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Cyllid Cymru  

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Wales Fiscal  
Analysis

# Welsh Budget Outlook 2020

**BRIEFING REPORT**

**Wales Fiscal Analysis**  
DECEMBER 2020

# Preface

## Declaration of funding

Wales Fiscal Analysis is hosted by the Wales Governance Centre and the School of Law and Politics at Cardiff University, and funded through a partnership between Cardiff University, the Welsh Government, the Welsh Local Government Association and Solace Wales. The programme continues the work of Wales Public Services 2025 hosted by Cardiff Business School, up to August 2018.

## About us

Wales Fiscal Analysis (WFA) is a research body within Cardiff University's Wales Governance Centre that undertakes authoritative and independent research into the public finances, taxation and public expenditures of Wales.

The WFA programme adds public value by commenting on the implications of fiscal events such as UK and Welsh budgets, monitoring and reporting on government expenditure and tax revenues in Wales, and publishing academic research and policy papers that investigate matters of importance to Welsh public finance, including the impact of Brexit on the Welsh budget and local services, options for tax policy, and the economics and future sustainability of health and social care services in Wales.

Working with partners in Scotland, Northern Ireland, the UK and other European countries, we also contribute to the wider UK and international debate on the fiscal dimension of devolution and decentralisation of government.

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# Welsh Budget Outlook

## 2020

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Briefing Report

Wales Fiscal Analysis  
Wales Governance Centre

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# Executive Summary

The Covid-19 pandemic has led to breathtaking levels of additional spending by both the Welsh and UK governments, to support individuals, businesses, and public services through the crisis. A stream of new announcements seemingly constantly adding to the size of the fiscal response. This report attempts to take stock following the UK government's Spending Review and ahead of the Welsh Government's Draft Budget for 2021-22.

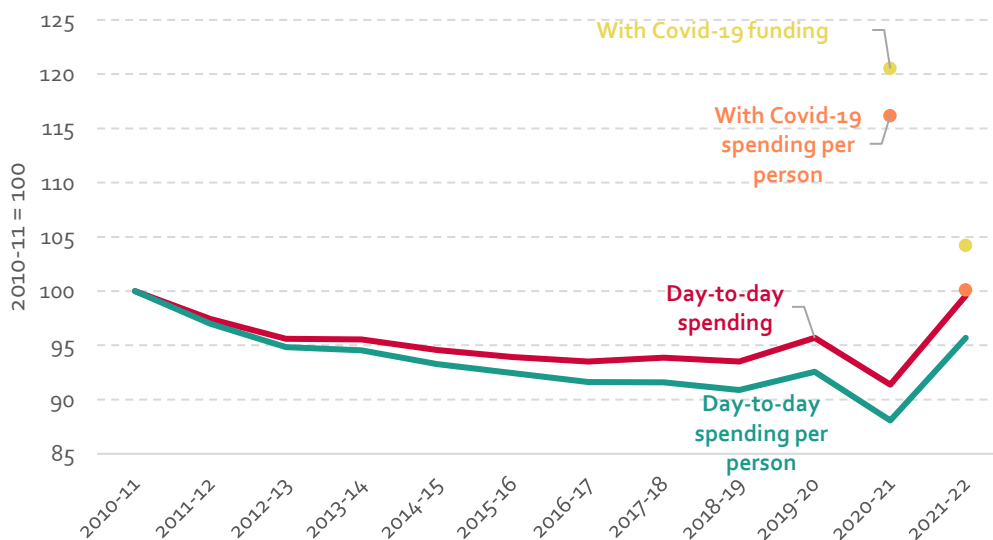
## Implications of the Spending Review on Welsh Government budget

In the face of a grim economic outlook, the Spending Review outlined further details on the government's fiscal response to Covid-19, as well as setting departmental budgets for the forthcoming year.

