Dadansoddi Cyllid Cymru

Wales Fiscal Analysis

The Welsh Budget: implications from UK Budget 2020 and the fiscal response to COVID-19

Briefing Paper

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Introduction

On Wednesday 11 March, the UK Chancellor Rishi Sunak set the first budget of Boris Johnson's government. The first half of the budget covered the UK's initial fiscal response to the coronavirus outbreak. The measures were quickly superseded by a much larger response, and at the time of writing, the crisis will likely require further fiscal actions over coming weeks and months.

The second half of the UK's budget confirmed large increases to spending on public services next year, as well a huge boost to capital spending as part of a plan to 'level up' underperforming UK regions. For the first time, the UK government also set out a total 'envelope' for departmental spending for the planned forthcoming Spending Review period, giving an indication of the increases in funding the Welsh Government will receive beyond 2020-21. The economic impact of coronavirus and the fiscal response will however significantly change the budget plans and the forecasts that underpinned them.

This short briefing analyses the implications of the UK Budget 2020 measures and subsequent announcements on the Welsh Government budget. The following analysis is merely a snapshot in time and the picture is likely to change significantly over coming days and weeks. We will be publishing further analysis of the likely fiscal and economic impact on Wales over coming weeks and months.

Consequentials from budget and subsequent announcements

Figure 1 provides a breakdown of the funding for the Welsh Government announced by the UK government, by type of funding. As well as confirming spending increases outlined in the Spending Round 2019, the **Budget announcements** contained an additional £364 million for the Welsh Government budget for 2020-21. This was comprised of an additional £122 million for the revenue budget, £239 million for the capital budget and a small amount of financial transactions funding.

On **16 March**, the UK government confirmed an additional £475 million of funding for the Welsh Government as part of the budget's coronavirus response. This was triggered by business support grants and rates relief in England, a hardship fund for English local authorities (to provide council tax relief) and a response fund for public services.

As non-domestic rates are fully devolved to Wales, a fall in business rates revenues in England leads to extra Barnett *consequentials* for the Welsh Government, who can then decide how to use the increased funding. On **17 March**, the Chancellor announced further business support measures (amplified in further guidance on 19 March) which triggered a further £1.16 billion for the Welsh Government.

Figure 1

Summary of *consequentials* for Welsh Government budget from UK Budget 2020 and subsequent announcements

	Revenue	Capital	Financial Transactions	Total
Budget 2020 consequentials:	122	239	3	364
Budget 2020 measures:				0
LA hardship fund	30			30
Business rates reliefs	65			65
Business support grants	130			130
Response fund:	250			250
Business package 17/03/2020:	1,160			1,160
Total	**1,757**	**239**	**3**	**1,999**

Day-to-day spending on public services

Figure 2 shows the path of the Welsh Government's budget for day-to-day spending on public services (resource Departmental Expenditure Limit, or RDEL). The Welsh Government Final Budget for 2020-21 already contained the largest increase in day-to-day spending for over a decade. Including the *consequentials* from Budget 2020, spending will increase by 2.4% in real terms in 2020-21 from the previous year (red line in **Figure 2**).

