



Dadansoddi
Cyllid Cymru

Wales Fiscal
Analysis

Welsh Government Draft Budget proposals for 2021-22

Written Response to Finance Committee Call for Information

Written response to Finance Committee Call for Information: Welsh Government Draft Budget 2021-22

03 DECEMBER 2020

1. Introduction

- 1.1 The Finance Committee of the Welsh Parliament is seeking information to inform their scrutiny of the Welsh Government's 2021-22 Draft Budget proposals. This written response draws upon Wales Fiscal Analysis' *Welsh Budget Outlook 2020* report, published by Cardiff University's Wales Governance Centre on the 3 December 2020. The full report can be found [here](#).
- 1.2 This written response contains an update on the Welsh Government's Covid-19 response in 2020-21 to date, analyses the implications of the UK Government's Spending Review 2020 for the Draft Budget 2021-22, and discusses some of the choices facing the Welsh Government.

2. Welsh Government's Covid-19 response to date

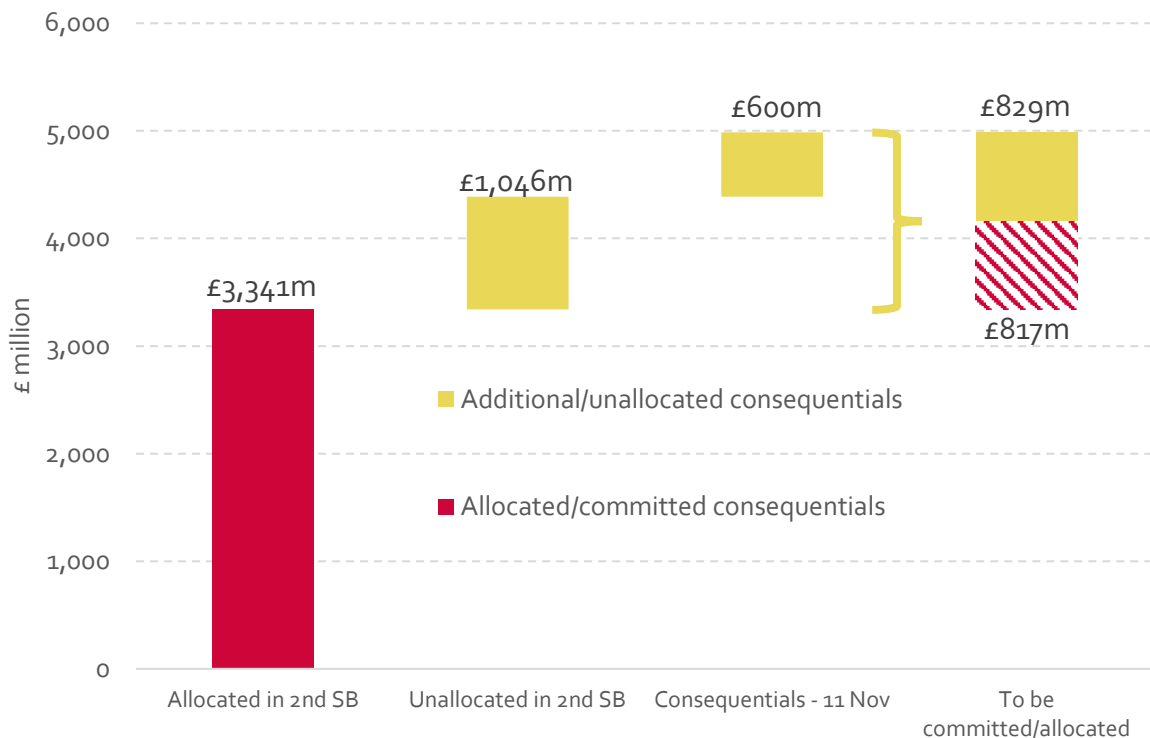
- 2.1 Since March, the size and composition of the Welsh budget for 2020-21 has changed dramatically, growing by over a quarter relative to Final Budget plans.
- 2.2 Available funding for the Welsh Government's Covid-19 fiscal response amounts to £5.6 billion, funded mainly by a funding guarantee from the UK government, repurposed funding from the European Union and reprioritised funding from within the budget.
- 2.3 The Welsh Government has so far allocated £4 billion of this funding in two supplementary budgets. The largest allocations have been made to the Health and Social Services budget (£1.4 billion) and the Economy and Transport (£1.5 billion).
- 2.4 Spending announcements not yet included in supplementary budgets include the £320 million Covid-19 Reconstruction Fund and a £340 million increase in support for businesses through the Economic Resilience Fund, to support businesses affected by tougher restrictions being introduced in December. This suggests Welsh Government support for businesses this year in grants and reliefs will equate to approximately £2 billion.
- 2.5 Taking recent commitments into account, it seems plausible that around £829 million of the Welsh Government's Covid-19 allocation remains uncommitted at this point. **Figure 1** shows how much of the Welsh Government's £5 billion funding guarantee remains uncommitted at

