IPPR NORTH

REPORT

BORDERLAND WEST

ASSESSING THE IMPLICATIONS OF A STRONGER WALES FOR THE WEST OF ENGLAND

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Institute for Public Policy Research

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SUMMARY

The Scottish independence referendum, and its fallout, has reawakened the debate about the constitutional settlement for the whole of the UK. This has deeply important implications for the other devolved nations of Wales and Northern Ireland, but also for England itself.

How power is devolved within all four nations of the United Kingdom and what this means for the operation of the UK as a whole is now at the centre of critical national debate. One important component of this debate is how each of these constituent parts will interact – not just as political nations, but as economic entities.

Much neglected in this debate is the likely impact of a further strengthening of Welsh devolution on the English 'borderland'. The Welsh–English border is far more porous and economically connected than the Scottish–English border, particularly in the area bridging Cardiff, Bristol and their respective city-regions. Ninety per cent of the Welsh population lives within 50 miles of the English border, and there is a huge amount of connectivity, with 138 million journeys taken between the two countries each year. Whereas Edinburgh and Newcastle are 120 miles apart, and a car journey of two and a half hours, Cardiff and Bristol are just 44 miles apart and under an hour away by road.

The market consequences of differing tax and political frameworks between Wales and England merit further scrutiny. Having different legislative and fiscal frameworks between two neighbouring but closely interconnected areas raises novel and potentially far-reaching questions for UK economic policy. Despite this, and the evident pace in which decisions on the devolved nations are being made, little research has been done on the potential consequences for the UK. This report is a first step in addressing this.

This report sets out to examine the potential impact of devolution for cities such as Bristol and regions such as the west of England – both the challenges and opportunities that flow from further Welsh devolution, but also from future devolution *within* England itself. The report's focus is a narrow one – looking at the implications of devolved fiscal policy, and in particular, tax policy. It does not address in detail the implications of different legislative frameworks or of the extra emphases that the devolved nations may place upon business support and wider economic strategy.

The broad finding of this report is that tax competition from Wales will affect the west of England to a limited extent – and these are most pronounced when the tax regime impacts on highly competitive markets where location decisions are more mobile and where the markets between Wales and England overlap considerably. Transport policy is the most obvious area, with the most prominent example being air passenger duty and its potential impact on Bristol and Cardiff airports where the impact of devolution could be considerable.

More generally, however, the drivers of prosperity in the west of England are unlikely to be substantially affected by the tax-related factors that are likely to be devolved.

For example, much of the likely focus of tax devolution will centre on land and property taxes. Yet if price were a significant factor in driving economic competition between the two places, Wales already has considerable advantages when it comes to office space and residential property.

The issues which the west of England principally faces relate to two sets of wider challenges: those coming from the continuing and growing economic dominance of London and its wider area, and those coming from the continuing development of devolution in the UK.

Largest among these is the high level of centralisation within England. In comparative terms, England remains one of the most centralised countries in the developed world. Indeed, while most other countries have devolved powers, the trend in England has gone into reverse.

The tools by which Bristol and the west of England are able to determine their own economic future remain highly constrained, despite the city-region's comparatively healthy recent economic performance. Bristol retains little of its own tax base or benefits from growth, and has precious few levers to pull to facilitate economic development free from the restrictive hand of Whitehall.

This high level of centralisation will be underlined by the evolving trend of other city-regions within England winning greater powers from Whitehall.

This uneven English political geography has already been well established by the distinctive role of London, with the cross-London authority mayoral model of government and the greater scope of powers – most notably over transport and housing.

But England's uneven devolutionary settlement is also being further rolled out to other core cities,[1] with a new settlement now in place for Greater Manchester, and in the process of being agreed for Leeds, Newcastle and Sheffield. These formal devolutionary settlements are also being matched by increased central government attention, particularly within economic and transport policy.

Under a fiscal environment that remains tightly constrained and a policy environment that stresses the role of cities in driving economic growth,[2] the ability to fight for resources and articulate a cross-region city economic vision becomes paramount.

The high-speed rail links HS2 and HS3 and the vision of a 'northern powerhouse' represent the clearest examples of the benefits of providing a coherent and strong city leadership and lobby voice into central government.

These cities, along with the failure of Bristol and the west of England to agree on a coherent joint vision for growth, represent a more pressing competitive challenge to the region.

The English devolution challenge could prove to be a much more substantial economic challenge for city-regions that are unable to maintain leadership.

1 A group of the eight largest English cities outside London, as well as Glasgow and Cardiff, see: http://www.corecities.com/

2 See Cox et al 2014 and City Growth Commission 2014a

INTRODUCTION

What are the implications of stronger Welsh devolution for the economy of the west of England? How should places like Bristol respond to fiscal devolution for Wales, the next phase of Welsh devolution?

Devolution in Wales is in a state of flux. In 2011, the national assembly acquired primary legislative powers, while the first report from the Silk Commission[3] recommended significantly boosting its fiscal powers (subject to approval in a referendum). For instance Silk recommended the introduction of a Welsh income tax as well as the devolution of business rates and air passenger duty (APD). The Silk Commission's Part 2 report considering the legal and constitutional powers of the national assembly was published in spring 2014, and recommended devolution of a range of functions including policing, youth justice and control over medium-sized energy projects. The UK government, in its response, proposed a more diluted set of powers than those recommended by Silk.

The package largely mirrored the powers devolved to Scotland through the Scotland Act 2012 and included:

- devolution of 10 points of income tax
- devolution of stamp duty land tax and landfill tax
- no devolution of aggregates levy or air passenger duty
- full devolution of business rates
- very limited borrowing powers.

Note, however, that unlike the Scotland Act 2012 the decision for the partial devolution of income tax to Wales will depend on securing a positive vote in a referendum.

Moreover, the structure of devolved powers remains anything but settled given events in Scotland. The publication of 'the Vow' in the final days of the referendum campaign committed the unionist parties to transferring substantial new powers to Scotland. The Smith Commission and the legislation that will follow it will see the Scottish parliament obtain major new powers particularly over taxation (income tax is to be devolved in full and a proportion of VAT will be assigned) and welfare (Holyrood will inter alia have powers to 'top up' UK wide benefits). Developments in Scotland are likely to have repercussions in other parts of the UK. For instance, the Smith Commission's decision to devolve APD to Scotland has prompted demands from the Welsh government that it should also be devolved to Cardiff. Developments in Scotland have also provided the backdrop to a renewed debate within England on the case for decentralisation: Manchester city-region is to gain major new powers in return for accepting the case for an elected mayor.

This report considers the potential impact of these developments for cities such as Bristol and the South West region more generally.

3 The first report of the Silk Commission, or the Commission on Devolution in Wales, was published in November 2012. The commission's second report was published in March 2014. Both are available online at: http://webarchive.nationalarchives.gov.uk/20140605075122/http:/commissionondevolutioninwales.independent.gov.uk/.

The report is structured in four sections:

1. **Understanding the relationship between Wales and the west of England:** To assess the likely consequences of future constitutional change we review the current economic relationship between Wales and the west of England. How interdependent are the two economic regions? How do the two economic regions compare? What are the comparative economic advantages of the Welsh economy and the west of England?
2. **Proposals for fiscal devolution in Wales:** Here we discuss the current political developments in respect of Welsh devolution, consider the main changes that are likely to take place, and assess how these may develop in the light of the Wales Act 2014 and other developments.
3. **The impact of Welsh fiscal devolution for the west of England:** From this analysis flows an assessment of the likely impact of these additional powers, in particular fiscal powers, on the economy of the west of England, and Bristol in particular. What scope would the national assembly have for introducing a more competitive tax regime? What are the risks – and potential opportunities – that this would create for Bristol?
4. **The west of England and decentralisation:** In the final section we argue that the real 'threat' to Bristol and the west of England does not come from Wales, but – given the degree of political centralisation within England – from Westminster. The transfer of additional powers to Wales through the Silk process should be used to make the case for the devolution of stronger powers from Westminster to Bristol, building on the existing City Deal. What additional powers might be devolved to allow the region to compete effectively?

1.
UNDERSTANDING THE RELATIONSHIP BETWEEN WALES AND THE WEST OF ENGLAND

In this section we analyse the economic relationship between Wales and the South West, with particular emphasis on the areas closest to the border, notably the west of England and the Cardiff city-region. It focuses on three aspects of the relationship:

- comparing the relative strengths of the South West and Welsh economies
- comparing public spending and the fiscal balances of Wales and the South West
- the degree of economic integration between Wales and the South West.

1.1 Comparing the relative strengths of the South West and Welsh economies

The South West of England may be neighbours with Wales, with a long pattern of interaction, but their economies are quite different. While the South West is one of the more prosperous parts of the UK, Wales is one of the poorest, and its economic performance has continued to weaken for many years, both before and after devolution in 1999.

On most economic indicators, the South West region outperforms Wales (each considered as a whole), and the gap has increased over recent years. The South West has a higher proportion of its working-age population being economically active and much lower levels of unemployment. Moreover, the South West has a significantly better skills profile than that of Wales (see figure 1.1).

