



Dadansoddi
Cyllid Cymru

Wales Fiscal
Analysis

Covid-19 and the Welsh Government Budget

Update No.2: Analysing the 1st
Supplementary Budget

Wales Fiscal Analysis

JUNE 2020

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

- On Wednesday 27 May, the Welsh Government published an historic supplementary budget, outlining the momentous changes to its funding and spending that have occurred since it published its Final Budget for 2020-21 in March.
- The latest projected cost of the UK government's direct fiscal response amounts to £123.2 billion in 2020-21. The Welsh Government's fiscal response in supporting the Welsh economy and public services amounts to well over £2.4 billion.
- The additional revenue funding available to the Welsh Government to allocate to its COVID-19 response in the Supplementary Budget amounted to £2,526 million, including: £123 million consequentials from Budget 2020; £1,856 million consequentials from COVID-19 response funding; £245 of repurposed EU funding; and £256 million of reprioritised funding from its own budget.
- By far the largest additional allocation was made to the Economy and Transport portfolio, which has increased by over £1.3 billion. Including £332 million of Non-Domestic Rates relief, this brings allocations to support the Welsh economy in 2020-21 to £1.7 billion – corresponding to 2.3% of Welsh GDP in 2019-20.
- £595 million was allocated to the Health and Social Services portfolio (£481 million net of reprioritised funding). The largest areas of additional spending relate to the opening of field hospitals (£166 million) and personal protective equipment (£100 million).
- £189 million has been made available to support local authority budgets, including £40 million for adult social care pressures, £40 million for free school meal provision, and £78 million to account for lost income during the crisis.
- Additional funding made available to the Welsh Government means the budget for day-to-day spending is already set to be 13% higher than the 2019-20 budget, and 8% higher than pre-austerity levels.
- Only consequentials deriving from UK government spending confirmed in the UK Main Estimates were included in this Supplementary Budget. Analysing announcements from the UK government, we estimate that approximately £404 million of additional consequentials has already been announced. These funding additions will be confirmed at supplementary estimates and will be allocated at the second supplementary budget.
- The Welsh Government budget also included £148 million of unallocated fiscal resource funding. Already announced consequentials and unallocated funding suggests the Welsh Government will be able to substantially increase the overall size of its fiscal response over coming months. It is also likely that further spending in England will be announced as the crisis unfolds.
- The Welsh Government will be largely insulated from the expected drop in devolved tax revenues when the forecasts are updated, through the operation of the Block Grant Adjustment mechanism. However, any asymmetric economic impact from the crisis will have a budgetary effect, and there is also the prospect of forecast error adjustments being made to future budgets.
- Relaxing the constraints on the Welsh Government's reserves, borrowing and capital budget would release additional resources for the response, mitigate the risk of unforeseen additional spending pressures later in the year, as well as allowing for better strategic planning on the part of the Welsh Government.

Covid-19 and the Welsh Government budget: analysing the 1st Supplementary Budget

02 JUNE 2020

Introduction

On Wednesday 27 May, the Welsh Government published an historic supplementary budget, outlining the momentous changes to its funding and spending that have occurred since it published its Final Budget for 2020-21 in March. The UK government's fiscal response to the coronavirus crisis has led to an unprecedented increase in the size of the budget. The Welsh Government's fiscal response in supporting the Welsh economy and public services amounts to well over £2.4 billion.

This briefing analyses the additional funding included in the supplementary budget, as well as the additional allocations made in response to COVID-19. The prolonged and highly uncertain nature of this crisis means further funding announcements and adjustments will need to be made over the course of this financial year. This briefing also analyses the additional funding likely to be made available by the UK government and the risks facing the Welsh Government budget in 2020-21.

Funding the fiscal response to Covid-10

The coronavirus pandemic has triggered massive fiscal responses from governments across the world. In the UK, the latest outturn data on the public sector finances for the month of April 2020 showed a huge impact on the public finances. Reduced revenues and increased public sector spending meant public sector borrowing surged to record levels.¹

The latest projected cost of the UK government's direct fiscal response amounts to £123.2 billion in 2020-21. A £15 billion increase in spending on public services and a £28 billion package of support for businesses through business rates reliefs and grants has led to a massive increase in the size of the Welsh Government budget.