- The UK government has given the Welsh Government a funding guarantee of £5 billion for the Welsh Government budget in 2020-21, with approximately £3.3 billion of this funding related to additional public service spending in England, and the rest related to business rates support and grants.
- The UK government has allocated £55 billion for Covid-19 related costs on public services in 2021-22. Already allocated funding has triggered £766 million for the Welsh Government in 2021-22. However, uncertainty over the size of the Welsh budget and large in-year revisions are likely to persist next year and beyond.

**Figure E1**

Real terms trends in Welsh Government resource budget, 2010-11 to 2021-22



Source: See Chapter 2.

- The Welsh Government's core, or "business-as-usual", day-to-day block grant will increase by £695 million from 2020-21 to 2021-22, to £13.5 billion. Despite recent growth, on a like-for-like basis, day-to-day spending for the Welsh budget in 2021-22 will still be slightly below pre-austerity levels (**Figure E1**).
- The Chancellor cut back on previously pencilled-in increases in day-to-day spending, by £10 billion in 2021-22, and by £13 billion in 2024-25. These spending plans suggest a bleaker outlook for the Welsh budget over the medium term and set the context for the public sector pay freeze announced for non-NHS staff.
- Meanwhile, the Welsh Government's capital block grant will be cut in nominal terms next year, due to a fall in Financial Transactions funding. Capital funding will remain below its 2009-10 peak, and recent increases are not as significant as those seen in response to the financial crisis of 2009-10.

### Other announcements

- The allocated spending for the UK Shared Prosperity Fund of just £220 million for the whole of the UK next year falls short of expectations. This compares to the £375 million a year allocation Wales received through EU structural funding. For the 2019 Conservative manifesto pledge to be met, Wales will need to receive a quarter of the eventual size of the fund.
- The Statement of Funding Policy published new 'comparability factors' to be used in the Barnett formula, which captures the extent to which UK government departmental spending is devolved. Wales' comparability factor for transport spending has collapsed from 80.9% to 36.6% due to the way HS2 and Network Rail are treated in calculations. We estimate this change could reduce consequentials to the Welsh budget by roughly £500 million from 2021-22 to 2025-26 compared to a reasonable alternative method of calculating the comparability factor.

### Welsh Government's Covid-19 response to date

Since March, the size and composition of the Welsh budget for 2020-21 has changed dramatically, growing by over a quarter relative to Final Budget plans.

- Available funding for the Welsh Government's Covid-19 fiscal response amounts to £5.6 billion, funded mainly by consequentials from the UK government, repurposed funding from the European Union and reprioritised funding from within the budget.
- The Welsh Government has so far allocated £4 billion of this funding in two supplementary budgets. The largest allocations have been made to the Health and Social Services budget (£1.4 billion) and the Economy and Transport budget (£1.5 billion).
- Spending announcements not yet included in supplementary budgets include £320 million Covid-19 Reconstruction Fund and a £340 million increase in support for businesses through the Economic Resilience Fund, to support businesses affected by

tougher restrictions being introduced in December. This suggests Welsh Government support for businesses this year in grants and reliefs will equate to approximately £2 billion.

- Taking recent commitments into account, it seems plausible that around £829 million of the Welsh Government's Covid-19 allocation remains uncommitted at this point.
- Current rules governing the use of the Wales Reserve would restrict the Welsh Government from carrying forward significant amounts of unallocated spending into future years if it wished to do so.

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

On 21 December, the Welsh Government will publish its draft budget for 2020-21, facing significant uncertainties around the size of its budget and spending pressures. Crucial decisions will need to be made around responding to the Covid-19 pandemic and funding public services.