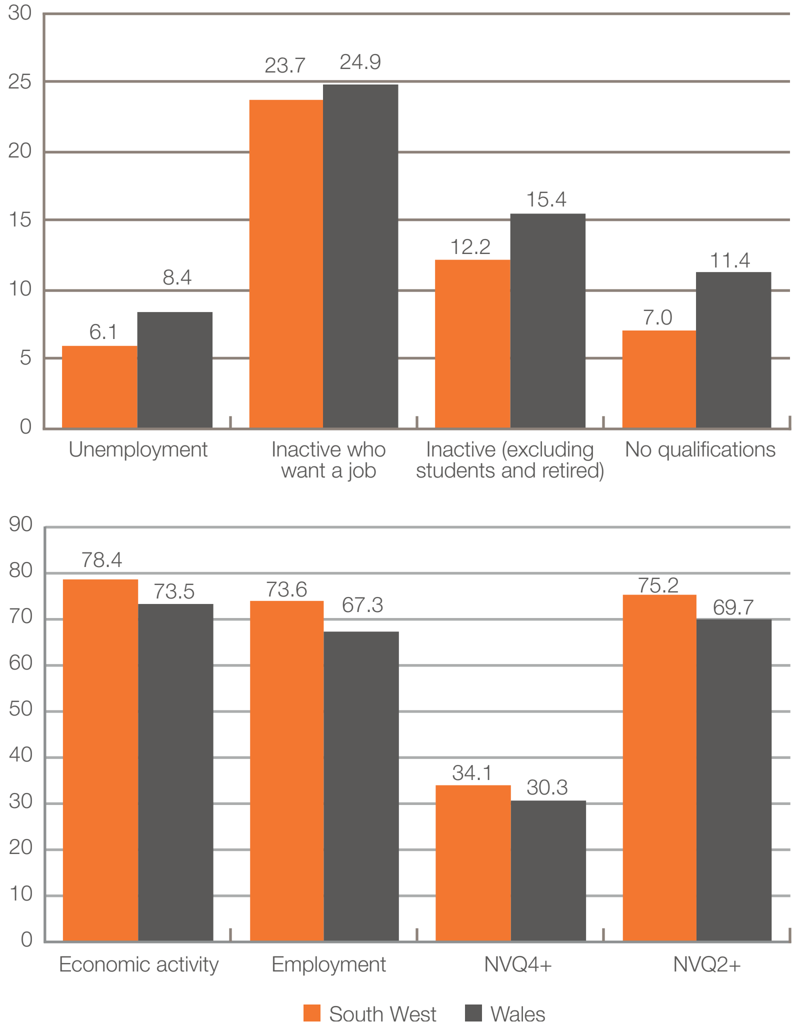
The South West's economy has grown faster in nominal GVA terms than Wales (6.8 per cent from 2007 to 2011) compared to 5.7 per cent in Wales, and the UK-wide rate of 6.5 per cent.

At a more disaggregated level (NUTS 3 subregions[4]), only Bristol and Swindon have GVA per head above the UK average. Out of the Welsh NUTS 3 areas, only Monmouthshire and Newport, and Cardiff and Vale of Glamorgan have GVA levels per head close to the UK average (see table 1.1).

On GVA growth forecast data to 2020, the South West economy looks set to continue to outperform the Welsh economy in the medium term.

4 NUTS, or the Nomenclature of Territorial Units for Statistics, is the official division of the EU for statistics. NUTS 3 areas refer principally to individual counties and unitary authorities.

Figure 1.1
Comparison of workforces in the South West and Wales, 2013 (%)



Source: ONS 2013a

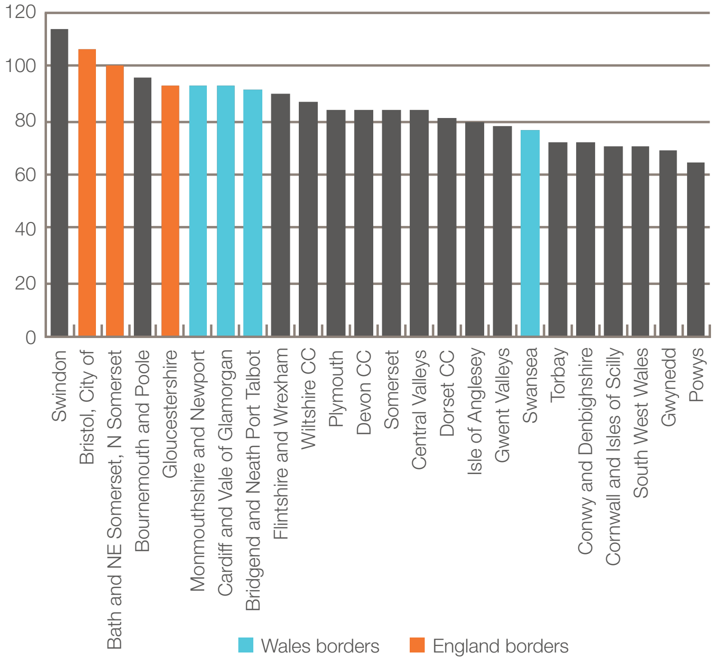
Table 1.1
GVA growth forecasts, 2014–2020 (%)

	2014	2015	2016	2017	2018	2019	2020
Wales	1.7	1.9	2.3	2.5	2.5	2.2	2.2
South West	2.0	2.3	2.7	2.8	2.9	2.6	2.6

Source: UKCES 2010

In terms of subregional productivity (GVA per filled job), the South West again outperforms Wales. It is worth noting that the areas close to the border on both sides, with the exception of Swansea, have comparatively higher productivity levels.

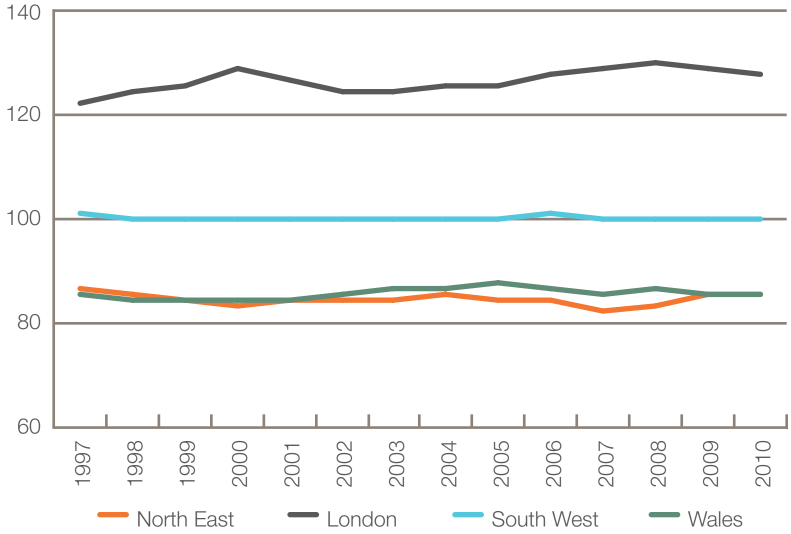
Figure 1.2
Subregional productivity in local authority areas in the South West and Wales, 2010 (GVA per filled job)



Source: ONS 2013b

Figure 1.3 shows the gross disposable household income (GDHI) per head from 1997 to 2010 for Wales, the South West and, for comparison purposes, the worst and best performing regions in the UK. GDHI per head in the South West has closely tracked the UK average, whereas in Wales the figure is not much higher than the region with the lowest level, the North East.

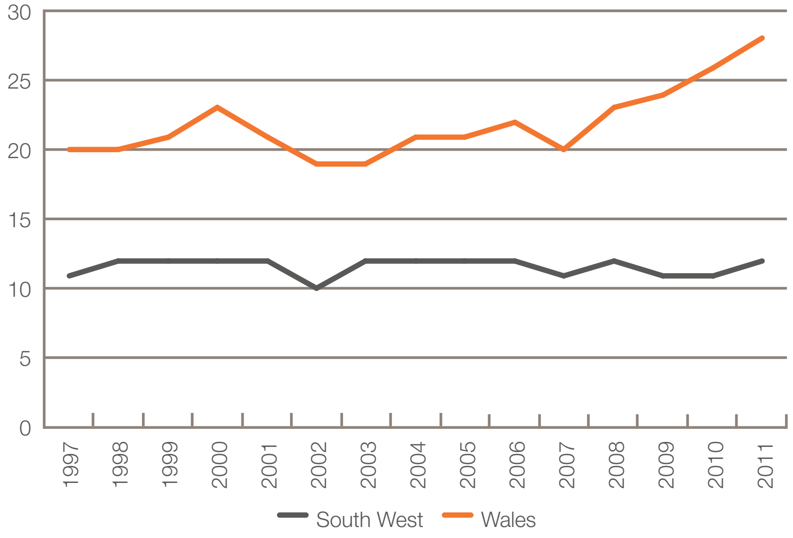
Figure 1.3
Gross disposable household income per head, 1997–2010



Source: ONS 2014

Where Wales has outperformed the South West is in overseas exports, particularly since 2007. While the South West's total exports have remained at around 12 per cent of GVA, in Wales exports hovered around the comparatively higher level of 20 per cent until 2007 and since then have climbed to a commendable 28 per cent.

