HOUSE OF COMMONS

Welsh Affairs Committee

Oral evidence: The Impact of the Budget on Wales, HC 440

Wednesday 27 November 2024

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Watch the meeting

Members present: Ruth Jones (Chair); David Chadwick; Ann Davies; Claire Hughes; Ben Lake; Llinos Medi; Andrew Ranger; Henry Tufnell; Steve Witherden.

Questions 1 - 27

Witnesses

I: Guto Ifan, Lecturer, Wales Governance Centre, Cardiff University; David Phillips, Associate Director, Institute for Fiscal Studies; and Dr Victoria Winckler, Director, Bevan Foundation.

Examination of witnesses

Witnesses: Guto Ifan, David Phillips and Dr Victoria Winckler.

Q1 **Chair:** Good morning and welcome to this first public evidence session of the new Welsh Affairs Select Committee. My name is Ruth Jones. I am the Chair of the Committee. We are discussing this morning a very important issue. Following the Budget, we are looking at the impact of the UK Government Budget on Wales. Before I ask our witnesses to introduce themselves, I will ask Committee members to declare any interests that they have that are relevant to today's session.

Henry Tufnell: My parents and my brother own and run an 895-hectare mainly arable farm in Gloucestershire. My parents also own 10 hectares in Pembrokeshire, which they let out to a local farmer. I have no financial interest in either of those holdings.

Ann Davies: I would like to declare that I farm in the Tywi valley with tenant farmers but we also own some land there as well. We also run a business that is affected by the Budget changes.

Llinos Medi: I want to declare that my mother owns land in Ynys Môn that she rents out and farms herself. I have no financial interest but am declaring as we are discussing farming and agriculture in today's agenda.

Chair: As Chair, I need to declare that I am a member of the Bevan Foundation and have been for at least 10 years now, I think. My husband is also a planner on HS2, just so you know. There we are, we have declared our interests. Thank you very much for that.

I will move on to the witnesses now. Thank you ever so much for joining us this morning. To the three of you, welcome. I will ask you to introduce yourselves, starting off with Dr Victoria Winckler.

Dr Winckler: Thank you very much. I am Director of the Bevan Foundation, which is an independent charitable think-tank. In respect of Ruth Jones MP's membership, membership is open to anybody.

Chair: Thank you, Victoria. A good plug there, that is fine. We will go on to Guto Ifan.

Guto Ifan: Bore da. I am a lecturer in politics at Cardiff University and part of the Wales Governance Centre and the Wales fiscal analysis team, which is a part of the Wales Governance Centre that focuses on Welsh public finances, the Welsh budget and Welsh public services.

Chair: Brilliant. Thank you very much, Guto. David Phillips, please.

David Phillips: Good morning, bore da. I am an associate director at the IFS and I lead our work on devolved and local government finance.

Q2 **Chair:** Lovely. Thank you very much to the three of you for agreeing to come before us this morning, albeit virtually. As you can see, the Committee is before you and as usual we will be asking questions. Please take your time to answer as fully as you feel able to. If you feel you have nothing to add and somebody else has already covered it, you are very welcome to say, "Nothing to add".

I will open with the first question. We are looking at the impact of the UK Budget on Wales and, in particular, the Welsh fiscal framework. We know that in the Welsh budget the majority of the funding comes from the Barnett consequentials. I will start off by asking Mr Phillips: is that an effective way of providing the funding that Wales needs?

David Phillips: If we were to take a step back and look at the design of a funding system, you probably would not put in the Barnett formula. That is because the Barnett formula each year takes the Welsh budget from the previous year and then adds on an amount equivalent to a population share of the change in what is spent in England now plus 5%, a factor that was introduced a couple of years ago. The reason you would not do that is because this takes no account of differences in needs across different parts of the UK or changes in those relative needs of different parts of the UK. If we were to design a system from scratch, that is probably not the way you would start.

However, I think that it is important to bear in mind that while historically analysis by Gerry Holtham in the late 2000s or the start of the 2010s suggested if you did an assessment of the spending needs of Wales, at that point the funding received by the Barnett formula was perhaps a little bit below that share of assessed needs that was in Wales. Subsequently, because of the way the Barnett formula operates—it gives Wales a population share of the change in England—when funding was cut during the 2010s, that population share was a smaller percentage cut in Wales. Nowadays, that means that if we were to do an assessment based on Gerry Holtham's estimates of Wales's relative needs compared to England, the amount of funding that Wales gets at the moment is probably slightly higher than that estimate that Gerry Holtham would have said back in 2010 that Wales needs as a percentage of England's funding.

While in principle the Barnett formula is not how you would design a system, it is not clear at this stage whether replacing it with a needs assessment now would lead to more funding for Wales, as has been assumed sometimes and as was the case back in 2010 when the estimates were initially made.

Q3 **Chair:** Thank you very much. Guto, David has already said if we were starting we would not have started from this point, but we are where we are. Do you have anything you would like to add? Is it an effective mechanism?

Guto Ifan: Just to reiterate what David said in terms of moving towards a needs-based system, now might not yield more resources for the Welsh Government. Of course, we do not know. There has not been an updated assessment of relative need for a while. Some of that Holtham estimate was based on census data from 2001, so we fundamentally do not know what relative needs are. We also do not really know what the estimate of relative spend is. It is quite an imprecise science of estimating what is spent in England and what is devolved to Wales.

