



Holtham Commission

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The Independent Commission on Funding & Finance for Wales (Holtham Commission) was established in 2008 to review the Welsh Assembly's funding and to consider further devolution of fiscal powers. The Commission examined the current funding arrangements, determined by the Barnett Formula, and assessed the case for increasing Wales's taxation and borrowing powers.

In July 2010, the Commission published its final report and recommendations. This note outlines the main recommendations from the final report, briefly summarises the Commission's first report and includes reaction from the Welsh Assembly and UK Government to the Commission's recommendations.

In October 2012, the UK and Welsh Governments announced that they had agreed, in principle, that the Welsh Government should have some borrowing powers, subject to an appropriate revenue stream being in place to support them.

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1 Background

The Independent Commission on Funding and Finance (Holtham Commission) was set up by the Welsh Assembly Government (WAG) in 2008 to review the funding arrangements for the Welsh Assembly Government. The Commission was a commitment of the 2007 One Wales agreement between the Labour and Plaid Cymru groups in the National Assembly for Wales.¹ The agreement stated that the review would include a study of the Barnett Formula and tax-varying powers and consider the Assembly Government's power to borrow.

A similar commission, the Calman Commission, was established in 2008 to look at the funding of the Scottish Parliament. For further information see Library standard note [The Commission on Scottish Devolution – the Calman Commission](#) (SN/PC/04744).

2 Current arrangements

Wales currently receives an annual block grant determined by the Barnett Formula. The National Assembly does not have tax-varying powers and the Assembly Government has limited powers to borrow.

The Barnett formula has been criticised on a number of grounds. Critics have argued that the Barnett formula, because of its focus on population, fails to recognise the higher levels of poverty and greater need for investment in Wales. As a consequence, it is claimed the Welsh Assembly's block grant is significantly less than it would be if the grant was calculated using a "needs based" formula. The Holtham Commission estimated that Wales was underfunded by £400 million in 2010-11 as a result of the current funding arrangements.²

Furthermore, the commission raised their concerns about the "Barnett Squeeze". This is an issue with the Barnett Formula which can lead to a gradual convergence in funding per head

¹ [One Wales: A progressive agenda for the government of Wales](#), June 2007

² Independent Commission on Funding & Finance in Wales, [Final Report: Fairness and accountability: a new funding settlement for Wales](#), July 2010, p27

in the devolved administrations and England, and which, the Commission claimed has led to a relative decline in Wales's funding per head compared to England in recent years.

Critics have also argued that the Barnett determined block grant system lacks sufficient accountability because the WAG is not responsible for raising any of its own revenue. The Commission said that a government which is not responsible for raising its own revenue, only spending it, is not fully directly accountable to its voters.

See [Library Research Paper 07/91](#) for detailed discussion of the Barnett Formula.

3 Terms of reference

The Commission was established in July 2008 and set the following terms of reference:³

- Look at the pros and cons of the present formula-based approach to the distribution of public expenditure resources to the Welsh Assembly Government; and
- Identify possible alternative funding mechanisms including the scope for the Welsh Government to have tax varying powers as well as greater powers to borrow.

Gerald Holtham was also appointed as Chairman in July 2008. Full membership of the Commission was announced in October 2008 with Professor David Miles and Professor Paul Bernd Spahn joining Gerald Holtham.⁴

4 The Commission's first report

The Commission published its first report in July 2009.⁵ It focused on the current funding arrangements for Wales and proposed a replacement for the Barnett Formula.

The Commission criticised the Barnett Formula, commenting that it "lacked any objective justification and had survived for 30 years solely for reasons of political and administrative convenience."⁶

It recommended replacing the Barnett Formula with a formula based on needs. It argued that the population-based Barnett formula fails to take Wales's additional funding requirements into consideration, and that the greater prevalence of poverty, sparsity of population and language translation requirements in Wales demand higher relative funding.

The report also discussed the convergence in Wales's funding caused by the Barnett Squeeze and while accepting that the implementation of a replacement funding formula would take time they recommended, as an interim measure, that a "funding floor" should be put in place to prevent further relative reduction of the Welsh block grant.

A number of other recommendations were made regarding operational issues, including access to End Year Flexibility (EYF). The extract below from the Commission's second report summarises:

³ WAG press release, [Chair of Commission on Funding and Finance announced](#), 8 July 2008

⁴ WAG press release, [Independent funding commission starts work with call for evidence](#), 7 October 2008

⁵ Independent Commission on Funding & Finance in Wales, *First Report: Funding devolved government in Wales: Barnett & beyond*, July 2009

⁶ Independent Commission on Funding & Finance in Wales, *Final Report: Fairness and accountability: a new funding settlement for Wales*, July 2010, p5

1.14 We also made a number of recommendations regarding operational issues, including the desirability of handing responsibility for technical aspects of the funding regime to a body that is at arm's length from both the UK Government and the devolved administrations. In addition, we recommended that the Assembly Government should be able to draw forward its capital budget across the period of a spending review and that the constraints on the ability of Welsh Ministers to move funds between capital and revenue budgets should be reduced. We proposed giving Welsh Ministers a free hand in accessing accumulated End Year Flexibility (EYF) funds. Finally, we recommended greater transparency in the publication of data of relevance to the operation of the funding regime and suggested that UK Government Ministers should be invited periodically to attend the National Assembly's Finance Committee to discuss the funding of Wales. Annex 2 includes a list of the recommendations made in our first report. A full list of the first reports recommendation is available in the appendices.

