UK Government Budget and Spending Review 2021: Implications for Wales

BRIEFING PAPER

Wales Fiscal Analysis

October 2021

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.

Contact details

Guto Ifan
ifandg@cardiff.ac.uk
029 2087 4626

Cian Siôn
sionc1@cardiff.ac.uk
029 2251 1795

Wales Fiscal Analysis
Cardiff University
Law Building
Museum Avenue
Cardiff CF10 3AX

UK Budget & Spending Review 2021: Implications for Wales

28 OCTOBER 2021

Amid an improved forecast economic outlook, the Chancellor presented a landmark budget and spending review, which will set the fiscal context over coming years. After the tax and spending increases announced earlier in September, departmental spending plans were increased again. This briefing paper highlights some of main implications for Wales:

- The outlook for the Welsh Government's budget has significantly improved relative to March 2021 spending plans, which will enable the Welsh Government to better meet the substantial post-pandemic spending pressures across a range of areas. The core budget for day-to-day spending (excluding Covid-19 funding in 2021-22) will increase by £2.9 billion a year by 2024-25 in nominal terms, equivalent to an average of approximately 3.1% a year over the Spending Review period, with the increases front-loaded in 2022-23.
- With per-person spending set to return to pre-austerity levels next year, almost all areas of core spending could see increases over coming years. However, spending outside the NHS will remain well below 2010-11 levels.
- New upgraded forecasts for devolved taxes and associated block grant adjustments continue to show a positive projected effect on the Welsh budget – we project that the impact in 2024-25 could amount to over £200 million a year in 2024-25.
- The Spending Review contained details on new funding streams. Ten projects in Wales will receive funding from the Levelling Up Fund, worth £121 million, or 7% of the UK total. The commitment for the Shared Prosperity Fund to match the size of EU funds for Wales was restated, though it remains unclear how this commitment can be honoured over the next two years as spending gradually increases.
- The Chancellor also announced major changes to the way Universal Credit payments are calculated for in-work claimants. This will help households in the lower half of the income distribution in Wales, though will not fully compensate for the recent removal of the Universal Credit uplift, especially for the lowest-income households.
- An increase in forecast inflation, combined with tax increases, will put additional pressure on household finances and living standards over coming months and years. Separate analysis by the Institute for Fiscal Studies suggests that real gross average wages are expected to remain stagnant over the forecast period – continuing a decade-long trend.

