

Welsh Budget Update

Analysis of the budget position for 2020-21 and the Draft Budget for 2021-22

Preface

Declaration of funding

Wales Fiscal Analysis is hosted by the Wales Governance Centre and the School of Law and Politics at Cardiff University, and funded through a partnership between Cardiff University, the Welsh Government, the Welsh Local Government Association and Solace Wales. The programme continues the work of Wales Public Services 2025 hosted by Cardiff Business School, up to August 2018.

About us

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

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

Working with partners in Scotland, Northern Ireland, the UK and other European countries, we also contribute to the wider UK and international debate on the fiscal dimension of devolution and decentralisation of government.

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Executive Summary

The Welsh Government published its Draft Budget for 2021-22 in the face of significant uncertainties surrounding consequential, funding pressures, and budget rules. Coming weeks and months will see large allocations being made at a supplementary budget for 2020-21 and the Final Budget for 2021-22. This briefing begins by assessing the Welsh budget position for 2020-21, before analysing the allocations in the Draft Budget for 2021-22, the local government settlement, and the latest devolved tax forecasts and policies.

2020-21 budget position update

- Since the 2nd Supplementary Budget for 2020-21 in October, the Covid-19 funding guarantee from the UK government has been increased twice: by £600 million on 5 November; and by £200 million on 24 December. These announcements bring Covid-19 guaranteed funding from the UK government to £5.2 billion in 2020-21. This means there will be £1.95 billion of resource spending to allocate at the 3rd Supplementary Budget for 2020-21.
- We estimate approximately £1,191 million has been committed by the Welsh Government since the last supplementary budget, including recent announcements for business support. This would leave £655 million of Covid-19 funding left to commit, or £760 million including the pre-existing unallocated spending in Final Budget plans.
- We estimate around £1.9 billion of the Covid-19 funding guarantee comes because of estimated additional business support in England this year. Allocated Covid-19 business support in Wales is likely to be significantly above this amount.

Sources of finance in the Welsh Government Budget

- Next year, the available core budget for day-to-day spending will grow to £17.1 billion, from £16.2 billion in 2020-21 (5.7% growth in nominal terms). This growth comes from spending consequential announced at the Spending Review, and the recovery in non-domestic rates revenue (in the absence of Covid-19 reliefs).
- Excluding Covid-19 funding, real terms growth in the core resource budget has averaged 2.8% since 2018-19, in stark contrast to previous trends since 2010. This budget has now exceeded pre-austerity levels in real terms for the first time, though the day-to-day budget per person remains 3% below its 2010-11 level.
- Covid-19 funding from the UK government for 2021-21 amounts to £766 million. This funding may be increased significantly, depending on the composition of additional spending from the UK government's £21 billion Covid-19 reserve for 2020-21.

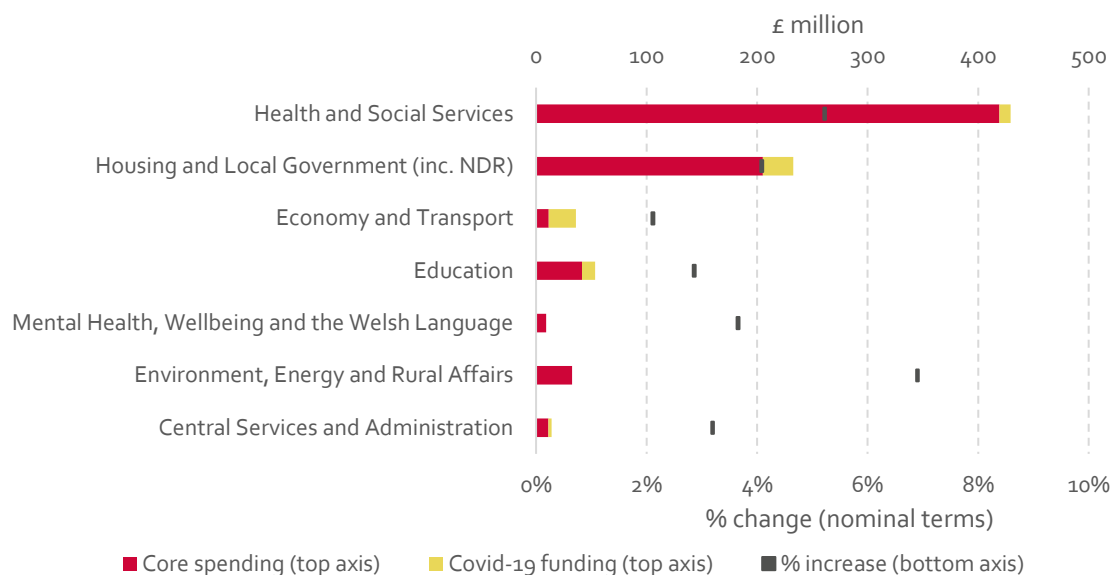
Covid-19 allocations

- In the Draft Budget for 2021-22, the Welsh Government allocated £77 million of the available Covid-19 funding. This leaves £689 million unallocated in spending plans. This was done to “retain as much flexibility as possible” and better understand the impact of the pandemic over winter months.

- Allocations to the NHS are likely to account for a large share of this unallocated funding in the Final Budget. Increased demand and cost pressures, alongside potential productivity losses, means addressing the effects of the pandemic on health services will require large and sustained investments over coming years.
- Local government budgets are also likely to require further support to account for income losses and spending pressures. The £12 million for in catch-up learning in schools allocated thus far in the Draft Budget for 2021-22 is also likely to fall short on what is needed, given the extended impact on education the scale of lost learning time.
- Further Covid-19 funding is likely to flow from UK decisions over coming weeks and at the UK budget on 3 March. The Welsh Government could anticipate some level of additional consequential in shaping its Final Budget plans, as done by the Scottish Government.

Figure E1

Fiscal resource DEL allocations in Draft Budget 2021-22 relative to Final Budget 2020-21 baseline, £ million and % change (nominal terms)



Source: Welsh Government (2020) Draft Budget 2021-22; and authors' calculations

Draft budget allocations

- Alongside Covid-19 allocations, the Welsh Government allocated £730 million of additional fiscal resource (day-to-day spending) in the Draft Budget for 2021-22, on top of Final Budget plans for 2020-21.¹
- More than half of these allocations (£419 million) were made to the Health and Social Services portfolio, which is set to grow by 5.2% in nominal terms. We calculate that core

¹ This figure includes the effect of the fall in Non-Domestic Rates revenue which forms a part of local government funding.

NHS spending (excluding Covid-19 spend) will increase by 4.2% in nominal terms next year, suggesting growth of 2.1% per year in real terms from 2019-20 to 2021-22. NHS spending is now 19% higher than 2010-11 levels and accounts for just under 50% of the Welsh day-to-day budget (up from 42% in 2013-14).

Local government and local taxes

- The settlement for Local Authorities includes a £176 million increase from 2020-21. This represents an average increase of 3.8% in nominal terms. Increases range from 2.0% in Ceredigion to 5.6% in Newport. Updated population data is likely to explain some of the outliers this year.
- Having adjusted for inflation, Aggregate External Finance (revenue support grant and non-domestic rate revenue) remains 8.7% below its 2013-14 level, and 11.4% lower on a per capita basis.
- Our previous research has shown that spending still fell by £570 million (7.7%) in real terms between 2009-10 and 2018-19. Outturn data for 2019-20 has not yet been made available but spending in 2020-21 is set to be substantially higher, reflecting the Covid-19 grant received by local authorities.
- As of mid-January, proposed Council Tax increases for 2021-22 range from 2.95% to 5.0%. When expressed as a percentage of income, the effect of Council Tax increases disproportionately impacts those households with lower income levels.