Figure 1.4
Total exports as a share of GVA, by region/country, 1997–2011 (%)



Source: ONS 2013c

Looking more specifically at the strength of the Bristol city-region, it has substantially outperformed the other core cities in terms of productivity, employment and skill levels.

The west of England is the only core city area which has higher labour productivity (GVA per hour worked) than the UK average. Moreover, it is the only core city area with either an employment rate above the UK average or a proportion of its workforce with at least NVQ2 levels above the UK average. Its GDHI per head, although the highest of the core cities, is below the UK average and substantially below that of London.

In terms of having a low unemployment rate, the west of England not only comfortably betters the UK average, but also London and each of the other core cities.

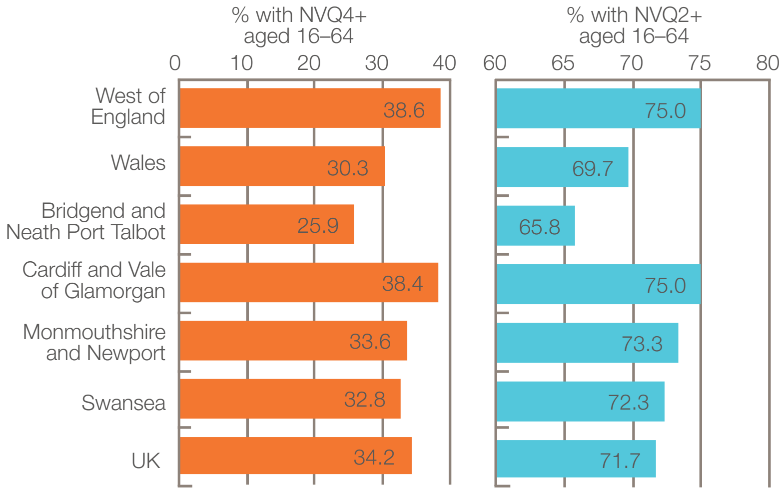
The west of England has a greater proportion of its workers in knowledge-intensive occupations, in particular, science, research, engineering and technology professionals, and business and public service associate professionals.

Comparing the Bristol city-region to Cardiff city-region, both have similar skill-level compositions, but the former does much better in terms of employment and productivity levels than neighbouring Welsh regions.

Figure 1.5
Rates of employment (left) and unemployment (right), April 2012 – March 2013 (%)

Source: ONS 2013a

Figure 1.6
Share of population with qualifications at NVQ level 4 or higher (left) and NVQ level 2 or higher (right), 2012 (%)

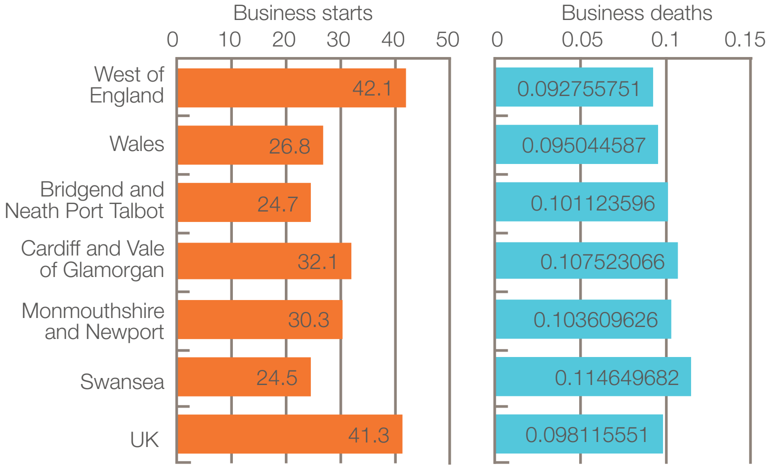


Source: ONS 2013a

None of the Wales NUTS 3 areas have labour productivity levels at or above the UK average. Monmouthshire and Newport does, however, attain almost the same level of GDHI per head as the west of England.

The Bristol city-region also has a significantly higher rate of business starts compared to that of Cardiff. This evidence suggests a more thriving entrepreneurial culture in Bristol than Cardiff (see figure 1.7).

Figure 1.7
Rates of business starts (left) and business deaths (right), 2011 (%)



Source: ONS 2012a

1.2 Comparing public spending and the fiscal balances of Wales and the South West

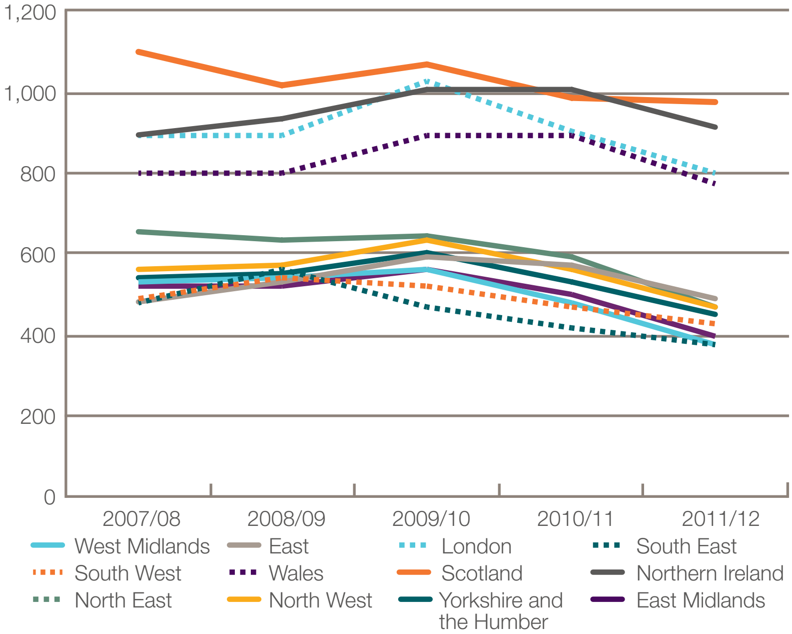
To an extent Wales already benefits from a 'devolution dividend' – it receives consistently higher levels of public spending than the English regions (as do Scotland, Northern Ireland and London). Wales receives £9,740 per head compared to the South West's £8,171. The Welsh government is responsible for around 55 per cent of total public spending in Wales, and can allocate money as it wishes within its block grant. However, its block grant is (slightly) less than it would be entitled to on the basis of 'relative need', a cause of ongoing debate in Welsh politics.[5]

The devolved administrations also have a greater say in how they spend public money. Public spending on economic affairs in the devolved nations is significantly higher than in the English regions outside London (see figure 1.8). Substantially less economic affairs spending on the South West year on year puts it at a sustained disadvantage to its Welsh neighbour.

Compared with the South West, Wales allocates almost double the amount of public money per head to transport, and almost three times that spent on enterprise and economic development (both subsets of economic affairs spending)(see figure 1.9). The spending on economic affairs per capita for Wales is, however, significantly lower than that for Scotland and Northern Ireland. It has been broadly similar to that spent on London for the last two fiscal years for which data is available.

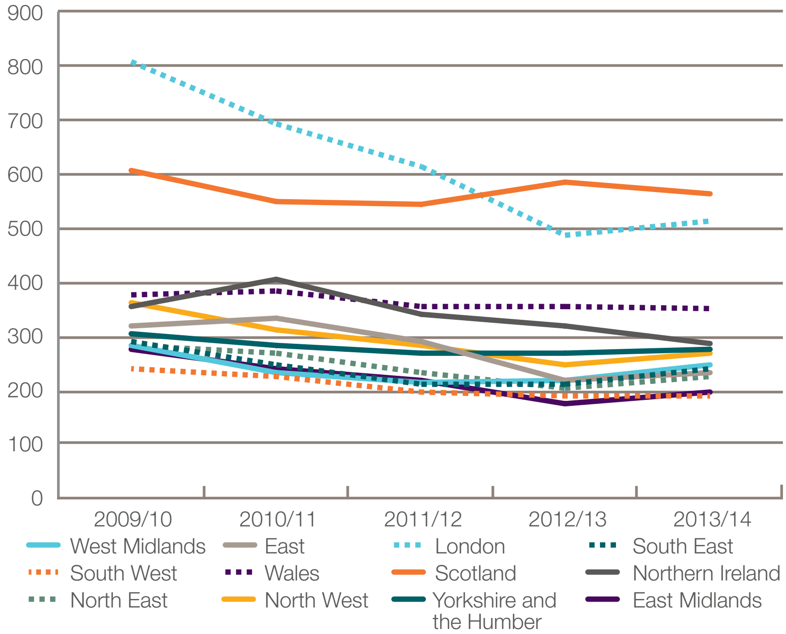
5 'Relative need' is the principle that resources should be allocated according to need, rather than by some other criterion such as an equal amount per person, or according to the revenues generated in a particular place. Relative need is the principle that underpins the formulae historically used to allocate funds for local government, the NHS and education across the UK.

Figure 1.8
Total public spending on economic affairs, 2007/06–2011/12 (£ per head)



Source: Author's calculations using HM Treasury 2013 and ONS 2012b

Figure 1.9
Total public spending on transport 2009/10–2013/14 (£ per head)



Source: Author's calculations using HM Treasury 2013 and ONS 2012b

In terms of its economic development institutions, Wales has not fared as well as might be expected. According to Ernst & Young (2014), Wales suffered the biggest slump in inward investment between 2012 and 2013, with its share of overall UK projects falling by 22.6 per cent to just to 3 per cent of UK projects.

