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Wales Fiscal Analysis

2

Local government & the Welsh budget:

Outlook and challenges for the next Welsh Government

WELSH ELECTION BRIEFING

Wales Fiscal Analysis
APRIL 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.

Accessing data tables

Data tables to accompany this report have been made available online:
www.cardiff.ac.uk/wales-governance-centre/finance

Contact details

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

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

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

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Wales Fiscal Analysis

Wales Governance Centre

Wales Governance Centre Director

Professor Richard Wyn Jones

Wales Fiscal Analysis Academic Lead

Dr Ed Gareth Poole

Honorary Senior Research Fellow – Wales Fiscal Analysis

Michael Trickey

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Executive Summary

COVID-19 has presented a series of unique challenges for local authorities. Not only has it required increased expenditure on existing – as well as new – responsibilities, but it has also constrained local authorities' own revenue-raising capacity. In 2020–21, most of these costs were met through the Welsh Government's Single Hardship Fund; but from April 2022, government spending is once again set to become more restrained.

This report outlines the sources and scale of local authority sending pressures over the next five years. It identifies a gap between the projected path of funding for local authorities and the levels of expenditure required to meet future spending pressures on current UK spending plans. The possibility that the next Welsh Government may be under pressure to divert a considerable sum of additional resources to the NHS to meet the legacy costs of COVID-19 means that this funding gap could be considerable.[1]

Recent trends in local government finance

- There has been a marked change in the way local authorities in Wales are funded over the past decade. The value of government grants to local authorities fell by 16.8% in real terms between 2009–10 and 2019–20.
- Council Tax now accounts for a significantly larger share of the total tax take in Wales (5.4%) than in England (4.3%) and Scotland (3.8%).
- Spending on local authority services fell by 6.0% in real terms between 2009–10 and 2019–20. Adjusting for population growth, spending per head is 9.4% lower than it was a decade ago.
- More than £500 million was delivered to local authorities through the Single Hardship Fund during 2021–21. In total, the value of Welsh Government support to aid local authorities' response to the pandemic exceeds £1 billion.

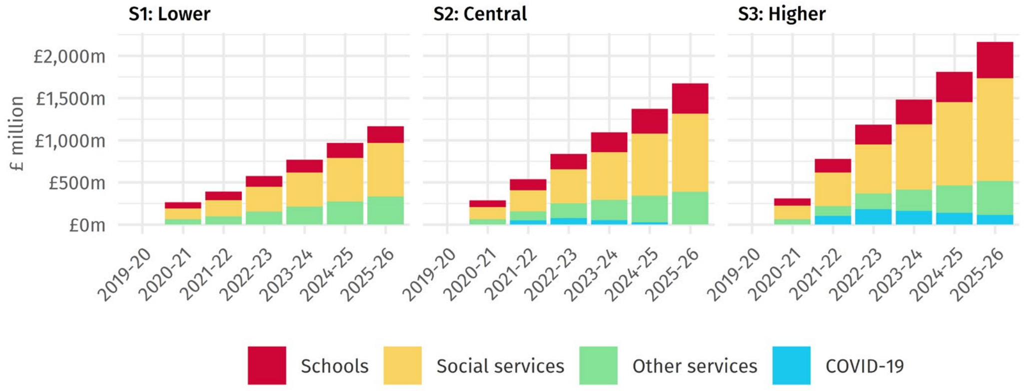
Spending pressures to 2025–26

- On central projections, meeting local authority spending pressures in full entails an average increase in spending of 3.4% a year (in cash terms) between 2020–21 and 2025–26 (2.5% and 4.4% in our lower and higher cost scenario, respectively).
- Despite the considerable uncertainty around the ongoing costs of COVID-19, they are dwarfed by the underlying demographic and inflationary pressures. Unfunded costs associated with the pandemic account for only 9% of total spending pressures in 2022–23, and this share continues to fall in future years.
- By 2025–26, social services accounts for 55% of all local authority spending pressures, with school pressures accounting for a further 21% (**Figure E1**).

[1] See, (Ifan 2021) for an analysis of the legacy costs of COVID-19 on the health service in Wales.

Figure E1

Components of spending pressures for local authorities from 2019–20



Source: WFA analysis. See **Annex A** for further detail. Excludes COVID-19 pressures funded through the Single Hardship Fund.

Revenues outlook to 2025–26

- On current spending plans, local authority gross revenue expenditure is projected to grow by 2.9% a year on average between 2022–23 and 2025–26. If the UK Chancellor reverses cuts made to planned spending since March 2020, gross revenue expenditure is projected to grow by an average of 3.8% a year over the same period.
- The local government settlement is spared from the real terms cuts that some government departments are set to face because of the multi-year spending plans for schools in England. Pupil numbers are set to rise in England and contract slightly in Wales meaning that the implied growth in funding for Welsh schools exceeds growth in underlying funding pressures.

Estimating the funding gap

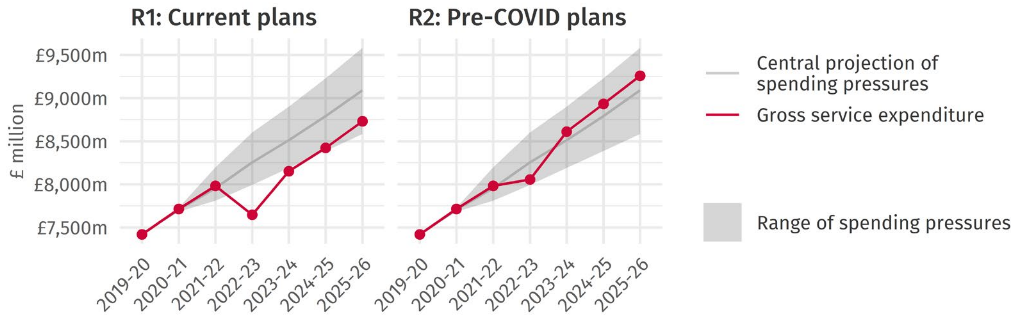
- In 2022–23, spending pressures are projected to exceed local authorities' spending power by £178 million due to a combination of COVID-19 legacy costs and slower growth in the settlement. This gap narrows in future years, but spending levels remains £132 million short of the amount required to meet all pressures in 2025–26 on current plans (in cash terms).
- If the Welsh Government decides to meet the projected legacy costs of COVID-19 on the NHS from within its own budget, local authorities' spending power could fall short of spending pressures by £607 million in 2022–23, and an average of £362 million a year over the following three years. Even if the UK government reverts to its pre-COVID

spending plans, funding remains £198 million short of spending pressures in 2022–23, though the pressures could be met in future years (**Figure E2**).

- Above-inflation increases to Council Tax are set to continue – the numbers quoted above are predicated on a 4.5% annual increase. Reversing the cuts made to spending plans since March 2020 could release enough funding to allow Council Tax to rise by inflation (2.0%), but this seems unlikely given the additional demands for funding in the health service. This arguably strengthens the case for revisiting the way the local taxation system operates in Wales.
- Although the UK government's spending plans act as a soft constraint on local government spending, the Welsh Government's newly acquired powers over devolved taxes and local taxation arrangements could provide an alternative way of funding additional local expenditure over the next Senedd term.

Figure E2

Estimate of the funding gap to 2025–26 (4.5% Council Tax increase & NHS COVID-19 legacy costs are met)



Source: WFA analysis. See **Annex A** for further detail. Excludes expenditure financed by COVID-19 grants in 2020–21 and 2021–22.

1 Introduction

COVID-19 has presented unprecedented challenges for governments across the UK. For local government, not only has the pandemic required increased expenditure on existing – as well as new – responsibilities, but it has also constrained local authorities' own revenue-raising capacity. Income that is normally generated by council activities has been considerably reduced as lockdown measures have restricted the operation of many of these services.

In 2020–21, local authorities could submit claims to the Welsh Government's Single Local Government Hardship Fund to cover the additional expenditure and income losses incurred because of COVID-19. As of mid-March 2021, around £500 million has been paid through this scheme. The Welsh Government has provided further hypothecated grants to fund other policies, such as extending Free School Meals provision over the holidays and financing direct payments to businesses and individuals through business rates grants and self-isolation payments. A relatively generous local government settlement allocated an additional £264 million to aid local authorities with their response to COVID-19 in 2021–22.

But from April 2022, government spending is once again set to become more restrained. The Chancellor's decision to revise UK spending plans downwards in November 2020 and March 2021 means that the projected size of the Welsh budget will be approximately £600 million a year smaller in 2022–23 and 2023–24, compared to pre-pandemic plans (Ifan, Rodríguez, and Siôn 2021, 7). A smaller spending envelope, underlying demographic and inflationary pressures, and the ongoing costs of dealing with the aftermath of the pandemic combine to create a challenging fiscal outlook. On current UK spending plans, local authorities face a funding gap of £178 million in 2022–23, and an average shortfall of £152 million a year over the following three years. If the Welsh Government decides to allocate additional resources to meet NHS spending pressures, the outlook for local government could be considerably more austere.

This report sets out the sources and scale of local government spending pressures over the next five years and presents an estimate of the funding gap under different scenarios. It proceeds as follows:

- **Chapter 2** sets the context by outlining the trends in local government expenditure and sources of financing from 2009–10 to 2019–20
- **Chapter 3** provides a breakdown of the spending pressures facing local authorities over the next five years
- **Chapter 4** presents the outlook for local government revenues to 2025–26
- **Chapter 5** brings together the discussion in the previous two chapters and offers estimates of the funding gap
- **Chapter 6** concludes by summarising the fiscal outlook.

2 Recent trends in local government finance

The 2010s marked a sustained period of restraint on public spending in the UK. These curbs on spending hit government departments unevenly, with local authorities being disproportionately subjected to steep spending cuts. As we shall see, even within local authorities, some areas of spending fared better than others. In Wales, the burden has been increasingly shifted onto Council Taxpayers to fund local authority services, though this only partly offsets the reduction in central government support. These themes have been explored in detail in our previous publications, so this chapter only offers a broad overview of the recent trends in local government finance.[2] This sets the context for our projection of spending pressures, revenues outlook and estimates of the funding gap over the next five years.

2.1. Funding revenue expenditure

Between 2009–10 and 2019–20, there was a marked change in the way local government revenue expenditure was funded in Wales. Figure 2.1 documents how the value of government grants fell by 16.8% in real terms over this period while Council Tax revenue increased from £830 million to £1,369 million (a 39.3% increase in real terms). By the end of the decade, grant funding financed less than 65% of gross revenue expenditure (down from nearly 73%), while Council Tax financed more than a fifth (up from 14% a decade earlier).

Figure 2.1

Components of gross revenue expenditure (excl. housing benefits grant), 2009–10 to 2019–20[3]

Funding source	Measure	2009–10	2019–10	% change	Real % change
Specific & general grants (excl. HB)	£ million	4,382	4,322	-1.4%	-16.8%
	% of total revenue	72.8%	64.5%		
Council Tax (net of CTRS)	£ million	830	1,369	65.0%	39.3%
	% of total revenue	13.8%	20.4%		
Non-domestic rates	£ million	805	1,008	25.3%	5.8%
	% of total revenue	13.4%	15.0%		
Total		**6,017**	**6,698**	**11.3%**	**-6.0%**

Source: WFA analysis of StatsWales (2019–20) Financing of gross revenue expenditure.

[2] See, for example, Ifan and Siôn (2019a, 2019b).
[3] The cost of council tax benefit has been added to the Revenue Support Grant in years prior to its devolution. This ensures consistency with the way the RSG-funded element of Council Tax Reduction Scheme is treated from 2013–14 onwards.

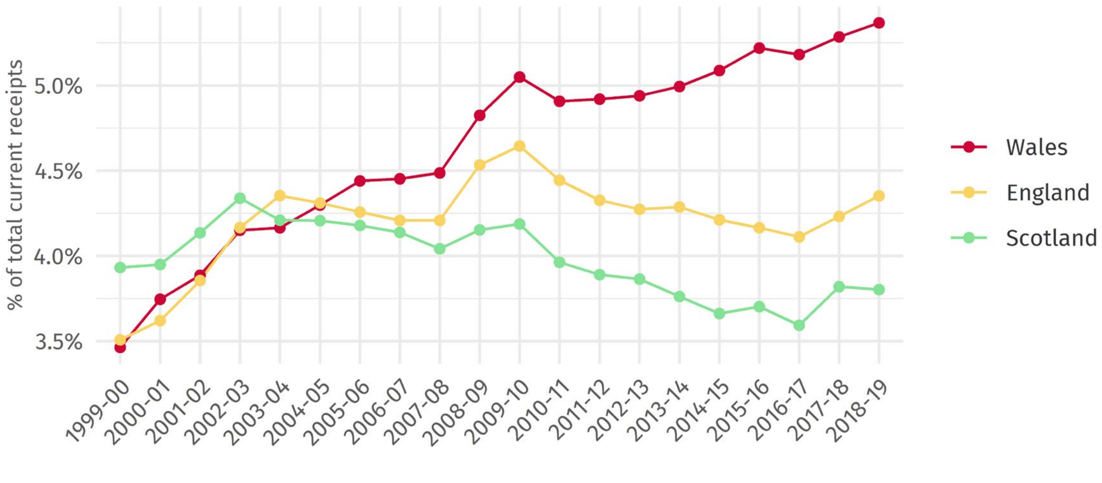
Overall, gross revenue expenditure fell by 6.0% in real terms over this period, directly impacting the funds available to spend on local government services.

But although local authorities across the UK have seen a reduction in central government funding, the policy response has differed. The Council Tax system has operated under an effective cap in England following the introduction of a local referendum requirement for 'excessive' increases. In Scotland, a Council Tax freeze was followed by a 3% cap on annual increases, which was only lifted in 2019–20 (it has been frozen again in 2021–22). In contrast, the Welsh Government did not impose a formal cap on Council Tax levels. Many Welsh local authorities responded by approving significant increases to Council Tax bills to mitigate some of the spending cuts. This has meant that spending on local services has been relatively better protected in Wales compared to other parts of the UK, but it has also meant that a larger share of the tax burden has been shifted onto Council Taxpayers.[4]

Figure 2.2 tracks the proportion of current government receipts collected through Council Tax between 1999–00 and 2018–19. In Wales, Council Tax revenues grew from 3.5% of current receipts to 5.4% in 2018–19. It now accounts for a significantly larger share of the total tax take than the equivalent share in England (4.3%) and Scotland (3.8%). This trend pre-dates the onset of the financial crisis, but unlike in England and Scotland where the trend appears to have been halted by measures put in place to curb Council Tax increases, Council Tax levels have continued to climb as a proportion of total receipts in Wales. Given the weak growth in earnings and working-age benefits over the past decade, this effect is likely to have been more acutely felt by households in more recent years.

Figure 2.2

Council Tax revenue as a share (%) of current receipts (excluding oil and gas revenues), 1999–00 to 2018–19



Source: WFA analysis of ONS (December 2019) Country and regional public sector finances.

