



Cynulliad  
Cenedlaethol  
Cymru

National  
Assembly for  
Wales

# Cofnod y Trafodion The Record of Proceedings

[Y Pwyllgor Cyllid](#)

[The Finance Committee](#)

19/10/2017

[Agenda'r Cyfarfod](#)

[Meeting Agenda](#)

[Trawsgrifiadau'r Pwyllgor](#)

[Committee Transcripts](#)

## Cynnwys Contents

- 4 Cyflwyniad, Ymddiheuriadau, Dirprwyon a Datgan Buddiannau  
Introductions, Apologies, Substitutions and Declarations of Interest
- 4 Papur(au) i'w Nodi  
Paper(s) to Note
- 5 Cyllideb Ddrafft Llywodraeth Cymru 2017–18: Sesiwn Dystiolaeth 4  
Welsh Government Draft Budget 2018–19: Evidence Session 4
- 31 Cynnig o dan Reol Sefydlog 17.42 i Benderfynu Gwahardd y Cyhoedd o  
Weddill y Cyfarfod  
Motion under Standing Order 17.42 to Resolve to Exclude the Public  
for the Remainder of the Meeting

Cofnodir y trafodion yn yr iaith y llefarwyd hwy ynnddi yn y pwyllgor. Yn ogystal, cynhwysir trawsgrifiad o'r cyfieithu ar y pryd. Lle y mae cyfranwyr wedi darparu cywiriadau i'w tystiolaeth, nodir y rheini yn y trawsgrifiad.

The proceedings are reported in the language in which they were spoken in the committee. In addition, a transcription of the simultaneous interpretation is included. Where contributors have supplied corrections to their evidence, these are noted in the transcript.

**Aelodau'r pwyllgor yn bresennol**  
**Committee members in attendance**

Neil Hamilton <a href="#">Bywgraffiad</a>   <a href="#">Biography</a>	UKIP Cymru UKIP Wales
Mike Hedges <a href="#">Bywgraffiad</a>   <a href="#">Biography</a>	Llafur Labour
Eluned Morgan <a href="#">Bywgraffiad</a>   <a href="#">Biography</a>	Llafur Labour
Nick Ramsay <a href="#">Bywgraffiad</a>   <a href="#">Biography</a>	Ceidwadwyr Cymreig Welsh Conservatives
David Rees <a href="#">Bywgraffiad</a>   <a href="#">Biography</a>	Llafur Labour
Simon Thomas <a href="#">Bywgraffiad</a>   <a href="#">Biography</a>	Plaid Cymru (Cadeirydd y Pwyllgor) The Party of Wales (Committee Chair)

**Eraill yn bresennol**  
**Others in attendance**

Dr Daria Luchinskaya	Gwasanaethau Cyhoeddus Cymru 2025 Wales Public Services 2025
David Phillips	Sefydliad Astudiaethau Cyllidol Institute for Fiscal Studies
Dr Ed Poole	Canolfan Llywodraethiant Cymru Wales Governance Centre
Michael Trickey	Gwasanaethau Cyhoeddus Cymru 2025 Wales Public Services 2025

**Swyddogion Cynulliad Cenedlaethol Cymru yn bresennol**  
**National Assembly for Wales officials in attendance**

Bethan Davies	Clerc Clerk
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Ben Harris	Cynghorydd Cyfreithiol Legal Adviser
Martin Jennings	Y Gwasanaeth Ymchwil The Research Service
Georgina Owen	Dirprwy Glerc Deputy Clerk

*Dechreuodd y cyfarfod am 09:31*  
*The meeting began at 09:31.*

### **Cyflwyniad, Ymddiheuriadau, Dirprwyon a Datgan Buddiannau** **Introductions, Apologies, Substitutions and Declarations of Interest**

[1] **Simon Thomas:** Bore da, a chroeso i gyfarfod y Pwyllgor Cyllid. Croeso, bawb. Gwnaf i jest atgoffa pobl i dawelu unrhyw ddyfeisiadau electronig, ffonau ac ati, a hefyd, wrth gwrs, atgoffa pawb fod y cyfarfod yn ddwyieithog, ac mae clustffonau i gael y cyfieithu ar sianel 1 a lefel y sain gwreiddiol ar sianel 0. Rydym ni wedi derbyn ymddiheuriadau gan Steffan Lewis, ac nid oes neb arall yn ymddiheuro, nid wyf yn meddwl.

**Simon Thomas:** Good morning, and welcome to the public meeting of the Finance Committee. I'd like to welcome everyone and just remind everyone to put any electronic devices on mute, phones and so forth, and also to remind everyone that the meeting is bilingual and that headsets are available—interpretation on channel 1 and amplification on channel 0. We've had apologies from Steffan Lewis; no-one else apologises, I don't think.

### **Papur(au) i'w Nodi** **Paper(s) to Note**

[2] **Simon Thomas:** Os felly, a gaf i jest ofyn i aelodau'r pwyllgor nodi llythyr gan Ysgrifennydd y Cabinet dros Gyllid a Llywodraeth Leol ynglŷn â'r ardoll safleoedd gwag yng Ngweriniaeth Iwerddon—rwy'n credu y gwnaethom ni ofyn iddo fe am beth

**Simon Thomas:** Therefore, could I just ask Members to note the letter from the Cabinet Secretary for Finance and Local Government in terms of the vacant sites levy in the Republic of Ireland—I think that we did ask him what's happening in

sy'n digwydd yng Nghymru yn Wales, rather than Ireland, but he has  
hytrach nag Iwerddon, ond mae e responded to confirm, in any case,  
wedi ateb i gadarnhau, beth bynnag, that this levy can be imposed on  
fod yr ardoll yma yn gallu cael ei roi Government property itself—and also  
ar eiddo'r Llywodraeth ei hunan the minutes of the last two meetings?  
hefyd—a chofnodion y ddau gyfarfod Everyone content to note those?  
diwethaf? Pawb yn hapus i nodi  
hynny?

[3] **Mike Hedges:** Hapus. **Mike Hedges:** Content.

[4] **Simon Thomas:** Ocê, diolch yn **Simon Thomas:** Okay, thank you very  
fawr. much.

09:32

#### **Cyllideb Ddrafft Llywodraeth Cymru 2017–18: Sesiwn Dystiolaeth 4** **Welsh Government Draft Budget 2018–19: Evidence Session 4**

[5] **Simon Thomas:** Os felly, fe **Simon Thomas:** Therefore, we'll turn  
wnawn ni droi at y tystion. Panel sydd to the witnesses and the panel that  
gyda ni, mewn ffordd—mae problem we have—there is an interpretation  
cyfieithu gan Mr Trickey, os gallwn ni problem for Mr Trickey, if we can just  
jest sortio hwnnw. sort that.

