Written evidence submitted by Wales Fiscal Analysis (BSW0003)

About Wales Fiscal Analysis (WFA)

Wales Fiscal Analysis (WFA) is a research body within Cardiff University's Wales Governance Centre that undertakes authoritative and independent research into the public finances, taxation and public expenditures of Wales.

The WFA programme adds public value by commenting on the implications of fiscal events such as UK and Welsh budgets, monitoring and reporting on government expenditure and tax revenues in Wales, and publishing academic research and policy papers that investigate matters of importance to Welsh public finance, including the impact of Brexit on the Welsh budget and local services, options for tax policy, and the economics and future sustainability of health and social care services in Wales.

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1. Introduction

1.1. This evidence submission outlines the findings from our WFA report, *Devolving Welfare: How well would Wales fare?*[1] Originally published in 2019, the report examines the fiscal sustainability of devolving control over aspects of the welfare system to the Welsh Government along similar lines to Scotland. Although the analysis has not been updated since its original publication, the considerations involved when determining the appropriate fiscal mechanisms to facilitate welfare devolution remain relevant.

1.2. The Scotland Act (2016) made provisions for devolving control over certain welfare benefits to the Scottish Government.[2] Among these were ill-health and disability benefits (including Disability Living Allowance, Personal Independence Payment, Attendance Allowance, and Carer's Allowance) and several miscellaneous, smaller benefits (including Cold Weather Payment, and Winter Fuel Payment).[3]

1.3 The Act also conferred powers to create new social security benefits in non-reserved policy areas, vary element of Universal Credit, and top-up existing benefits.

1.4 This evidence paper outlines the fiscal implications of devolving these benefits (hereafter referred to as S-benefits) to Wales.

1.5 We do not endorse a recommendation on whether S-benefits *should* be devolved to Wales. Rather, we assess whether devolving S-benefits to Wales would be fiscally sustainable, and outline the risk and opportunities associated with their devolution.

[1] Guto Ifan and Cian Siôn, *Devolving Welfare: How well would Wales fare?* (Cardiff: Wales Fiscal Analysis, 2019). https://www.cardiff.ac.uk/__data/assets/pdf_file/0010/1476352/devolving_welfare_final2.pdf

[2] Scotland Act 2016, Part 3.

[3] Executive competence for the Cold Weather Payment and Winter Fuel Payment have not yet been transferred to the Scottish Government.

Figure 1
Total Welsh identifiable expenditure on benefits devolved to Scotland (S-benefits), 2017−18

Benefit	Outturn 2017−18 (£000s)	Share of total (%)
Personal Independence Payment & Disability Living Allowance	1,264,071	62.3
Attendance Allowance	378,589	18.7
Carer's Allowance	176,996	8.7
Winter Fuel Payment	110,247	5.4
Industrial Injuries Disablement Allowance	55,501	2.7
Cold Weather Payment	21,520	1.1
Severe Disablement Allowance	10,249	0.5
Discretionary Housing Payment	9,744	0.5
Sure Start Maternity Grants	1,295	0.1
Total	**2,028,212**	**100.0**

Source: HM Treasury (2018) Country and Regional Analysis

2. Fiscal arrangements and block grant adjustments

2.1 The devolution of specific social security benefits to the Welsh Government would require a transfer of funding from the UK government and an appropriate fiscal framework thereafter. These fiscal arrangements would determine the type of financial risks borne by the Welsh Government after devolution.

2.2 The recent Fiscal Framework Agreement between the Welsh and UK governments stated that:

> "When further areas of spending are devolved, the changes to the Welsh Government's block grant funding comprise two elements:
>
> - Initial baseline adjustment – this reflects UK government spending plans at the point of devolution
> - Subsequent block grant changes – these are based on changes in equivalent UK government spending in the rest of the UK (via the Barnett Formula)"[4]

2.3 The first element outlined above would ensure that Wales is compensated for its higher levels of spending on S-benefits (£649 per head) compared to England (£434 per head) at the point of devolution.[5]

2.4 The second element – subsequent block grant changes – can be determined using several different methods (e.g. Barnett Formula, Indexed Per Capita, and the Comparable Model). The precise mechanism used became a contentious issue during the latest round of fiscal framework negotiations between the Scottish and UK governments.[6]