- Available funding from the UK government for Covid-19 related costs in 2021-22 equates to only 14% of the funding available for the Welsh Government's response in 2020-21. If spent exclusively on public services, as per the UK government's spending plans in England, additional public services spending on Covid-19 pressures next year would fall by two-thirds relative to 2020-21.
- Under current plans, a significant portion of Covid-19 related costs will need to be met from within the Welsh Government's own budget next year. Plans also leave no funding to allocate to provide funding for business rates reliefs or grants, at a time other UK-wide economic schemes are also coming to an end.
- As ever, allocations to the NHS next year will have a big impact on funding available for all other services. Matching the NHS share of Covid-19 spending this year, as well as matching the per person increase in NHS spending in England, would mean around £430 million of Covid-19 related funding and a £350 million increase in the core NHS budget. This would mean £340 million of Covid-19 related funding for all other areas of the budget, as well as £590 million for their core budgets.
- Social distancing and infection control will reduce what the NHS can deliver for a given level of funding. There is also a significant backlog of patients who were not treated in the spring, as well as new demand pressures, notably mental health. However, increasing NHS allocations would entail smaller increases in spending for other public services which may not adequately cover the huge demand and cost pressures they too face.

### Outlook beyond 2021-22

Although no firm spending plans have been made by the UK government beyond 2020-21, the indicative spending plans announced by the Chancellor will set the context for the Welsh parliamentary elections next May, and will have implications for the feasibility of manifesto commitments and tax policy options.

- The day-to-day budget is set to increase over the course of the next parliament, with additional consequential in 2022-23 and 2023-24 almost entirely triggered by extra NHS and schools spending commitments in England. However, even by the middle of the next parliamentary term, per person spending will still be lower than 2010-11 levels. If consequential from health spending in England are passed on to the Welsh NHS, this could leave non-NHS day-to-day spending in the Welsh budget still around 8% below pre-austerity levels.
- While debates around UK government fiscal policy will intensify in the aftermath of the Covid-19 pandemic, this austere outlook for the Welsh budget in the face of huge spending pressures should trigger a debate about the future of Welsh public services and devolved tax powers ahead of the election next May.

### Devolved taxes in the Welsh budget

The fiscal framework agreement protects the Welsh Budget from any asymmetric shock to devolved tax revenues, but slower population growth is expected to hit the Welsh Income Tax take next year. Given the austere outlook for the Welsh Budget, it is even more important to bear in mind that increasing the basic rate of devolved Income Tax could allow the Welsh Government to fund higher levels of spending in a progressive manner, or shield poorer households from less progressive elements of the local and reserved tax system.

- The deductions to the Block Grant are expected to exceed revenues from the devolved taxes by around £40 million in 2021–22.
- When expressed as a percentage of income, the effect of any Council Tax increase disproportionately impacts households with lower income levels, whereas an increase in the basic rate of devolved Income Tax would see richer households contribute more, both in absolute terms and as a percentage of their income (**Figure E2**).

**Figure E2**

**Distributional impact on households of a 1p increase in the Welsh basic rate of income tax, 2021–22**



Source: See Chapter 5.

# 1

## Introduction

The Covid-19 pandemic has led to breathtaking levels of additional spending by both the UK and Welsh governments, to support individuals, businesses, and public services through the crisis. Since final budget plans were published in March, public spending and revenues have changed dramatically, with new announcements each month seemingly adding to the size of the fiscal response. This report attempts to take stock and provide some information on and analysis of the Welsh Government's budget in an extraordinary year.

The Spending Review on 25 November finally provided details of the UK government's spending plans; both on the response to Covid-19 and for departmental spending for 2021-22. Amid the focus on record levels of borrowing and a huge hit to the economy, decisions taken last week will have a significant impact on Wales and the Welsh budget.

On 21 December, the Welsh Government will outline its own budget plans for 2021-22, in the face of unprecedented uncertainty. Even the budget outlook for the remainder of 2020-21 still looks up in the air. In recognition of this unpredictability, the Welsh Government has large amounts of funding left unallocated in its current budget plans. Over coming months, crucial decisions will need to be made around spending this year and next that will shape the Welsh Government's fiscal response to the crisis and the future of Welsh public services.

