

# The Welsh Budget Outlook 2023

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## Pre-budget slide pack

14/12/2023

### Wales Fiscal Analysis

Canolfan Llywodraethiant Cymru, Prifysgol Caerdydd  
Wales Governance Centre, Cardiff University

# Summary (1)

- The Welsh Government's Draft Budget for 2024-25 has a gloomy economic backdrop – economic growth is slowing and inflation is set to remain higher for longer. Real household disposable incomes have not fallen by as much as forecast, but living standards are not expected to reach pre-pandemic levels until 2027-28.
- The Autumn Statement used a boost in tax receipts from higher inflation to fund tax cuts, while eroding the real terms value of public spending totals. However, tax as a share of national income is still set to increase by 4.5 percentage points compared to pre-pandemic, primarily because of frozen tax thresholds.
- Welsh Government day-to-day spending in 2023-24 is 6% higher than in 2010-11 in real terms – but outside the NHS, spending is still about 10% lower this year compared to pre-austerity levels.
- Growth in the Welsh Budget over recent years has been boosted by a positive net effect from tax devolution and the inclusion of the 105% Needs-Based Factor in the Barnett formula. However, growth has still been much lower than during the first decade of devolution.
- Higher inflation has eroded the real terms value of the Welsh Budget. Using an economy-wide measure of inflation, the Welsh Government's settlement is set to be worth £800m less in real terms than expected at the October 2021 Spending Review (equivalent to 3.5% of the budget).
- In October 2023, the Welsh Government announced emergency additional funding for the NHS and Transport for Wales in 2023-24 (£425m and £125m, respectively), funded by in-year cuts to other spending areas, assumed consequentials from the UK government, a budget switch from capital to resource, and use of reserves.

# Summary (2)

- Despite some additional consequentials from the Autumn Statement, the resource block grant is set to fall slightly in real terms next year, while the capital block grant will fall by 6%.
- Total day-to-day spending is set to increase by 0.4% in real terms in 2024-25 (accounting for the effect of devolved financing and the capital to resource budget switch in 2023-24)
- Compared to its indicative spending plans for 2024-25 published in February, the Welsh Government has an additional £368m to allocate for day-to-day spending, mainly resulting from consequentials from Business Rates reliefs and childcare spending in England.
- If the Welsh Government wants to maintain NHS spending at its elevated 2023-24 level in real terms, it will need to allocate an additional £353m on top of its existing spending plans for 2024-25.
- Maintaining spending on the NHS in real terms, keeping to planned funding for local government, and extending Non-Domestic Rates reliefs for Retail, Hospitality and Leisure businesses to 2024-25 would require cuts of £102m across other spending areas. Increasing childcare spending in line with the additional consequentials and providing some additional funding for Transport for Wales next year would increase these required cuts to £293m (5.6%).
- Even maintaining NHS spending in real terms is unlikely to meet spending pressures, assuming NHS pay deals match average earnings growth next year (3.3%) and demand for services increases.
- Assuming no further funding from the Welsh Government and council tax increases of 5%, we project local authorities face a funding gap of £469m in 2024-25.

# Summary (3)

- Beyond 2024-25, we project the Welsh Government budget for day-to-day spending is set to increase by just 0.9% per year in real terms on average to 2028-29, based on the indicative spending plans of the UK government. Day-to-day spending will remain below 2022-23 levels in real terms until 2027-28.
- If the Welsh Government “passes on” assumed consequentials from the NHS and schools spending in England, all other spending will fall by an average of 2.2% per year in real terms – cuts similar in scale to the austerity period of the early 2010s.
- At the Autumn Statement, the Chancellor also extended the cash freeze in capital spending for another year – the Welsh Government’s capital block grant could fall by 15% in real terms from this year to 2028-29.
- The outlook is hugely uncertain, especially given these spending plans will be implemented after the next UK General Election. The feasibility of implementing these spending plans and further cuts to public services raises serious questions around the credibility of the public finance forecasts and the tax cuts announced at the Autumn Statement.

# Content

- Economic and fiscal outlook
- The context for the Welsh Government budget
- Options for the Welsh Government budget for 2024-25
- The outlook beyond 2024-25

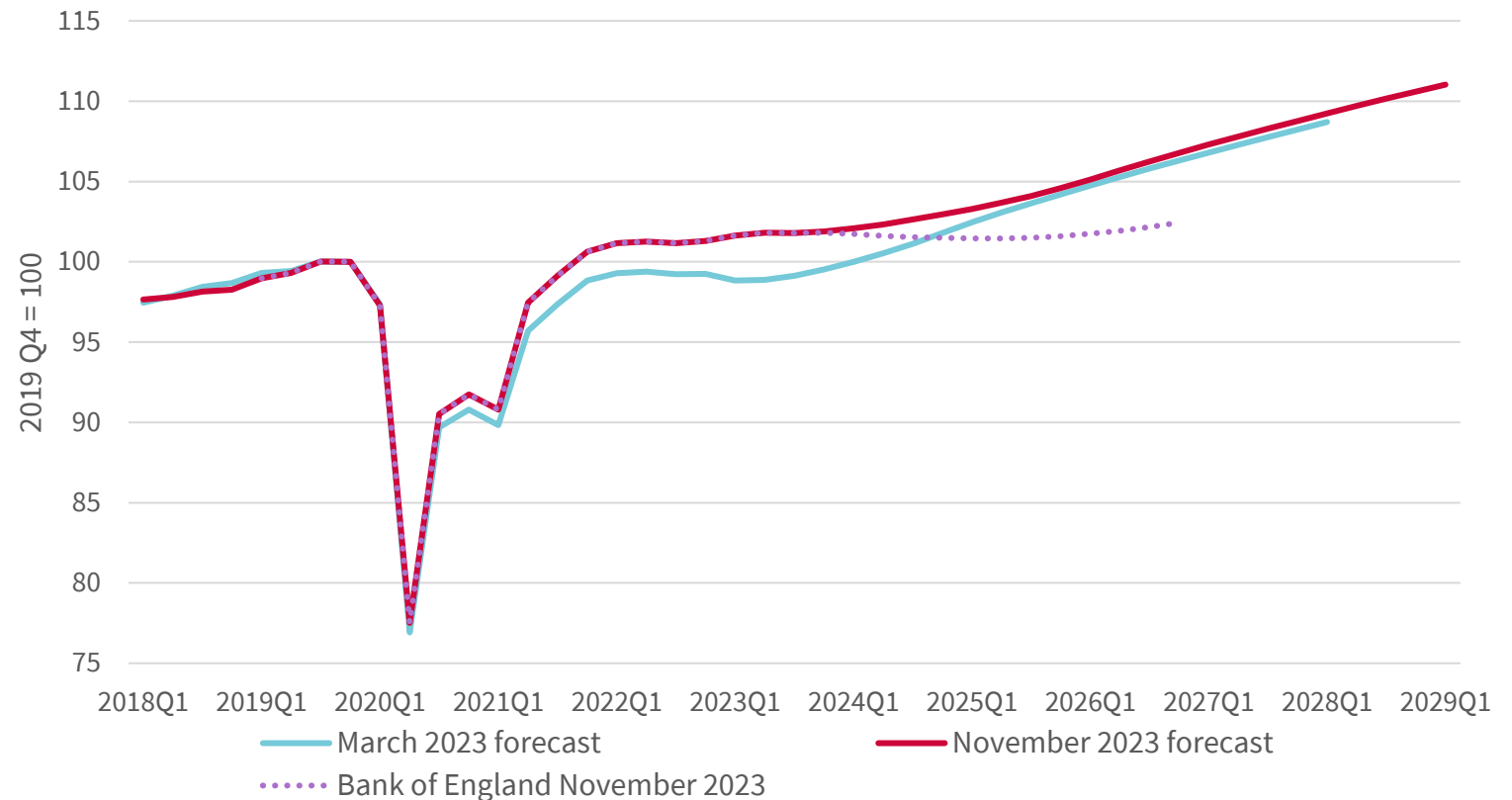
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# Economic outlook

- Data revisions mean GDP stronger in 2023 than expected – above pre-pandemic levels
- But outlook has worsened – interest rates have risen higher than expected, weak wage growth in 2024 and fading fiscal support
- OBR still more optimistic than the Bank of England...

UK real GDP (2019Q4 = 100)

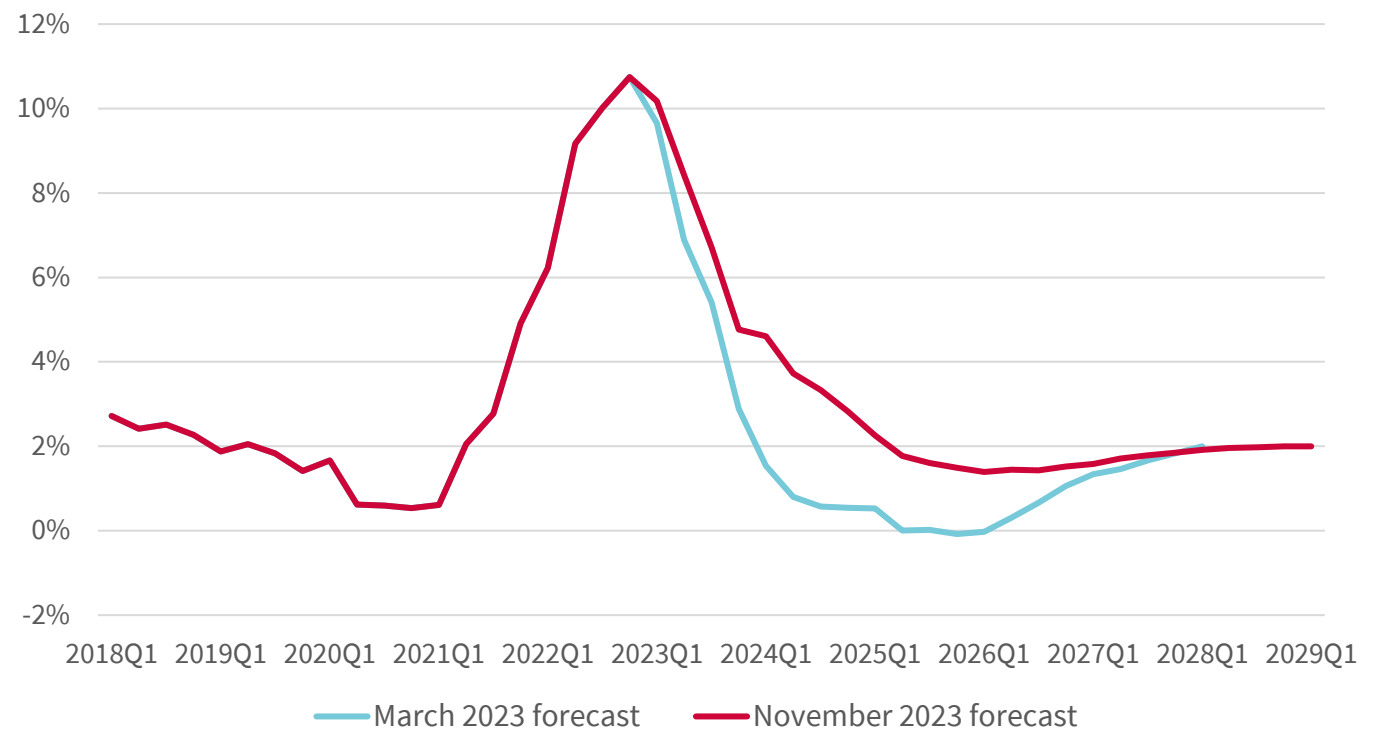


Source: OBR (2023) Economic and Fiscal Outlook November 2023; Bank of England (2023) Monetary Policy Report November 2023

