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Wales Fiscal
Analysis

Austerity is over – for now

Analysis of the Welsh Government Draft
Budget 2020-21

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17 DECEMBER 2019

As the dust settled from the UK general election result, the Welsh Government published its Draft Budget for 2020-21 on Monday 17 December. This was a significant budgetary event, setting out spending priorities in devolved areas including health, education and local government, as well as devolved tax policy, over the next financial year. For the first time in almost a decade, the Welsh Government was able to increase funding for most spending areas and avoid further cuts. This briefing discusses the factors that have shaped the size of the 2020-21 Draft Budget, analyses the broad funding decisions made for day-to-day spending, and lastly points to the uncertainty surrounding future Welsh budgets.

The 2020-21 budget in context

Following a loosening of the UK government's fiscal policy and fiscal rules over recent years, planned departmental spending on the NHS and schools in England has increased significantly. This means the path of the Welsh budget is significantly different from original plans laid out at the March 2017 Budget, which were the basis for the 2017 Conservative manifesto. The Welsh resource block grant is set to be around £496 million higher in 2019-20 and £837 million higher in 2020-21 than under those plans. In fact, planned spending more closely resembles the projected Welsh block grant under the 2017 Labour manifesto commitments.

The Welsh block grant for day-to-day spending will grow by £593 million in 2020-21 relative to 2019-20. This represents a real terms increase of 2.3% from 2019-20. As in its 2019-20 plans, the Welsh Government draws down £125 million in resource funding from the Wales Reserve in 2020-21, which held £306 million resource funding at the start of 2019-20. There were no changes to devolved tax policies, with the Welsh Rates of Income Tax maintained at 10p in the pound. The 2020-21 budget will be the first in which relative trends in the income tax base in Wales will influence the size of the budget.¹ Overall, the forecasts indicate a small but positive effect from tax devolution on the Welsh budget for 2020-21, with forecast revenues slightly higher than projected block grant adjustments. Forecasts for Non-Domestic Rates revenue are also higher, which has boosted redistributed revenues to local authorities. Given these funding sources, and after allocations made to budget expenditure lines, the Welsh budget has £103 million of unallocated fiscal resource funding, which could be allocated at the final or supplementary budgets.

The real terms increases of 1.0% for 2019-20 and 2.3% in 2020-21 represent a step-change in the path of the Welsh resource budget, which fell by an average of 0.7% a year in real terms between 2010-11 and

¹ The block grant adjustment for 2019-20 will be reconciled with actual revenues raised in Wales, leaving the Welsh Government neither better or worse off.