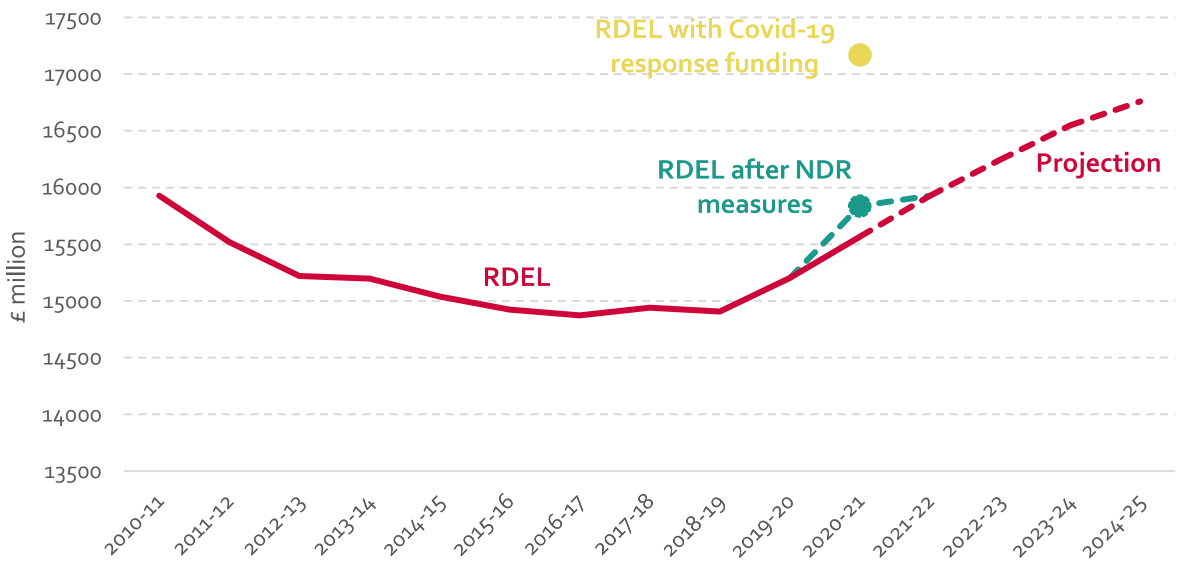
The yellow dot in **Figure 2** shows the extent of extra funding the Welsh Government has received as a result of the coronavirus response. Most of the *consequentials* received from these announcements will feed into lowering non-domestic rates revenues, as the Welsh Government introduce similar measures to the UK government policy in England (discussed below). Excluding the revenue funding which has been pledged to non-domestic rates relief, we estimate there will currently be approximately £397 million of additional revenue funding available to allocate at future supplementary budgets, on top of Final Budget plans. Including this funding, day-to-day spending in 2020-21 will increase by 4.2% in real terms from 2019-20.

The Chancellor also set a total spending 'envelope' for departmental spending, which is the pot of money he intends to allocate to various departments later in the year. The Spending Review, which is set to take place in July, will set day-to-day spending limits for the years 2021-22 to 2023-24. Assuming NHS and schools funding in England follow previously-set plans, we project the Welsh Government budget would grow by an average of 2.1% in real terms from 2021-22 to 2023-24 (the dotted line in **Figure 2** not accounting for the higher Covid-19-related spending for 2020-21). In nominal terms, this would mean around £560 million additional funding for 2021-22, and slightly smaller amounts in subsequent years.

By 2024-25, we project that the Welsh Government's day-to-day spending will be around 5% higher than 2010-11 levels in real terms. On a per-person basis, spending will reach 2010-11 levels by 2023-24. It should be noted that this projected increase in funding is highly uncertain, given the unknowable effects of coronavirus on the UK's public finances and the demands that will be placed on public services over coming months and years. **Figure 3** compares the annual planned changes in day-to-day spending with changes since the start of devolution. The planned increases follow a sustained period of cuts to the Welsh budget from 2010-11 onwards, but are still well below the average increases seen during the first decade of devolution.

Figure 2

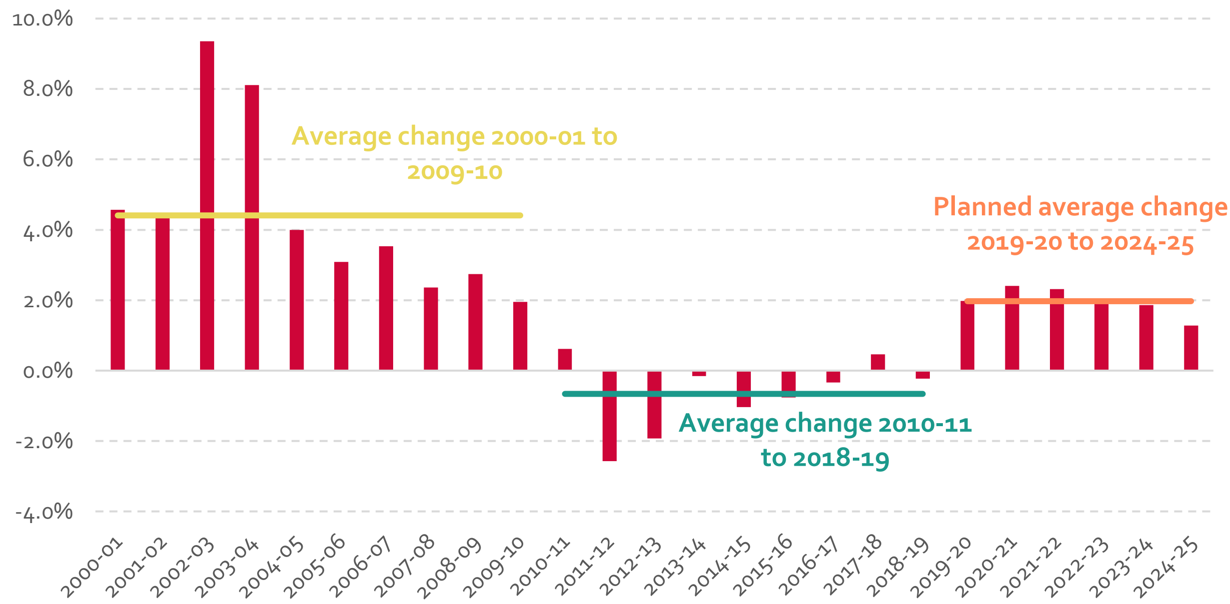
Welsh Government day-to-day funding, 2010-11 to 2024-25 (real terms)