this stage. However, there is significant uncertainty around this number, as it is not possible to determine whether all funding announcements are entirely additional or if they will be funded from within existing allocations.

- 2.6 The Welsh Government has provided timely and detailed information on Welsh Government Covid-19 spending commitments this year, through two supplementary budgets over 6 months. When publishing its Draft Budget for 2021-22, the Welsh Government should again set out its spending commitments for 2020-21, to aid scrutiny of its plans for 2021-22.

Figure 1

The £5 billion COVID-19 funding guarantee for the Welsh Budget for 2020-21



Source: Welsh Government 1st Supplementary Budget 2020-21 (2020); Welsh Government 2nd Supplementary Budget 2020-21 (2020); and authors' calculations. Note: Unallocated totals do not include unallocated fiscal resource already in Final Budget plans; consequentials from UK Government March 2020 Budget and funding found from within Welsh budget not included. Committed funding estimates only based on available information and Welsh Government announcements.

- 2.7 The size of the uncommitted funding in the Welsh budget partly reflects the late revisions to the UK government's funding guarantee to the Welsh Government. It also reflects the unprecedented uncertainties the Welsh Government faces in planning its budget this year. Even in 'normal' years, it is not uncommon for around 2%-5% of the budget to be unallocated until the usual 2nd Supplementary Budget in February.
- 2.8 This year, the cost and demand pressures for public services over the remaining months of the financial year are even more uncertain. Pressures will depend on several factors, from the severity of future waves of Covid-19, the potential roll out of a vaccine over coming months, alongside recurring winter pressures on services. The economic context and the need for

further support for businesses this year is also highly uncertain. Future periods of tight public health restrictions would need to coincide with more grant funding for affected businesses. These uncertainties are amplified by inflexible budgetary arrangements currently in place (discussed in section 5).

3. Impact of Spending Review 2020 on the Welsh budget

- 3.1 The Spending Review 2020 provided the first detailed breakdown of additional spending on public services planned by the UK government, which influences the amount of funding available for the Welsh Government. The £113.5 billion of additional public services spending by the UK government this year includes £22 billion for the Test and Trace system and £15 billion on Personal Protective Equipment (PPE) procurement this year.
- 3.2 Although the Spending Review provides greater clarity on Covid-19 related public services spending, it is not possible to exactly determine which spending programmes in England have resulted in additional consequential for Wales. This is because some areas of additional spending, such as on vaccine procurement and a portion of the Test and Trace programme will be UK-wide and will not result in additional consequential. This complicates comparisons between the Welsh Government's Covid-19 response with that of the UK government.
- 3.3 In July, the UK government gave the devolved governments a funding guarantee, based on total estimated additional spending on services in England in 2020-21. This provided the devolved governments with greater certainty around their budgets this year, as they would not need to wait for individual spending commitments in England to be approved for the size of their budgets to be increased. The funding guarantee amounts to an additional £5 billion for the Welsh Government budget in 2020-21, with approximately £3.3 billion of this funding guarantee related to estimated additional public services spending in England.
- 3.4 The Spending Review documents also state that £2 billion of the funding guarantee has not yet been triggered through the Barnett formula. This would imply that approved spending in England would need to rise by an additional £10.6 billion for the funding guarantee to be increased again this year. Such an increase is a possibility, given that the UK government has put aside an additional £25.3 billion for a Covid-19 reserve, to allow for additional costs this year.
- 3.5 The UK government has allocated £55 billion for Covid-19 related costs on public services in 2021-22. £34 billion of this funding has been allocated to departments, with a further £21 billion in reserve. Already allocated funding has triggered £766 million for the Welsh Government in 2021-22.
- 3.6 The Welsh Government's core, or "business-as-usual", day-to-day block grant will increase by £695 million from 2020-21 to 2021-22, to £13.5 billion. Despite recent growth, on a like-for-like basis, day-to-day funding for the Welsh budget in 2021-22 will still be slightly below pre-austerity levels.