# Economic outlook

- Inflation “halved” – but set to be higher for longer
- More domestically generated than previous forecasts through lower energy costs, stronger “second-round” effects and less economic slack

## CPI inflation

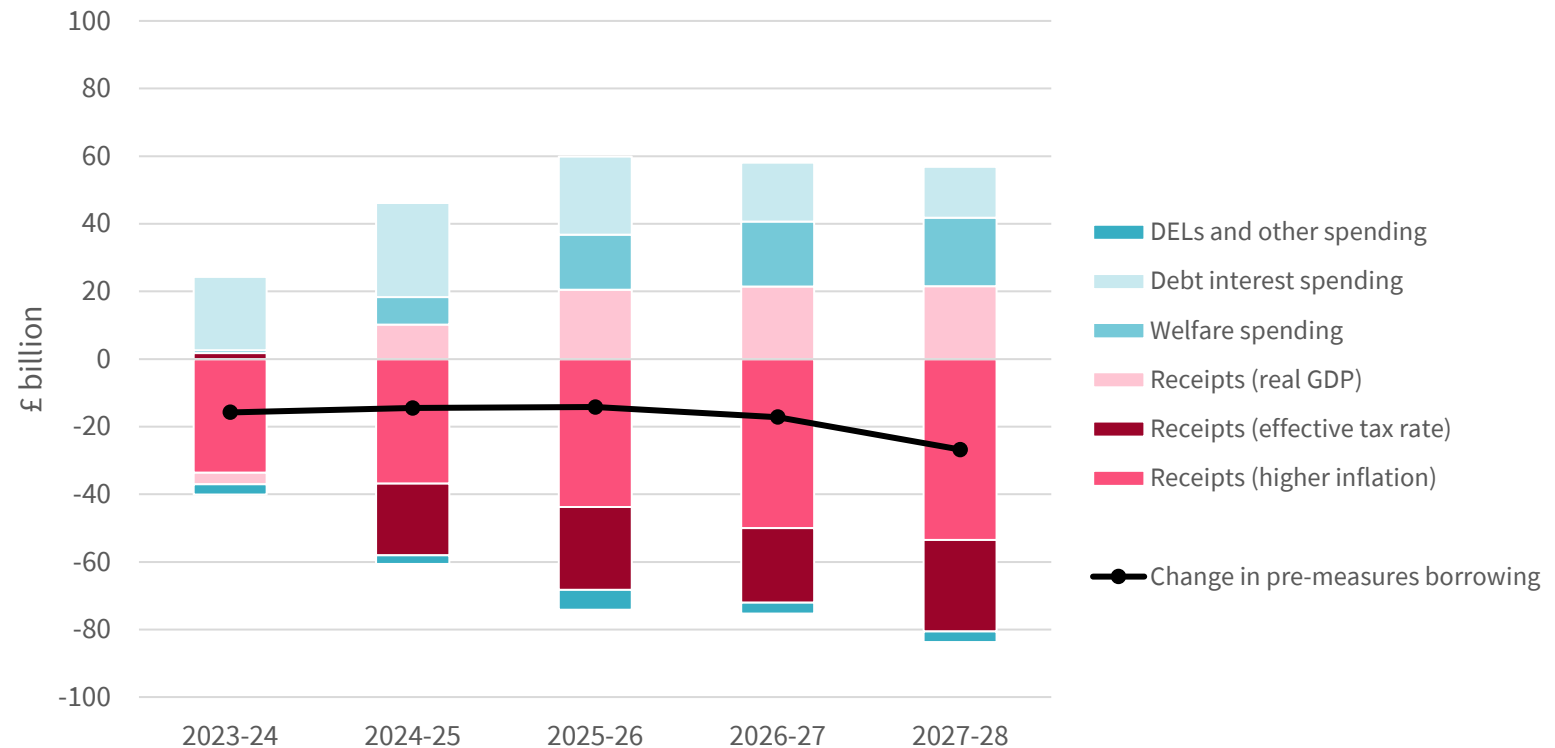


Source: OBR (2023) Economic and Fiscal Outlook November 2023

# Autumn Statement 2023

- Higher receipts reduces borrowing by £35 billion in 2023-24, rising to £59 billion in 2027-28 – higher inflation and earnings driving higher income tax, NICs, corporation tax and VAT, with a higher effective tax rate (fiscal drag)
- Partly offset by a lower forecast for real GDP and increasing spending – higher debt interest spending and welfare payments

## Public sector borrowing: changes since March 2023

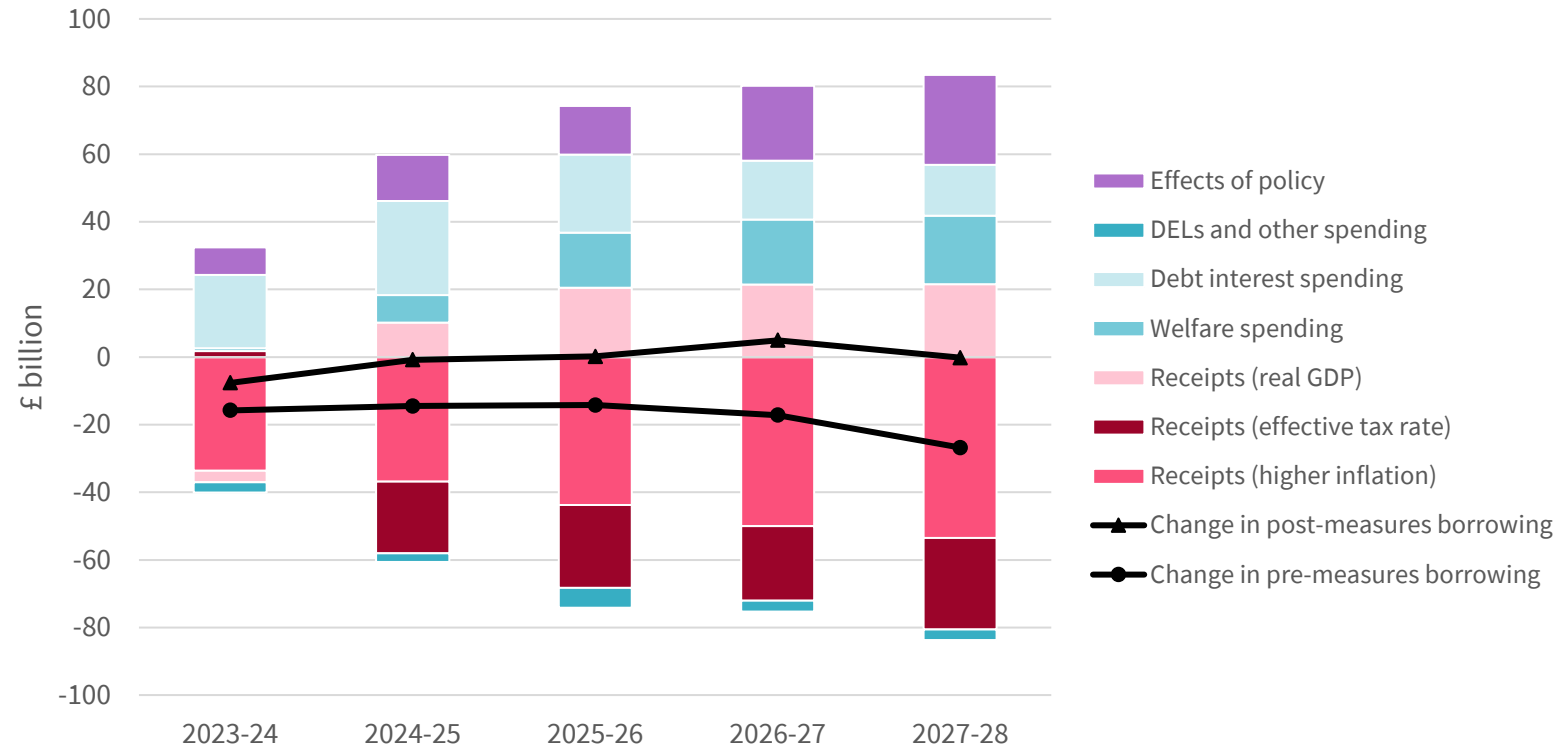


Source: OBR (2023) Economic and Fiscal Outlook November 2023

# Autumn Statement 2023

- Policy decisions increase borrowing every year – mainly tax cuts:
  - Cuts to National Insurance Contributions increase borrowing by an average of £8.6 billion
  - Permanent full expensing measures (corporation tax) increases borrowing by an average of £9.1 billion
  - Some additional departmental spending - £5.3 billion per year on average