Source: HM Treasury (2019 and previous) Public Expenditure Statistical Analysis and authors' calculations. Note: RDEL is resource departmental expenditure limit. Changes expressed before block grant adjustments for tax devolution after 2018-19 but reflect the devolution of non-domestic rates revenue from 2015-16 onwards. Excludes the effect of increased public sector pension contributions from 2019-20 onwards.

Figure 3

Year-on-year changes in Welsh Government day-to-day funding, 2000-01 to 2024-25 (real terms)



Source: HM Treasury (2019 and previous) Public Expenditure Statistical Analysis and authors' calculations. Note: RDEL is resource departmental expenditure limit. Changes reflect the devolution of non-domestic rates revenue from 2015-16 onwards. Excludes the effect of increased public sector pension contributions from 2019-20 onwards and the Covid-19-related increases in 2020-21.

The planned increases in day-to-day spending would allow the Welsh Government to continue growing spending on the NHS in line with recent trends (the planned increase for 2020-21 was 2.7% a year before accounting for further coronavirus-related spending). This would also allow for some real-terms increases for all other spending areas. However, non-NHS spending will remain well below pre-austerity levels even by 2024-25. The effects of coronavirus on health care demands are impossible to predict but may well impact the amount of money available for non-NSH spending.

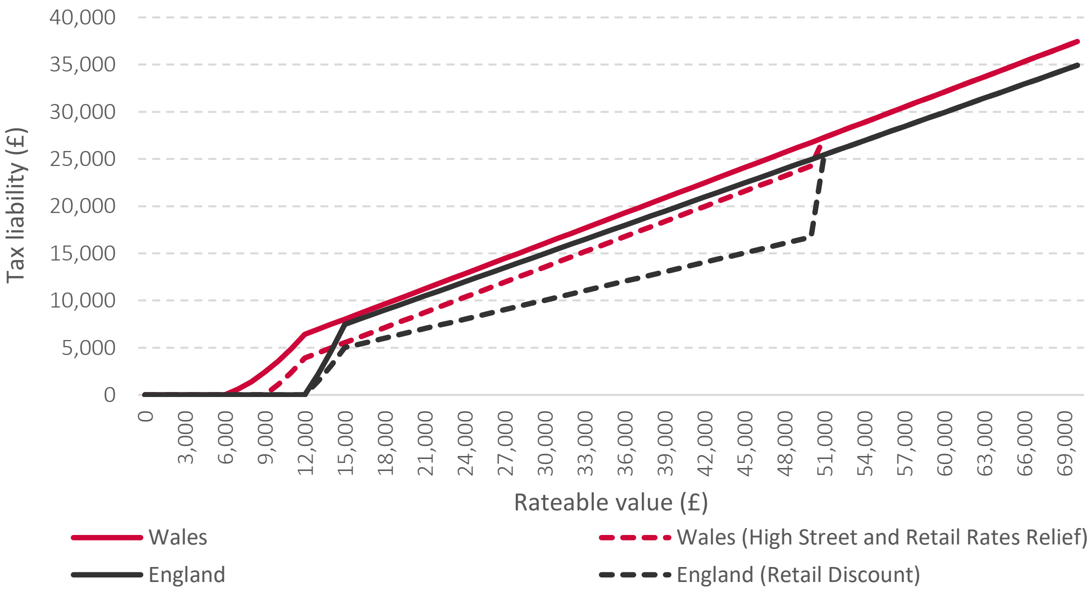
Non-domestic (business) rates

As outlined earlier, in response to the Covid-19 pandemic, the UK Chancellor announced a one-off package of tax relief and grants to support small businesses in England during his Budget announcement. Since business rates are fully devolved to Wales, these reliefs do not apply to businesses in Wales. However, the Welsh Government confirmed that Barnett consequentials received as a result of this announcement and any future measures to support businesses in England will be directed in full to support Welsh businesses.[1]