The then First Minister of Wales, Rhodri Morgan, welcomed the report and endorsed its main findings, stating that the Assembly Government intended "to pursue the Commission's recommendations with the UK Government."⁷

5 The Commission's final report

The Holtham Commission published its second and final report in July 2010.⁸ The report re-affirmed the first report's proposals for funding reform in Wales as well as considering the limited devolution of tax powers and the Assembly Government's ability to borrow to fund capital expenditure. It concluded that the devolved government should be funded by a combination of a reformed block grant based on needs and revenue raised by increased powers of taxation.

The report expanded upon the recommendation from the first report to replace the Barnett Formula with a formula based on needs. A possible replacement funding system was detailed and the recommendation from the first report to introduce a "funding floor" in the interim was reiterated.

The report called for the devolution of tax varying powers. It recommended that the Assembly Government be given the power to vary income tax by three pence in the pound, up or down, and that other taxes should also be devolved. It also recommended that the Assembly Government be given the power to introduce new taxes with the UK Government's consent.

Coupled with the greater control the Welsh Assembly Government would have over their finances the Commission also called for access to End Year Flexibility (EYF) and increased borrowing powers to allow to Assembly Government to cope with fluctuations in tax revenue over the economic cycle.

5.1 Needs-based formula

The Commission argued that the population-based Barnett Formula fails to recognise the greater public service funding needs of Wales relative to England, and demonstrated how Welsh funding will continue to converge to the England average if current funding arrangements are maintained.

⁷ WAG press release, [The Welsh Assembly Government welcomes today's publication of the Holtham report](#), 7 July 2009

⁸ independent Commission on Funding & Finance in Wales, [Final Report: Fairness and accountability: a new funding settlement for Wales](#), July 2010

As an alternative to the Barnett Formula, the Commission set out a possible needs-based formula, attributing importance to six indicators relating to demographics, deprivation and costs, which would indicate the need for public services and greater funding:⁹

- Number of children
- Number of older people
- Ethnicity
- Income poverty
- Prevalence of ill health, and
- Sparsity of population (affects cost of delivering services)

The Commission calculated that if the proposed funding formula was applied, it would indicate Welsh funding needs of around £115 per person, compared to the £100 per person average for England.¹⁰

To prevent further convergence in Wales's funding the report also recommended the introduction of a funding floor to be set at a minimum level indicated by English needs formula. The floor would be maintained until a new needs based formula was introduced.¹¹

5.2 Taxation

The report recommended that certain powers of taxation should be devolved to the Assembly Government to improve accountability.

A key recommendation was to grant Welsh Ministers the power to vary the basic and higher income tax rates by three pence in the pound, up or down, relative to the UK rate.

It also proposed the devolution of stamp duty, council tax on second homes, and other minor taxes such as landfill tax and air passenger duty. The Commission recommended that a discussion about devolving corporation tax and capital gains tax should also take place, although it recognised the political and practical difficulties with this.

The revenue raised by the Assembly Government from Welsh taxpayers would partially replace funding from the current Treasury block grant.

The commission criticised the current block grant system which does not allow Welsh citizens the opportunity to choose between higher taxes and better funded public services or lower taxes but less well funded public services.

It argued that restricting the Assembly Government's ability to manage its economic affairs ultimately undermines its direct accountability to Welsh citizens.

5.3 Borrowing powers and access to End Year Flexibility

The Commission further recommended that the Welsh Assembly Government should be given limited powers to borrow from money markets to finance capital expenditure. It said

⁹ Ibid, p20

¹⁰ Ibid, p21

¹¹ Ibid, p5

that any borrowing should be through the Debt Management Office (an executive agency of the Treasury) and a ceiling on the amount of debt should be put in place.

To accompany the WAG's power to borrow the Commission also recommended that the Assembly Government should have access to End Year Flexibility (EYF). Access to EYF would allow the Assembly Government the flexibility to save unspent funds from the annual grant and carry them forward to the next financial year. This would allow the Assembly Government to plan and manage its resources over a number of years without the need to re-negotiate with the Treasury each year for the necessary funds. Currently any unspent funds from the block grant are returned to the Treasury. In 2009-10 the WAG had an EYF stock of £594 million.¹²

The End Year Flexibility system was abolished in 2010 and replaced in 2011 by a new Budget Exchange scheme for the devolved administrations. See Treasury [press release](#) for further detail.¹³

5.4 Transitional arrangements and improved statistics

Other recommendations from the Commission dealt with the arrangements leading up to possible reform and modifying UK statistics to reflect any changes made. The summary below from the Commission's press notice explains these recommendations further:¹⁴

Transition arrangements

The preparatory work that is under way to implement tax devolution for Scotland should proceed on the assumption that similar tax powers could be devolved to Wales. The Assembly Government should have a seat at the table in any discussions about fiscal devolution that are taking place at UK level. Building this assumption in from the start will help minimise the implementation costs of tax devolution in Wales. The Assembly Government will need to develop stronger relationships with HMRC. An early priority would be to agree a memorandum of understanding to set out how a devolved tax regime would be implemented.