Devolved taxes

- The publication of the 2021-22 Draft Budget was accompanied by an increase to the Land Transaction Tax (LTT) rates paid by owners of multiple properties and a reduction in the rates applied to transactions involving non-residential properties.
- From December 22nd, 2020, the supplement payable by additional rate payers increased from 3 to 4 percentage point on the base (standard) rates of Land Transaction Tax. The Office for Budget Responsibility (OBR) forecasts that increasing the higher rates will generate £5 million in additional revenue during the current financial year (2020-21), and an average of £15 million each year thereafter. The extent of the behavioural response (if any) and the impact on house prices in Wales will likely become clearer once outturn data is released over the coming months.
- The pandemic is expected to have a lasting hit on revenues, with WRIT revenues being around £200 million lower at the forecast horizon. However, any reduction in devolved tax revenues only has a budgetary impact insofar as they deviate from the trend in the size of the Block Grant Adjustments (BGA).
- The BGA for Income Tax is set to exceed the amount of tax raised by around £35 million next year. This is partially offset by the other taxes meaning that the overall negative net effect is around £25 million in 2021-22.

Welsh Budget Update

04 FEBRUARY 2021

Introduction

On 21 December, the Welsh Government published its draft budget for 2021-22. It faced significant uncertainties surrounding the eventual size of the budget, the likely funding pressures for next year, and whether any additional budget flexibilities agreed by the Treasury would have an impact on budget plans. As such, the Welsh Government has kept significant Covid-19 funding unallocated, as it assesses the course of the pandemic over winter months. Large additional allocations will need to be made at the Final Budget for 2021-22 set for 2 March, as well as in later supplementary budgets. The UK government is expected to make further Covid-19 allocations this month and at the Budget on 3 March, which will likely result in additional consequential for Wales.

Meanwhile, the Welsh Government will publish its Third Supplementary Budget for 2020-21 this month, which will update spending plans for this financial year. This briefing begins by assessing the additional allocations which will need to be made at this supplementary budget and the extent of unallocated and uncommitted funding still in the budget. The briefing will then analyse the allocations made at the Draft Budget for 2021-22, the provisional local government settlement, and finally, the devolved tax forecasts and policies in the Welsh budget.

2020-21 budget position update

This section provides an update on the budget position of the Welsh Government for 2020-21, ahead of the publication of the 3rd Supplementary Budget for 2020-21 this month. The Welsh Government's 2nd Supplementary Budget for 2020-21, published in October 2020, provided the last update of the huge changes to Welsh Government funding since March, as well as detailing the large budget allocations being made. At the time, the Welsh Government had allocated £4 billion to its Covid-19 response in 2021-22, funded through Covid-19 funding from the UK government, reprioritised funding from within the budget, and other consequential. Unallocated Covid-19 consequential (£1,046 million) combined with pre-existing unallocated spending in Final Budget plans meant there was £1,151 million of unallocated fiscal resource spending.

Since this publication, the Covid-19 funding guarantee from the UK government has been increased twice: by £600 million on 5 November; and by £200 million on 24 December. These announcements brought Covid-19 guaranteed funding from the UK government to £5.2 billion

in 2020-21. This means there will be £1.95 billion of resource spending to allocate at the 3rd Supplementary Budget for 2020-21 next week.

The Welsh Government has also made significant policy announcements and spending commitments since October, which will be confirmed at the supplementary budget. In analysis published in early December, we estimated these funding commitments amounted to approximately £817 million, though there was some uncertainty around the cost implications of various announcements.² This included £320 million for the announced Covid-19 Reconstruction Fund, which was yet to be allocated.³ Additional announcements made since our publication include:

- £110 million further support for Welsh businesses (18 December);⁴
- £5.6 million additional funding for community pharmacies;⁵
- £40 million additional support for students;⁶
- £17.7 million for the Spectator Sports Survival Fund;⁷
- £200 million further support for Welsh businesses (29 January)⁸

This suggests approximately £1,191 million of the unallocated funding in the Supplementary Budget has been committed at this point. That would leave £655 million of Covid-19 funding left to commit, or £760 million including pre-existing unallocated spending in Final Budget plans.⁹ To put this unallocated funding in context, the Spending Review documents revealed that £600 million of the Welsh Government's Covid-19 funding guarantee had not yet been triggered by the Barnett formula, meaning the equivalent had not been allocated in England. The surplus funding also partly reflects the £500 million of reprioritised funding found within its own budget to fund its Covid-19 response.

As well as changes to funding and allocations, the circumstances surrounding the pandemic have changed significantly since the supplementary budget in October. The second wave of Covid-19 cases will have had an impact on the costs and pressures felt by public services. In August, £800 million was allocated to a stabilisation fund for Welsh NHS organisations, to prepare for winter challenges and a potential second wave of the virus, bringing total additional allocations to the Health and Social Services MEG to £1.3 billion (net of reprioritised spending). It remains to be seen whether costs incurred over the last months of the financial year will exceed the size of this fund. To the end of November, £939 million of the additional funding had been allocated to NHS organisations.¹⁰ In previous years, large additional allocations have

² See page 27 here:

https://www.cardiff.ac.uk/_data/assets/pdf_file/0010/2481634/welsh_budget_2020_report_formatted.pdf

³ <https://gov.wales/multi-million-pound-boost-to-support-post-covid-pledge>

⁴ <https://gov.wales/extra-110-million-support-welsh-businesses-affected-new-restrictions>

⁵ <https://gov.wales/written-statement-additional-funding-community-pharmacies-response-covid-19>

⁶ <https://gov.wales/40-million-extra-support-students-facing-financial-hardship>

⁷ <https://gov.wales/written-statement-spectator-sports-survival-fund>

⁸ <https://gov.wales/further-details-200-million-support-welsh-businesses>

⁹ In evidence to the Finance Committee, Finance Minister Rebecca Evans noted that Covid-19 reserve funding currently stood at around £800 million. <https://record.assembly.wales/Committee/11115>

¹⁰ This includes a combination of full year allocations and funding allocated on an actual basis as incurred for centrally funded costs.

been made to this portfolio at last supplementary budgets – averaging £98 million over the course of this Welsh parliamentary term (though these allocations have been trending downwards).

In the first six months of 2020-21, surveys of local authorities estimated financial costs of around £325 million due to the pandemic, comprised of £160 million in lost income and £165 million in additional expenditure.¹¹ Thus far, additional allocated support for local authority budgets stands at £495 million for 2020-21 (discussed in more detail below). Given the likely scale of public health restrictions over the last two quarters of 2020-21, revenue income losses for local authorities may be on a similar scale as during the first two quarters, which primarily came from losses in leisure and cultural services. If this is the case, it would leave very little room for local authorities to meet any additional expenditure demands from the additional budget allocations, which are likely to still be present in social services and education. Additional support for local authorities may need to be allocated at the 3rd Supplementary Budget to avoid funding shortfalls this year.

As well as the prospect for further Welsh Government allocations, the UK government's Supplementary Estimates may also affect available funding.¹² Late allocations made to UK government departments may have an impact on consequentials for Wales. A decision will also need to be made around how much funding the Welsh Government will be able to carry forward into future years through the Wales Reserve. The UK Supplementary Estimates will also provide transparency on allocations made in England and allow comparisons between the fiscal response of the governments of the UK.