I guess, stepping back from that, I would agree that the issue of underfunding is largely abated, more through an accident rather than by design. There are safeguards in the system to stop Wales's relative funding from falling down once again through the needs-based factor and a funding floor that was agreed in the fiscal framework agreement. One of the issues now with the way that Wales is funded is more towards budget management tools, the lack of powers for the Welsh Government to smooth its spending over years, to borrow, to plan for day-to-day spending and to pay into the Wales reserve. There are quite strict and stringent caps on how much the Welsh Government can pay into the Wales reserve to carry forward to future years. There are also limits on how much it can draw down from that Wales reserve in any given year.

For example, next year the Welsh Government will be able to draw down £125 million for day-to-day spending. That equates to about 0.5% of day- to-day spending. Arguably, Wales's current budget management tools are more restrictive than what is in place for ordinary UK Government Departments. I think that makes it very difficult to hold the Welsh Government properly to account because they are operating within very stringent, very strict budget management tools or rules for operating their budget. That was quite disappointing from the Budget. There wasn't anything updating those agreed limits on Wales's powers in that regard, despite there being an acknowledgement in the Labour manifesto that the fiscal framework was out of date.

Chair: Thank you very much. Victoria, do you have anything briefly you wanted to add to that?

Dr Winckler: Just briefly, I agree with David's comments that you would not start from here, and also with Guto. I would like to stress how much Wales has changed since the time of the Barnett formula being put in place and since the assessment in 2010. Our population is much older. It is much poorer, much sicker, we know that. We also have new challenges coming from climate change. We are highly susceptible, as we have seen in the last few days, to issues around coal tip safety and flooding and a lack of resilience, which comes from Wales's geography. If I were to put my cards on the table, I would say that it is time for another look.

Chair: Thank you, Victoria. I will hand over to Claire Hughes now.

Q4 **Claire Hughes:** Diolch. Thank you. Guto, this is a question for you. The Welsh Government received an additional £1.5 billion of Barnett consequentials for day to day spending in the autumn Budget. You state that this uplift has transformed what could have been an exceptionally tricky budget round for Wales. What options does this unlock for the Welsh Government?

Guto Ifan: It is probably worth breaking down that £1.5 billion into what is coming down this year and then what is additional for next year. For this financial year, 2024-25, you have an additional £744 million and that itself means that this budget looks very different from what the Welsh Government originally set back in December last year. When the Welsh Government set their draft budget for that year, they had to look for a range of cuts across many areas of the Welsh budget, from arts and culture, environmental protection, which you would have heard about, transport outside of Transport for Wales, higher education, further education, apprenticeships, and rural investment schemes. They were finding cuts from across the Welsh Government budget because it is what they saw as unfunded pressures on the NHS and the Transport for Wales budget. That is what the Welsh Government did originally.

Of course, since that budget was set, in the matter of six months of the first financial year we have seen about £1.2 billion more funding coming for day-to-day spending this year. That means that maybe the Welsh Government are now in a position for assessing how much they allocate to the NHS, which, of course, is always the biggest part of the Welsh budget. It is always the biggest question as to how much goes to the NHS. They can relook maybe at some of the cuts that they had to make in the original budget round for this year. That again goes back to that this is not a proper, sensible way for a Government to be budgeting. Back when they were setting their original budget, they fundamentally did not know how much they would have to spend by the end of the financial year.

Secondly, next year there is an additional £700 million of day-to-day spending on top of what will be spent this year. As I said in our blog, that transforms what would have been really difficult spending choices. To properly fund to expected funding for the NHS, which would require additional funding, you would have had to cut back on other areas. Now the Welsh Government are probably in a position to increase the size of the NHS budget and avoid having to make cuts to other areas of the budget.

Perhaps a point to make is that the additional spending that was made at this Budget is very frontloaded for the Welsh Government. Even though next year’s funding settlement has been transformed, if you believe the medium-term spending plans, the indicative spending plans of the UK Government, we return to quite tight spending plans after that, which implies perhaps some cuts to public services after 2025-26.

Chair: Thank you very much. Andrew, do you want to come in?

Q5 **Andrew Ranger:** Yes, thank you, Chair. Good morning. It is great to have you with us.

I have a couple of supplementary questions linked to the framework. You have already mentioned it, Victoria, but the needs-based factor in the Barnett formula, 5%, is that still appropriate now, given, as you mentioned, the relative older, poorer, sicker population in Wales? Although we know we would not start with the Barnett formula now if we were going to design a new framework, does that 5% need to be looked at? I will ask Victoria, seeing as she brought up that subject.

Dr Winckler: The 5% is the population share and then there is a factor added in to try to maintain some reflection of need. The difficulty fundamentally is that the formula does not track what is happening on the ground. There can be quite dramatic changes within Wales, the closure of Port Talbot steelworks or whatever else might happen, that is then not reflected in the spending allocation. That is the point I am trying to make. It may or may not be that the 5% is the right figure. I think that David wants to come in.

