It is a pleasure to participate in this interesting conference on redesigning devolution, and I am very grateful for the invitation to participate in it.

The timing of the conference is in one sense particularly opportune from my point of view. The Commission on Devolution in Wales, of which I am a member, is scheduled to report on fiscal devolution in Wales later this autumn, so it is valuable to be able to hear the contributions of today's speakers. As a Commission, we have been particularly keen to take international experience into account in our deliberations.

My task today is to discuss the work of the Commission on Devolution in Wales, often called the Silk Commission. I shall say something about the background, how we have worked, some of the issues that have arisen and some of the arguments we have heard. I cannot, of course, at this stage speak about our likely recommendations.

The commission was established by the UK government to consider the powers of the Welsh Assembly and to make recommendations for any changes that may be necessary to allow the Welsh Government and National Assembly to best serve Wales within the UK.

Our remit has two parts: the first is on the financial powers and accountability of the Assembly - this will be the main part of this talk today. Part Two will start after we have published our report for Part One, and that will consider more broadly the subjects that are devolved and those that are retained at Westminster, with a view to suggest what changes need to be made to the devolution settlement.

As I said, we are a commission established by the Westminster government with a remit set by the Westminster government, but agreed with the four party leaders in the Assembly. We report to the Secretary of State and Chancellor of the Exchequer.

A commission was first proposed in the coalition agreement in May 2010. It was agreed that there would be a referendum on the legislative powers of the Assembly, as requested by the Welsh Assembly before the general election and as set out in the Government of Wales Act 2006. Depending on the outcome of the referendum –and in the event Wales convincingly voted *yes* in March 2011 – the Agreement was that a process similar to the Calman Commission in Scotland would be established in relation to Wales.

You will recall that the Calman Commission was launched in 2008 by the Westminster Government and the Scottish Parliament. However, this was without the Scottish National Party, who had formed the minority Scottish Government earlier that year. The purpose of the Calman Commission was to improve how the Scottish Parliament served the people of Scotland and how the Union could be strengthened. Its recommendations, most significantly on the financial powers of the Scottish Parliament, formed the basis of Scotland Act, which became law earlier this year.

Our Commission was established with all the agreement of the four main parties in Wales – that is significant - and we have worked well together as independent members and members of the different parties.

In addition to the Chair, Paul Silk, the independent members are Dyfrig John and myself. The other members are former Welsh Finance Minister Sue Essex, nominated by Labour, former leader of the opposition Nick Bourne, nominated by the Conservatives, economist Eurfyl ap Gwilym, nominated by Plaid Cymru, and Director of the Open University in Wales, Rob Humphreys, who was nominated by the Liberal Democrats.

It is understandable that two parties new to Government would want to re-examine devolution, as, of course, set up by the new opposition. But I think it is also useful to see it as a natural next step in assessing the value of devolution in Wales, just over 13 years old. Devolution came first with an Assembly with executive powers, transferred to the Welsh Government in 2006; then came legislative powers after the referendum in 2011. Now we consider financial powers.

Our remit required us to present recommendations that were likely to command a wide degrees of support in Wales. Rather than take agreement within our cross-party commission as representing consensus, we were very keen to open our process up as much as possible to the public and to interest groups in Wales. If we were eventually to recommend that the Welsh Government and National Assembly should have tax-varying powers, we felt that we should to consult the people who would pay the tax.

We travelled across Wales, visiting every one of the 22 local authority areas, holding a variety of events. At each we heard a range of interesting views and these helped to develop our thinking.

This experience did bring home to me how difficult it is to generate a public debate on complex issues like taxation. Issues around tax and how devolution is funded have been discussed by politicians and the media for years – and in particular since the Holtham Commission reported two years ago. But these are technical issues, and part of our task was to increase understanding of them.

It was clear that relatively few people in Wales had previously fully engaged in this debate. To encourage the debate and understand public attitudes in more detail we commissioned an opinion poll (by ICM), the most comprehensive of its kind on these issues in Wales.

As part of our work, we visited Scotland and Northern Ireland. We were struck by the similarities but also the differences in the debate on the future of devolution in the three devolved countries.

We are also able to draw on the work of the Holtham Commission on funding in Wales, which reported to the Welsh Government in 2010. This report contains a great deal of very valuable analysis.

Currently in Wales only two taxes are the responsibility of the Welsh Assembly: council tax and business rates – though they are collected by local authorities rather than by the Assembly. All other taxes are entirely set and collected by Westminster.