The downward trend in inward investment in Wales has been in evidence over the past decade, following a very strong period of success in the 1990s when it attracted up to 15 per cent of all UK foreign direct investment. A report by the Welsh government (2010) suggests that since 2007 there have been fewer foreign-owned enterprises active in Wales than in any English region.

This poor performance may be partly explained by the institutional set-up. Previously, the Welsh Development Agency (WDA) coordinated inward investment, but this institution was absorbed into the Welsh government in 2006. Today, responsibility for inward investment is overseen by the Welsh government's brand for inward investment, International Business Wales – working with UK Trade & Investment – and a plethora of separate local and national agencies which, although present under the WDA, have since accrued a substantial increase in power and influence. There is also a feeling in Wales that it has lost out to Scotland on inward investment opportunities, largely because Scotland has retained a single active agency (Welsh Government 2010). Poor transport infrastructure has in addition been cited by the Welsh affairs committee in its report on inward investment in Wales[6] as having had a detrimental effect on both domestic and overseas investment.

1.3 The degree of economic integration between Wales and the South West

The issue of economic integration is most important in the areas close to the border, particularly Bristol, Cardiff and their surrounds. The border is much more porous than the Scottish–English border for instance, which increases the scope for both competition and collaboration.

Ninety per cent of the Welsh population lives within 50 miles of the English border. There is a huge degree of travel between England and Wales throughout the year, be it commuters, business people, freight or leisure seekers. Some 138 million journeys take place each year on roads and trains across the border, an average of 2.6 million journeys each week (Welsh Affairs Committee 2013).

One often-cited fear of increased devolution is the worry that devolving air passenger duty to the Welsh government could damage prospects for international connections from Bristol. Due to the proximity of Cardiff airport, it would be relatively easy for passengers to take their business across the border if it were worth the time and cost of additional connecting travel to do so.

The M4 motorway is the main road link between England and South Wales with over 60,000 journeys made between England and Wales each day – almost a fifth of all road journeys between England and Wales. The motorway suffers from congestion and poor reliability of journey times due to the high level of traffic and outdated design standards. (There are currently plans to upgrade the M4 in Wales in the near future.) The Severn Bridge and Second Severn Crossing in South Wales are two of the most important transport links between England and Wales – traffic on these two routes represents almost a quarter of all road journeys between England and Wales.

In respect of rail transport, cross-border services have seen significant growth in passenger numbers in recent years, and it is expected that demand will further increase in the future. First Great Western's Cardiff to Bristol service has seen

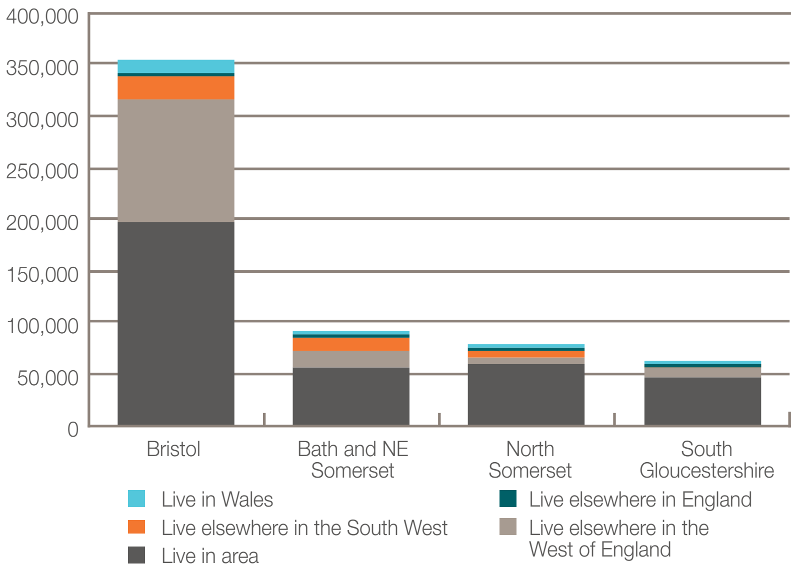
6 See http://www.parliament.uk/business/committees/committees-a-z/commons-select/welsh-affairs-committee/inquiries/parliament-2010/inward-investment-in-wales/

particularly high growth due to an increase in commuters between South Wales and Bristol. The UK government has announced significant investment in cross-border rail routes between England and Wales in the last couple of years (ibid).

The House of Commons Welsh affairs committee noted that there was room for improved coordination of efforts between the UK and Welsh governments on cross-border roads. The South West, and Bristol in particular, needs to ensure that as far as possible it is involved in these conversations.

Figure 1.10 shows the levels of inward commuting to those areas in the South West which are close to the border. This suggests that while cross-border commuting is not insignificant, it only accounts for a very small proportion of the workforce.

Figure 1.10
Workforce inward commuting patterns, 2010/11



Source: ONS 2013d

The key sectors of Bristol and Cardiff show a considerable amount of overlap, specifically the finance and business services, creative industry, technology and tourism sectors. However, the higher levels of productivity, gross disposable household income and per capita GVA suggest Bristol enjoys a significant advantage over Cardiff in these areas.

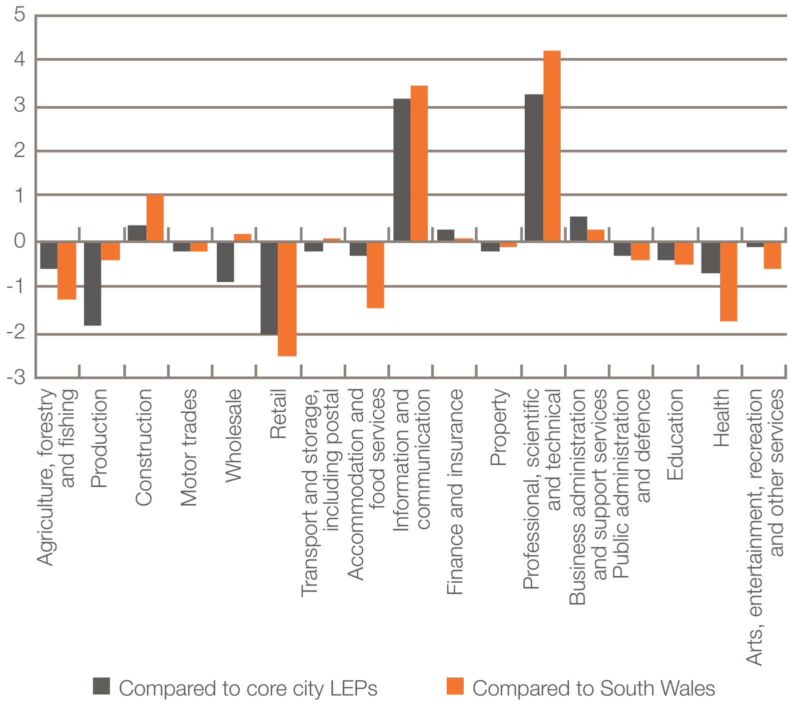
Table 1.2
Key business sectors in Bristol and Cardiff

Bristol	Cardiff
Advanced engineering, aerospace and defence	Finance and business services
Finance, insurance and professional services	Bioscience
Creative industries	Creative industries
Low-carbon economy, including environmental technology and marine renewable industries	Technology
ICT – microelectronics and silicon design	Leisure and tourism
Tourism	
Construction	
Retail and distribution	

Figure 1.11 shows the proportion of businesses in each broad industry category in the Bristol city-region as compared to the Cardiff city-region and core cities average. It shows the percentage point difference in industrial composition between Bristol city-region and these averages. Bristol has a lower proportion of its businesses in the industry groups of production, retail and health. A greater proportion is comprised of professional, scientific and technical, information and communication, and construction. Both the professional, scientific and technical, and information and communication industries are among the most knowledge intensive, creating the scope for good quality jobs and playing towards the UK's comparative advantage.

Figure 1.11 shows that Bristol city-region has very similar degrees of specialisation across industries to the UK average. It also has very similar levels of specialisation to Cardiff, albeit with more strength in manufacturing and less in energy and water. The Bristol city-region has in many respects a far more 'modern' economy than that of South Wales (particularly outside Cardiff) with strengths in knowledge-intensive industries. These differences in areas of specialisation point more to there being scope for greater collaboration rather than there being the need to be overly preoccupied by competition.

Figure 1.11
Proportion of businesses in industry categories in Bristol city-region compared to Cardiff city-region and core cities average, 2012



Source: ONS 2012a
Note: Businesses here are local units.