David Phillips: Yes. The 5% increment that Wales currently gets on top of the Barnett formula population share is, if you like, a transitional arrangement. Underlying the funding floor is the idea that funding should not fall below 115% of the English level per capita. That was based on Gerry Holtham's estimates or the mid-point, effectively, of Gerry Holtham's estimates back in 2010. The 5% transitional figure is because at the moment it is estimated that we are above that 115% level. When the Government looked at it a few years ago, it was about 120%. Therefore, they said, "Until you get down to that 115%, we will give you a 5% increment to slow down the rate at which you return to that. We then change it to 115% so that you do not fall below it." Because Wales's population is growing slower than England's usually, you then start to rise a little bit. However, that was the idea with the plan.

What Victoria is saying is that the challenge is that 115% was based on a comparison of Wales's demographics to England's demographics back in 2010 and the pattern of spending across England in 2010 and how that responded to demographics within England. Given the changes in the population we have seen over the last 15 years, given how spending has changed, in more ways focused on health and less on many other public services, for example, the characteristics of Wales might have changed compared with England, and the pattern of spending and how that responds to those characteristics may have changed, too.

I think that is why Victoria was saying that now is the time to start thinking about updating those assessments of need so at least we can tell whether that 115% floor needs to be changed at some point. Of course, there is some risk that if we look at it, it turns out that Wales's relative needs may have fallen, but given that Wales's population has aged somewhat more rapidly, given more is going to the NHS, if I had to guess

I would expect it would go the other way and you might see that floor increase from 115% to a little bit higher, perhaps.

Q6 **Llinos Medi:** Bore da. Going back to Claire's question to Guto, you mentioned the pressures on NHS. One word that is quite concerning to me is that it has "transformed" the Welsh Government's ability to vote in their budget. For clarity, it has transformed their ability to add up the sums, but around service delivery do you think that there is enough money in the system, especially when we know the pressures that are on local government, social care, and the preventive services? Will it transform services or will it just balance the budget and the service pressures will still be there? That will then obviously have an impact on the NHS and all the acute care.

Guto Ifan: I used the word "transform" in the way that it has fundamentally changed the position that the Welsh Government are in in terms of funding. They can offer a sizeable increase in the NHS budget for next year in line or greater than the historical averages of about 3.6% real terms increase in NHS spending. You can perhaps argue whether that fully meets the demand and cost pressures in the NHS, considering the waiting lists and the post-pandemic pressures.

Outside of the NHS budget—the other half of the Welsh Government day-to-day budget—that is still well below in real terms 2010 levels. The latest forecast was still about 10% on a population basis below where the rest of the budget was in 2010. It is still a tight budget. As you mentioned, there are large public service pressures, cost and demand pressures on other services. It will allow the Welsh Government to increase spending on those areas. It will allow an increase in the size, for example, of the local government settlement, which would allow more funding for social care, schools and so on.

However, you are right that this will still mean that spending outside of the NHS will be below where it was in 2010 considering the demographic and population changes that we have discussed. This does not solve or reverse the effects of austerity. I guess the increase in spending is very much almost a down-payment on restoring public services. More will be required after 2025-26 if public services are to be put on a more sustainable footing after next year.

Chair: Thank you, Guto. I am conscious that your answers are very comprehensive. We are going to move on a little bit now to the impact of the autumn Budget. I will ask Andrew Ranger again.

Q7 **Andrew Ranger:** This is a question to Victoria. Given how earnings differ across the UK nations, will the national minimum wage increase have a disproportionately high price for Welsh businesses? Adding on to that, will that mean that low-margin, labour-intensive sectors like retail and hospitality will struggle to stay viable?

Dr Winckler: I think that the increase in the minimum wage will affect businesses that have large numbers of low-paid workers. It will increase their wage bill, together with their national insurance contributions. However, I would say that every time there have been increases in minimum wages, businesses express concerns and rarely do those concerns translate into large-scale closures and job losses in those sectors.

What we would see at the Bevan Foundation is that the increase in the minimum wage is an important step towards making work pay for low-paid workers. We have estimated that around about one in 10 of all workers will benefit from the increase in minimum wages. We also estimate that for younger workers and older workers that figure is even higher.

It may well be that the combination of the pressure of raising minimum wages and national insurance contributions results in some cuts elsewhere, whether it is job cuts or reductions in conditions, but given that the minimum wage is still below the amount estimated to be needed for a decent standard of living, the real living wage, it is a step in the right direction.

Q8 **Andrew Ranger:** Linked to that, should Wales, if it needs to, use its own income tax powers and should there be devolved tax thresholds?

Dr Winckler: The Bevan Foundation has previously argued that the thresholds should be devolved alongside the rates. It is a bit of a halfway house just to have the rates. There are pros and cons of using the powers to vary income tax. In particular, an uplift on the basic rate does not raise that much additional revenue for the Welsh Government. That said, it is a tool in the toolbox and if the Welsh Government's budget is under pressure it is a tool that we have argued they should consider using.

David Phillips: I think that the Welsh Government, when looking at their budget situation, should always think about the tax powers that they have at their disposal. At the moment, as Victoria was saying, the income tax powers are substantially more constrained than they are in Scotland. Given that for income tax only 10% of each band is devolved to Wales, one of the reasons why the Government have not yet devolved powers over bands as well as rates is potentially related to the complexity of the structure that you might then see with different bands applying to the UK portion of income tax compared to the Welsh portion of income tax. You could go down the route of the full Scottish case where all tax on at least non-dividends and non-savings income is devolved.