Figure 1 outlines the additional resource funding (for day-to-day spending) that has been made available to the Welsh Government since it published its Final Budget. These include £123 million of consequentials from the March 2020 Budget. The UK's fiscal response to the COVID-19 crisis has triggered £1,856 million

¹ Available at:

<https://www.ons.gov.uk/economy/governmentpublicsectorandtaxes/publicsectorfinance/bulletins/publicsectorfinances/april2020>

of consequentials for the Welsh Government. Importantly, this amount excludes consequentials not included in the UK Main Estimates (discussed below). Other smaller consequentials, adjustments and changes in devolved tax revenues mean resource funding available for the Welsh Government has increased by over £2 billion.

In addition to funding provided by the UK government, European Commission proposals have provided flexibility in how funding from the European Social Fund (ESF) and European Regional Development Fund (ERDF) can be utilised. The Welsh Government are planning on repurposing £245 million of such funding in 2020-21 to fund its response to COVID-19. The Welsh Government has also reviewed departmental allocations to find £256 million of additional funding for its fiscal response. This brings the total amount at the disposal of the Welsh Government to allocate in the Supplementary Budget to £2,526 million.

Figure 1
Changing funding sources from Final Budget 2020-21 and fiscal response (day-to-day spending or RDEL)

Funding sources in Supplementary Budget	
	£ million
UK March 2020 Budget consequentials	123
COVID-19 response funding consequentials	1,856
Other consequentials and adjustments	73
Changes in devolved tax revenues	- 27
Repurposed EU funding for COVID-10 measures	245
Reprioritised funding from within budget	256
Total amount to be allocated	2,526
Fiscal response in Supplementary Budget	
	£ million
COVID-19 response	2,464
of which:	
NDR reliefs	332
Health and Social Services	574
Housing and Local Government	200
Economy and Transport	1,316
Environment, Energy and Rural Affairs	15
Central Services and Administration	24
Other allocations (including to reserves)	62

Source: Welsh Government (2020) Supplementary Budget 2020-2021 Explanatory Note and authors' calculations. Excludes direct payments funding for farm subsidies from funding sources and fiscal response as these were accounted for in Final Budget. Other allocations include £43 million increase to unallocated fiscal resource reserves, changes to allocations to directly funded bodies, and funding increase to the NHS in respect of the Immigration Health Surcharge.