The UK government's Spending Review documents published in November suggested that £3.3 billion of the funding guarantee was based on estimated additional public services spending in England, while £1.7 billion was based on estimated business support in England. Since then, the funding guarantee has increased by a further £200 million, which UK government press releases suggested was linked to increased business grants and reliefs in England. Around £1.6 billion has been allocated in grants and reliefs to businesses in supplementary budgets thus far. This means the (at least) £650 million committed to further business support since the 2nd Supplementary Budget would bring allocated business support in Wales significantly above the amount of consequentials triggered by business support in England included in the funding guarantee.

Sources of finance in the Welsh Government Budget 2021-22

On the 21 December 2020, the Welsh Government published its Draft Budget for 2021-22. **Figure 1** shows the sources of finance for the Welsh Government's budget for day-to-day spending in nominal terms, from 2018-19 to 2021-22. Next year, the available core budget for day-to-day spending will grow to £17.1 billion, from £16.2 billion in 2020-21 (5.7% growth in

¹¹ <https://www.audit.wales/sites/default/files/2020-11/Financial%20Sustainability%20of%20LG-english.pdf>

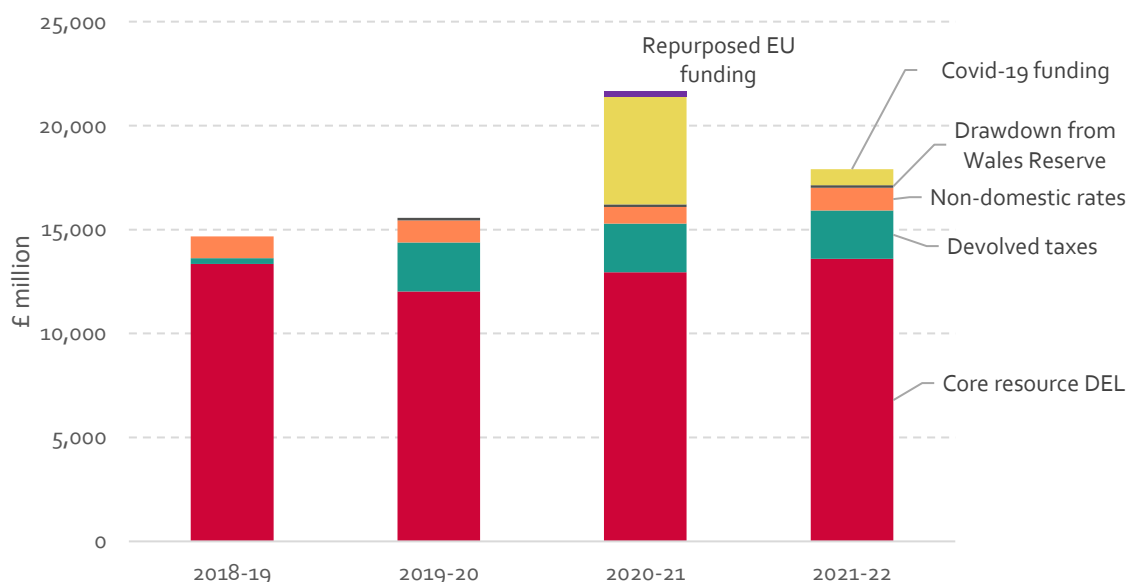
¹² <https://record.assembly.wales/Committee/11115>

nominal terms). This growth comes from the £694 million of resource spending consequential announced at the Spending Review, and the recovery in non-domestic rates revenue (in the absence of Covid-19 reliefs). The Welsh Government will once again plan to draw down £125 million from the Wales Reserve for day-to-day spending – this figure may change if additional budget flexibilities are granted by the Treasury.

Excluding Covid-19 funding, real-terms growth in the core resource budget has averaged 2.8% since 2018-19, in stark contrast to previous trends since 2010. This budget has now exceeded pre-austerity levels in real terms for the first time, though the day-to-day budget per person remains 3% below its 2010-11 level.¹³

Figure 1

Sources of finance for Welsh Government fiscal resource (day-to-day) spending, nominal terms



Source: Welsh Government (2020) Draft Budget 2021-22; Welsh Government (2020) 2nd Supplementary Budget 2020-21; Welsh Government (2020) 2nd Supplementary Budget 2019-20; Welsh Government (2019) 2nd Supplementary Budget 2018-19; and authors' calculations

At the Spending Review, the UK government allocated an additional £55 billion for Covid-19 related costs on public services next year. This suggests the UK government assumes almost 40% of this year's departmental Covid-19 spending will carry forward into 2020-21. £34 billion of this funding has been allocated to departments, with a further £21 billion in reserve. Already allocated funding has triggered £766 million for the Welsh Government in 2021-22. This funding may be increased, depending on the composition of additional spending from reserves.

¹³ These figures account for inclusion of funding for farm subsidies in 2021-22 but does not account for the increased public sector pension costs since 2019-20.

However, confirmed Covid-19 funding equates to only 13% of the funding available for the Welsh Government's Covid-19 response for this year.

Covid-19 allocations for 2021-22

In the Draft Budget for 2021-22, the Welsh Government decided to allocate £77 million of the available Covid-19 funding, including:

- £23 million for Free School Meal provision during school holidays next year;
- £19 million for the Bus Industry in Wales;
- £12 million for Catch-up learning in schools; and
- £10 million for the contact tracing workforce.

This leaves £689 million of the Covid-19 related funding unallocated in the draft budget. This was done to “retain as much flexibility as possible” and better understand the impact of the pandemic over winter months.

Allocations to the NHS and local government are likely to account for a large share of this unallocated funding in the Final Budget. The pandemic has caused a significant backlog of long waiting patients, which the Welsh Government plans on addressing over the next four years. The sharp drop in the number of referrals over the course of the pandemic also raises the prospect of a surge in referrals next year, alongside other likely demand pressures, such as on mental health services. At the Spending Review, the UK government allocated a £3 billion NHS recovery fund in England for next year, which would equate to approximately £170 million on a per person basis for Wales. However, this funding in England was described as inadequate by the Health Foundation.¹⁴ A big unknown is the extent to which social distancing and infection control will continue to reduce output levels for a given level of funding – a 5% reduction in productivity would entail costs of over £400 million for the Welsh NHS, which would amount to a large part of the unallocated Covid-19 funding. Addressing the effects of the pandemic on health services will require large and sustained investments over coming years.

Local Government budgets are also likely to require further support from the unallocated funding. Local authorities are likely to face income loss across some months of next year if public health restrictions continue. Additional spending pressures are also likely to persist, for example, in the continued need for PPE and additional staffing costs for social care. The Welsh Government may also wish to extend the support offered to individuals this year through the allocations to the Discretionary Assistance Fund and the Council Tax Reduction Scheme. Another area of pressing need will be education spending. The £12 million for “catch-up” learning in schools allocated thus far in the Draft Budget for 2021-22 is also likely to fall short of what is needed, given the impact on education and the scale of lost learning time.¹⁵

¹⁴ <https://www.health.org.uk/news-and-comment/news/spending-review-leaves-nhs-england-6bn-short-next-year>

¹⁵ See, for example: <https://www.ifs.org.uk/publications/15291>

The Welsh Government will also need to decide on the magnitude and composition of support offered to businesses. Allocated support for businesses through grants and reliefs in 2020-21 is likely to reach approximately £2.3 billion. Given the likelihood of restrictions on businesses and subdued economic activity persisting into next year, the Welsh Government will need to consider extending the reliefs offered to businesses this year as well as offering grant support if some sectors remain closed.

Although quantifying these various funding needs and pressures is difficult, it is unlikely the unallocated funding in the Draft Budget will be sufficient to meet all these needs. One of the largest uncertainties for the Welsh budget is how the UK government will meet its own funding challenges in England next year, and the likely additional consequentials for Wales. The UK government is set to announce their own plans for business support over coming weeks, which may result in consequential funding for Wales, and the UK Budget is likely to include allocations of the £21 billion Covid-19 reserve.