Before the additional measures announced in the 2020-21 Budget, the business rates liability relative to rateable value for most English businesses was already lower than Wales: the multiplier used to calculate tax liability is lower (0.499 compared to 0.535 in Wales); the upper threshold to qualify for small business rates relief is higher (£15,000 compared to £12,000); and England has a more generous relief scheme for retail properties. The pre-budget liability by rateable value is shown in **Figure 4**.

Figure 4

Pre-budget business rates tax liability, Wales and England (2020-21)



Source: Authors' calculations. The chart accounts for the permanent Small Business Rates Relief, the High Street and Retail Rates Relief in Wales and the Retail Discount in England, but does not reflect other permanent, transitional or discretionary reliefs.

[1] https://gov.wales/emergency-support-businesses-hit-coronavirus

The Welsh Government's decision to offer 100% reliefs to non-domestic properties in the hospitality, leisure and retail industries with a rateable value of less than £51,000 ensures greater parity with post-budget policy in England. Since the Budget, the UK Chancellor announced additional changes to the non-domestic rates regime in England. This includes extending the 100% relief to all businesses in the hospitality, leisure and retail industry, regardless of rateable value. He also announced that businesses eligible for small business rates relief will now be eligible for between £10,000 and £25,000 in grant support.

On 19 March, the Welsh Government announced a £1.4 billion business support package for businesses. This support – extending earlier measures – also provided retail, leisure and hospitality businesses in Wales with a year long business rates holiday, along with a grant of £25,000 offered to businesses in the same sector with a rateable value of between £12,001 and £51,000. Businesses eligible for Small Business Rates Relief with a rateable value of £12,000 or less will be provided with a £10,000 grant.

The *consequentials* passed on to the Welsh budget from business rates measures in England are based on the Barnett Formula, calculated using Wales' population share. This means that amounts received will not necessarily reflect the cost of delivering the same policy in Wales.

The composition of the stock of rateable properties in Wales differs from England – this will impact the cost of delivering targeted relief to businesses in certain sectors. Wales has a higher share of retail, leisure and hospitality properties (43%) compared to England (38%), which could push up the cost of providing targeted relief to these sectors. But this is likely to be offset by their lower average rateable values (**Figure 5**). On the other hand, the lower average rateable value of business properties in Wales may mean that a relatively larger share of businesses would qualify for Rishi Sunak's grant support scheme under a similar package of support introduced in Wales – pushing up the cost of the policy.

Figure 5

Rateable properties and values in retail, leisure and hospitality sector, 2018

	Wales			England		
	Rateable properties	Rateable value £'000s	Average rateable value £'000s	Rateable properties	Rateable value £'000s	Average rateable value £'000s
Retail	29,440	692,062	24	487,380	16,311,729	33
Leisure	12,900	256,170	20	180,720	5,577,557	31
Hospitality	7,940	83,795	11	63,100	2,150,483	34
Sub-total	50,280	1,032,027	21	731,200	24,039,769	33
Total	**116,960**	**2,414,983**	**21**	**1,932,620**	**63,565,409**	**33**