When thinking about changes in income tax, it is probably quite important to bear in mind that while you might want to use income tax, for example, to make the tax schedule more progressive, evidence from Scotland suggests that the highest income individuals there have been quite responsive to the changes in income tax. Therefore, while there are changes to the higher rate threshold, the higher rate, the introduction of a new advanced rate of tax, a 45% rate of tax above £75,000, probably did raise money to help fund public services. On the increase in the top rate of tax, while there is lots of uncertainty about this, the central estimates from HMRC suggest that that might have reduced revenue, given the scale of behavioural responses.

I do not mention that to say there is no way to make the tax system more progressive and raise more from those higher-income individuals. The reason I mention that is that Wales also has other tax powers it could consider, for example, in relation to council tax, and those can sometimes be ways to raise more revenue from higher-income, higher-wealth individuals where there is less scope to have behavioural response. It is much harder to hide a house or move a house than it is to hide or move income.

Q9 **Ann Davies:** My question is to Guto. Guto, I have not seen you for years, so it is lovely to see you again.

Employer national insurance is where I am coming from with this. We know that it will impact universities, which are already struggling. It will also impact charities like the National Botanic Garden of Wales, which I have on my doorstep, and other sectors as well, including the third sector and social care. Do you think that the Budget has provided enough funding to mitigate these pressures?

Guto Ifan: From what I understand, there will be additional allocations made. There is a pot of funding that has not yet been allocated at a UK Government level. Once that is allocated to UK Government Departments to meet the costs of that on public sector employers, that will have consequentials for the Welsh Government. As to whether that fully reflects the actual levels of increased employer contributions that public sector employers in Wales will have to face, there might be some shortfall if it is based on the Barnett formula—a population-based share rather than a full share—because the public sector is proportionately a bit larger in Wales relative to population.

There is then the question that you have raised as well about being outside the direct impact on public sector employers. You mentioned social care, which sits outside the public sector pay bill. Then you have other sectors like higher education and the charity sectors, which are in devolved areas but sit outside the Welsh Government’s public sector pay bill. That might mean that any additional funding on top of the consequentials that we have already discussed might not cover the full costs in other sectors. I guess that it is something the Welsh Government might use the other part of their consequentials to cover if they wanted to address, for instance, the crisis in higher education funding, using some of the consequentials from other parts of the budget to meet some of those costs.

Q10 **Henry Tufnell:** Good morning. I would like to ask about freeports. Tax reliefs were announced in the Budget, specifically around enhanced capital allowances or employer NICs for new employers. I wondered what your view was on how effective those tax reliefs would be for driving up investment and employment in south Wales and west Wales.

David Phillips: We wrote a report about the freeports. I should declare that we are part of the official evaluation of freeports at the IFS, so playing the role of a critical friend of the main evaluation team. As part of this role we did an in-depth look at the economics of freeports and the evidence about their potential impacts.

What that analysis showed is that evidence suggests that tax incentives—reductions in tax on, for example, employers, reductions on the cost of investment, reductions on stamp duty and land tax, or I guess in Wales land transactions tax—all those things we would expect to boost activity and investment and employment in the freeport areas. That will also perhaps be further enhanced by the range of complementary support being provided alongside it: seed funding, land remediation, support for marketing and promotion, and so on. We would expect an impact in those areas.

However, the evidence also suggests that a substantial amount of the impacts of special economic zones, which effectively is what freeports are, is displaced from elsewhere, often quite close by if it is support services and offices and retailers that are attracted to some of these areas, but potentially from further away in the country if it is the more industrial type activities. In general, these time-limited, location-specific subsidies for particular areas would be inefficient compared with just doing a smaller tax cut across the board. What you need is some reason why having a tax incentive for a particular area has a bigger benefit than spreading that out across a wider area. That requires agglomeration effects so that by attracting businesses to one location they end up becoming a self-reinforcing economic cluster.

I mention that because I think what will be key for the success of the freeports is making sure that these are sustainable clusters that can survive beyond the end of the tax incentives. That means attracting a set of complementary businesses that can sustain into the long term. While I think that this will attract activity to these areas, whether it is good value for money or not will depend on whether this can attract clusters that otherwise would not have existed in Wales or the UK.

Q11 **Henry Tufnell:** Can I ask a follow-up about how you view the difference between the English freeports as they are currently set up and the ones being set up in Wales?

David Phillips: My understanding is that they are fairly similar. They obviously have the same UK national relief, for employer national insurance or corporate tax, and the Welsh Government are also providing the same reliefs from land transactions tax and I think business rates as well. I know that there has been some debate about the Welsh investment zones, but my understanding is that the support package is pretty similar between England and Wales. The bigger difference is between Scotland and England and Wales, where in Scotland they are very much focused on renewables and environmentalism—their green freeports.

I should say that I am not an expert on the Welsh situation. When we wrote the report, the Welsh plans had not been fully confirmed. If there are some differences, my understanding is that they are fairly minor, but do correct me if I am wrong.

Q12 **Henry Tufnell:** I think that there are added protections for workers' rights and the environment. I would be interested in the other panellists' views. Guto or Victoria, it would be helpful to hear your views on the freeport and those questions I asked initially.

Dr Winckler: I don't have much to add to David's comments. Going back many years where a similar model was tried with enterprise zones, the conclusion was that there was limited lasting impact, partly because businesses hopped over the boundary and when the benefits of an enterprise zone ended, the businesses either ended or moved away. There are some things to look at very carefully, but I am not an expert on that area, I'm sorry.