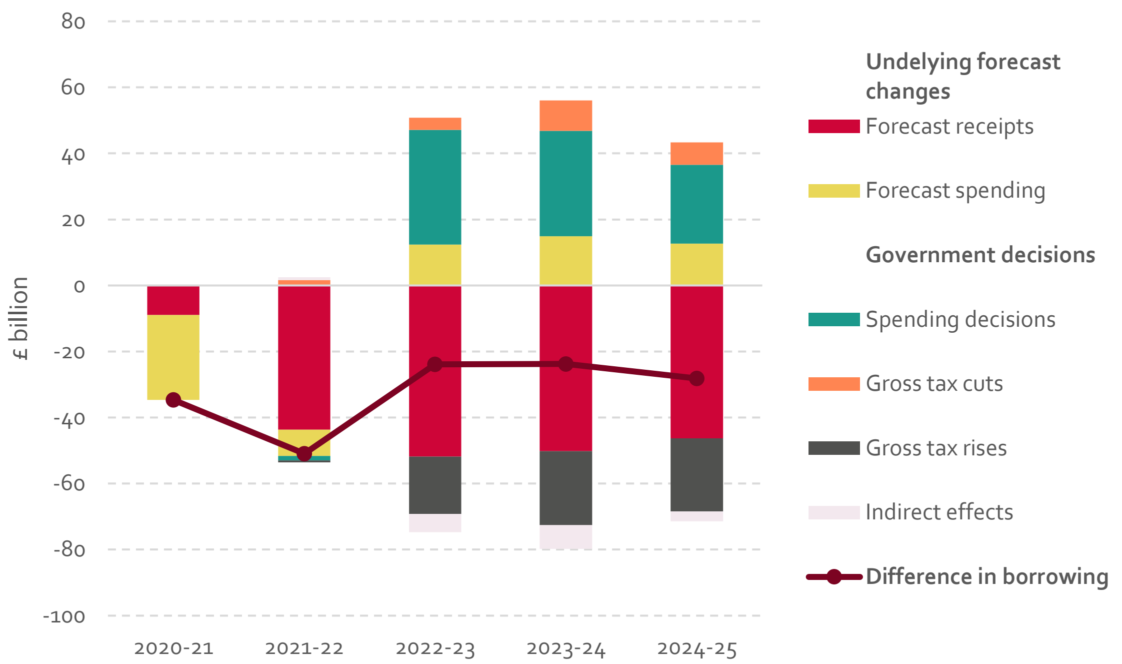
Economic and fiscal outlook

The latest forecasts made by the Office for Budget Responsibility (OBR) show an improved economic outlook, with a faster than expected recovery this year and a smaller 'scarring' effect on the size of the economy over the longer term.

- The January 2021 lockdown had a smaller effect on the economy than anticipated, while the rollout of the vaccine and lifting of public health restrictions led to a stronger than expected growth in demand. This meant total output was 1.1 per cent below its pre-pandemic peak in August 2021, rather than the 4.9 per cent shortfall forecast in March.
- With buoyant demand for labour, the OBR now forecast unemployment to peak at 5.2 per cent in the fourth quarter of 2021, some 1.3 percentage points lower than previous forecasts. Meanwhile, CPI inflation is expected to continue to rise to 4.4 per cent in the second quarter of 2022, 2.6 percentage points higher than forecast in March 2021.

Figure 1

Changes in UK public sector net borrowing since March 2021 forecast



Source: OBR (2021) Economic and Fiscal Outlook October 2021

- The improved economic outlook, as well as departmental underspending, significantly lowered borrowing compared to previous forecasts. **Figure 1** shows the factors that contributed to borrowing being £35 billion lower than forecast in 2020-21, £51 billion in 2021-22, and an average of £25 billion per year lower across the Spending Review period. The main driver over the forecast period was the improvement in forecast receipts (red bars), slightly offset by higher spending forecast after this year.

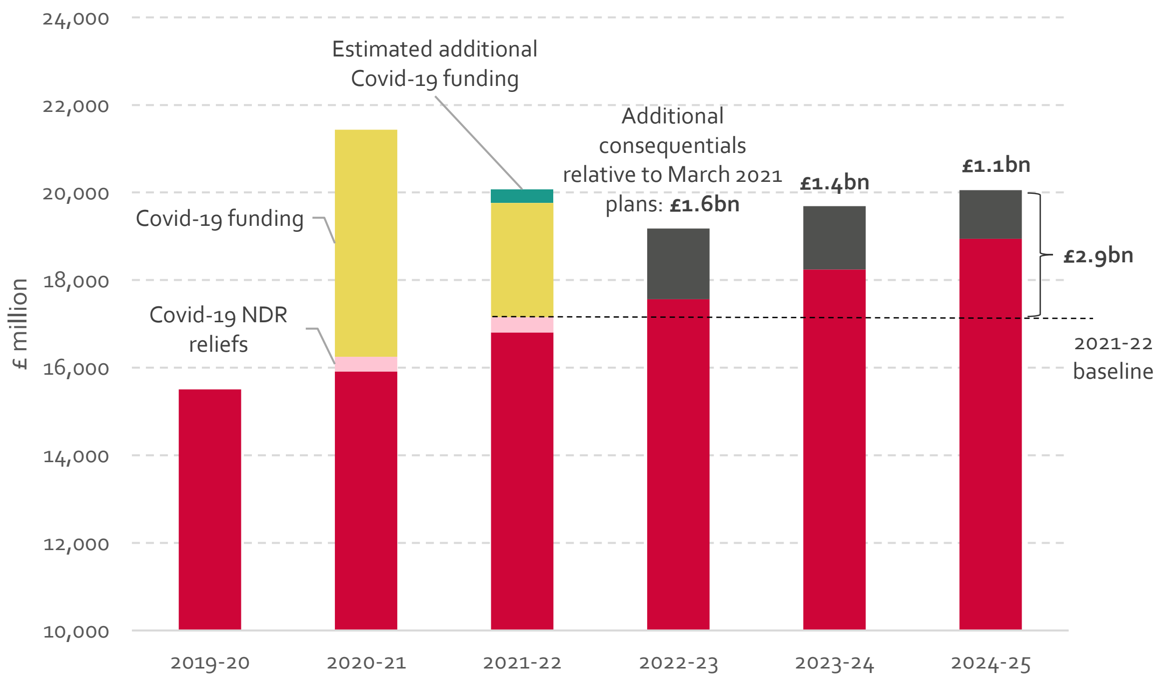
- The Chancellor announced some tax cuts (orange bars), but the main policy effects was the tax rises driven by the Health and Social Care Levy (dark grey bars) and even higher departmental spending (green bars). The Chancellor also announced new fiscal rules, and as expected, will target a current budget balance (excluding net investment), with a three-year rolling target. The forecasts imply these rules will be kept, with some fiscal 'headroom' across coming years.