In laying out plans for the Scottish Budget on 28 January, the Scottish Government assumed the UK Budget would provide an additional £500 million of Covid-19 consequentials to the Scottish Budget, based on the UK government's unallocated Covid-19 funding. An equivalent assumption for Wales would mean an additional £300 million of funding. Given the Final Budget for 2020-21 is set to be published a day before the UK Budget (3 March), it may be prudent for the Welsh Government to make similar assumptions about anticipated additional consequential funding for Wales.

Draft budget allocations

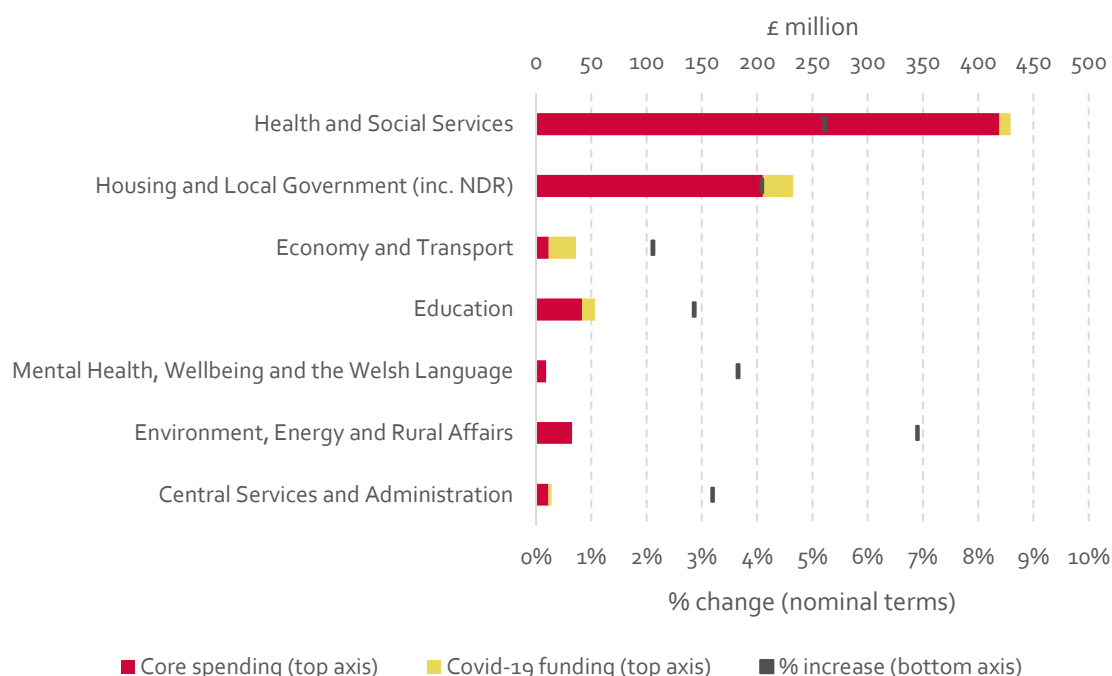
Relative to the Final Budget for 2020-21 – therefore excluding in-year Covid-19 funding allocations – the Welsh Government allocated an additional £842 million of fiscal resource spending in the Draft Budget for 2021-22. This figure falls to £807 million if you include non-domestic rates income (which forms a part of funding for local governments). £730 million of this funding increase was not related to the Covid-19 allocations discussed above. This means allocations to core day-to-day spending increased by 4.5% in 2021-22 (in nominal terms) over Final Budget plans for 2020-21. As was the case last year, all Main Expenditure Groups (MEGs) of the budget have seen increases in the Draft Budget.

As shown in **Figure 2**, more than half of these allocations (£419 million) were made to the Health and Social Services portfolio, which is set to grow by 5.2% in nominal terms. Increases to Core NHS services make up the largest share of this funding (discussed below), while other increases include £10 million for Public Health Wales, a £10 million increase in the Social Care Workforce Grant, and a £16.9 million increase in support for childcare and play.

The Housing and Local Government portfolio in the Draft Budget increases by 4.1% in nominal terms, after accounting for the fall in Non-Domestic Rate income. The settlement for Local Authorities includes a £176 million increase on the previous year. The Housing Support Grant also increases from £127 million in the Final Budget 2020-21 plans to £167 million in 2021-22.

Figure 2

Fiscal resource DEL allocations in Draft Budget 2021-22 relative to Final Budget 2020-21 baseline, £ million and % change (nominal terms)



Source: Welsh Government (2020) Draft Budget 2021-22; and authors' calculations

Alongside the unallocated Covid-19 funding for next year, the Welsh Government has an additional £122 million in core resource funding unallocated in current plans, broadly in line with previous draft budgets. This brings total unallocated day-to-day spending in the Draft Budget to £811 million.

NHS spending

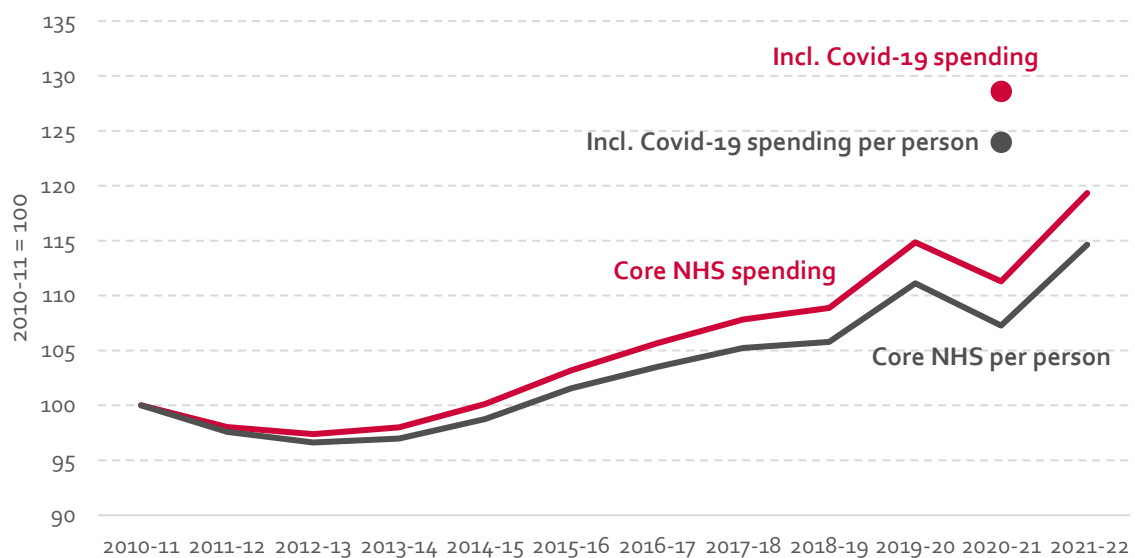
The Draft Budget states that funding for core NHS services will increase by more than £385 million in 2021-22, to more than £8.4 billion. However, some presentational and portfolio changes this year makes it harder to compare trends across multiple years. In line with our previous reports, we build a consistent definition of NHS spending by aggregating across budget lines. This definition includes spending on the delivery of core NHS services, targeted NHS services, education and training spending, mental health spending (now in a different portfolio) and the substance and misuse action plan fund (both now in a different portfolio). Public Health Wales and A Healthier Wales spending is excluded.

