Dadansoddi Cyllid Cymru
Wales Fiscal Analysis

Spring Statement 2022:

Implications for Wales

BRIEFING NOTE

MARCH 2022

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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Spring Statement 2022

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Executive Summary

On Wednesday, the Chancellor delivered his annual Spring Statement address to parliament. The looming squeeze in living standards compelled the Chancellor to adjust his plans once again. This briefing assesses some of the main implications for Wales.

- The main economic backdrop to the Spring Statement was one of rising inflation, which will erode real incomes and economic growth this year. However, the public finances have recovered faster than expected, with stronger forecast revenues lowering forecast borrowing and providing a fiscal windfall for the Chancellor.
- The Chancellor used this windfall to deliver tax cuts, but these only partly offset previously announced tax increases. The overall tax burden is now forecast to climb to 36.3% of GDP in 2026-27 – its highest level since the late 1940s.
- The tax cuts provide non-targeted support to households across the income distribution to assist with the cost of living. The 5p cut in fuel duty delivers nearly three times more support for UK households in the most affluent income quintile than those in the poorest income quintile. Only a quarter of the tax cut from the increase in the national insurance threshold will go to the bottom half of the income distribution.
- A combination of tax policy changes and energy price increases will leave average Welsh households £315 a year worse off, even after the measures announced yesterday and in February have been applied. Welsh households in the poorest income decile will see the largest proportional hit to their finances. The Chancellor did not announce any changes in the way benefits are uprated, meaning a real terms reduction of more than 4% in working-age benefits and the state pension.

The Spring Statement contained nothing in the way of spending on public services. Despite rising inflation eating into planned real terms increase in spending, there was no new funding for the Welsh Government. This will likely squeeze public services and public sector workers during a time of huge demand pressures in the aftermath of Covid-19.

- The cash-terms block grant settlement announced in October now appears considerably less generous. Rising inflation has wiped out 16% of the planned increase in spending, implying a loss of £298 million a year through higher inflation by 2024-25.
- Actual inflationary pressures felt by public services will be influenced by pay settlements determined later in the year. For example, a 5% pay award for the Welsh NHS (still below CPI inflation) would cost an extra £275 million next year. After a decade of real pay cuts in the public sector, holding down nominal pay awards could have a big impact on the quality of public services, affecting recruitment and retention of staff during the Covid-19 recovery.
- There was good news for the Welsh Government in the OBR's latest assessment of devolved taxes. Forecast revenues from the Welsh Rates of Income Tax in 2022-23 were revised upwards by £167 million, far above the increase in the projected Block Grant Adjustment for income tax. Our projections suggest the Welsh Government could have £175 million more to spend than it has currently budgeted for in 2024-25.
- The total net effect of tax devolution could boost the Welsh budget by nearly £500 million a year by 2024-25, though these projections are inherently uncertain.

Spring Statement 2022: Implications for Wales

24 MARCH 2022

On Wednesday, the Chancellor delivered his annual Spring Statement address to parliament. Though the event had been trailed as a relatively low-key, “policy-light” affair, the looming squeeze in living standards compelled the Chancellor to adjust his plans once again.

In an attempt to bolster his credentials as a tax-cutting Chancellor, Rishi Sunak opted to increase the National Insurance threshold from £9,568 to £12,750 from July 2022. For most individuals, this more than offsets the 1.25 percentage point increase to national insurance rates that come into effect next month. The Chancellor also announced a planned cut to the basic rate of income tax in 2024–25. But despite this, the overall tax burden is now forecast to climb to 36.3% of GDP in 2026–27 – its highest level since the late 1940s – and fully a percentage point *higher* than forecast in October 2021 as inflation drives faster growth in nominal receipts.

The Office for Budget Responsibility (OBR) now expects the monthly Consumer Price Inflation (CPI) rate to peak at close to 9 per cent in the fourth quarter of this year – higher and later than what had been implied by their previous forecasts in October 2021. The Chancellor again opted for broad-based tax measures to assist with the cost-of-living, rather than targeted support. The fuel duty cut delivers *nearly three times more support* for UK households in the most affluent income quintile than those in the poorest income quintile (due to higher car ownership rates). There were no changes to the way benefits are uprated either. As it stands, benefit payments and the state pension will increase by 3.1% next month, which represents a 4.3% reduction in the real value of awards.