2.
PROPOSALS FOR FISCAL DEVOLUTION IN WALES

2.1 Financing the Welsh assembly

Since the establishment of the National Assembly for Wales in 1999, it has been funded – as the former Welsh Office (now Wales Office) was – by a block grant from HM Treasury. That grant depends on the Barnett formula, which allocates a population share of changes in spending in England on what are called 'comparable functions' to the national assembly. Unlike Scotland, the national assembly did not get the power to vary income tax in Wales. The assembly had the power to allocate its grant as it sees fit, but the amount would be determined by the Treasury.[7]

The operation of the Barnett formula has been widely discussed, and criticised. In a Welsh context, reform has come firmly onto the political agenda following the report of the Holtham Commission, published in 2010.[8] Holtham proposed a grant calculated on the basis of relative need (that is, Welsh needs relative to those in England, or other parts of the UK), using a small number of indicators. The Holtham Commission calculated Welsh relative needs as 114–117 per cent of those in England, with Wales then funded at 112 per cent. A further problem was the impact of convergence under the Barnett formula – an arithmetic property of the system, caused by the fact it allocates a share of spending in England, where needs are below those of Wales or other devolved governments.

It is important to bear in mind that applying the criterion of relative needs may mean more generous funding, but does not constitute privileged treatment for Wales. Relative need means the cost of providing similar quality of public services, given different costs of providing those services or different demands for public services. Key to this calculation are demographic factors – the proportions of younger and older people in a population – as well as such factors as overall health or poverty. The Holtham methodology, which was also endorsed by the House of Lords Select Committee on the Barnett Formula (2009), seeks to put Wales in the same position it would be if treated as part of England.

The only taxes under the national assembly's control at the time of devolution were (indirectly) council tax and non-domestic rates. There were limits on what it could do with both taxes. The *Statement of Funding Policy* (the operating manual for the Barnett formula) provided that the UK government could 'take into account' the situation if levels of self-financed spending were to grow significantly more rapidly than equivalent spending in England 'over a period', and that growth threatened targets for the public finances as part of the management of the United Kingdom economy (HM Treasury 2010). In addition, non-domestic rates were managed by HM Treasury as part of a pooling arrangement. This meant that, while the national assembly was sheltered from some risks associated with control of business rates,

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7 The National Assembly for Wales as it exists now is a fundamentally different body to the national assembly established in 1999. That national assembly was a single body corporate with executive functions, operating rather like a local authority. In 2002, an internal split separated the executive arm from the deliberative body, with the former called the Welsh Assembly Government. The Government of Wales Act 2006 created a legally distinct executive (the Welsh Assembly Government, now called the Welsh Government) and legislature (the National Assembly).

8 Independent Commission on Funding & Finance for Wales 2010. See also Independent Commission on Funding & Finance for Wales 2009a and 2009b.

it lacked the ability to use them as tools of economic development or fiscal policy and thereby reap the potential rewards of doing so.

2.2 The Silk Commission

The Commission on Devolution in Wales – known as the Silk Commission after its chairman Paul Silk – was established by the Coalition government after the Yes vote on the national assembly's legislative powers in March 2011. The commission had a broad membership, representing all four parties in the national assembly together with a number of independent members, and a carefully crafted, two-part remit. Part 1 of its work focused on finance and how to make the national assembly 'financially accountable' – this report was published in November 2012. The report from Part 2 of the inquiry addressed legislative issues and was published in March 2014 – it recommended devolution of a number of additional functions including policing, youth justice and control over medium-sized energy projects.

The Silk Part 1 report focused on aspects of fiscal devolution, as 'fair funding' and borrowing issues had been deliberately excluded from its terms of reference. It recommended devolution of the following:

- 10 'points' of income tax, subject to approval at a referendum
- stamp duty land tax (SDLT)
- landfill tax
- aggregates levy
- air passenger duty.

The recommendations largely mirrored those of the Calman Commission in Scotland, established by the pro-UK parties north of the border.

The Calman model for income tax devolution

The Calman approach to income tax devolution is intended to enable devolved and UK governments to share access to income tax, and so improve the financial accountability of devolved legislatures. It involves reducing the UK rate of income tax by 10 'points' in Scotland or Wales, so the UK rates of income tax become 10p, 30p and 35p (instead of 20p, 40p and 45p). The devolved government can then decide what rate to set in that vacated 'tax space'. However, it is under great pressure to make a decision rather than simply offer a large tax cut, as the devolved government's block grant is reduced commensurately as well. If it fails to set a tax rate, its overall funding will be substantially reduced.

The devolved rate of tax must be set in whole pence or half-pence, for each year, and is levied on those who have a closer connection with that part of the UK than any other during a particular tax year (in effect, a residency test). Taxes are still collected by HM Revenue & Customs, and the UK government continues to set the personal allowance, the thresholds between the various tax bands, and other exemptions and reliefs.

Under the Calman model, the devolved rate of income tax has to be the same across all tax bands – so a devolved government can set a 10p rate (meaning taxpayers pay 20p, 40p or 45p as before), a 9p rate (so total rates would be 19p, 39p and 44p) – but cannot set a 10p rate for the standard rate and a different rate for the higher and additional rates (producing, in this example, total rates of 20p, 39p and 43p). This is intended to ensure that the UK government retains control of how progressive the tax system is.

The Silk Commission followed the Holtham Commission in recommending the devolution of 10 points of income tax, but without the lockstep in place. It would therefore be open to the Welsh government and national assembly to set different Welsh rates of income tax on each of the tax bands. This package, if implemented, would mean that the Welsh government would have control over taxes accounting for about 25 per cent of its own spending, broken down as shown by table 2.1.

Table 2.1
Revenue yield from devolved taxes in Wales, 2010–11

Tax	Revenue yield (£m)
Income tax – 10p of each band	2,000
Stamp duty land tax	115
Landfill tax	62
Aggregates levy	21
Air passenger duty (long-haul flights)	1
Total	**2,199**

Source: Reproduced from table 9.1 of the Silk Commission Part 1 report

2.3 The Wales bill and Wales Act 2014

The UK government took over a year to respond to the Silk Commission's Part 1 report. Rather than follow the commission's recommendations, it came up with a package that mirrored the Scotland Act 2012 (which implemented the Calman Commission's proposals for Scotland). This meant that the package includes:

- devolution of 10 points of income tax, with the lockstep in place
- a referendum to be held before income tax devolution takes place
- devolution of stamp duty land tax and landfill tax
- no devolution of aggregates levy or air passenger duty
- full devolution of business rates
- a 'prudential' borrowing power, enabling the Welsh government to borrow £500 million in the short term to pay for infrastructure improvements, notably the M4 upgrades, and an additional £500 million if or when income tax is devolved.

The package did not offer any progress on 'fair funding'. The UK government pointed to an October 2012 agreement with the Welsh government as resolving these issues, but the Welsh government insisted that it would not seek to hold a referendum until the issue of fair funding is resolved. Action on fair funding and a revision of the Barnett formula would create serious problems in relation to Scotland, however, as the formula treats Scotland generously (and more generously than any system based on relative need would). Both Labour and the Liberal Democrats had indicated that retention of the Barnett formula would form part of any scheme they support for further devolution in the event of a No vote in the September 2014 independence referendum, and were effectively ruled out by pledges to preserve Barnett, seemingly indefinitely made by all the pro-UK parties during the closing stages of the referendum campaign.

The retention of the lockstep in the UK government plans undermined support for them – Carwyn Jones, the Labour Welsh first minister, described the proposed tax power as 'useless'; the Welsh nationalist party Plaid Cymru decided not to support the tax powers while the lockstep remains in place; and opinion in the Conservative party was divided, with the lockstep supported by the then Welsh secretary David Jones, but rejected by the Conservative leader in the national assembly, Andrew RT Davies.

The UK government's proposals were set out in a draft Wales bill, published by the Wales Office in December 2013. After pre-legislative scrutiny by the Commons Welsh affairs committee and a series of changes, it was introduced into parliament in March 2014 and had its second reading on 31 March. It completed its progress through the Commons and had its Lords second reading before the 2014 summer recess. However, following the removal of David Jones as Welsh secretary in the

June 2014 cabinet reshuffle, the UK government decided to abandon the 'lockstep' and the bill was amended to that effect during its Lords committee stage. The bill received royal assent in December 2014.

Even with this change, the absence of any movement regarding 'fair funding' (and Welsh Labour's general reluctance to accept fiscal devolution) mean there is still little likelihood that the Welsh government will seek to call a referendum on income tax devolution in the foreseeable future. There remains little positive incentive for it to do so as matters stand. The situation may change following the conclusion of cross-party talks on constitutional matters, initiated by Stephen Crabbe MP shortly after he became Welsh secretary and known as the 'St David's day process', which are due to wrap up by 1 March.

Holding a referendum on income tax devolution in Wales

A referendum on the partial devolution of income tax is highly problematic. First, there are significant constitutional hurdles to be overcome before a referendum can be called. It would have to be proposed by the Welsh government (not a backbencher or opposition party). It would then have to recruit support from two-thirds of the members of the national assembly, which in practice means at least three of the four parties currently represented there. (The custom in Wales has been for there to be agreement of all four parties on such matters.) While the Conservatives and the Liberal Democrats support the principle of income tax devolution, neither Labour nor Plaid Cymru presently does. At least one party would have to change its position, if not both.

A referendum campaign would be even more difficult. Income tax devolution would not increase the resources of the Welsh government. Arguably, depending on how the reduction in the block grant were to work in practice, it would in fact reduce resources (and would certainly create the risk of doing so). Asking voters to support a complicated proposition that would potentially both increase taxes and reduce public spending would be a considerable challenge for tax devolution advocates.

