

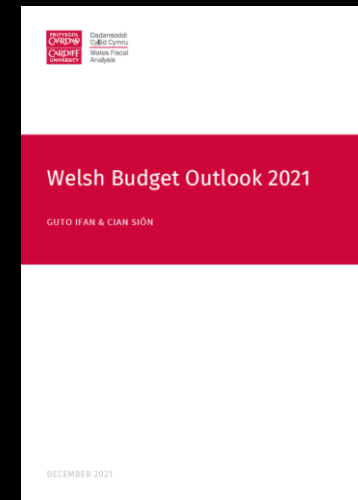
Rhagolwg Cyllideb Cymru 2021

Welsh Budget Outlook 2021

07/12/2020

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Dadansoddi Cyllid Cymru, Canolfan Llywodraethiant Cymru, Prifysgol Caerdydd
Wales Fiscal Analysis, Wales Governance Centre, Cardiff University





Content

- Economic and fiscal context
- Outlook for Welsh Government budget
- Outlook for local government
- Funding pressures and the Welsh Government-Plaid Cymru co-operation agreement



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Economic and fiscal context (1)

- The Office for Budget Responsibility (OBR) revised down its pandemic ‘scarring’ assumption from 3 per cent to 2 per cent.
- Unemployment now expected to peak at 5.2% (rather than 6.5% as forecast in March 2021). Wales has consistently recorded a lower unemployment rate than the UK average and has seen a faster recovery in employee numbers compared to the UK average over the past 21 months.
- The OBR forecasts that CPI inflation is set to peak at 4.4% in the second quarter of 2022 – but recent increases “consistent with inflation peaking at close to 5% next year”
- The outlook for household finances remains challenging.

Economic and fiscal context (2)

- Improved economic outlook, as well as departmental underspending, significantly lowered forecast UK public sector borrowing.
- Two big upward revisions to departmental spending in September and October – the Chancellor now plans to spend £9 billion more on public services in 2024-25 than under pre-pandemic (March 2020) spending plans.
- Meeting newly-set fiscal targets and increasing departmental spending as planned predicated on increasing the tax-to-GDP ratio to 36% in 2026-27, up from 33% in 2019-20 – its highest level since the 1950s and above the average for developed economies

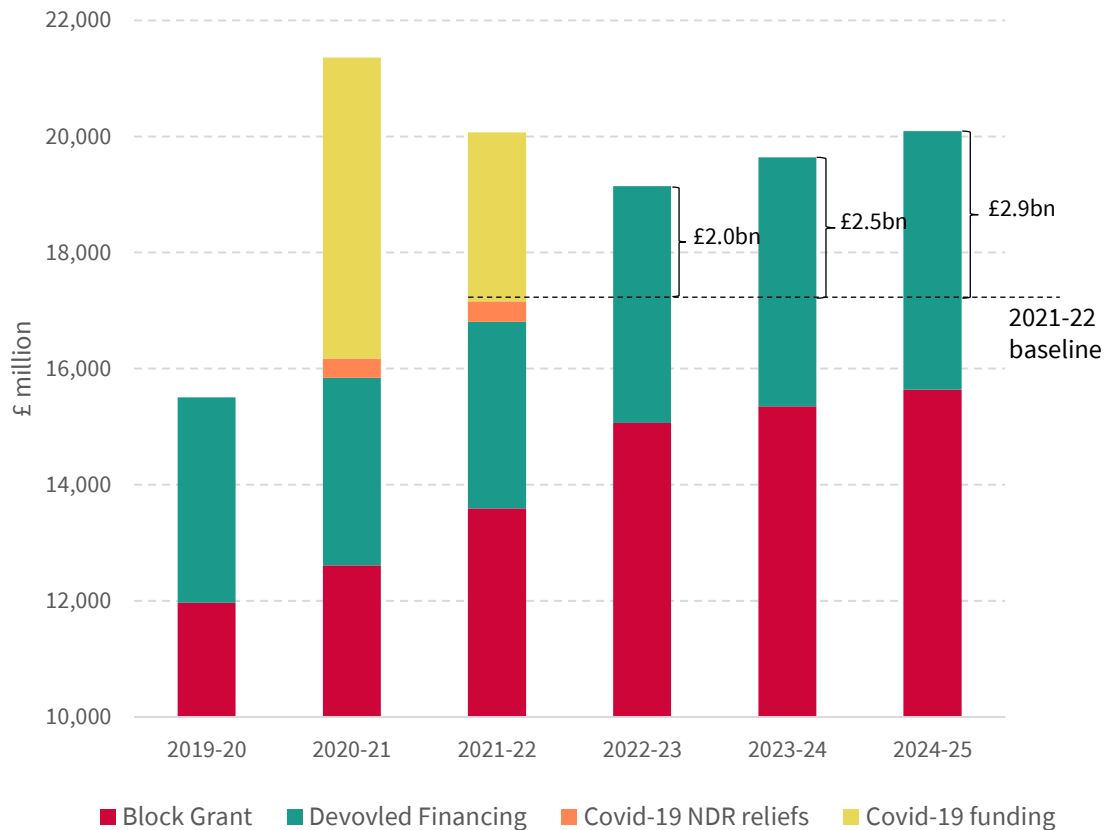


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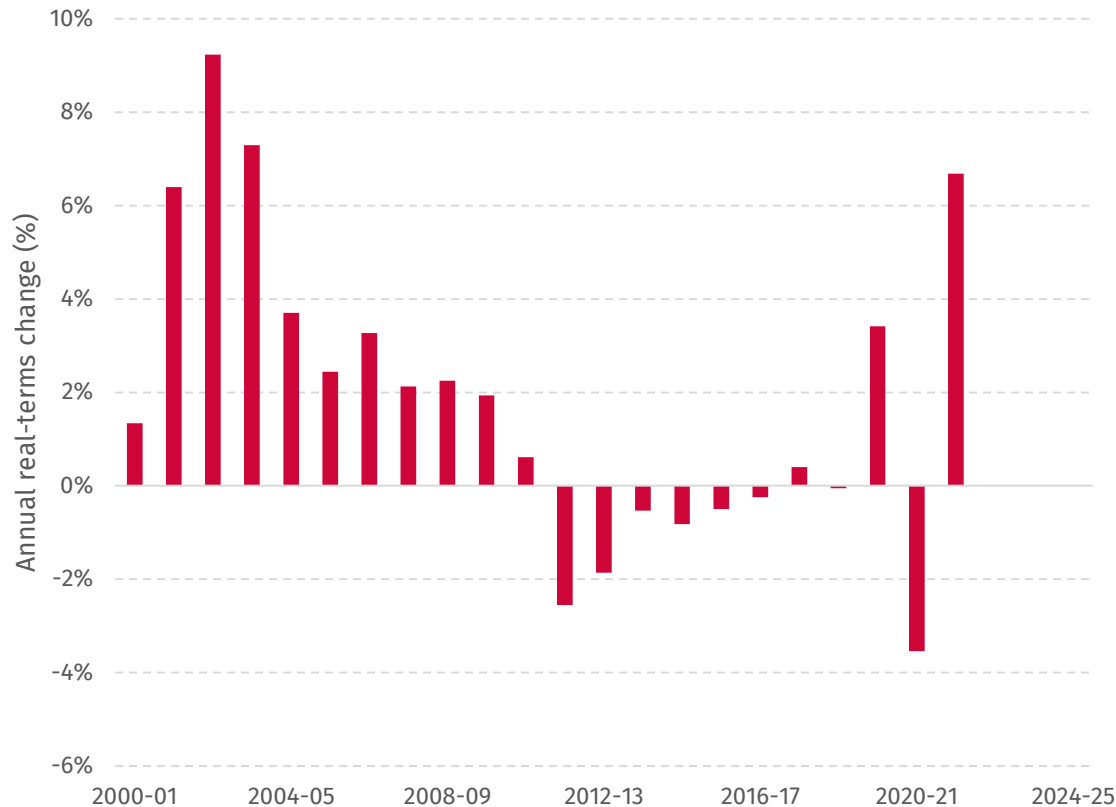
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Outlook for Welsh Government day-to-day spending (nominal terms)

- Block Grants set for 2022-23 and 2024-25 and new devolved tax forecasts
- Big improvement relative to outlook based on March 2021 spending plans
- Core day-to-day spending (excluding Covid-19) increasing by £2.0 next year and by £2.9 billion by 2024-25
- Still lower than 2020-21 and 2021-22 given Covid-19 funding – pandemic-related pressures will need to be funded from within the core budget

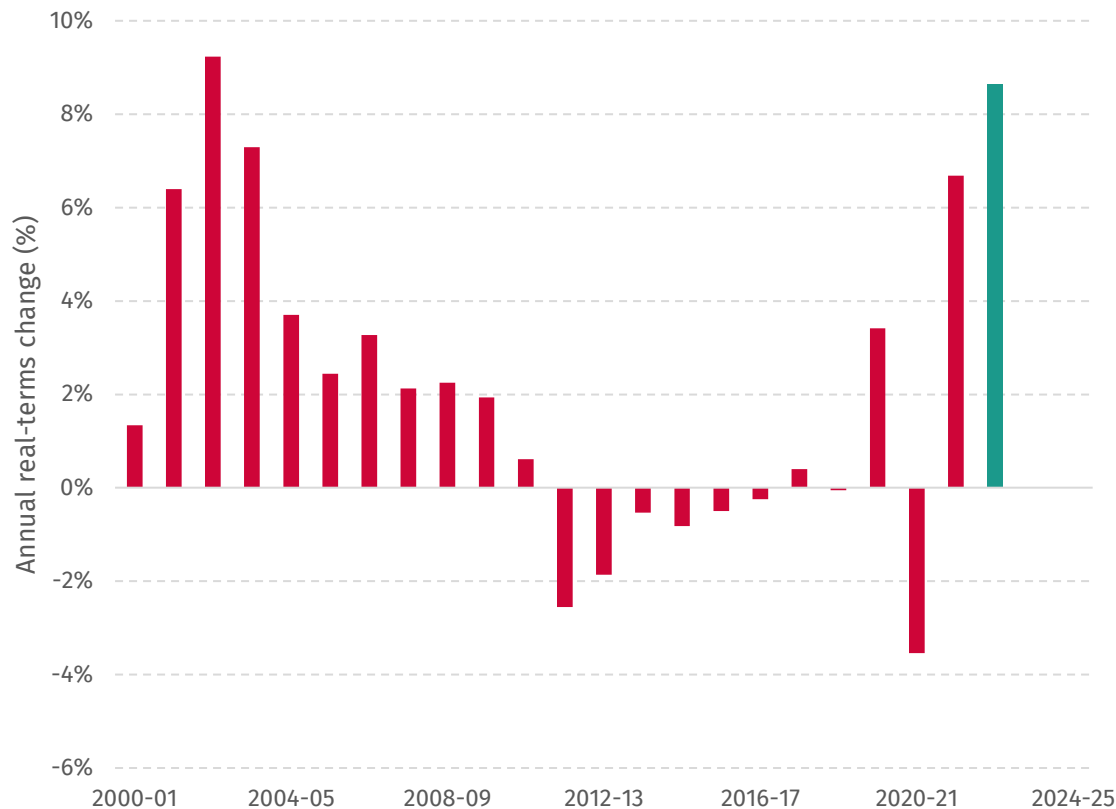


Annual real-terms changes in day-to-day spending, 2000-01 to 2024-25



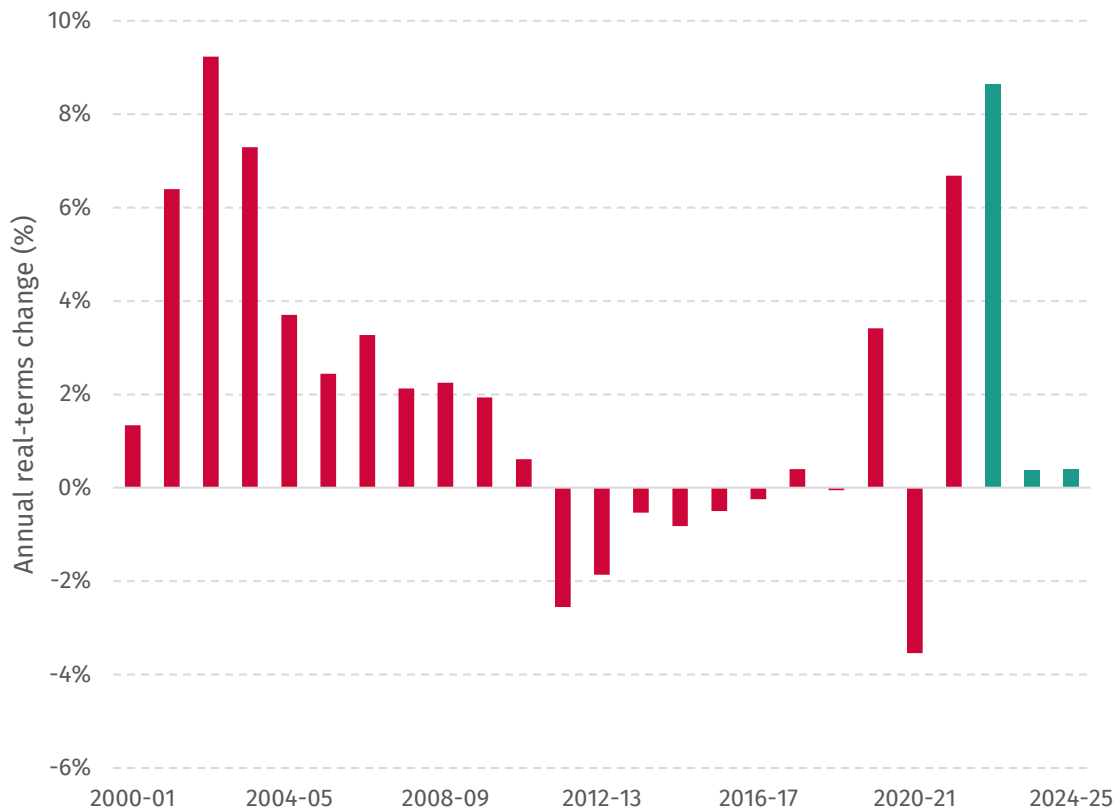
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- In real terms, day-to-day spending set to increase by 8.6% in 2022-23...