The Spring Statement contained precious little in the way of spending on public services. Despite rising inflation eating into planned real terms increases in spending, there was no new funding for the Welsh Government. The cash-terms block grant settlement announced in October now appears considerably less generous. Rising inflation has wiped out 16% of the planned increase in spending, implying a loss of £298 million a year through higher inflation by 2024-25. This will likely squeeze public services and public sector workers during a time of huge demand pressures in the aftermath of Covid-19.

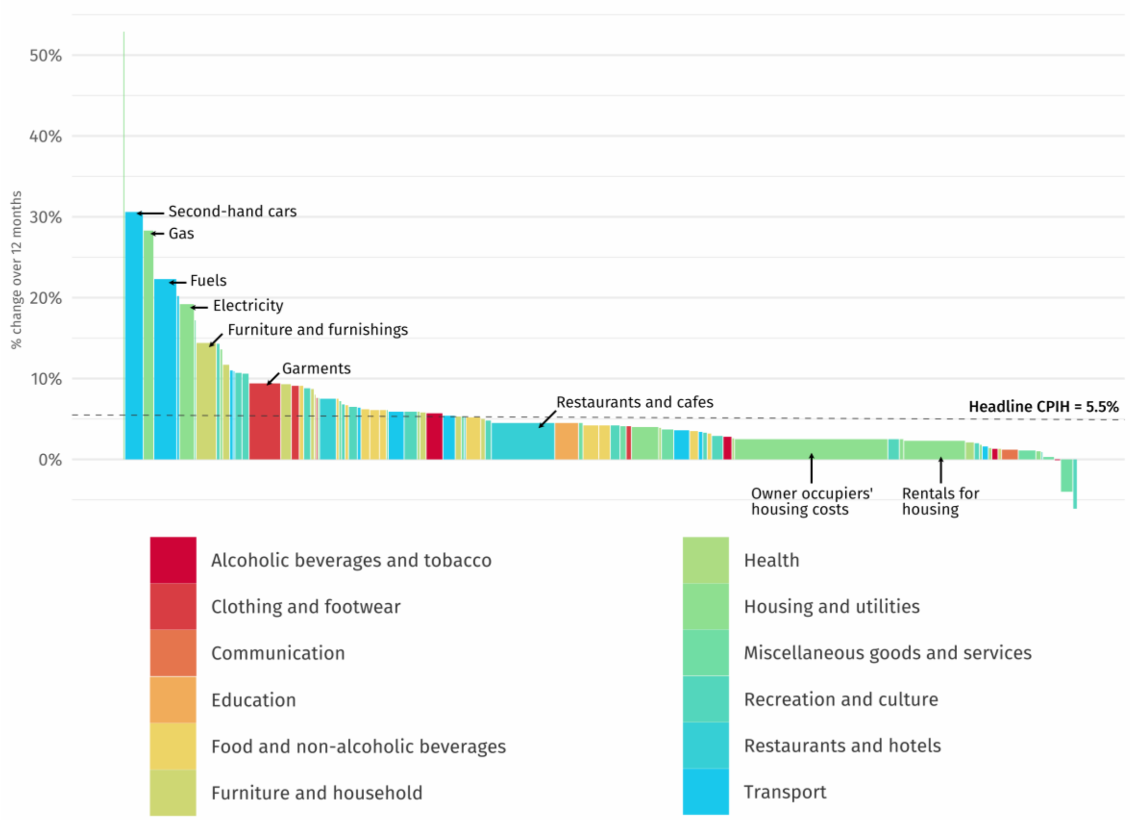
There was some better news for the Welsh Government in the OBR’s latest assessment of devolved tax revenues. Faster forecast growth in Welsh revenues could mean that tax devolution boosts the Welsh budget by nearly £500 million a year by 2024-25, though these projections are inherently uncertain.

Economic and fiscal outlook

The main economic backdrop to the Spring Statement was one of rising inflation, which will erode real incomes and economic growth this year. However, the public finances have recovered stronger than expected, with stronger forecast revenues lowering forecast borrowing and providing a fiscal windfall for the Chancellor.