On this measure, NHS spending (excluding Covid-19 spend) is set to grow by 4.2% in nominal terms next year. This suggests growth of 2.1% per year in real terms from 2019-20 to 2021-22.

This broadly continues the trend in growth in NHS spending since 2013-14. As shown in **Figure 3**, NHS spending is now around 19% higher than 2010-11 levels. Given the overall Welsh Government budget for day-to-day spending has barely recovered to 2010-11 levels, this means the NHS now accounts for just under 50% of the Welsh day-to-day budget (up from 42% in 2013-14).¹⁶

Figure 3

Trends in spending on the NHS in Wales, 2010-11 to 2021-22 (real terms)



Source: Welsh Government (2020 and previous); and authors' calculations (see main text for NHS spending definition)

Figure 3 also shows the effect on the trend of including Covid-19 related spending this year. In-year funding allocations for the NHS this year has increased spending by approximately 16% compared to baseline core spending (net of reprioritised funding). As explained above, Covid-19 funding allocations for 2020-21 and 2021-22 may increase again over coming weeks and months.

Local government and local taxes

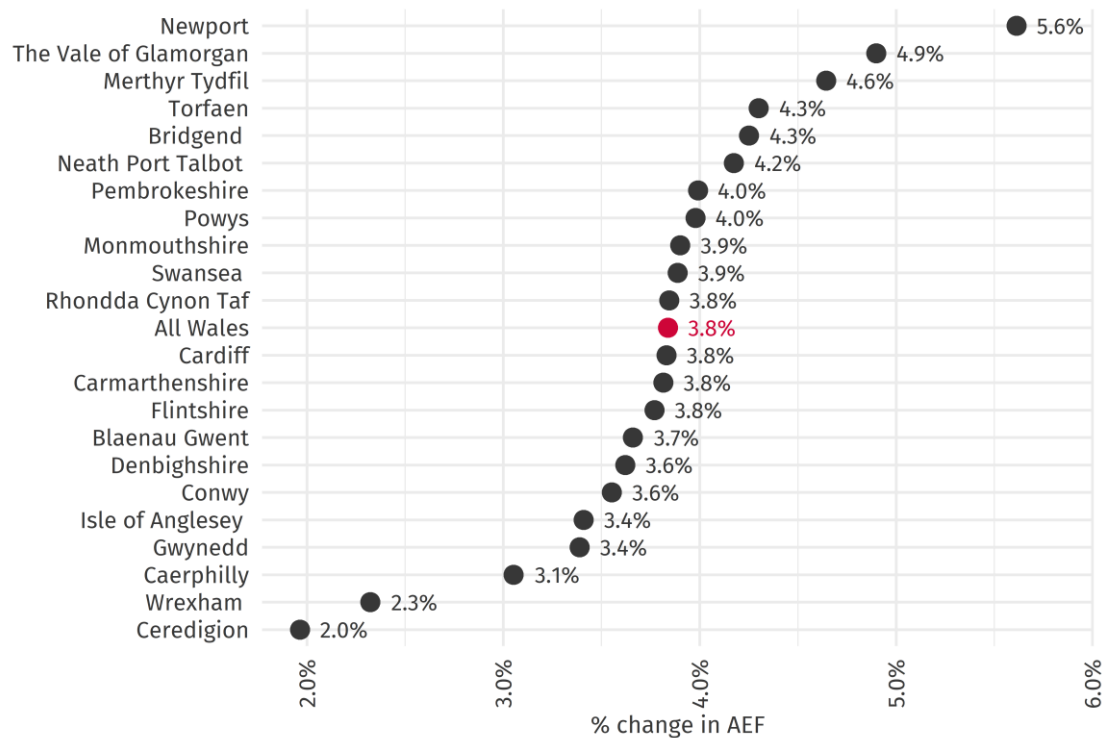
Shortly following the release of the draft budget, the Welsh Government published the provisional revenue and capital settlement for local authorities in 2021-22. The settlement document sets out the amount local authorities are expected to receive in Aggregate External Finance next year. Aggregate External Finance refers to the non-hypothecated grant funding

¹⁶ This figure excludes funding for farm subsidies in 2021-22 which were not previously included in total spending.

delivered through the “Revenue Support Grant” and the sum of Non-domestic Rates revenue to be re-distributed to local authorities from the central pool.

Figure 4

Percentage change in Aggregate External Finance* (adjusted for transfers), 2020–2021 to 2021–22



Source: Welsh Government (December 2020) Provisional local government revenue and capital settlement, 2021–22.

* Aggregate External Finance includes funding delivered through the non-hypothecated Revenue Support Grant and centrally redistributed non-domestic rates revenue. Hypothecated grant funding (including £510m delivered through the COVID-19 Local Government Single Emergency Hardship fund in 2020–21) is not included.

The provisional sum of Aggregate External Finance for 2021–22 has been set at £4.65 billion, of which around £1.05 billion comes from redistributed Non-domestic Rates revenue, and the remaining £3.60 billion delivered through the Revenue Support Grant. Having adjusted for transfers to provide a like-for-like comparison, this represents an average increase of 3.8% on the previous year.

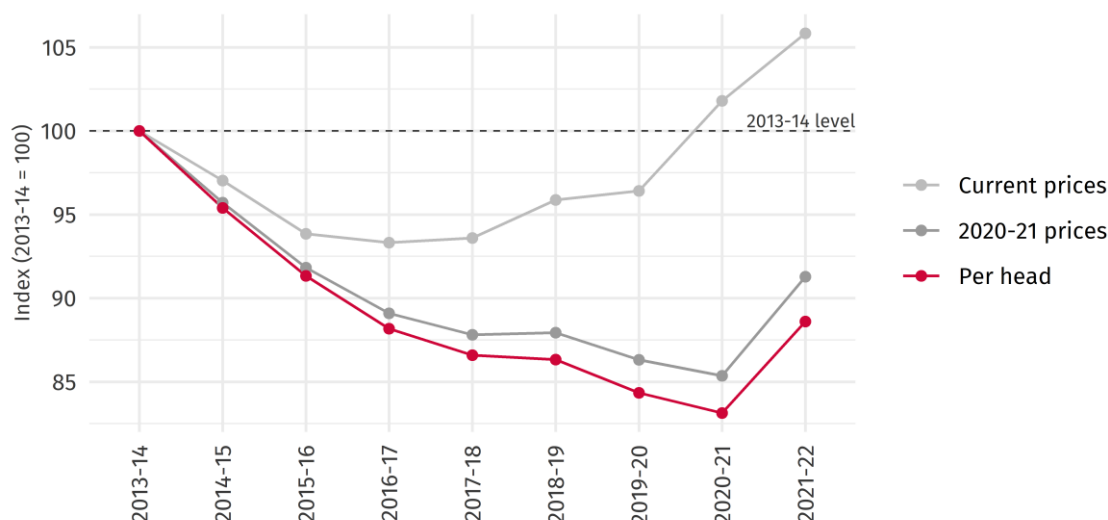
As illustrated in **Figure 4**, this increase ranges from 2.0% in Ceredigion to 5.6% in Newport. In the absence of a funding floor, any deviation from the average increase reflects differences in indicator values (and the weighting given to each indicator) for each local authority. Indicators reflect characteristics of the local area, such as population size, sparsity, the number of people on low income etc. The use of a new population dataset is likely to explain the presence of several outliers this year. A full account of the indicators and values used for each local authority

is set out in the annual Green Book – typically released after the final settlement has been published.

Having adjusted for inflation, Aggregate External Finance remains 8.7% below its 2013-14 level, and 11.4% lower on a per capita basis (Figure 5).¹⁷ This is lower still on an age-adjusted measure.