## Public sector borrowing: changes since March 2023

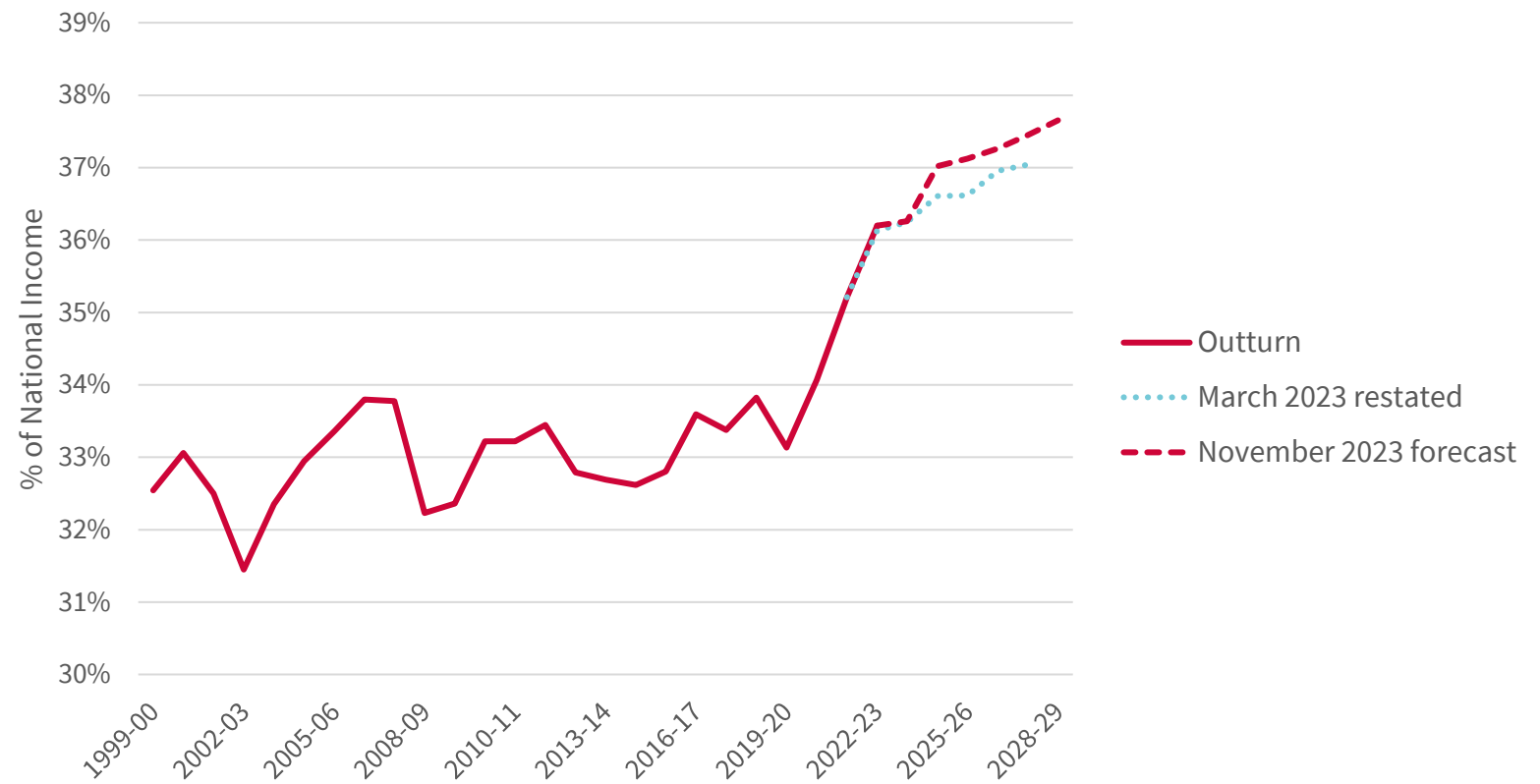


Source: OBR (2023) Economic and Fiscal Outlook November 2023

# Autumn Statement 2023

- Tax as a share of national income still rising to a post-war high – 37.7% in 2028-29, 4.5 percentage points higher than pre-pandemic (and higher than OBR forecasts from March)
- Main reason is fiscal drag from frozen tax thresholds and tax richness of the economy

## Tax as a % of GDP

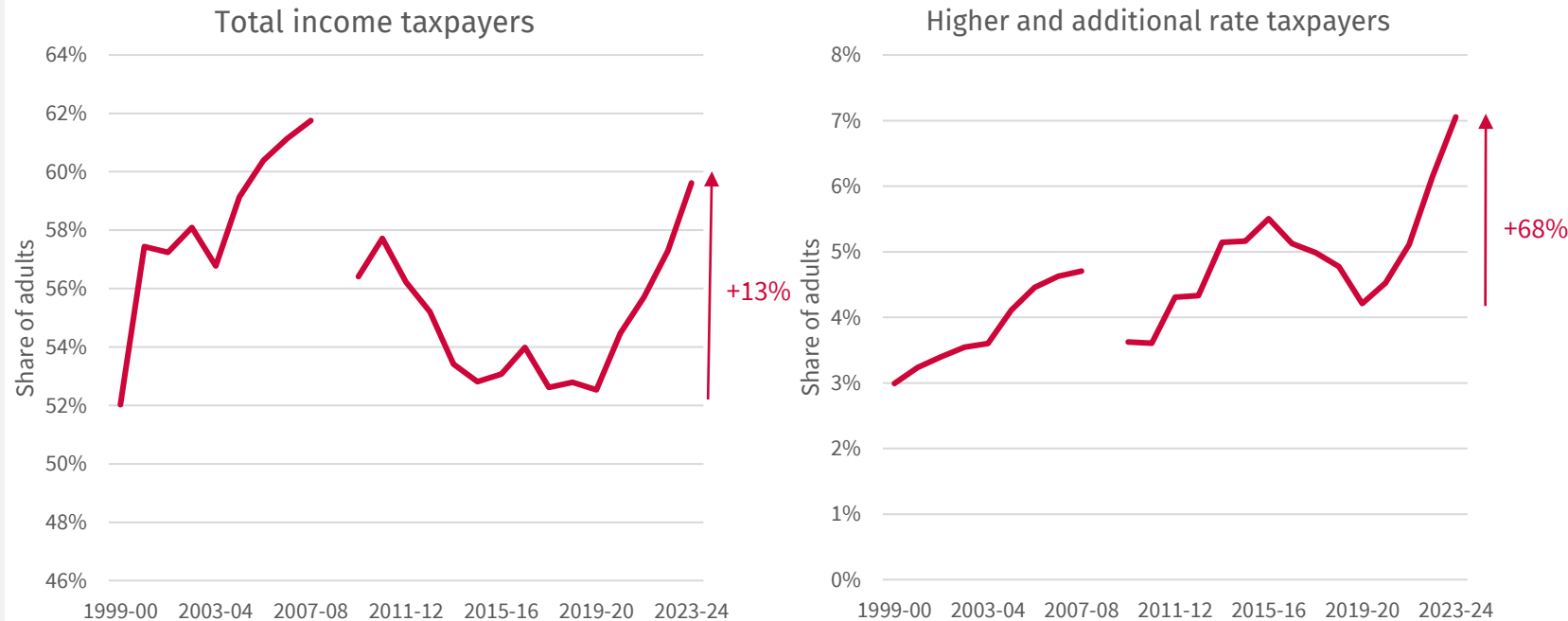


Source: OBR (2023) Economic and Fiscal Outlook November 2023

# UK Government tax increases

- Freezing of NI and income tax thresholds for six years now expected to raise £45 billion - £1,200 per household
- Has already increased share of adult population in Wales paying income tax back to pre-financial crisis levels – higher and additional rate taxpayers increased by 2/3rds since 2019-20
- Implications for Welsh Government’s devolved income tax powers
  - Forecast revenues in 2024-25 increased by 6.3% relative to March forecasts
  - Higher and additional rate changes would be more impactful
  - Basic rate changes less progressive

## Income taxpayers as a share of the adult population in Wales, 1999-00 to 2023-24

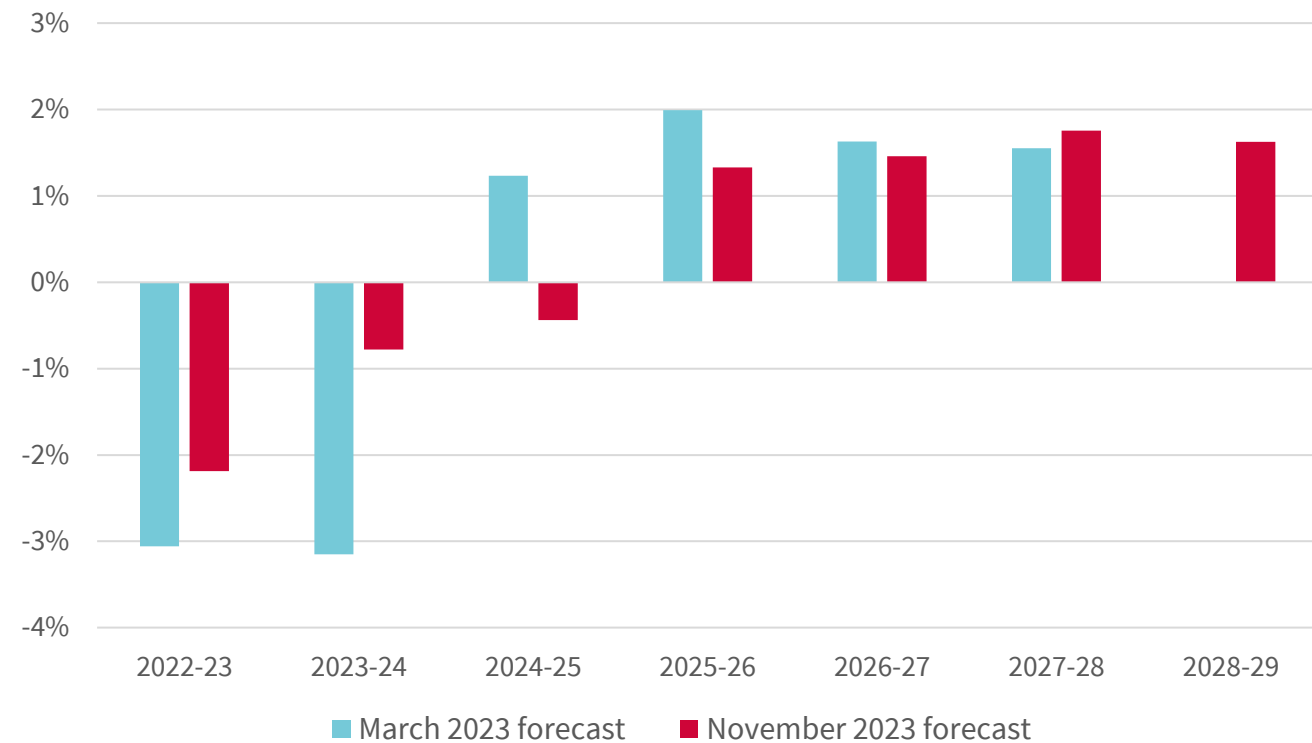


Source: Statswales (2023) 2020-based Population projections by year and age; Statswales (2023) National level population estimates by year, age and UK country; HMRC (2023) Table 2.2 Number of individual Income Taxpayers by country and region

# Economic outlook

- Real household disposable incomes have not fallen by as much as forecast...
- However, slowing growth, persistent inflation and the high tax burden mean that living standards not expected to reach pre-pandemic levels until 2027-28

Annual change in real household disposable income per person (%)