This report proceeds as follows. The following introduction provides an update on the current economic and fiscal context. Section 2 assesses the implications of the Spending Review on the Welsh budget. The Welsh Government's fiscal response to Covid-19 so far, both in published supplementary budgets and in subsequent spending announcements, is outlined in Section 3. Section 4 analyses the outlook for the Welsh Government budget in 2021-22 and beyond, highlighting some of the key budget decisions which will need to be made. Section 5 analyses the latest forecasts for taxes in the Welsh budget and the options for future tax policy.

### **The economic and fiscal context**

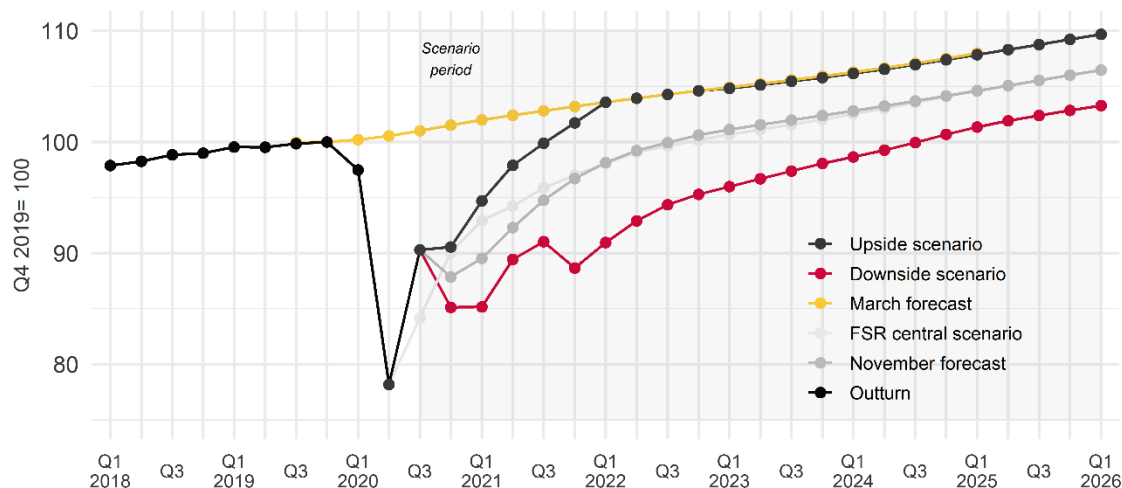
Last week's Spending Review was accompanied by a new set of economic and fiscal forecasts by the Office for Budget Responsibility (OBR). Their Economic and Fiscal Outlook (EFO) report, published twice yearly, was last updated in March 2020, before the UK-wide lockdown was announced. November's edition is the first EFO to incorporate the effects of Covid-19 and the subsequent policy response. Not surprisingly, the pandemic has had a huge impact on public finances.

The UK economy is expected to shrink by 11% this year and recover only about half of that ground next year in the central scenario. Output is expected to remain permanently scarred by 3% at the forecast horizon in 2025-26. This assumes a smooth transition to a free-trade



agreement with the European Union. Failure to agree on a negotiated deal would further reduce output by 2 per cent initially and 1.5 per cent at the forecast horizon. The impact of leaving the European Union with a trade agreement has already been incorporated into previous OBR forecasts.

**Figure 1.1**  
OBR forecasts of UK GDP, 2018 – 2025



Source: Office for Budget Responsibility (March & November 2020) Economic and fiscal outlook; Office for Budget Responsibility (2020) Fiscal Sustainability Report and authors' calculations.