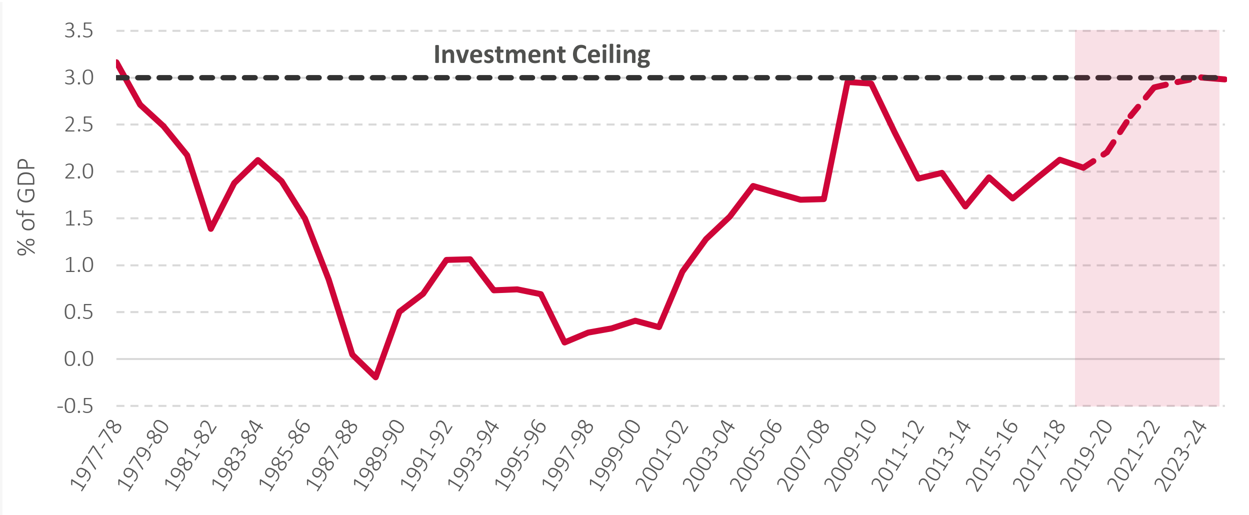
Source: Valuation Office Agency (2018) Non-domestic rating: stock of properties and authors' calculations.

Capital spending

The 2019 Conservative Party manifesto promised substantial increases in capital spending along with a net investment ceiling set at 3% of national income. The spending envelope laid out in the UK Chancellor's 2020-21 Budget suggests that public sector net investment will reach this ceiling by 2022-23 and will be sustained at this level over the course of the parliament (**Figure 6**). This would see net investment average 2.9% of GDP over the next five years – a sharp departure from historic trends. Boosting net investment by this amount will require large increases in departmental capital budgets.

Figure 6

UK public sector net investment as % of GDP, 1977-2024



Source: OBR (March 2020) Economic and Fiscal Outlook and authors' calculations.

It is perhaps not surprising therefore that the Chancellor announced a £17.4 billion uplift in capital DEL for 2020-21, bringing the total to £88.5 billion. This represents a 24.5% increase on the previous year in cash terms (22.2% increase in real terms) and a larger annual increase than any year since at least 2004-05, as illustrated in **Figure 7**.

When the UK government announces additional spending on capital projects in areas that are devolved to Wales, this triggers Barnett consequentials. In its written response to the UK budget, the Welsh Government confirmed that the additional £239 million announced at the budget did not account for the £100 million cut made to its capital budget at the end of this financial year, reducing the additional capital spending available to £140 million.[2] It is unclear why the capital allocations for Scotland and Northern Ireland are set to increase at a much faster rate compared to Wales. We can expect further clarification on the breakdown of capital consequentials for Wales when HM Treasury publishes its Block Grant Transparency report.

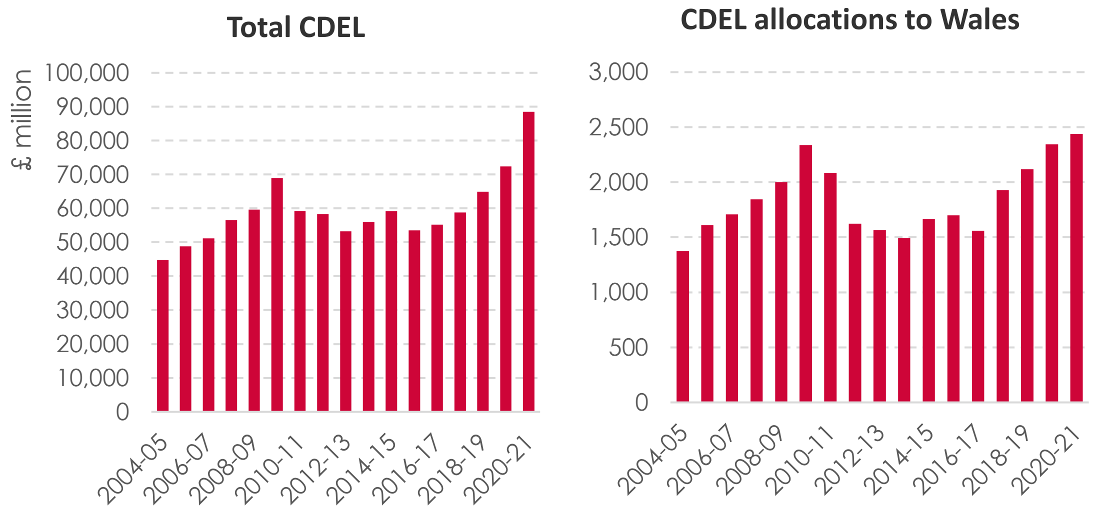
Unlike the Scottish Government, the Welsh Government did not factor potential consequentials resulting from UK Budget spending decisions in its draft or final budgets for 2020-21. This will leave the Welsh Government with scope to make further spending announcements during the next financial year.