Implications for the Welsh Government budget

- The outlook for the Welsh budget has been transformed since the March 2021 budget plans. Under those plans, the UK government day-to-day spending on public spending would have been substantially lower than pre-pandemic spending plans, despite the huge impact of the pandemic on public services. Since then, the Chancellor has twice revised spending upwards.

Figure 2

Estimated Welsh Government budget for day-to-day spending, 2019-20 to 2024-25 (nominal terms)



Source: Authors' calculations based on Welsh Government budget documents; HM Treasury (2021) Block Grant Transparency 2021; HM Treasury (2021) Autumn Budget and Spending Review 2021; OBR (2021) Economic and Fiscal Outlook October 2021

- **Figure 2** shows our projection of the Welsh Government's budget for day-to-day spending from 2019-20 to 2024-25, based on the announced increase in the Welsh Government's block grant, alongside new forecasts for devolved taxes and non-domestic rates. The Budget confirmed that the Welsh Government will receive an additional £314 million for day-to-day spending on its Covid-19 response in 2021-22 (green bars), bringing the total available to £2.9 billion.
- Relative to our projections of the block grant under March 2021 budget spending plans, we estimate that core day-to-day spending (excluding Covid-19 funding) will be £1.6 billion higher in 2022-23 and £1.1 billion higher by 2024-25, as a result of increased UK government spending. The overall day-to-day budget increases to approximately £20.1 billion by 2024-25, which will be £2.9 billion higher in nominal terms compared to the 2021-22 baseline. We now project that the core resource budget will increase by approximately 3.1% a year, with the increases front-loaded in 2022-23.
- While the Welsh Government will be able to spend the increase in its budget as it wishes, it is useful to outline which areas of UK government spending has triggered the improved outlook for day-to-day spending. Based on our analysis of UK government department budgets, we estimate that just under half of the consequentials in 2022-23 (from 2021-22) are driven by increased NHS spending, with another 16% by other Health and Social Care spending (covering social care and public health). The share accounted for by these areas increase over time to 2024-25. Consequentials are also increased by schools spending and local government spending in England, especially in 2022-23, as well as the announced business rates cuts in England.
- Overall, the Welsh Government's budget for day-to-day spending will be approximately 9% higher in 2024-25 in real terms compared to 2010-11, on a broadly like-for-like basis. On a per person basis, spending will return to pre-austerity levels next year and will remain 4% higher in 2024-25. However, we estimate that the day-to-day budget in 2024-25 will be £2.8 billion lower than if spending had been increased in line with economic growth since 2010-11. Outside of the NHS, spending will also remain significantly below pre-austerity levels, despite the projected growth over the coming three years.
- It should be noted that overall spending, including Covid-19 funding, will fall from 2021-22 to 2022-23 (as shown in **Figure 2**). Since there is no Covid-19 funding available after 2021-22, the additional costs of the pandemic will need to be borne from the (now larger) core budgets. An example of this is found in the UK government's Department for Transport (DfT) budget, where day-to-day funding to support the rail sector was categorised as Covid-19 funding from 2019-20 to 2021-22, but as 'core' resource DEL from 2022-23 onwards. Wales received 100% consequential when it was included in Covid-19 funding, but since the overall comparability factor for the DfT is 37%, Wales will now only receive a smaller share of this spending.[1]