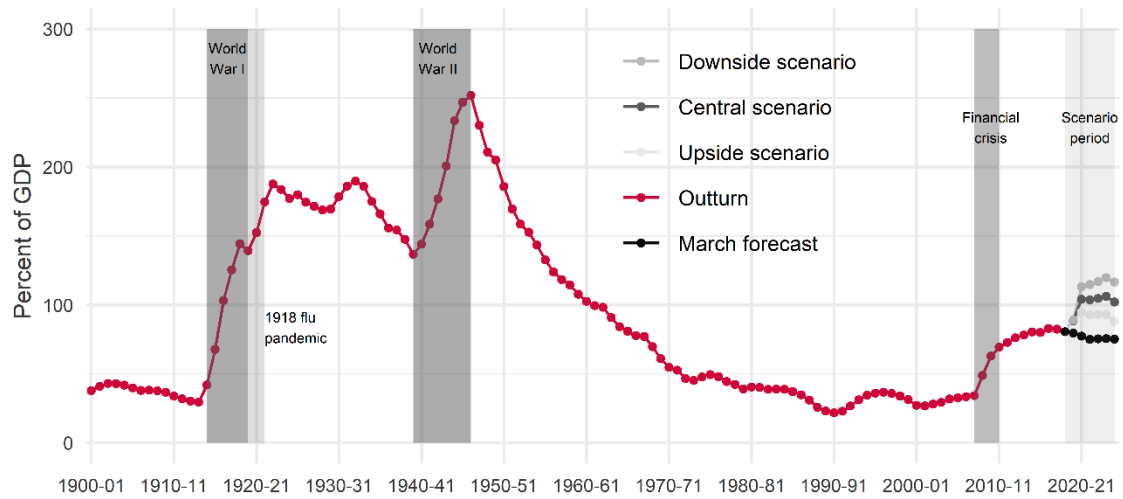
The report paints a gloomy picture of the labour market, with unemployment forecast to reach 7.5% next year, and potentially higher under a 'no deal' outcome from the Brexit negotiations. At a Welsh level, that could mean around 110,000 of the workforce unemployed, much higher than recent years, but still lower than the peak after the last financial crisis. The furlough scheme and other employment support measures appear to have prevented more severe job shedding. But even for those in employment, slower growth in wages and salaries will further squeeze living standards – this already follows a decade of weak earnings growth.

UK government borrowing could reach close to £400 billion (around 20 per cent of GDP), with debt as a percentage of GDP rising through to 2024-25. But the cost of servicing that debt will actually fall because of further reductions in interest rates. And a debt-to-GDP ratio in excess of 100% is still not particularly onerous by historical standards (Figure 1.2).

The fiscal response to the crisis has been equally vast – government spending is set to be £280 billion higher than last year. Nearly £130 billion has been allocated to public services and almost £75 billion on employment support to cushion the financial blow on households and businesses. Receipts are expected to be £57 billion lower compared to last year. While this is partly the result of economic contraction, policy measures, including cuts to VAT, business (non-domestic) rates and property transaction taxes have also impacted tax revenues this year.

**Figure 1.2**

**UK historic debt-to-GDP ratio, and OBR forecast to 2025–26**



Source: Office for Budget Responsibility (March & November 2020) Economic and fiscal outlook; Bank of England; ONS and authors' calculations.

Of course, these numbers are all subject to a margin of uncertainty. The fiscal and economic outlook strongly hinges on the UK and devolved governments' ability to contain the spread the virus and the public health restrictions imposed. Recent news related to the development of vaccines – and the potential beneficial effects on the economy – did not come in time to be incorporated into the OBR forecasts. The continued uncertainty surrounding the UK's future trading relationship with the European Union makes the economic outlook more nebulous still.