[6] Gan obeithio bod pawb yn Hoping that everyone can hear me  
clywed nawr—popeth yn iawn, grêt. now—everything's fine, good. We  
Gan fod gyda ni banel, os caf i ofyn have a panel now, so could I just ask  
ichi yn eich tro i jest ddweud eich you, in your turn, to state your  
enwau a'r sefydliadau rydych chi'n eu names and your institutions for the  
cynrychioli, os liciwch chi, a dechrau record, please, starting with Ed  
gydag Ed Poole. Poole?

[7] **Dr Poole:** Diolch, Gadeirydd. Thank you, Chair. So, I am Dr Ed  
So, Dr Ed Poole ydw i, darlithydd Poole, a lecturer with the Welsh  
gyda Chanolfan Llywodraethiant Governance Centre at Cardiff  
Cymru, Prifysgol Caerdydd. University.

[8] **Mr Phillips:** Diolch yn fawr. I'm David Phillips, I'm from the Institute for  
Fiscal Studies in London.

[9] **Mr Trickey:** Michael Trickey from Wales Public Services 2025.

[10] **Dr Luchinskaya:** I'm Daria Luchinskaya, Wales Public Services 2025.

[11] **Simon Thomas:** Diolch yn fawr iawn. Mae rhai ohonoch chi'n gyfarwydd iawn i'r pwyllgor, rwy'n gwybod hynny. Gan fod gyda ni banel, jest i nodi—teimlwch yn rhydd i ateb unrhyw gwestiwn neu sylwadau gan aelodau'r pwyllgor, ond mae rhyddid ichi deimlo nad oes angen ateb pob un hefyd. So, peidiwch â theimlo bod rhaid ichi wneud hynny. Ond rwy'n credu y byddwn ni jest yn dechrau, efallai, gyda rhywbeth cyffredinol iawn, ac yn benodol i gynrychiolwyr Gwasanaethau Cyhoeddus Cymru 2025, sef sut, bellach, gyda'r gyllideb amlinellol yma, ydych chi'n gweld y gyllideb yn cymharu â'r asesiad yr oeddech chi wedi ei wneud o flaen llaw gyda'r papur yn edrych ar sut mae maintioli'r gyllideb?

**Simon Thomas:** Thank you very much. Some of you are very familiar to this committee, we know that. Given that we have a panel, just to note—please feel free to answer any questions or comments from committee members, but you don't have to answer every question either. So, I think we'll just start with a general question, and maybe specifically to the representatives of Wales Public Services 2025, namely: with this outline budget, how do you feel that this budget does compare with the assessments that you'd made beforehand with the paper looking at how the budget is quantified?

[12] **Mr Trickey:** Shall I—? I'll start this off.

[13] **Simon Thomas:** Yes, thank you.

[14] **Mr Trickey:** The draft Welsh budget that we've now had reflects a commitment to exploring new tools in terms of the tax powers and borrowing powers, and we will probably come on to that later. We've seen new ways of trying to think about the land transaction tax and so on. When you look at the resource budget, you see just how limited the room for manoeuvre is, and although there are a lot of changes at the margin, broadly, the main thrust of the resource allocations reflects previous policy in terms of protections for the NHS, social care and schools and so on. So, it feels very much of a piece with the previous trends and sorts of issues we were outlining in that paper.

[15] **Simon Thomas:** In which case, to what extent can we say that the budget that has been produced in any way reflects legislation such as the Well-being of Future Generations (Wales) Act 2015, or wider considerations around the demographic trends in Wales? You said, in effect, the budget repeats the trends of recent years, so it doesn't seem to have been prepared with these new challenges in mind.

[16] **Mr Trickey:** Well, in terms of the future generations, it does make a number of commitments in terms of process, in exploring participatory budgeting and carbonisation and so on. But these are for the longer term in terms of their impact on the actual spending allocations.

[17] The draft budget talks quite a bit about social care. There is a question in our minds—it may just be semantics about the distinction between protecting social care and social services, because they're not quite the same thing. We can come back to that later. So, in terms of protecting social care, it does refer to the ageing population and the changes in numbers. I suppose you could say that the action on the NHS, the increasing NHS budget, is surely partly driven by demographics. So, to that extent, it probably does reflect that, but it's very much in line with previous trends.

[18] **Simon Thomas:** There is no significant step change here.

[19] **Mr Trickey:** There doesn't seem to us to be, no.

[20] **Simon Thomas:** Just on this—Mike Hedges.

[21] **Mike Hedges:** Tell me if I've got this wrong: put simply, what we've continued is something that's happened for several years—that money's been taken off every other service, but mainly local government, and transferred into health. That's based on the Nuffield report. Have you, or do you know of anybody who has, peer reviewed that Nuffield report, because people seem to have taken it as being absolute gospel truth? And have you, or do you know anybody who has, peer reviewed it? Or would you be interested in peer reviewing it?

[22] **Mr Trickey:** The Nuffield report—I'm not aware of a peer review. David may have had some knowledge of that. But it is very consistent with the subsequent report of the Health Foundation from last year. They're both pointing in the same directions.

[23] **Mike Hedges:** Was the Health Foundation peer reviewed?

[24] **Mr Trickey:** They will have their internal quality control processes. I don't know the detail of those.

[25] **Mike Hedges:** I did a science degree, and everything that was ever created would be peer reviewed and re-looked at by everybody, but in the social science area, it seems to be that somebody produces a report and everybody else follows that report, which may be right, but no-one actually is challenging it in a way that Higgs boson was challenged, for example, and people wanted to prove it existed. It seems this challenge, which in science is normal, in social science seems to be anathema.

[26] **Mr Phillips:** I think in general I would disagree about the general social sciences. We have a strong peer-review system for published research. I'm not sure about these particular reports, but I think when there is a range of reports from different organisations coming to very similar conclusions using slightly different methodologies, it does provide some evidence that this is not just one organisation cherry picking figures. There is a general consensus here that several factors—rising cost pressures, something called Baumol's cost disease, which is: things that are labour intensive become relatively more expensive, and take up more resources as the economy grows, because the productivity growth in those areas doesn't keep pace with the broader productivity growth, so the costs are going up. And, of course, there's the ageing population.

[27] Now, where there's a bit of a debate is: actually what matters more for costs in terms of healthcare is—is it age, or is it time-to-death? I think some economists looked at this, looking at—actually, the proportion of the population that's going to be old is going to increase quite rapidly. The proportion that's going to be in the last five years of life isn't going up so much. So, I think that's where the debate is when you talk about the long-term pressures in healthcare. Fundamentally, what is the needs driver? Is it how close you are to dying? How much of it is the last few years of life? Or is it just generally your age?

[28] So I agree there's uncertainty around this area. I wouldn't want to be, you know—. I don't know the specific methodologies, or if they did it as a peer review, but there are several factors, I think, that are pushing in this direction. It's not like climate change where there's no debate, but there is good evidence in this area.

[29] **Simon Thomas:** We won't touch on climate change. [*Laughter.*] And we certainly won't have a debate on climate change in this committee. We'll move on with David Rees.