[2] https://gov.wales/written-statement-welsh-government-response-uk-budget?_ga=2.174728295.410359720.1583846172-307989854.1569823945

The UK Chancellor announced an additional £27 billion to be spent on motorways and arterial roads, £2.6 billion on flood defences and £2.5 billion on resurfacing roads in England. Of course, the Welsh Government is free to use its consequentials from these spending announcements and set its budget according to its own priorities.

Figure 7

UK Government total CDEL and allocations to Wales (2020-21 prices)



Source: UK Government (2019 and previous) Public Expenditure Statistical Analyses; UK Government (2020) Budget Report and authors' calculations.

Perhaps the biggest challenge for the UK government – and possibly the Welsh Government – will be whether it can meet its plans for investment spending and spend this money effectively. A recently published report by the Institute for Government notes that UK government departments have persistently underspent on their capital budgets since at least the early 1990s. This is attributed to departments being overoptimistic about project timelines, departments lacking the staff required to manage capital projects, increasing pressure in the construction sector, and in more recent years, the reallocation of capital funds to meet day-to-day spending.[3] The capacity to deliver the planned increase in capital spending will be further eroded by the current coronavirus crisis, though may be a key part in the economic recovery.

As the UK government increases its capital spending, a key element of 'levelling up' from a Welsh perspective is the amount of spending which will come in currently reserved areas. While capital spending per person in Wales is consistent with the UK average in most devolved areas (which are subject to the Barnett formula), spending per person significantly trails the UK average in non-devolved areas, for example in non-devolved transport and science and technology spending.

Meeting the Prime Minister's 'levelling up' agenda will also require more than investment alone, particularly if this investment is poorly targeted and does not sufficiently benefit underperforming UK countries and regions. While the investment plans laid out by the Chancellor are ambitious, it remains to be seen whether they can be delivered and whether they are complemented by a new industrial strategy

[3] https://www.instituteforgovernment.org.uk/publications/capital-investment-governments-spending-plans

that has boosting relative productivity and economic growth in areas outside of London and the South East of England as one of its aims.

An uncertain future

The UK 2020 Budget was delivered in the context of widespread economic uncertainty. Even before considering the challenges of the global pandemic, there were uncertainties surrounding the UK's departure from the EU. The health of the UK economy and public finances were dependent on an orderly and non-disruptive free-trade deal at the end of the transition period. These negotiations have now been put on hold.

The coronavirus pandemic is already putting abnormal pressures on public finances in the UK and across the globe. It was therefore no surprise that the UK Chancellor devoted the first half of this Budget statement to outlining the government's fiscal response to the pandemic. Taken together, the measures represented £12 billion in additional spending. Less than a week later, the Chancellor announced a further £350 billion package of support, comprising mostly of government-backed loans for affected businesses.

The Office for Budget Responsibility's Economic and Fiscal Outlook which underpinned the Budget closed its global forecasts for new data in February 2020, when the Covid-19 outbreak was largely concentrated in China. This means that the forecast does not fully consider the potential impact of the virus on the UK's public finances, nor does it consider the impact of the additional measures announced by the Chancellor in response to the outbreak. Economic growth expectations – which were already weak – will inevitably be revised downwards when the next set of forecasts are released. The fiscal deficit is likely to substantially increase, as is appropriate in a crisis.

Given how little is known about the potential spread of the virus, the impact it might have and policy responses, it is impossible to forecast the economic and fiscal impact with any accuracy. On 19 March, the Bank of England further cut its benchmark interest rate to 0.1% and expanded its quantitative easing programme to support the economy by £200 billion. Covid-19 will however demand a fiscal response on an enormous scale. Yields on UK gilts remain at relatively low levels, meaning that the UK government could borrow with relatively little cost.

Brexit stasis and a general election had already delayed publication of firm spending plans for coming years by the UK government. When a budget was finally delivered, it coincided with a global pandemic which will throw budget plans and the forecasts that underpinned them totally off-course. Wales' public finances and public services face a period of unprecedented uncertainty.

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