Source: OBR (2023) Economic and Fiscal Outlook November 2023

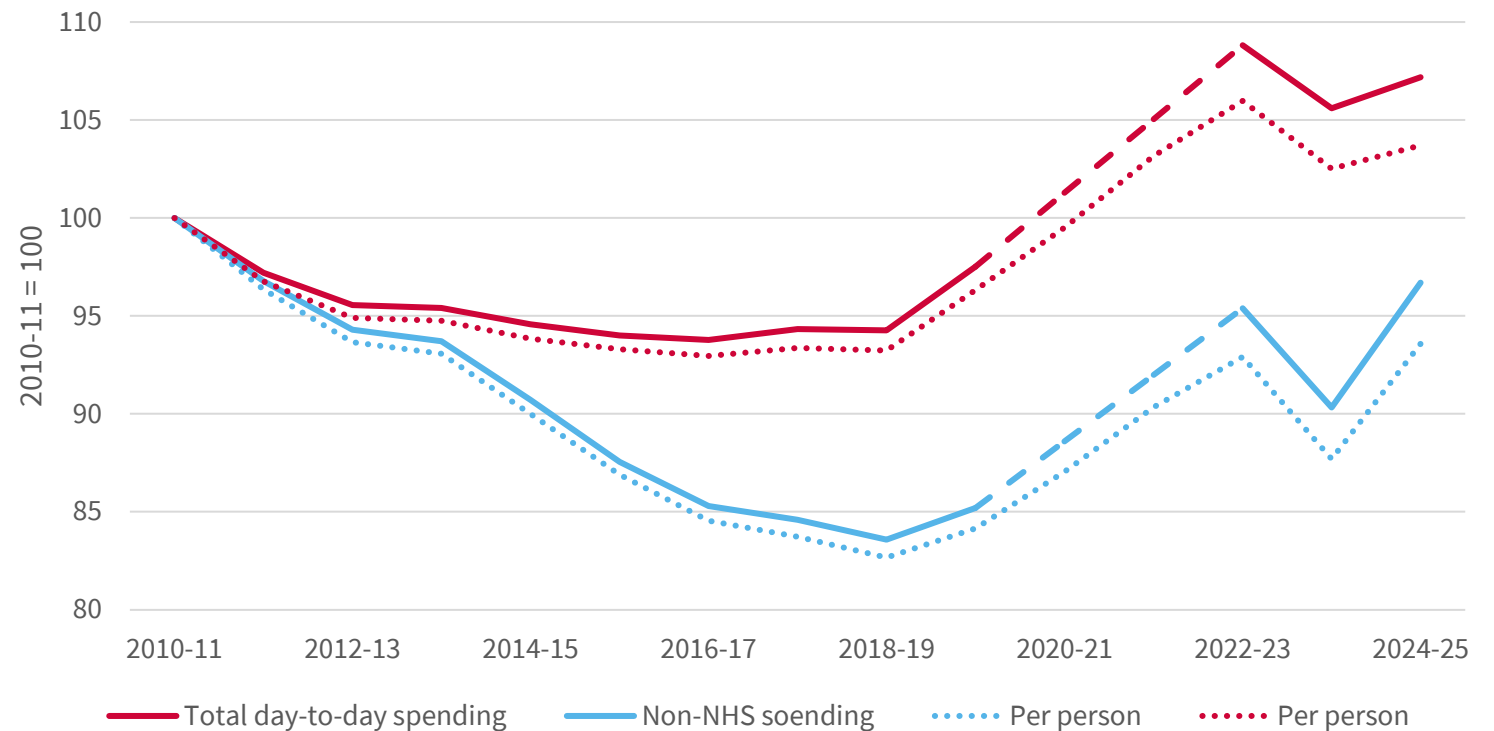
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# Historical context

- The Welsh Government budget for day-to-day spending is approximately 6% higher than 2010-11 in real terms in 2023-24, but only 3% higher on a per person basis
- Outside of the NHS, spending remains 10% below pre-austerity levels in 2023-24 (12% below on a per person basis)

## Real terms trend in Welsh Government day-to-day spending on public services (2010-11=100)

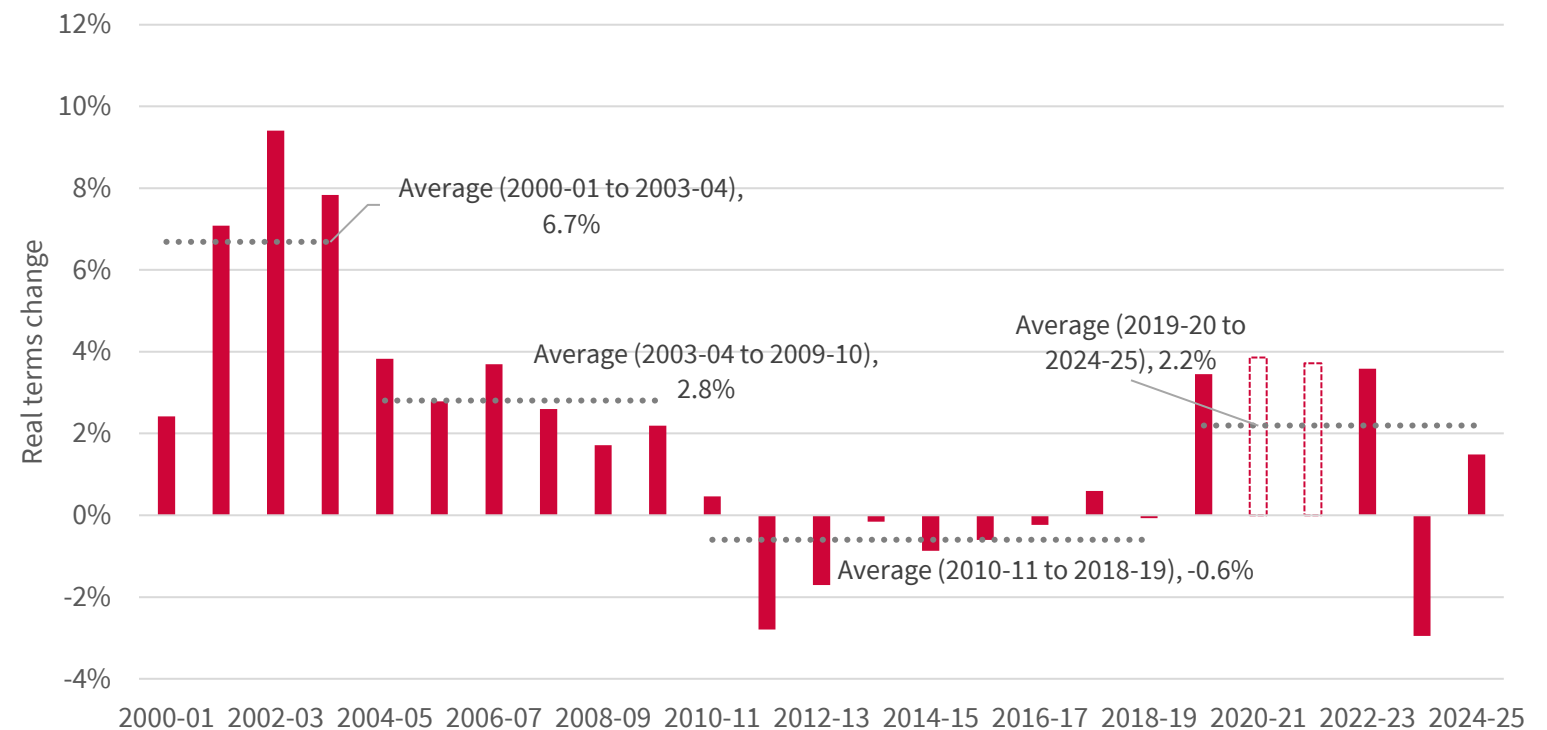


Source: Wales Fiscal Analysis calculations based on HM Treasury (2023) Block Grant Transparency data; HM Treasury (2023 and previous) PESA reports; Office for Budget Responsibility (2023) Economic and Fiscal Outlook 2023; Office for National Statistics (2023) 2022 mid-year population estimates. Note: Various adjustments are made to construct time-series data to account for Council Tax Benefit devolution, tax devolution, EU replacement funding and IFRS16 accounting changes. 2019-20 and 2020-21 excluded given pandemic-related volatility in funding and inflation. Non-NHS spending for 2023-24 based on October '23 update and 2024-25 based on February '23 Final Budget plans.

# Historical context

- Growth in day-to-day spending over 2019-20 to 2024-25 has averaged 2.2%, following a decade of austerity budgets. This is still significantly below spending growth during the first decade of devolution, despite huge post-pandemic pressures on public services
- Growth over these recent years has been boosted because of tax devolution and the 105% “Needs-Based Factor” applied to the Barnett Formula

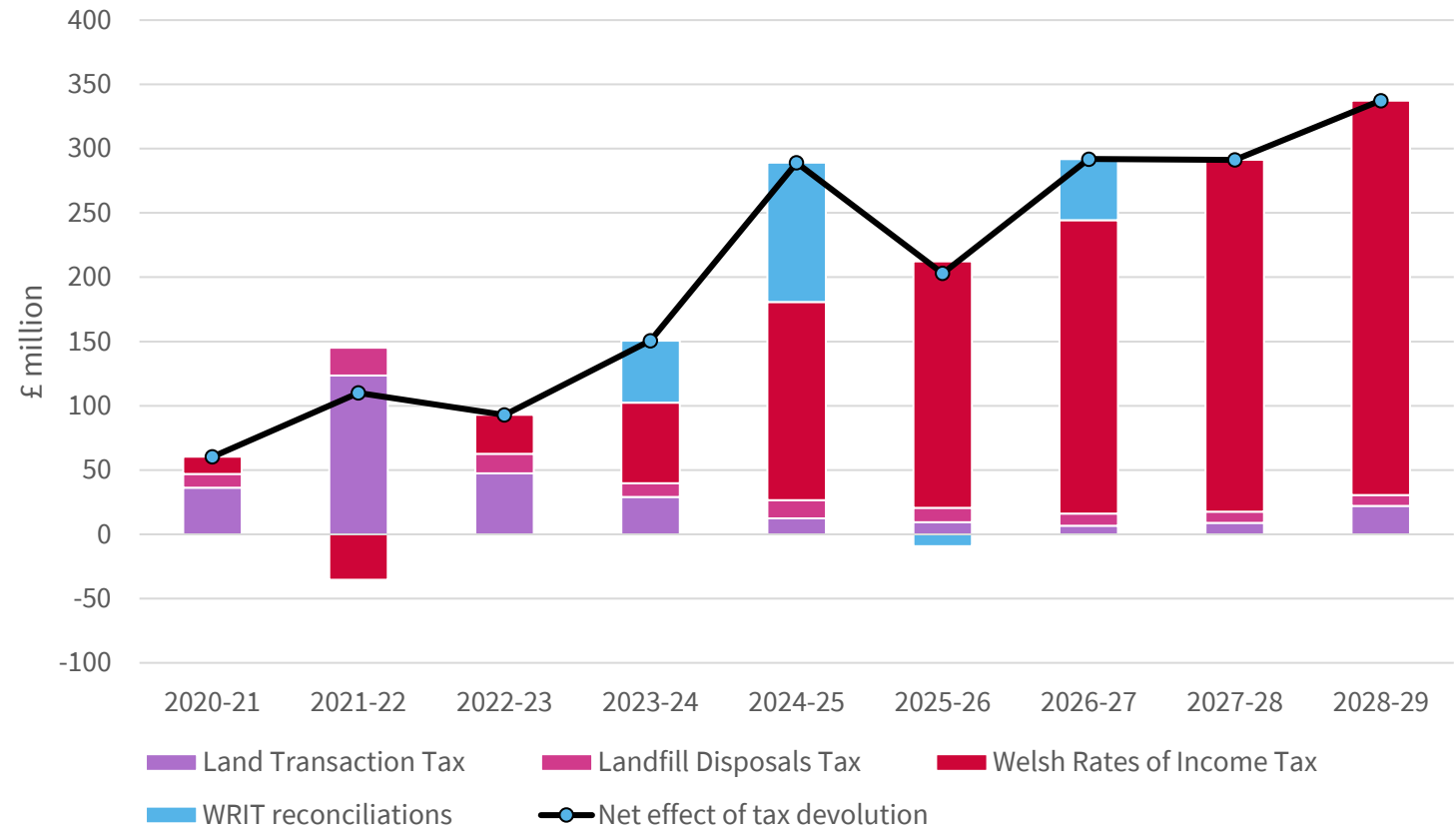
## Average real terms annual change in funding for Welsh Government day-to-day spending