- The Consumer Price Index (CPI) rose by 6.2% in the 12 months to February 2022. The CPIH index (which includes owner occupiers' housing costs) rose by 5.5% over the same period, up from 4.9% in the 12 months to January 2022. The increase to the CPIH rate is driven by the outsized contribution of utility bills, and the price of motor fuel (**Figure 1**). This is notable as utility bills tend to constitute a larger share of household spending for poorer households.[1]

Figure 1
Components of CPIH rate, 12 months to February 2022



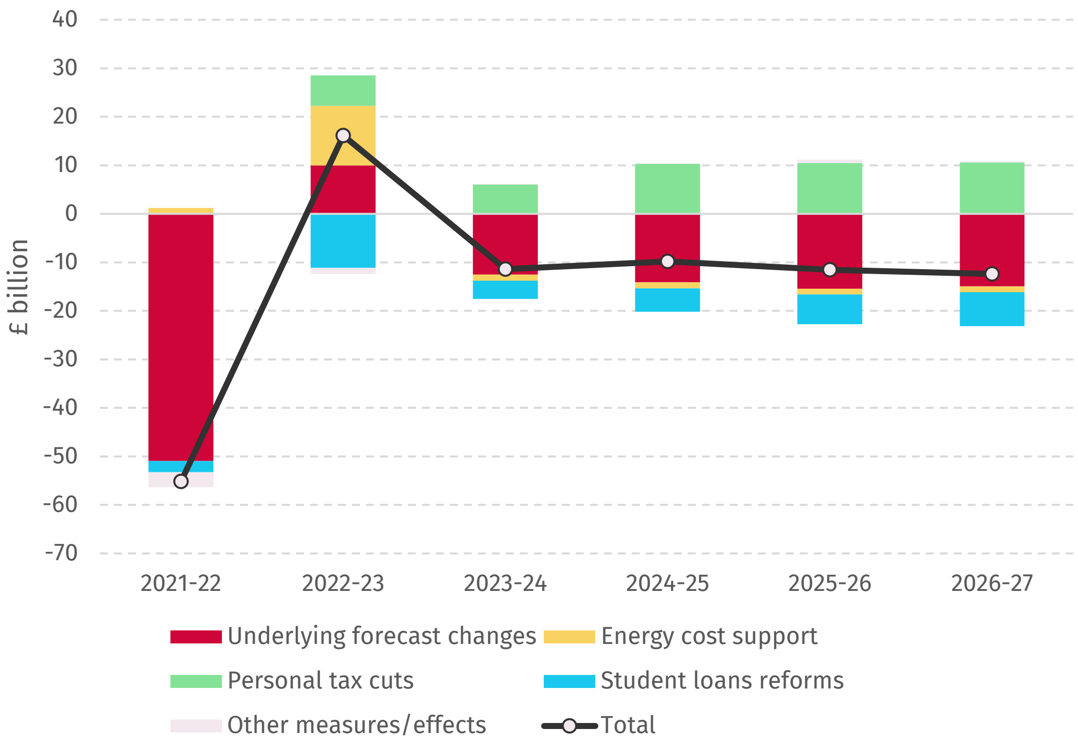
Source: ONS (2022) CPIH Index – February 2022. • Notes: The width of the bar denotes the weight of the respective item in the consumer basket.

[1] https://orca.cardiff.ac.uk/148317/1/cost_of_living_report_08Mar2022.pdf, pp. 10-11.

- The OBR now expects CPI to peak at close to *9 per cent* in the fourth quarter of the year – a higher and later peak than previously projected due to growing expectation of another hefty increase to the energy price cap in October 2022.
- The OBR expects rising inflation to erode real incomes and consumption, as it revised down its forecast GDP growth in 2022 from 6.0 per cent to 3.8 per cent.
- However, the public finances have recovered faster than expected. Borrowing is set to more than halve from £322 billion in 2020-21 to £128 billion in 2021-22, some £55 billion less than forecast in October. As shown in **Figure 2**, underlying forecast changes – of higher revenues, somewhat offset by higher debt interest payments – created a fiscal windfall for the Chancellor after 2022-23.
- The Chancellor used this fiscal boost for cuts in personal taxation, with the increased National Insurance threshold and 1p cut to the basic rate of income tax in 2024-25. But this only partly offsets previously announced increases in taxes and the overall tax burden is now forecast to climb to 36.3% of GDP in 2026–27 – its highest level since the late 1940s.