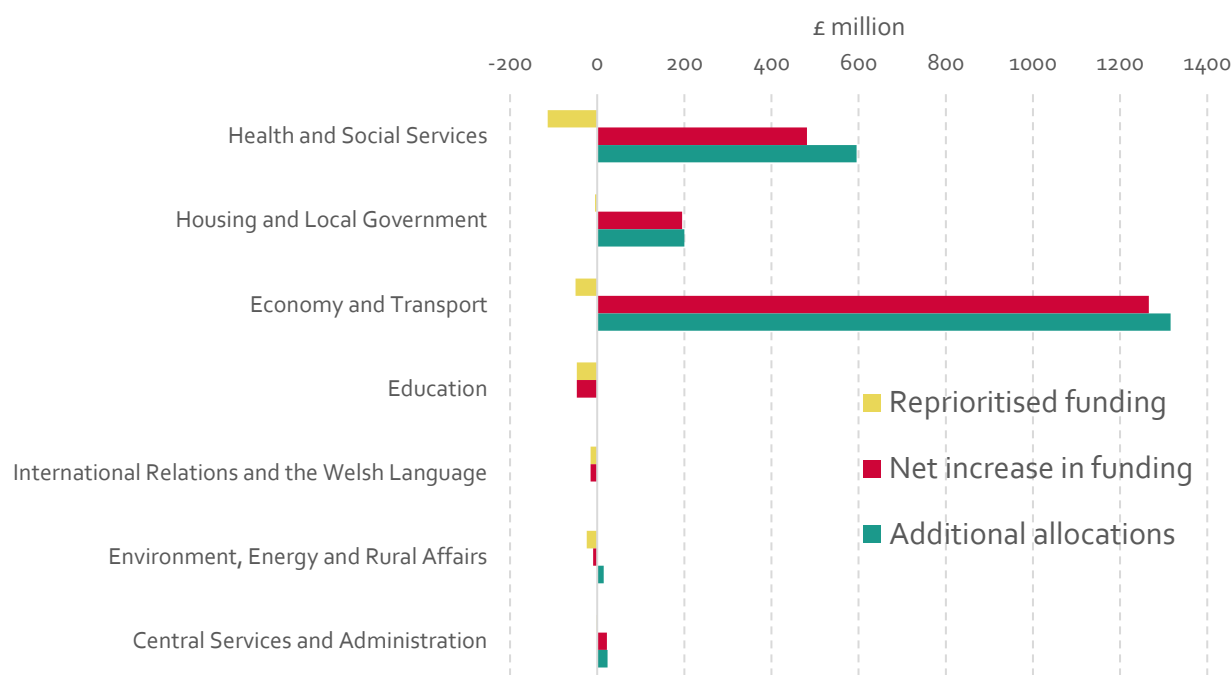
Allocations in the Supplementary Budget

Figure 2 shows the fiscal resource allocations made in the supplementary budget by Main Expenditure Group (green bars). It also shows the reprioritised funding found in each budget (yellow bars) and the net change from Final Budget 2020-21 allocations (red bars). By far the largest increase has been to the Economy and Transport portfolio, which has increased by over £1.3 billion. This includes £623 million for grants of £10,000 to small businesses, as well as £214 million for grants to retail, leisure, and hospitality businesses with a rateable value of between £12,001 and £51,000. In addition, the Economic Resilience Fund is providing £400 million of grants to businesses. While not included in revenue funding, the fund will also use £100 million in repurposed capital funding within the Development Bank of Wales to provide loans to businesses.

In addition to this support in the Economy and Transport budget, £332 million of Non-Domestic Rates relief is also being provided to businesses in the retail, leisure, and hospitality sectors with a rateable value of up to £500,000. This brings allocations to support the Welsh economy in 2020-21 to £1.7 billion. This corresponds to a not insignificant 2.3% of Welsh GDP in 2019-20.²

Figure 2

Changes in fiscal RDEL by Main Expenditure Groups (MEGs) from Final Budget 2020-21 allocations



Source: Welsh Government (2020) Supplementary Budget 2020-2021 Explanatory Note and authors' calculations. Excludes direct payments funding for farm subsidies from funding sources and fiscal response as these were accounted for in Final Budget. Health and Social Services increase includes £21 million of funding in respect of the Immigration Health Surcharge.

Given the significant impact on health services, it is unsurprising that the Health and Social Services portfolio provided the largest amount of reprioritised funding for the COVID-19 response. Additional

² Calculated using ONS (December 2019) GDP: UK regions and countries and authors' projections.

allocations made to this portfolio at this supplementary budget amount to £595 million (£481 million net of reprioritised funding). The largest areas of expenditure for health relate to:

- The opening of field hospitals (£166 million)
- Personal Protective Equipment (£100 million)
- Increasing staff resources within the NHS (£91 million)
- The Welsh Government's Test, Trace, Protect strategy (£57 million)
- Use of private hospitals (£30 million)
- And childcare costs of critical workers (£30 million)

In addition, up to £40 million has been allocated towards providing social care workers in Wales with an extra payment of £500.

Additional support for adult social care worth £40 million is also included in the allocations made to local authority budgets, as part of a £189 million Local Authority Hardship Fund. This funding also includes £40 million for free school meals provision, £10 million for homelessness, and a recently announced £78 million fund to account for lost income. The effect of the lockdown on sales, fees and charges income had been a concern for local authorities, with a high-level estimate by the Welsh Local Government Association (WLGA) suggesting Welsh authorities would lose £33.2 million for each month that the restrictions were in place. The additional allocations made at the supplementary budget should broadly cover the additional spending pressures and lost income identified by WLGA over the first quarter of this financial year. Future risks to spending and income over the rest of the financial year are difficult to predict – for example, the extent to which the large increase in Universal Credit claimants in Wales will increase demand for the Council Tax Reduction Scheme.