- 3.7 The Chancellor cut back on previously pencilled-in increases in day-to-day spending, by £10 billion in 2021-22, and by £13 billion in 2024-25. These spending plans suggest a bleaker outlook for the Welsh budget over the medium term and set the context for the public sector pay freeze announced for non-NHS staff.
- 3.8 Meanwhile, the Welsh Government's capital block grant will be cut in nominal terms next year, due to a fall in Financial Transactions funding. Capital funding will remain below its 2009-10 peak, and recent increases are not as significant as those seen in response to the financial crisis of 2009-10. This suggests the Welsh Government should make full use of its capital borrowing limit in 2021-22 (of £150 million).

4. Outlook for the Welsh Government's 2021-22 Draft Budget

- 4.1 On 21 December, the Welsh Government will publish its draft budget for 2021-22, facing significant uncertainties around the size of its budget and spending pressures. Crucial decisions will need to be made around responding to the Covid-19 pandemic and funding public services.
- 4.2 Available funding from the UK government for Covid-19 related costs in 2021-22 equates to only 14% of the funding available for the Welsh Government's fiscal response in 2020-21. If spent exclusively on public services, as per the UK government's spending plans in England, additional public services spending on Covid-19 pressures next year would fall by two-thirds relative to 2020-21.
- 4.3 Under current plans, a significant portion of Covid-19 related costs will need to be met from within the Welsh Government's own budget next year. Plans also leave no funding to allocate for business rates reliefs or grants, at a time other UK-wide economic schemes are also coming to an end.
- 4.4 As ever, allocations made to the NHS next year will have a big impact on funding available for all other services. Matching the NHS share of Covid-19 spending this year, as well as matching the per person increase in NHS spending in England, would mean around £430 million of Covid-19 related funding and a £350 million increase in the core NHS budget. This would mean £340 million of Covid-19 related funding for all other areas of the budget, as well as £590 million for their core budgets.
- 4.5 Social distancing and infection control will reduce what the NHS can deliver for a given level of funding. There is also a significant backlog of patients who were not treated in the spring, as well as new demand pressures, notably on mental health services. However, increasing NHS allocations would entail smaller increases in spending for other public services which may not adequately cover the huge demand and cost pressures they too face.
- 4.6 Surveys and modelling carried out by the Welsh Local Government Association find underlying pressures for local government budgets will total £279 million, most related to workforce costs (including social care commissioning costs), which may be affected by the public sector wage announcements made by the UK government last week.

- 4.7 The position of these services going into the Covid-19 crisis should also be considered. Total Welsh Government support for local authorities was still around 13.5% lower than 2010-11 levels in real terms, before the pandemic hit. Older age social care spending has remained broadly flat in real terms for over a decade, and there is a strong argument for improving staff remuneration given that less than half of the personal care workforce are paid less than the Real Living Wage. Per pupil schools spending fell by 6% in real terms from 2009-10 to 2018-19, according to the Independent Review of School Spending in Wales.¹
- 4.8 A key part of government economic support this year has been provided through the Welsh Government budget, with up to £2.1 billion of grants, reliefs and loans being made available to businesses. Barring significant changes in the flow of consequentials next year, the prospect of similar support being provided next year is unlikely. Even providing half of the level of reliefs offered to businesses in 2020-21 (£332 million) in 2021-22 would take around a third of the additional funding available for non-NHS funding increases, in the scenario outlined in paragraph 4.4.
- 4.9 With forecasts suggesting a rise in unemployment in Wales to around 110,000 next year, support provided for those out of work will become hugely important. Skills related spending was set to be around £157 million in 2020-21 and increased to £186 million in the 2nd Supplementary Budget. There is a strong argument for increasing this spending again next year.