Figure 2

Public sector net borrowing: changes since October 2021



Source: OBR (2022) Economic and Fiscal Outlook March 2022

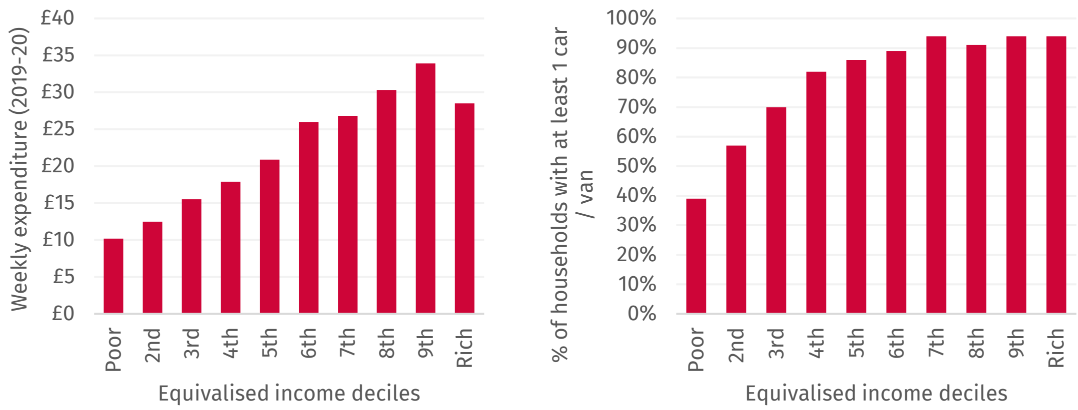
Household finances

In the face of price rises and trailing income growth, the Chancellor announced several measures to assist households with the cost-of-living. Once again, he opted not to use the benefits system to deliver targeted support, but rather relied on tax cuts to provide more broad-based support to households across the income distribution.

- As was widely anticipated before Wednesday, the Chancellor announced a cut of 5 pence to the fuel duty rate in 2022–23. Though this will provide a welcome relief to households whose fuel costs constitute a large share of their spending, most of the direct benefits will accrue to richer households who are more likely to own cars, and more likely to own multiple cars. The cut to fuel duty delivers nearly three times more support for UK households in the most affluent income quintile than those in the poorest income quintile (**Figure 3**).

Figure 3

Weekly spending on motor fuel, and car/van ownership rates by equivalised UK household income decile, 2019–20