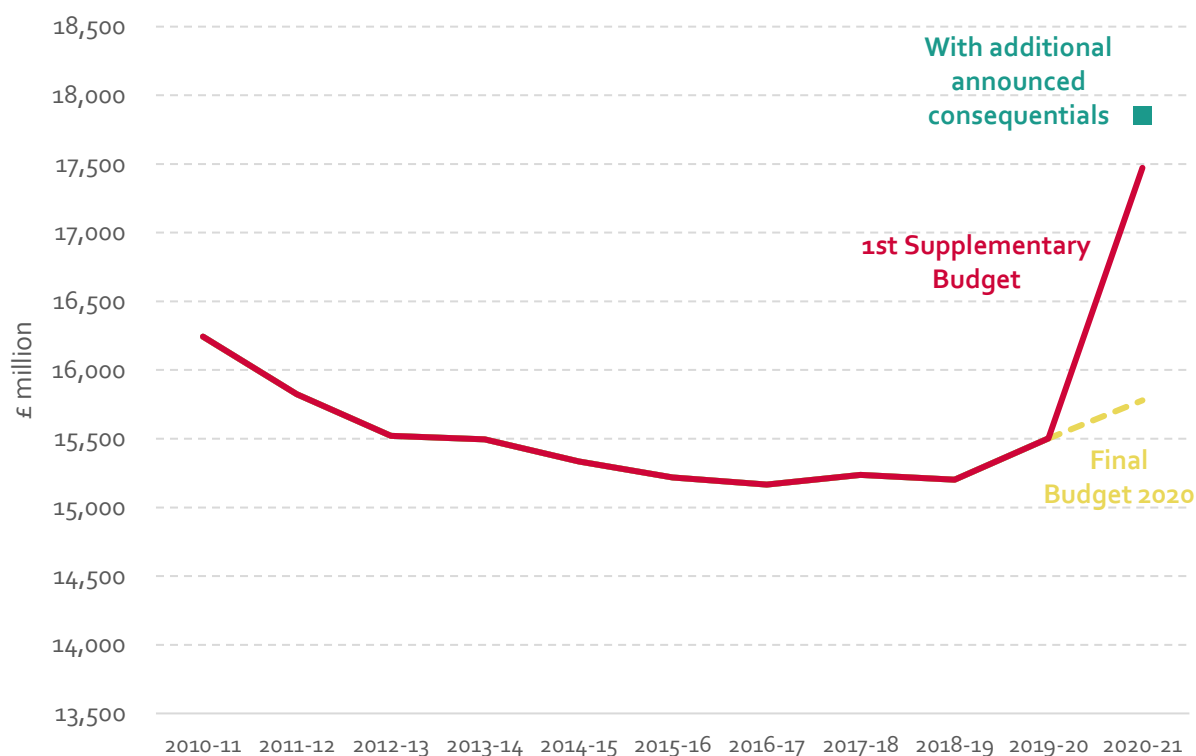
The Supplementary Budget in context

The allocations made at the Supplementary Budget are unprecedented in scale. The extraordinary magnitude of the changes since the Final Budget allocations can be seen when compared to previous years - the average additional allocations made at 1st supplementary budgets over the course of this Welsh parliamentary term was only £136 million.

Figure 3 shows this increase in the context of the path of Welsh Government day-to-day spending on public services since 2010-11. Funding for day-to-day Welsh Government spending is now set to grow by 13% from 2019-20 to 2020-21. Funding was already set to gradually return to 2010-11 levels in real terms. The additional COVID-19 consequential has now pushed funding to 8% above pre-austerity levels. Furthermore, the total fiscal response to the crisis will continue to grow over the course of the year, with additional consequential already resulting from further UK government announcements (represented in green in **Figure 3**).