[1] Wales' lower comparability factor for Department for Transport spending is driven by a 0% weighting applied to HS2 spending as well as the inclusion of the non-devolved Network Rail spending in the baseline from 2020-21 onwards.

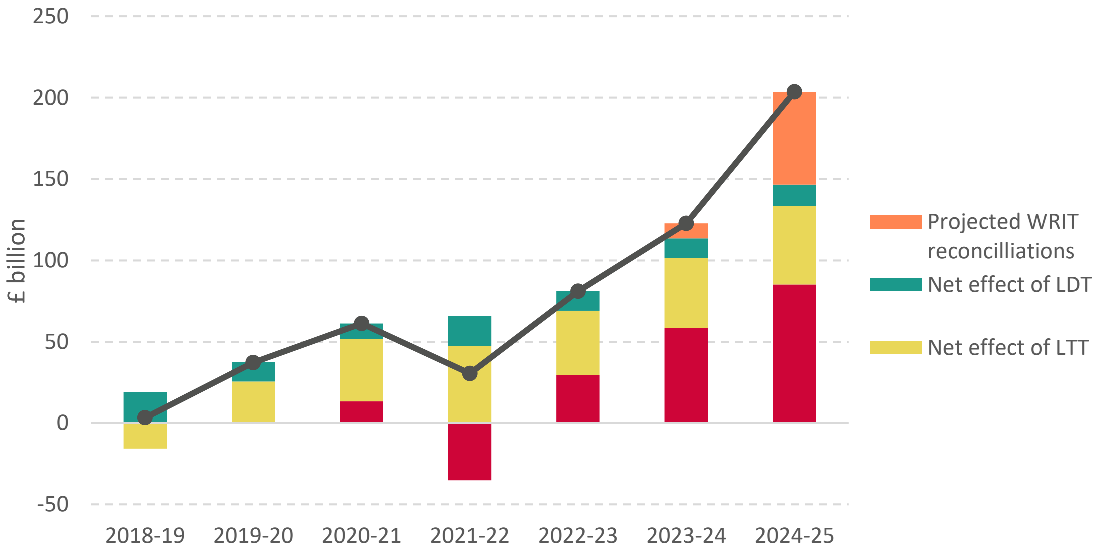
Devolved taxes

Alongside its economic and fiscal forecasts, the OBR published updated forecasts for the Welsh Government's devolved tax revenues.

- Relative to March 2021 forecasts, there was a large upgrade in forecast revenues from the Welsh Rates of Income Tax (WRIT) across the forecast period, amounting to £188 million in 2021-22. Since the Welsh Government doesn't bear any in-year risks in the case of WRIT with revenues fixed at the beginning of the financial year, any changes in forecasted revenues will be reconciled at outturn when available (usually 18 months after the end of the financial year). We currently project small but positive reconciliations for the years 2020-21 and 2021-22 which will apply in 2023-24 and 2024-25 (orange bars in **Figure 3**).[2]
- There was also an increase in forecast Land Transaction Tax revenues compared to June 2021 forecasts (of £44 million in 2021-22), which will impact the funding available to allocate at the Welsh Government's supplementary budget this year.