Figure 5

Aggregate External Finance* (unadjusted for transfers) 2013-14 to 2021-22



Source: WFA analysis of StatsWales (2020 and previous) Local Government – Financing of Gross Revenue Expenditure; Welsh Government (December 2020) Draft local government revenue and capital settlement, 2021-22.

* Aggregate External Finance includes funding delivered through the non-hypothecated Revenue Support Grant and centrally redistributed non-domestic rates revenue. Hypothecated grant funding (including £510m delivered through the Covid-19 Local Government Single Emergency Hardship fund in 2020-21 is not included.

Although the impact on local government spending power has been partly mitigated by increased revenue from Council Tax, our previous research has shown that spending still fell by £570 million (7.7%) in real terms between 2009-10 and 2018-19.¹⁸ Outturn data for the 2019-20 financial year has not yet been made available but spending in 2020-21 is set to be substantially higher, reflecting the – mostly one-off – COVID-19 grants received by local authorities.

Specific grants, including the £1.05 billion allocated in 2020-21 to aid local authorities with their response to COVID-19, are not included in Aggregate External Finance. Not all this amount represents an increase in local authorities' spending power, however. The one-off funding for 2020-21 has been partly offset by reductions in other streams of revenue, including income

¹⁷ The inflation-adjusted series are produced using a GDP deflator which measures the gap between changes in cash spending and changes in actual output. The series incorporate a large increase in the GDP deflator (6.8%) in 2020-21 due to a sharp contraction in output whilst government spending increased. By contrast the GDP deflator for 2021-22 is forecast to be negative (-2.8%) as output bounces back.

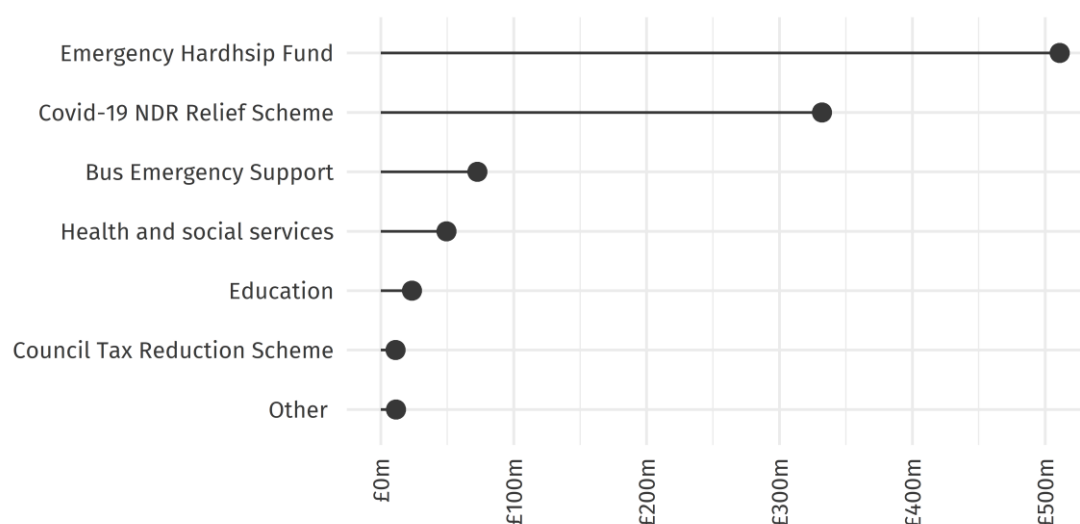
¹⁸ Guto Ifan and Cian Siôn, *Trends in local government finance: October 2019* (Cardiff: Wales Fiscal Analysis, 2019). https://www.cardiff.ac.uk/_data/assets/pdf_file/0003/1709904/Local_Government_Briefing_Oct19.pdf

from fees and charges (e.g. car parking charges) and decreased tax revenue (e.g. NDR relief for retail, leisure and hospitality industries). As outlined above, in the first two quarters of 2020–21 alone, estimates provided by the WLGA suggest that local authorities lost £160 million in income (excluding the effects of lower tax revenue).¹⁹ The Welsh Government provided £332 million to cover the cost of the retail, leisure, and hospitality Non-domestic Rates relief scheme.

As set out in **Figure 6**, the bulk of COVID-19 support for local authorities has been delivered through the Single Emergency Hardship Fund (£510.9 million). Under this scheme, local authorities have been able to submit claims for additional expenditure incurred and loss of income for its relevant service areas because of COVID-19.

Figure 6

Estimated value of Covid-19 resource grants for local authorities, 2020–21



Source: Welsh Government (December 2020). *Provisional local government revenue and capital settlement*.

Separate allocations were made to provide emergency support to bus operators (£72.7 million), support for the social care workforce (£40.5 million), an Accelerated Learning Programme for pupils that may not have progressed as much as they might (£16.6 million) and a contribution towards the cost of increased claims through the Council Tax Reduction Scheme (£11 million), among other initiatives.

So far, only £12.9 million has been allocated in COVID-19 grants for 2021–22. Of the funding already committed, £11.8 million has been allocated to the Accelerated Learning Programme and £1 million towards the COVID-19 element of the Domestic Abuse and Sexual Violence Grant. While some budget lines have been set at zero for next year (e.g. the Single Emergency Hardship Fund), others are described as yet “to be confirmed”. This includes spending on both

¹⁹ Audit Wales, *Financial Sustainability of Local Government as a result of the COVID-19 pandemic* (Cardiff: Audit Wales, 2020), 13. <https://www.audit.wales/publication/financial-sustainability-local-government-result-covid-19-pandemic>

the Retail, Leisure and Hospitality Rates Relief Scheme as well as Bus Emergency Support. Depending on the Welsh Government's end-of-year fiscal position and the possibility of more spending announcements on business support in England, it is very possible that this figure will be revised upwards at future fiscal events.

Local authorities will currently be setting budgets and Council Tax levels for 2021-22. As of mid-January, proposed Council Tax increases for 2021-22 range from 2.95% to 5.0%, though most councils were yet to publish their proposals.²⁰

As previously argued, the effects of Council Tax increases are particularly regressive with respect to household income. **Figure 7** shows the distributional impact on households of a 4.78% increase in Council Tax rates in April 2021 (the average increase for 2020-21) against a baseline scenario where Council Tax is frozen in nominal terms. The nominal tax burden falls relatively equally on households across the income distribution – with households in the lowest quintile partially shielded by the Council Tax Reduction Scheme (CTRS). But when expressed as a percentage of income, the effect of the Council Tax increase disproportionately impacts those households with lower income levels. The effect on the incomes of households in the second quintile would be nearly three times greater than the richest quintile. Even those in the poorest quintile would see a larger proportional drop in their income compared with the 50% of households with the highest income. This is explored further in our recently published Welsh Budget Outlook report.²¹

Though there is arguably a good case not to increase Income Tax rates this year given the uncertainty around the Welsh Government's end-of-year and next year's fiscal position, future governments might want to consider how the new devolved Income Tax powers could be used to shield poorer households from less progressive elements of the local and reserved tax system.

In a scrutiny session held by the Finance Committee, the Finance Minister Rebecca Evans confirmed that the Welsh Government will continue to review demand for the CTRS scheme and any shortfall in Council Tax collection and may decide to make further allocations to this end at a later date.²²

As part of the Draft Budget, the Welsh Government has opted to freeze the Non-domestic Rate multiplier this year. In a letter published alongside the settlement, the Finance Minister confirmed that the baseline settlement had been further increased by £176 million to compensate local governments for the fall in Non-domestic Rates revenue.