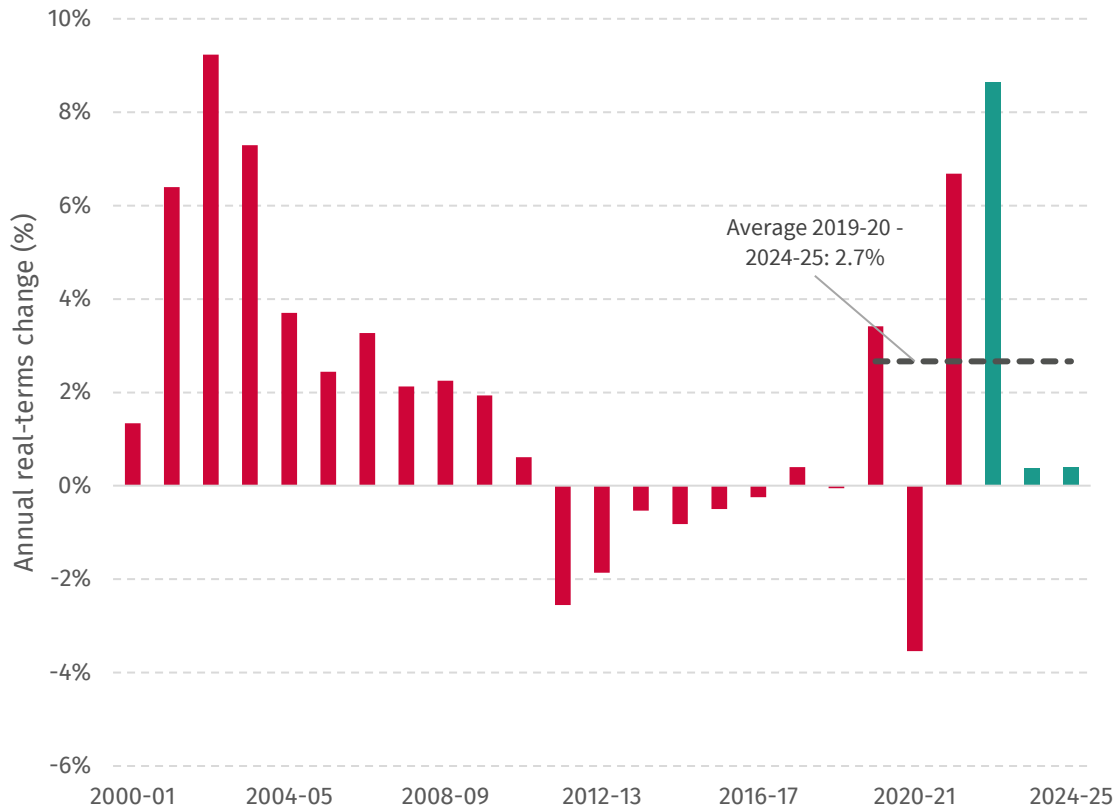
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- ... followed by almost no real-terms growth in the following two years



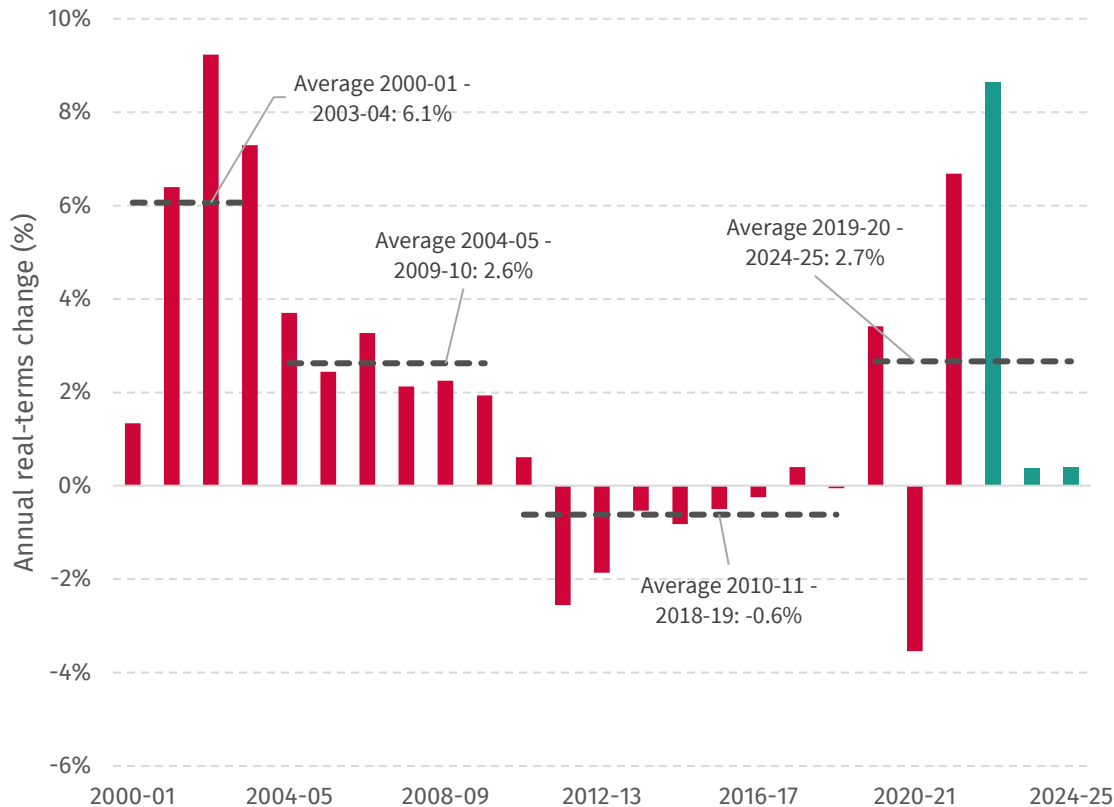
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- In real terms, day-to-day spending set to increase by 8.6% in 2022-23...
- ... followed by almost no real-terms growth in the following two years
- Smoothing over pandemic-related volatility in the measure of inflation (GDP deflator) – average increases in 2019-20 to 2024-25 set to be 2.7%



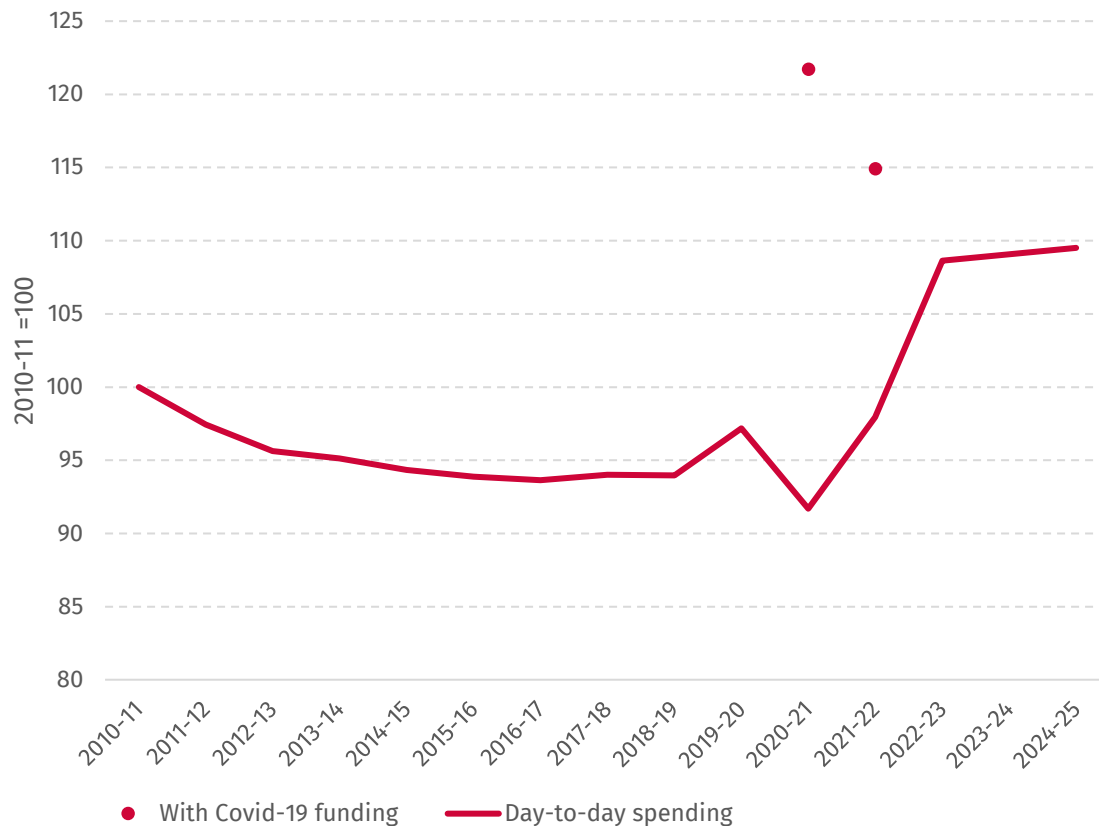
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- Smoothing over pandemic-related volatility in the measure of inflation (GDP deflator) – average increases in 2019-20 to 2024-25 set to be 2.7%
- Step-change on previous decade, more in line with average increases between 2004-05 and 2009-10



- Relative to pre-austerity levels, day-to-day spending will be around 9% above 2010-11 levels in real terms next year

Trends in day-to-day spending since 2010-11 (real terms, 2010-11 = 100)



- Relative to pre-austerity levels, day-to-day spending will be around 9% above 2010-11 levels in real terms next year
- On a per person basis, it'll be 4% higher

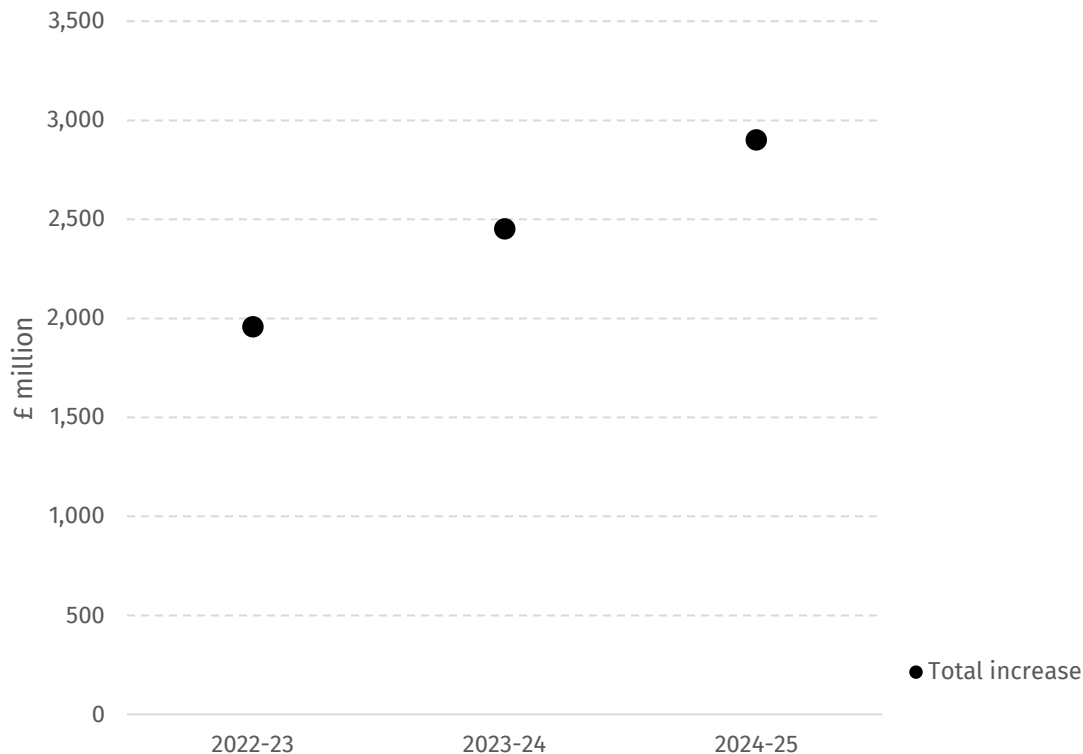
Trends in day-to-day spending since 2010-11 (real terms, 2010-11 = 100)



Illustrative spending scenario (1)

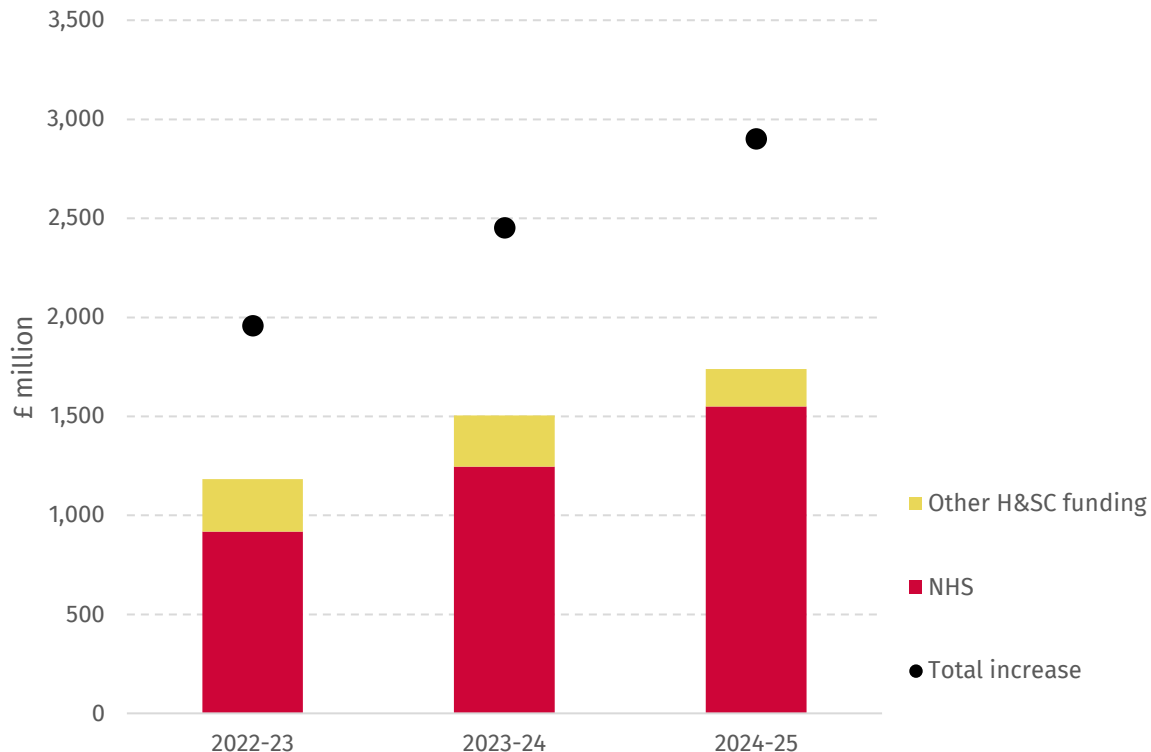
- We make several assumptions about Welsh Government decisions – broadly following UK government decisions on spending in England:
 - Welsh Government passes on **consequentials from NHS England**, while consequentials from other Department of Health and Social Care funding is also allocated towards health costs
 - The Welsh Government allocates **consequentials from funding for adult social care reform** in England (£5.3 billion over three years) towards social care reform in Wales
 - **Consequentials from schools spending** in England are passed on to local governments in Wales
 - The Welsh Government uses estimated funding from recent changes to **Business Rates** in England to implement similar policies in Wales
 - The remaining funding in the budget is allocated proportionally to all other service areas

Illustrative spending scenario (2)



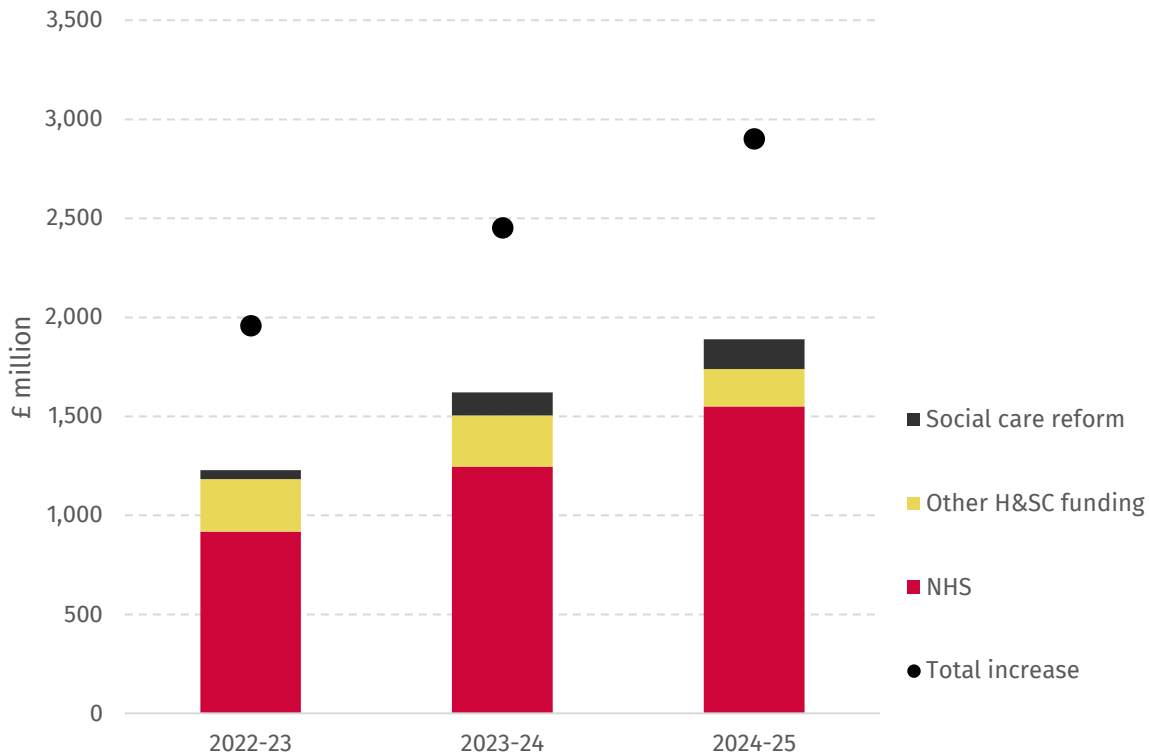
Illustrative spending scenario (2)