Source: Wales Fiscal Analysis calculations based on HM Treasury (2023) Block Grant Transparency data; HM Treasury (2023 and previous) PESA reports; Office for Budget Responsibility (2023) Economic and Fiscal Outlook 2023; Office for National Statistics (2023) 2022 mid-year population estimates. Note: Various adjustments are made to construct time-series data to account for Council Tax Benefit devolution, tax devolution, EU replacement funding and IFRS16 accounting changes. 2019-20 and 2020-21 are straight-line estimates given pandemic-related volatility in funding and inflation. Non-NHS spending for 2023-24 based on October '23 update and 2024-25 based on February '23 Final Budget plans.

# Net effect of tax devolution

- Overall, tax devolution has a significantly positive net effect on the Welsh budget, with revenues exceeding the corresponding Block Grant Adjustments
- This amounts to £289 million in 2024-25 (equivalent to 1.4% of day-to-day spending) and almost equivalent to a 1p increase in all Income Tax rates

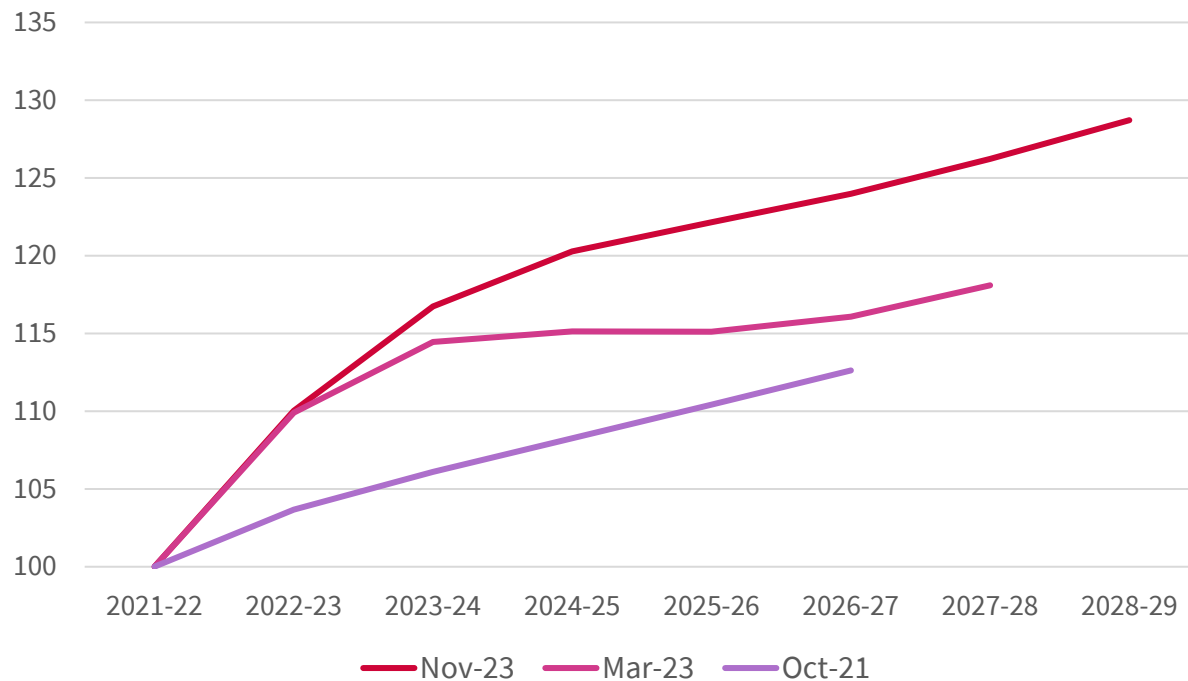


Source: WFA analysis of OBR (2023) Devolved Tax Forecasts.

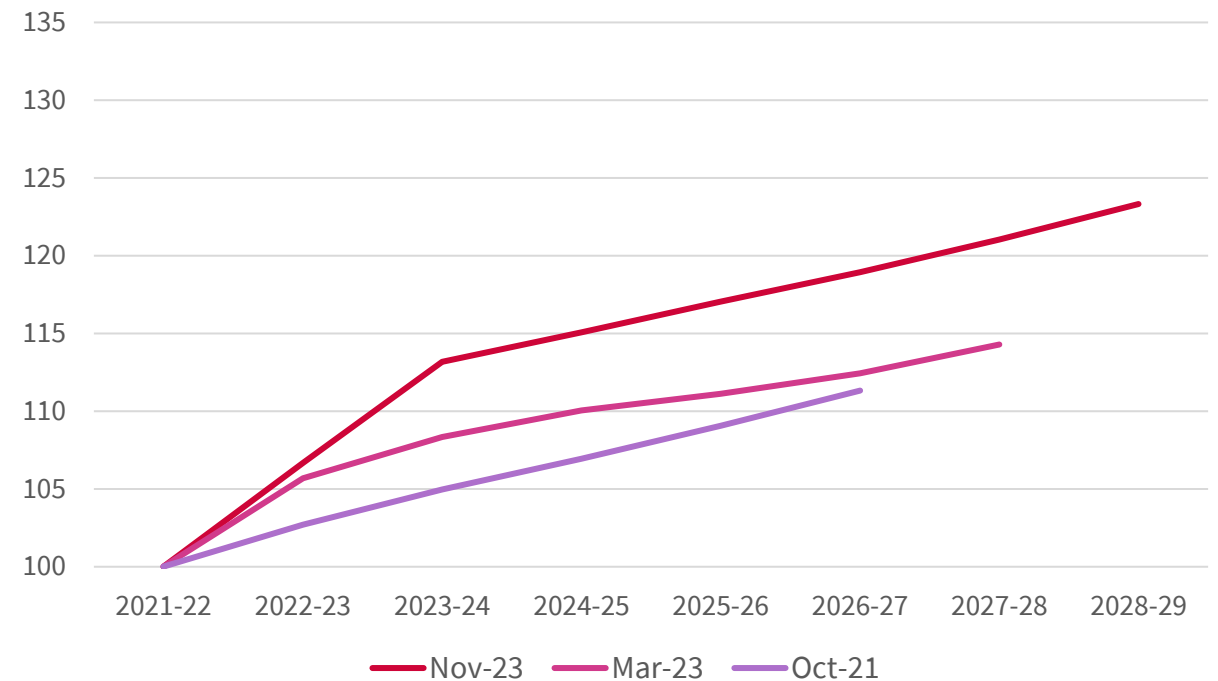
# Much higher inflation

- Prices are much higher than expected either back in October 2021 when budgets were originally set – as measured by the CPI or the GDP deflator measures
- Despite some additional funding from the UK government, this has significantly reduced the real-terms value of the Welsh Government’s settlement

Cumulative change in CPI inflation level (2021-22 = 100)



Cumulative change in GDP deflator level (2021-22 = 100)

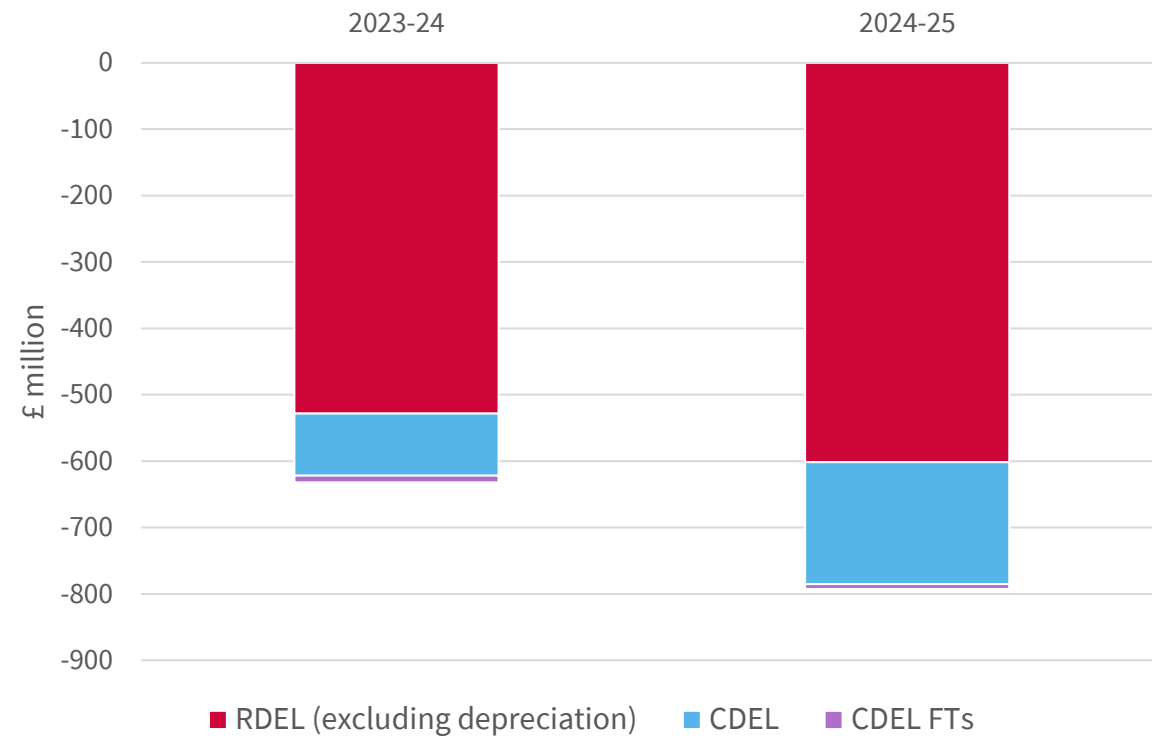


# Losses from higher inflation

- Welsh Government funding for 2024-25 is set to be worth nearly **£800m** less in real terms than expected at the October 2021 Spending Review (using GDP deflator measure) – equivalent to 3.5% of the budget
- Using the CPI measure of inflation, this loss is worth **£1.5 billion** in 2024-25\*

\*After accounting for IFRS16 changes

## Loss from higher inflation (as measured by GDP deflator) relative to original October 2021 Spending Review plans



Source: Wales Fiscal Analysis calculations of HM Treasury (2023) Block Grant Transparency data and Office for Budget Responsibility (2023) Economic and Fiscal Outlook 2023. Note: these calculations account for IFRS16 changes which has increased funding relative to original plans (but without impacting actual spending power). RDEL refers to Resource Departmental Expenditure Limit, while CDEL refers to Capital Departmental Expenditure Limit.