Figure 3

Projected net effect of tax devolution on the Welsh budget, 2018-19 to 2024-25 (nominal terms)



Source: Authors' calculations based on HM Treasury (2021) Block Grant Transparency 2021 and OBR (2021) Economic and Fiscal Outlook October 2021

- The net effect of tax devolution on tax devolution is determined by the difference in growth between devolved revenues and the associated block grant adjustments, which are linked to growth in comparable UK government revenues in England and Northern

[2] The projected reconciliations are also influenced by the error in forecast associated block grant adjustments which are also fixed at the beginning of the year.

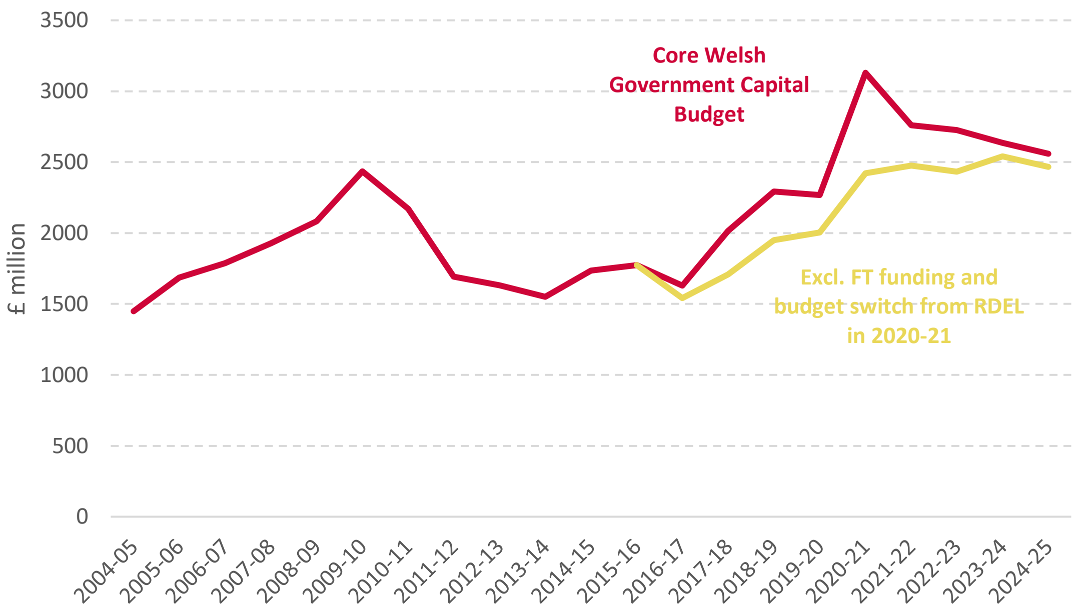
Ireland. **Figure 3** shows our projections of the difference between revenues and block grant adjustments from 2018-19 to 2024-25, with faster growth in revenues in Wales leading to a positive net effect on the budget. Alongside projected positive reconciliations with respect to WRIT, this positive effect could amount to over £200 million by 2024-25.

Capital funding

- The Spending Review also set the Welsh Government's block grant for capital spending for years 2022-23 to 2024-25, which provides some certainty to spending totals which will enable the Welsh Government to set a multi-year capital budget and plan its devolved borrowing. After a big increase in the Welsh Government's block grant over recent years, there is a further nominal terms increase next year (excluding Covid-19 funding).

Figure 4

Projected Welsh Government capital budget excluding Covid-19 funding, 2004-05 to 2024-25 (2021-22 prices)



Source: Authors' calculations based on HM Treasury (2021) Block Grant Transparency 2021 and HM Treasury (2021) Autumn Budget and Spending Review 2021; HM Treasury (various years) Public Expenditure Statistical Analyses and Welsh Government budget documents.