[30] **David Rees:** Thank you, Chair. Since you've highlighted the question of productivity, your director, in October, highlighted the concerns around the forecasts of the Office for Budgetary Responsibility. In fact, the OBR's own report in October highlighted,

[31] 'One recurring theme...has been productivity falling short of our forecasts'

[32] and they expect that this,

[33] 'will be repeated again for our March 2017 forecast'.

[34] So, based upon the fact that even the OBR recognise that they are falling short, often, on their forecasts for productivity, how much weight do we actually need to give to the reports and forecasts of the OBR as the basis of our analysis?

[35] **Mr Phillips:** All economic forecasting is uncertain. The range of forecasts are around tax revenues, around economic growth—. You know, if you see the fan charts that the Bank of England produce in its inflation reports, they very quickly fan out massively, and there's like an 80 per cent chance, in the next couple of years, that we'll grow between 0 per cent and 4 per cent. So, these are very uncertain, but I think they still matter, because it's on this basis that Government makes its policy.

[36] So, whilst outturns may differ, the Westminster Government will be basing their overall fiscal policy on these forecasts, given the aim, whether it's under the current Government, eventually to reach budget balance, or if it's a different Government—you know, Labour proposed having a current budget balance—the OBR forecast will be what drives the decisions they make in terms of spending and in terms of taxes, to meet those forecasts. So, whilst there's definitely uncertainty there, I think it's important to pay heed to what they're saying and pay heed to their central forecast, because that will be driving what Government does.

[37] I think the point you raise there about the OBR suggesting a

productivity downgrade is really important, if you think about what might be happening in the coming budget, and actually, certainly further down the line, we've got political pressure to ease up on austerity, but economic pressure suggesting an extension of austerity if this productivity growth doesn't happen. So, I think there's a real question about how the Government will square that circle. My feeling would be that it would likely mean that, if there is an easing up, it will be target-specific and time limited, and, actually, there could be further austerity in the 2020s.

[38] **David Rees:** So, if the OBR stopped being so over-optimistic, because it seems to me that they've continually been over-optimistic, what would the impact be upon, perhaps, Government thinking and Government fiscal policies, as a consequence of that?

[39] **Mr Phillips:** Well, if the OBR was to downgrade its productivity growth forecasts, that would likely reduce its economic growth forecasts, or it would otherwise be forecasting that we're about to enter into an unsustainable boom and inflation would be about to kick off. So, probably, downgrade the economic forecast, which would reduce revenues and could push up certain elements of spending on, say, welfare. That would weaken the public finances and the Government would then have to decide: does it tighten in response to that? If it thinks there's a permanent downgrade in economic growth, it probably would want to tighten, at some point—further cuts, more tax rises. If it thought it was a temporary further slowdown in productivity growth, it may actually want to loosen, somewhat, to give a bit of a boost through that period. So, I think it'll depend on what the OBR says. Is it just a temporary kind of effect and we think, actually, it'll all still come back to trend, or is it going to be a permanently lower forecast in the years ahead?

[40] **David Rees:** Based upon the fact that the OBR themselves are saying that they're regularly over-optimistic, how long do you expect that to continue? When would you expect them to say, 'Well, actually, we've been over-optimistic for too long, now, we need to downgrade a little bit'?

[41] **Mr Phillips:** Well, they've indicated that they expect to downgrade it in the coming forecasts, coming in the autumn budget. It's not for me to say the extent to which they'll downgrade it. What's going on with productivity at the moment is puzzling a lot of economists.

[42] There are several reasons suggested why productivity growth isn't doing so well: we've got zombie firms because of loose monetary policy;

we've got not enough investment; we've got not enough infrastructure—there are lots of things being discussed. But nobody knows exactly for sure. So, I wouldn't want to say, 'They're going to downgrade it for the next five or 10 years.' I don't know the answer to that, but they've already indicated that they will downgrade. I think the question is, you know: will this lop off a percentage point or two over the next five years or are they thinking this is a permanent kind of trend we're into?

09:45

[43] **David Rees:** And is productivity the only one that's regularly over-optimistic or are there other factors that we often see that could be the same?

[44] **Mr Phillips:** So, productivity growth has been one of the ones that they've been over-optimistic on. They've tended to be under-optimistic on employment growth. So, one of the reasons why, despite low productivity growth, in the last couple of years at least, public finances have been coming in relatively on track, although they made much bigger errors at the start, is that employment has been doing well whilst productivity has been doing badly. I think the kind of issue there is that we're coming to a point where employment can't really continue rising much more because we are at 4 per cent unemployment.

[45] So, in the past, whereas productivity's kind of underperformed, it's been made up for by employment; I think that's less likely going forwards. So, that's why they say we are getting some upside, potentially, as well, but the downside's likely to offset that going forwards now.

[46] **Mike Hedges:** You might say this is simplistic and, if you do, I'm quite happy for you to say it, but surely the position is that employing people is relatively cheap, increasing productivity through capital investment is relatively expensive, so productivity hasn't gone up because it's been cheaper to employ more people than to drive up productivity by spending money on equipment.

[47] **Mr Phillips:** This isn't my area of expertise, but I'll answer that briefly, if I can. So, I think that's kind of interesting in that there are two factors going on. So, you're right that one of the factors people talk about that could be reducing productivity is that we've seen this increase in the number of people wanting to work because of welfare reform. Cutbacks in benefits

mean that some people are kind of forced into work, and migration from the EU and from other places boosts the labour supply, making it cheaper to hire people. So, you hire more people rather than invest. On the other hand, you have very low interest rates for lots of businesses to borrow, which makes it cheaper for them to borrow. There's a question of whether there's a mismatch between who can borrow cheaply and who has the kind of high-growth potential. So, I think it's a complicated pattern, but I think you're right that relatively cheap labour at the moment is one of the factors that people say is holding back investment and productivity improving.

[48] **Mike Hedges:** Can I just come back? It might be cheap to borrow, but it's not necessarily easy to borrow, and I think that's the difference, isn't it? You may be borrowing at 2 per cent or 3 per cent or 4 per cent above base rate, which is under 5 per cent, but if banks are not prepared to lend to you, which seems to happen to a large number of small and medium-sized companies, then it's easier to increase the labour rather than try and, effectively, save up for the capital investment because banks are very loath to lend.

[49] **Mr Phillips:** Yes, potentially that's a factor that is involved, and there can be a difference between the access to finance for big and small businesses. I know in the US one of the big factors has been that there's been a huge decline in the growth of new businesses. It's becoming more and more concentrated in the incumbent businesses, and that can hold back productivity growth. I'm not sure if that's happening in the UK quite so much though.

[50] **Simon Thomas:** Can I just ask you, Mr Phillips, if you have a view as to whether this signal from the Office for Budget Responsibility, which is quite recent, and post our budget being laid it has to be said—? So, there are challenges then for the autumn budget, with implications for the Welsh Government's budget. Is this something that's just a readjustment of the figures or is it a structural fault in the way that they've been approaching this forecasting? Are you able to tell from the situation in which it is in?