- Excluding Covid-19 funding, NHS funding allocations in 2024-25 would be 11% higher in real terms than 2021-22 – other H&SC funding to meet Covid-19 costs



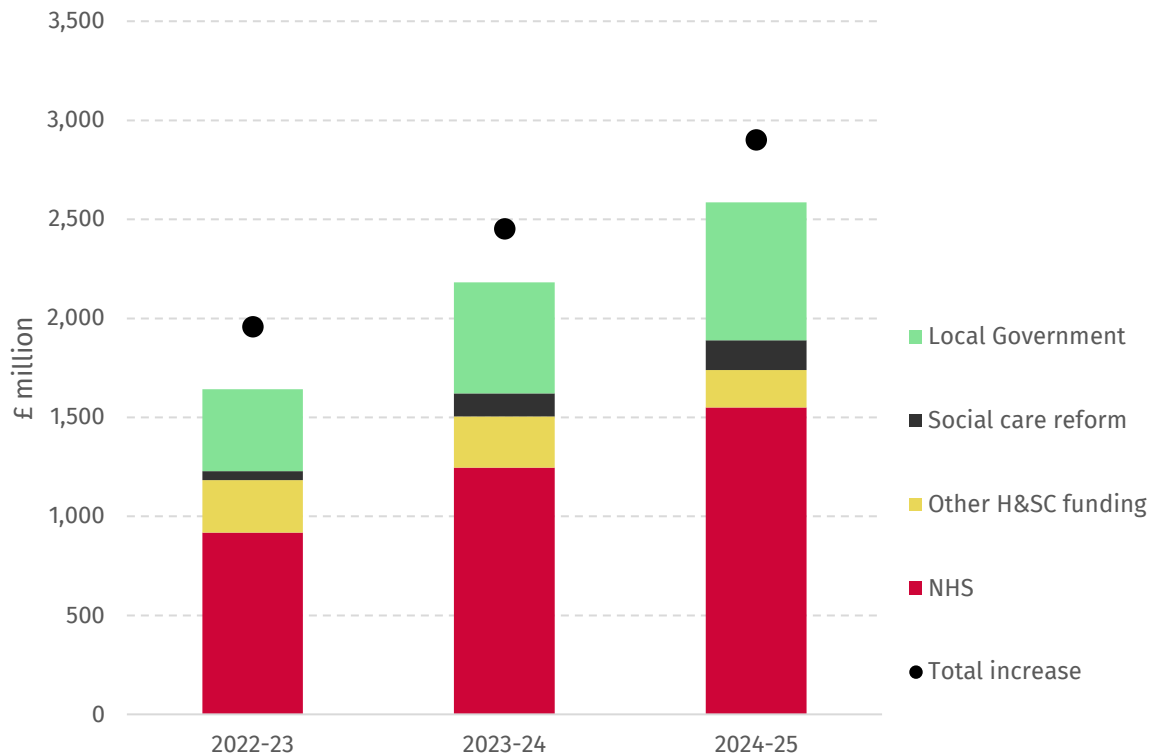
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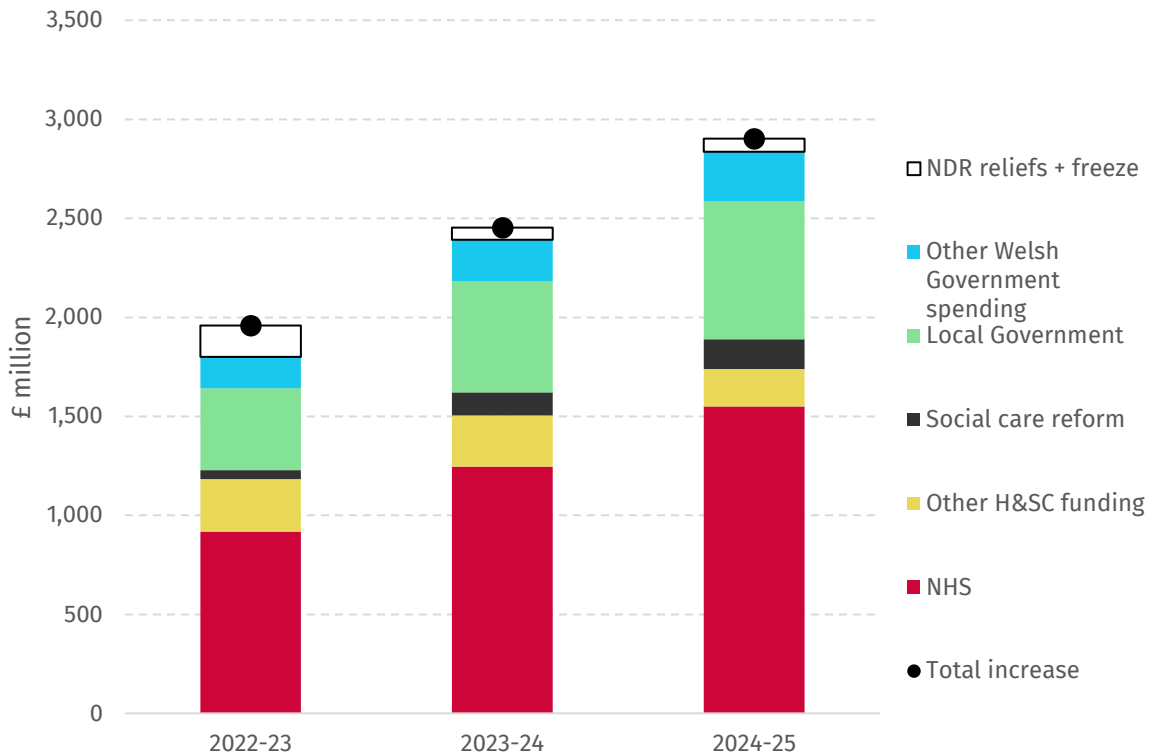
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- 5.1% real terms increase in core local government funding by 2024-25, driven by schools consequentials



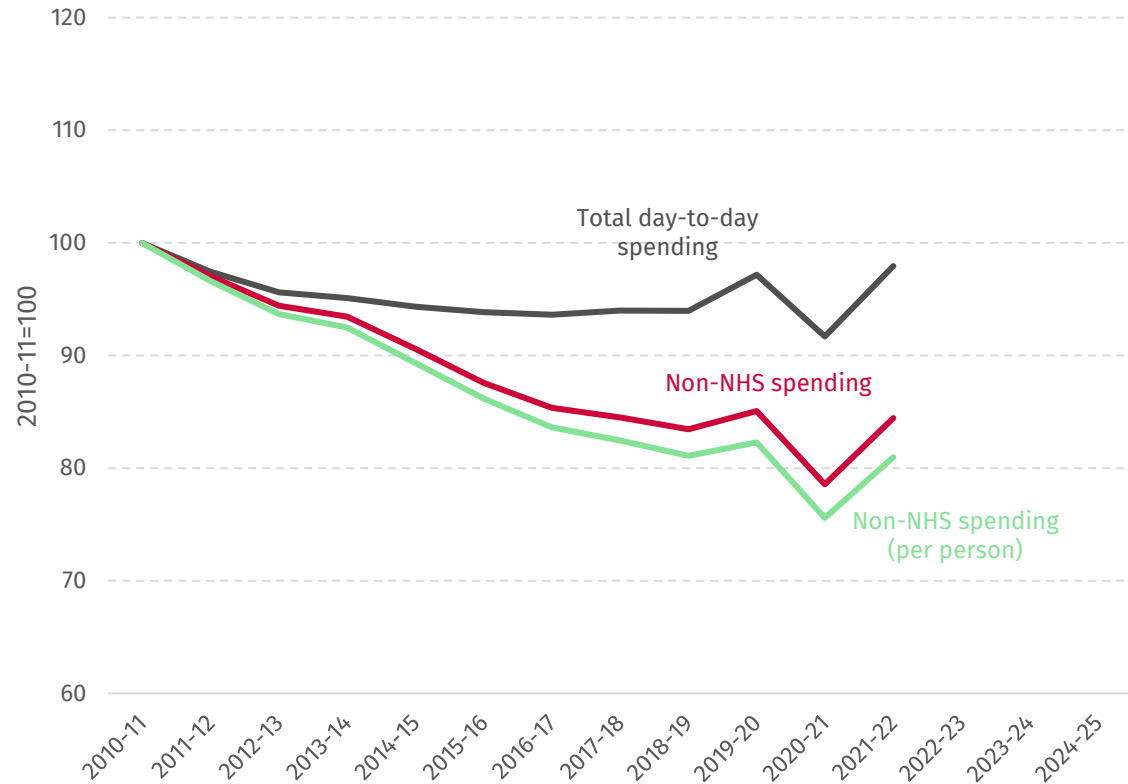
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- £150 million by 2024-25 for adult social care reform
- 5.1% real terms increase in core local government funding by 2024-25, driven by schools consequentials
- Funding for other Welsh Government services could increase by 2.7% in real terms in 2022-23



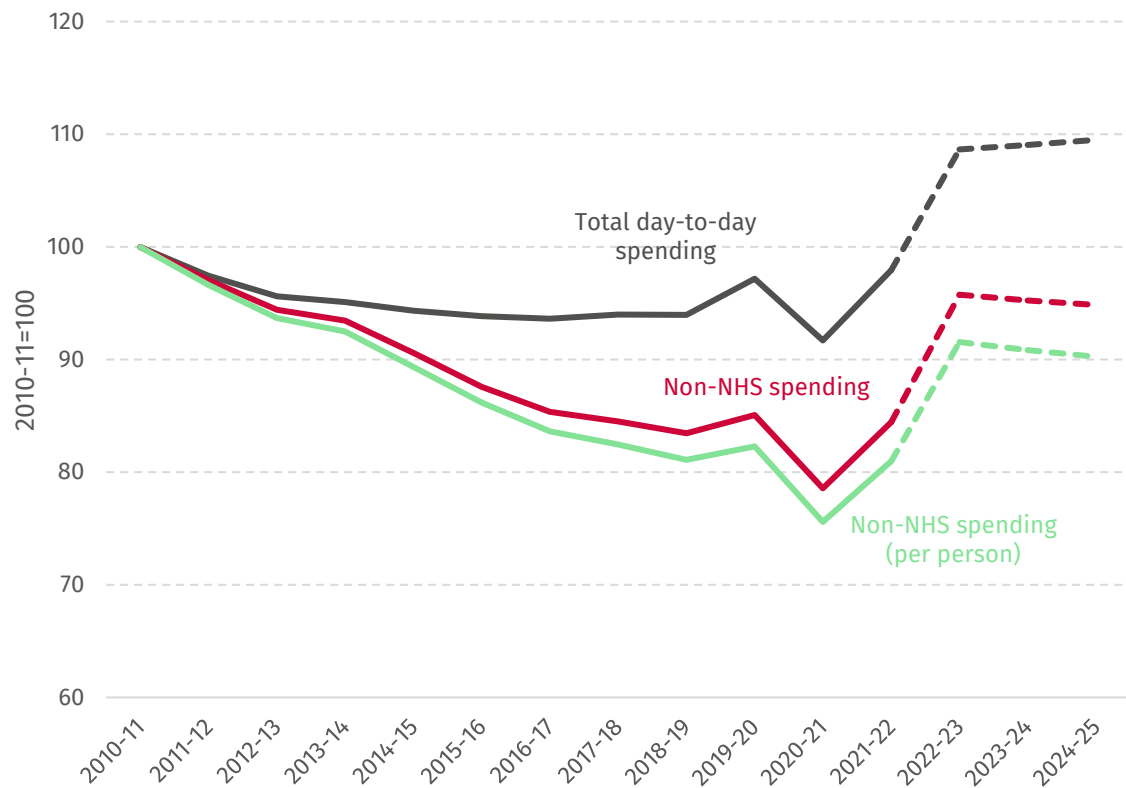
Illustrative spending scenario (3)

- Total spending outside of the core NHS budget would increase substantially in real terms for the first time in over a decade, reversing some of the cuts seen after 2010-11
- However, spending outside of the NHS will remain around 5% below pre-austerity levels in 2024-25...
- ... or 10% below on a per person basis



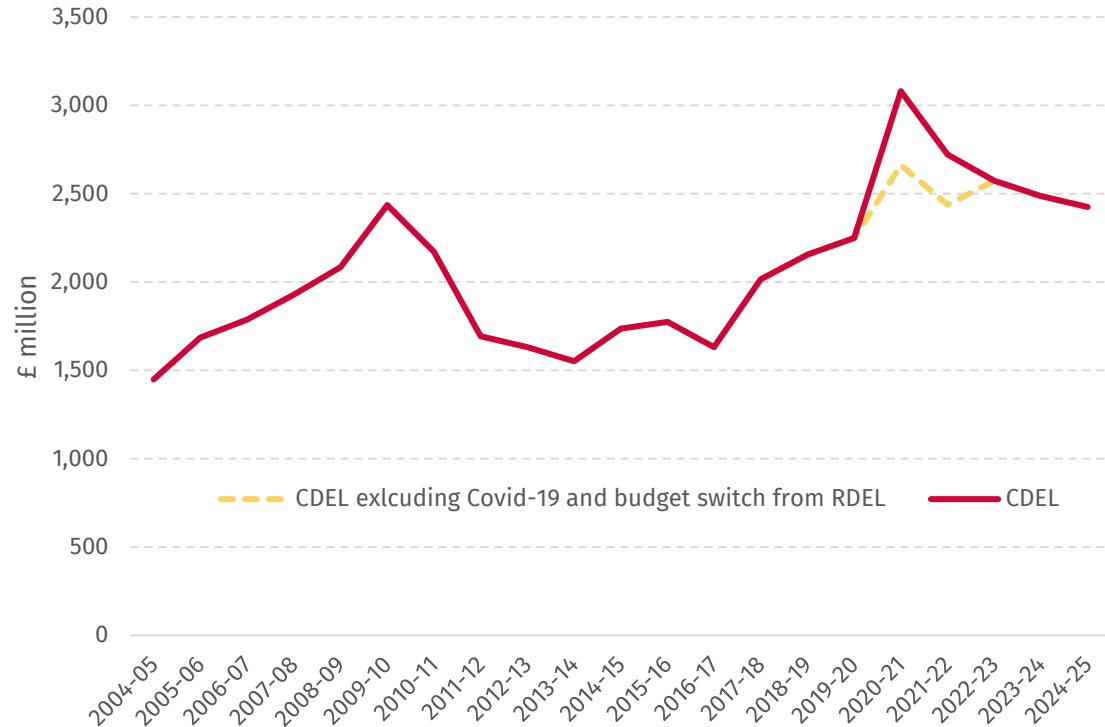
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Welsh Government capital block grant (2021-22 prices)

- The Welsh Government's core capital block grant will increase in nominal terms in 2022-23, driven by increases in Financial Transactions funding which reduces in subsequent years.
- After recent increases, capital block grant will fall slightly in real terms during this Spending Review period
- Capital spending will be higher in this Senedd term compared to the previous term



Capital spending

- Multi-year settlement will allow planning of investments over coming years. We assume the Welsh Government borrows up to the limit of £150 million each year.
- 2 pressing areas of the capital budget:
 - **Climate change spending** - net zero public spending will require Welsh Government investments
 - **Health spending** – need to build capacity to recover from Covid-19
- Increasing capital spending in both these areas will mean difficult choices for all other areas of capital spending given a declining capital block grant and very limited capital borrowing powers



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Local government finance during the pandemic

- Local authorities faced substantial additional costs (e.g. supporting care sector, homelessness support, FSM)
- Drop in non-tax income (e.g. parking, council-owned facilities)
- Hardship Fund devised to compensate local authorities based on self-reported funding needs – a unique approach within the UK (Ogden, Phillips, Siôn 2021)

In 2020-21...

- £400 million was paid with respect to additional expenditure claims
- £190 million was paid to compensate councils for non-tax income losses

Hardship Fund has now been extended until March 2022...