[4] See, Box 3.2 in GERW 2019 (Ifan, Siôn, and Poole 2019, 28).

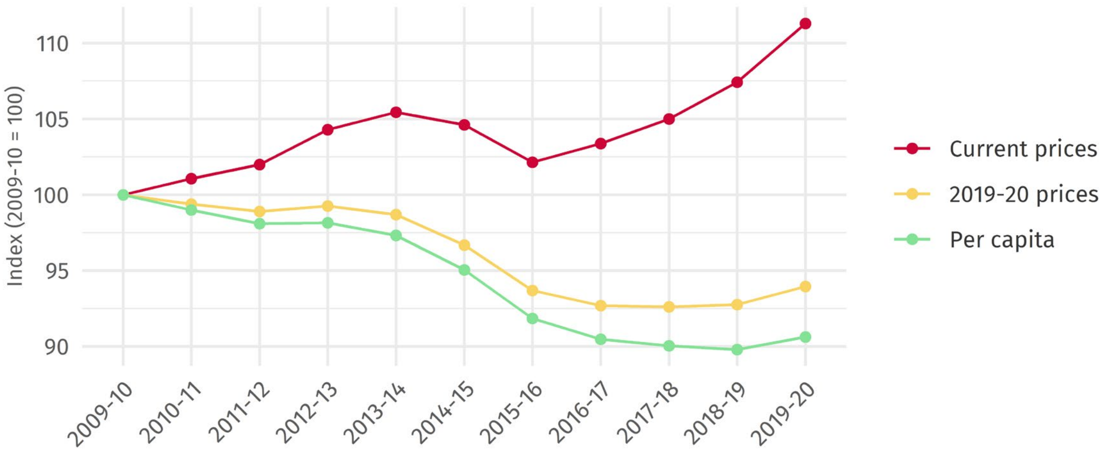
This is worth highlighting for several reasons; not only is local taxation a larger component of the tax system than it was two decades ago, but it is well documented that the way Council Tax operates is regressive (Adam et al. 2020). Similar households in different local authorities can pay vastly different levels of tax for the same level of services. And even within local authorities, Council Tax is regressive relative to its base: the more a dwelling is worth, the less is paid in tax as a proportion to its value. Even though the Council Tax Reduction Scheme dulls the bluntness of its application to poorer households, the overall effect remains regressive with respect to income – Council Tax bills account for a relatively larger share of the disposable income of poorer households.[5]

2.2. Trends in revenue expenditure

Net current expenditure on services fell by 6.0% in real terms between 2009–10 and 2019–20 (**Figure 2.3**).[6] Adjusting for population growth, spending per head is 9.4% lower than it was a decade ago.

Figure 2.3

Net current expenditure on local authority services, 2009–10 to 2019–20[7]



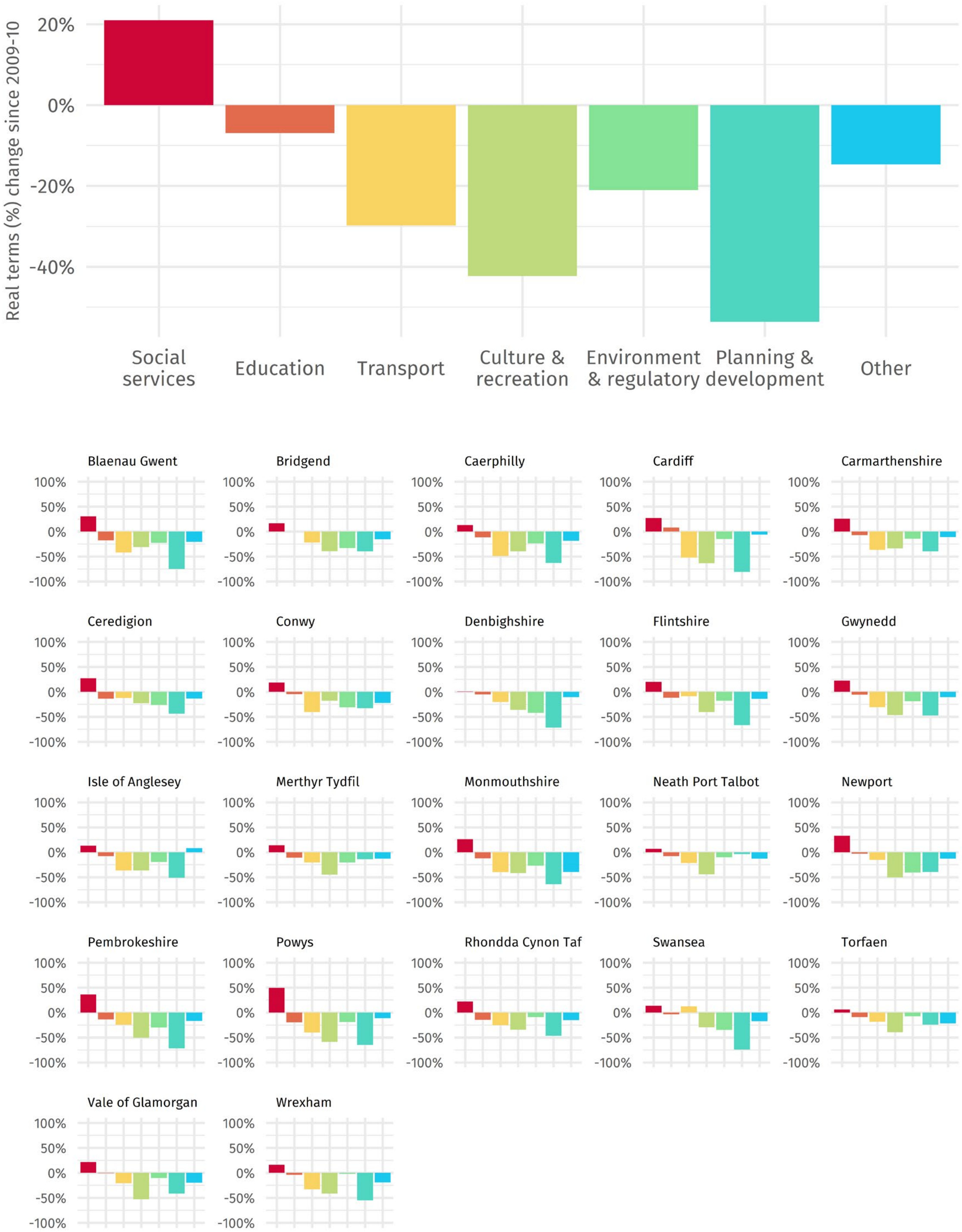
Source: WFA analysis of StatsWales (2019–20 and previous) Local authority outturn tables. Excludes element financed by the Housing Benefit grant.

These headline figures disguise the variation in the way cuts have impacted different local authority services. As shown in **Figure 2.4**, social services and education spending have been relatively better protected than other service areas, with planning departments across Wales seeing real terms cuts of more than 50% over a 10-year period.

[5] Further discussion on the operation of Council Tax in Wales can be found in (Ifan and Poole 2018).
[6] The minor difference between the change in gross revenue expenditure and net current expenditure on services is explained by trends in non-service expenditure.
[7] The 'current prices' series is unadjusted for inflation.

Figure 2.4

Real terms percentage (%) change in net current service expenditure, 2009–10 to 2019–20



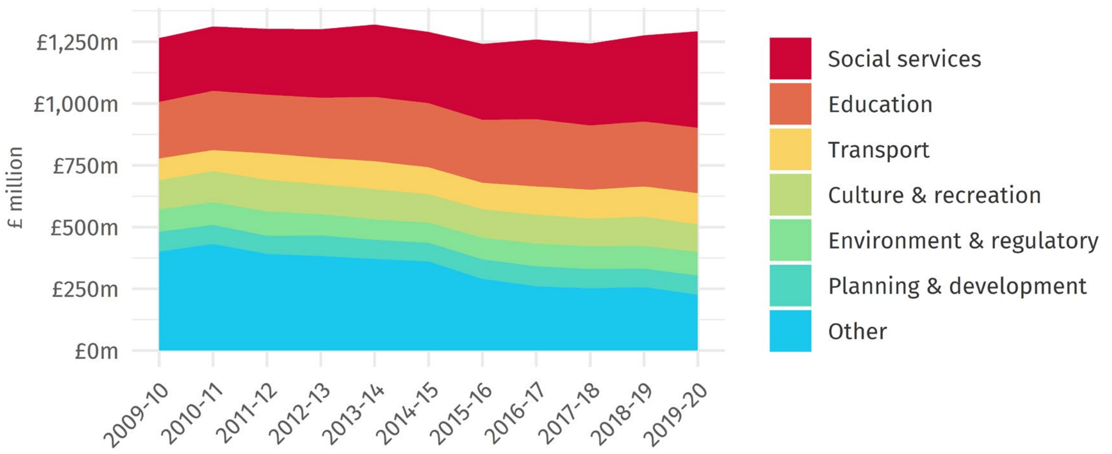
Source: WFA analysis of StatsWales (2019–20 and previous) Local authority outturn tables.

2.3. Other income (including fees & charges)

In addition to the revenue sources previously discussed, local authorities offset service expenditure against other income – most of which is generated through fees and charges levies on commercial activities. Total local authority income has remained broadly flat in cash terms over the past decade (**Figure 2.5**), with a slight increase in income levied from social services (mostly relating to the fees charged for older adult care).

Figure 2.5

Total income by service area, 2009–10 to 2019–20 (current prices)



Source: WFA analysis of StatsWales (2019–20 and previous) Local authority outturn tables.

2.4. The impact of COVID-19 on local authority budgets

The data presented in this chapter precedes the onset of the COVID-19 pandemic, which has had a huge impact on both local government spending and financing. Additional costs and new responsibilities combined with income losses from commercial activities to create a challenging picture for local authorities. In Wales, these challenges have been largely met through additional grant funding by the Welsh Government and the introduction of a Single Emergency Hardship Fund, from which local authorities could submit claim for additional expenditure and income losses incurred as a result of COVID-19.

More than £500 million worth of claims have been paid from this fund as of mid-March 2021, and the overall value of COVID-19 support to local authorities in 2021–22 exceeds £1 billion. The final local government settlement for 2021–22 included further allocations totalling £264 million to aid local authorities with their response to COVID-19 (Siôn 2021). But the medium-term outlook is much less certain. In the next chapter, we evaluate the spending pressures that are likely to arise over the next five-year period.

3 Spending pressures to 2025–26

This chapter presents estimates of local authority spending pressures over the next five years. These estimates are underpinned by several assumptions about future costs and demand. By adjusting these assumptions, we can delineate a range of plausible scenarios that track the trajectory of spending pressures over the forecast period. A detailed description of the methodology used can be found in **Annex A** of this report and the key assumptions made in each scenario are summarised in **Figure 3.1**.

The core assumptions can be split into four categories – demand, productivity, earnings, and COVID-19. We assume that demand for local government services is driven by the underlying rate of population growth, as outlined in the ONS 2018-based population projections. These demand projections are adjusted for the two largest areas of spending – schools and social services – with school spending being driven by the pupil projections published by the Welsh Government and demand for children and adult social services varying in each scenario (as set out in **Figure 3.1**). Productivity refers to the rate at which unit costs grow relative to input costs, or how the output for each unit of input changes over time. We assume zero productivity growth for non-school spending in our central scenario and vary this assumption in our alternative scenarios. We also make varying assumptions about earnings growth relative to the OBR's forecast for average earnings and the National Living Wage. Lastly, the scenarios are adjusted to include assumptions about the scale and persistence of COVID-19 costs, and the extent to which local authority income recovers its pre-pandemic level over the forecast period.

As we are primarily interested in the spending pressures that must be met from local authority budgets; additional costs incurred (and income losses experienced) as a result of COVID-19 during 2020–21 and the first half of 2021–22 have been excluded from our analysis. Local authorities will be compensated for most of these costs through claims submitted to the Welsh Government's Single Hardship Fund. According to current plans, as set out in the Welsh Government's Final Budget, this fund will be withdrawn at the end of September 2021, therefore only COVID-19 costs incurred from September 2021 onwards are included in our analysis (Welsh Government 2021, 4).

The three scenarios are labelled as follows:

- **S1** Lower cost & demand pressures
- **S2** Central cost & demand pressures
- **S3** Higher cost & demand pressures

Figure 3.1

Summary of key assumptions made in each spending pressures scenario*

S1 **Lower cost & demand pressures**	**Demand** • Demand for adult social care services grows by **1%** a year • Number of children looked after grows by **2%** a year **Productivity** • Unit costs rise in line with input prices for services other than education; education sees **0.4%** growth in productivity each year **Earnings** • Pay freeze for all non-NLW staff in 2021–22 • Earnings grow at **50%** of the OBR forecast for average earnings in future years; non-NLW staff earnings grow in line with the NLW forecast • Earnings for social care workers grow in line with average earnings, with adjustments for NLW increases **COVID-19** • No COVID-19 costs beyond September 2021 • Local authority income recovers its pre-pandemic level by September 2021
S2 **Central cost & demand pressures**	**Demand** • Demand for adult social care services grows by **2%** a year • Number of children looked after grows by **4%** a year **Productivity** • Unit costs rise in line with input prices for services other than education; education sees **0.2%** growth in productivity each year **Earnings** • No pay freeze in 2021–22, but the Chancellor's decision indirectly impacts earnings growth (non-NLW staff earnings grow by **1.0%**) • Earnings grow in line with the OBR forecast for average earnings in future years; non-NLW staff earnings grow in line with the NLW forecast • Earnings for social care workers grow in line with average earnings, with adjustments for NLW increases **COVID-19** • **10%** of COVID-19 costs continue beyond September 2021, reducing to zero by 2025–26 • Local authority income recovers **95%** of its pre-pandemic level by September 2021, and fully recovers by 2025–26
S3 **Higher cost & demand pressures**	**Demand** • Demand for adult social care services grows by **3%** a year • Number of children looked after grows by **6%** a year **Productivity** • Unit costs rise in line with input prices for services other than social care; social care sees a **2.0%** fall in productivity in 2021–22, recovering its pre-Covid level by 2025–26 **Earnings** • No pay freeze in 2021–22 (non-NLW staff earnings grow by **2.4%**) • Earnings grow in line with the OBR forecast for average earnings in future years; non-NLW staff earnings grow in line with the NLW forecast • Real Living Wage introduced for social care workers in 2021–22; wages grow in line with average earnings or the RLW (whichever is higher) thereafter **COVID-19** • **20%** of COVID-19 costs continue beyond September 2021, reducing to **10%** by 2025–26 • Local authority income recovers **90%** of its pre-pandemic level by September 2021, increasing to **95%** of pre-pandemic levels by 2025–26

* **Note:** A detailed description of the methodology used can be found in **Annex A**.