²⁰ Based on proposals outlined by 7 out of 22 local authorities.

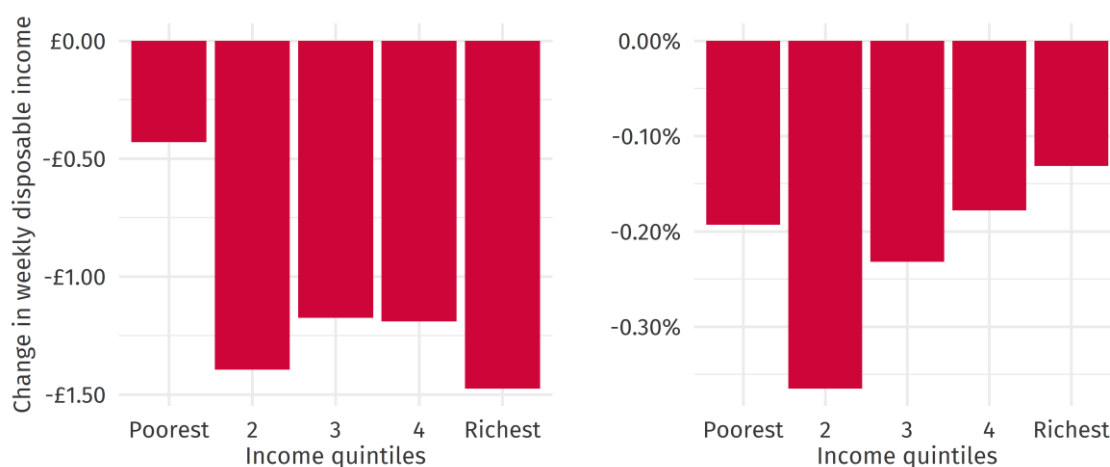
²¹ Guto Ifan and Cian Siôn, *Welsh Budget Outlook 2020* (Cardiff: Wales Fiscal Analysis, 2020).

https://www.cardiff.ac.uk/_data/assets/pdf_file/0010/2481634/welsh_budget_2020_report_formatted.pdf

²² <https://www.senedd.tv/Meeting/Archive/e3afo1cb-16f7-4afo-ac45-2bdc103e7cob?autostart=True>

Figure 7

Distributional impact on households of another 4.78% increase in Council Tax, 2021–22²³



Source: WFA analysis based on UKMOD A2.0+ using ONS (2016–18) Family and Resources Survey input data. Change in weekly disposable income calculated before housing costs. Assumes that the Job Support Scheme comes to an end before April 2021 and that Covid-related unemployment shocks persist.

Devolved taxes

The publication of the 2021–22 Draft Budget was accompanied by an increase to the Land Transaction Tax (LTT) rates paid by owners of multiple properties and a reduction in the rates applied to transactions involving non-residential properties.

From December 22nd, 2020, new tax rates apply to those purchasing an additional property in Wales. The supplement payable by additional rate payers has been increased from 3 to 4 percentage point on the base (standard) rates of Land Transaction Tax. This brings Wales in line with Scotland, which increased its Additional Dwelling Supplement to 4 percentage point on the base rates in January 2019. The Office for Budget Responsibility (OBR) forecasts that increasing the higher rates will generate £5 million in additional revenue during the current financial year (2020–21), and an average of £15 million each year thereafter.²⁴ In its draft budget narrative, the Welsh Government committed to using this additional revenue to invest in social housing.²⁵

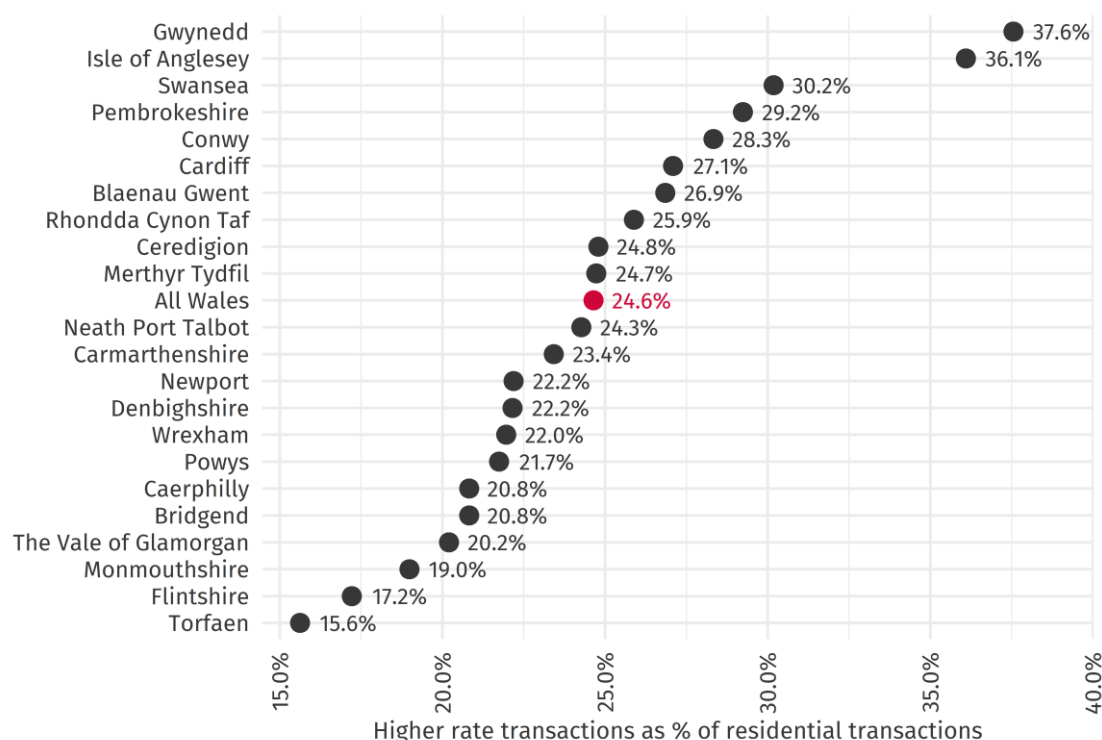
²³ The results presented here are based on UKMOD version A2.0+. UKMOD is maintained, developed, and managed by the Institute for Social and Economic Research (ISER) at the University of Essex. The process of extending and updating UKMOD is financially supported by the Nuffield Foundation, based on the annual update of the UK component of EUROMOD funded by the European Union Programme for Employment and Social Innovation “EaSI” (2014–2020). The results and their interpretation are the authors’ responsibility.

²⁴ Office for Budget Responsibility. *Welsh Taxes Outlook: December 2020* (London: Office for Budget Responsibility, 2020). <https://obr.uk/download/welsh-taxes-outlook-december-2020/>

²⁵ Welsh Government. *Draft Budget 2021–22 – Protect, Build, Change* (Cardiff: Welsh Government, 2020), iii. <https://gov.wales/sites/default/files/publications/2020-12/2021-2022-draft-budget-narrative.pdf>

Figure 8

Higher rates transactions as a share (%) of all residential transactions, 2019–20



Source: StatsWales (2020) Land Transaction Tax statistics by local authority and transaction type.

The amount of additional revenue raised depends on several assumptions, not least the elasticity of demand (the propensity of owners of multiple properties to change their purchasing behaviour in response to the tax increase). The OBR refers to the methodology used when estimating the cost of increasing the Additional Dwelling Supplement in Scotland in 2019. They assumed that the policy change in Scotland would mean that “higher taxes led to fewer transactions with the tax also lowering prices”, but that over three years “75% of the transactions ‘lost’ are displaced to first time buyers and owner occupiers” charged the standard rate of tax.²⁶ The extent of the behavioural response (if any) and the impact on house prices in Wales will likely become clearer once outturn data is released over the coming months.