Removal of the lockstep means that income tax devolution is likely to have a greater impact if it does take place. The Welsh Conservative leader in the national assembly has signalled his desire to use such a power to abolish additional rate tax in Wales (the 45p rate) by setting it at zero, so the top rate of income tax in Wales would be 40p. Plaid Cymru has suggested that it would not cut the higher rates of tax at all (so might maintain or even increase the tax burden on higher-rate taxpayers but reduce it on those paying lower rates). Each of these approaches would have an effect on the labour market, as it would affect the after-tax income of Welsh residents – whether they work in Wales or across the border in England. However, there is a difference between the impact of tax reductions on lower and higher rates of tax. Cuts on lower rates of tax would have a larger effect on overall Welsh public finances, but create only a limited measure of fiscal competition as the marginal rate is low. A 1p reduction in the standard (20 per cent) rate would produce a maximum saving of £318.65 for the taxpayer, possibly less depending on their income.

What is likely to happen in the short term is the devolution of land taxes. Business rates will be fully devolved from April 2015, and SDLT and landfill tax from April 2018. In revenue terms, stamp duty land tax and landfill tax are not significant – they accounted for only £177 million in 2011–12. Their importance – and why devolving them is attractive for the Welsh government – is the extent to which devolving them opens up the possibility of borrowing by the Welsh government, and the extent to which they can be used as a lever to secure economic growth.

For SDLT and landfill tax, the model applied in Scotland will be used for Wales; the current UK taxes will cease to apply in Wales, and the national assembly will have the power to set a tax on transactions in land or interests in land, and on disposals to landfill, as it sees fit.

The Scottish approach to devolving land taxes

The Scottish government has had full control of business rates since devolution in 1999. The most striking change it has proposed has been a higher rate for non-domestic rates for out-of-town retail space – to reduce the advantage of retail warehouses compared to city and town centres.

The Scottish parliament has already legislated for the replacement of stamp duty land tax, to be called the land and buildings transaction tax (LBTT). The new tax will not have 'cliff edges' as SDLT does, but be charged as a progressive tax with higher rates of tax for larger transactions.

A consultation on replacing landfill tax took place in 2013, and the Landfill Tax (Scotland) Act 2014 creates the framework for the new tax. It will be charged at two rates: a standard rate of ££82.60 per tonne and a lower rate for designated materials of £2.60 per tonne.

The Scottish government is establishing a new agency, Revenue Scotland, to collect and administer the LBTT and replacement for landfill tax, and advise it on tax policy generally.

As part of the package of devolving SDLT and landfill tax, there is to be a reduction in the block grant to offset the revenues of the devolved taxes. Despite protracted negotiations between Scottish and UK governments, and the closeness of the date on which devolution is to take place, there has still been no agreement on how that reduction should be calculated.

A further possible contender is the at least partial devolution of air passenger duty (APD). The Silk Commission called for the devolution of APD on long-haul flights, echoing the Calman Commission's call for devolution of APD on all flights for Scotland. The case for doing so in Scotland is stronger than in Wales, given Scotland's distance from other major cities and other airports. (The case is mitigated somewhat by the fact that APD is not charged on flights between destinations in the Highlands and Islands – so it is charged on flights between London and Aberdeen, or Cardiff and Edinburgh, but not between Aberdeen and Shetland.) The UK government initially rejected the case for devolving APD to Scotland (it was not included in the Scotland Act 2012) but has subsequently reversed this decision as part of the post-referendum Smith Commission process. The decision to devolve APD to Scotland has prompted demands from the Welsh government that it should also be devolved to Cardiff. So far the UK government has resisted such political pressure but it is clear that APD may form part of any 'extra devolution' option approved at Westminster in the future. Moreover, APD has been devolved and removed for long-haul flights from Northern Ireland.[9] Northern Ireland shares a land border with the Republic of Ireland, which has much lower rates of APD and can offer other advantages to transatlantic travellers (notably the ability to clear US Immigration before departure).

2.4 Borrowing powers

Under the Wales Act 2014, the borrowing powers of the Welsh government have changed. Previously, it had very limited powers to borrow; it could do so either from the Welsh secretary to maintain a balance in the Welsh Consolidated Fund (in effect, to manage its cashflow), or using powers originally conferred on the Welsh Development Agency, again from the Welsh secretary (or from other lenders with the Welsh secretary's consent), and for the purposes for which the WDA existed. These could be used for infrastructure projects such as road or rail schemes, but not for social projects such as schools or hospitals.

Under the Wales Act 2014, the Welsh government has acquired a more extensive 'prudential' borrowing power. This is, however, subject to financial limits, linked to devolved taxes and the revenue streams they provide. Initially, on the basis of the agreed devolution of SDLT and landfill tax, the Welsh government will be able

9 There is presently one such service, from Belfast International to Newark, New Jersey in the US.

to borrow £500 million. The proposed partial devolution of income tax will open the door to a further £500 million. (These figures bear little relation to the revenue streams involved.) Borrowing powers are a necessary accompaniment to tax devolution, not just because of the power they give to borrow against a stream of tax revenue, but to help manage the risks of fluctuating revenues, from which devolved governments are insulated by the current block grant arrangements.

2.5 Corporation tax

It is worth noting that devolution of corporation tax has not been seriously proposed for Wales, although this tax has figured in debates about fiscal devolution in Scotland and (particularly) Northern Ireland. However, Welsh first minister Carwyn Jones has said that he would expect corporation tax to be devolved to Wales if it were to Scotland and Northern Ireland, though he has not argued for it more forcefully. The limited available evidence suggests that Wales has a very small corporation tax base. While the Holtham Commission discussed the possible devolution of the tax and suggested how it might be accomplished, there has been little enthusiasm for this in Wales or at UK level.

The argument has (like APD) been most aggressively pursued in Northern Ireland, in the context of the need for an economic ‘game-changer’, a land boundary with the Republic of Ireland where the rate of corporation tax is only 12.5 per cent, and a broad political consensus across all major parties in Stormont in favour of devolution. Devolving it would be a complex undertaking, however: it would present administrative and accounting problems, it would have to satisfy EU law regarding state aids and regional selective assistance, and it would involve a reduction to the block grant. Devolution of the rate of tax on trading profits (not allowances, credits or other aspects of the tax) was agreed in principle in December 2014 as part of the ‘Stormont House agreement’, conditional on the Northern Ireland assembly passing welfare reform legislation and the Northern Ireland executive taking steps to put its finances on a ‘sustainable’ footing. Legislation is to be submitted to the new parliament so that devolution could take effect from April 2017. It remains unclear how the reduction to the block grant might be calculated, however, or how it would be done in such a way as to satisfy EU state aids law.

3. THE IMPACT OF WELSH FISCAL DEVOLUTION FOR THE WEST OF ENGLAND

Following the above discussion we can identify three forms of fiscal devolution that are meaningfully likely to happen. In descending order, these are:

1. the devolution of land taxes, and the ability of the Welsh government to offer fiscal incentives for development projects (coupled to this are the devolved borrowing powers, and the scope these create for further investment in physical infrastructure)
2. the devolution of air passenger duty, at least for long-haul flights
3. the partial devolution of income tax.

In this section we will consider how such powers might be used, and their likely effect on the west of England if they were to be devolved.

3.1 The devolution of land taxes

The devolution of land taxes creates scope for the Welsh government to pursue different approaches to taxation, which may act as a spur for economic growth and development. The key taxes here are SDLT and business rates. The underlying logic of devolving land taxes is that they are so specific to a particular place that devolution cannot lead to economic distortions – that is, behaviour shaped purely by tax considerations. While tax factors may influence price and so behaviour, other issues about the suitability of one location over another take precedence.

The impact of land tax devolution needs to address three key sectors of the property market: office space, retail space and residential property. As far as office space is concerned, Bristol enjoys significant advantages: rents are consistently higher, and vacancy rates are currently lower.

Table 3.1
Office space and vacancy rates in Bristol and Cardiff, 2011–2013

	Bristol		Cardiff	
	Prime rents (£ per sq foot)	Vacancy rates (%)	Prime rents (£ per sq foot)	Vacancy rates (%)
2011	27.50	16.1	19.50	15.2
2012	27.50	14.7	18.50	15.3
2013 (2nd half)	26.75	–	22.00	–

Note: Data for 2011 and 2012 from Lambert Smith Hampton 2013; data for second half of 2013 from Knight Frank Research 2013a and 2013b.

In addition, Knight Frank's data suggests a significantly greater reliance in public sector lettings in Cardiff (around 20 per cent of take-up), and on the professional services sector in Bristol (around 18 per cent). This underscores the difference between the dynamism of the two cities, and the extent of reliance on the public sector in Cardiff.