3.1. Schools

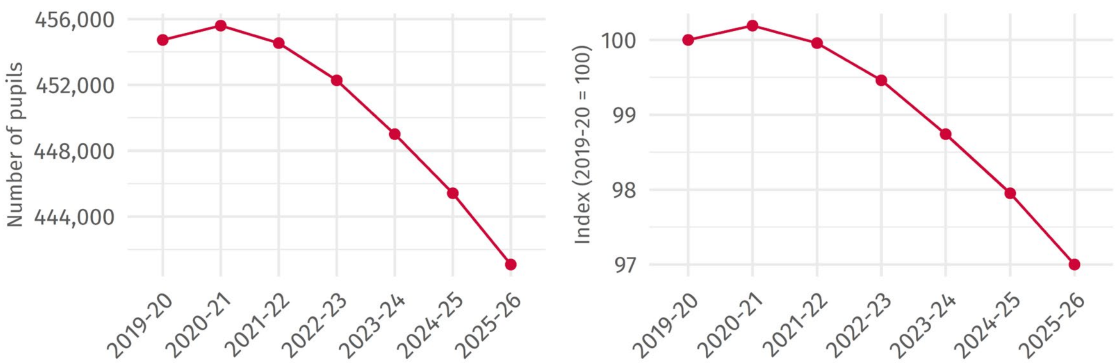
Among local authorities' key responsibilities is the provision of education to the resident school-age population. In 2019–20, education spending accounted for more than 40% of local authority gross expenditure on services.[8] Of the £3.1 billion spent on education services, £3.0 billion was classed as school-based expenditure, with the remainder spent on education-related services provided in other settings, including adult and community education. In this section, we focus solely on school-based expenditure.

Although schools were spared from some of the steepest cuts to spending between 2009–10 and 2018–19, levels of spending per full time equivalent learner still fell by 6% over this period – roughly equivalent to the change in the block grant (Sibieta 2020, 25).

There is strong evidence in the academic literature on the link between school spending and learner outcome, and that these effects may be compounded for learners from more disadvantaged backgrounds (Sibieta 2020, 20). Given the amount of school-time lost because of the pandemic, there is also an increased risk that the current school-age cohort will be at a disadvantage compared to their older (and younger) counterparts. Based on an extensive review of the international evidence, one academic paper found that a year of schooling increases individuals' earning by 8% per year, on average, in more economically developed countries (Psacharopoulos and Patrinos 2018). This may strengthen policy-makers' resolve to increase school spending by an amount at least equal to underlying funding pressures over the coming years.

Figure 3.2

Pupil population projections for local authority-maintained school, 2019–20 to 2025–26[9]



Source: WFA analysis of StatsWales (2018-based) Pupil Projections.

[8] Gross expenditure on services is presented net of the element financed by the Housing Benefit grant. See **Annex A** for further detail.

[9] Demand for school places in local authority-maintained schools is driven by the change in the school-age population, adjusted to account for the proportion of the population educated in other settings.

As illustrated in **Figure 3.2**, the pupil population in local authority-maintained schools is projected to fall by around 13,000 (3%) between 2019–10 and 2025–26; this has a significant dampening effect on spending pressures.[10]

But even if overall demand for school places trails the underlying rate of population growth over the next five years, growth in earnings will continue to drive spending upwards. Employee costs account for roughly two-thirds of total spending on schools. Although education policy is devolved, responsibility for setting public sector pay in the sector does not neatly align with devolved responsibilities. The Welsh Government determines pay awards for the 27,000 teachers and associated professionals employed by local authorities based on recommendations made by the Independent Welsh Pay Review Body. But pay for school support staff, along with other local authority workers, is determined on an England-and-Wales basis (Ifan and Siôn 2020a).

In theory, the UK Chancellor's decision to freeze public sector pay in 2021–22 (with exceptions for those earning less than £24,000 a year) applies to school support staff in Wales. However, the final recommendation on pay awards will be made by the National Joint Council for Local Government Services – this decision may not be finalised until a few months into the new financial year. If the pay-determining body recommends a pay uplift in 2021–22, this cost will need to be met from local authority budgets.

Figure 3.3 sets out the path of school employee costs in each of our spending scenarios. In our central scenario, we assume that the salaries of both teachers and support staff **grow by 1.0% during the 2021–22 academic year** and rise in line with average earnings thereafter.[11] This reflects the possibility that the Chancellor's announcement may indirectly influence decisions on pay awards. We further assume that the starting threshold on the main pay range for teachers rises to £30,000 by 2023–24 (a year later than planned in England), and that growth in productivity averages 0.2% a year (in line with historic trends). In this scenario, total employee costs are projected to reach £2.26 billion by 2025–26, increasing by 1.6% in 2021–22 and 1.7% a year on average between 2022–23 and 2025–26.

Our higher cost projection assumes that wages grow in line with average earnings from 2021–22 onwards, that the increase to the starting threshold of the main band is completed by 2022–23 (as originally planned), and zero productivity growth. This implies that staff costs are £57 million higher than our central projection at the forecast horizon, of which, £29 million is due to faster earnings growth in 2021–22 and £28 million is due to slower productivity growth.

The lower projection assumes that **earnings are frozen in cash terms in 2021–22**, and that restraints on public sector pay continue. To model this, we assume that the wages of teachers and support staff that are not subject to the National Living Wage grow at **half the rate of average earnings** over the forecast period and that productivity growth outpaces historic trends, averaging 0.4% a year.

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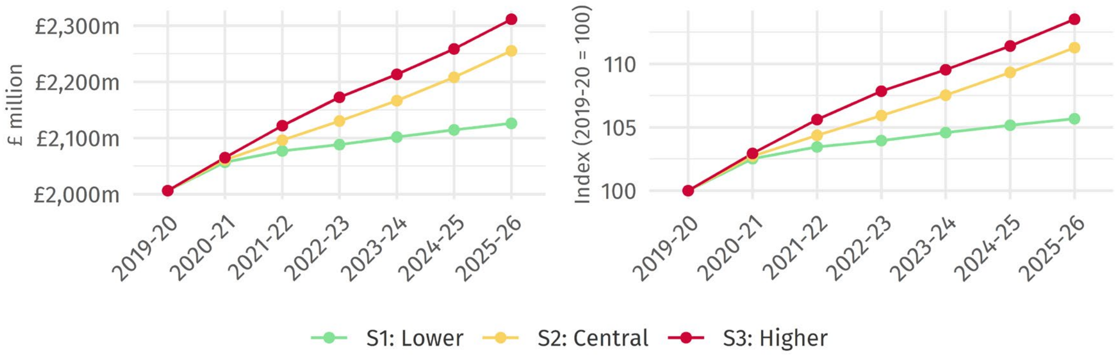
[10] This reduction will not be uniformly felt across age cohorts (e.g. the secondary population is expected to grow).
[11] This does not apply to staff that are otherwise subject to increases in the National Living Wage.

Figure 3.3

Projection of school staff costs, 2019–20 to 2025–26



Source: WFA analysis. See **Annex A** for full methodology.

On our central projection, fully meting the spending pressures implies that total spending on schools increases by 1.6% in 2021–22, and averages 1.8% a year thereafter (**Figure 3.4**). This is only slightly faster than the rate of growth in school spending over the past decade (1.6%), but the projected decline in the pupil projection implies that spending per learner will grow considerably faster over the next five years. School spending will need to increase by £357 million between 2019–20 and 2025–26 (£197 million and £431 million in our lower and higher cost scenarios, respectively).

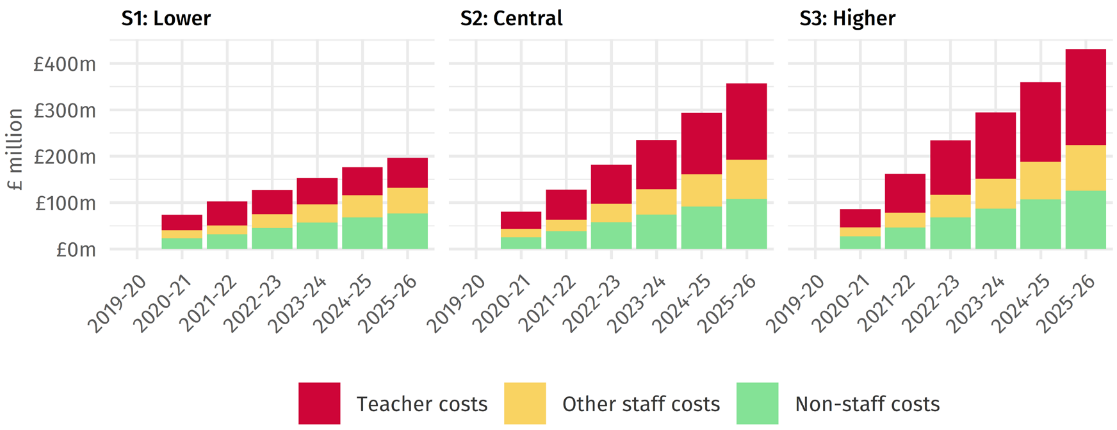
However, these figures are subject to important caveats. An inbuilt assumption of our model is that as demand for school places falls, this feeds through into a reduction in the size of the workforce. This may not be desirable – or even plausible – given that the pupil-teacher ratio has been rising over recent years (Ifan and Siôn 2020a, 34). On top of this, the demand for catch-up tuition to compensate for lost learning is likely to require more rather than fewer school staff. Maintaining – or even expanding – the size of the current workforce would entail higher levels of spending than what is outlined in our central projection.

The final local government settlement for 2021–22 allocated £11.8 million towards an Accelerated Learning Programme (on top of the £16.6 million already allocated in 2020–21). Around half of this programme funding is targeted at disadvantaged pupils – a larger share than in England and Scotland (20-30 per cent) (Sibieta and Cottell 2021, 28-30). A further £72 million package to support learners was announced by the Welsh Government last month.[12] To put these announcements in context, the cost of providing half a year of school education amounts to £1.5 billion annually. Further allocations may be necessary to meet demand, and any future costs associated with these "catch-up" programmes would be in addition to the pressures quantified in our model.

[12] See, https://gov.wales/extra-72m-support-learners-they-return-school

Figure 3.4

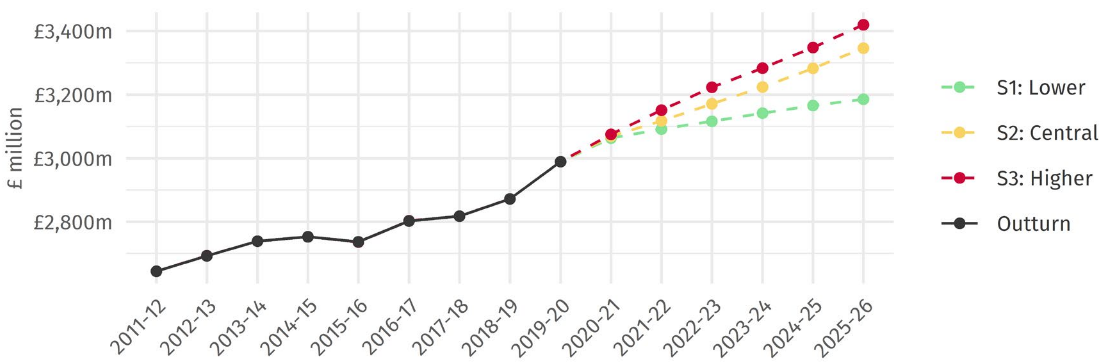
Components of school spending pressures from 2019–20



		£ million						
Scenario	**Pressures**	**2019–20**	**2020–21**	**2021–22**	**2022–23**	**2023–24**	**2024–25**	**2025–26**
S1 (lower)	Teacher costs	0	34	52	53	57	61	64
	Other staff costs	0	17	19	29	39	48	56
	Non-staff costs	0	23	32	45	57	68	77
	Total	**0**	**74**	**103**	**127**	**153**	**176**	**197**
S2 (central)	Teacher costs	0	36	65	84	106	132	164
	Other staff costs	0	18	25	40	54	70	85
	Non-staff costs	0	25	38	58	74	92	108
	Total	**0**	**80**	**128**	**182**	**235**	**294**	**357**
S3 (higher)	Teacher costs	0	39	84	117	143	171	207
	Other staff costs	0	19	32	49	64	81	98
	Non-staff costs	0	27	46	68	87	107	125
	Total	**0**	**86**	**162**	**234**	**294**	**359**	**431**

Figure 3.5

Gross expenditure on schools, with projections of spending pressures to 2025–26

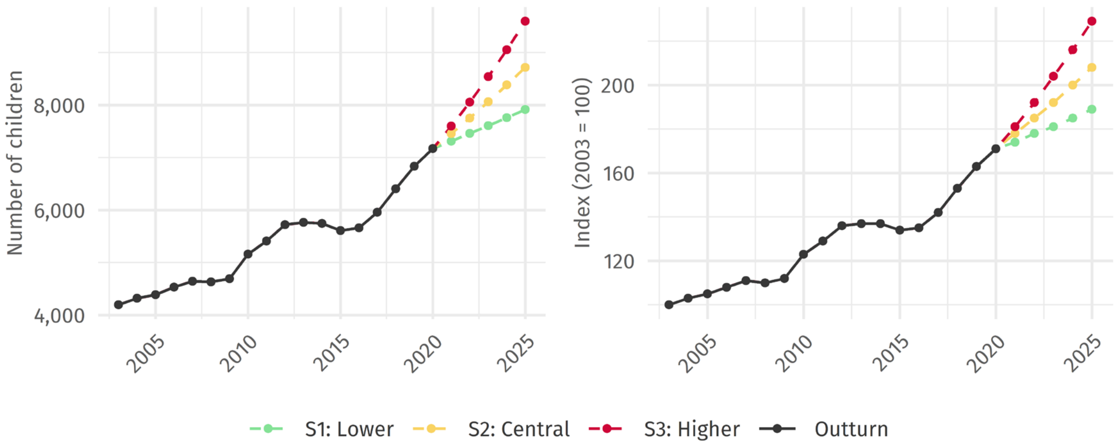


3.2. Social services

Spending on social services accounts for a further £2.4 billion (32.8%) of local authority gross revenue expenditure. Historically, this has been one of the largest sources of councils' funding pressures. Perhaps counterintuitively, the largest proportional increase in demand – and by extension, spending – over the past decade has been on children and families' services rather than older adult care (Ifan and Siôn 2019b, 10). Of the three recorded spending categories – care for older adults, younger adults, and children and families' services, the latter category is now the largest element of spending on social services. Figure 3.6 plots the rise in the number of children looked after from 2003 to 2020. This follows a similar trajectory to overall levels of spending on children and families' services over the same period.

Figure 3.6

Number of children looked after, 2003 to 2020, with projections to 2025



Source: WFA analysis of StatsWales (2021) Children looked after at 31 March by local authority.

Between 2016 and 2020 alone, the number of children looked after rose by 27% to over 7,000. The Commission on Justice in Wales (2019, 304) highlighted that in 2018, the rate of looked after children in Wales was 102 per 10,000, compared with 64 per 10,000 in England. Several factors contribute towards higher rates of looked after children in Wales, including the relationship with deprivation, variations in the way local authorities and the judiciary deal with individual cases, as well as the role of parenting capacity and resources (Hodges and Bristow 2019). And although the reasons behind the rising rates of children in care are complex, it is nevertheless clear that future patterns will be a significant determinant of social services spending pressures going forwards.