- Part of the increase in the Welsh Government's capital budget in 2022-23 appears to be driven by an increase in Financial Transactions funding. As shown in **Figure 4**, the total core Welsh Government capital budget (excluding Covid-19 funding) is set to fall in real terms over the Spending Review period. The yellow line shows our estimate of the core capital budget on a more historically consistent series, excluding Financial Transactions funding and a budget switch from resource spending in 2020-21. This shows the capital budget, including Welsh Government borrowing, will be sustained in real terms in each of the next three years at a similar level to 2009-10, before the period of austerity.

UK government spending in Wales

Welsh projects have been successful in bidding for £121m from the first tranche of the Levelling Up Fund. And further detail was provided on the roll-out of the UK Shared Prosperity Fund. However, despite assurances by the UK government that they will match the size of EU funds to Wales in each year, it is unclear how this commitment can be met over the next two years given the announced funding profile.

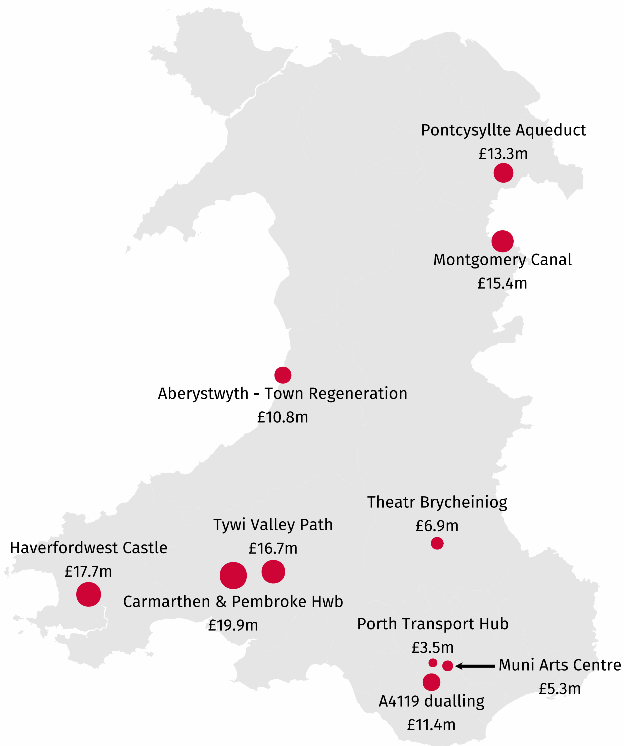
- The Spending Review provided more detail on the funding profile of the UK Shared Prosperity Fund (UKSPF) – the successor to EU structural funding. The UK-wide fund will amount to £0.4 billion next year, rising to £0.7 billion in 2023–24, and £1.5 billion in 2024–25.
- The UK government reaffirmed that "total funding through the UKSPF will at a minimum, match the size of EU funds in each nation, and in Cornwall, each year".[3] If the UK had remained in the EU, Wales would have received approximately £375 million annually from January 2021. While matching this amount may be achievable when the fund has been fully ramped up, it is unclear how this commitment can be honoured over the next two years.
- The first allocation from the UKSPF was made yesterday. £560 million has been earmarked for a programme to improve adult numeracy across the UK over a three-year period. Traditionally, UK government spending announcements in areas devolved to Wales (including education) trigger a Barnett consequential. However, since the programme is funded from the Shared Prosperity Fund rather than the Department for Education's departmental budget, this will not be the case. The Levelling Up Fund and the Shared Prosperity Fund have been treated as separate departments in the budget documents, with no attached comparability factor.
- No further detail was provided about the outcome of bids to the single-year UK Community Renewal Fund, the precursor to the UKSPF. The fund closed to new submissions in June 2021. Projects were originally expected to be completed by March 2022. It is unclear whether local authorities will be given additional time to complete their projects when the successful bids are eventually announced.
- In total, 10 Welsh projects were funded from the first tranche of funding from the new Levelling Up Fund, worth a combined total of £121 million (equivalent to 7% of the total UK-wide allocation of £1.7 billion). Further allocations from the £4.8 billion fund are expected in future years.

[3] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1028814/Budget_AB2021_Web_Accessible.pdf, p.88.