# Immediate budget challenges 2023-24

## Winter pressure may hit NHS Wales wait targets - minister

19 November · Comments

## Mark Drakeford makes 'crisis' cuts to prop-up NHS and trains

17 October



## Financial Statement: Extra £425m to protect NHS - 'budget not adding up' says Plaid Cymru

WALES | WELSH GOVERNMENT | SPENDING REVIEW | HEALTH | Tuesday 17 October 2023 at 4:56pm



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## Welsh public services must make cuts, Mark Drakeford says

9 August



## Cuts warning as Welsh councils face £395m shortfall

23 August

# Immediate budget challenges

## Welsh Government budget for 2023-24

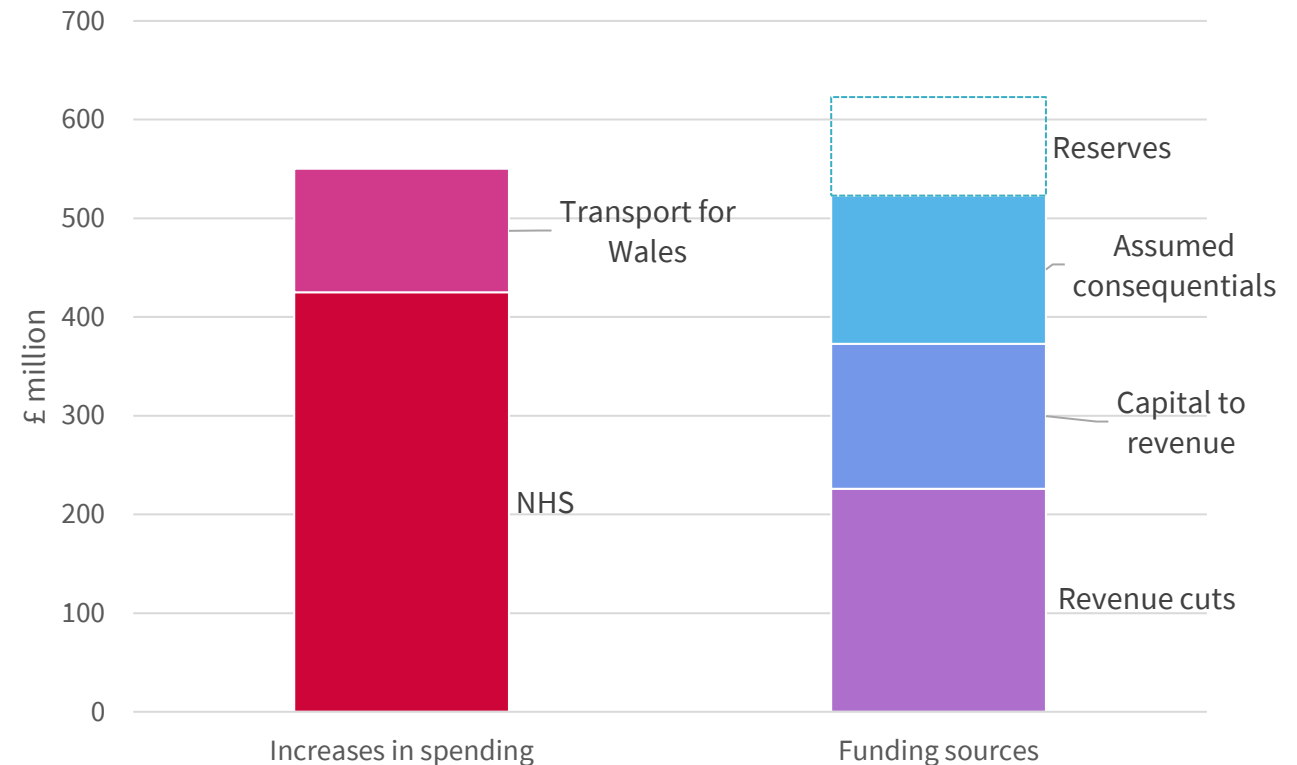
- Higher-than-expected pay increases will have added £300m-£400m to the devolved and local public sector pay bill - despite still representing real terms pay cuts for most workers
- In-year budget mitigations announced on 17 October
  - Additional spending on the NHS and Transport for Wales
  - Cuts across other portfolios and in capital spending
- Assumptions made around consequentials, switching capital to resource spending, and use of reserves

# Immediate budget challenges

## Update on 2023-24 Financial Position:

- +£425 million for NHS (4.6% increase)
- +£125 million for TfW (increase of over half)
- £226 million of resource cuts (some unspecified)
- £147 million of capital to resource budget switch
- £150 million assumed consequentials
- Up to £100 million from Reserves (£119 million available)

## Additional in-year spending allocations and funding source in 2023-24 (£ million)



Source: Wales Fiscal Analysis based on Welsh Government (2023) Update on 2023-24 Financial Position

# Immediate budget challenges

## Welsh Government budget for 2023-24

- Autumn Statement confirmed **£133m** of consequentialials (linked to NHS pay deals in England) for 2023-24
- Offset by latest devolved tax and Block Grant Adjustment forecasts (**-£40m**)
- Would imply using **£60m** of unallocated funding and a further **£24m** drawdown from the Wales Reserve (barring further changes stemming from the UK government's Supplementary Estimates)
- Unclear to what extent cuts in 2023-24 reflect savings to be baselined into future years and how much are one-off reductions...

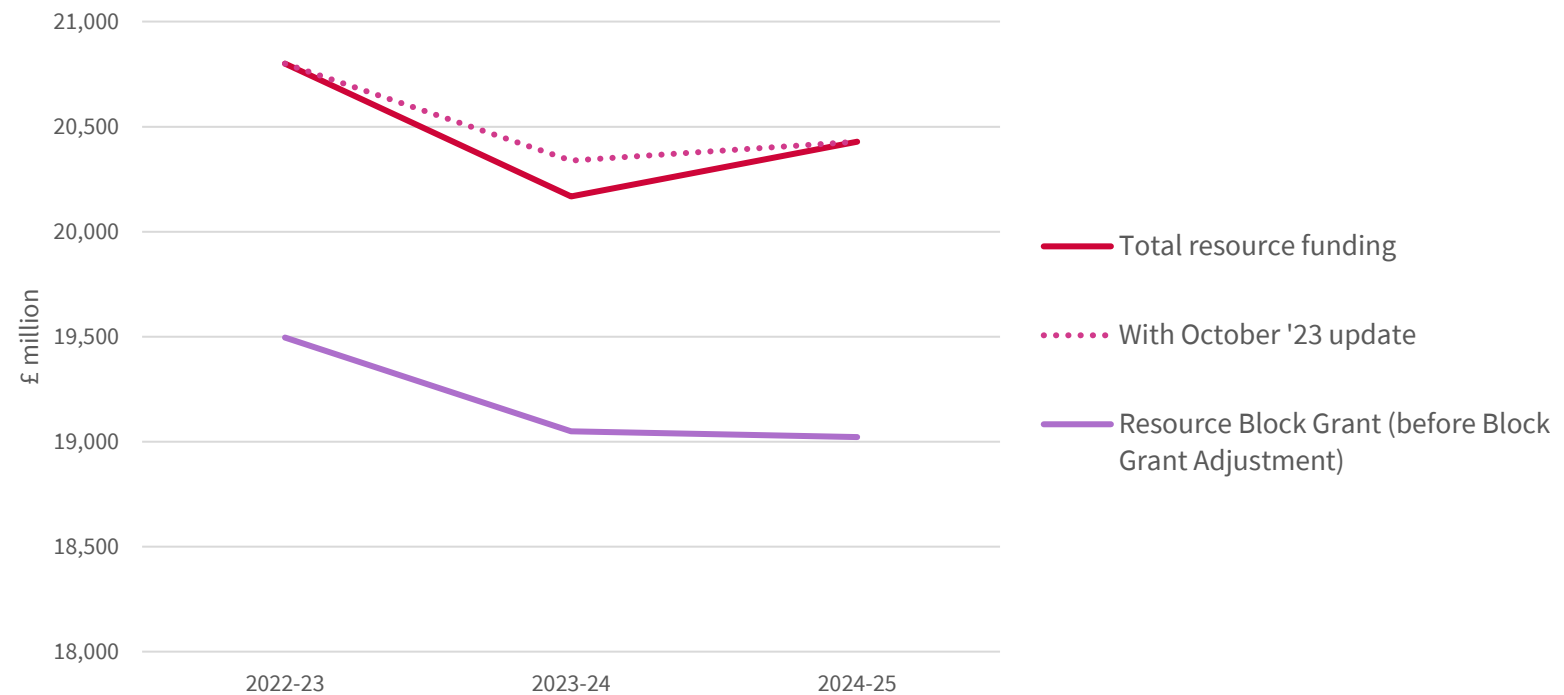
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# Welsh Government Budget for 2024-25

- The resource block grant (before Block Grant Adjustments) is set to fall slightly in real terms next year (*purple line*)
- Including projected Non-Domestic Rates revenue growth (before further reliefs) and a positive effect from tax devolution, total funding for resource spending is set to grow by 1.3% in 2024-25 (*red line*)
- Accounting for planned capital to resource budget switch and additional Wales Reserve drawdowns in 2023-24, spending would grow by 0.4% in real terms

## Welsh Government day-to-day spending from 2022-23 to 2024-25 (in real terms, 2023-24 prices)



Source: Wales Fiscal Analysis calculations of Welsh Government budget documents, Office for Budget Responsibility (2023) Devolved Tax Forecasts; HM Treasury (2023) Block Grant Transparency data

# Welsh Government Budget for 2024-25

- The Welsh Government have indicative spending plans for 2024-25 (from February 2023)
- These do not yet reflect October 2023 changes to 2023-24 spending or changes to the funding available for 2024-25 from block grant funding and devolved tax revenues
- Spending plans for 2024-25 (especially for Health and Social Services) will need to be “topped up”