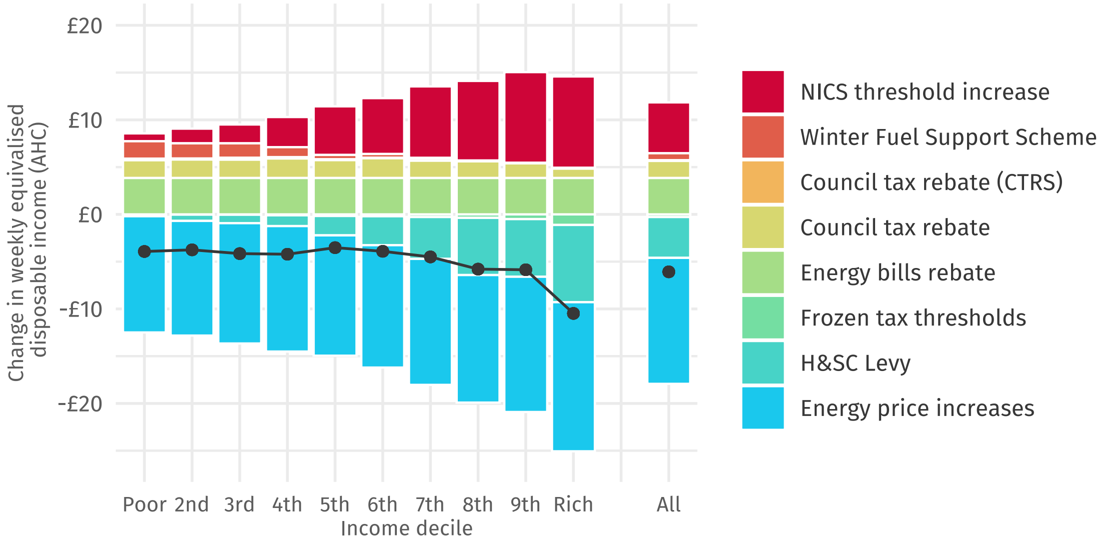


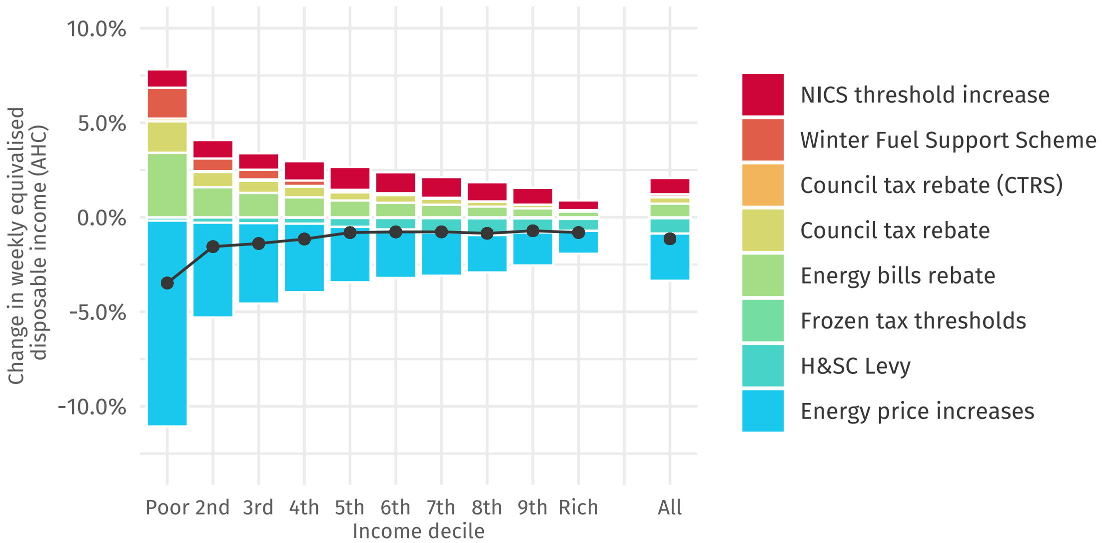
Source: ONS (2021) Living Costs and Food Survey FYE 2020.

- The decision to increase the primary national insurance threshold to £12,570 negates the effect of the national insurance rate rise for most Welsh households. However, for every £4 in tax cuts for Welsh households, only £1 will go to the bottom half of the income distribution.
- A combination of tax policy changes, and energy price increases will leave the average Welsh households £315 a year worse off, even after the measures announced yesterday and in February have been applied (**Figure 4**). This does not factor in the general cost of goods and services – which is also set to increase – as well as a further increase to the energy price cap next Autumn. Welsh households in the poorest income decile will see the largest proportional hit to their finances.

Figure 4

Distributional impact of policy and price cap changes, by equivalised disposable income decile in Wales: April 2022*





Source: WFA analysis using UKMOD A2.51+[2] and ONS (2016–18) Family and Resources Survey input data. • Notes: Energy price increase represents the increased costs for households on a standard dual-fuel tariff after the price cap is increased in April 2022. This increase (£693/year) is weighted to reflect differences in energy consumption by equivalised income decile using data from the Living Costs and Food Survey. The Winter Fuel Support Scheme reflects the £200 payment that is scheduled to eligible households during Winter 2022/23; a separate payment has already been made in Winter 2021/22. Assumes full take-up of all policy measures.

* Increased NICS threshold will apply from July 2022.

[2] The results presented here are based on UKMOD version A2.51+. UKMOD is maintained, developed and managed by the Centre for Microsimulation and Policy Analysis (CeMPA) at the University of Essex. The process of extending and updating UKMOD is financially supported by the Nuffield Foundation (2018-2021).

- The Chancellor did not announce any changes to the way benefits are uprated, meaning that working-age benefit awards, pension credit and the state pension will increase by 3.1% from next month – a real terms reduction of more than 4%.
- The expansion of the Household Support Fund in England will trigger £25 million for the Welsh Government. This could be used for further support for households in Wales but equates to less than a tenth of the package announced by the Welsh Government in February, which was already significantly more generous than elsewhere in the UK.

