to model potential scenarios for each tax that is considered for transfer. This would ensure that the chosen mechanisms minimise potential risks;

ii. A standing commission should be jointly established by the Welsh and UK Governments to determine funding issues (including a post-Barnett needs based formula). This should be constituted on an arm's length basis from government, as are the Bank of England’s Monetary Policy Committee and the recently established Office for Budget Responsibility; and

iii. The ongoing effects of the mechanisms used to calculate adjustments should be transparent and closely monitored. Reviews should be conducted from time to time to ensure that long term divergences between the capacity of Wales and the rest of the UK to provide public services can be corrected.

3.14 The Crown Estate: This has a diverse range of holdings in Wales. As well as agricultural land and mineral rights, these include the seabed out to a 12 nautical mile limit. All profits from such holdings (including from onshore and offshore wind farms) are passed to the UK Treasury. These are likely to grow substantially, mainly due to the demand for renewable energy. Given that, in the past, Wales has not fully benefited from its abundant energy resources, ownership and control over the Crown Estates in Wales should be transferred to the Welsh Government.

4: Responses to the supplementary questions posed by the Commission on Devolution in Wales

What are the key principles that should guide consideration of the case for devolution of some fiscal powers to the National Assembly for Wales?

4.1 These are outlined in the introduction.

What form of fiscal devolution would be appropriate for Wales which are consistent with the UK’s fiscal objectives?

4.2 We believe that our approaches, as set out in this paper, are realistic, deliverable and consistent with the UK’s fiscal objectives.
Which tax receipts (if any) should be assigned to Wales and which (if any) tax powers should be devolved to Wales?

4.3 See the response to the core questions (tax) section.

What borrowing powers (if any) should the Welsh Government acquire (a) in the absence of fiscal devolution, (b) in the presence of fiscal devolution?

4.4 We have set out the borrowing powers that should be acquired. Capital borrowing powers should be acquired by the Welsh Government in either the absence or presence of fiscal devolution.

How would any devolution of borrowing powers fit into a UK macroeconomic control framework?

4.5 We believe that that our approaches, as set out in this paper, are prudent, realistic and deliverable within the UK’s macroeconomic control framework.

Are the proposals in the final report of the Holtham Commission the appropriate model for fiscal devolution for Wales?

4.6 The Holtham Commission’s final report, published in July 2010, was a valuable assessment. However, the circumstances and debates surrounding fiscal devolution have since progressed. Although we support some of the Commission’s general principles on combining tax devolution with a needs based block grant, some of its recommendations on taxation and borrowing should be reconsidered.

Which recommendations of the Holtham Commission do you agree with and which do you disagree with and why?
4.7 In broad terms, Plaid Cymru:

i. **Agrees** with the abolition of the Barnett formula and its replacement with a needs based formula;

ii. **Agrees** with the need for greater borrowing powers, but **disagrees** with restrictions on allowing the Welsh Government to choose the most efficient source of funds;

iii. **Agrees** with the need for the transfer of taxation powers and revenues to the Welsh Government, and for National Insurance Contributions to remain under central control. We **disagree** with the limits proposed for powers over income tax rates and the exclusion of many taxes from those considered suitable for transfer. There should be a greater emphasis on the transfer of powers (allowances, rates etc.) as well as revenues; and

iv. **Agrees** with the need to pay close attention to the mechanisms used to calculate tax related offsets to the block grant. Risks to the Welsh budget must be minimised.

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To what extent are the fiscal powers proposed in the Scotland Bill transferable to the Welsh context?

4.8 In December 2011, the Scotland Bill Committee of the Scottish Parliament stated that it:

...*is unable to recommend that the Parliament approve a Legislative Consent motion on the Scotland Bill unless it is amended in line with the Committee’s conclusions and recommendations.*
The Scotland Bill is unlikely to be enacted in its present form if the Sewell Convention is followed. Against this background, any proposals for fiscal devolution in Wales must be tailored to meet the circumstances faced by our nation.