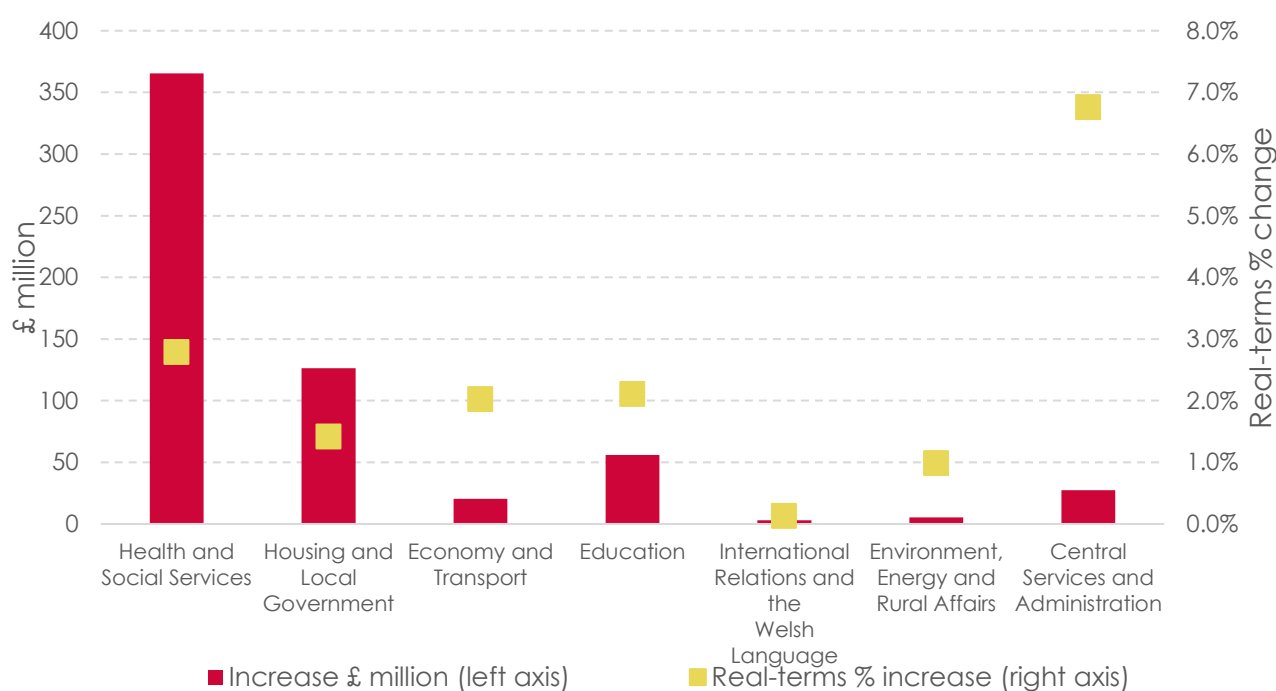
2017-18. However, Welsh Government day-to-day spending in 2020-21 will remain 3% below its 2010-11 level in real terms.² Accounting for population growth during this time, on a per capita measure, funding will be around 6% lower.

Meanwhile, the Welsh Government’s capital budget for 2020-21 will increase by 2.4% this year. The Welsh Government will also borrow £125 million to fund capital spending in 2020-21, while repayable financial transactions from the UK government accounts for more than a tenth of available capital financing. On top of existing plans for 2020-21, the Welsh Government allocated an additional £545 million for capital spending in this Draft Budget, including £145 million for decarbonisation and biodiversity projects.

Day-to-day spending on public services

Figure 1 shows the changes in planned (fiscal) allocations by main expenditure group. As at the 2019-20 budget, Health and Social Services is the main beneficiary of the Welsh Government’s additional funding. The fiscal resource allocation will increase by around 2.8% in real terms relative to the latest 2019-20 plans. Most of this additional allocation – around £341 million – will go towards NHS services.

Figure 1
Welsh Government fiscal resource allocations by Main Expenditure Group, changes from 2019-20



Source: Welsh Government (2019) First Supplementary Budget 2019-20; Welsh Government (2019) Draft Budget 2020-21; authors’ calculations