Impact on Welsh public services

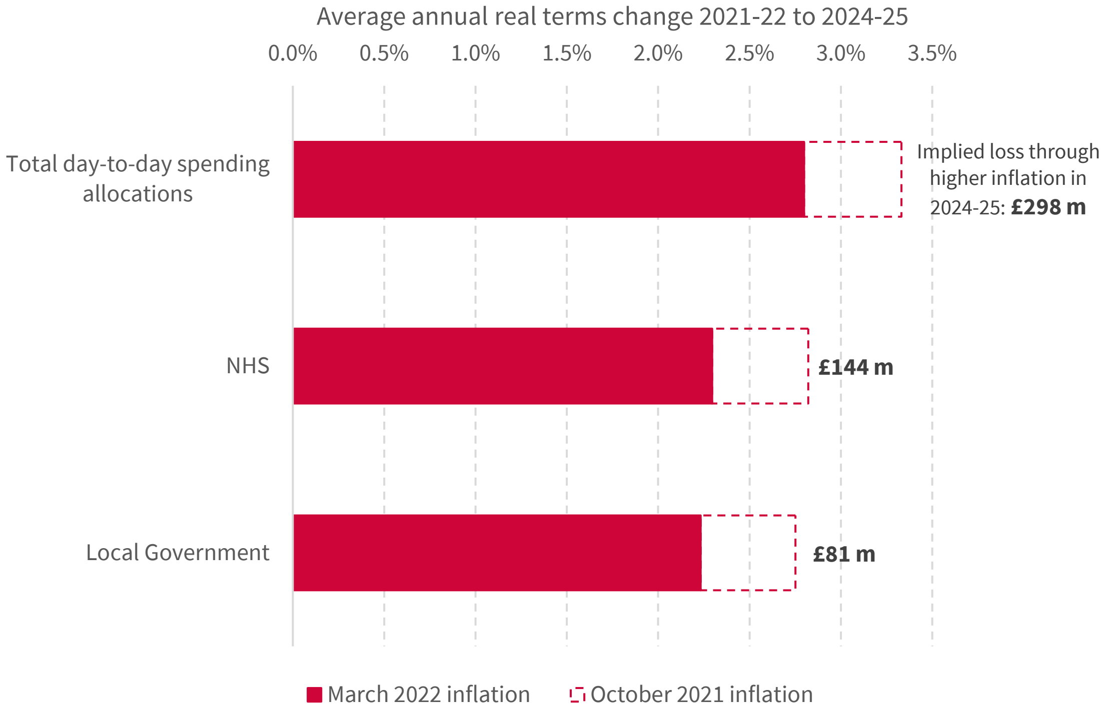
The Spring Statement also contained precious little in the way of spending on public services. Despite rising inflation eating into planned real terms increases in spending, the Chancellor announced no new funding for the NHS, schools, or other public services in England. As a result, there was no new funding for the Welsh Government, while October's cash-terms block grant settlement now appears considerably less generous.

- On 3 March, the Welsh Government's published its Final Budget for 2022-23, with indicative spending plans to 2024-25. Relative to the 2021-22 baseline (excluding Covid-19 spending), the Welsh Government planned to increase day-to-day spending on public services by £2.1 billion in 2022-23, and by nearly £3.0 billion by 2024-25.
- Using October 2021 inflation forecasts (when the block grant was set), this implied spending would grow by an average of 3.3% per year in real terms over the next three years. The latest inflation forecasts imply real growth of 2.8% per year instead. In other words, rising inflation has wiped out 16% of the planned increase in spending, implying a loss of £298 million a year through higher inflation by 2024-25.
- Planned spending increases on the NHS will now average 2.3% per year to 2024-25, rather than the 2.8% initially planned. Similarly, the average annual growth in the Local Government settlement funding will be 2.2% (rather than 2.8%).
- The measure of inflation typically used to analyse real changes in public services spending is the GDP deflator. This measure is now expected to average 4.1% over 2022-23, up from the 2.7% increase forecast back in October. However, for a variety of reasons, this is significantly lower than the forecast increase in the CPI measure of inflation (8.0%). The true inflationary pressures felt by public services will depend on the price increases of their various inputs. For example, the Welsh NHS spent over £50 million on energy in 2019-20 – a total which will increase significantly given recent and projected energy price increases.
- Around half of day-to-day spending on public services goes towards public sector pay. The spending pressures felt by public services will therefore be greatly affected by the pay settlements recommended by Pay Review Bodies later in the year. For example, a 5% pay award for the Welsh NHS (still below CPI inflation) would cost an

extra £275 million next year, well over one-quarter of the planned NHS cash budget increase.