Guto Ifan: The same; I do not really have anything to add on top of what David and Victoria covered.

Q13 **Llinos Medi:** Just to follow up—and perhaps I need to declare an interest as the guardian of Ynys Môn freeport for many years until I started in this role—there are differences in England and Wales around workers' rights, planning rules and regulations, and environmental rules and regulations within the freeport prospectus, which strengthen the local hold and make sure that the people and those communities are protected during the freeport's development.

My question is specifically about Ynys Môn. Ynys Môn has supported the move of the Celtic freeports following the Tata Steel announcement. Unfortunately, this now means that the Ynys Môn freeport is delayed. I think that this is quite worrying for Wales because obviously the Ynys Môn freeport is located in the second busiest port in the UK, a strategic site for Wales and the UK. The implications for growing the economy in that area and losing out on opportunities is worrying. Going back to you, David, recognising what you just said about the displacements, not benefiting south and north Wales within the freeport agenda might have a detrimental effect on growing the economy across Wales.

David Phillips: Given that one of the impacts of the tax incentives and other support provided to one location is to attract activity, not necessarily just from overseas but from other locations in the country, if there is a freeport in south Wales in operation you may see activity that otherwise could have gone to a port in north Wales or somewhere else in the UK that has not got freeport status go to south Wales instead. That is a risk.

One of the bigger challenges with the freeports is when looking at the business plans and cases for each freeport, a lot of them are looking for the same investments in the same industries. A lot are looking for investments in the green transition. There is a lot to do in the green transition, but one risk is competition and just moving the deckchairs around in some of those investments.

My advice would be for each freeport to think about what the comparative advantage is that they have over not just other ports that are not freeports but the other freeports as well so that we see net additions to the stock of investment in the UK and not just a bidding war between freeports as they use their seed funding and other things to make themselves the most attractive of the freeports to individual occupiers.

Q14 **Chair:** I will move on now from freeports to coal tips. Given the recent flooding and the particular incident in Cwmtillery in Blaenau Gwent with a landslide, the Budget earmarked £25 million for ensuring the safety of coal tips in Wales. Given that the Welsh Government have said that they need £500 million to £600 million, do you have any thoughts about the apparent shortfall in this funding? If so, how do you see the funding being made up?

Guto Ifan: I do not have too much expertise in this, but it is a welcome commitment. It is a one-year commitment and it is welcome that they have accepted the principle that this should be at least partially funded by Westminster. It is an issue that pre-dated devolution. We discussed earlier the fact that the Barnett formula does not deal very well with asymmetric costs. This is an issue that affects Wales much more than elsewhere in the UK, which means that a population-based share of any funding will not cut it. It is welcome that this additional funding has been made available and the principle has been accepted. Again, this is just a one-year commitment. It will require funding over a prolonged period of time and much more funding to come over future years for this issue to be properly rectified.

Chair: Thank you, Guto. Victoria, did you want to say anything?

Dr Winckler: I have nothing to add. It just urgently needs sorting.

Chair: Absolutely. Thank you very much for that. I will move on from coal to rail with Ben Lake.

Q15 **Ben Lake:** Diolch yn fawr iawn i chi am ddod bore ’ma. Can I ask Guto to begin with about the matter of HS2 and the categorisation of HS2 as an England and Wales project under the statement of funding policy? There has been a lot of discussion about this in recent years and that it is to the detriment of the Welsh budget, or at least investment in rail in Wales. Would you agree with the assessment that the classification of HS2 as an England and Wales project is unfair to Wales?

Guto Ifan: I would agree with that assumption. I think that it is complicated by the fact that rail infrastructure was not devolved to Wales like it was in Scotland. It is the combination of the fact that this has been classed as an England and Wales project on top of the fact that Wales receives historically low levels of investment from the UK Government in what is a reserved area. It would be less unfair, if you like, if we were receiving vast amounts of investment from the UK Government in rail infrastructure. That has not been the case. The percentages of rail enhancement spending that Wales receives has been historically low, is far below the population share. The combination of those two facts—the fact that we are not getting the consequentials from HS2 funding and the fact that we are not receiving an equivalent share or a proportional fair share of rail and other rail enhancement spending—does mean that rail infrastructure in Wales is underfunded. It is very difficult to know the degree to which Wales is losing out or has lost out already from HS2 being designated an England and Wales project. Of course, the Welsh Government are using their own funding to fund investment in an area that is reserved. That I think strengthens the case for this to be changed fundamentally.

Q16 **Ben Lake:** Thank you. On that point, in a meeting of the previous Committee—it seems an age ago now—the then Chief Secretary to the Treasury, Mr John Glen, tried to justify the Treasury's approach to classifying HS2 as in England and Wales. The point made at the time was that there seemed to be an inconsistency in which rail projects were classified as England only and those that were England and Wales. As far as you are aware, has there been a clearcut explanation as to why HS2 is deemed England and Wales but other major rail projects have been classified as just England only?

Guto Ifan: The definition that they use is whether it is a national project or a local project. Crossrail is the example that is often used, which was classed as an England project and did lead to consequentials, that being a local project, but it is a very fine line, I guess, between what is a national and a local project. This is a political decision and it could be changed by the Treasury, which holds all the powers when it comes to declaring what is and is not devolved.