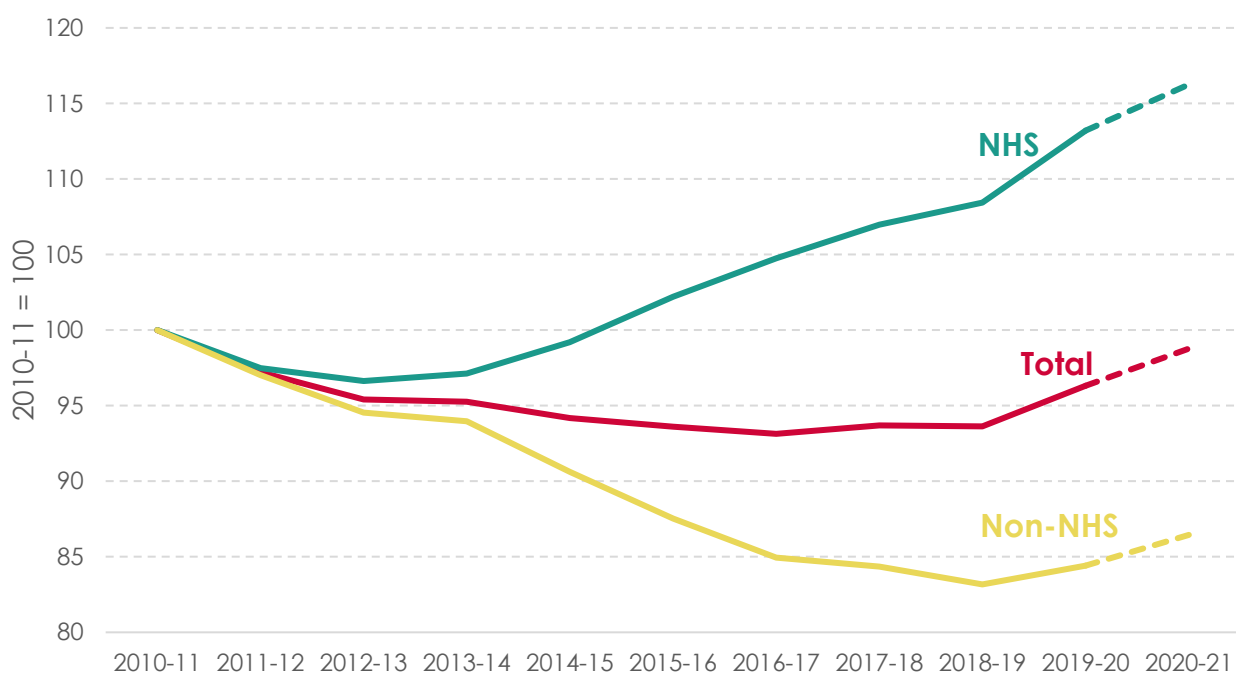
² This calculation accounts for the increased public sector employer pension costs in 2019-20 and 2020-21, the abolition and transfer of responsibility for the Council Tax Benefit, and the full devolution of Non-Domestic Rates.

This 2.6% real terms increase in NHS spending follows a 4.2% increase in 2019-20, though a significant portion of the previous year's increase went toward funding increasing pension costs. Once these increased pension costs are accounted for, this budget provides the largest increase in NHS funding of this Assembly term. The announced increase in Wales is slightly below the funding increase of 3.1% announced for the NHS in England for 2020-21. However, given that the Welsh population is growing significantly slower than England's, the per person increase is similar (2.4% to 2.6%).

As shown in **Figure 2**, despite decreasing during the first years of austerity, NHS spending is now 16% higher in real terms than its 2010-11 level, and after accounting for population growth, spending is 13% higher on a per-person basis. Health spending now equates to around 10% of the Welsh economy, back in line with 2010-11 levels.

Figure 2

Change in Welsh Government budget for day-to-day spending, real terms (2010-11=100)



Source: Welsh Government (2019) Draft Budget 2020-21 and previous budget documents.