Figure 5

Welsh Government Final Budget plans - average annual real terms change in day-to-day spending from 2021-22 to 2024-25



Source: OBR (2022) Economic and Fiscal Outlook March 2022; Welsh Government (2022) Final Budget 2022-23; and authors' calculations. • Notes: Total day-to-day spending allocations refers to fiscal resource allocations and redistributed non-domestic rate revenues.

- After a decade of real pay cuts in the public sector, holding down nominal pay awards could have a big impact on the quality of public services, affecting recruitment and retention of staff during the Covid-19 recovery.
- If further funding is not forthcoming later in the year, Welsh public services and public sector workers will again feel the squeeze at a time of huge demand pressures.

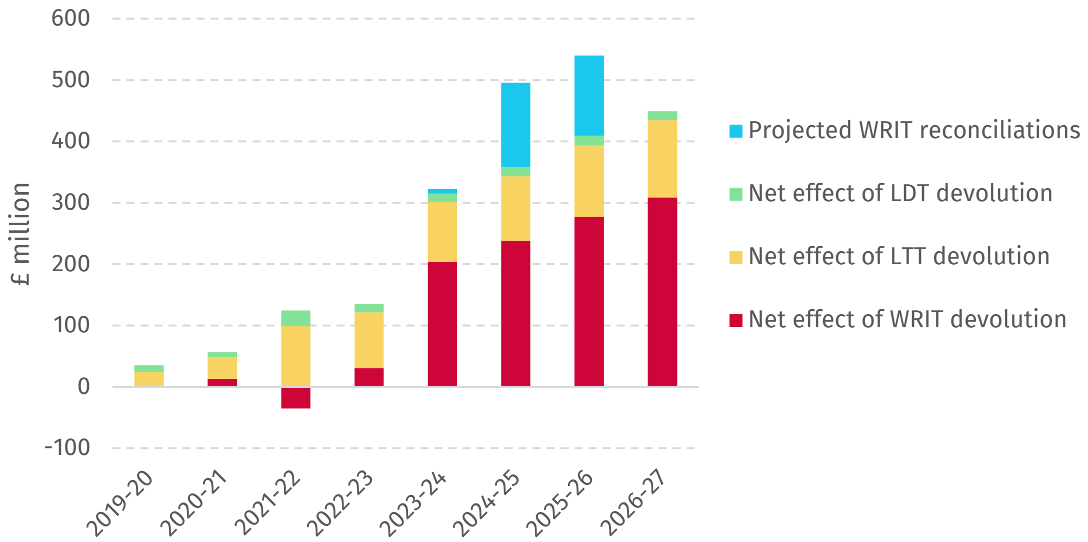
Devolved taxes

Despite no increase in block grant funding from the UK government, there was some good news for the Welsh Government in the OBR's latest forecasts for devolved taxes. A part of the projected growth in the Welsh Government's spending power over coming years is down to strong forecast growth in devolved revenues, which have again been revised upwards.

- Forecast revenues from the Land Transaction Tax are now set to be on average £50 million per year higher in 2022-23 to 2024-25 than was budgeted for at the Final Budget earlier this month. This boost is offset slightly by larger Block Grant Adjustments (BGAs) which are linked to comparable UK government revenues in England and Northern Ireland. The latest forecasts suggest a net boost of £24 million a year to the Welsh budget from LTT revenues.
- There was also a large upward revision to forecast revenues from the Welsh Rates of Income Tax, which are set to reach £2,645 million in 2022-23, compared to £2,478 million as previously budgeted. This increase of £167 million is far above the corresponding increase in the projected BGA for income tax (again linked to forecast revenues in England and Northern Ireland) of £36 million.