## Welsh Government day-to-day spending for 2023-24 and 2024-25, by Main Expenditure Groups (£ million)

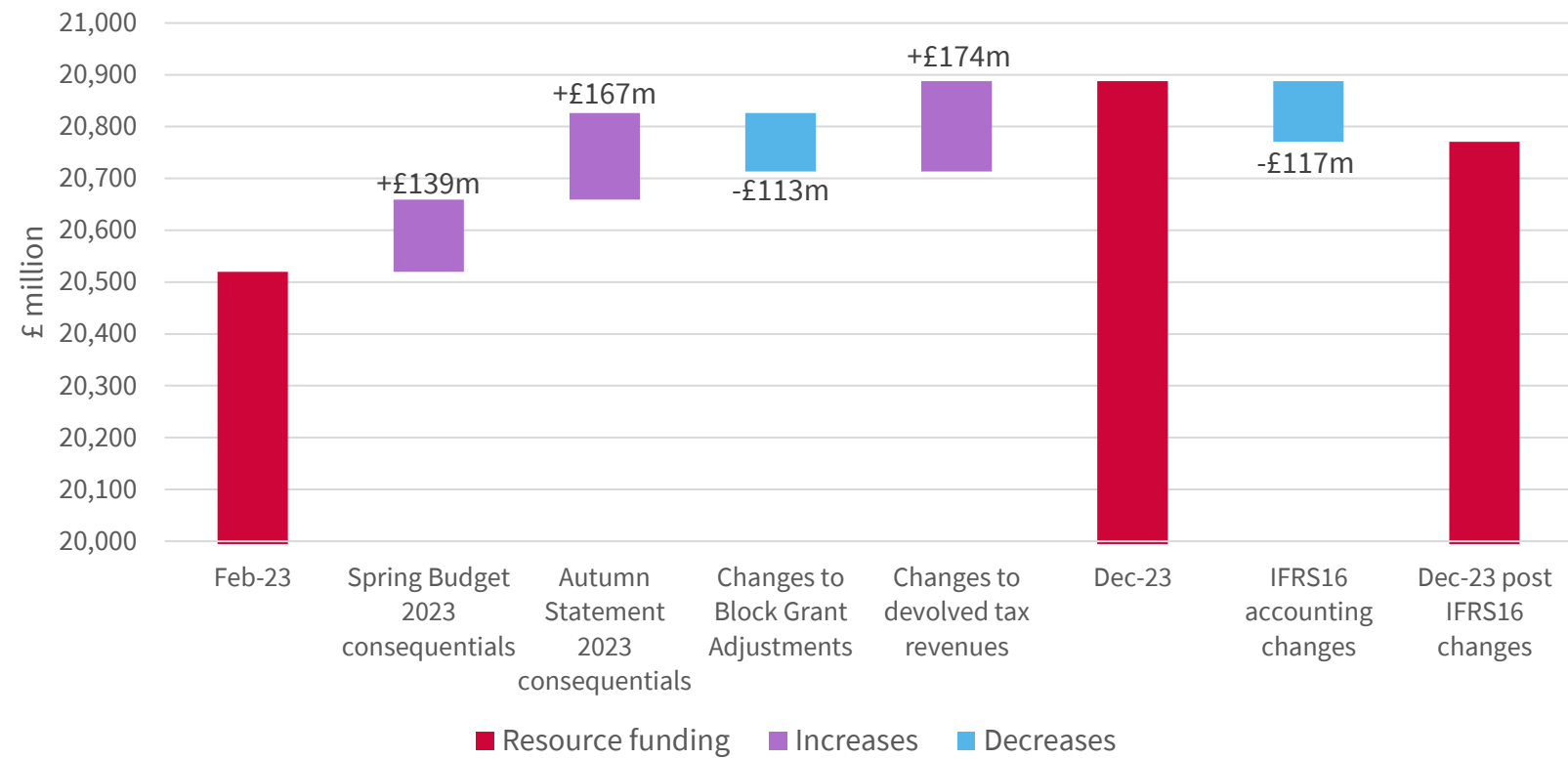
	1st Update on 2023-24 Financial Position (October '23)	Indicative spending plans in Final Budget (February '23)	Change to 2024-25 relative to October '23 plans		
	Supplementary Budget (June '23)		2023-24	2024-25	£m
<b>Health and Social Services</b>	10,170	10,347	10,595	-248	-2.3%
<b>Finance and Local Government (including NDR revenues)</b>	5,807	5,964	5,778	186	3.2%
<b>Education and Welsh Language</b>	1,817	1,814	1,742	72	4.1%
<b>Climate Change</b>	952	941	1,035	-93	-9.0%
<b>Economy</b>	444	469	415	54	12.9%
<b>Rural Affairs</b>	377	432	359	73	20.3%
<b>Social Justice</b>	139	139	132	7	5.1%
<b>Central Services and Administration</b>	333	334	305	29	9.4%

Source: Wales Fiscal Analysis calculations of Welsh Government budget documents. Notes: 2023-24 figures presented with effect of IFRS16 changes removed for comparability with 2024-25 spending plans.

# Welsh Government Budget for 2024-25

- **Consequentials** announced at the Spring Budget 2023 and Autumn Statement 2023 amount to **£306m**
- **+£61m** from net positive changes to **devolved tax forecasts and block grant adjustments** (including reconciliations)
- Welsh Government has an additional **£368m** to allocate (before IFRS16 accounting changes)

## Changes in funding for Welsh Government day-to-day spending for 2024-25, by source



Source: Wales Fiscal Analysis calculations of Welsh and UK government budget documents and HM Treasury (2023) Block Grant Transparency data

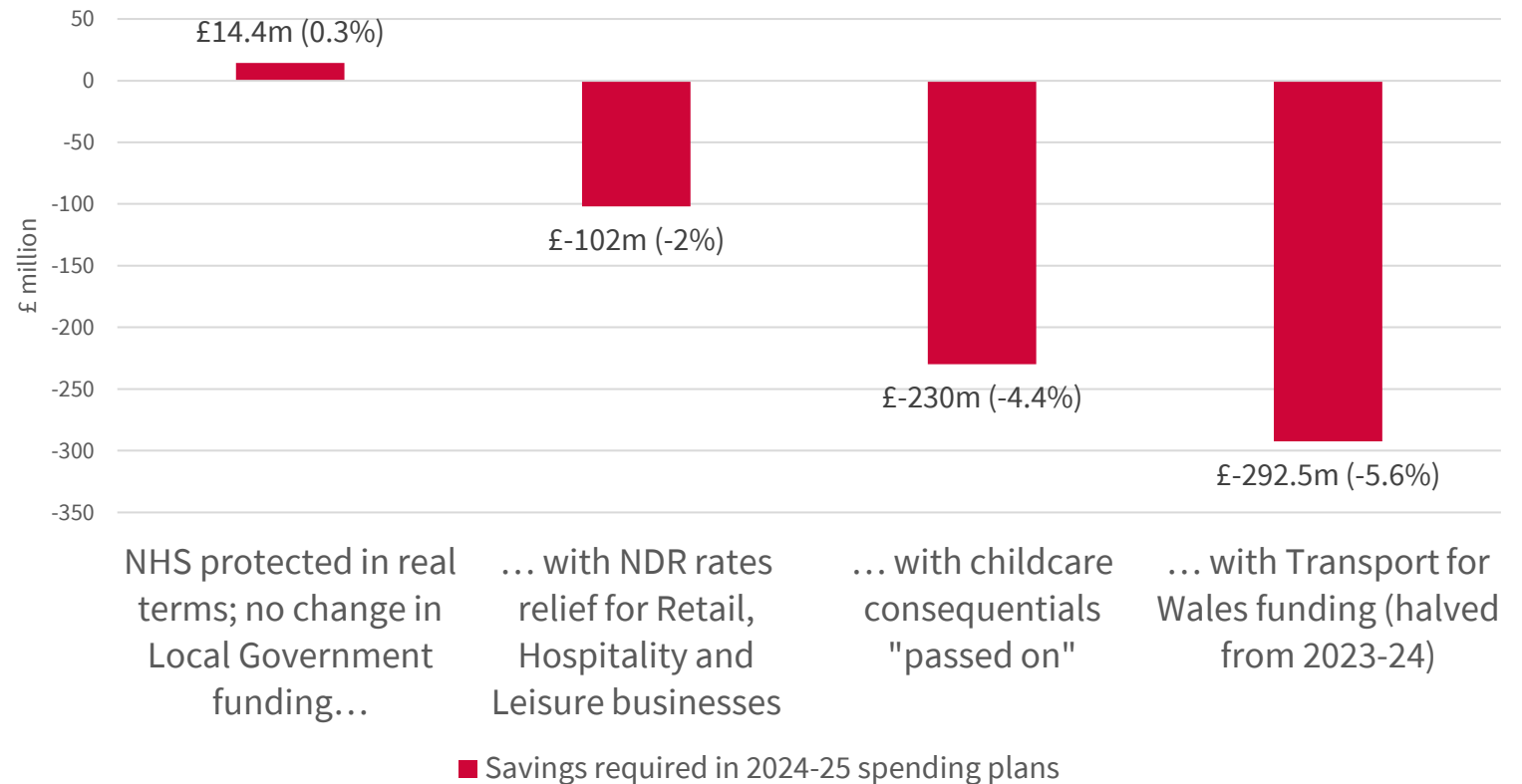
# Welsh Government budget options

- The Welsh Government has an additional **£368m** to allocate for day-to-day spending (1.8% on top of existing spending plans for 2024-25)
- Options and priorities?
  - Extend 75% non-domestic rates relief for Retail, Hospitality and Leisure businesses (with £110,000 cap) to 2024-25: **£116m**
  - Maintain NHS spending at elevated 2023-24 level in real terms: **£353m**
  - Maintain planned cash-terms increase of 3.1% in Local Government settlement: **£0m**
  - “Pass on” consequential for childcare spending in 2024-25: **£128m**
  - Further financial support for Transport for Wales? Halving additional support from 2023-24 package: **£63m**
- These commitments could require cuts to spending plans in other areas

# Welsh Government Budget for 2024-25

- If the Welsh Government...
  - Maintains spending on the NHS in real terms
  - Extends NDR reliefs for Retail, Hospitality and Leisure businesses
  - Maintains planned cash-terms increase in Local
- ... it would need to find **cuts of £102m** (2.0%) across other spending areas (relative to existing plans for 2024-25)
- With additional childcare spending and financial support for Transport for Wales, required cuts could be **£293m** (5.6%)

## Changes in spending



Source: Wales Fiscal Analysis calculations of Welsh and UK government budget documents and HM Treasury (2023) Block Grant Transparency data