[4] HM Treasury and Welsh Government, *The agreement between the Welsh government and the UK government on the Welsh government's fiscal framework*, 19 December 2016. https://www.gov.uk/government/publications/the-agreement-between-the-welsh-government-and-the-united-kingdom-government-on-the-welsh-governments-fiscal-framework
[5] Ifan and Siôn, 17−18.
[6] David Bell, David Eiser, and David Phillips. *Scotland's Fiscal Framework: Assessing the Agreement* (London: Institute for Fiscal Studies, 2016). https://ifs.org.uk/uploads/publications/wps/wp201605.pdf

2.5 Under the Barnett Formula, subsequent changes to the block grant would equate to a Welsh population share of changes in spending on S-benefits in England.

2.6 An in-built property of the Barnett Formula is that if spending is growing in England, spending per person in Wales converges with the English level over time (a phenomenon known as the "Barnett Squeeze"). This is because the same pounds-per-person increase in spending in England and Wales represents a smaller percentage increase in Wales.[7] Over time therefore, one would expect per person spending on S-benefits in Wales to converge to the English level unless resources are found from elsewhere in the Welsh budget.

2.7 As a result of the most recent fiscal framework agreement between the Welsh and UK governments, increments to the Welsh block grant triggered by the Barnett Formula are now multiplied by a Needs-Based Factor (NBF) of 105%.[8] This leads to larger increases in the Welsh block grant and slows (but does not halt) the rate of convergence in spending levels.

2.8 An alternative method of calculating subsequent block grant changes is the Indexed Per Capita (IPC) method. This was the method agreed during the latest round of negotiations between the Scottish and UK governments.[9] Under this method, if spending per person on S-benefits in England increased by 5%, then Wales's block grant change for S-benefits would also grow by 5% per person. The IPC method does not have the same convergence property as the Barnett Formula, and Wales's initial per person spending difference would essentially be "locked in" after devolution.

2.9 Although the Welsh Government would not face the risk of convergence in relative funding under IPC, it would still bear the risk and rewards of differential growth in needs (e.g. if demand for a given Welsh benefit outpaced the growth in demand in England, the annual increase to the block grant *vis-à-vis* the devolved benefit may not be sufficient to cover the increased costs incurred by the Welsh Government and *vice versa*). Thus it is the *relative* growth in demand (needs) that determines the outcome for the Welsh budget.

2.10 Another method of determining changes to the Welsh block grant is the Comparable Model (CM). This would mirror the arrangements used when adjusting the block grant to account for tax devolution. Under the CM, a comparability factor would be applied to reflect relative spending per person in Wales compared to England at the point of devolution (e.g. 146% in the case of Attendance Allowance).

2.11 As outlined in the next section, both IPC and CM would likely produce similar outcomes in Wales. The main difference between the two methods comes down to their treatment of relative population growth. IPC would protect Wales from the risk

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[7] Ed Gareth Poole and Guto Ifan. *The Welsh Tax Base: Risks and Opportunities after Fiscal Devolution* (Cardiff: Wales Centre for Public Policy, 2018). https://www.wcpp.org.uk/publication/the-welsh-tax-base-risks-and-opportunities-after-fiscal-devolution/

[8] The Needs Based Factor increases to 115% if total relative spending per person in Wales on devolved areas converges to 115% of the English level (otherwise known as the "Barnett Floor").

[9] HM Treasury and Scottish Government, *The agreement between the Scottish government and the United Kingdom government on the Scottish government's fiscal framework*, 23 February 2016. https://www.gov.uk/government/publications/the-agreement-between-the-scottish-government-and-the-united-kingdom-government-on-the-scottish-governments-fiscal-framework

that welfare spending grows because of relatively faster population growth compared to England, whereas this risk is only partially mitigated under CM.[10]