[51] **Mr Phillips:** Okay, so, I've not looked in detail at the methodological issues. I think basically what they've done in this report is they've looked at their past forecasting errors and they've said, 'Look, now, for six years in a row, we've consistently overestimated productivity growth. Since the March budget, we've continued to overestimate it. We think something's going on here. We're likely to downgrade it.' I think, all along, the productivity growth

forecast has basically been, 'It's got to start going up again.' And I think they just realised, 'Well, maybe that's not the case.'

[52] **Simon Thomas:** So, economic forecasters are as prone to optimism and hope as the rest of us.

[53] **Mr Phillips:** Optimism and hope when things are going well and kind of—. They never predict upturns; they never predict downturns. Economic forecasting is one of the most difficult parts of economics.

[54] **Mr Trickey:** I mean it's part of the issue, isn't it, which is that I think there was an implicit expectation from the OBR that productivity would return to the kind of long-term historic trend—

[55] **Simon Thomas:** Long-term trends as we—

[56] **Mr Trickey:** And it just hasn't done that.

[57] **Mike Hedges:** We thought the same about interest rates.

[58] **David Rees:** They don't call them errors, they call them differences. They don't like you calling them errors.

[59] **Simon Thomas:** Right, okay. I did want just to ask if either Michael Trickey or Dr Luchinskaya had a view as to—because the Welsh budget is based on OBR figures, and those OBR figures themselves are the old figures, they're not very up-to-date figures, and now we know that there's going to be a significant realignment in the autumn budget—whether your assessment of the challenges, you know, whether you've had an opportunity to look at it again or re-evaluate what you were saying in your earlier reports.

[60] **Dr Luchinskaya:** Yes, well, we were—. After the UK autumn budget would come out, our plan was always to go back to our scenarios paper and to review what the changes mean. And as we use OBR figures as the basis for some of our assumptions, we may need to look at those again. It would just depend on what the figures do.

[61] **Simon Thomas:** And we haven't—. When we see them. Yes, okay. Nick Ramsay then, thanks.

[62] **Nick Ramsay:** Diolch, Chair. The Chair's just mentioned the budget. What sort of effects do you think that the UK budget decisions will have on the Welsh budget?

[63] **Mr Trickey:** I think it's the most significant event that's going to happen over the next few months. You've talked about the impact of the OBR, the downgrade on productivity, potentially. There was also an OECD report last week, which was bleak, in terms of the short to medium-term prospects for the UK economy.

[64] There's been a thought that the Chancellor was building up a bit of what's called a war chest, in terms of contingency for Brexit, and that the pushing back the target date for the balance budget into the 2020s will give him some more room for manoeuvre. I suppose the big issue is to what extent the OBR changes and other forecasts have really been restricting his room for manoeuvre. So, I sort of sense, but it's only a gut feeling—it has no evidential basis—that the budget's going to be tighter, perhaps, than we might have otherwise expected.

[65] **Nick Ramsay:** You were more optimistic when we last spoke to you.

[66] **Mr Trickey:** Well, we just thought that there was some room for manoeuvre that he had, but if anything, that room for manoeuvre seems to me to be less now than it felt a couple of weeks ago. I don't know whether David would—.

[67] **Mr Phillips:** I think we are likely to see some targeted giveaways. They've already announced some kind of changes they're making in the budget. So, they've announced these changes to student fee repayment thresholds and changes to the Help to Buy scheme. There have been announcements on easing the pay cap in certain areas and rumours about stamp duty. But it doesn't look like these things are going to feed through into higher resource DELs.

[68] Most of these things seem to be about tax giveaways or things that kind of impact on the long term in terms of the public finances. The big question is: what happens with the public sector pay cap? What they did with the police and prisons is that they had to find it within existing budgets. Also, when they found additional money for education to kind of—. Because in redoing the formulas for English schools, they found the money to compensate some of the losers from elsewhere in their education budget.

[69] So, I think there's a question. If they do, more generally, loosen the pay cap, and they continue the current form, actually, rather than that easing up austerity, it actually—. If Wales wants to follow, it makes austerity harder because you've got to find more pay within the same budget.

[70] **Nick Ramsay:** And, basically, there's no thought that the changes that are going to be made will really give us the money through the block grant. It's not going to inflate it. If anything, it'll be tighter, I imagine.

[71] **Mr Phillips:** I would imagine the block grant may not change that much. It could be tighter—it'll feel tighter if the wages are going up more. I think there's an interesting question, which is probably quite politically controversial to say this, but we did some work at the public sector pay gap in different parts of the UK and public sector recruitment pressures. Certainly on the pay-gap side, you see in London and the south-east, public sector pay has fallen behind private sector pay when you adjust for the characteristics of the jobs.

[72] In Wales, it is still substantially above that level. Now, there could be reasons for doing that, and you might want parity between different parts of the UK, but I think there is a question for the Welsh Government about does it necessarily want to just follow the English lead, if they do relax the pay gap or if they want to think about what the actual pressures are and what the recruitment issues are in Wales. It's obviously a politically difficult issue, but there are different public sector labour markets in England versus Wales, or at least south-east England versus Wales.

[73] **Nick Ramsay:** Say that again—so public pay is lower in England.

[74] **Simon Thomas:** Relative.

[75] **Mr Phillips:** Relative to the private sector pay. In London and the south-east, we estimate that public sector pay is below private sector pay, whereas in most of the rest of the country, including Wales, we estimate that, conditional upon occupation et cetera, it's higher—including in Wales. So, there could be different pressures there.

[76] **Nick Ramsay:** I hadn't thought of that side.

[77] **Simon Thomas:** Sorry—David.

[78] **David Rees:** On that particular point, though, whilst I appreciate that argument, there are many other factors that need to be taken into consideration. Particularly if you have a differentiation of public sector pay across the nations, you're going to have a major impact upon recruitment, workforce morale and satisfaction in the job. Therefore, you might actually see as a consequence not just austerity measures but staff leaving, which means you're going to actually not be able to deliver the services.

[79] **Mr Phillips:** I think that is an issue. When setting pay policy, you need to have all these things in mind. When public sector pay is falling under the private sector pay—. Some research that colleagues have been doing on police suggests that you do run into recruitment issues when doing that. It's a difficult balancing act, but because the current levels are different, I was just saying that it's one thing to bear in mind: are the other professions going to necessarily be the same?

[80] **Nick Ramsay:** Finally, for now, looking back to the autumn statement of 2014, how did the changes to UK stamp duty rates in that statement impact on the Scottish Government after their original land and buildings transaction tax announcement on rates and bands?

[81] **Dr Poole:** The 2014 statement?

[82] **Nick Ramsay:** Yes.

[83] **Mr Phillips:** They initially set the bands in Scotland and then there was the—

[84] **Simon Thomas:** There was the additional rate, I think, that then came in, didn't it?

[85] **Mr Phillips:** They removed the slab structure; they copied the Scottish policy. I don't know. I do know that when—

[86] **Nick Ramsay:** [*Inaudible.*]—I presume. The reason for asking that is, I suppose, just to see how changes would happen in this—

[87] **Simon Thomas:** I suppose to frame it in a wider context is to ask: do we have the Welsh data for these changes in land transaction tax in Wales? I think the question is around—. There was a mismatch. The Scottish policy

was based on something that then changed. Do we now have robust enough Welsh data for the decision making that is now happening in Wales? I think that's the wider question.