- All successful Welsh bids were submitted by local authorities in the highest priority group. Of the 22 Welsh local authorities, 17 were deemed to be in the highest priority group for funding under the UK government's classification system. Between them, they represent 14% of the highest priority areas in the GB-wide index.[4]
- Three successful Welsh bids were made to the smaller Community Ownership Fund, worth a combined total of £464,000.
- Elsewhere, the UK government increased departmental spending in some reserved areas, such as Justice and the Home Office. These only partly reverse the cuts made since 2010, and reflect the pressures exacerbated by the pandemic on the justice system.

Figure 5

Projects funded from the first tranche of allocations from the Levelling Up Fund



Source: HM Treasury (2021) Autumn Budget and Spending Review 2021 regions and nations factsheets.

[4] https://www.gov.uk/government/publications/levelling-up-fund-additional-documents/levelling-up-fund-prioritisation-of-places-methodology-note

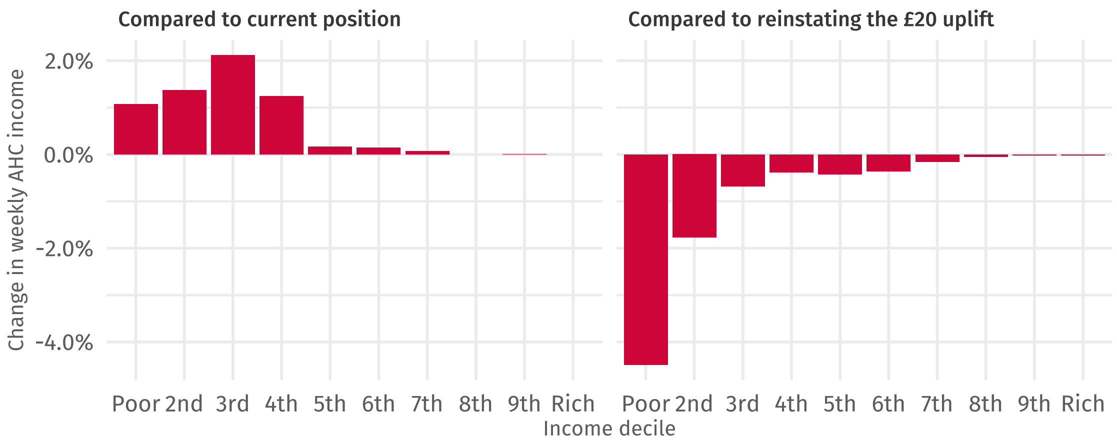
Changes to Universal Credit

The Chancellor announced major changes to the way Universal Credit payments are calculated for in-work claimants. These changes, set to be implemented by 01 December 2021, mean that individuals will be able to keep a larger share of any income earned whilst in receipt of the benefit. However, the average Welsh household in each income decile will still be worse off than they would have been had the £20 a week uplift been maintained.

- Once the new changes come into effect, the taper rate – the rate at which the Universal Credit award is reduced for any given increase in earnings – will be cut from 63% to 55%. In addition, the work allowances – the amount that eligible individuals can earn before their Universal Credit award is affected – will increase by £500 a year.

Figure 6

Distributional analysis of changing the Universal Credit taper rate and work allowance on Welsh household income



Source: WFA analysis using UKMOD version A2.5+, Family & Resources Survey (2016-18) input data. Charts show percentage change in mean equivalised Welsh household income after housing costs.

- The poorest 50% of Welsh households will be, by far, the largest beneficiaries of these changes (with 95% of the benefit accruing to households in the bottom half of the income distribution).
- However, the policies are not targeted at the very poorest households. The average Welsh household in the bottom income decile will see their disposable income increase by just over 1%, while a household in the third income decile will see their income increase by more than 2%.
- The average Welsh household in each income decile will still be worse off than they would have been had the taper rate and work allowances remained unchanged, and the £20 a week uplift reinstated instead. In particular, the poorest 10% of Welsh households will be 4.5% worse off under the new arrangements than they were in September 2021 (before the uplift was removed).