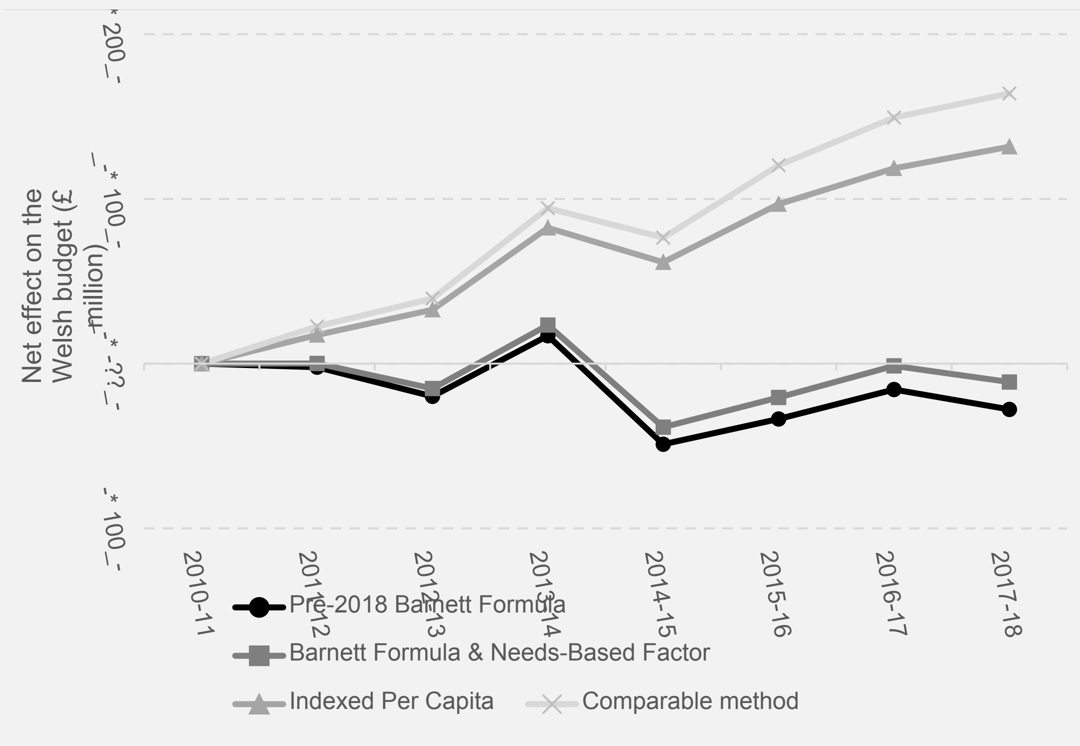
3. Fiscal implications of welfare devolution

3.1 Our 2019 report estimates the hypothetical impact on the Welsh budget had S-benefits been devolved in 2011−12. It also uses caseload forecasts for the four largest benefits to project the fiscal impact of devolving these benefits in 2018−19.

3.2 Although the analysis has not been updated since the report was originally published, the findings likely still stand. Most S-benefits are linked to ill-health and demographics which makes them less cyclical compared to other benefits (e.g. unemployment benefits) – one of the reasons why they were selected as good candidates to be devolved to Scotland. Thus, in the absence of policy changes, trends in claimant rates tend to be stable in the short-to-medium term.

Figure 2

Annual net effect of S-benefit devolution to Wales from 2011−12 (excluding Cold Weather Payments and Discretionary Housing Payments)



Source: WFA analysis. See Ifan and Siôn (2019) for further detail.

3.3 Assuming that S-benefits had been devolved to Wales in 2011−12 (using 2010−11 as a baseline), we can calculate the net cost (surplus) to the Welsh budget in each year. Using the simple Barnett Formula with the Needs-Based Factor of 105% in place, these 'losses' would have amounted to £8 million a year on average between 2011−12 and 2017−18.[11]

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[10] Bell, Eiser and Phillips, 22−26.
[11] Ifan and Siôn, 39−41.

3.4 However, had the method agreed for Scotland been in place – the IPC method – the Welsh Government would have been substantially better off. The Welsh budget surplus would have amounted to £132 million a year in 2017−18, with the CM yielding similar results.

3.5 Using caseload projections for England and Wales and applying these to the OBR forecasts of projected UK expenditure on Disability Living Allowance, Personal Independence Payments, Attendance Allowance and Carer's Allowance, we can project the fiscal impact of devolving these four largest S-benefits to Wales in 2018−19. The results are similar to those shown in **Figure 2**, with CM and IPC resulting in large surpluses for the Welsh budget.[12]

3.6 These large surpluses are the result of relative trends in caseload numbers. Even in the absence of welfare devolution, Welsh spending on S-benefits fell from 155% of the English level to 150% between 2010−11 and 2017−18. Per capita spending on Personal Independence Payments and Disability Living Allowance alone fell from 171% to 157% of the English level over the same period.