As regards retail, accurate comparative material is harder to find, and the most useful evidence is somewhat dated – the *Property Market Reports* formerly published by the Valuation Office Agency ceased in 2011. The final 2011 report suggests that Cardiff retail space has a premium value over that in Bristol: a rental value per square metre of Zone A space in standard shop units of £2,800 versus £2,300 (VOA 2011). (It also suggests that the reverse is the case for non-food warehouse space: £330 per square metre in Bristol, compared with £185 in Cardiff.) Bristol City Council's *Bristol City Centre Retail Study* identifies Cardiff (and Newport) as among the primary competitors to Bristol – identified as being slightly ahead of Bristol according to a range of indicators including size of primary catchment area, shopping population and quantum of retail floorspace. But the study also notes the impact of the Cabot Circus development, and singles out The Mall at Cribbs Causeway as a major competitor (DTZ 2013). While some of the catchment area of Bristol and Cardiff is shared – essentially, that between the two cities – substantial parts of each city centre's catchment is unlikely to travel to the other centre. The extent to which there is indeed direct competition between them can therefore be exaggerated.

As regards the housing sector, south-eastern Wales lags a long way behind the west of England. Moreover, rates of increase in property prices are greater in the west of England than south-eastern Wales. Table 3.2 illustrates the point with data for average house prices for January 2014:

Table 3.2
House price comparisons between Bristol and Cardiff, and secondary centres

	Average house price (£)	Change over previous 12 months (%)
Bristol	179,385	+6.3
South Gloucester	185,049	+5.1
Cardiff	145,216	+4
Newport	112,114	-0.3

Note: Data from HM Land Registry House Price Index (January 2014).

If price is a factor, Wales already has advantages when it comes to office space and residential property. Cardiff has a modest advantage already when it comes to retail space and higher rents are charged there as a result. Price is, of course, only one of the factors that shape the property market, but it is hard to see how tax changes might be used to extend existing price advantages for south-eastern Wales.

Given its visibility and economic impact, SDLT is a possible tax to change. As a very visible tax paid by purchasers of homes as well as those undertaking commercial property transactions, there might be political attractions in reducing rates for certain sorts of transactions – most probably, lower-value residential transactions. Wales might well wish to adopt a progressive approach to SDLT, as has been the case in Scotland, so that higher rates would be charged on larger transactions and lower rates on smaller ones. This might encourage some land transactions or affect the pricing of property as well as be more rational in terms of tax policy. However, the recent significant reforms from the chancellor, with the elimination of the old 'slab' structure and the shift to a more progressive structure for properties over £1m, have reduced Wales' political scope for manoeuvre, particularly given the low number of residential transactions in higher value property bands within Wales. A further alteration might be in the way net present values of rents on leasehold properties are calculated, a detailed change that could affect the amounts of tax due on certain transactions. However, it is hard to see how that would fundamentally change the balance of competitive advantage between the west of England and south-eastern Wales.

A more far-reaching approach would be to alter the way land taxes in general are charged, and to reconsider the incidence of land taxation. One change would be to charge sellers not buyers in transactions, which would make land transactions somewhat less expensive for buyers and put the burden of tax charges onto sellers, who are in funds at the time of a sale in any event. (This approach might create problems of enforcement, however – SDLT in its present form is a very easy tax to collect.)

A more radical approach would be to move away from transactional taxes altogether, in favour of yearly taxes – implying a land value tax (on the value of land), a housing services tax for property occupied for residential purposes, and the replacement of such taxes as the council tax. This approach has been advocated by the Institute for Fiscal Studies as part of the Mirrlees review of taxation (IFS 2011: ch 16). However, such an approach would be hard to accomplish at present, notwithstanding the legal devolution of taxes like council tax, business rates and SDLT. The nature of the devolved powers of the National Assembly for Wales is such that it is questionable whether it would have the legal powers to legislate for new taxes that were so different in their structure and incidence. In any event, doing so would raise major questions about the application of the block grant and the *Statement of Funding Policy*, which assumes a similar structure to tax revenues across the UK. The *Statement of Funding Policy* is normally reviewed at each spending review, and this issue may be addressed at the next such review.

3.2 The devolution of air passenger duty

While it has not been incorporated into the UK government's proposals for fiscal devolution so far, the devolution of air passenger duty remains on the cards. Devolution could take two forms: first, it could be devolved outright, for all flights; or, second, it could be devolved for long-haul flights only, as has happened for Northern Ireland. The key issue here, of course, is the impact on competition between Bristol and Cardiff airports.

The more likely option is partial devolution of APD, covering long-haul flights only. This would have less impact on Bristol than outright devolution but it would still present considerable challenges. While no long-haul flights currently operate from Bristol,[10] it nevertheless continues to serve the long-haul market through frequent connections to European hubs such as Amsterdam Schiphol, Brussels, Dublin and Frankfurt. Moreover, direct long-haul flights remain a target for Bristol airport. Currently the length of its runway inhibits its long-haul capacity, but advances in aircraft technology may increase the range achievable from Bristol. Securing the return of a transatlantic service and attracting a Middle East carrier are ambitions frequently quoted by Bristol airport, both of which could be impacted by devolution of long-haul APD to Wales.

Cardiff airport is already in a better position than Bristol in this regard, having a runway that can accommodate Boeing 747s and other large aircraft for maintenance and a number of seasonal long-haul charter flights to the Caribbean. The question of whether Cardiff can attract carriers for scheduled long-haul routes will depend on a number of factors, and no doubt a reduction in APD would make it more attractive.

Although less likely, devolution of APD on all flights remains an objective of the Welsh government (and what is proposed for Scotland). If this were to materialise there is little doubt that this could significantly affect competition between the two airports. Approximately one-fifth of the 6.2 million passengers per annum using Bristol airport have an origin or destination in Wales, further underlining the porous

10 A direct daily service to New York ran from 2005–2010, and charter airlines flew to destinations in the US and Mexico as recently as October 2013.

nature of the border between England and Wales. With just 94km between the two airports, there is a significant overlap in catchment areas which makes this highly competitive market particularly sensitive to price differences. Indeed, a report by HMRC (2012) concludes that Bristol airport would see a 25 per cent reduction in passengers by 2020 if APD was zero-rated in Wales, with a corresponding five-fold increase in passengers at Cardiff airport. In Bristol's favour is the fact that it serves six times more passengers than Cardiff, while it also has significantly better facilities for passengers in the terminal and for handling aircraft, a wider established range of carriers and better local transport links.

A further issue would arise with the status of Cardiff airport, now that it has been acquired by the Welsh government. Since Cardiff airport is the only substantial airport in Wales, any use of tax levers which advantaged it would have to satisfy EU rules regarding state aids and 'state monopolies of a commercial character' – issues of which the management of Bristol airport are clearly already well aware.

3.3 Income tax devolution

Income tax devolution is unlikely to happen in the short term, and certainly not without a major political shift. The lack of political support from key political actors in Wales, plus the need to win public support for the change in a referendum, provides very considerable obstacles to such a move. Even the Silk Commission's own timetable didn't envisage it starting until April 2018 and not coming fully into effect until April 2020.

Given the extent to which there is a shared labour market between the west of England and south-eastern Wales, devolution of income tax creates scope for a noticeable effect. Depending on the tax decisions made by the national assembly, there may be an attraction for some workers to live on the Welsh rather than English side of the border, even if they continue to work in England. But the amount of such an incentive is small – at most, around £318 per year for workers on the basic rate of income tax, if income tax rates were 1p less in Wales than in England. Moreover, as figure 1.11 showed, the number of workers commuting from Wales even to Bristol is about 10 per cent of the total workforce in the city (and less to the neighbouring local authority areas). Such a modest incentive is likely to have a limited impact, even in the medium term – and even if it did, would not affect the resources or labour market in the Bristol area (as workers might move homes but keep a higher-paying job around Bristol). In only a small number of cases would the amount of tax saved or other benefits (such as reduced commuting time) compensate for lower pay levels in Wales.

The impact would be greater if the lockstep were broken and a significantly lower rate were set for higher or additional-rate taxpayers (where the amounts of tax saved could be much more substantial), but that remains a remote prospect at present. In any event it could not occur before April 2018 at the very earliest.

4. THE WEST OF ENGLAND AND DECENTRALISATION

The analysis above has emphasised the limited extent to which tax competition from Wales is likely to affect the west of England, and the South West more generally. The drivers of prosperity in the west of England are unlikely to be affected by tax-related factors – although in some specific markets they will matter.

4.1 The impact of further devolution of economic development powers

One area that this report has not examined in more detail is the impact that greater regulatory and economic development powers would have if they were passed to Wales. There is nervousness among business actors that an uneven distribution of these powers may unbalance the current level playing field between existing markets.

For example, measures such as the Silk Commission's recommendation 12 – the devolution of port development – could have a significant impact on port competition, which, like APD, would occur in a highly competitive market where price sensitivity is high and location choices are much more mobile.

This area requires a much closer examination of the possible impact of devolution. Given the pace of current decisions, and the political momentum behind them, this issue merits impact assessments being built into further devolution agreements to assess whether damage to competition in sensitive markets is caused.

The issues which the west of England principally faces relate to two sets of wider challenges: those coming from the continuing and growing economic dominance of London and its wider area, and those coming from the continuing development of devolution in the UK.

On the former it might reasonably be argued that the real challenge for the west of England is presented not by developments in Wales but by the relative centralisation of power *within England.* In comparative terms, England remains one of the most centralised countries in the developed world; indeed while most other countries have devolved powers, the trend in England over the last 30 years has been the reverse. Developments in Scotland, Wales and Northern Ireland provide a countervailing force, as does London, which, having also seen the establishment of devolved government, is the one exception to the general pattern in England. As discussed below, the devolutionary momentum in the capital and in the other nations of the UK will continue apace, and we argue that this presents an opportunity for places like Bristol to demand more powers to be transferred to it from Westminster.