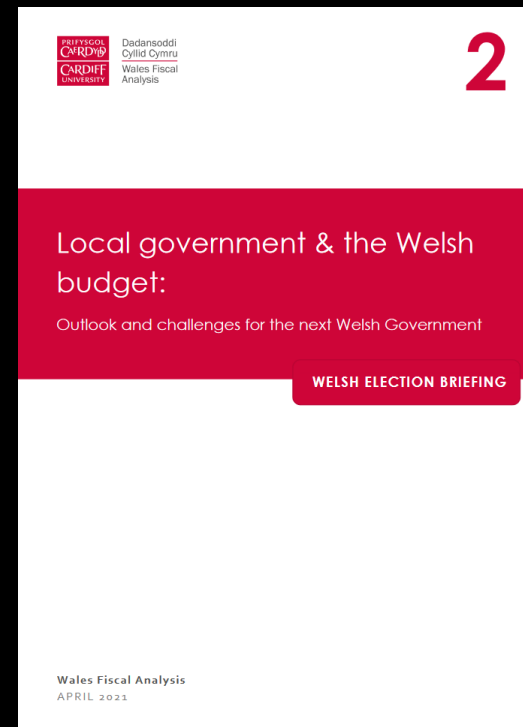
Payments made to local authorities from the Single Emergency Hardship Fund, 2020-21



Source: Welsh Government (2021) FOI request. • Notes: Other payments include £40m for central services, £25m for digital transformation, £25m to compensate for savings not achieved, and smaller allocations for planning and development, self-isolation payments, and statutory sick pay enhancements. These figures were correct as of 10 August 2021, when a small number of claims were still on hold.

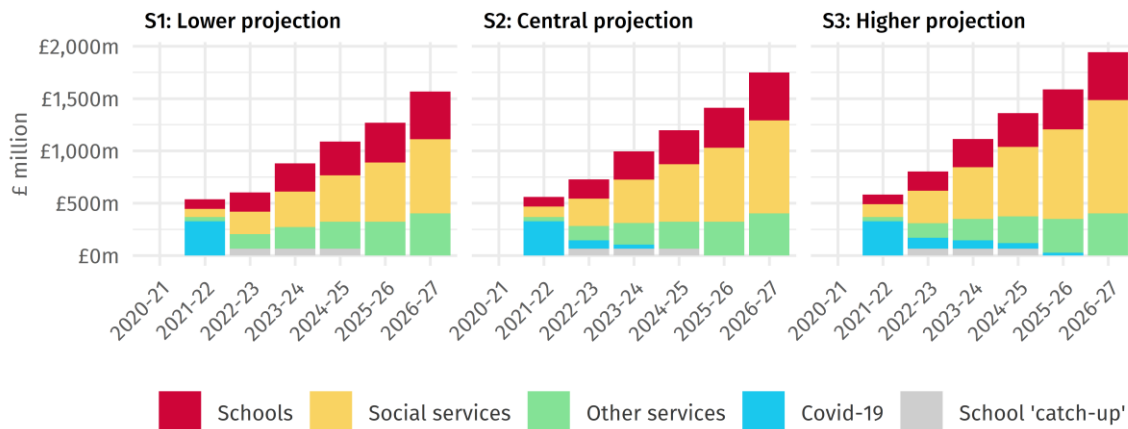
Changes to the outlook since March 2021...

- A considerably improved outlook for devolved public finances...
- Partially offset by increased local government spending pressures:
 - Near-term inflationary pressures feed into higher input costs
 - Faster earnings growth forecast in the near-term (particularly NLW)
 - Increased employee costs as a result of the new H&SC Levy (~£27m for the teaching and LA workforce in 2022-23)



- Social services accounts for ~50% of the pressures in future years.
- Additional costs and lost income as a result of Covid-19 only have a limited impact on councils' additional spending requirements from 2022-23 onwards.

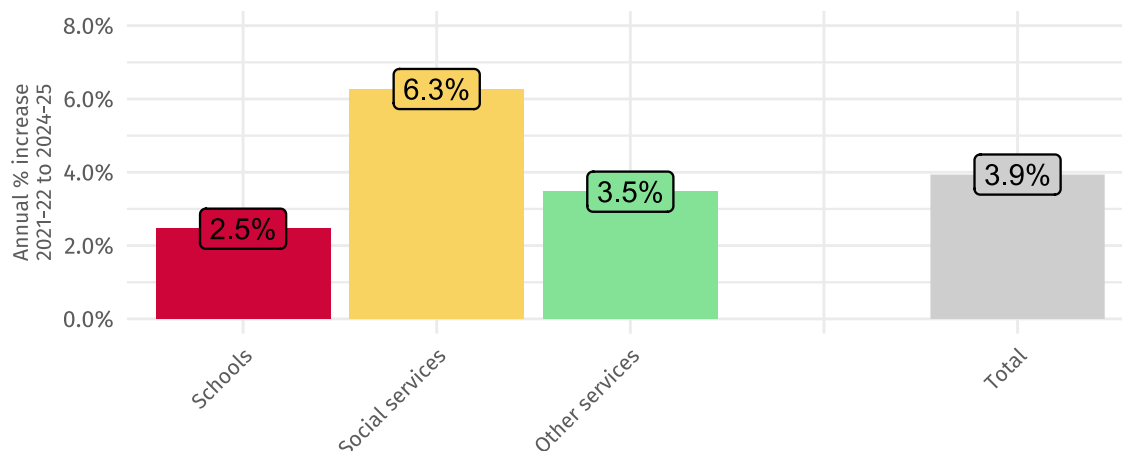
Components of local authority spending pressures from 2020-21



Source: See report for full methodology • Notes: Charts show additional funding required to meet councils' spending requirements relative to the 2020-21 (non-Covid) baseline. Lower cost scenario reflects slower growth in demand for adult and children's social services, and less persistent Covid-19 costs and income losses. Higher cost scenario reflects faster growth in demand for adult and children's social services, and more persistent Covid-19 costs and income losses.

- Annual spending increases of 3.9% (nominal) for the next three years are required to meet baseline (non-COVID) pressures in 2024-25.
- A declining pupil population limits the growth in schools' spending pressures.

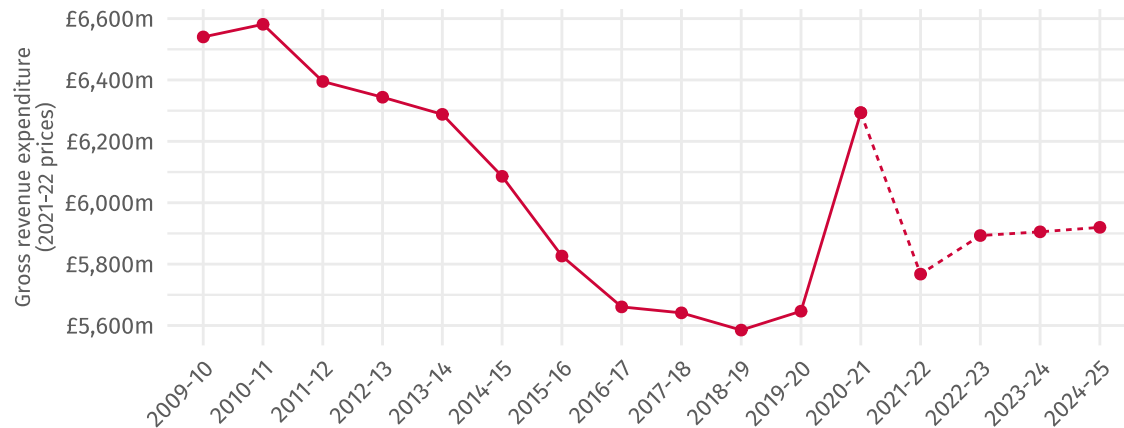
Annual percentage (%) increase in spending requirement, 2021-22 to 2024-25



Source: See report for full methodology • Notes: Chart shows the annual increase in spending required over three years to meet spending pressures in 2024-25 according to the central scenario. Excludes the spending requirements on Covid-19 and “catch-up” learning initiatives.

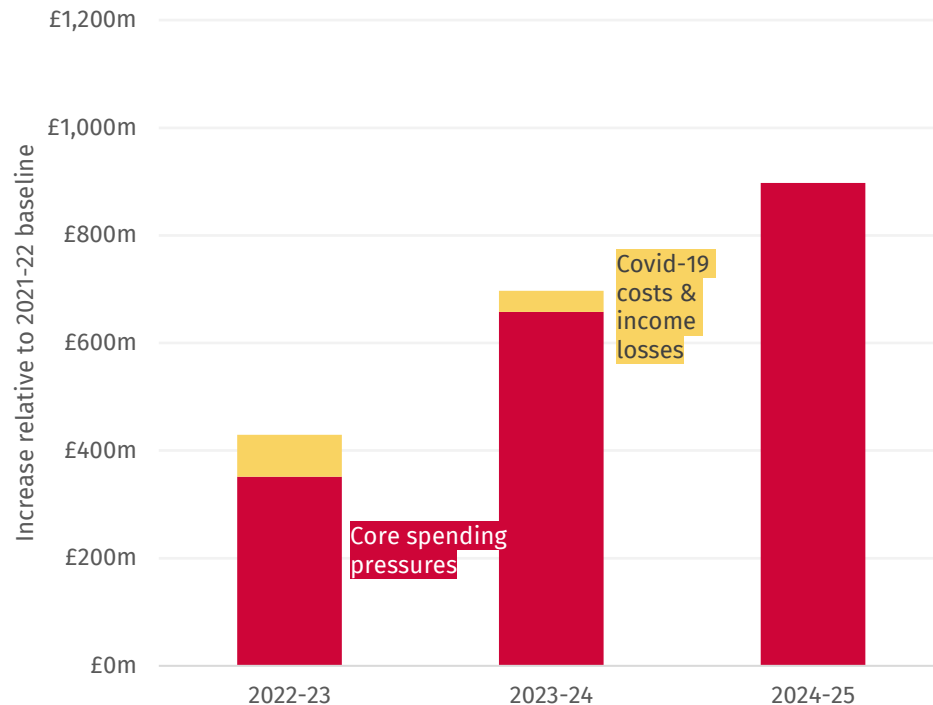
- 3.8% average (nominal) annual increase to principal council funding over the next three years
- Since the funding is front-loaded, councils might only see modest real-terms increases from 2023-24 onwards

Welsh Government funding to local authorities, and projections to 2024-25 (2021-22 prices)



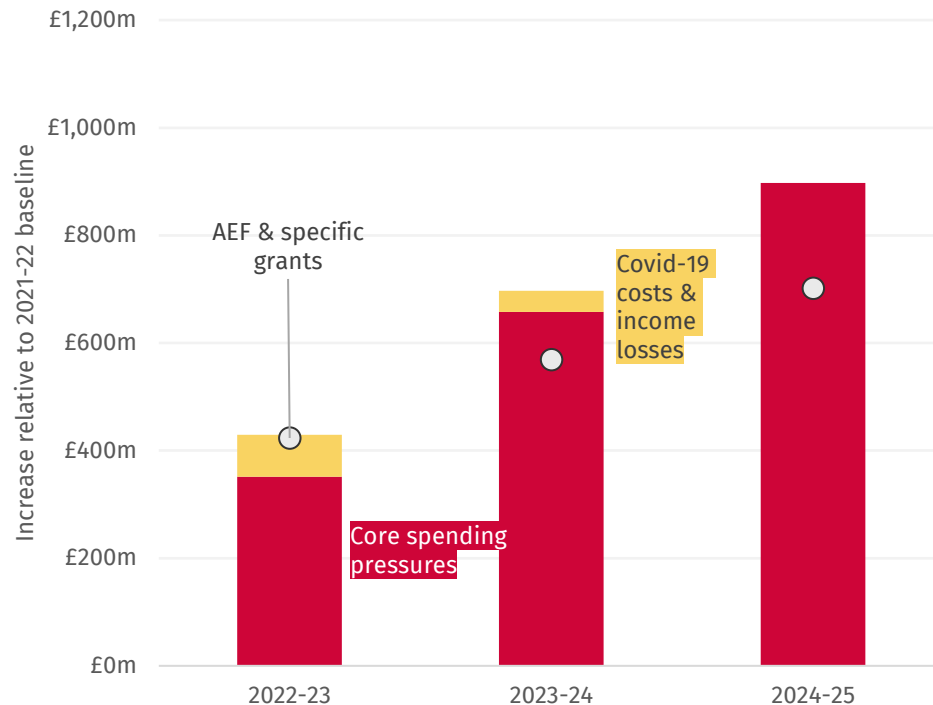
Source: See report for full methodology. • Notes: A fall in public sector output during 2020-21 temporarily raised the GDP deflator, which suppresses the real terms increase in funding between 2019-20 and 2020-21. The figure for 2021-22 represents the amount allocated at the Final Local Government Settlement, plus subsequent funding announcements – although the outturn may be higher

Increases to local Government funding and pressures relative to 2021-22 baseline



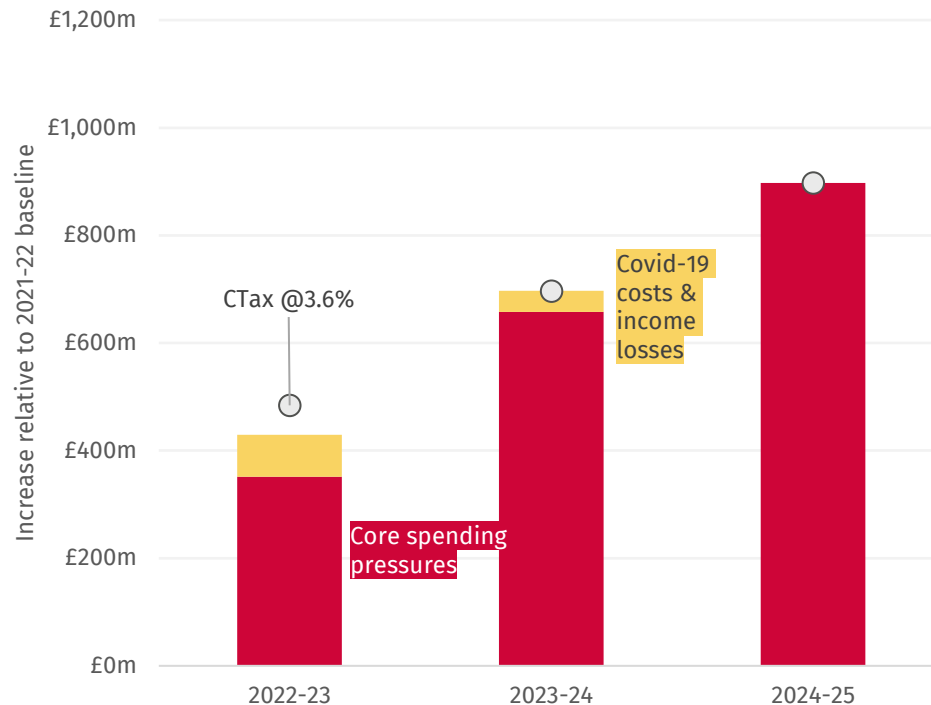
- Increase in the settlement alone is sufficient to meet spending pressures next year
- But Council Tax will need to take more of the strain in future years