During the 2019–20 financial year, higher rate transactions accounted for around a quarter of residential transactions in Wales, though as illustrated on **Figure 8**, the picture varies considerably across local authorities. In Gwynedd, nearly 38% of residential transactions were made by owners of multiple properties compared to less than 16% in Torfaen.

In addition to increasing the higher rates for residential transaction, the Welsh Government extended the NIL rate of land transaction tax for non-residential property purchases. From

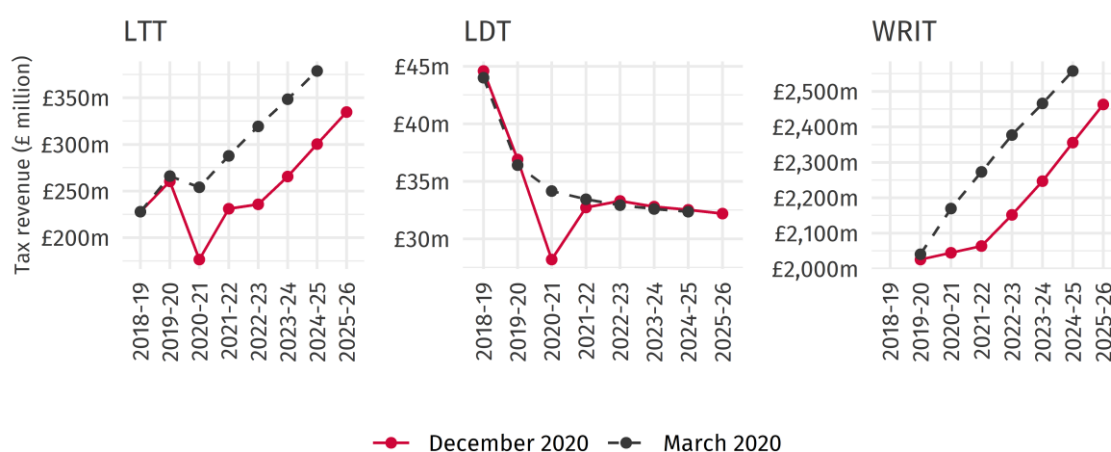
²⁶ Office for Budget Responsibility. *Devolved tax and spending forecasts – March 2019* (London: Office for Budget Responsibility, 2019), 32–33. <https://obr.uk/download/march-2019-devolved-tax-and-spending-forecasts/>

December 22nd, 2020, businesses will not pay any tax on purchases costing up to £225,000. This has a much more modest impact on revenues. According to the OBR, raising the threshold is forecast to cost around £0.3 million in 2020–21 and £1.3 million a year on average thereafter.²⁷ To put this in context, around 540 transactions would have benefitted from changes to the rates paid by non-domestic properties had this policy been in place in 2019–20; 13,600 transactions would have been impacted by changes to the higher residential rates.²⁸

The Finance Minister also announced the Welsh Rates of Income Tax (WRIT) are set to remain unchanged at 10 pence on each rate over the next financial year, while Landfill Disposals Tax (LDT) rates will be updated in line with inflation.

Figure 9

OBR devolved tax forecasts (March and December 2020)



Source: OBR (March 2020) *Economic and Fiscal Outlook*; OBR (December 2020) *Welsh Taxes Outlook*.

Figure 9 compares the latest devolved tax forecasts to the (pre-COVID) March 2020 forecasts by the OBR. The pandemic is expected to have a lasting hit on revenues, with WRIT revenues being around £200 million lower at the forecast horizon. However, as explained in our previous report, any reduction in devolved tax revenues only has a budgetary impact insofar as they deviate from the trend in the size of the Block Grant Adjustments.²⁹

Nevertheless, the reduction in revenues, and the substantial amounts of in-year consequentials received in 2020–21 means that own-sourced revenue accounts for a smaller share of funding for the Welsh Budget. It also means that any future tax changes (e.g. changing the WRIT rates) would have a proportionately smaller impact on the size of the budget.

²⁷ Office for Budget Responsibility. *Welsh Taxes Outlook: December 2020*, 30.

²⁸ 540 non-domestic property transactions valued between £150,000 and £225,000 were made in 2019–20 according to data published by the Welsh Revenue Authority:

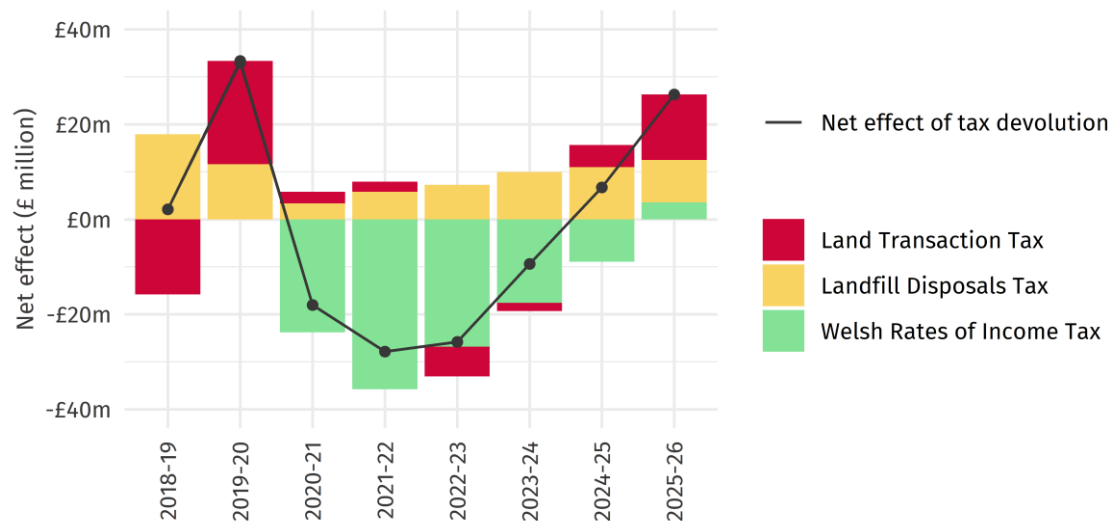
<https://gov.wales/land-transaction-tax-statistics-april-2019-march-2020>

²⁹ Ifan and Siôn, *Welsh Budget Outlook*, 43.

The Block Grant Adjustment (BGA) for the fully devolved taxes is £254 million in 2021–21, while the BGA for Income Tax is £2,099 million. **Figure 10** offers a visualisation of the budgetary impact of these deductions set against the tax forecast to be collected. The BGA for Income Tax is set to exceed the amount of tax raised by around £35 million next year. This is partially offset by the other taxes meaning that the overall negative net effect is around £25 million in 2021–22.

Figure 10

Forecast budgetary impact of tax devolution on the Welsh Budget, 2018–19 to 2025–26



Source: WFA analysis of OBR (December 2020) Welsh Taxes Outlook.

Needless to say, the abnormal fiscal context means that forecasts for both the devolved taxes and the block grant adjustments are subject to uncertainty. Any difference between the forecast at the beginning of the financial year and the outturn for Wales and England & Northern Ireland will not be resolved until the reconciliation exercise. This can only occur after outturn data has been made available, normally around 15 months after the end of the financial year. WRIT outturn data for 2021–22 will not be available until Summer 2023, with the reconciliations being applied to the Welsh Government’s budget for 2024–25. This means that, at least in the short-term, the forecasts are a bigger determinant of the path of the Welsh Budget than the outturn.

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