The renegotiation of the UK's devolutionary settlement, precipitated by the Scottish referendum, is an opportunity for English cities to make clear their demands for corresponding powers so that they too can be given greater control over their own economic future. Rule from the centre is failing to deliver this: the economic potential outside of the Greater South East is not being capitalised upon, while investment continues to be sucked towards London (IPPR North and NEFC 2012).

Indeed, IPPR North and NEFC's analysis of the infrastructure spending plans reveals the extent to which current processes of decision-making in Whitehall skews resources to the needs of the Greater South East. Given the role of infrastructure development in economic growth, this pattern of spending serves to perpetuate existing economic imbalances within England. Table 4.1 shows that spending per head in the South West is £19, compared to £792 in the South East and £2,731 in London.

Table 4.1
Planned capital spend in England, as announced alongside the 2011 autumn statement (public £ per head)

Region	Public spend (£ per head)
London	2,731
South East	792
East Midlands	311
West Midlands	269
Yorkshire and the Humber	201
North West	134
East	43
South West	19
North East	5
England average	**638**

Source: Cox and Schmuecker 2011

Furthermore, the English themselves are increasingly questioning whether Westminster and Whitehall can be trusted to promote their interests (Wyn Jones et al 2012). The overwhelming majority of the English electorate believe that the UK government 'looks after the some parts of England more than others'. Unsurprisingly, when asked which part of England is the beneficiary of this bias, the answer is London. Perhaps the most eloquent testimony to the ubiquity of this belief is that it is shared by a clear majority of Londoners themselves. In the Midlands and the north, this is an almost universally shared view, expressed by 87 per cent and 89 per cent of respondents respectively.

Part of the reason for the depth of feeling being so strong in regions outside the South East stems from a lack of voice and control (as well as the lessons of past experience). While London has its mayor and assembly and Scotland its parliament and first minister, England's other city-regions have underresourced – and in some cases weak – partnership arrangements that are expected to drive economic growth and development.

There is a mismatch between the political and economic geography in operation in England's regions outside the South East. The west of England, for example, has a distinct set of economic challenges and characteristics that separate it from the South East and yet policy is almost comprehensively controlled by Whitehall. Decision-makers in the west of England control little in the way of economic or political levers.

Given the economic diversity of England, decisions about economic development need to be made at a scale that coincides with the footprint of the real economy – as defined by travel to work or travel to learn patterns – which broadly coincides with the city-regions. It is at this scale that local authority joint working through combined authorities and local enterprise partnerships is beginning to emerge.

If the UK government wants to even begin to level the playing field, this is where a far more significant devolution of economic development decision-making powers needs to be achieved within England – including transport, skills and the tools needed to develop active industrial and growth strategies.

4.2 Maximising the west of England's opportunities

The west of England is already making some progress towards maximising its opportunities. The region's city deal addresses a number of key requirements for the economic strength of the west of England: cross-authority working, improvement of physical infrastructure relating both to development sites and transport networks, skills training and development of human capital, and the ability to retain some of the extra public revenue generated by this growth to fuel further development.

The west of England is also taking gradual steps towards better cross-boundary cooperation. It now operates a Joint Transport Board under the control of the four local authority leaders and has taken the first steps towards producing a Joint Planning Strategy for the region. It is also conducting a west of England-wide strategic housing market assessment (SHMA), which should lead to a more coordinated approach to delivering future housing and land supply to meet the region's future housing needs.

Nonetheless, the west of England lags considerably behind other regions in its governance arrangements and record of cooperation, and this is negatively impacting on key areas of importance for its economic future, notably for transport, housing and infrastructure.

All other English core cities, bar Nottingham, have long-established integrated transport authorities (ITAs). This has meant that the west of England has fallen behind other English core cities in the quality and comprehensiveness of its transport planning and delivery. It has reduced its access to transport funding, visibility within the Department of Transport and made it harder to formulate, agree, fund and deliver major transport infrastructure projects. Lead times for its planned infrastructure improvements have been considerably longer than other cities, despite Bristol regularly being cited as one of the most congested cities in the UK.

Lack of cross-boundary cooperation has also hampered the ability of the west of England to deliver one of its major economic competitive threats: housing costs.

Although the west of England's relative lower housing costs means it is able to present itself as an attractive alternative business location to the overheating London market, its housing costs are putting pressure on some critical parts of the labour market and its wider social composition.

Only 34 per cent of Bristol's younger households (age 35 or younger) can afford to buy or privately rent their home. It is estimated also that nearly 60 per cent of newly formed households in Bristol between 2010 and 2021 will be unable to afford market housing provision and will require some form of affordable housing (Bramley 2009).

The west of England is also increasingly uncompetitive in relation to all other English core cities.

Yet, cross-boundary cooperation and delivery – vital for a city like Bristol with very tight administrative boundaries – has long been problematic. Delivery of the future land and housing necessary to cope with future and current growth has been poor, while housing costs have been inexorably rising. For example, in the wake of the abolition of regional spatial strategies, all four west of England authorities were in the top ten authorities nationally in terms of the scale of proposed cuts in housing numbers (Boddy and Hickman 2013).

This is further exacerbated by the lack of powers currently available to local authorities to tackle the housing shortage – for example the current borrowing caps on Bristol's housing market account (HMA), or a lack of local control over central government's affordable housing programme (AHP), or local housing benefit spending.

This comparative failure to deliver robust cross-boundary governance alongside coherent cross-boundary delivery is now of even greater significance.

Whitehall is currently offering all English core cities the opportunity to negotiate devolution agreements similar to that agreed with Greater Manchester in November 2014. One of central government's primary concerns is that cities can demonstrate both a strong record of delivery and cooperative working, and that new devolution deals agree to far more robust and accountable cross-boundary governance arrangements – witnessed in the introduction of a 'metro mayor' as a critical part of the Greater Manchester deal.

In the eyes of Whitehall, the progress of devolving powers within England now rests upon the ability of English areas to demonstrate they have the institutions and capacity in place to cope with additional power. The pace of devolution is likely to be set by 'the pace of the fastest ship'. As Jim O'Neill puts it in the recent RSA report on city growth and decentralisation:

> *'It is only sensible to devolve … to those urban areas that can demonstrate they can succeed with greater autonomy … Indeed, it is probably the case that only the best organised and most focused should be given those responsibilities.'*
> City Growth Commission 2014b

Formal indications, and informal discussions with central government officials, suggest the west of England is furthest behind in this process and least able to present a common devolutionary negotiating agenda or manage local political tensions to achieve an agreed city-region settlement.

The most pressing danger is that Bristol and the west of England fail to define a clear enough economic agenda or a robust enough governance model in the heightened domestic and international competition it faces. This will lead to either no devolution deal being struck, or the wrong sort of deal – driven by the priorities of Whitehall and not the needs of the west of England.

In the longer term, this could mean the west of England not only faces being left behind in comparative economic performance by London, but also losing its current comparative economic and spatial advantage among English cities.

4.3 Fiscal devolution across the UK

Fiscal devolution as proposed by the Silk Commission is only part of the story about fiscal devolution. The political intensity of debates around the Scottish independence has created additional significant momentum here.

A No vote has presented different, but scarcely less far-reaching, issues than independence. The Smith Commission commits all the major UK parties to devolving significant new powers to Scotland that go far beyond what was set out in the Scotland Act 2012. Scotland is to see income tax devolved in full and a proportion of VAT assigned to Holyrood, while the Smith Commission also recommended devolving APD. On welfare, the Scottish parliament will be given control over a number of smaller benefits (including disability benefits) as well as being given the power to 'top-up' UK-wide benefits.

Scotland and Wales are not the only parts of the UK where greater fiscal devolution is under discussion. As already mentioned, Northern Ireland has (successfully) sought partial devolution of air passenger duty and (so far unsuccessfully) devolution of corporation tax. A wider debate about fiscal devolution is starting, with publication of a report from PwC (2013) commissioned by the Northern Ireland Council for Voluntary Action. The Commons Political and Constitutional Reform Committee (2013) has called for the assignment (hypothecation) of 10 points of personal income tax to fund local government generally House of Commons Political and Constitutional Reform Committee. The London Finance Commission (LFC 2013), established by the mayor of London, has called for land taxes, including stamp duty land tax on transactions in property and non-domestic rates, to be devolved to the Greater London Authority (GLA) and the London boroughs. (Among the problems the LFC's recommendations present is that they propose devolution to 'London government' without specifying how this would work given the relationship between the boroughs and the GLA, or the wider effects of devolving SDLT to local government in London when London accounts for a very large proportion of overall SDLT revenues, as a consequence of high property values there.)

Nonetheless, the overall trend is clear: a move towards a UK in which varying levels of subnational governments have taxing powers of their own, and rely more on directly controlled taxes, and less on grants allocated from central government. Such an environment will present both challenges and opportunities to an area like the west of England, but such challenges and opportunities are ones of which the west of England is well positioned to take advantage.

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