Figure 3

Welsh Government day-to-day spending on public services, 2010-11 to 2020-21 (2020-21 prices)



Source: Welsh Government (2020) Supplementary Budget 2020-2021 Explanatory Note; Welsh Government (2020) Final Budget 2020-2021; various press announcements on consequential funding; HM Treasury (2019 and older) Public Expenditure Statistical Analysis. Note: Refers to fiscal resource DEL. Includes non-domestic rates revenue after 2015-16. Increase in 2020-21 is shown net of increased NDR reliefs. We exclude extra funding for direct payments funding for farm subsidies not previously counted in RDEL. Excludes the effect of increased public sector pension contributions from 2019-20 onwards. Figures before 2013-14 adjusted for the devolution of Council Tax Benefit.

Future funding and risks

As explained in previous sections, only consequentials deriving from UK government spending confirmed in the UK Main Estimates were included in this Supplementary Budget.³ **Annex A** contains a table tracking other spending announcements made by the UK government which were not included in the Main Estimates which will have an impact on the Welsh Government budget. These announcements amount to approximately £404 million of additional consequentials. These funding additions will be confirmed at supplementary estimates and will be allocated in the Welsh budget at the second supplementary budget.

In its first supplementary budget, the Welsh Government also increased its unallocated fiscal resource in the 2020-21 budget by £43 million. This brings total unallocated fiscal resource to £148 million, meaning the Welsh Government will be able to allocate this amount at the second supplementary budget. If it did

³ For explanation and outline of the UK government department's Main Estimates, see: <https://researchbriefings.files.parliament.uk/documents/CBP-8926/CBP-8926.pdf>

so, barring departmental over-spending, we previously estimated that the Wales Reserve would hold £155 million for the start of 2021-22.⁴ Since the Welsh Government is already drawing down £125 million from the Wales Reserve for 2020-21, the Welsh Government is unable to access those reserves in 2020-21 under current fiscal framework rules.

Already announced consequentials and unallocated funding suggests that the Welsh Government will be able to substantially increase the overall size of its fiscal response over coming months. It is also likely that further spending in England will be announced as the crisis unfolds. The uncertain nature of the crisis means there will be a balancing act between being proactive in announcing funding for priorities and keeping some funding in reserve to respond to unexpected increases in demand pressures later in the crisis. The balance may be tilted towards the latter due to the restrictions on the Welsh Government's budgetary tools. Finance Minister Rebecca Evans reiterated the demand for reforming the "rigid financial rules" on how the Welsh budget is managed.⁵

As we previously argued, allowing the Welsh Government full access to its reserves this year would release additional resources for the response, mitigate the risk of unforeseen additional spending pressures later in the year, as well as allowing for better strategic planning on the part of the Welsh Government. Unallocated capital in the 2020-21 budget increased from £31.8 million to £177.3 million. The Welsh Government has also asked for the ability to switch this resource from capital to fund revenue spending, which would increase the resources available to fund the response to COVID-19. Furthermore, given the unprecedented nature of the crisis, we also argued that there should be a temporary relaxation of the restrictions on Welsh Government borrowing. Introducing these budgetary flexibilities would increase the financial accountability of the Welsh Government over its response to the coronavirus crisis.

One element of the supplementary budget which will significantly change are forecast revenues from devolved taxes and the Welsh Rates of Income Tax. The forecasts included in the budget are taken from the OBR forecasts from March 2020, which showed a slight reduction in forecast devolved tax revenues of £27 million. These forecasts will be significantly revised downwards later this year. Given the expected fall in economic activity over the course of the crisis, these downward revisions will be in the order of hundreds of millions. However, a strength of the current fiscal framework is that the Welsh Government is largely insulated from UK-wide economic shocks. The Block Grant Adjustment (BGA) – the amount taken off the block grant to reflect tax devolution – will also fall significantly, as it will be linked to the fall in comparable UK government revenues elsewhere in England and Northern Ireland.