[88] **Mr Phillips:** On the first part, what happened was, thinking back, because the new rate introduced by the UK was lower than what the Scottish Government said the rate was going to be and the UK rate was going to apply for a few months, there was going to be forestalling and people were going to bring forward their transactions. So, what was agreed was that there would be transfer from Westminster to Scotland to cover some of that forestalling side of things. I think there's been some discussion. The Welsh budget talks about a transfer from Westminster to Wales if there's forestalling in response to Wales having a higher tax rate, as proposed in the budget for higher transactions.

[89] **Nick Ramsay:** It's an interesting situation, isn't it, because more often than not—other than in the cases of new taxes—the changes made in the devolved areas are primarily based—. You're deviating from the initial UK tax, so if then after that process, or in the middle of it, the UK tax changes, suddenly what you based it on is different.

[90] **Mr Phillips:** It's interesting. The Scottish Government were able to get a transfer from Westminster to compensate for people bringing stuff forward to take advantage of the lower UK rate. The Welsh Government, assuming they do the same—I think it's an open question about whether they are able to negotiate that.

[91] **Nick Ramsay:** Would that be part of the overall fiscal framework discussions?

[92] **Mr Phillips:** The fiscal framework says that, if they are policy decisions that have a direct effect on the revenues of the other Government, there's a transfer. Where there are demonstrable and commonly agreed behavioural effects, that can be done in exceptional circumstances. Westminster and Scotland agreed this was an exceptional circumstance. There's a question of whether this would be the case in Wales, especially if they don't change policy. The Westminster Government could say, 'You always knew what the policy was, so we're not going to pay the compensation in this instance'. That could be a risk in this case, whereas in Scotland, Scotland could say, 'Actually, no, it was exceptional because you changed policy after we set things.'

10:00

[93] **Simon Thomas:** If I understand it correctly, the hint from Westminster is they might change stamp duty as part of the energy package, if you like. So, there might be a cap on energy prices, and they might change stamp duty for particular kinds of properties that have particular energy efficiencies. It's something that we did debate in this committee when we did the land transaction Bill, now Act. At the time, the Welsh Government didn't take up that opportunity. But is that an example of where the fiscal framework would need to come into play, in your opinion? Perhaps Dr Poole as well might have a view on this.

[94] **Dr Poole:** If there's a material and first-order effect on the revenues that would come through, then that would be eligible to be brought up with the Treasury on that. On the specific details, we'll have to see about the magnitude of that effect.

[95] **Simon Thomas:** And if I could just, while we're on here, ask a wider question about whether you think the data on which the Welsh Government is basing its policy decision is robust enough to give the security—. Obviously, Bangor Business School have verified the methodology, but it's all based on Office for Budget Responsibility data, it's all based on wider UK-wide data. Is this a robust enough evidence base to be making these policy decisions?

[96] **Mr Phillips:** So, in terms of what matters—

[97] **Simon Thomas:** You can all have a go at this one.

[98] **Mr Phillips:** So, in terms of what matters to the overall Welsh budget, the Bangor paper shows how revenues from that stamp duty would change—sorry, land transaction tax—if growth was higher and prices and transactions were lower. Now, what matters more for the actual budget for Wales is not whether growth in Wales is higher or lower, but is it higher or lower relative to what's happening in the rest of the country. So, if the OBR is wrong, and wrong in the same way across all of the UK, it doesn't really matter that much for the Welsh Government's budget. What matters more is whether taking OBR forecasts for the UK as a whole is the right approach for Wales. And there, I'm not so sure. What you tend to see is that the market has traditionally been more cyclical in London, that the market in London tends

to lead the rest of the country. Whether they want to have more statistical analysis looking at how trends in Wales—you know, whether they lag or lead trends in the rest of the UK, are they less cyclical than the rest of the UK—that could be something that would be worth while exploring in this analysis.

[99] I think they also look at the policy costings. So, while they look at how revenues would change if growth is higher or not, they don't look at how revenue would change if they're wrong about how responsive people are to policy changes. So, one thing that might be good to see is some sensitivity analysis in the forecasting report about how would revenues change and the cost of these policy changes they're making—so, the cuts at the bottom and the increases at the top—how would that change if the behavioural response of that was different from the central estimates they use. So, more responsive or less responsive—would that have a material impact on the revenues?

[100] **Simon Thomas:** Cardiff Business School did some modelling earlier on this, didn't you, so I don't know whether you wanted to—

[101] **Dr Poole:** Yes, and that point that David just raised is absolutely key about the relative differentials. The best thing about this block grant adjustment system is that Wales is protected on a lot of economic shocks. So, even if we go into the income tax, which is obviously not in this budget but in the following budget, we were very concerned about a year ago that OBR was quite considerably overestimating the potential for income tax revenues in Wales, because they weren't forward modelling the Conservative Government's policy to increase the threshold at which you start paying income tax, which was pulling disproportionately more Welsh people out of the income tax-paying base than was true of the UK as a whole. That would have caused a significant shock to the Welsh budget, but with the new fiscal framework that's been agreed, that risk is minimised because of the modelling and the three different block grant adjustments for the three different rates of income tax. So, in the new fiscal framework some of those big risks in differentiation have been removed somewhat. The Bangor Business School raise in their report that next month there's going to be a new OBR report. We expect it to be worse in terms of the tax forecast, but in the budget, it's probably not going to have a very material impact, because even if there is a big hit in the forecast revenues, a lot of that will be taken up with the block grant adjustment number. So, unless David or anybody—. So, I think the material risk is, I think, manageable on this side.

[102] **Simon Thomas:** Okay. So, in effect, the fiscal framework is a cushion for the Welsh budget around this.

[103] **Dr Poole:** Yes.

[104] **Mr Phillips:** Yes, definitely.

[105] **Simon Thomas:** I don't know whether anyone has further questions on this. In which case, we'll move on with Neil Hamilton.

[106] **Neil Hamilton:** I want to ask about the assumptions that are made for behavioural change in relation to the devolved taxes and, therefore, the likely yield from differential rates. I tried to find the technical papers from the OBR, which gave me the equations upon which the elasticities were calculated, which I thought I would find from references in the Bangor report, but all I found was very broad-brush one or two-paged documents. So, I'm no wiser now than I was before I started. So, I was just wondering: are the demand elasticities and behavioural and economic impacts around devolved taxes suitably incorporated, do you think, into the modelling? And how might these behavioural impacts be different in Wales or in England? Assumptions are made, for example, in relation to Welsh land transaction tax that indicate that the growth in the yield of this tax will be 9 per cent in Wales compared with 7 per cent in England and Northern Ireland. So, revenue is forecast to grow slightly faster, therefore, than in England and Northern Ireland. I don't know on what basis that assumption is made, because what we do know is, as regards the UK, the UK residential property market and the Welsh property market, in terms of transactions, have a very strong correlation of 0.99, so they're almost an identity. So, can you shed any light on this technical issue?