Figure 6

Projected net effect of tax devolution on the Welsh Budget, 2019-20 to 2026-27



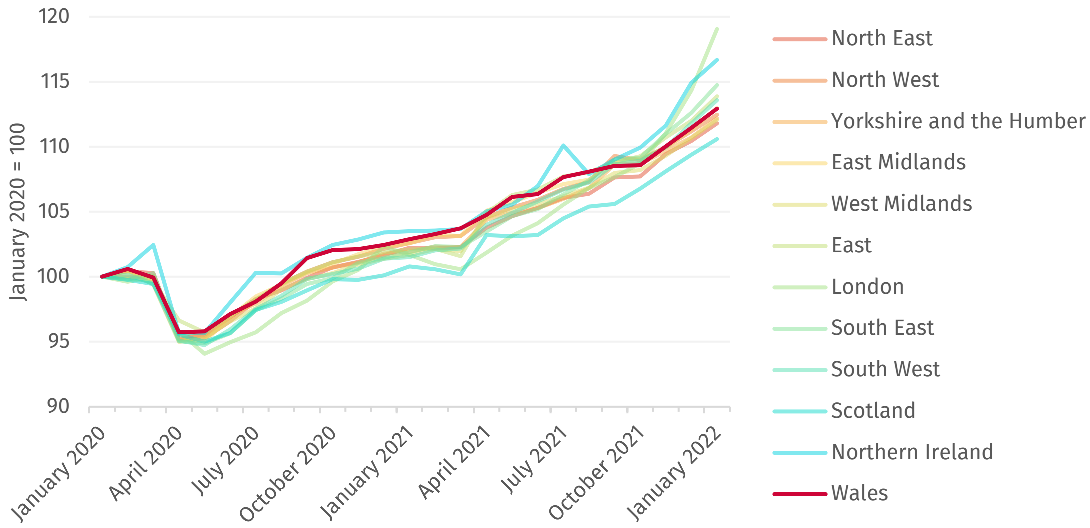
Source: OBR (2022) Economic and Fiscal Outlook March 2022; HM Treasury (2022) Block Grant Transparency Data December 2021; Welsh Government (2022 and previous) budget documents; and authors' calculations • Notes: Figures for the net effect of WRIT devolution to 2022-23 reflect budgeted amounts for revenues and BGAs (and fixed) – subsequent reconciliations reflect the differences between these budgeted amounts and current forecasts (e.g. 2024-25 WRIT reconciliation reflects forecasts errors in budgeted amounts for 2021-22.

- Because the Welsh Government does not bear the risk of in-year changes to forecast income tax revenues (the BGA and devolved revenues are fixed at the Final Budget), the Welsh Government will not see its budget boosted in 2022-23. However, it raises the prospect of significant positive reconciliations to the Welsh budget made in future years to compensate for forecast errors in previous years (shown by the yellow bars in **Figure 6**). Based on current forecasts, we project these reconciliations would be worth £137 million in 2024-25, though this will not be confirmed until 2021-22 outturn data is available (in summer 2023).

- As shown in **Figure 6**, current OBR forecasts suggest a significant positive effect of tax devolution on the Welsh Budget over coming years, growing to £358 million by 2024-25 (or £495 million including projected reconciliations). This would suggest the Welsh Government would have £175 million more to spend than it has currently budgeted for in 2024-25. However, the eventual path of devolved revenues relative to these forecasts represent a key uncertainty for the budget outlook.
- The positive outlook for devolved income tax revenues chimes with the strong performance of the Welsh labour market. At 3.0%, Wales' headline unemployment rate remains below the UK average for the 29^{th} consecutive month – the longest period since records began in April 1992.
- Aggregate pay from pay-rolled employment recovered from its pandemic-induced slump ahead of the UK average, though other English regions have recorded stronger performance in recent months (**Figure 7**).

Figure 7

Aggregate pay from pay-rolled employment, by NUTS 1 area (January 2020 = 100)



Source: HMRC (March 2022) Earnings and employment from Pay As You Earn Real Time Information, seasonally adjusted. • Notes: Aggregate pay is equivalent to mean pay multiplied by the number of pay-rolled employees.

- Whether or not the stronger income tax performance continues will depend on future growth in pay and employment relative to England and Northern Ireland. If the real erosion in the Welsh Government and UK government departments' spending power leads to another period of public sector pay restraint, this may have a relatively greater impact on income tax revenues in Wales.

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