David Phillips: I would agree with much of what Guto says, but the question of whether Wales gets an unfairly low share of rail funding is one that I think needs a little bit of interrogation sometimes. It depends on what your definition of a fair share of funding for rail is. One factor that affects the demand or the need for rail funding is known demand and capacity constraints, and traditionally at least those have been less of an issue in Wales than perhaps elsewhere in the UK. Of course, another way you might think about rail funding is to increase connections between places to promote new demand and economic linkages. There, of course, Wales has a relatively sparse rail network compared with large parts of England. I think that we need to take a step back and think about what rail investment is for and whether that should be affecting how Network Rail is making its decisions on investment across the country.

The reason I mention that is that we need to avoid the temptation of calling for needs-based funding or population-based funding depending on which benefits Wales most in that particular instance. Funding allocations are something of a zero-sum game, but it is a repeated game and there are risks to taking an overly mercenary approach by saying, "This should be needs based. We need a higher share of coal-tip funding, but this should be population based because we lose out from needs-based funding." I think that we need to have a consistent approach and maybe as part of that assess what rail investment is for. Is it for increasing connections or is it for just responding to the demand that is already there?

Q17 **Ben Lake:** It perhaps also could be the case that if you want to encourage more people away from private car use, for example, you would want to encourage that, in which case I would throw the question back at you. In terms of Wales's network percentage, for example, compared with the total amount of mileage in the rail in England, how does Wales fare in its investment from Network Rail for network improvements? I would be very interested to know whether we fare well in that regard and against that metric.

David Phillips: I haven't got those figures to hand. The point I was making is that whether or not Wales is underfunded for rail depends on what one thinks the objective is. Is it to meet the known demand and capacity constraints or is it to be more proactive, if you like, to try to reduce car use, as you say, or try to create greater economic connections between areas that do not currently exist?

Q18 **Ben Lake:** That is a fair point well made. As my final point, then, in terms of some of the investment that the Welsh Government are having to make, for example, in the South Wales Metro and some of the transport infrastructure improvements there, could it be the case that an argument could be made, given that much of that is actually a reserved function, that the funding to cover the South Wales Metro should be covered by the UK Treasury? Is that something that might be a way forward for us in this discussion?

David Phillips: I would probably start from a more principles-based case on the decision made in the late 2000s not to devolve rail to Wales, which I think was probably taken in the context that they wanted to wrap that up into a bigger discussion about the overall Barnett formula at that stage and replacement with the overall assessment with the needs-based funding. If I were the Welsh Government I would go back to that decision and say, "This was the wrong decision. We think that we should be looking at this, not just case by case." What the Treasury could say is, "If we fund projects that you have decided to fund, then that opens up a risk to us because it encourages you to fund more and more projects here and come to us and ask for funding for them." Whereas if you go with a principles-based approach of, "We should do a new needs assessment for rail funding based on a set of criteria, including, for example, reducing car use and improving economic connections" and then devolve rail funding on that basis to Wales, I think the Treasury would be more open to that, although not necessarily particularly open, than it would be about funding projects case by case, given the risk that potentially comes back for additional cases coming down the line and almost an open chequebook.

Ben Lake: Thank you very much, Mr Phillips.

Q19 **Steve Witherden:** I have a question on rail infrastructure in Wales. Ruabon station is in my constituency and the Chester-Wrexham-Ruabon line is the oldest rail line in Wales. It is terrible that Ruabon station appears unique in that the north-bound platform is totally isolated. There is no connection with the village. There is no lift. There is no ramp to get across. If you are a wheelchair user or even have a pram with a baby, your options are to get off at Wrexham or to stay on until Chirk. It is not an acceptable state of affairs. You mentioned a moment ago, David, needs-based funding and population-based funding. I would argue that surely rail infrastructure that is in possible potential breach of the Equality Act 2010 has to take priority. I would be very interested to hear your thoughts.

David Phillips: I should say that I am not an expert on the Equality Act and its provisions in this area, but I would say that, yes, if there are stations or facilities that are not meeting the requirements under legislation, that clearly is an area where it should be a priority for inclusion in any investment plan.

Steve Witherden: Thank you. Diolch.

Chair: Do you want to move on to agriculture now, Steve?

Q20 **Steve Witherden:** This is a question for David. There is a wide range of figures on the number of farms that will be affected by the inheritance tax changes to agriculture relief, with *Farmers Weekly* recently reporting that no impact assessment had been done. Is it clear how many farms will be affected by these changes?

David Phillips: Yes. We are aware obviously that there are different figures floating around. Colleagues of mine at the IFS on Monday put out an analysis of the inheritance tax changes for farms. HMRC has looked at the tax data on the number of claims for reliefs at the moment. Of the around 1,800 estates per year that claim agriculture relief, around 500, approximately 30%, could potentially pay more inheritance tax as a result of curtailing agriculture and business reliefs.

There are a couple of points that I would make. First, these figures do not account for any behaviour changes that happen as a result of the Budget policy measures. For example, if farmers pass on some of the assets more than seven years prior to death, if there is a fall in land prices because agricultural land is now no longer so valuable as an investment in which to avoid inheritance tax, you might see those numbers somewhat lower. Of course, if that is a threshold that is frozen for many years and inflation pushes up the cost of land and the property and assets that sit on it, you could see that number increase over time. HMRC estimates are probably the best estimates of the share of estates that currently claim these reliefs that will potentially be subject to taxation going forward.