[107] **Mr Phillips:** Okay. So, I think there are two questions there. One is about behavioural elasticities that are used to make an adjustment to the raw costing when they change policies, and one is about what's happening with the underlying revenue forecasts. Now, I've not looked at the underlying revenue forecasts in great detail, but as I understand it, they've used the determinants that the OBR has for transactions growth and for price growth, and applied those in Wales. Now, the reason you can get different effects on revenues could be that the price distribution is different in Wales than it is in Northern Ireland or in England. And because we have this kind of marginal rate structure, the price distribution matters because you can have people being pushed onto the tax for the first time and people being pushed up into different bands. That happened a lot more under the slab structure, but it

can still happen under this marginal rate structure, to some extent. So, some of the reasons that it could be are because of the difference in the price distribution. I'd imagine the Welsh Government or Bangor University could tell you in more detail what is driving those differences.

[108] In terms of behavioural elasticities, as I understand it, what the OBR did was it didn't do its own estimations; it did a review of the evidence from a number of studies, and there's a number of studies by people at the London School of Economics. I know the Welsh Government contracted people at Essex university to do work on stamp duty; I'm not sure if that's reported yet. But these were chosen as central estimates. But I've been doing some work myself on income tax behavioural elasticities, and we found there that there are quite wide margins of uncertainty around it, because it's hard to estimate these. And that's why I think, actually, it would be good in future reports if they were to produce some sensitivity analysis about these elasticities: if the elasticities are 50 per cent higher or 50 per cent smaller, how does that effect the yield of the tax, but also, the specific yield from the policy changes? One of the things I was a little bit disappointed with in the documentation from the budget was—. In the UK budget, there's a table that sets out—it's called the score card—all the measures and the expected revenue effects. And there wasn't a scorecard setting out the effects of these changes. But if it did that, and showed some sensitivity, that would make it easier to potentially scrutinise the costings and the policy decisions.

[109] **Neil Hamilton:** The other interesting point that arises—we talked about Scotland a moment ago—is that, of course, a much larger proportion of the Welsh population lives within 50 miles of the English border than is the case in Scotland, so we must expect greater porosity and, therefore, the risk of forestalling is greater if there are rate changes in Wales—which are announced in advance—and also the behavioural response to rate changes might also be greater on both sides of the border, actually. Of course, the same is true of England, as it would be for Wales in a sense, but probably greater in Wales because of the much higher proportion of the Welsh population that is going to be affected and can do something about it without making massive changes to lifestyle. So, I was wondering whether you think that the determinants incorporated in the model, based on observations in Scotland in the transition to LBTT, are given undue weight in these forecasts, because Wales is different from Scotland.

[110] **Mr Phillips:** As I understand it, these were not elasticities specifically used for Scotland; these were elasticities that the OBR were more generally

using, so they're kind of estimates of the UK-wide effects. You're right that you might expect elasticities to be somewhat higher when there's a porous border between an area where it's being affected and where it's not. There might be other reasons why you might think it'd be less responsive: if you thought, for instance, that a lot of the response, particularly at the top end in London, was coming from overseas investors and people with complex, financial arrangements, whereas, in Wales, that's not so much the case. So, Wales is different on several dimensions.

[111] Unfortunately, because there's been no variation in tax rates between England and Wales so far, you haven't got good evidence with which to estimate what these things are. So, maybe, economists in a couple of years' time can look back and do some estimates based off this and, going forward, have better estimates. But, in the meantime, I think that's why sensitivity analysis matters.

[112] **Neil Hamilton:** Right. Well, I think that's very sensible.

[113] Do you have a view on how changes to LTT bands and rates might impact on the Welsh housing market and the wider economy?

[114] **Mr Trickey:** It's not something we've looked at.

[115] **Neil Hamilton:** No.

[116] **Mr Phillips:** So, I had a little think about this on the train up here. So, there are two things going on: there are cuts at the bottom and increases at the top. So, at the bottom, the Welsh Government says that what you might expect is that there'd be a small price rise and an increase in transactions. Actually, those increases in prices—. The estimate is, if stamp duty falls by, say, £1,000, the increase in the price will be more than £1,000. So, if someone's buying lots of properties—if someone's kind of going to be moving on, they'll save more in the stamp duty than they end up paying in higher prices. If someone's buying somewhere as a one-off, they actually might end up paying more because the price increase more than offsets the fall in stamp duty. So, what it'll tend to do is it'll benefit those more who are going to be moving more frequently and might cost those who are not moving so much.

[117] But, actually, that is a good thing. In general, stamp duty is thought by economists to be a bad tax—it taxes mobility; it taxes people doing mutually

beneficial trades. It would be better to abolish it and replace it with the current taxes on properties, with a form of council tax or a form of business rates.

[118] At the top end, you've got the opposite issue: you've got fewer transactions and lower prices. I think the question there is: is this going to be significant enough to have a big knock-on effect on the economy? And that I don't know. What you might see with commercial transactions in particular is that one thing that might happen is that, if you have fewer transactions because of the higher tax, maybe there'd be less scope for—. One of the benefits of people investing in properties can be that: someone owns it, they're not sure what to do with it, they sell it on to someone who has got better ideas on how to use that property. If the transactions are happening less frequently, that might stop those beneficial 'passing on to someone else who's got better ideas'. I think, if there was going to be an impact from these changes, that's where it would come from. The actual general changes in price levels I'm not so concerned about.

[119] **Neil Hamilton:** Okay.

[120] **Eluned Morgan:** Can I ask—

[121] **Simon Thomas:** Eluned, yes.

[122] **Eluned Morgan:** —to what extent—? The chance is—. It sounds like there's going to be an increase in interest rates at some point. So, then you've got two different variables coming together. Can you make any predictions on the basis of that?

10:15

[123] **Mr Phillips:** I wouldn't want to put my neck on the line and make a prediction about what's going to happen to the Welsh property market.

[124] **Simon Thomas:** Otherwise you'd be investing here—or not, as the case may be. [*Laughter.*]

[125] **Mr Phillips:** Yes, otherwise, I'd be making a mint. But you're right, yes. Increases in interest rates are going to have many effects on the property market. It will tend to depress prices. It may impact on transactions if it kind of makes new mortgages less affordable for people. How these will interact,

I'm not sure. I think it's important to note that the interest rates will affect the whole of the UK, not just Wales.

[126] **Simon Thomas:** Just a couple of things that arise, if I may, from your evidence, but also the evidence that the committee had last week with Bangor and the Welsh Treasury as well, which is that there seems to be very thin evidence, actual evidence, of the impact of Welsh taxes. And I know we haven't had them, so you understand the reason, but some of the descriptions you were giving, Mr Phillips, of the assumptions on the basis of assumptions on the basis of assumptions, almost—you know, it was kind of that you're building a house on sand there, aren't you, in terms of predicting, or forecasting, I should say, what might happen. Now, in terms of the overall Welsh budget, we're protected, because we have this fiscal framework. So, in a sense, it's a fairly risk-free option for the Welsh Government, but we still are doing some tax changes on very thin evidence. Is that fair?