However, any asymmetric economic impact from the crisis, for example on prominent industries or employers in Wales, will have a potential budgetary effect. There is also the prospect of forecast error adjustments being made to Welsh Government budgets in future years when outturn data becomes available, as experienced by the Scottish Government this year. This again points to the need for more budgetary flexibilities for the Welsh Government over future years to manage these risks.

As well as the risk of asymmetric economic impact, the crisis also creates the risk of asymmetric impact on the demand for public services. It appears that from the first wave, that the direct impact of coronavirus on health services has been slightly smaller in Wales, at least as indicated by the number of hospitalisations and deaths. However, the impact on the demand for public services is likely to extend well beyond the direct impact of COVID-19. For example, the greater levels of pre-existing health conditions in Wales may mean the backlog created by non-coronavirus related treatments not taking

⁴ See page 8 of

https://www.cardiff.ac.uk/_data/assets/pdf_file/0005/2132654/COVID19_Welsh_Budget_FINAL.pdf

⁵ <https://gov.wales/640-million-pounds-reaches-businesses-in-welsh-government-covid-19-response>

place during the crisis will be greater. Likewise, given higher levels of deprivation in Wales, more resources will be needed to mitigate the educational impact of school closures. As during the crisis, the population-based Barnett formula is likely to be ill-suited in distributing funding to the devolved administrations to meet these additional demands in the recovery period.

Annex A – tracking COVID-19 consequentials

Figure 2
Coronavirus-related consequentials

Consequentials included at Main Estimates		
	Revenue	Capital
Communities & Local Government		
Covid-19 Response Fund - local government	94	
Local authority hardship fund	29	
Business rates relief (12-month retail, hospitality and leisure holiday) - compensation for LAs	627	
Business rates reliefs (12-month nurseries holiday) - compensation for LAs	7	
Business, Energy & Industrial Strategy		
Small Business Grants Fund	731	
Environment, Food & Rural Affairs		
Shielding - Food boxes for the clinically vulnerable	12	
Work and pensions		
Call centre for the National Shielding Centre	3	
Health		
Enhanced NHS discharge/suspension of means test	77	
Purchasing independent sector capacity	81	
Shielding measures DHSC elements	17	
PPE procurement	6	
Transport		
Emergency Measures Agreements	171	
Total at Main Estimates:	1856	0
Further consequentials announced		
	Revenue	Capital
Additional DEL compensation for existing BR reliefs ¹	5	
Charities (8 Apr) ²	20	
Charity support - National Lottery Community Fund (8 April) ³	18	
Increased response fund (13 April) ⁴	144	
Local government funding (18 Apr) ⁵	95	
Care homes in England (15 May) ⁶	35	
Transport for London (19 May) ⁷	44	20
Test and Trace Service and housing for rough sleepers in England (26 May) ⁸	23	
Additional announced spending beyond Main Estimates	384	20
	Revenue	Capital
Total consequentials	2240	20

Notes:

1. Included in Main Estimates but not in Supplementary Budget
2. <https://www.gov.uk/government/news/chancellor-sets-out-extra-750-million-coronavirus-funding-for-frontline-charities>

3. *England-only share (“Barnettised”) will depend on recipients of grants.*
<https://www.gov.uk/government/news/chancellor-sets-out-extra-750-million-coronavirus-funding-for-frontline-charities>
 4. *Residual (difference from Response Fund allocation in Main Estimates) to bring total allocation to £605 million, as per*
<https://www.gov.uk/government/news/chancellor-to-provide-extra-350m-to-tackle-coronavirus-in-wales>
 5. <https://www.gov.uk/government/news/uk-government-provides-extra-95m-to-tackle-coronavirus-in-wales>
 6. <https://www.gov.uk/government/news/extra-35m-for-wales-in-fight-against-coronavirus>
 7. *Split between revenue and capital according to split between grant and loan funding.*
<https://www.gov.uk/government/news/wales-to-receive-additional-645m-as-a-result-of-transport-funding-in-england>
 8. <https://www.gov.uk/government/news/uk-government-to-provide-up-to-23m-in-extra-funding-to-tackle-coronavirus-in-wales>
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