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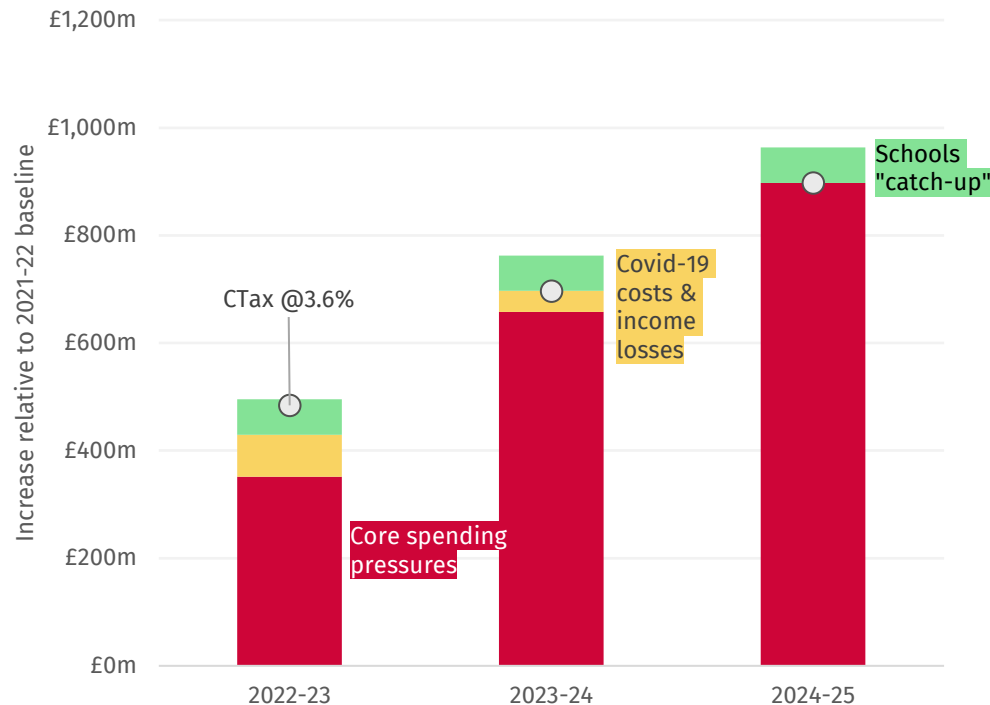
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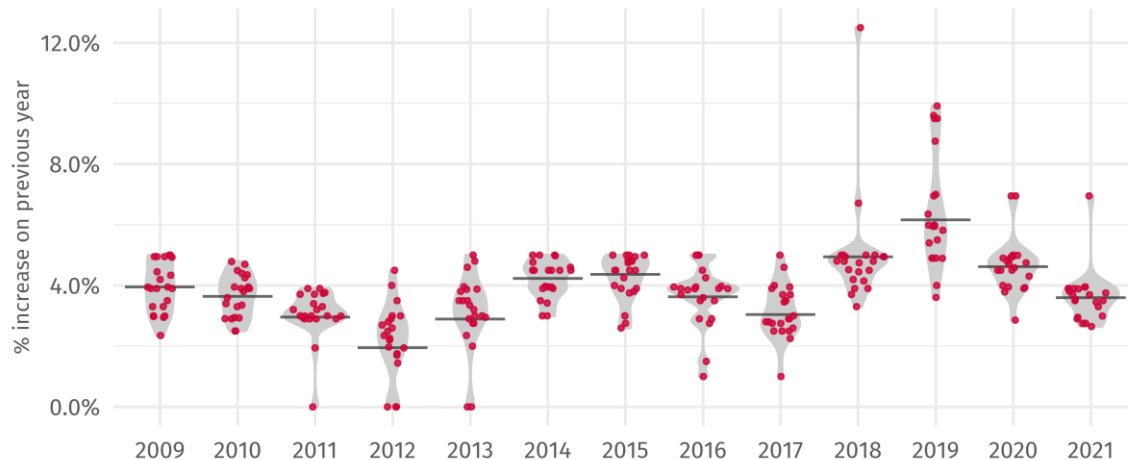
- Increase in the settlement alone is sufficient to meet spending pressures next year
- But Council Tax will need to take more of the strain in future years
- Council tax increases of 3.6% a year required to meet pressures...
- Some schools' "catch-up" costs remain unfunded

Increases to local Government funding and pressures relative to 2021-22 baseline



- A 3.6% Council Tax increase would be lower than most recent years – and may not be much higher than CPI inflation in 2022-23.
- Still a strong case for making council tax “fairer”

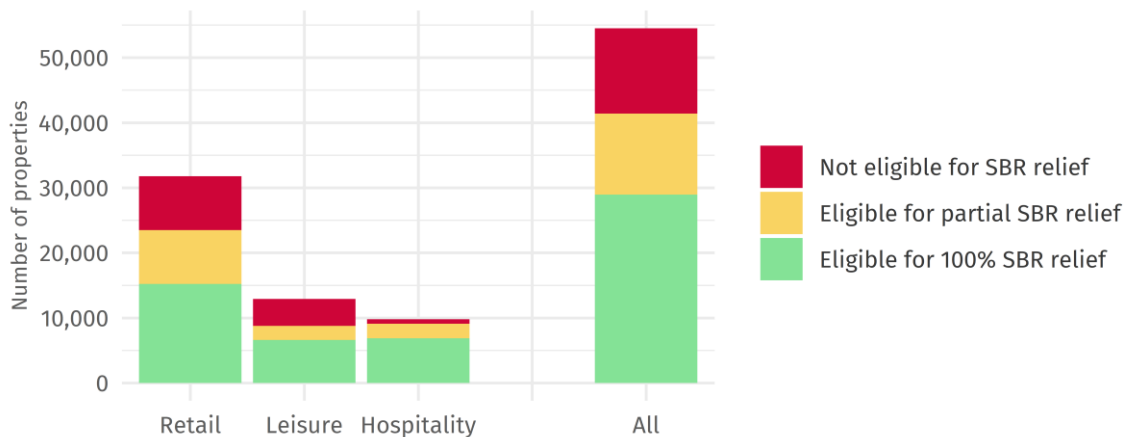
Annual percentage (%) increase in Council Tax levels, 2009 to 2021



Source: StatsWales (2021) Council tax by billing authority. • Notes: Grey lines denote the average increase in council tax levels across Wales.

- An estimated 54,500 retail, leisure, and hospitality businesses are registered on the local rating list in Wales
- A majority (29,000) of these already qualify for full tax relief under the Small Business Rates relief scheme.

Number of retail, leisure, and hospitality premises eligible for SBR relief, April 2021



Source: WFA analysis of VOA (2021) Stock of properties tables. • Notes: The breakdown of leisure and hospitality premises eligible for partial and 100% relief is estimated.

Non-domestic (business) rates policy

- UK Budget announcements triggered approximately **£160m** of consequential funding for the Welsh budget in 2022-23
- Offering 50% relief to retail, leisure and hospitality businesses would cost roughly **£250m**
- Setting an upper rateable value threshold of £205,000 would halve the cost to **£125m**
- Freezing the multiplier would cost **£42m** in 2022-23
- Changes to revaluation schedule?

Adult social care reform

- An estimated **£150m** of H&SC Levy funding available for adult social care reform in 2024-25
- But any reforms will need to address more than who pays for care, and how...
- Reforms will need to be accompanied by an adequate funding settlement for local authorities
 - Estimated cost of Free Personal Care if implemented in 2021 **~£190m** (LE Wales 2020)
 - Lessons from Scotland?
- Impact on different age cohorts & intergenerational fairness?

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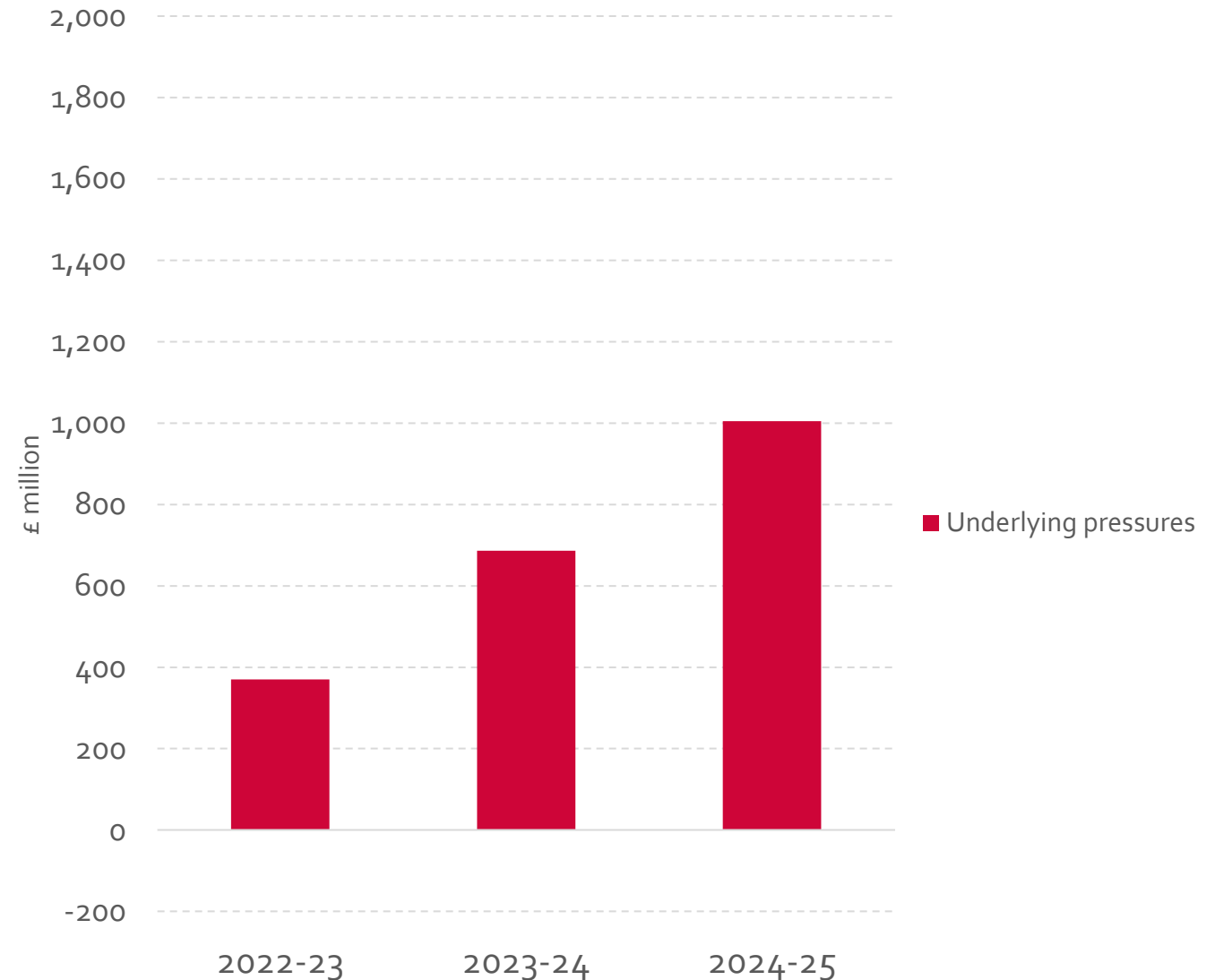
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Funding pressures (1)