There are other figures that we are aware of that basically have been calculated by, I think, the National Farmers Union using figures from the agriculture and rural affairs Department's figures. There are some differences there. Those figures relate to larger farms with a certain amount of agricultural production. They measure things in somewhat different ways, but they see it as a higher share of farms that might be affected. I should add that those don't take account of things like the existing reliefs you get for the standard allowance for the main property and the potential to pool reliefs across a couple. I think that the best figures we have at the moment, bearing in mind they include all those who claim agricultural relief, not just those whose binary job is farming, are the HMRC figures.

Q21 **Steve Witherden:** Thank you. I have a very important follow-up question. Just how hard will this affect the ability of farmers to pass the family farm down to future generations?

David Phillips: We would expect that for some of those farms that do come into inheritance tax as a result of this, in some cases the farmers inheriting the land and the assets, usually from their parents, may not have the liquidity to pay inheritance tax. I would add there that there are some things to bear in mind. First, the relief is quite substantially higher than the reliefs available to people who own shares or even just a family home. Secondly, it can be spread across 10 years. While you can debate whether we should have an inheritance tax or not, our view is that if you do have an inheritance tax, taxing different assets equivalently is both more equitable and more economically efficient because it does not distort how people hold their investments and their assets.

However, bearing that in mind, we recognise that there will be people impacted by this and that there could be some farmers who otherwise would have inherited the farm and kept it in the family, and some of those may now feel that either they have to sell or it is more beneficial to them to sell. So they will be affected. I guess our contention is that as part of broader efforts to reform the tax to make it more equitable across people, that is just one of the impacts that will be there.

Colleagues have also suggested some ways in which these impacts could be mitigated, for example, by making it easier for couples to pool the allowances—because the process is actually quite complicated for the proposed agriculture and business reliefs—and potentially to give a bit more time for those who are currently approaching very old ages to take advantage of the ability to pass on some tax free. If you are in your 70s or 80s, the seven-year gift rule may not benefit you. There could be some inequities for people who do not have time to plan now.

Q22 **David Chadwick:** I have a question for David. Thank you for joining us. Many farmers have told me that they are simply devastated by the proposed changes to APR. What they find most devastating is the impact on future generations. They are simply devastated by the fact that their sons and daughters will find it harder to run a farm after them. We know that agriculture is a critical part of the rural economy. There are plenty of jobs sustained in the agricultural supply chain and that is vital for propping up the local economy and for helping to tackle other issues in rural areas such as depopulation. With that in mind, what economic or demographic contractions do you see taking place as a result of this decision to impose higher taxes on farming?

David Phillips: We have not looked at the potential behavioural impacts of this in great detail. As I said, we would expect some behavioural impact. Some of this would be taking account of the tax avoidance strategies that still potentially exist. We would expect a fall in the value of land. To some extent, the fall in the value of land as it becomes less attractive as a way for people to park their money and avoid inheritance tax might make it easier for some farmers who want to farm to expand their provision and buy up more land. It will be cheaper to do that because it is no longer being used effectively to avoid inheritance tax to the same extent as now. There could be impacts with some families having to sell up their farms or feeling it is more beneficial to sell up their farms now than otherwise would have been the case. That might then lead to a change in the use of that land or it might lead to it being bought up by a larger operation, perhaps, that takes control of more farms in an area or maybe more small farms that are below this threshold.

Taking a step back, inheritance tax is quite a blunt tool for promoting what we want from agriculture. If we want to be supporting food production or supporting environmental protection, biodiversity, traditional practices, traditional breeds and so on, there are more direct routes to do that than through an inheritance tax relief that can also benefit people who have no connection to agriculture whatsoever. I would suggest that if we are concerned about the issues that could come from these changes for some farmers, use the tools through the agricultural policies that we have post-Brexit to target more directly those things that we think farmers do that are beneficial for society, whether that is food security or being custodians of our natural environment.

Chair: I am very conscious of time and I have other members who want to come in with supplementary questions. I will ask the three witnesses whether they are okay to stay on until 11.05. Thank you very much for your patience.

Q23 **Llinos Medi:** Just quickly on a few of those comments that you made, the HMRC details that you used, I am not sure if that is Wales data or

UK-wide data. I think that the difference between agriculture in Wales and in the rest of the UK needs to be taken into consideration, especially here at the Welsh Affairs Committee.

You also mentioned couples, and I am going to ask a question about that. Do you think that there is some discrimination, especially when you have young widows who will be negatively affected by this? You have mentioned that the price of land could become cheaper, which would make it more affordable for farmers. I am not sure how you could make it more affordable when their actual business plan will be affected by the inheritance tax, so their ability to invest also diminishes with this as well. I want to make sure that you clarify those details. Thank you.

David Phillips: The figures I mentioned are HMRC figures for the UK as a whole. DEFRA breaks down its figures about estimated values of properties by type of farm. For example, upland pastoral farms have lower than average values, and I would imagine that there is a relatively higher share of upland pastoral farms in Wales compared with, for example, the crop-growing farms you get in East Anglia or flatter parts of England. I would expect, although I do not know this for certain, that the average value of a farm in Wales is lower than the average value of a farm in England, at least given those figures on the average value by type of farm produced by DEFRA.