Improved statistics

The Assembly Government should seek modification of the UK's national accounts to include a "provincial" tier of government spending. This reform would ensure that official statistics reflect the reality of devolved government and would help clarify the distinction between expenditure by UK Government departments and by the devolved administrations.

6 Reaction to the Holtham Commission and developments

In March 2010, prior to the publication of the final report, the recommendation of a needs based formula received support from the Welsh Affairs Committee:

The Barnett Formula is overdue for reform. Recent reviews have highlighted its deficiencies, and the Holtham Commission has put forward a needs-based formula. Whilst we recognise the commitment given to the Secretary of State for Wales from HM Treasury that Wales will not be disadvantaged by convergence under the Barnett Formula, we urge the Government to review the current arrangements and to adopt a needs-based approach to a new financial settlement.

¹² HM Treasury, *Public Expenditure Outturn White Paper (PEOWP)*, p17

¹³ HM Treasury, *Alexander announces new budget flexibility for Devolved Administrations*, 18 July 2011

¹⁴ WAG press release, *Holtham Commission calls for fairness and accountability in Welsh funding*, 5 July 2010

In the May 2010 Coalition Agreement, the Government commented on the Commission's work and agreed to establish a "Calman-like" commission to consider Welsh Assembly funding, but stated any reform must wait until the public finances have stabilised:¹⁵

We recognise the concerns expressed by the Holtham Commission on the system of devolution funding. However, at this time, the priority must be to reduce the deficit and therefore any change to the system must await the stabilisation of the public finances. Depending on the outcome of the forthcoming referendum, we will establish a process similar to the Calman Commission for the Welsh Assembly.

In July 2010, the Welsh Assembly Government welcomed the Commission's final report. The Minister for Business and Budget, Jane Hutt, commented:¹⁶

I welcome both the report's demonstration of how a needs-based funding regime could be made to work in practice and also how its reassertion of the case for the introduction of a floor in the Barnett formula for Wales, pending further reform. This is something that commands support across the Assembly and the Assembly Government will continue to press the UK Government to implement a floor in the forthcoming spending review."

The main political parties of the Welsh Assembly supported the Holtham Commission's report and on 12 October 2010 an Assembly Government resolution supporting its findings was endorsed unanimously.¹⁷

On 5 July 2011, the National Assembly also unanimously endorsed a motion supporting the reforms set out in the Commission's reports and on working towards achieving financial reform for Wales.¹⁸

In the 2011 Budget, the UK Government stated that it was "committed to fair and accountable funding for Wales, including taking forward discussions on all aspects of the final Holtham report."¹⁹

Subsequently, in July 2011, Cheryl Gillan, the Secretary of State for Wales, announced plans to establish, by autumn 2011, a new independent commission to look at Welsh financial accountability. She stated that the new commission would take the findings of the Holtham Commission into consideration.²⁰

On 11 October 2011, Cheryl Gillan announced the terms of reference of the new Commission on Devolution in Wales. The Commission is expected to report on financial accountability and fiscal devolution by autumn 2012 and is chaired by Paul Silk, former Clerk to the National Assembly for Wales.²¹

In October 2012, in a joint statement from the Welsh and UK Governments, it was announced that the UK Government had agreed, in principle, to grant the Welsh Government limited powers to borrow money to finance major projects. This is subject to the establishment of a new independent revenue stream being in place to support it.²² The Silk

¹⁵ HM Government, [The Coalition: our programme for government](#), May 2010, p28

¹⁶ WAG press release, [Holtham Commission report welcomed](#), 6 July 2010

¹⁷ WAG, [Cabinet Written Statement on financial reform](#), 14 October 2011

¹⁸ Ibid

¹⁹ [HM Treasury, Budget 2011, March 2011](#)

²⁰ [HC Deb 19 July 2011 c115WS](#)

²¹ [HC Deb 11 October 2011 c25-8WS](#)

²² HM Government and Welsh Government, [Funding reform: joint statement of progress](#), 24 October 2012

Commission is currently considering the devolution of tax-varying powers and the Government said that any decision about which tax powers could provide an appropriate revenue stream will not be made until the Commission reports.

However, the statement also said that, in anticipation of a future revenue stream, both Governments would explore the case for early access to borrowing powers for funding “specific infrastructure projects”.

In regards to the Welsh block grant, the Governments agreed that at future spending reviews they would jointly review the pattern of convergence in Welsh relative funding. Both Governments said they are committed to negotiating a sustainable arrangement for Welsh funding and the UK’s public finances.

For further information about the Silk Commission see Library standard note: [Devolution in Wales: the Silk Commission](#) (SN/PC/06108).