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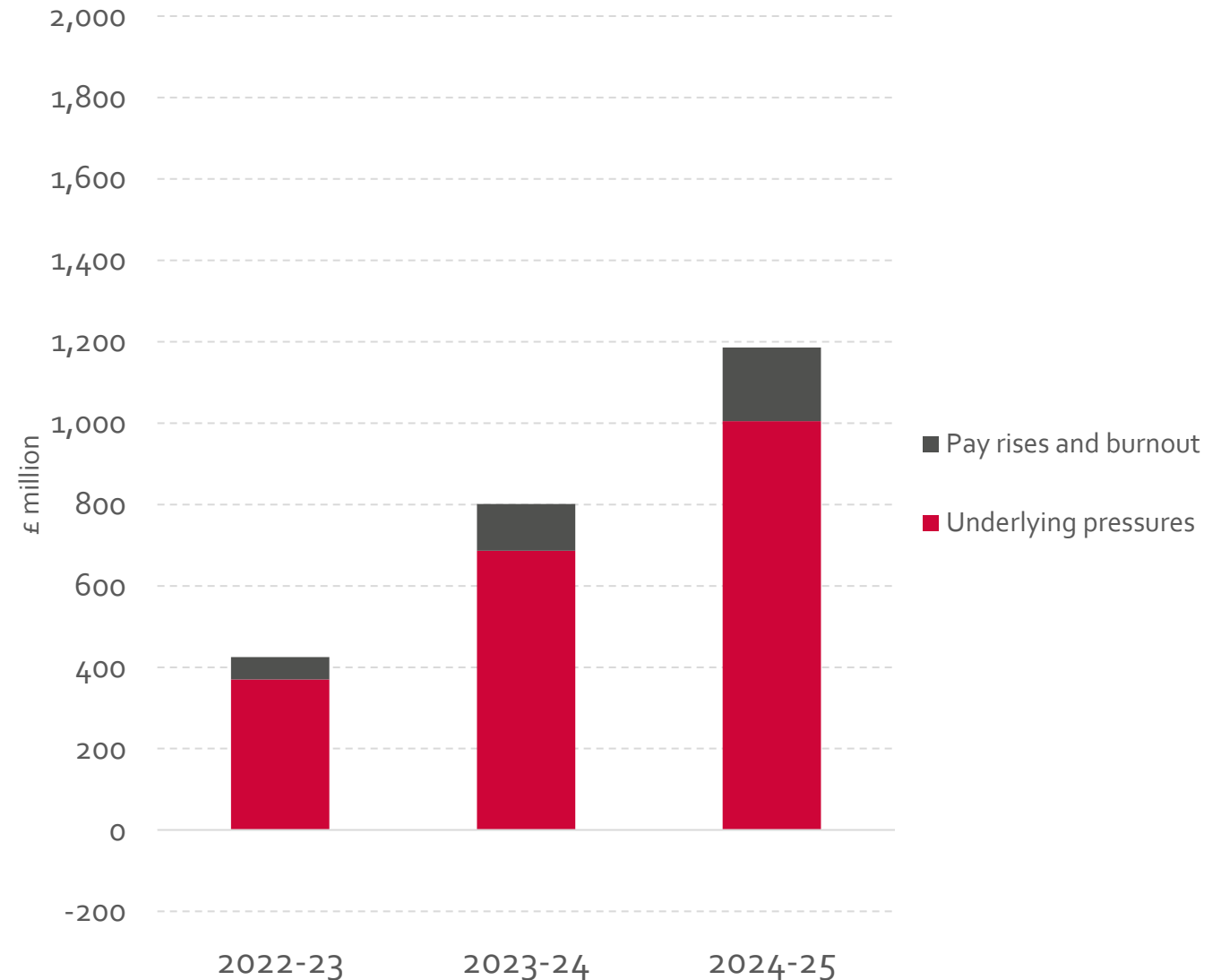
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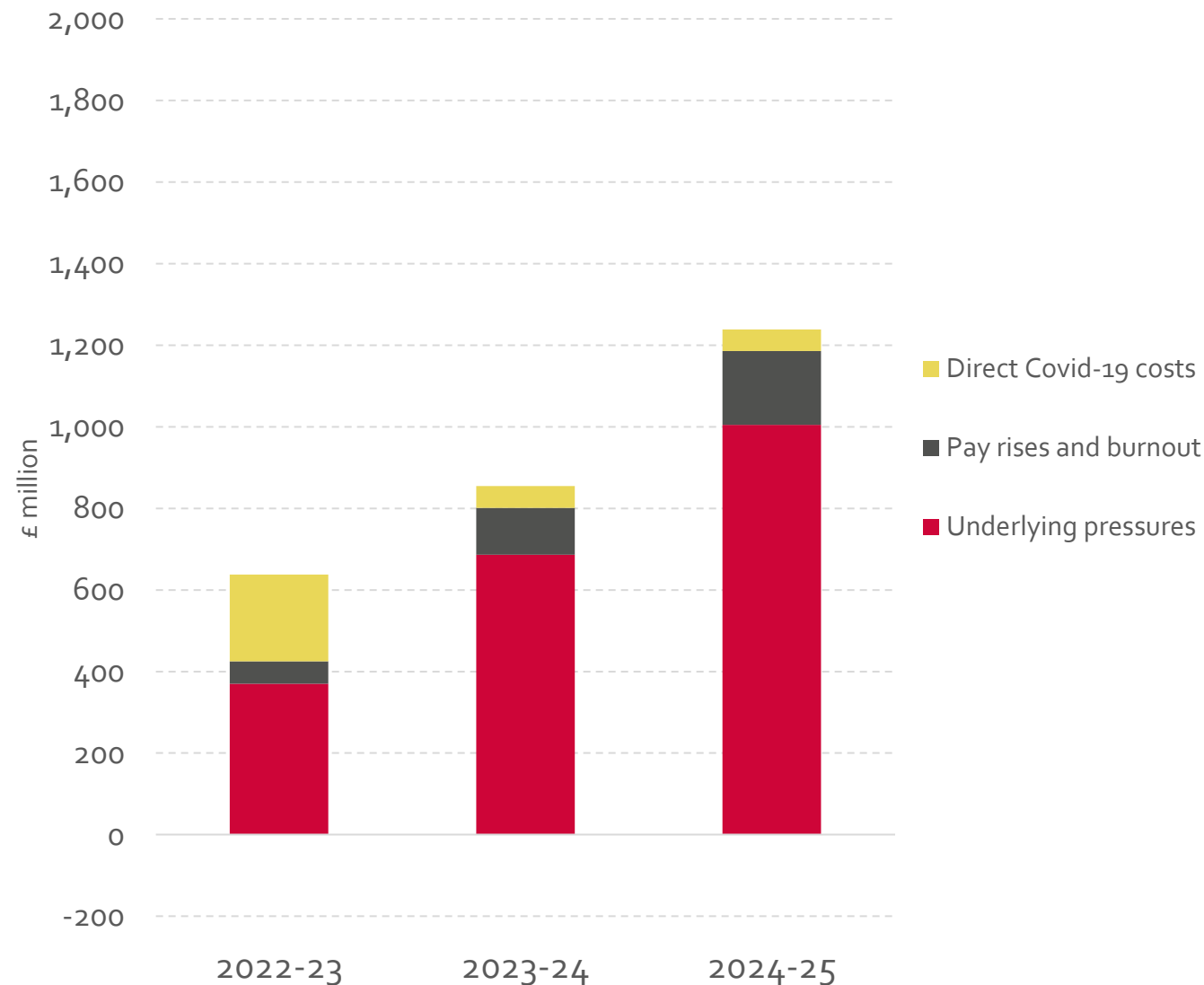
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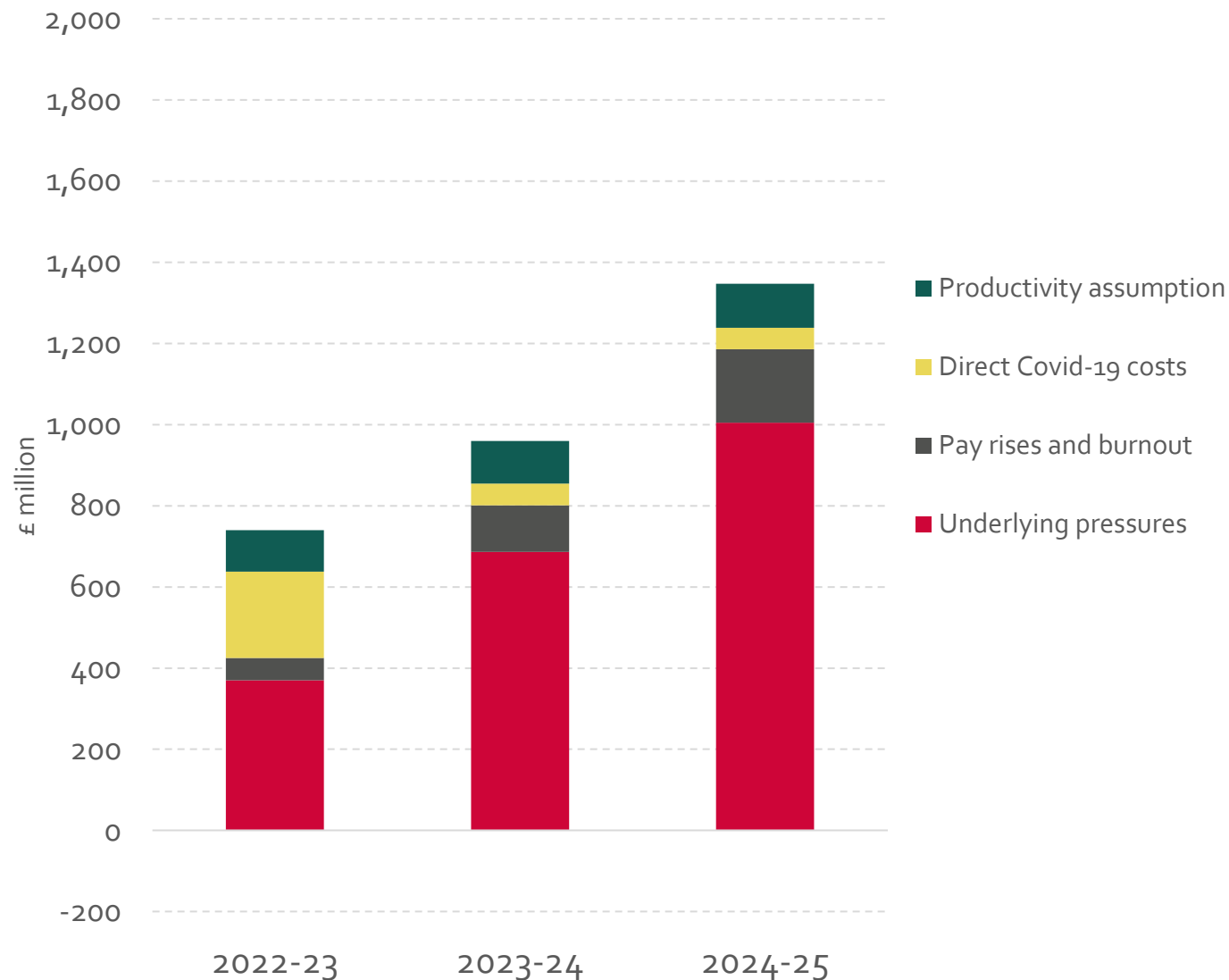
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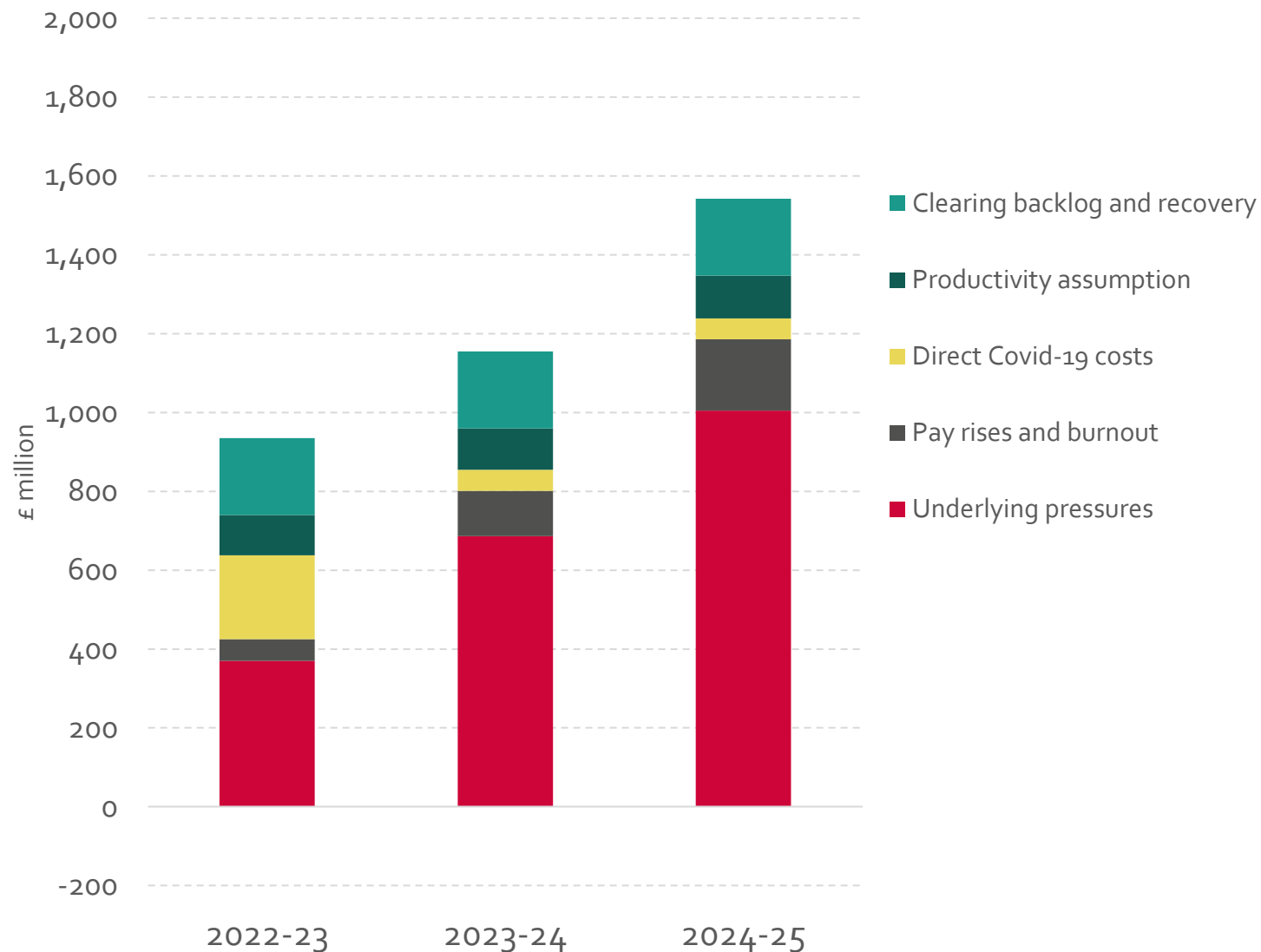
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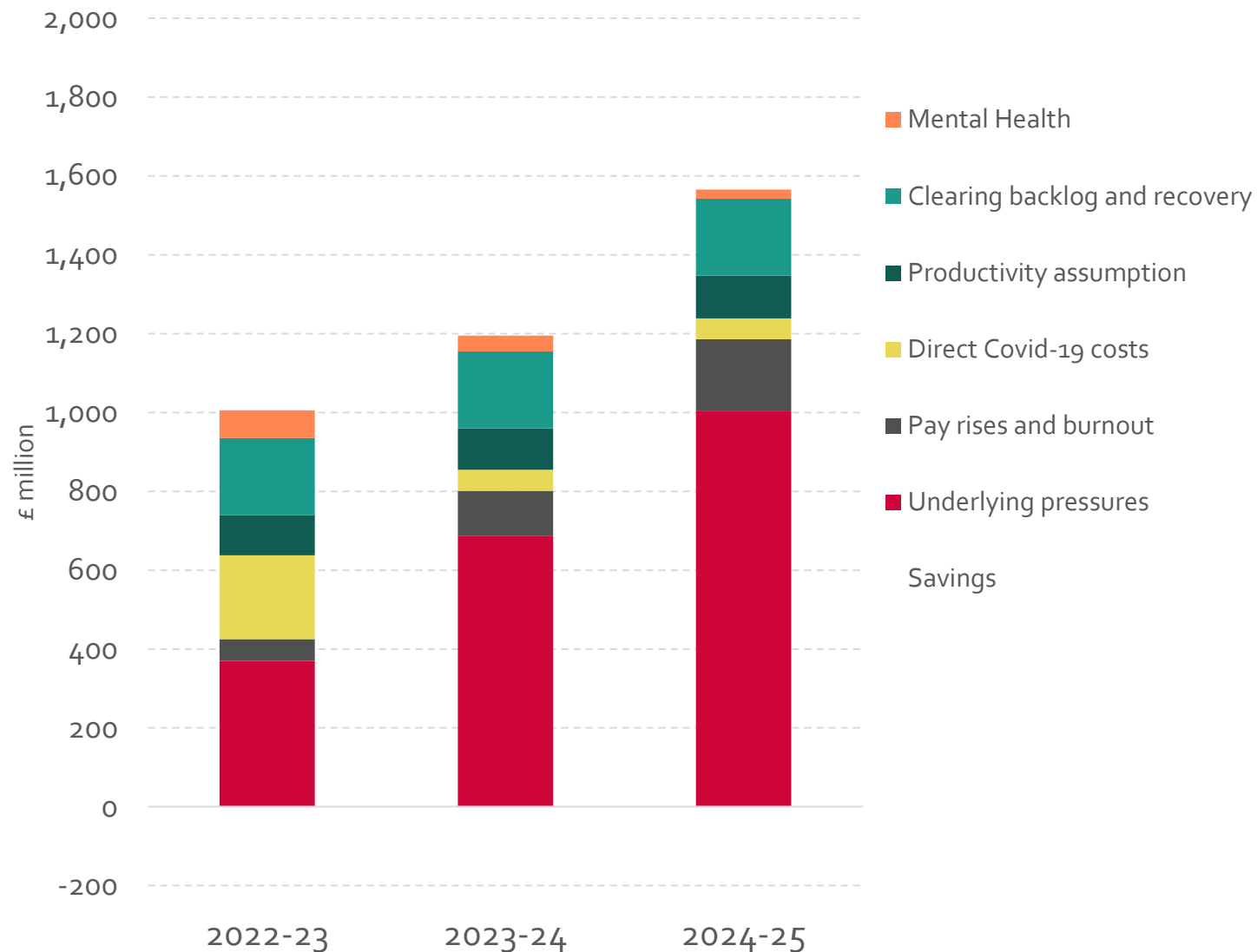
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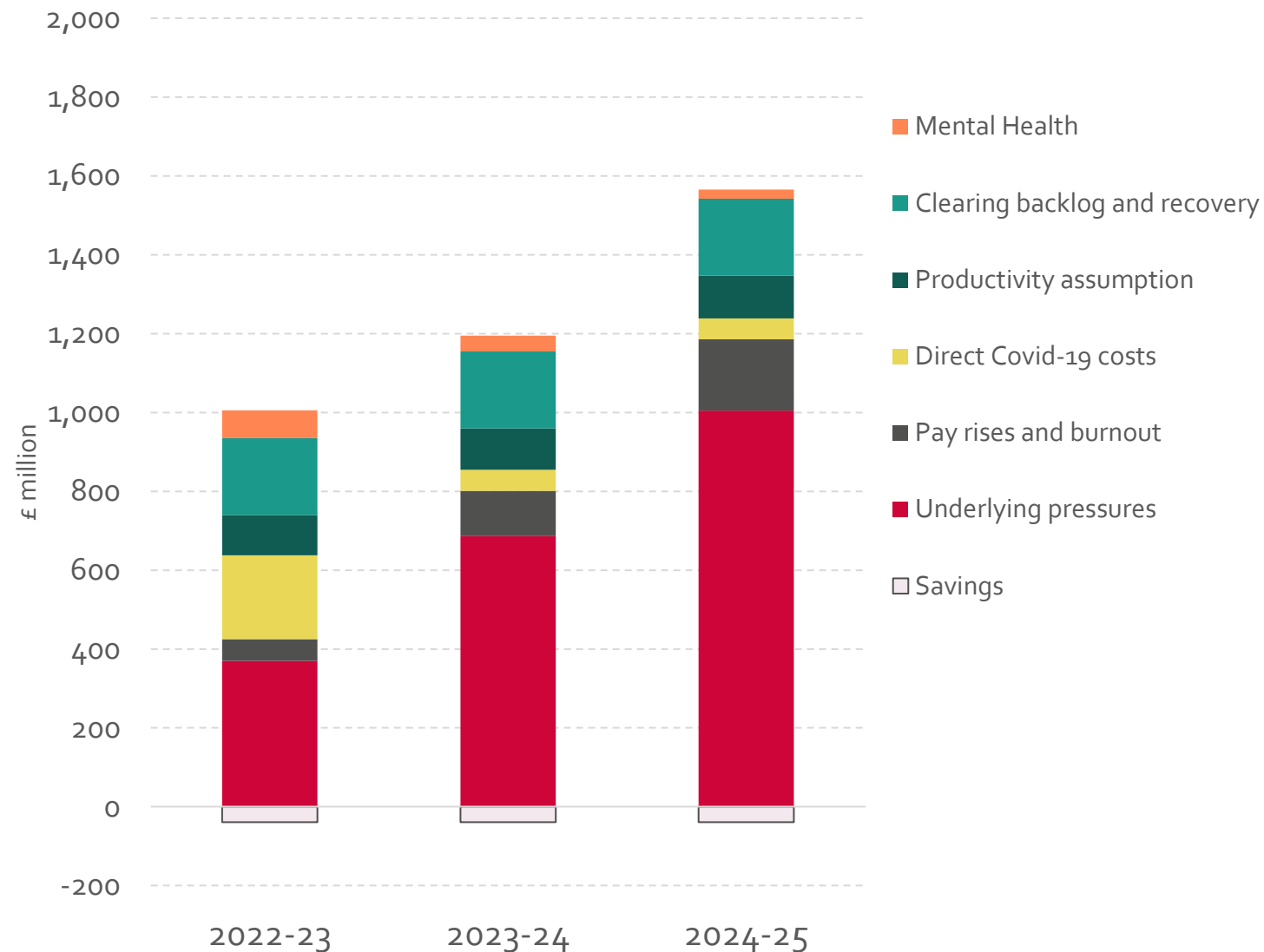
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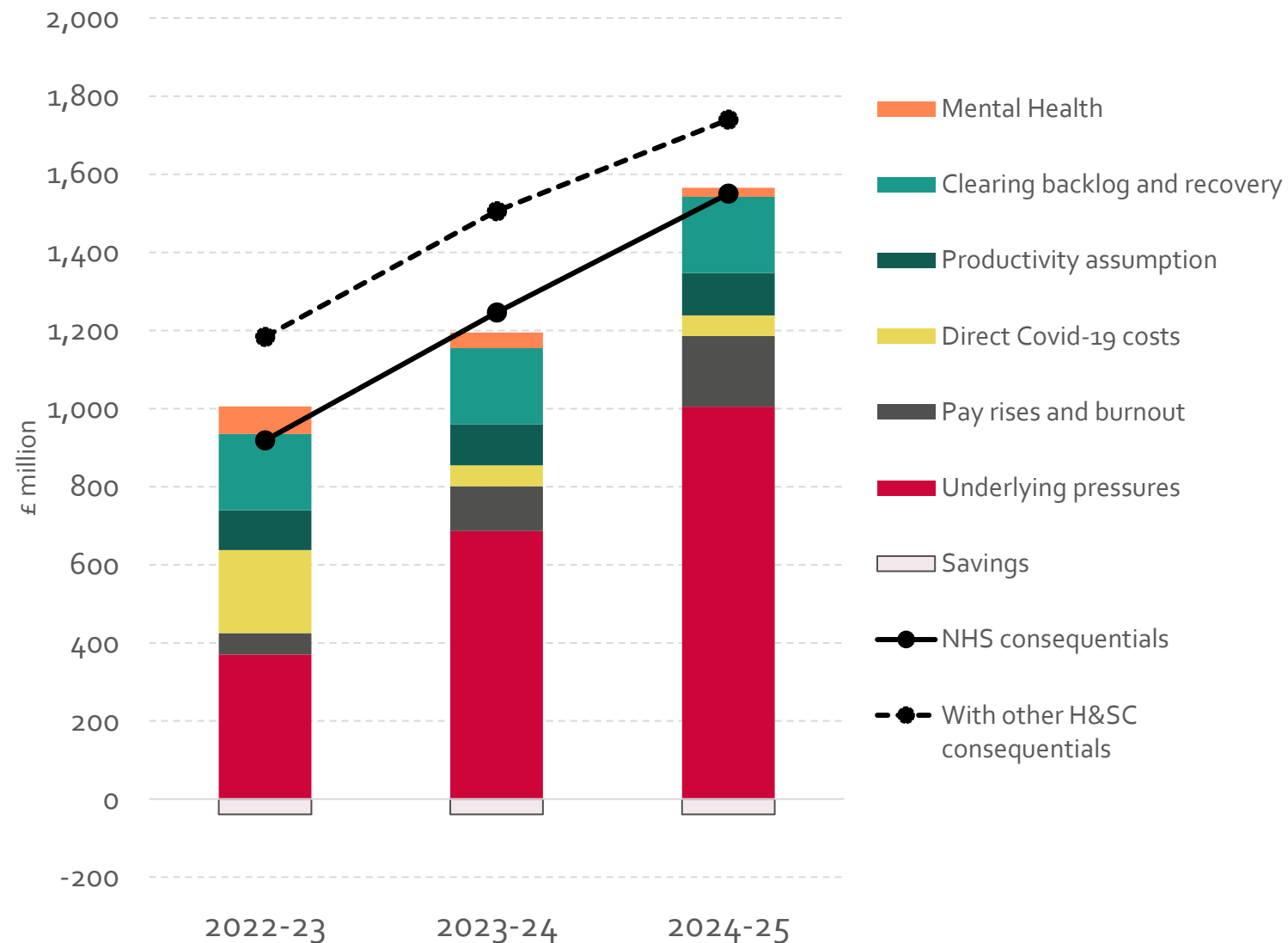
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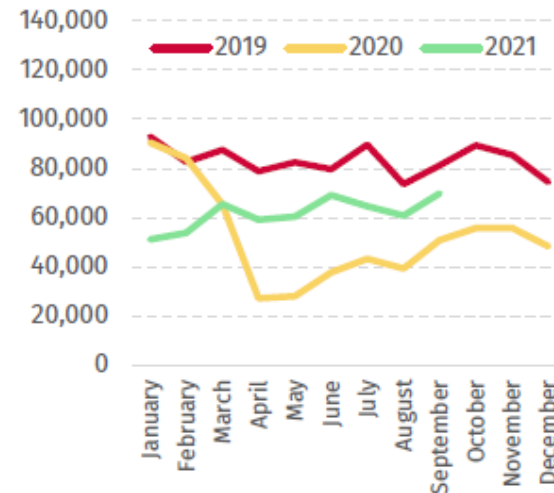
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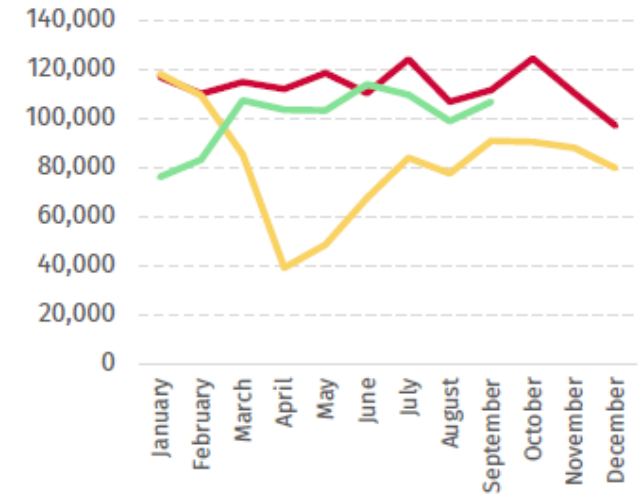
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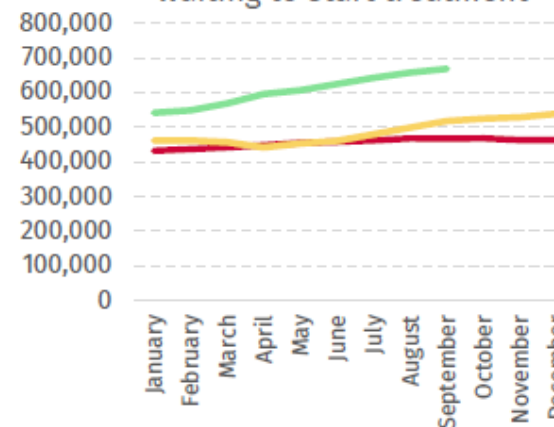
Closed patient pathways