[127] **Mr Phillips:** Well, I'm not sure I'd say it's thin evidence. I mean, I agree with—and I think Ed—. Well, he can say as well, but—. I agree with Bangor's assessment that, given the available data that we have, given the existing evidence that this is a reasonable methodology, they've actually done a kind of back-cast to see actually if this methodology would do a reasonable job of predicting what happened, and, you know, any forecasts are going to be wrong, but there's a reasonably good job. I think this is just, you know—. The Welsh Government, the Welsh Assembly, is entering a new world, if you like, where it's not just trying to kind of track predictable year-to-year changes in grants—and even those can change, because of the budget positions. Fundamentally, tax revenues, particularly taxes like land transaction tax, are volatile, and they are going to be going up and down.

[128] I think the issue is that you need to make it a forecast, and the important thing is that those forecasts are made on the best evidence and best methodology that is practical and available, and I think I agree with Bangor that, whilst there is room for improvement on some of it, and there's room for testing things more, the Welsh Government has built a robust and suitable model for these forecasts.

[129] **Dr Poole:** Yes, and we know, and, indeed, one advantage of the first two taxes is that they're based on some sort of physical element, so landfill or stamp duty. We know where these transactions have been taking place. Income tax has been a lot harder, because it's based on a survey of personal incomes. We don't really know, yet, exactly how much tax is paid by every

single taxpayer in Wales, although we will know that with the coding changes that are going to be made by HMRC. But, from the stamp duty and landfill, we know what is being collected, so even though it is volatile, at least we have some sense of what's going on for those taxes right now.

[130] **Simon Thomas:** Okay, thank you. Mike Hedges.

[131] **Mike Hedges:** Could I just ask one question on land transaction tax? You were quite critical of it a few moments ago, but isn't one of its strengths that it's not easy to avoid, whereas corporation tax for multinationals almost became an optional payment?

[132] **Mr Phillips:** So, yes, land transaction tax is—. So, two kinds of benefits mentioned on this: (1) is, yes, it's less easy to avoid, because you need to register the transaction for it to be legal. And (2) is that it's kind of a moment when people are spending lots of money anyway, so the goose is going to hiss less when you pluck it at this point.

[133] Now, I think, actually, that easy-to-collect element applies to other taxes as well, other property taxes like residential property taxes and commercial property taxes, and the reason that economists tend to favour replacing stamp duty with other taxes, such as those recurrent taxes on property, is that, by taxing a transaction, you're fundamentally stopping trades that have mutual gain. So, you're reducing the frequency with which company A sells to company B because company B has got better ideas what to do with the property. You're reducing the chance that someone moves from Llanelli to Cardiff because they can get a better job offer because they've got to pay this tax when they do that. So, you can raise the same taxes from the same kinds of people from the same tax base without these distortional effects on mobility and trades by doing it on council tax or business rates. Of course, that is politically difficult and economists have recognised that. I think that's why it is good that the Welsh Government is considering property tax in the round.

[134] **Mike Hedges:** Okay. I'd love to continue this discussion, but the Chair won't let me do that. But can I—

[135] **Simon Thomas:** We'll move on to another tax, I think, yes.

[136] **Mike Hedges:** Can I move on to land disposal tax? It was interesting because you said, 'We know how much is coming in in land disposal tax'.

Well, the Welsh Government have told me they don't, and I think that's something that they ought to know. I did suggest to them that we know who the site operators are, we know a large number of them are local authorities: why don't they go and ask the local authorities how much they paid last year? Most of the rest of them are very large companies such as Biffa—go and ask them how much they allocated to their Welsh sites. Now, the Welsh Government didn't seem very keen, or Welsh Government officials didn't seem very keen, on doing that. Do you see any problem with doing that?

[137] **Dr Poole:** No. I was unaware of that, actually. So, I think it would be a reasonable first step, yes.

[138] **Simon Thomas:** I think it's true to say the Welsh Treasury, last week—the evidence we had was that they are inferring from other waste figures from Natural Resources Wales rather than direct figures of tax collected at sites.

[139] **Mike Hedges:** The point I was trying to make is that, if you go and—. Biffa, for example, which is one of the major ones in Wales, will, when they do their British return, actually add up all the returns from every site. All I was asking is if they could ask Biffa what they were collecting from the Welsh sites, but that did seem to cause the Welsh Treasury confusion. Do you think that's fair?

[140] **Neil Hamilton:** [*Inaudible.*—that was not the point you were making.

[141] **Mike Hedges:** But do you think it would be a good idea for them to ask?

[142] **Dr Poole:** Yes, I think if it's—. Yes, I think that would be reasonable.

[143] **Simon Thomas:** Have you seen—? Because, again, you did some modelling on the potential for Welsh taxes—did you see any figures at that stage in Cardiff business school for the land disposal tax?

[144] **Dr Poole:** No.

[145] **Simon Thomas:** Okay, Mike? Yes. Lovely. Just to ask more generally now, the overall budget, of course, also has more flesh on the bones around how they're going to use the new borrowing powers, the mutual investment model, and, particularly in public services, this is seen as alternative to PFI,

shall we say, or whatever you want to call it. I wondered if—Wales Public Services 2025 in particular—you have a particular view, now having seen the draft budget, whether that is looking like an appropriate use of the borrowing powers and also whether it will—perhaps a wider question—trigger some wider economic benefits, and if the budget is correctly designed to achieve that, if you see what I mean.

[146] **Mr Trickey:** The big argument is about using the borrowing powers to strengthen the infrastructure. That does seem the right strategic choice to make in terms of the Welsh economy, and, in a sense, the use of the new powers is sort of an extension of work that's been going on for some time in terms of innovative forms of capital financing and so on. So, that all seems appropriate and in the right direction. There will be an issue about long-term exposure and build-up of debt and so on. We haven't yet done any work on that. I think it's something we'll be wanting to do. But this is an early stage. It feels to me as though this is the kind of direction that was clearly envisaged when they were trying to secure the powers.

[147] **Simon Thomas:** Can I just ask you specifically on that: what would you expect to see in future budgets that demonstrates this exposure and the way the Welsh Government was addressing that? What would you expect to see?

[148] **Mr Trickey:** There'll need to be—it's not quite at David's scorecard, but there will need to be a constant reflection on the build-up of the debt and the repayment implications and so on.

[149] **Mike Hedges:** That's something we've asked for.

[150] **Simon Thomas:** It is, yes.

[151] **Mike Hedges:** For a paper to have, somewhere in there, how much the total debt is, and then what the revenue implications of that debt are: that's something we've asked for. Do you think that's a good idea—us having access to that?

[152] **Mr Trickey:** Yes, absolutely.

[153] **Simon Thomas:** And including historic debt, I think, was the essential point—not just the new powers—historic debt.

[154] **Mike Hedges:** All debt.