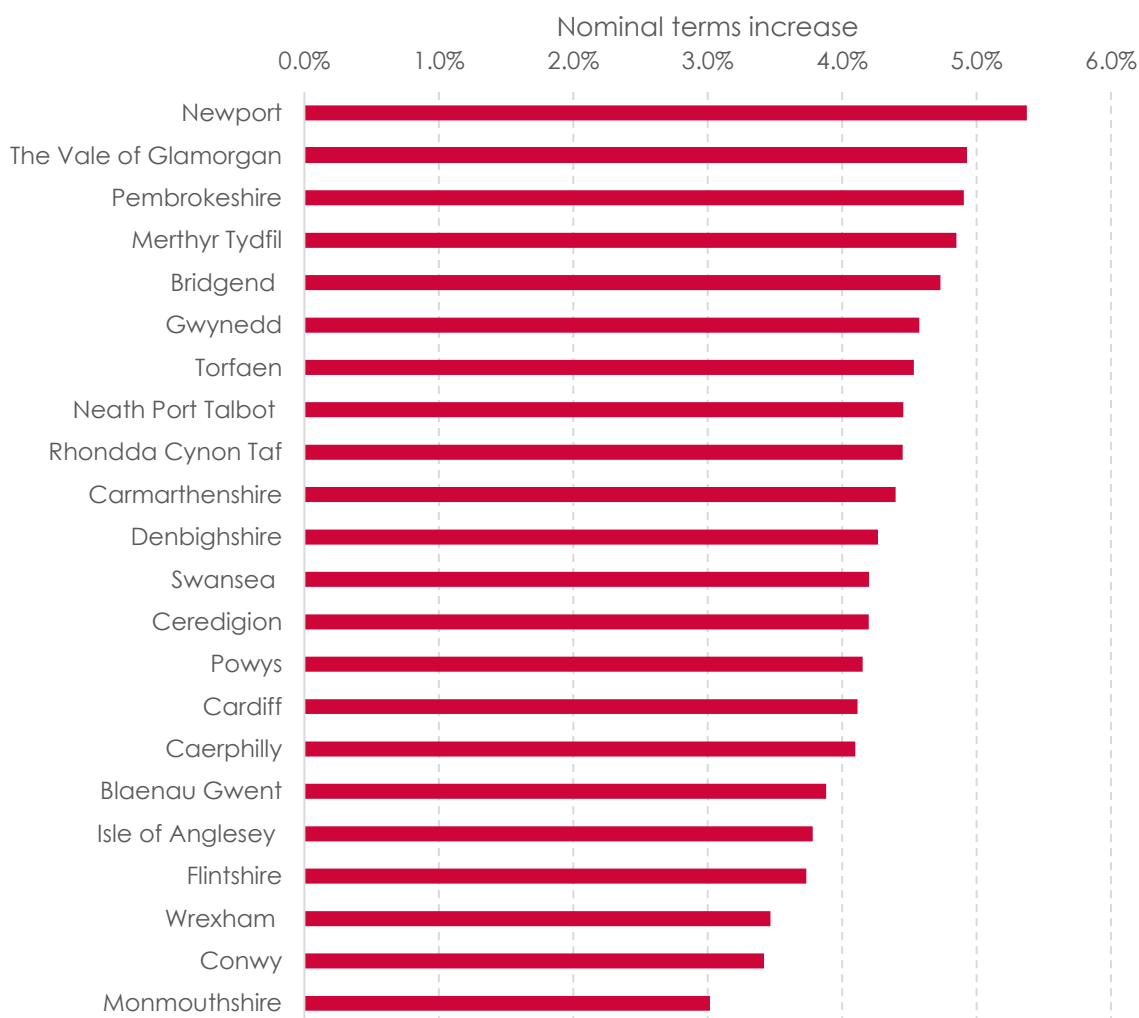
Note: Total refers to fiscal resource allocations to Welsh Government Main Expenditure Groups. We also include redistributed Non-Domestic Rates revenues, included in Annually Managed Expenditure (AME) in budget documents, but forms part of the Local Government settlement. Figures for 2019-20 and 2020-21 include the effect of increased public sector pension contributions. Included in the definition of NHS spending is funding for the delivery of core NHS services, targeted NHS services, education and training spending, mental health spending and the substance misuse action plan fund. Public Health Wales and A Healthier Wales spending is excluded. This roughly corresponds to what would have been called NHS Delivery and Health Central Budgets in previous budget documents. To get NHS spending on a fiscal resource basis (excluding non-fiscal spending e.g. depreciation), we assume that the split between fiscal and non-fiscal spending for the NHS matches the total for the HSS MEG.

As NHS spending increased in real terms after 2013-14, this generally meant steeper cuts to other areas of the Welsh budget. The NHS share of the fiscal resource budget grew from around 42% in 2013-14 to its current level of 49%. Non-NHS spending (yellow line in **Figure 2**) fell by around 17% in real terms from 2010-11 to 2018-19.

However, in contrast to much of the past decade, substantial increases in NHS spending this year has not resulted in cuts to other areas of the budget. As shown in **Figure 1**, all portfolio spending groups received real terms funding increases compared to 2019-20 plans, and for the first time since 2013-14, the NHS share of the budget did not significantly increase at this budget.