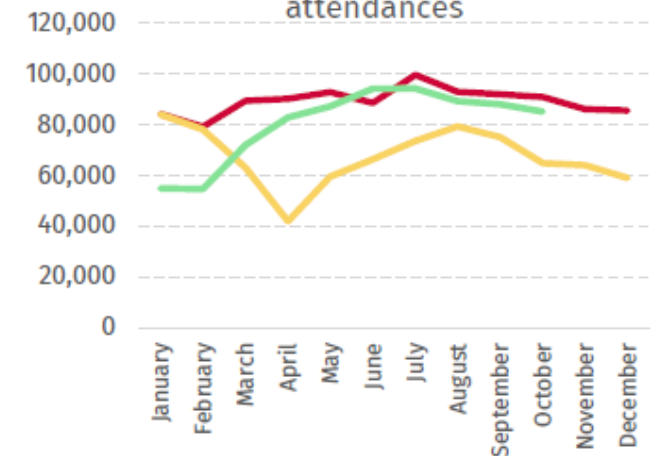
Referrals



Total patient pathways waiting to start treatment



Emergency department attendances



Funding pressures and commitments (2)

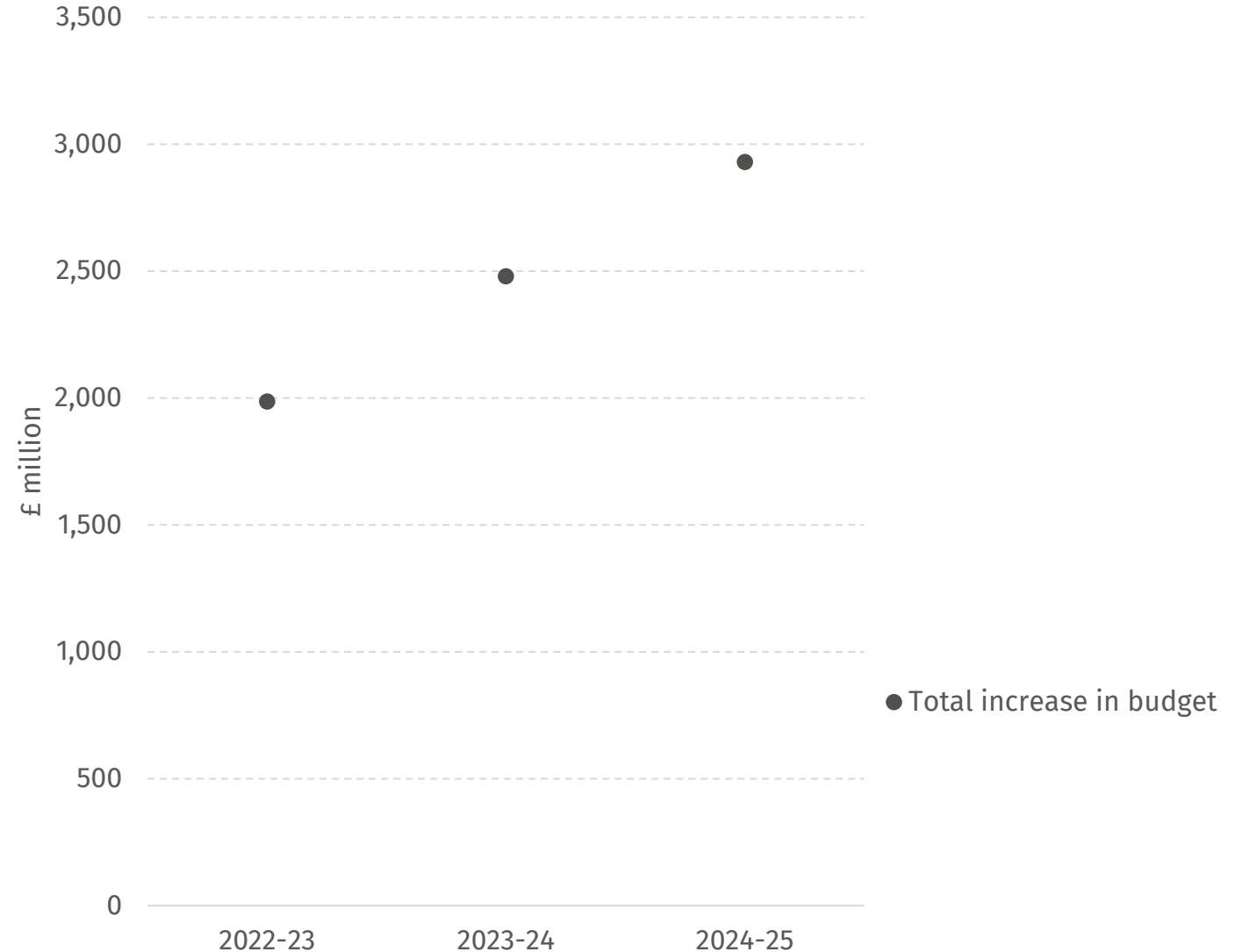
- NHS funding pressures – huge pressures from the direct and indirect costs of Covid-19
- Local authorities – how much funding pressures should be met by central funding as opposed to council tax increases?
- Other Covid-19 costs e.g. public transport, further education, business support, skills spending, cost of living support
- Funding new policies/expansion of services?

Funding pressures and commitments (3)

- The Co-operation Agreement between the Welsh Government and Plaid Cymru included additional spending commitments:
 - *Free School Meals for all primary school pupils: £86m a year (Bevan Foundation 2021)*
 - *Expansion of early years childcare to include all two-year olds: ≈£40m a year*
 - *Ambition for the creation of National Care Service free at the point of need: £190m a year (LE Wales 2020)*
- Feasibility of policies given funding pressures and outlook?

Total modelled spending pressures

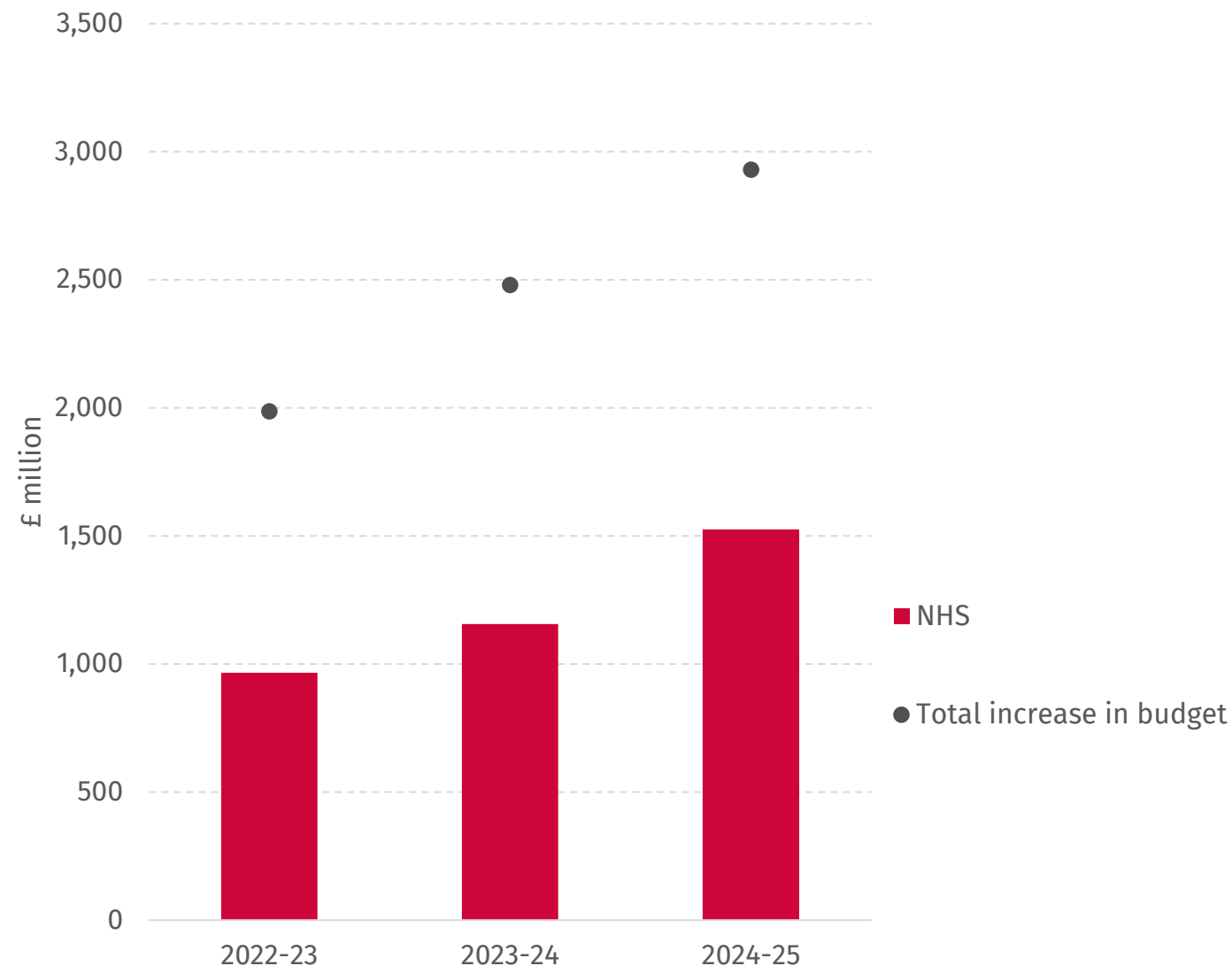
Spending allocations if:



Spending allocations if:

- Welsh Government meets our central assumptions of NHS pressures from 2022-23 to 2024-25

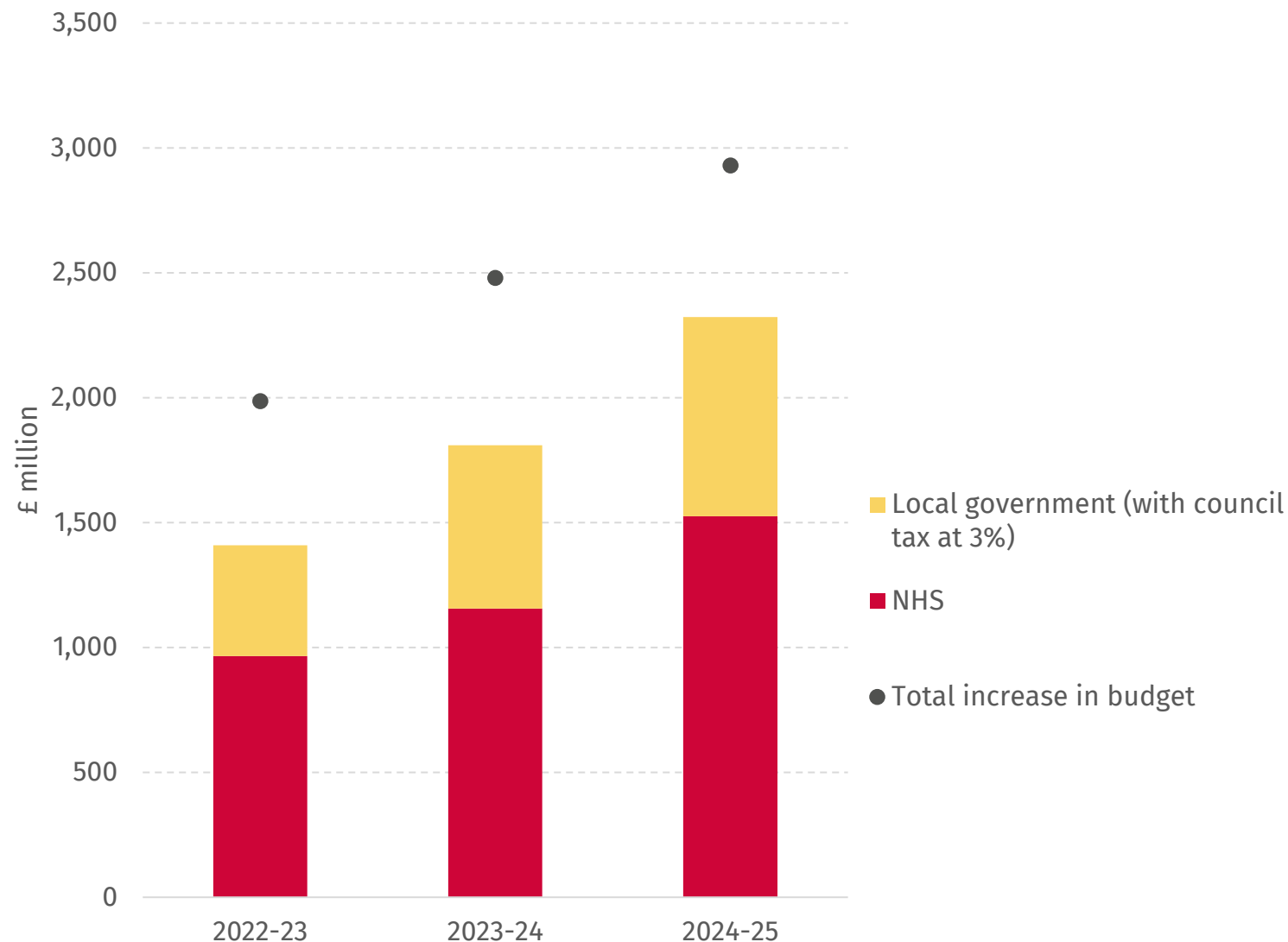
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Total modelled spending pressures

Spending allocations if:

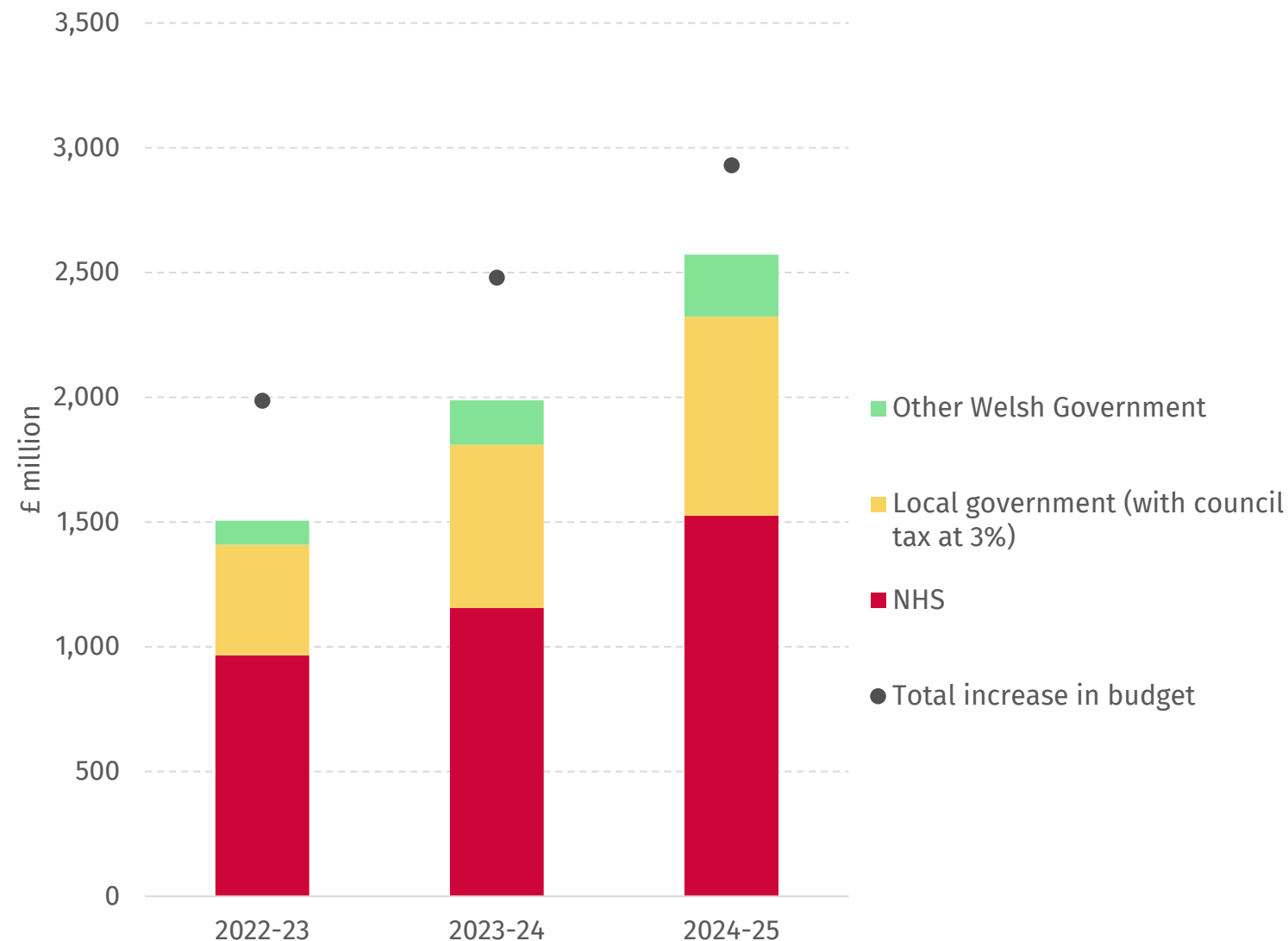
- Welsh Government meets our central assumptions of NHS pressures from 2022-23 to 2025-26
- Funding for local government is increased so that projected funding pressures by 2024-25 can be met with council tax increases of 3% per year



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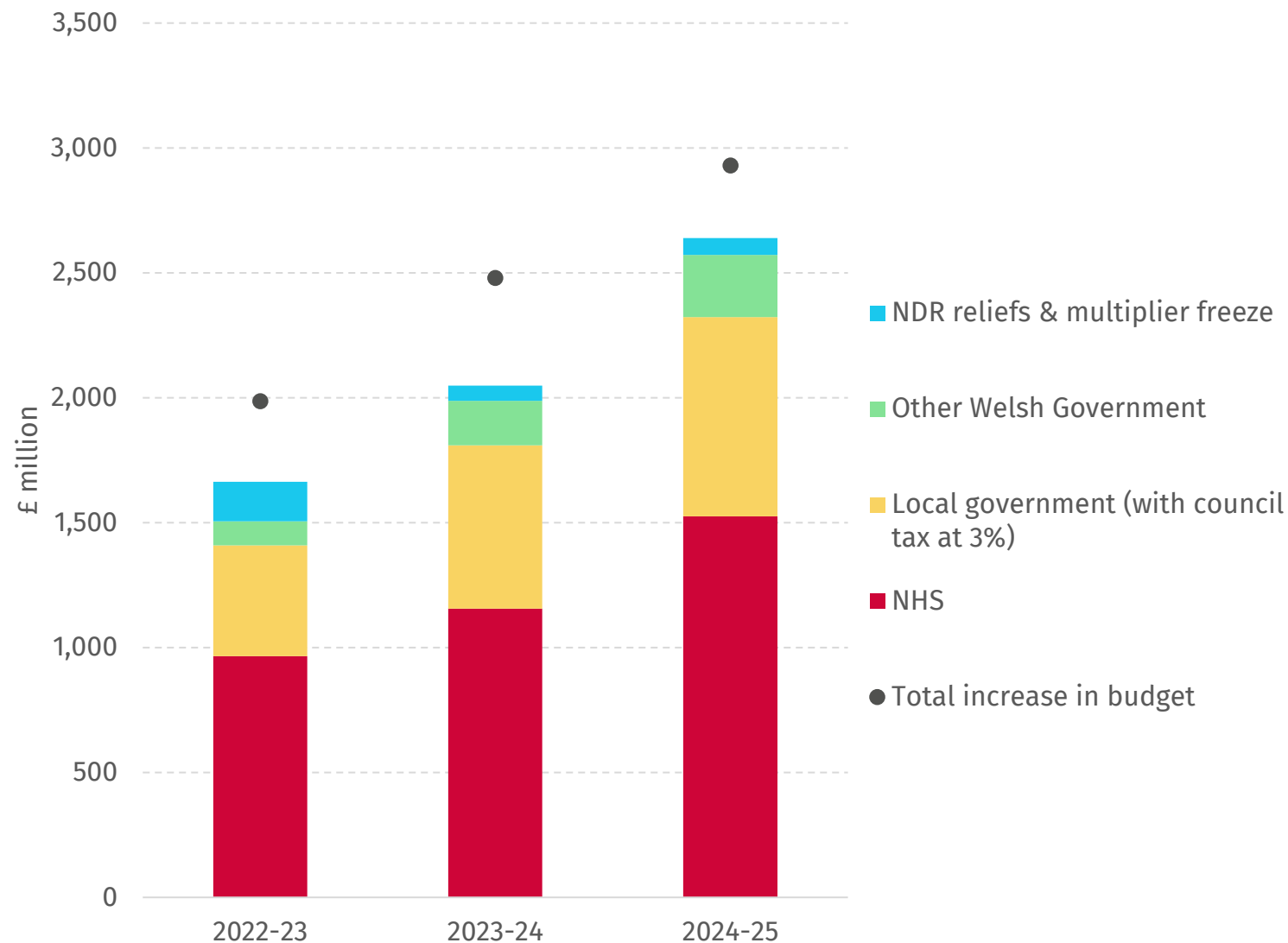
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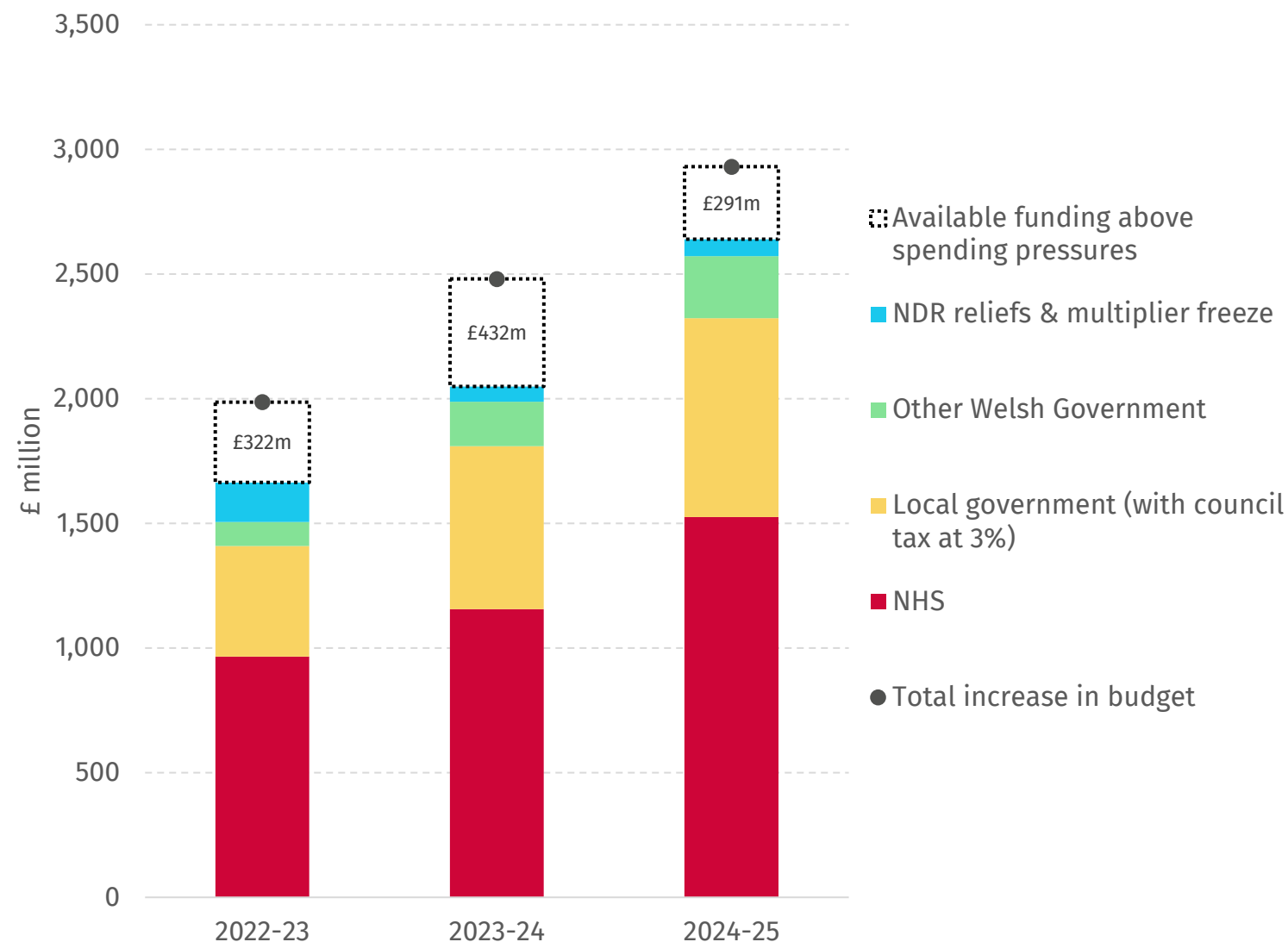


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Significant funding over and above funding pressures modelled here



Conclusion

- Some certainty for multi-year budget setting and planning and trade-offs arguably less acute than for any budget of the last decade
- But lingering uncertainty around Covid-19 (magnified by the emergence of the new Omicron variant) and huge funding pressures facing most of the budget in a challenging economic context
- Prudent to keep significant funding unallocated for 2022-23 and beyond to respond to various funding pressures if and when they arise
- Longer-term sustainability of Welsh public services and new policy proposals subject to future changes in the direction of UK fiscal policy