There is limited evidence to assess the impact of the COVID-19 crisis on demand for children and families' social care services. As a result, we do not incorporate any assumptions about a COVID-induced shock to demand into our modelling. However, as noted by the Institute for Fiscal Studies in their analysis of local government spending pressures in England, this presents a potential risk of further upwards pressure on spending (Ogden, Phillips, and Spiliotis 2020, 15).

In the absence of more detailed modelling of the factors that influence the number of children in care, we assume that recent trends will continue in our central scenario, and that the number of children in care – a proxy for demand for children and families' services – will grow by 4% a year on average over the forecast period. This figure is reduced to 2% in our lower scenario and increased to 6% in our higher scenario.

Demand for older adult care can be expressed as a function of the number of people receiving formal care services and the average amount of care being delivered per person. A widely used model developed by Wittenberg et al. (2018) projects that demand for adult care services in England will increase by an average of 2.2% a year over the forecast period, significantly higher than projected population growth (0.5% a year). We adjust this projection slightly to reflect differences in the age profile of the Welsh population with respect to England. This implies that demand for care in Wales (which represents the total volume of formal care services delivered) grows by an average of 2.0% a year to 2025–26. This is adjusted by +/- 1 percentage point in our higher and lower cost scenarios, respectively.

There are limitations to this approach, not least the fact that demographic pressures do not appear to have been the sole driver of demand for older adult care services in recent years (Siôn and Trickey 2020, 28-29). Moreover, the projection makes no assumption about a COVID-induced shock to demand or changes in preferences towards different types of care offerings. The growing prevalence of homeworking and the potential for increased wariness of care homes could both play a role in shifting the balance of care that is delivered formally and informally post-COVID. However, given the limited evidence on the long-term impact of the pandemic on attitudes towards adult care services, we have not incorporated any assumption about changing preferences into our model.

Another factor driving costs of providing social services is the trend in productivity. Over the longer term, healthcare spending typically lags economy-wide measures of productivity (A. Charlesworth and Johnson 2018, vi). This phenomenon is referred to as the Baumol effect; the cost of inputs (including salary costs) rises in line with other jobs that have experienced faster growth in productivity, rather than rising in line with output in the healthcare sector, which grows more slowly. While there is some scope for improvements in productivity through better treatment and diagnosis, the delivery of care services changes less rapidly. Since social care services largely encompass the delivery of care, productivity gains are harder to find. Quality-adjusted estimates produced by the ONS show that the productivity of publicly funded social care services in England fell by an average of 0.4% a year over the last five years.[13] The gap between earnings growth and productivity is a key driver of spending.

[13] Estimates based on ONS (2020) Public service productivity, adult social care, England: financial year ending 2019: https://www.ons.gov.uk/economy/economicoutputandproductivity/publicservicesproductivity/articles/publicserviceproductivityadultsocialcareengland/financialyearending2019

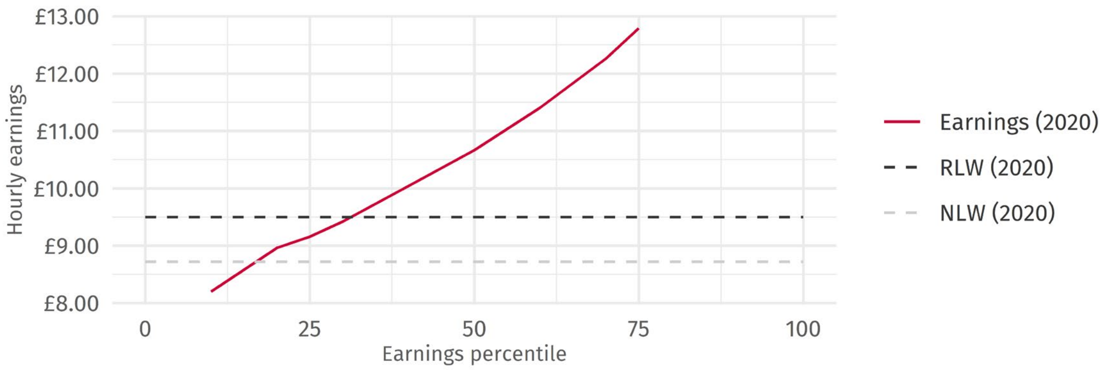
In our central and lower cost scenario, we assume zero productivity growth over the forecast period – this would represent a marginal improvement on historic trends. Our higher cost scenario assumes a 2% decrease in productivity in 2021–22 to reflect the possibility that enhanced infection control measures could have a lasting impact on output in the medium term. We assume that productivity recovers its pre-COVID level by 2025–26.

Since most care provision is outsourced, "staff costs" only capture the direct costs of the social care workforce employed by local authorities. In our model, we assume that growth in earnings feed into non-staff costs, which include payments to commissioned provides. In other words, increases in labour costs for commissioned providers will be largely mirrored by larger payments to those providers. The projection of non-staff costs is based on a weighted average of earnings growth (70%) and inflation (30%), as measured by the smoothed GDP deflator series.

Figure 3.7 presents an estimate of the earnings distribution for full-time social care workers in Wales using data from the Annual Survey of Hours and Earnings (ASHE). Approximately a third of the full-time social care workforce earned less than the Real Living Wage in 2020, though this estimate is higher when looking at the sub-group of residential care workers and including part-time employees in the calculation (Siôn and Trickey 2020, 23-24).

Figure 3.7

Distribution of hourly earnings for care workers in Wales, 2020



Source: WFA analysis of ONS (2020) Annual Survey of Hours and Earnings.

Several political parties have made commitments to increase the salaries of care worker during the next Senedd term.[14] To reflect this, our higher cost scenario assumes that the Real Living Wage is introduced in 2021–22, with approximately a third of the workforce benefitting from this policy, and that earnings then grow in line with the annual proportional increase to the National Living Wage. Based on our own analysis of the ASHE data, we estimate that the cost of implementing this policy would amount to £20 million in the first year and similar amounts

[14] See, for example, https://www.bbc.co.uk/news/uk-wales-politics-56428352

in each subsequent year.[15] Shortly prior to the publication of this report, more detailed modelling by LE Wales using surveys of local authorities found that implementing the real living wage for carers would cost approximately £19 million in the first year (Devnani et al. 2020, 121).

In our central scenario, we assume that earnings for non-NLW workers grow by **1.0%** in 2021–22 and rise in line with average earnings thereafter. Our lower cost scenario assumes that wages are **frozen in 2021–22** and grow at half the pace of average earnings over the remainder of the forecast period.

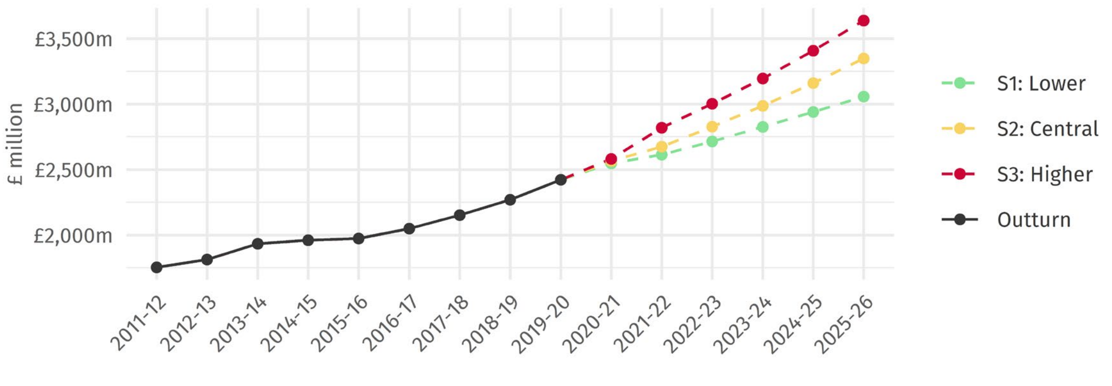
On central projections, total costs grow by 5.5% a year on average between 2021–22 and 2025–26 – broadly comparable to the average growth in spending between 2017–18 and 2019–20 (5.7%). Our lower and higher scenarios imply growth of 3.7% and 7.1% a year, respectively. On higher estimates, local authority gross expenditure on social services could exceed £3.5 billion by 2025–26 (**Figure 3.8**).

A breakdown of the projected spending pressures is provided in **Figure 3.9**. Children and families' services continue to be the largest driver of spending pressures, accounting for over 40% of the growth in spending over the forecast period.

However, unlike schools, demand for social services is much more difficult to predict. Any changes to the way people access care post-COVID could have a significant impact on the trajectory of spending pressures. These cost projections should therefore be interpreted alongside the demand assumptions outlined in **Figure 3.1**. Nevertheless, the range of estimates presented here strongly suggest that social services will continue to be the largest driver of local authority spending pressures over the next five years.

Figure 3.8

Gross expenditure on social services, with projections of spending pressures to 2025–26

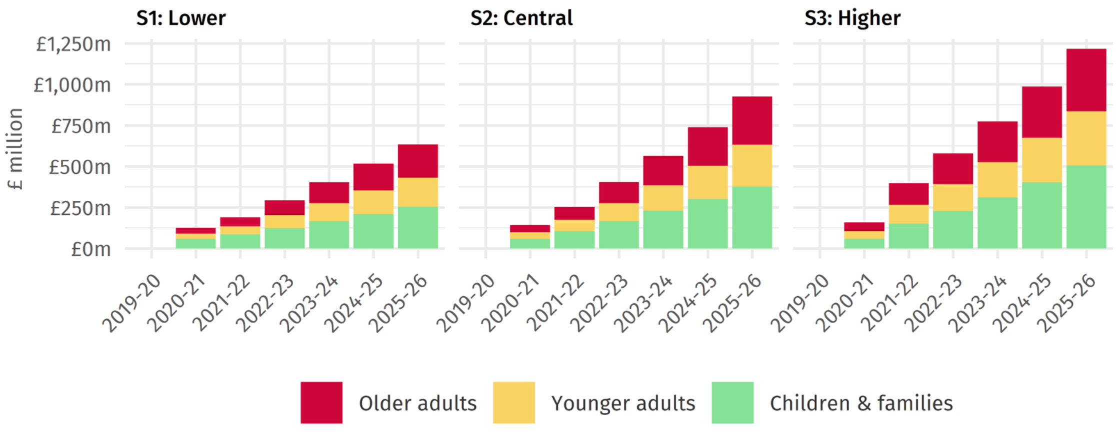


Source: WFA analysis. See **Annex A** for full methodology.

[15] This assumes that increased employee costs for commissioned providers are fully mirrored by increased payments to those commissioned providers.

Figure 3.9

Components of social services spending pressures from 2019–20



		£ million						
Scenario	**Pressures**	**2019–20**	**2020–21**	**2021–22**	**2022–23**	**2023–24**	**2024–25**	**2025–26**
S1 (lower)	Older adults	0	35	56	90	127	165	203
	Younger adults	0	31	49	78	110	143	177
	Family / children	0	59	86	124	166	209	254
	Total	**0**	**125**	**190**	**293**	**403**	**517**	**635**
S2 (central)	Older adults	0	44	79	128	179	234	293
	Younger adults	0	39	68	111	155	204	255
	Family / children	0	59	105	166	230	301	377
	Total	**0**	**142**	**252**	**404**	**564**	**738**	**926**
S3 (higher)	Older adults	0	54	132	188	247	311	380
	Younger adults	0	47	115	164	215	271	331
	Family / children	0	59	151	228	311	403	505
	Total	**0**	**160**	**398**	**580**	**773**	**986**	**1,216**

3.3. Other local government services

When combined, spending on schools and social services account for over 70% of local authority gross revenue expenditure on services. The rest is spent on the provision other local authority-provided services (including transport, non-HRA council fund housing, non-school education expenditure, environmental and regulatory services, planning, libraries, and other cultural venues). Spending on several of these service areas has been scaled back significantly over the past decade. We assume that the current level of service provision is maintained going forwards.

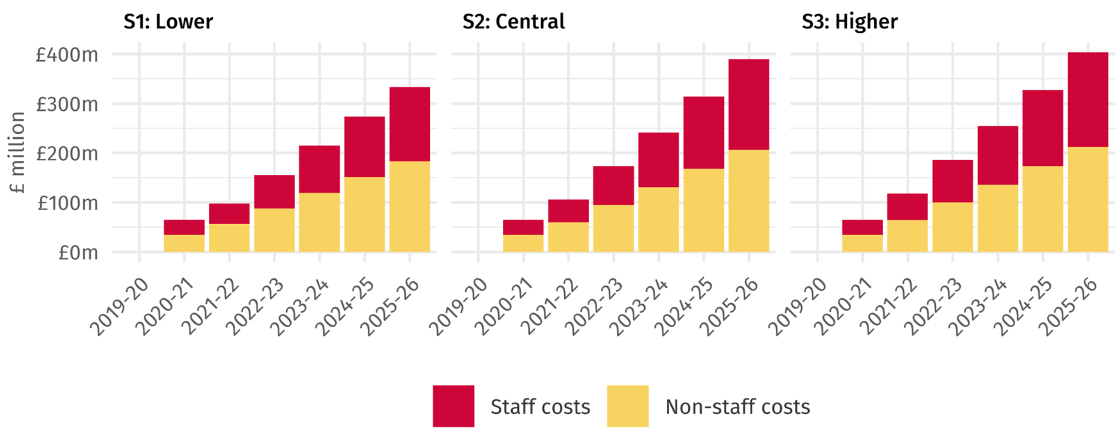
In our model, changes in demand for these services is measured by headline estimates of population growth. In other words, we assume that each resident is equally likely to access these local government services. Slow population growth implies that demand grows by less than 2% over the 6-year period between 2019–20 and 2025–26 (0.3% a year).

We assume zero productivity growth in each of our scenarios. UK-wide estimates show that productivity growth for government services has only averaged 0.14% over the last 5 years.[16] Given the scale of spending cuts to local government services over the last decade, it is reasonable to assume that any capacity to make further operational savings without impacting service provision is likely to be limited. Our assumptions about earnings mirror those made in previous sections.

Figure 3.10 disaggregates the spending pressures by staff and non-staff costs. On our central projection, non-schools, non-social services spending must grow by 2.0% in 2021–22, and average 3.2% in subsequent years to ensure pressures are fully met. This is faster than the growth in school spending pressures but slower than the growth in pressures for social services.