[155] **Mr Trickey:** All debt, yes.

[156] **Simon Thomas:** Okay. The final question from myself is really reflecting, I think, work that Cardiff Business School had done previously, when you looked at—just before the Brexit referendum—Wales's net contribution and what we were getting out of the union, from the Welsh perspective not the UK perspective now. I wondered if you, now that we know—well, we don't know. We are in the middle of the process of trying to find out what it means, and how we will leave the European Union. I wondered whether you have looked at that work since then, and whether that has got any lessons for how the Welsh budget should be trying to deal with Brexit. We hear that the UK budget talks about some sort of Brexit fund, but this is about whether we have something like that, or need something like that, for the Welsh budget as well.

[157] **Dr Poole:** We haven't updated it—the reason being that we don't have sufficient information on the future shape of the settlement to be able to do a detailed look. It's something that we are keeping in the pending tray at all times. Clearly, the different settlements that could be negotiated will have very different effects, both on the budget, through how much is available through the block grant being made available from the UK Government, and also how much is being raised in Welsh taxes should there be different economic activity outcomes as well.

[158] **Simon Thomas:** And the wider question of whether the budget prepares for Brexit sufficiently.

[159] **Mr Trickey:** I'm going on to a discussion with a group of people shortly to explore that issue. My concern about the Brexit process is that a lot of decisions are going to come very fast at the end of the process. It is quite difficult to know exactly what form those decisions are going to take. We can work out the areas that they are going to be in, but precisely what the implications of those are going to be is difficult to forecast. But I do think there is an issue about a kind of contingency preparation for this, albeit in a very, very difficult situation, where it's so fluid. But the capacity of the UK Government and the Welsh Government to handle a rush of late decisions is going to be extremely highly and strongly tested, I think.

[160] **Simon Thomas:** Indeed. David, just to conclude.

[161] **David Rees:** I have two questions on that basis. The contingency planning that you are talking about is important, but, clearly, there's a lot of discussion at the moment on the 'no deal' circumstances. Therefore, I would have thought that would be something you would want to be looking at now, irrespective of what deals are being placed at the end of the day, because that's a possibility. So, are you now preparing a forecast for a 'no deal' situation to see the possible impacts on the economy?

[162] The second one is: yes, I appreciate a lot of detail toward the end—decisions towards the end. But we were in Brussels this week and highlighted concerns that a lot of businesses are making capital investment decisions very shortly that will have an effect upon that. Therefore, whatever happens now is going to affect those decisions. So, in a sense, will you also be looking, perhaps, in the next three months, based on what happens at Christmas, at the December council meeting, because that will influence capital investment decisions by many major organisations.

[163] **Mr Trickey:** Well, I mean—*[Inaudible.]*—that's right. There are three broad scenarios, aren't there? You have got the 'no deal' scenario, which suddenly seems to have become much more prominent in the last two or three weeks than it had seemed four or five months ago. Then, you've got the whole resiling to the World Trade Organization rules and all the rest of the implications of that. I think that there has to be—. I think those are all different scenarios that really do need to be developed and tested, but they will develop over time. You have to start the process off and then add to them as information becomes more definite.

[164] **David Rees:** Can I ask, though: that process is starting then?

[165] **Mr Trickey:** Yes.

[166] **Dr Poole:** I just wanted to clarify that, on the report that we were doing just before the referendum, it was very much about the budget impact and how much Wales is paying versus how much is being returned through the structural funds and the common agricultural policy. I think the problem we've got here is not only do we not know the shape of the settlement and the economic impact of any settlement, or lack thereof, but also whether or not, and to what extent, the existing European budget programmes will be replaced by domestic budget programmes for agriculture and for regional funds. We understand a little about the shape of the regional funds but, for example, if we have—there was a report this last week about the potential

impact on hill farming of a 'no deal' scenario—an open scenario that would be a very, very significant income hit on Welsh farmers in particular, would there be a replacement for CAP that would assist in that or would the Welsh Government have to find its own funds? So, again, it's not even the settlement we don't know, it's what would replace the budget fund as well. So, it makes a real challenge in terms of forecasting anything that's worth while.

10:30

[167] **David Rees:** But we should be able to identify the gaps that will exist and which will need replacing?

[168] **Dr Poole:** Yes. Yes, we could do that.

[169] **Mr Phillips:** Can I just say, on the budget side of things, one of the things that happens at the moment is that the EU regional funds have cliff edges in them and the Welsh Valleys happen to benefit from one of the cliff edges. They get lots of support via what was called Objective 1 but I'm not sure what it's called now, and then you go beyond, I think, 75 per cent of EU gross value added and it massively falls off. There's a question, actually: will the UK system replicate that kind of cliff-edge structure? If it doesn't, that might mean areas a bit above that cliff edge, places like South Yorkshire and some other parts of England, might get a bit more, and Wales could potentially get less. So, actually looking at just what the structure looks like there would matter a lot for Wales.

[170] I think the Chartered Institute of Public Finance and Accountancy have a Brexit commission for public services and I think they are doing some work looking at this as well as looking at the broader impacts on public services. I should say that at IFS we're doing some work in the coming months looking at the regional labour market impact, or the regional labour market exposures to trade with the EU and to trade with other trade partners to see which parts of the UK are going to be particularly exposed at a regional level but actually at the kind of a local level as well in some of that, which might provide some evidence about which parts of the UK are going to be hit harder under that kind of scenario or could do well under deals with China or the US.

[171] **David Rees:** [*Inaudible.*—64 per cent of our exports go to the EU.

[172] **Simon Thomas:** Okay. If there are no further questions from Members of the committee, I'd just like to thank you—all the witnesses. You'll have a transcript just to check for veracity, and thank you for your evidence this morning. Diolch yn fawr iawn i chi.

10:32

**Cynnig o dan Reol Sefydlog 17.42 i Benderfynu Gwahardd y Cyhoedd o  
Weddill y Cyfarfod**

**Motion under Standing Order 17.42 to Resolve to Exclude the Public  
for the Remainder of the Meeting**

*Cynnig:*

*Motion:*

*bod y pwyllgor yn penderfynu that the committee resolves to  
gwahardd y cyhoedd o weddill y exclude the public from the  
cyfarfod yn unol â Rheol Sefydlog remainder of the meeting in  
17.42(vi).*

*accordance with Standing Order  
17.42(vi).*

*Cynigiwyd y cynnig.*

*Motion moved.*

[173] **Simon Thomas:** A yw'r **Simon Thomas:** Is the committee  
pwyllgor yn gytûn, o dan Reol content, under Standing Order 17.42,  
Sefydlog 17.42, ein bod ni yn mynd i that we will move into private  
gyfarfod preifat nawr? A ydy pawb yn session? Is everyone content with  
hapus? that?

[174] We'll go into private then. Thank you.

*Derbyniwyd y cynnig.*

*Motion agreed.*

*Daeth rhan gyhoeddus y cyfarfod i ben am 10:33.*

*The public part of the meeting ended at 10:33.*