# NHS spending

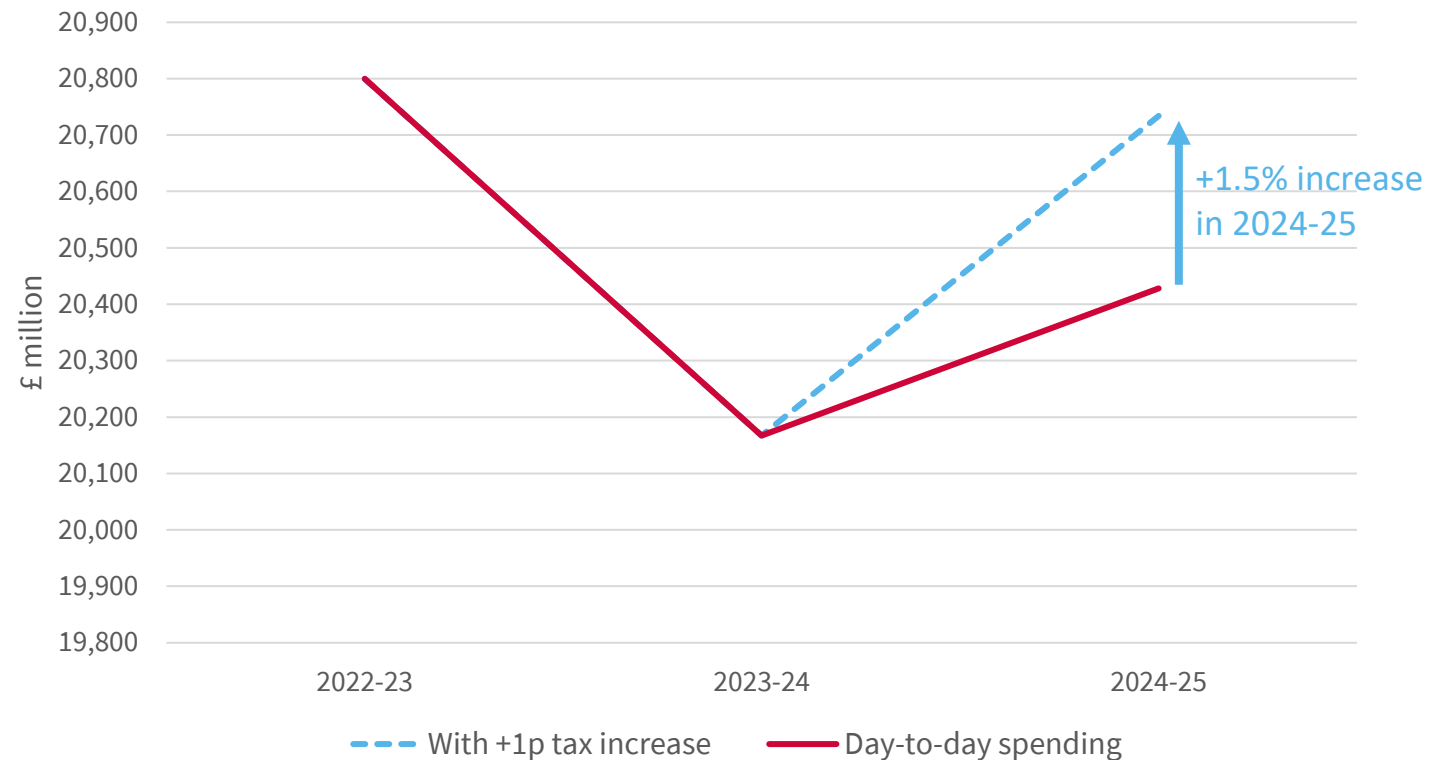
- If spending on the NHS in 2024-25 is to be maintained in real terms at 2023-24 levels, spending will need to grow by **£163m** in cash terms from 2023-24 to 2024-25 (**£353m** above current 2024-25 spending plans)
- This is still unlikely to meet spending pressures felt by the health service, assuming:
  - NHS pay deals matching forecast average earnings growth of 3.3%
  - Non-pay costs growth in line with the GDP deflator measure of inflation (1.6%)
  - Demand grows by 2.1% (in line with assumptions made in previous modelling – see [here](#))
  - This would imply a funding gap of **≈£300m** in 2024-25 (before any assumptions on productivity improvements)
  - If NHS productivity increased by 1%, this funding gap would reduce to about **£200m**

# Local government funding

- Core funding for local government is currently set to increase by £168m (or 3.1% in nominal terms) from 2023-24 to 2024-25
- Our [briefing](#) in October on the outlook for local government warned that spending pressures had significantly outstripped increases in funding since 2021-22
  - Local authorities have responded by increasing Council Tax levels by 5.8% and drawing down on reserves built-up in previous years
- Updating our projections to reflect new forecasts for earnings growth and inflation, we now project the funding gap will grow to **£469m** in 2024-25 (assuming no further funding from the Welsh Government and council tax increases of 5%)

# Using the Welsh Rates of Income Tax?

## Welsh Government day-to-day spending from 2022-23 to 2024-25 (in real terms, 2023-24 prices), with increase in Welsh Rates of Income Tax



Source: Wales Fiscal Analysis calculations of Welsh Government budget documents, Office for Budget Responsibility (2023) Devolved Tax Forecasts; HM Treasury (2023) Block Grant Transparency data; Welsh Government (2022) Welsh Rates of Income Tax Ready Reckoner;. Note: Estimate of revenue impact based on Welsh Government modelling of behavioural effect, updated to reflect the latest OBR forecasts for income tax in 2024-25.

- Given challenging funding outlook across public services, the Welsh Government could consider using its powers over the Welsh Rates of Income Tax
- A 1p increase across all bands would increase revenue by approximately **£311m** in 2024-25
- This would equate to around 1.5% of day-to-day spending, and would see spending increase by 2.8% from 2023-24 to 2024-25
- This would be a more progressive way of meeting local government pressures compared to Council Tax increases (see [here](#))

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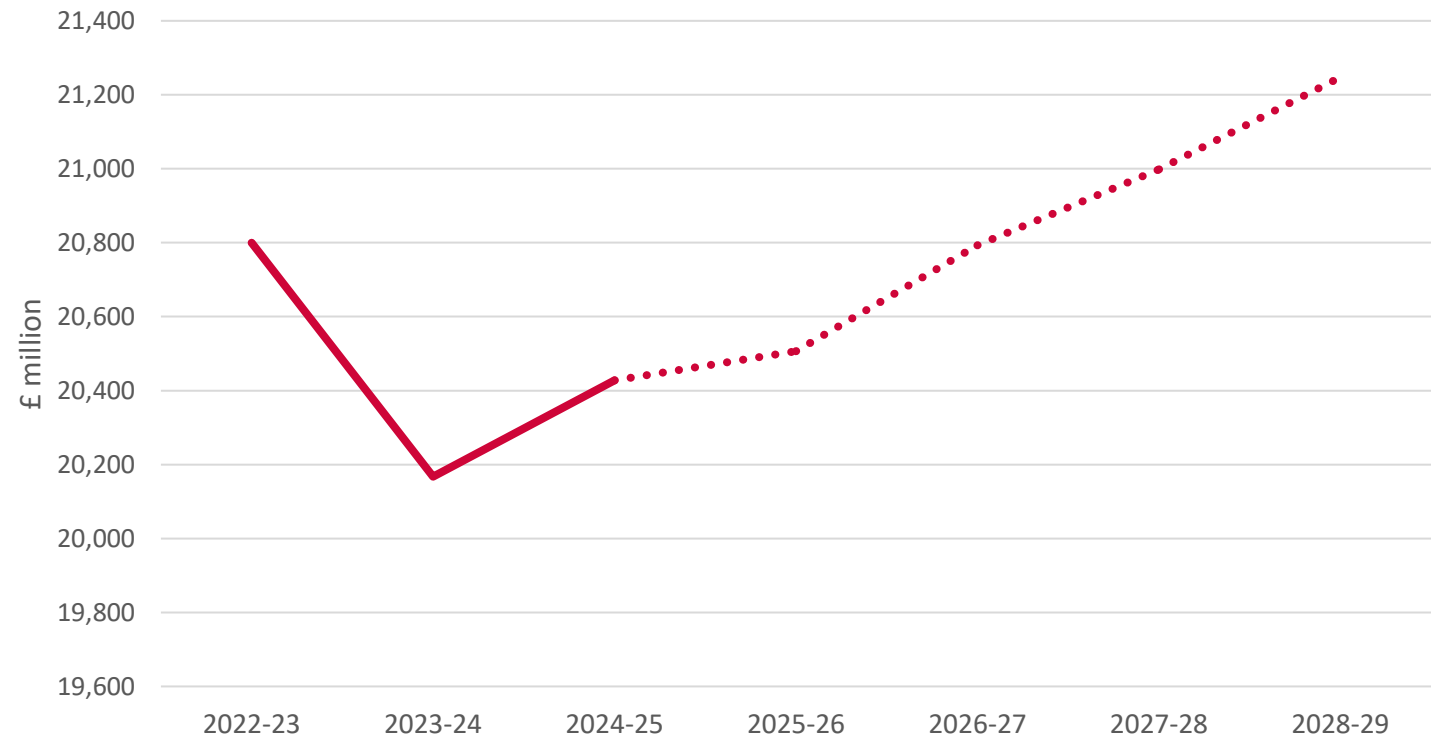
# The medium term outlook

- At the Autumn Statement, the Office for Budget Responsibility estimated that the real value of UK government departmental budgets have been eroded by £19 billion by 2027-28 (relative to March 2023 plans), through higher inflation not offset by increased planned public spending
- Based on the UK Government's indicative spending plans, day-to-day spending will grow by 0.9% per year in real terms from 2025-26 to 2028-29. Assuming:
  - NHS spending in England grows by 3.6% a year in real terms
  - Schools spending in England is kept flat
  - Defence and aid spending grow in line with GDP
  - We calculate projected Barnett consequentialials for the Welsh Government budget, alongside latest forecasts for devolved taxes

# Welsh Government budget outlook

- The Welsh Government budget for day-to-day spending is set to increase by 0.9% per year in real terms on average from 2025-26 to 2028-29
- Day-to-day spending will remain below 2022-23 levels in real terms until 2027-28
- If the Welsh Government “passes on” consequential stemmings from the NHS and schools spending in England, all other spending will fall by an average of 2.2% per year in real terms

## Welsh Government day-to-day spending on public services (real terms, 2023-24 prices)



Source: Wales Fiscal Analysis calculations

# The medium term outlook

- Annual cuts outside “protected” areas will be similar in scale to the austerity period of the early 2010s
- At the Autumn Statement, the Chancellor also extended the cash freeze in capital spending for another year. The Welsh Government’s block grant for core capital spending could fall by 15% in real terms from this year to 2028-29
- Huge uncertainty, especially given these spending plans will be implemented after the next UK General Election
- How feasible are these cuts? Past experience suggests that when Chancellors produce detailed spending plans by department, the total pot increases – this raises serious questions around the credibility of the public finance forecasts and the tax cuts announced at the Autumn Statement

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