Figure 3.10

Components of spending pressures for local government services (excl. schools & social services) from 2019–20



Scenario	Pressures	£ million 2019–20	2020–21	2021–22	2022–23	2023–24	2024–25	2025–26
S1 (lower)	Staff costs	0	30	42	68	95	122	149
	Non-staff costs	0	35	56	88	120	151	183
	Total	**0**	**65**	**98**	**155**	**214**	**273**	**333**
S2 (central)	Staff costs	0	30	47	78	111	146	183
	Non-staff costs	0	35	60	95	131	168	207
	Total	**0**	**65**	**106**	**173**	**241**	**314**	**389**
S3 (higher)	Staff costs	0	30	53	86	118	154	191
	Non-staff costs	0	35	64	100	136	173	212
	Total	**0**	**65**	**118**	**186**	**254**	**327**	**403**

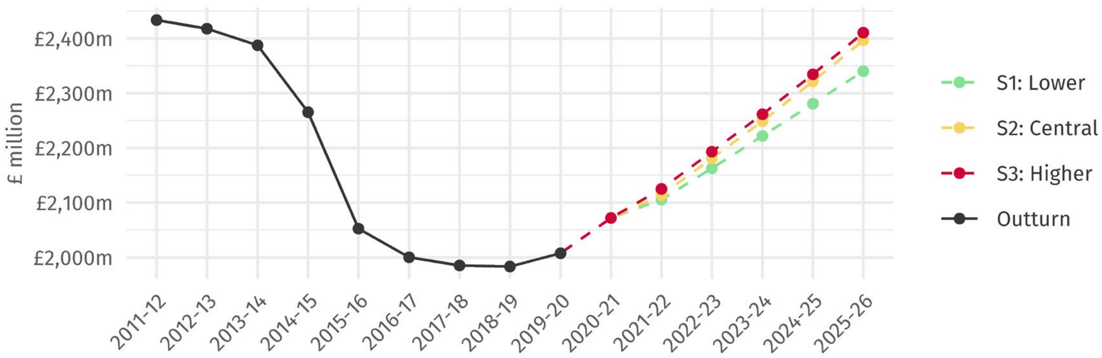
Source: WFA analysis. See **Annex A** for full methodology.

[16] Estimates based on ONS (2021) Labour productivity time series: https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/labourproductivity/datasets/labourproductivity

In the context of spending cuts over the past decade, these scenarios all represent a complete reversal of the historic trajectory (**Figure 3.11**). But even assuming that the pressures quantified in our higher cost projection are met, spending on these local government services remains below pre-austerity levels in 2025–26, and lower still having adjusted for inflation and population growth.

Figure 3.11

Gross expenditure on local government services (excl. schools & social services), with projections of spending pressures to 2025–26



Source: WFA analysis. See **Annex A** for full methodology.

3.4. Ongoing COVID-19 expenditure and income losses

So far, we have made no assumptions about additional costs and income losses incurred as a result of COVID-19. Throughout 2020–21 and the first six months of 2021–22, local authorities will be compensated for most of these additional costs through the Single Hardship Fund. But there is considerable uncertainty about the scale of these pressures beyond September 2021.

There are several grounds for thinking that the impact of COVID-19 on local government finance will extend beyond the expiration date for the Single Hardship Fund. Demand for personal protective equipment is likely to continue for the near future, and larger payments to commissioned residential care providers may be required to 'shore up the sector' in the wake of reduced occupancy rates.[17] Enhanced infection control measures and a reluctance to resume pre-COVID behaviours could mean that income from council-owned leisure and culture venues are slower to recover. Commercial parking income may be permanently scarred, particularly if the increase in homeworking and online retail patterns continue. However, unlike England, local authorities in Wales are less reliant on income from commercial property investments – therefore falling commercial rents are unlikely to make much of a dent in their income

[17] According to data obtained by BBC Wales Live, in parts of Wales the number of care home residents has dropped by 20% since February 2020: https://www.bbc.co.uk/news/uk-wales-56323779

streams.[18] In practice, local authorities could opt to increase fees to offset any reduced income, but this may not be possible for all services.[19]

When modelling the continued effect of COVID-19 on local government finance, we consider the extent to which income from commercial activities might recover its pre-pandemic level, and the additional expenditure that will be necessary in future years as a proportion of the amount claimed through the Single Hardship Fund in 2020–21. According to data provided by the Welsh Local Government Association, £311 million has been paid from the Single Hardship Fund to compensate local authorities for additional expenditure in 2020–21, and a further £190 million to offset income losses. These figures are correct as of March 21st, and we assume that they broadly match the totals at the end of the financial year.

The assumptions made about COVID-19 expenditure and income losses in each scenario are restated in **Figure 3.12** below:

Figure 3.12

Summary of assumptions made in each scenario about COVID-19 expenditure and income losses

S1 **Lower cost & demand pressures**	**Expenditure** • No COVID-19 costs beyond September 2021 **Income** • Local authority income recovers its pre-pandemic level by September 2021 (when the Single Hardship Fund is withdrawn)
S2 **Central cost & demand pressures**	**Expenditure** • 10% of COVID-19 costs continue beyond September 2021, reducing to zero by 2025–26 **Income** • Local authority income recovers 95% of its pre-pandemic level by September 2021, and fully recovers by 2025–26
S3 **Higher cost & demand pressures**	**Expenditure** • 20% of COVID-19 costs continue beyond September 2021, reducing to 10% by 2025–26 **Income** • Local authority income recovers 90% its pre-pandemic level by September 2021, increasing to 95% of its pre-pandemic levels by 2025–26

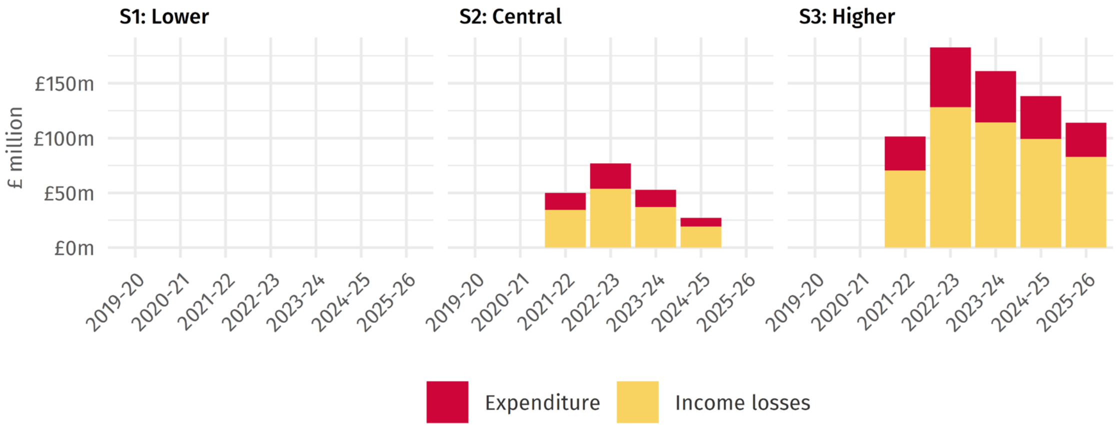
As set out in **Figure 3.13**, unfunded COVID-19 cost pressures total £50 million during the second half of 2021–22, £77 million in 2022–23 and return to zero by 2025–26. In our higher cost scenario, COVID-19 cost pressures peak at £183 million in 2022–23, reducing to £114 million at the forecast horizon. On these assumptions, the effects of income losses are likely to dominate. These projections should be interpreted with caution and in conjunction with the list of

[18] See (Ogden, Phillips, and Spiliotis 2020, 38-39), for a discussion of how COVID-19 might impact commerical property income for English local authorities.
[19] For many services, local authorities are either prohibited from charging more than the cost of provision, or there are nationally prescribed eligibility and charge levels in place and little or no local discretion on these levels.

assumptions as there remains considerable uncertainty about the extent to which costs will continue and income remains subdued from September 2021 onwards.

Figure 3.13

Components of unfunded COVID-19 pressures from 2019–20 †



		£ million						
Scenario	**Pressures**	**2019–20**	**2020–21**	**2021–22**	**2022–23**	**2023–24**	**2024–25**	**2025–26**
S1 (lower)	Expenditure	0	0	0	0	0	0	0
	Income losses	0	0	0	0	0	0	0
	Total	**0**	**0**	**0**	**0**	**0**	**0**	**0**
S2 (central)	Expenditure	0	0	16	23	16	8	0
	Income losses	0	0	34	54	37	19	0
	Total	**0**	**0**	**50**	**77**	**53**	**27**	**0**
S3 (higher)	Expenditure	0	0	31	54	47	39	31
	Income losses	0	0	70	128	114	99	83
	Total	**0**	**0**	**102**	**183**	**161**	**138**	**114**

† Assumes that pressures up to September 2021 are fully funded.

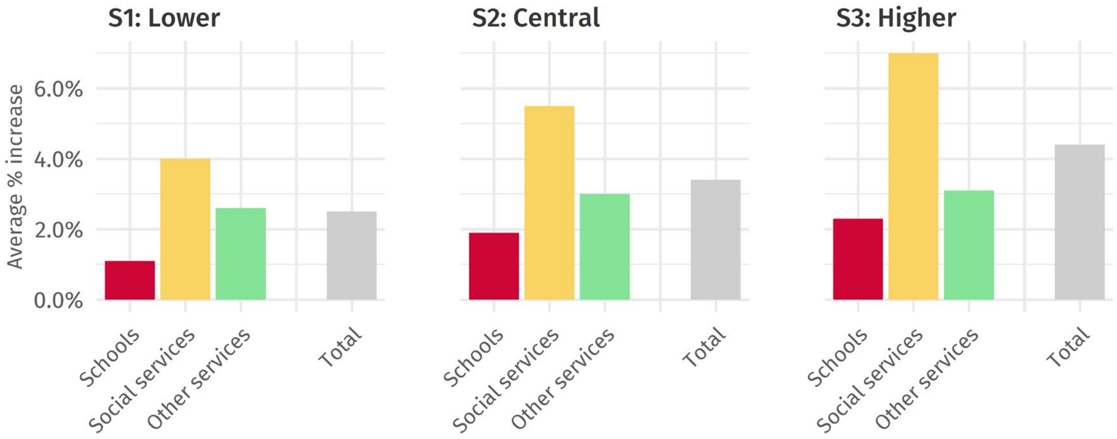
3.5. Summary of spending pressures

Having identified the spending pressures for each service area, we can now project the cumulative spending pressures for local authorities over the next five years.

On central projections, meeting the cost pressures entails increasing gross expenditure on services by an average of 3.4% a year between 2020–21 and 2025–26 (2.5% and 4.4% in our lower and higher cost scenario, respectively). As outlined in **Figure 3.14**, social services are the main driver of spending pressures. Schools face relatively smaller pressures due to a declining school-age population and a better outlook for productivity compared to other local government services.

Figure 3.14

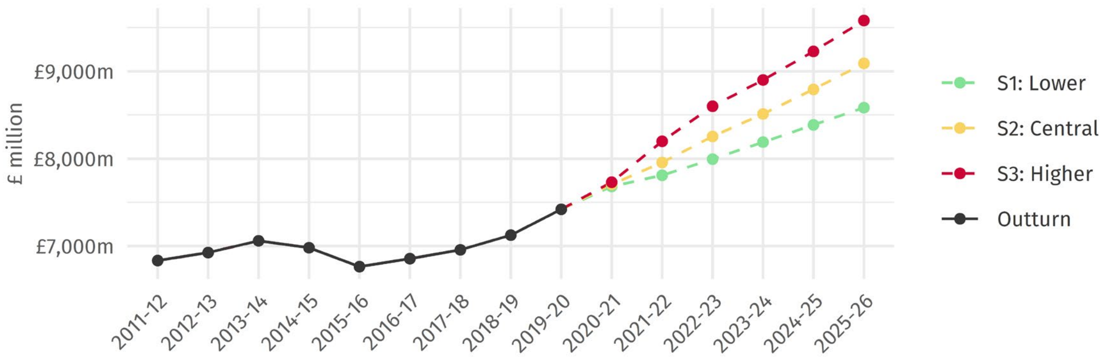
Average annual (%) increase in gross spending to meet spending pressures, 2020–21 to 2025–26



Source: WFA analysis. See **Annex A** for full methodology.

Figure 3.15

Gross expenditure on all local government services, with projections of (unfunded) spending pressures to 2025–26



Source: WFA analysis. See **Annex A** for full methodology.

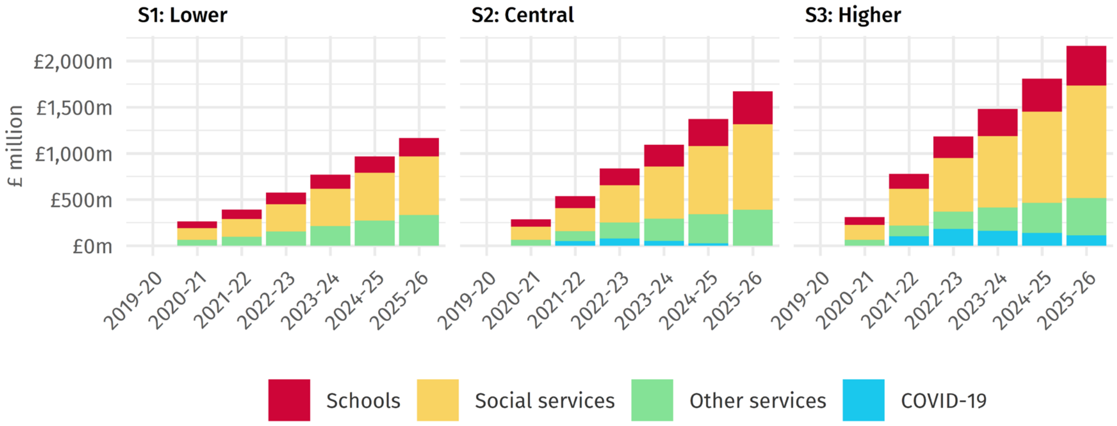
Meeting spending pressures in full implies a £1,672 increase in gross expenditure between 2019–20 and 2025–26. This would bring total gross expenditure on services (excluding the element financed by the housing benefit grant) to £9,091 million by 2025–26 (**Figure 3.15**).

Despite the considerable uncertainty arounds COVID-19 costs, they are likely to be dwarfed by the underlying demographic and inflationary pressures. Unfunded costs associated with the pandemic account for only 9% of total spending pressures in 2022–23, and this share continues to fall in future years. By 2025–25, social services accounts for 55% of all spending pressures in our central scenario, with school pressures accounting for a further 21%.

Whether these funding pressures can be met will largely depend on the growth in the local government settlement over the next five years. If the growth in the settlement falls short of the growth in spending pressures over the same period, local authorities may be required to propose larger increases to Council Tax bills to retain current levels of service provision. The outlook for local government revenues is set out in the following chapter.