5. Budget management and borrowing rules

- 5.1 The system of funding guarantees introduced by the UK government in July provided some welcome certainty for the devolved government budgets and increased transparency on the additional funding being made available. However, with large amounts of Covid-19 funding being held in reserve by the UK government, uncertainty over the size of the Welsh budget and large in-year revisions are likely to persist next year and beyond.
- 5.2 While some unexpected increases in demand pressures this year may be covered by late increases to consequentials, the Welsh Government will be unable to borrow to cover overspending in this financial year. This means the Welsh Government may need to keep back unallocated funding in response to these uncertainties. This also impairs the Welsh Government's ability to make 'open-ended' spending commitments, such as the commitments made by the UK government to businesses in England, with grants depending on the extent of restrictions in place over coming months.
- 5.3 There are also restrictions on the Welsh Government's use of the Wales Reserve, which were agreed as part of the 2016 Fiscal Framework agreement. The Welsh Government has drawn down the maximum annual amount of resource funding (£125 million) in its budget plans for this

¹ Available [here](#).

year. This would mean it will be restricted from accessing £107 million of resource funding from the reserve should it wish to use all remaining amounts.

- 5.4 Conversely, if the Welsh Government underspends relative to the increase in its budget this year, it will be restricted in the amounts it can carry forward to future years. Although there are no annual limits for payments into the reserve, it is capped in aggregate at £350 million. Given the projected position of the Wales Reserve at the end of this year, the maximum the Welsh Government could carry forward under current rules into 2021-22 would be £138 million. The UK government has agreed some flexibility over previous years when late changes were made to the Welsh Government's block grant via the UK Supplementary Estimates. As in the case of current borrowing powers, the rules governing the Wales Reserve should be amended to reflect the heightened uncertainty which the Welsh Government faces this year and will likely face over coming years.

6. Devolved taxes in the Draft Budget 2021-22

- 6.1 A key strength of the fiscal framework is that the Welsh Budget is only exposed to volatility in the tax base insofar as an economic shock is felt asymmetrically across the UK. The net effect on the Welsh budget will be determined by the *relative* change in revenues compared to England and Northern Ireland.
- 6.2 In November 2020, the Office for Budget Responsibility (OBR) published their devolved tax forecasts on behalf of the Welsh Government. Despite differences in the sectoral composition of the Welsh economy relative to the UK as a whole, there is little evidence to suggest that Income Tax liabilities in Wales are expected to be hit by more or less than the UK average due to the pandemic.
- 6.3 Although devolved tax revenues are not expected to be disproportionately impacted by the pandemic, a forecast decline in the Welsh share of UK non-savings, non-dividend (NSND) Income Tax means the Block Grant Adjustments for the Welsh Rates Income Tax (WRIT) is set to grow faster than tax revenues over the next four years, negatively impacting the Welsh Budget. This is true to a smaller extent for Land Transaction Tax (LTT), but slightly offset by the net effect of revenue from Landfill Disposals Tax (LDT) and its associated BGA.
- 6.4 For LTT and LDT, the Welsh Government can adjust their supplementary budgets to account for an in-year update to the forecast. For WRIT, any difference between forecast at the beginning of the financial year and the outturn for Wales and England & Northern Ireland will not be resolved until a reconciliation exercise after outturn data becomes available (normally around 15 months after the end of the financial year). This reconciliation process may introduce some volatility to the Welsh Budget over future years.
- 6.5 Given the relatively austere outlook for the Welsh Budget over coming years (as described in our section 4.2 of our main report), debates over the use of devolved tax powers should intensify. Increasing the basic rate of Income Tax could allow the Welsh Government to fund higher levels

of spending in a progressive manner or shield poorer households from less progressive elements of the local and reserved tax system.

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