I think that there is a case to consider transitional arrangements around the removal or restriction of this relief. I would say that allowing the automatic pooling of couples' allowances, potentially including those where one partner has died, would make sense compared with the slightly convoluted way in which that would need to be done under the legislation as it is currently planned.

Lastly on this point about the extent to which it affects people's ability to buy new land, I think that will depend on many circumstances. For a highly leveraged farmer who has lots of borrowing against their current asset values, yes, you are right. To the extent this reduces the current value of their land, that makes it even more highly leveraged and might make it harder to buy new land. However, for those who are less leveraged I would expect that the reduction in the price of land would be the thing that outweighs that. It will, as you say, depend very much on people's individual circumstances.

Q24 **Claire Hughes:** On a point of clarification, David, on that figure that you quoted, the estimate of 500 farms affected based on HMRC figures, that was for all the UK, not just for Wales?

David Phillips: Yes. That is for all the UK annually. Of the 1,800 estates per year claiming agricultural relief, including those that claim business relief as well, around 500 could potentially pay more inheritance tax as a result of curtailing agricultural and business reliefs across the UK.

Chair: Thank you for clarifying that, Claire.

Q25 **Henry Tufnell:** I wanted to ask for your views on the impact of Welsh language and culture as an effect of this policy, given that there is a disproportionate number of Welsh speakers working in the agricultural sector. I think that Farming Connect came up with 43% compared with 19% in the general population. I wanted to ask for your views about whether there had been an impact assessment or whether you had done the piece of work about what the impacts of IHT would be on the Welsh language and culture.

David Phillips: We have not had a look at that particular issue.

Chair: Guto might want to answer that question.

Guto Ifan: Yes, maybe just to reiterate what David said. Of those 500 farms, we do not know how many of those each year could be affected by this change. We do not know the proportion of those that are in Wales. My guess is that it would be less than Wales's share of agriculture because of lower land values and lower property prices and the different types of farms that we have in Wales compared with the UK average.

I think that if you were starting from scratch and if you were looking at a measure to support Welsh farming, you would not choose inheritance tax relief. It is not the most efficient, effective and targeted way of supporting farmers. Far more financially important for Welsh agriculture will be what happens to farm payments after next year, trade deals with the rest of the world, and other problems that exist with what is arguably a broken economic model for agriculture at the moment. There are other far greater and important factors to consider rather than these tax changes, which will affect a relatively small share of Welsh farms.

Chair: Thank you, Guto. The final question goes to Ann Davies.

Q26 **Ann Davies:** Before I ask my question, which follows up on what you have just said, personally I do not think that land values will go down because land is infinite. We do not create land, and although there may be a slight dip in the short term, I do not think that land prices will be affected by this tax change.

Moving on from that, the Barnett formula calculates relative need based on population with a blanket 5% needs-based factor in Wales. Will it provide the appropriate level of funding to ensure a fair settlement for farmers? According to the FUW, this means a reduction of £148 million per annum, which is astronomical. That equates to a 40% decrease—a 40% reduction in the size of the pot that will be shared out between the farmers. I just want your views on that, Guto.

Guto Ifan: It goes back to the point that fundamentally the Barnett formula does not take into account different initial levels of spending and that a populated-based share does not take into account the higher levels of initial spending. On that point, the Barnett formula works on the annual change from year to year rather than the total amount, so we would not see an immediate fall in the size of that pot of funding that got transferred to the Welsh Government for agriculture. It would happen year after year after year and you would see gradual convergence down to English levels of spending per person. That will be influenced by how quickly spending grows in England. There are a lot of issues like that that might affect how quickly that relative level of spending gets taken down to English levels of spending.

There is a similar issue that I think the Committee should consider in terms of the shared prosperity fund. Wales gets a far greater share of spending from the shared prosperity fund than a population-based share. After next year, that appears likely to potentially be rolled up into local government funding in England, which will lead to similar concerns that the Barnett formula will not reflect the higher initial levels of spending in Wales.

David Phillips: I would agree with what Guto was saying. For agriculture, the existing funding is being baselined in, and therefore any impacts of moving to the Barnett formula will affect what happens in subsequent years, depending on how spending changes in England. I think that the much bigger issue, and if I can be as bold as to say that this is something for the Committee to look into, is what is happening with the shared prosperity fund. That is not being baselined into the Welsh Government's budget. That was never part of the Welsh Government's budget. It always came from MHCLG. That is being cut by £600 million in 2025-26 and the indications are that it might be abolished completely in 2026-27, to be rolled up into, as Guto said, reforms to English local government funding. That could see Wales lose out substantially and there are questions about post-UKSPF regional development funding, which matters a lot for Wales, which gets about 25% of that funding compared to its 5% population share.

Q27 **Chair:** Thank you, David. Obviously, shared prosperity is something we will, I am sure, take into account. Victoria, did you want to have the final word?

Dr Winckler: I think that what Guto and David have highlighted is that the Barnett formula is stretched to its limits in meeting Wales's needs. We have not talked about social security changes in the Budget, which also have a huge impact on people in Wales, both pensioners and working age. If the Committee has any further questions, I for one and I am sure the other witnesses would be happy to follow up.

Chair: Thank you very much. I am conscious that we have gone over time. Dr Victoria Winckler, Guto Ifan and David Phillips, thank you so much for your time this morning on behalf of the Committee. It is good to see you all. I shall now bring this Committee to a close. Diolch.