Figure 3.16

Components of spending pressures for all local government services from 2019–20



Scenario	Pressures	£ million						
		2019–20	**2020–21**	**2021–22**	**2022–23**	**2023–24**	**2024–25**	**2025–26**
S1 (lower)	Social services	0	74	103	127	153	176	197
	Schools	0	125	190	293	403	517	635
	Other services	0	65	98	155	214	273	333
	COVID-19	0	0	0	0	0	0	0
	Total	**0**	**264**	**391**	**575**	**770**	**967**	**1,164**
S2 (central)	Schools	0	80	128	182	235	294	357
	Social services	0	142	252	404	564	738	926
	Other services	0	65	106	173	241	314	389
	COVID-19	0	0	50	77	53	27	0
	Total	**0**	**287**	**537**	**836**	**1,093**	**1,373**	**1,672**
S3 (higher)	Social services	0	86	162	234	294	359	431
	Schools	0	160	398	580	773	986	1216
	Other services	0	65	118	186	254	327	403
	COVID-19	0	0	102	183	161	138	114
	Total	**0**	**311**	**779**	**1,182**	**1,482**	**1,810**	**2,164**

Source: WFA analysis. See **Annex A** for full methodology. Excludes COVID-19 pressures funded through the Single Hardship Fund.

4 Revenues outlook to 2025–26

Although Council Tax has emerged as an increasingly important source of revenue for local authorities in recent years, gross revenue expenditure is still funded, by and large, by funds distributed as part of the local government settlement. As a result, the Welsh Government's decisions on local government grant allocations remain a large determinant of local authorities' spending power. The picture is somewhat blurred by the fact that the Welsh Government itself still largely relies on the Block Grant, which tracks the change in spending on equivalent services in England, for most of its revenue budget. This acts as a soft constraint on the Welsh government's overall spending power – although it bears mentioning that newly-devolved tax powers could be utilised to adjust spending levels at the margins.

In this chapter, we consider two plausible scenarios for UK government spending (outlined in **Figure 4.1**) and examine what impact they might have on the resources available for local authorities in Wales. The first scenario (**R1**) takes the UK government spending plans announced in March 2021 as a given, while the second scenario (**R2**) assumes that the UK government reverts to its – more generous – pre-COVID (March 2020) plans for total spending. In both scenarios, we assume that the Welsh Government passes on all projected consequentials allocated for NHS and school spending in England to fund equivalent services in Wales, and that all other day-to-day spending grows in line with the rest of the Welsh budget.

Figure 4.1

Summary of key assumptions made in each revenue scenario

R1 **Current UK spending plans**	**UK government** • **No change in current spending plans.** Funding for NHS and Schools in England grow in line with multi-year spending plans (to 2023–24 and 2022–23 respectively, and grow in line with GDP thereafter), defence and foreign aid spending grow according to commitments, and other departmental spending change in line with all other spending. **Welsh Government** • Passes on projected consequentials from NHS and Schools spending in England. All other day-to-day spending grows in line with the rest of the budget.
R2 **Pre-COVID UK spending plans**	**UK government** • **Cuts made in November 2020 and March 2021 are reversed,** reverting to pre-pandemic plans for total spending. This increase in spending is distributed evenly across all departments – this means that spending plans for NHS and Schools in England are also higher than in R1. **Welsh Government** • Passes on projected consequentials from NHS and Schools spending in England. All other day-to-day spending grows in line with the rest of the budget.

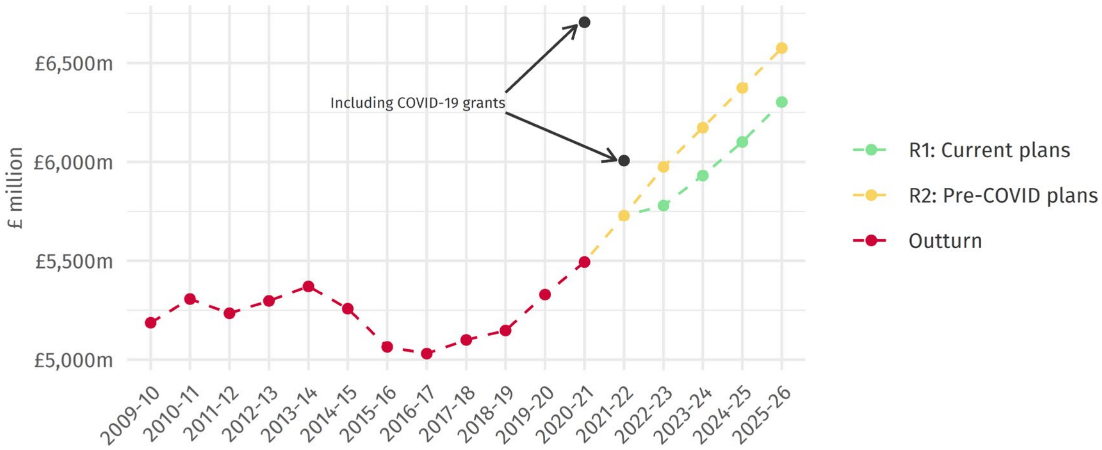
4.1. Aggregate External Finance & specific grants

In a reversal of earlier trends, central government funding for local authorities (Revenue Support Grant, specific grants, and Non-domestic rates revenue) is now set to rise over the next five years. On current UK spending plans (**R1**), spending grows in 2022–23, and grows at a faster pace over the remainder of the forecast period. The sum of Aggregate External Finance (RSG & NDR) and specific grants is set to grow by 0.9% in 2022–23 and average 2.9% over the remaining three years. If the UK government reverted to its pre-COVID spending plans (**R2**), this implies that Aggregate External Finance grows by 4.3% in 2022–23 and 3.3% a year from 2023–24 to 2025–26.

We assume that specific grants grow proportional to the RSG, bringing total government support to £6.3 billion in 2025–26 (nearly £6.6 billion on pre-COVID plans).

Figure 4.2

Projection of Aggregate External Finance (AEF) & specific grants (excluding Housing Benefit grant) to 2025–26[20]



		£ million						
Scenario	**Pressures**	**2019–20**	**2020–21**	**2021–22**	**2022–23**	**2023–24**	**2024–25**	**2025–26**
R1	AEF	4,237	4,474	4,651	4,704	4,825	4,961	5,121
	Specific grants	1,092	1,020	1,077	1,076	1,106	1,140	1,181
	Total	**5,329**	**5,494**	**5,729**	**5,779**	**5,931**	**6,101**	**6,302**
	% increase		3.1%	4.3%	0.9%	2.6%	2.9%	3.3%
R2	AEF	4,237	4,474	4,651	4,854	5,011	5,170	5,332
	Specific grants	1,092	1,020	1,077	1,121	1,162	1,203	1,244
	Total	**5,329**	**5,494**	**5,729**	**5,974**	**6,173**	**6,373**	**6,576**
	% increase		3.1%	4.3%	4.3%	3.3%	3.2%	3.2%

Note: All figures are expressed in current prices (cash terms).

[20] The cost of council tax benefit has been added to the Revenue Support Grant in years prior to its devolution. This ensures consistency with the way the RSG-funded element of Council Tax Reduction Scheme is treated from 2013–14 onwards.

The local government settlement is spared from the real terms cuts that some government departments are set to face because of the multi-year spending plans for schools in England (we assume that the Welsh Government passes on these consequentials to local authorities in full). Pupil numbers are set to rise in England and contract slightly in Wales meaning that the implied growth in funding for Welsh schools exceeds growth in underlying funding pressures. Local authorities may decide to allocate some of the additional funding towards COVID-19 catch-up learning programmes (the cost of which are not included in our calculation of the underlying funding pressures), or divert the cash to fund social care pressures, which are expected to grow at a faster pace than Aggregate External Finance.

There are additional uncertainties attached to these numbers. Not only are the projections contingent on the UK government sticking to its spending plans and the Welsh Government passing on all school consequentials to local authorities, but they also rely on NDR forecasts produced by the OBR alongside the UK Budget in March 2021.[21] The OBR forecasts includes adjustments for irrecoverable debts and the potential for liabilities to be reduced due to successful appeals to the Valuations Office Agency (VOA). A previous report by Wales Fiscal Analysis highlighted that the number of challenges submitted to the VOA by Welsh businesses increased six-fold during the first quarter of 2020–21 (Ifan and Siôn 2020b, 51-52). And in the medium-term, the OBR have lowered their UK forecast for business rates receipts by around £2 billion a year (Office for Budget Responsibility 2021, 177). This implies that Welsh NDR revenues are forecast to grow by 1.9% a year from 2023–24 onwards.

But there remains a prospect that the pandemic has changed shopping and working habits permanently; this could mean that the commercial property tax base shrinks by an even greater amount than the OBR assumes. Were this to happen, the Welsh Government could opt to increase the multiplier faster than inflation, effectively increasing the rate of tax to equalise the tax yield from a smaller tax base. Alternatively, they could either increase the value of the Revenue Support Grant to compensate local authorities for the reduction in NDR revenues or let local authorities bear the cost. If they opted for the latter, local authority budgets could be strained. As an illustrative example, if NDR revenues were 10% lower than forecast in 2022–23, this would equate to an additional 3 percentage points of growth in the value of the Revenue Support Grant.

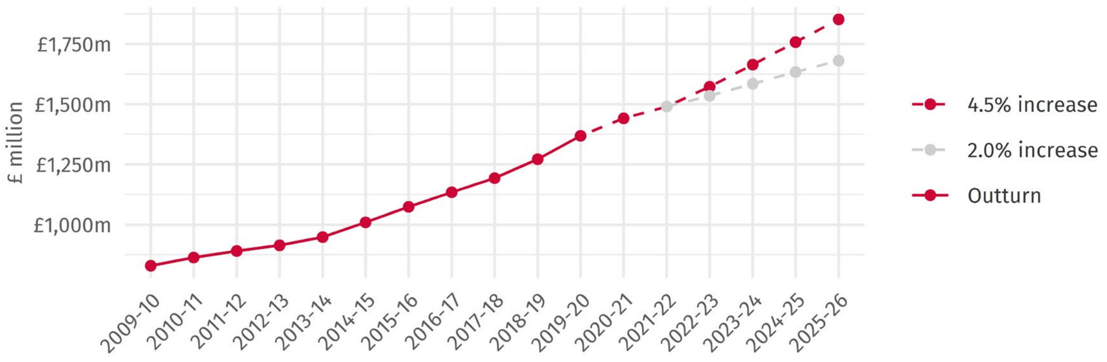
4.2. Council Tax

The trajectory of Council Tax revenue will depend on several factors, not least the rate of increase in Council Tax levels. To project this revenue stream forwards, we assume that bills increase by 4.5% a year between 2022–23 and 2025–26. This is in line with the five-year average and compatible with the assumptions made by many councils in their medium-term financial plans. **Figure 4.3** presents our projection for Council Tax receipts (net of the Council Tax

[21] Unlike the OBR, we include the value of NDR reliefs in our forecasts for NDR receipts. In effect, these reliefs have no impact on local authority budgets as the cost of providing them is fully offset by increased funding from the Welsh Government.

Reduction Scheme). Total receipts are projected to reach £1.85 billion by 2025–26. This figure is reduced to £1.68 billion were Council Tax levels to grow by 2% each year (broadly tracking inflation) from 2022–23 onwards.

Figure 4.3
Projection of Council Tax receipts (net of CTRS) to 2025–26



		£ million						
		2019–20	**2020–21**	**2021–22**	**2022–23**	**2023–24**	**2024–25**	**2025–26**
4.5%	Amount budgeted	1,629	1,724	1,794	1,890	1,990	2,097	2,208
	CTRS	-260	-283	-303	-317	-326	-339	-357
	Total (net of CTRS)	**1,369**	**1,441**	**1,491**	**1,573**	**1,664**	**1,757**	**1,852**
2.0%	Amount budgeted	1,629	1,724	1,794	1,844	1,896	1,950	2,005
	CTRS	-260	-283	-303	-310	-311	-316	-324
	Total (net of CTRS)	**1,369**	**1,441**	**1,491**	**1,535**	**1,585**	**1,634**	**1,680**

Note: All figures are expressed in current prices (cash terms).

Since the amount budgeted for collection is netted off against the cost of the Council Tax Reduction Scheme (CTRS), changes in the CTRS caseload will impact local authority receipts. Even if the caseload remains constant, the cost of operating the scheme will continue to rise as Council Tax liabilities increase. Research commissioned by the Welsh Government found that the value of CTRS awards for working-age households increased from £166 million to £183 million between 2019 and 2020 (Z. Charlesworth et al. 2021, 15). If we assume that the working-age caseload tracks the OBR forecast for unemployment, and that the cost of operating the scheme continues to grow proportional to Council Tax liabilities, the value of CTRS awards for working-age households could reach £209 million by 2025–26. This would bring the total cost of the scheme to £357 million.

There is limited evidence about the impact of COVID-19 on collection rates for Council Tax. The same research commissioned by the Welsh Government found that although there had been a 2% increase in the number of working-age households in Council Tax arrears, the average level of arears had fallen in the year to September 2020. The authors posit that the relative generosity of the CTRS scheme in Wales has protected households form the levels of council tax arrears accumulation seen in England (Z. Charlesworth et al. 2021, 26-27). Separate analysis of historical data on collection and arrears finds that labour market shocks only have a marginal impact on collection rates (Ifan and Siôn 2020b, 49-50). As a result, we assume that COVID-19 and the economic fallout has no impact on Council Tax collection rates for the purpose of producing our projections.

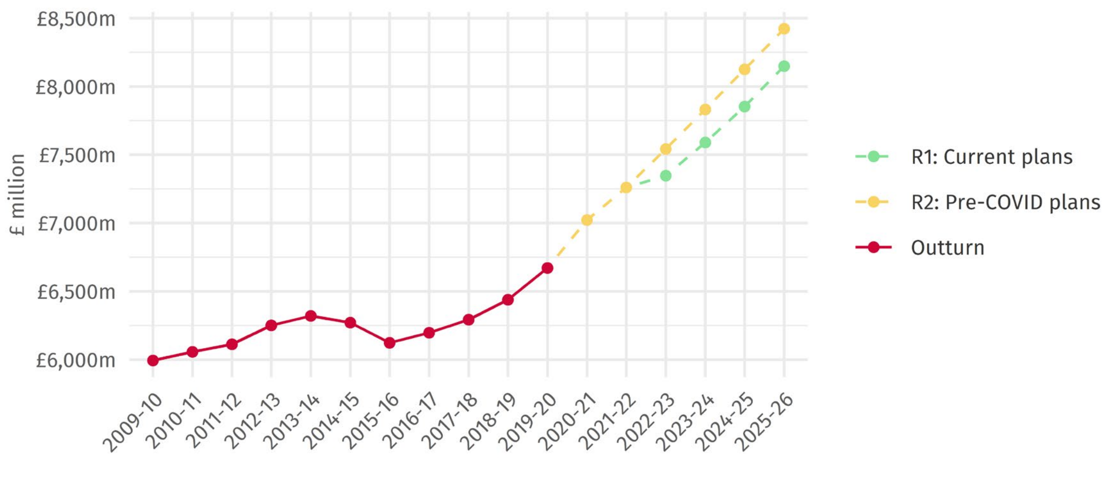
4.3. Overall revenues outlook

To generate the overall outlook for revenues, we make three further assumptions. First, we assume that drawdowns from, and payments to, reserves reduce to zero by 2023–24. This is consistent with the logic that in the long-run, payments into reserves must equal drawdowns. Second, we assume that any accounting adjustments equal zero from 2021–22 onwards (in line with the long-run average). Third, we assume that the amount of discretionary NDR relief financed by local authorities – which is relatively small – remains fixed at its 2020–21 budgeted level (£5 million).