- At a UK level, these policies will cost £2 billion next year, considerably lower than the estimated £5 billion cost of reinstating the £20 a week uplift.

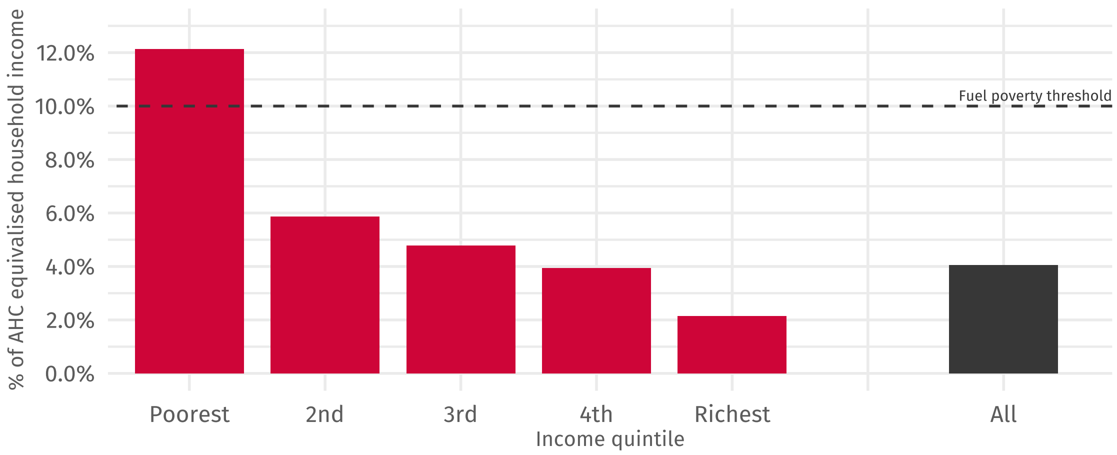
Cost of living

The forecast for consumer goods (CPI) inflation was revised upwards in the latest set of updates by the Office for Budget Responsibility (OBR). This could put additional pressure on household finances over the coming months.

- According to the OBR forecasts released alongside the Budget, CPI inflation is set to peak at 4.4% in the second quarter of 2022, averaging 3.7% in 2022–23, slowing to 2.3% in 2023–24. However, this does not account for the rises in fuel and energy prices that have occurred after the forecast was closed in September.
- The OBR further comment that recent developments are "consistent with inflation peaking at close to 5% next year", and that it could reach a level not seen in the UK for three decades.[5]

Figure 7

Combined gas and electricity bills as a proportion (%) of mean equivalised Welsh household income



Source: WFA analysis using ONS (2019-20) Living Costs and Food Survey; UKMOD version A2.5+, Family & Resources Survey (2016-18) input data.

- The cost of energy is likely to be a key source of pressure on household finances over the coming months, both because it accounts for a relatively high share of household spending and because of the scale of the expected price increases. We estimate that the poorest 20% of Welsh households spent, on average, 12% of their income (after

[5] https://obr.uk/download/october-2021-economic-and-fiscal-outlook-executive-summary/, p.7.

housing costs) on energy bills in 2019–20.[6] Although the price cap will continue to shield consumers from the volatility of wholesale costs, the recent increase to the price cap and the dwindling number of fixed-term tariffs are already pushing up bills. A further increase to the price cap is likely in the first half of 2022.

- Separate analysis by the Institute for Fiscal Studies suggests that real gross average wages are expected to remain stagnant over the forecast period – continuing a decade-long trend.[7]

[6] https://blogs.cardiff.ac.uk/thinking-wales/when-ends-dont-meet-part2/
[7] https://ifs.org.uk/budget-2021

Wales Fiscal Analysis
Cardiff University
Law Building
Museum Avenue
Cardiff CF10 3AX

wgc@cardiff.ac.uk
www.cardiff.ac.uk/wales-governance