The Welsh Government is currently funded through a block grant from the UK government. Changes to this block grant are worked out through the Barnett mechanism, a formula that was in place way before devolution. The base line is historical and the formula determines changes in block grant related to changes in public expenditure in England on those matters policy on which is devolved; involves the population of Wales as a proportion of that of the UK as a whole.

The block grant can be spent on anything the Welsh Government chooses with the approval of the Assembly – none of it is hypothecated. But the Welsh Government cannot vary any taxes – for example, to increase its budget or reduce the tax burden in Wales, to stimulate economic activity, or try to influence behaviour, for example through environmental taxes.

Consideration of the Barnett formula was excluded from the commission's terms of reference. Instead, the Welsh Government and Westminster Government are discussing the so-called 'fair funding' issue in separate intergovernmental talks.

We <u>have</u> been asked to look at improving the financial accountability of the Assembly. Of course, people are used to holding their Assembly Members to account at the ballot box. Financial powers would be an additional type of accountability, with changes in the Welsh economy's health being more directly reflected in the budget of the Welsh Government.

There are many positive arguments in support of tax devolution. People would take a greater interest in the Welsh Government if they were paying their taxes directly to them. The Welsh Government could further encourage Welsh economic growth or improve Welsh public services to meet the preferences and needs of Welsh citizens more effectively. A mature government should have large and serious responsibilities. And a government should have responsibility for collecting some taxes as well as for spending.

But there are also downsides to consider. There is a large border with England that many people live very close to – the degree of movement to work across the border is considerable. About 1.4m people, almost 50% of the population of Wales, live within 25 miles of the border, and about 2.7 m live within 25 miles of the border on the England side. The figures for Scotland are quite different.

In addition, some evidence received expressed doubts about the capacity and experience of a Welsh Government to manage tax policy in Wales. We have also heard concerns over the risks that would be transferred to the Welsh Government. Another view is that the main responsibility for macroeconomic and fiscal management and social redistribution should continue to lie with the UK Government.

The Commission has approached all this with a genuinely open mind. We have also considered the question of whether the Welsh Government should be able to borrow to finance higher capital spending. This seems to be quite widely supported provided it is subject to prudent limits.

As I said at the beginning, we want to produce a report that is good for Wales, and good for the UK. We know that people are nervous about Government borrowing across the UK and Europe, and people are never keen on tax rises or too much competition over tax rates. They are also worried about the costs of a separate Welsh tax and borrowing system. We have considered these views very carefully.

We have also spoken to neighbours in England about how they would feel if the Assembly had tax-varying and borrowing powers. There may be of course be some that are nervous that different tax rates either side of the border would create tensions. It may be the case ultimately that the border will not make too much difference – people don't really notice the different council tax rates they pay on each side of the border (in some circumstances from one street to the next) and people are generally comfortable that devolution means different public services across the border. However, it is right that we take all views into account in our work.

Throughout our deliberations we have been mindful of experience elsewhere in the world, where neighbouring regions often have different taxation arrangements. One of a number of research papers which will appear on the Commission's website is concerned with the international comparisons, and the lessons which we can learn from experience elsewhere. We reviewed the international evidence, and heard from various experts in the field.

There is also the EU dimension to consider, including in particular the legal constraints. Moreover, does it make sense to devolve fiscal powers to Wales when the Eurozone crisis is making clear the importance of fiscal and monetary policy being determined together? Also important is the forthcoming referendum on Scottish independence. How might the outcome of that referendum impact on Wales and the rest of the UK?

Our recommendations need to be robust in the face of these uncertainties and we have to 'future –proof' our recommendations appropriately. Early on we established a set of principles against which we would assess our recommendations. The most important are Accountability, Empowerment and Equity.

Among the key lessons are, first, the UK's system of asymmetric devolution is unusual and does not allow for easy read across to the sorts of federal systems more commonly found elsewhere. Second, there is no single best system. Across the world there are many different systems and models, each of which has its own costs and benefits. Third, Wales is very unusual in having legislative and executive powers but no fiscal powers. Fourth, work by organisations such as the OECD does seem to point to some taxes being easier to devolve than others – for example, as property taxes, where property is immobile, rather than others where the tax base is very mobile.

As I said, we are still forming our own conclusions. We will be reporting later in the Autumn, and then we will start on the second part of our work on non - financial aspects of the devolution settlement.

To conclude, there are no easy solutions here and it is a question of balancing costs and benefits. But it is invaluable to draw on overseas experience. I look forward to hearing the contributions of all today's speakers.