This allows us to project gross revenue expenditure to 2025–26 in **Figure 4.4**. This measure is consistent with the *gross revenue expenditure* line from the *Financing of gross revenue expenditure* tables published by StatsWales (less the value of the Housing Benefit grant).[22] On current spending plans, gross revenue expenditure grows by 2.9% a year on average between 2022–23 and 2025–26, reaching £8,149 million at the forecast horizon. A return to pre-COVID UK government spending plans implies average growth of 3.8% over the same period.

Figure 4.4

Projection of gross revenue expenditure (excluding Housing Benefit grants) to 2025–26



Source: See **Annex A** for full methodology. **Excludes COVID-19 funding.**

[22] These tables can be accessed here: https://statswales.gov.wales/Catalogue/Local-Government/Finance/Revenue/Financing/FinancingOfGrossRevenueExpenditure-by-Authority

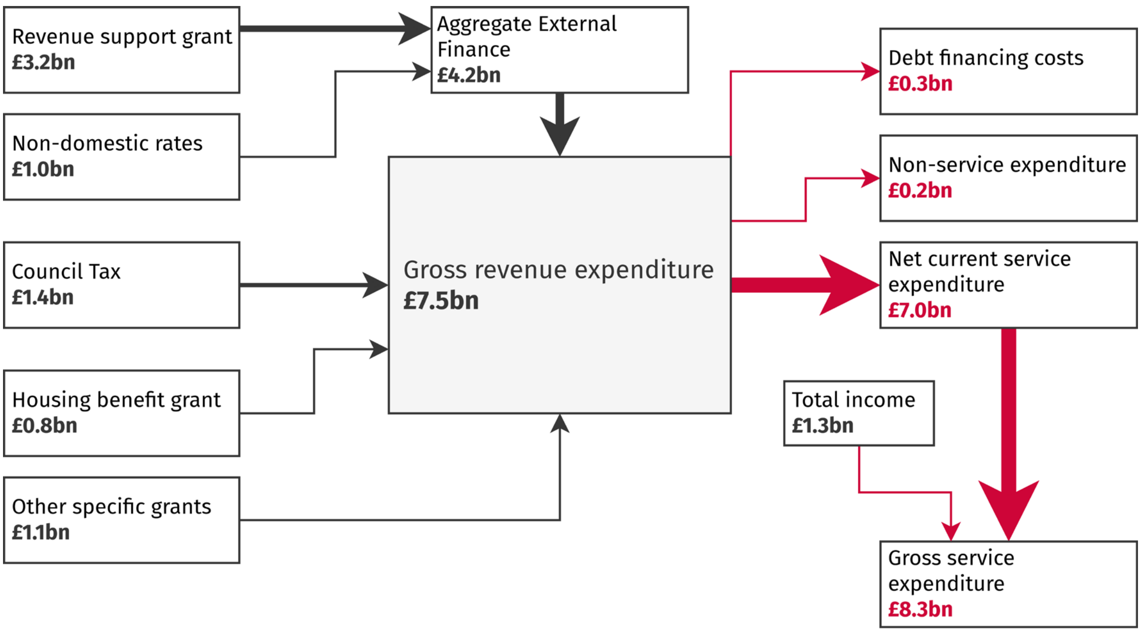
5 Estimating the funding gap

To facilitate comparisons between the spending pressures identified in Chapter 3 and the outlook for revenues presented in Chapter 4, a few final assumptions must be made to derive a projection of gross service expenditure – a proxy for local authorities' spending power.

We assume that debt financing costs as a share of gross revenue expenditure remain fixed at their 5-year average (6.2%). We further assume that the value of levies and community precepts as a share of gross revenue expenditure also remain fixed at their 5-year average (3.0%). Deducting these elements from **gross revenue expenditure** leaves us with **net current expenditure on services**. We assume that other local authority income grows in proportion to net current service expenditure from 2019–20 onwards (before adjusting for the impact of COVID-19). Adding these two elements together leaves us with a projection of **gross service expenditure** (Figure 5.1).[23]

Figure 5.1

Financing and components of local authorities' revenue expenditure, 2019–20



Source: WFA analysis. See Annex A for further detail.

[23] Unless otherwise specified, gross service expenditure is presented net of the element financed by the Housing Benefit grant.

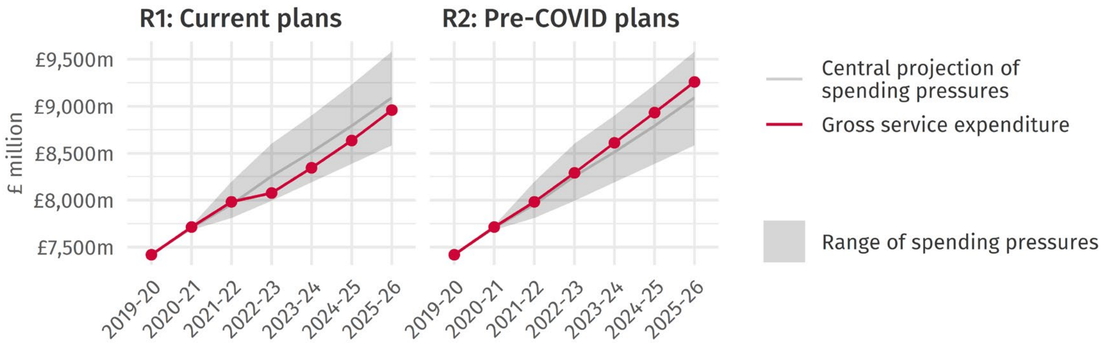
5.1. The funding gap to 2025–26

On current UK spending plans, and if Council Tax levels grow by 4.5% a year from 2022–23 onwards, gross service expenditure falls short of meeting the spending pressures in our central scenario (**Figure 5.2**). In 2022–23, spending pressures are projected to exceed local authorities' spending power by £178 million due to the combination of COVID-19 legacy costs and slower growth in the settlement. This gap narrows in future years, but spending power remains £132 million below spending pressures by 2025–26.

If the UK government reverted to its pre-COVID spending plans, thus reversing the cuts made since March 2020, the spending pressures identified in our central projection could be met over the forecast period.

Figure 5.2

Estimate of the funding gap to 2025–26 (4.5% Council Tax increase)



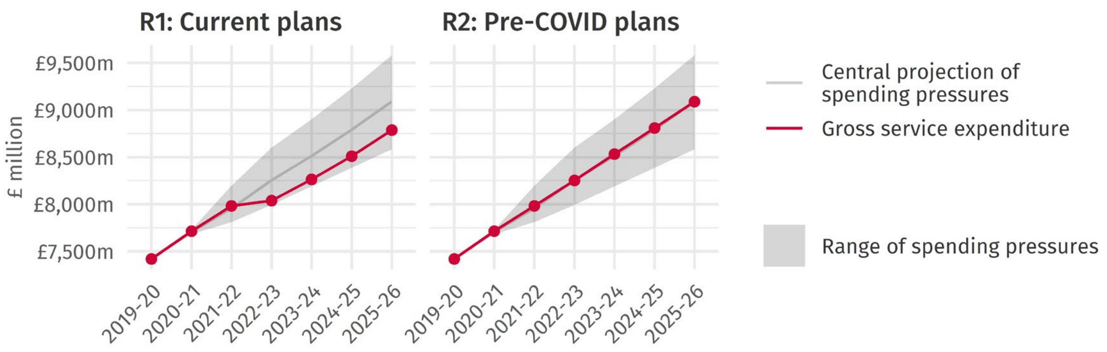
Scenario	Pressures	Difference between gross service expenditure and spending pressures (£ million)						
		2019–20	2020–21	2021–22	2022–23	2023–24	2024–25	2025–26
R1	S1: Lower	0	32	173	83	155	248	376
	S2: Central	**0**	**9**	**27**	**-178**	**-168**	**-158**	**-132**
	S3: Higher	0	-14	-215	-524	-557	-595	-624
R2	S1: Lower	0	32	173	297	421	547	676
	S2: Central	**0**	**9**	**27**	**36**	**99**	**141**	**169**
	S3: Higher	0	-14	-215	-310	-291	-296	-323

Source: WFA analysis. See **Annex A** for further detail. Excludes expenditure financed by COVID-19 grants in 2020–21 and 2021–22.

Indeed, if the UK government reverts to its more generous pre-COVID spending plans, increasing Council Tax levels by 2% a year from 2022–23 onwards (roughly in line with inflation) would be sufficient to meet the spending pressures in our central scenario (**Figure 5.3**).

Figure 5.3

Estimate of the funding gap to 2025–26 (2.0% Council Tax increase)



		Difference between gross service expenditure and spending pressures (£ million)						
Scenario	**Pressures**	**2019–20**	**2020–21**	**2021–22**	**2022–23**	**2023–24**	**2024–25**	**2025–26**
R1	S1: Lower	0	32	173	45	76	125	204
	S2: Central	**0**	**9**	**27**	**-216**	**-247**	**-281**	**-303**
	S3: Higher	0	-14	-215	-562	-636	-718	-795
R2	S1: Lower	0	32	173	259	342	424	505
	S2: Central	**0**	**9**	**27**	**-2**	**20**	**18**	**-3**
	S3: Higher	0	-14	-215	-348	-370	-419	-495

Source: WFA analysis. See **Annex A** for further detail. Excludes expenditure financed by COVID-19 grants in 2020–21 and 2021–22.

5.2. The potential impact of NHS COVID-19 legacy costs

Despite the existence of a funding gap on current plans, these estimates arguably paint a more optimistic outlook for local government finance compared to the past decade, with real terms growth in revenues allowing most – but not all – spending pressures to be met. In producing these estimates, we assume that the Welsh Government passes on all projected consequentials allocated for NHS and school spending in England to fund equivalent services in Wales, and that all other day-to-day spending grows in line with the rest of the Welsh budget. But there is room to doubt whether this assumption is credible.

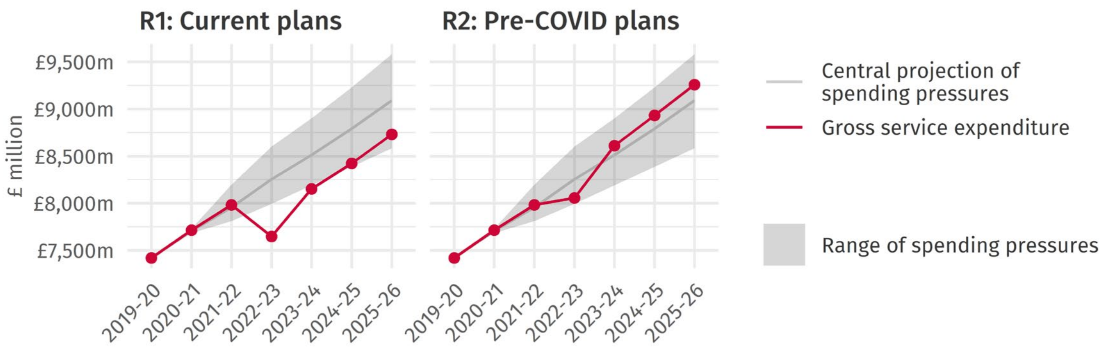
An earlier report in our **Welsh Election Briefing** series found that there is a significant funding gap between projected consequentials stemming from health spending by the UK government in England and total funding pressures for the NHS in Wales, including the legacy costs of the pandemic. The costs of clearing the elective care backlog, productivity losses, and new demands on the NHS, such as on mental health services could mean that funding allocated to the NHS in Wales falls short by £740 million in 2022–23, with further shortfalls averaging £360 million a year from 2023–24 to 2025–26 (Ifan 2021). Though these estimates are uncertain, were the Welsh Government to meet these costs, this would result in significantly slower growth for other parts of the budget, including the local government settlement.

Indeed, in our central scenario, meeting the legacy costs of COVID-19 on the NHS implies that local authority spending power falls short of spending pressures by £607 million in 2022–23, and by an average of £362 million a year over the following three years. Even on pre-COVID spending plans, funding remains £198 million short of spending pressures in 2022–23 on our central projection, though the pressures could be met in future years.

In the absence of additional funding to deal with NHS cost pressures, decisions made by the Welsh Government about NHS spending, the extent to which waiting lists are reduced, and over what timescale, will have a huge impact on the fiscal outlook for local authorities over the coming years. Of course, there is precedent for UK governments to revise their spending plans in-year, and this could well trigger additional consequentials for Wales. But given that local authorities must set their budgets at the start of the financial year, a lack of clarity on the settlement at the time of the budget-setting process could still result in cuts to spending areas and larger than necessary increases to Council Tax levels.

Figure 5.4

Estimate of the funding gap to 2025–26 (4.5% Council Tax increase & NHS COVID-19 legacy costs are met)



Scenario	Pressures	Difference between gross service expenditure and spending pressures (£ million)						
		2019–20	2020–21	2021–22	2022–23	2023–24	2024–25	2025–26
R1	S1: Lower	0	32	173	-346	-37	37	149
	S2: Central	**0**	**9**	**27**	**-607**	**-360**	**-369**	**-358**
	S3: Higher	0	-14	-215	-953	-749	-806	-851
R2	S1: Lower	0	32	173	63	421	547	676
	S2: Central	**0**	**9**	**27**	**-198**	**99**	**141**	**169**
	S3: Higher	0	-14	-215	-544	-291	-296	-323

Source: WFA analysis. See **Annex A** for further detail. Excludes expenditure financed by COVID-19 grants in 2020–21 and 2021–22.

6 Conclusion

Under the more restrained spending plans outlined by the Chancellor in March 2021, funding for local authorities is set to fall short of the amount required to meet funding pressures – even though the block grant is set to grow in real terms over the next five years. If the Chancellor reverses the cuts made since March 2020, the Welsh Government passes on consequentials from schools spending in England to local authorities, and the local government settlement grows in line with the rest of the Welsh budget, spending pressures for local authority services could be met over the forecast period. Even then, this is only possible because of Wales' slower growing pupil population. Meeting the funding pressures in full entails diverting some of the school consequentials to fund pressures in other areas like social services, where pressures are expected to grow at a faster pace than councils' core funding. Of course, this may not be particularly desirable, not least because of the additional demands to compensate for lost learning time in classrooms – the cost of which would be in addition to the spending pressures identified in this report.