This year's Local Government Revenue Settlement represents by far the fastest growth in funding for Welsh local authorities in over a decade. The Revenue Support Grant and redistributed NDR revenues will increase by £184 million compared to 2019-20. Including specific grants, total support for local authorities will increase by 1.8% in real terms from 2019-20. For individual local authorities, core funding increases for 2020-21 range from 3.0% for Monmouthshire to 5.4% for Newport (1.2% to 3.5% in real terms). By contrast, for 2018-19 and 2019-20, floor funding was provided to limit individual authority funding decreases to 0.5% and 0.3% respectively.

Figure 2
Change in Aggregate External Finance (RSG & NDR) adjusted for transfers, nominal terms



Source: Welsh Government (2019) Local Government Revenue Settlement 2020-2021

This represents a significant turning point in the path of local authority funding in Wales. However, the Welsh Local Government Association had estimated that local authorities required a £254 million uplift in their budgets to maintain existing service provision during 2020-21, mainly resulting from increased workforce costs.³ One area of sharply increasing demand over recent years has been children and families' social services, and resources have had to be diverted from other local services to meet this demand.⁴ Total government support for local authorities (including the RSG, NDR and specific grants) will still be around 13% lower in real terms compared to 2010-11 (£839 million in 2019-20 prices).

This means that council tax rises may again be needed to meet additional cost and demand pressures. The "standard tax element" (a measure of council tax at 'standard spending' used to calculate funding for local authorities) assumes a 7.1% increase in Council Tax levels (5.2% in real terms). An average council tax rise of 4.3% would raise approximately an additional £70 million for public services across Wales next year. However, council tax increases will vary across the 22 authorities depending on local circumstances.

UK Government budget and outlook

The Draft Budget document repeatedly acknowledges the current uncertainty surrounding UK public finances. The 2019 Spending Round commitments - which were the basis for the Welsh Government's assumed block grant for this budget - were made before a full budget event and without updated economic and fiscal forecasts from the Office for Budget Responsibility. A full multi-year spending review was postponed until 2020. Although multi-year settlements have been set for the NHS and schools in England, the eventual implications of these for the Welsh budget is uncertain, since they could be funded by cuts to other areas also devolved to Wales.

We will gain a clearer picture of the prospects for the Welsh budget in February, when the UK government publishes its promised budget. There was very little change to existing spending plans in the Conservative manifesto. Manifesto spending commitments would mean approximately an additional £80 million in revenue spending in 2020-21. Larger capital spending commitments would mean an additional £182 million for 2020-21, with further capital spending a possibility within the new fiscal rules.

The limited scope of the day-to-day public spending commitments and tax cuts in the Conservative manifesto was testament to a likely worsening picture for the public finances next year. The Office for Budget Responsibility (OBR) has published a re-stated March 2019 forecast showing the large effect of accounting changes on forecast government borrowing. Already made spending commitments and slower growth forecasts will leave very little room for further spending increases. Over coming years, the 'triple-tax lock' manifesto pledge not to raise Income Tax, National Insurance Contributions or VAT, along with a stated preference for more tax cuts, will limit spending growth under this government, if the Chancellor Sajid Javid is to meet his new fiscal targets. The Welsh Government Chief Economists' report notes that a worse-case 'No-Deal Brexit' at the end of the transition period could mean a significant reduction in the resource budget of around £900 million to £1 billion in 2021-22, though this assumes the Chancellor would stick to his fiscal rules in such a scenario.

³ See <https://www.wlga.wales/SharedFiles/Download.aspx?pageid=62&mid=665&fileid=2476>

⁴ Ifan and Siôn (2019), Trends in local government finance: October 2019, available at: https://www.cardiff.ac.uk/_data/assets/pdf_file/0003/1709904/Local_Government_Briefing_Oct19.pdf

Therefore, this year's funding increase from the UK government may prove to be only a temporary respite for the Welsh Government. Meeting ever increasing demand for public services without increasing taxes is likely to be unsustainable at the UK level. In the absence of UK government action, whether to meet this challenge at a Welsh level using limited devolved tax powers may well be a key consideration at future Welsh budgets.

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