Annex: Fiscal devolution models
1. Introduction

1.1 Fiscal devolution models are varied and complex. Such models often vary between different constituent units of the same country (such as Canada and Spain). Differing approaches include:

i. **Spain**: Funds are vertically distributed between different levels of government, with varying models of sharing revenue and powers. For example, the Basque Country collects all general taxes itself, such as income tax, corporation tax, VAT and excise duty. It has almost full autonomy in terms of collecting and varying direct taxes, and has introduced a lower rate of corporation tax than found in the rest of Spain;

ii. **Germany**: Funds are horizontally distributed between regional governments. Revenues from personal income tax, corporation tax and VAT are shared between different levels of government; and

iii. **Australia**: Vertical distribution of goods and services tax revenues, with an independent statutory body (the Commonwealth Grants Commission) recommending how these should be allocated to achieve fiscal equalization.

1.2 Compared to other countries, the UK has a very low share of total tax revenues attributed to the sub-national (central) level. For example, the final report of the Independent Commission on Funding and Finance for Wales (Holtham) drew on Organisation for Economic Co-operation and Development (OECD) data to conclude that **sub-central taxes as a share of total tax revenue**:  

\[ \text{... tend to be highest in federal states and in countries with highly decentralised systems of public services (for example Denmark, Sweden and Spain). The UK has a strikingly low proportion of tax revenue collected at the sub-national level, even by the standards of unitary states.} \]

1.3 An earlier study carried out by the OECD found that, on average, half of **sub-central expenditure** within member states was covered by own taxes and half by grants.  

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1.4 Further data are available from the OECD on the proportions of the **sub-central governmental revenue** that are derived from collected taxes. These are available for two sub-central levels: 

i. **State:** These consist of intermediate units of government (state, provincial or regional) exercising a competence at a level below that of central government. Administration of social security funds is excluded. In unitary countries, regional governments are considered to have a separate existence where they have substantial autonomy to raise a significant proportion of their revenues from sources within their control. Federal countries comprise eight of the nine cases where revenues attributed to state government are identified separately in these data. Spain is the only unitary country where data are identified. In the remaining unitary countries, regional revenues are included with those of local governments; and

ii. **Local:** These include all other units of government exercising an independent competence within a country’s territory, with the exception of the administration of social security funds.

1.5 These data show that in 2009:

i. State governments in six of the nine countries for which data are available sourced at least 40 per cent of their revenue from tax receipts (graph 1); and

ii. Local governments across 32 OECD member countries (including those with federal systems) sourced an average of 37.3 per cent of their revenue from taxes collected at a sub-central level. This compares to 12.9 per cent in the UK (graph 2).

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2. State government revenues by type

2.1 State governments in OECD member countries vary widely in terms of their ability to levy taxes and collect social contributions.

2.2 Graph 1 demonstrates that German states raised the most revenues via taxes other than social contributions, representing over 70 per cent of state finances. All other state governments raised at least 20 per cent, with the exception of those in Mexico and Belgium.

**Graph 1: Structure of state government revenues (2009) (see notes a – d)**

Notes
(a) Australia: 2008;
(b) Local government is included in state government for the United States;
(c) Australia does not collect revenues via social contributions because it does not operate government social insurance schemes; and
(d) Grants can be from foreign governments, international organisations or other general government units. Other revenues include sales, fees, property income and subsidies.

3. Structure of local government revenues

3.1 For OECD countries where data are available, an average of 37.3 per cent of local government revenues were raised from tax receipts (see graph 2). The figure for the UK was 12.9 per cent, one of the lowest figures of the countries compared. Intergovernmental grants and other revenues were key features of local government’s finances in most countries, representing 61.5 per cent of local revenues on average.

Graph 2: Structure of local government revenues (2009) (see notes a – g)

Notes:
(a) Data for Australia are from the Government Finance Statistics, Australia 2008-2009;
(b) Data for Chile are missing;
(c) Data for Israel are supplied by and under the responsibility of the relevant Israeli authorities;
(d) Australia, Japan, Korea and New Zealand: 2008 instead of 2009;
(e) Local government is included in state government for the United States;

(f) Australia does not collect revenues via social contributions because it does not operate government social insurance schemes; and

(g) Grants can be from foreign governments, international organisations or other general government units. Other revenues include sales, fees, property income and subsidies.