3.7 Trends in the age profile of claimants suggest that this convergence in per capita spending will continue in the medium term. The evidence points to a generational divide in claimant rates for Personal Independence Payment and Disability Living Allowance. Whereas over-65s in Wales are nearly twice as likely to be claiming these benefits as in England, for those under 25, the rate is roughly similar in both countries.[13]

4. Welfare devolution: risks and opportunities

4.1 Wales's higher levels of per capita spending on S-benefits compared to England is not in itself a barrier to welfare devolution. The impact on the Welsh budget would be determined by the *relative* trends in spending in the two countries from the point of devolution onwards. Recent trends in claimant rates point to a potentially favourable outcome for the Welsh Government.

4.2 If the UK and Welsh Governments were to commit to devolving elements of the welfare system to Wales, an appropriate fiscal framework would need to be agreed. The fact that the Indexed Per Capita method is currently used in Scotland means that there is precedent for such an agreement for Wales. Such an agreement would eliminate the threat of funding convergence posed by the Barnett Formula.

4.3 Even under a devolved system, Wales would still benefit from the pooling of fiscal resources across the UK. Using any of the methods described in Section 2, the Block Grant would be increased to fully compensate Wales for its higher levels of relative need *at the point of devolution*. The methods differ in how they determine changes to the Block Grant in *subsequent* years.

4.4 The devolution of benefits to Wales would involve administration and implementation costs. As part of the Scottish Fiscal Framework, it was agreed that the UK government would provide £200 million to support the implementation of new powers

[12] Ifan and Siôn, 42−44.
[13] Ifan and Siôn, 21−14.

in Scotland and a baseline transfer of £66 million to cover ongoing administration costs.[14] As of 2020, the Scottish Government estimates that one-off spending on implementation will total £651 million from 2018−19 to 2024−25.[15]

4.5 While it is reasonable to assume that some of the implementation and ongoing administration costs that would come along with a devolved Welsh welfare system would be covered by the UK government to reflect any marginal savings to their own administration costs, the Welsh Government may be required to meet any shortfall from its own budget. The experience in Scotland suggests that this amount could be considerable.

4.6 Since the net effect on the Welsh budget is likely to differ between benefits, this strengthens the case for devolving a basket of benefits to manage the risk. Thus, if the relative trends in the claimant rate for any given benefit do not go in the Welsh Government's favour, this may be offset by the relative trends for another devolved benefit. Put simply, devolving multiple benefits would allow the Welsh Government to diversify its risk pool.

4.7 The demand-led nature of benefits would make it appropriate to increase the Welsh Government's resource borrowing powers to use as a budget management tool. Some additional borrowing powers were conferred to the Scottish Government as part of the most recent fiscal framework agreement between the Scottish and UK governments.[16]

4.8 There would be a strong incentive (particularly for the Welsh Government) to lead a campaign to increase uptake of benefits to be devolved in the year immediately preceding their devolution to ensure that number of claimants during the baseline year closely reflects the number of eligible claimants in that year. In particular, the Bevan Foundation has previously expressed concern that Attendance Allowance is under-claimed in Wales.[17]

4.9 We find no evidence to suggest that devolving welfare powers to Wales along similar lines to Scotland would be fiscally unsustainable for the Welsh Government, although one-off set-up costs could be significant. Depending on the precise mechanism used for calculating the block grant and the outcome of negotiations with the UK government, the Welsh Treasury could even stand to benefit from the devolution of welfare powers.

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[14] HM Treasury and Scottish Government, 5.
[15] Scottish Government, *Social Security Programme Business Case*, 12 February 2020. https://www.gov.scot/publications/social-security-programme-business-case-executive-summary/
[16] HM Treasury and Scottish Government, 9−11.
[17] Bevan Foundation, *The future of Attendance Allowance* (Cardiff: Bevan Foundation, 2016). https://www.bevanfoundation.org/wp-content/uploads/2016/11/The-Future-of-Attendance-Allowance-in-Wales.pdf