Moreover, even if the current UK spending plans are revised upwards, there is room to doubt whether the Welsh Government would be able to sustain the necessary increase to the local government settlement, especially if it opts to meet the legacy costs of COVID-19 on the NHS. A previous report in our **Welsh Election Briefing** series identified a £740 million funding gap between projected health consequentials from the UK government and NHS Wales funding pressures in 2022–23, with further shortfalls averaging £360 million a year between 2023–24 and 2025–26 (Ifan 2021, 33). These estimates are highly uncertain and depend, in part, on whether the sharp drop in referrals seen during the pandemic signals significant pent-up demand. But were the Welsh Government to meet these additional NHS costs, the outlook for local government services suddenly becomes more austere, with councils facing a potential funding gap of over £607 million in 2022–23 and £362 million a year over the following three years. Indeed, even a real-terms increase to the block grant is no guarantee that local government services will be spared from spending cuts. The next Welsh Government may well find itself – once again – in the unenviable position of having to prioritise areas of the budget to be protected.

Above-inflation increases to Council Tax are set to continue – our central scenario models a 4.5% increase in Council Tax levels each year between 2022–23 and 2025–26. Although reversing the cuts since March 2020 could release enough funding to allow Council Tax to rise by inflation, this seems unlikely to occur given the additional funding demands for health services. This arguably strengthens the case for revisiting the way the local taxation system operates in Wales. Research by Bangor University (Gwilym, Jones, and Rogers 2020), the Welsh Government (Bunt 2020), and the Institute for Fiscal Studies (Adam et al. 2020) has shown that a replacement Land Value Tax, a local tax on income, or simply re-banding and revaluing properties could prove to be more progressive alternatives.[24] The current policy, which pivots around continual Council Tax increases, is far from the most sustainable way of funding local authorities in the long-term.

One of the largest constraints on local government spending are the spending plans outlined by the UK Chancellor, which impact the Welsh Government's block grant. Reversing the cuts to planned spending made since March 2020 could allow councils to broadly meet spending pressures in the absence of NHS COVID-19 legacy costs. But having committed not to raise Income Tax rates, VAT or National Insurance Contributions – which together account for three-fifths of government tax receipts – and pledging to balance the current budget by 2025–26, the options available to fund additional expenditure at a UK level are limited.

It is worth reiterating that even if the spending pressures identified in this report are met, this alone would not be sufficient to restore local government services to their pre-austerity levels. Having adjusted for inflation, spending per person would remain below their early-2010s peak. Spending decisions made over the past decade will also have a bearing on local government's capacity to respond to future periods of spending retrenchment: for example, the potential to make further operational and productivity savings is likely to be diminished.

But although the UK government's spending plans act as a soft constraint on local government spending, the Welsh Government's newly acquired powers over devolved taxes and local taxation arrangements could provide an alternative way of funding additional local expenditure. In the face of continuing economic uncertainty and a relatively austere budget outlook, these levers may well play a role in shaping Welsh fiscal policy over the coming years. These possibilities, and the outlook for other parts of the Welsh budget, will be explored in more detail in our forthcoming pre-election briefing.

[24] See also Ifan and Siôn (2020b, 53-59) for an analysis of the distributional impact of Council Tax on Welsh households.

A Annexes

A1. Projecting spending pressures

To project local authority spending pressures, we make varying assumptions about demand, productivity, earnings, and the persistence of COVID-19 costs and income losses beyond September 2021. The key assumptions are set out in **Figure 3.1**. This annex provides a more detailed description of the methodology used and can be read in conjunction with the data tables published online alongside this report.

Demand

A growing population is likely to increase demand for services. Our baseline assumption is that demand pressures grow in line with the Office for National Statistics (ONS) principal projection for population growth from 2018. According to this source, the Welsh population is projected to grow by 0.34% in 2021, slowing to 0.19% by 2025. We amend these demand projections for the two largest areas of spending – social care and education services – according to the factors outlined below.

Demographic change makes it likely that demand for adult social care services will exceed the underlying rate of population growth. A widely used model developed by Wittenberg et al. (2018) projects that demand in England will increase by 2.2% a year, ahead of the underlying rate of population growth in England (0.52% a year). We adjust this projection slightly to reflect relative differences in the projected growth of different age cohorts in Wales. This implies that demand for care in Wales (which represents the total volume of formal care services delivered) grows by an average of 2.0% a year to 2025–26. This is adjusted by +/- 1 percentage point in our higher and lower cost scenarios, respectively.

An area of spending which has seen fast growth in demand and spending over recent years is children and families' social care services (Ifan and Siôn 2019b). This has been driven by an increase in the number of children looked after by local authorities. Future demand pressures will critically depend on the extent this trend continues over coming years. In our central scenario, we assume demand pressures in this area grow by 4% a year – the average annual rate of growth in the number of children looked after between 2009 to 2020.

For schools spending, we assume that demand pressures grow in line with projections of the number of full-time equivalent pupils in local authority-maintained schools.

Productivity

Projecting the future cost of delivering services requires us to make assumptions about the cost of inputs and productivity growth. Productivity refers to the rate at which unit costs grow relative to input costs, or how the output for each unit of input changes over time.

Based on the available evidence about trends in productivity, we assume that, in our central scenario, unit costs grow in line with the price of inputs for all services apart from education. We assume that schools experience modest productivity gains of 0.2% a year. These assumptions are adjusted in our higher and lower scenarios, as set out in **Figure 3.1**.

Earnings

For non-teacher staff costs, we assume that earnings grow in line with the OBR's forecast for average earnings from March 2021 (Office for Budget Responsibility 2021). We also model the effect of planned increases to the National Living Wage to two-thirds of median hourly earnings by April 2024 (currently forecast to be £10.09 in cash terms). We assume that a third of local government workers are directly affected by increases to the NLW, based on data of full-time equivalent employees on various pay points across Wales and England. In our lower cost scenarios, we assume that earnings for non-NLW staff grow at half the pace of average earnings, and that as a result, the proportion of the workforce subject to the NLW grows over time.

Research suggests that increases in minimum wages lead to significant but incomplete squeezing of differentials (Ogden, Phillips, and Spiliotis 2020, 44). We therefore assume that labour costs increase by a weighted average of two scenarios: firstly, that all non-NLW workers' pay increase with average earnings (80% weighting); and secondly, that all non-NLW workers' pay increase in line with NLW increases (20% weighting). We also account for the UK government's public sector pay freeze announcement made at the November 2020 Spending Review. Following discussion with local authority officials, we assume that average earnings for non-NLW staff grow by 1.0% (instead of 0.0%) in 2021–22 – this reflects the possibility that local authorities will continue to fund a pay increases for their workforce, but that the Chancellor's announcement indirectly impacts the increase amount.

For non-staff costs, we assume that the projected increase in local authorities' own labour costs feed through into payments made to providers for outsourced services, for example in the adult social care sector. Our assumed growth in non-staff costs is therefore a weighted average of inflation as measured by the GDP deflator (50% weighting) and our assumed increase in staff costs (50% weighting).[25] For social services, a larger (70%) weighting is given to staff costs than the GDP deflator (30%).

[25] Lockdown measures in 2020–21 and 2021–22 have had a significant impact on the GDP deflator measure, which were negative for 2020–21 and 2021–22 but set to recover in future years. Since this is unlikely to reflect actual trends in input costs for local authorities, we instead use a 'smoothed' straight-line projection for the deflator between 2019–20 and 2025–26, which increases by 1.9% a year on average.

Data for the 2019–20 academic year is used as a baseline to project the pay bill for teachers. This data is derived from evidence submitted by the Welsh Government to the Welsh Pay Review Body in 2020 (Welsh Government 2020). Future growth in teachers' pay is calculated using the same methodology outlined in Sibieta (2020). Sibieta (2020) assumes that starting salaries for teachers would reach £30,000 by September 2022, as per the UK government's commitment in England. However, the indirect effect of the public sector pay freeze in 2021–22 is likely to have delayed this objective. We therefore assume that this target will be reached by 2023–24 in our central and lower cost scenarios, meaning that starting salaries are set to grow by 4.8% a year on average between 2019–20 and 2023–24. Other pay points on the main pay range are assumed to grow by progressively smaller amounts (3.4% for M2, 2.4% for M6).[26] This implies that 21% of the pay bill covers all the teachers on the main pay range.

Pay for other teachers, including teachers on the upper pay range, leadership scales and unqualified teachers, are assumed to grow in line with OBR forecasts for average earnings in our central and higher scenarios, except for 2021–22 when they grow by 1.0%. We adjust our projections to account for the split of each academic years across multiple financial years.

Ongoing COVID-19 expenditure and income losses

To reflect the possibility that some COVID-19 costs and income losses will continue beyond September 2021 – when the Single Hardship Fund is set to be withdrawn – our central and higher cost scenarios are adjusted accordingly. These additional costs may include payments for personal protective equipment, as well as initiatives to 'support the market' (e.g. for social services), as discussed in **Section 3.4**.

Our estimate of claims to the Single Hardship Fund during 2020–21 is correct as of 21 March 2021. In our central projection, we assume that 10% of COVID-19 costs persist beyond September 2021, reducing linearly to zero by 2025–26. We assume that local authority income recovers 95% of its pre-pandemic level by September 2021, and fully recovers by 2025–26. Details about the assumptions made in the higher cost scenario can be found in **Figure 3.12**.

These projections should be interpreted with caution and in conjunction with the assumptions made. There remains considerable uncertainty about the extent to which costs will continue and income remains depressed from September 2021 onwards.

[26] A breakdown of the pay bill by each point on the main pay range is not available for Wales. Therefore, this is estimated by taking the share of teachers at each pay point in Wales (25% from M1 to M6) and adjusting using the ratio between the share of the pay bill accounted for by each pay point in England, and the share of English teachers on each respective pay point.

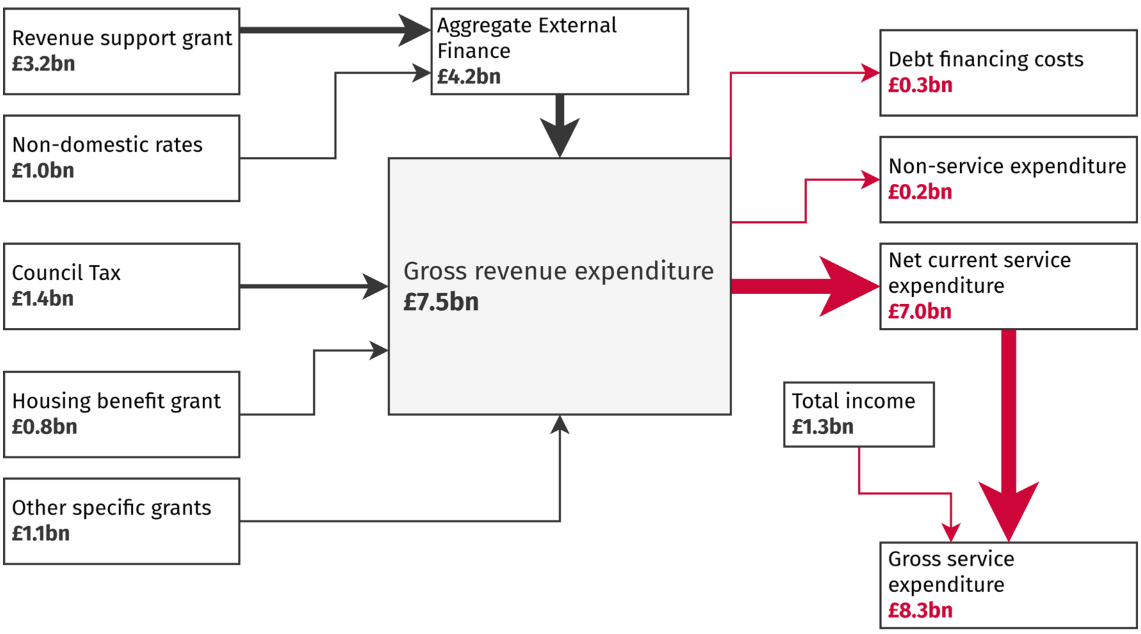
A2. How are local authorities funded?

The cost of running local authority services, including staff costs, utilities, and any goods or services consumed within the year is referred to as revenue expenditure. This is distinct from capital expenditure – spending on investments, including fixed assets – which is financed separately. Gross revenue expenditure is funded from four main sources: un-hypothecated grant income, Non-domestic rates, Council Tax, and hypothecated grant income. Most grant funding comes from the Welsh Government and is delivered through the Revenue Support Grant (RSG), which can be spent at the discretion of local authorities. In 2019–20, this accounted for £3.2 billion (43%) of gross revenue expenditure.

Non-domestic (business) rates are a recurrent tax on a non-domestic property's rateable value. This tax was fully devolved in 2015 and under the present system, revenues are collected by local authorities, pooled by the Welsh Government and re-distributed among local authorities alongside the Revenue Support Grant. In 2019–20, this source of revenue amounted to £1.0bn, accounting for another 13% of gross revenue expenditure. Together, the Revenue Support Grant and Non-domestic rates are referred to as Aggregate External Finance (AEF), which accounts for £4.2 billion (56%) of gross revenue expenditure.

Figure A1

Financing and components of local authorities' revenue expenditure, 2019–20



Source: WFA analysis of StatsWales (2019–20) Financing of gross revenue expenditure; StatsWales (2019–20) Local authority outturn tables. Excludes the financing and expenditure of police authorities.

Local authorities also generate revenue by levying Council Tax on residents. This is a recurrent tax on a property's rateable value at the time of the last revaluation in 2003. Although local authorities are free to set their own rate of Council Tax, the ratios between the charges applied to different bands (relativities) are centrally fixed. In 2019–20, this tax (net of the Council Tax Reduction Scheme) brought in £1.4 billion (18% of gross revenue expenditure). The cost of operating the Council Tax Reduction Scheme (CTRS) – which offers tax relief for those on low income – is largely included within the RSG.

The final components of gross revenue expenditure are specific grants, which represent £1.9bn (26%) of gross revenue expenditure. These grants are ring-fenced and hypothecated for particular objectives. They include an annual grant from the Department for Work and Pensions (DWP) to fund housing benefit payments and administration. In general, we exclude the housing benefit grant and the elements of expenditure financed by this grant from our analysis. By doing so, we can generate consistent comparisons between periods preceding and following the rollout of universal credit. Once the universal credit rollout is complete, housing benefit payments will be made directly to the head of household as opposed to local authorities in most cases.

Together, plus or minus any payment to / drawdown from reserves, these sources of funding amount to £7.5 billion, which is used to cover debt financing costs, non-service expenditure (e.g. levies to community councils and other authorities), and net current expenditure on services.

Local authorities can also charge users for services like council-owned car parks and leisure facilities and impose fees for other services which are governed by specific regulations. For many services, they are either prohibited from charging more than the cost of provision, or there are nationally prescribed eligibility and charge levels in place and little or effectively no local discretion on these levels. These brought in £1.3 billion in 2019–20 and although they are not treated as a component of gross revenue expenditure in local government accounting, service expenditure can be offset against this income, meaning that the total outlay of local authorities on services (gross service expenditure) was £8.3 billion in 2019–20.

Funding for police authorities, including the police grant and precept are excluded from this analysis, as are specific grants for national parks and fire and rescue authorities, although any levies paid directly to these authorities by councils are included.

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

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

Dadansoddi Cyllid Cymru
Wales Fiscal Analysis