# 2 Implications of the Spending Review 2020

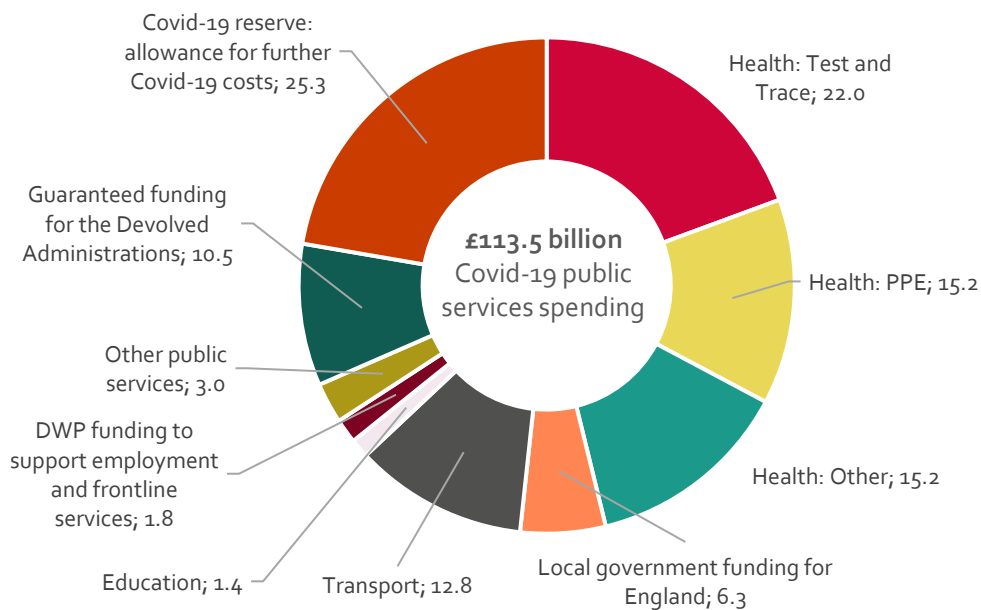
In the face of a grim economic outlook, the Spending Review outlined further details on the UK government's fiscal response to Covid-19, as well as setting departmental budgets for the forthcoming financial year.

This section outlines the UK government's spending plans to deal with Covid-19 and what this will mean for the Welsh Government's budget for this year and for next year. It then analyses the implications of the Spending Review on the Welsh Government's core, or 'business-as-usual', budget over coming years. Finally, this section outlines some of the other major implications for Wales from last week's announcements.

## 2.1 Covid-19 spending and consequential

For the first time, the Spending Review provides a detailed breakdown of the planned additional Covid-19 spending on public services which will take place this year, shown in **Figure 2.1**.

**Figure 2.1**  
UK government Covid-19 spending on public services in 2020-21, £ billion



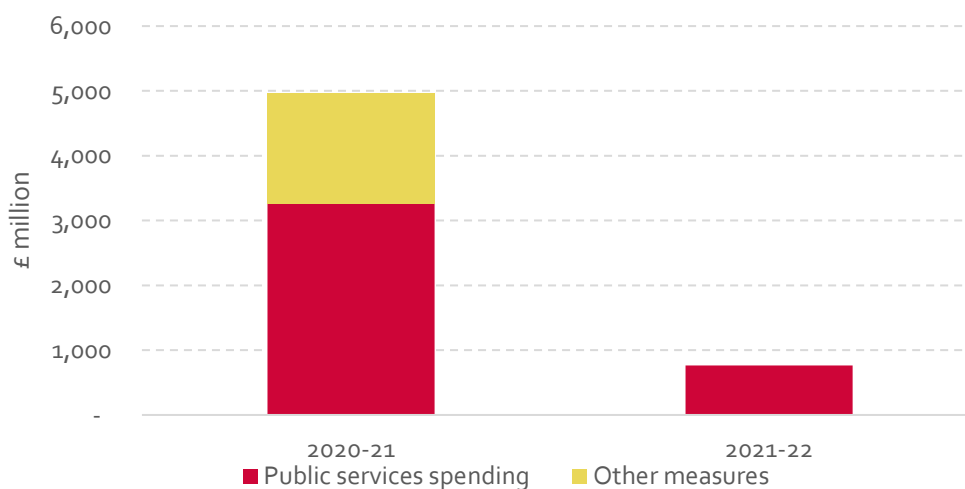
Source: HM Treasury (2020) Spending Review 2020.

Of the £113.5 billion additional public services spending, health related spending makes up the largest part. This includes £22 billion for the Test and Trace system and £15 billion for Personal Protective Equipment (PPE) procurement this year. Support for rail and other transport services amounts to £12.8 billion, while local governments in England have been given an additional £6.3 billion to deal with Covid-19 related spending pressures and loss of incomes.

In July, the UK government gave the devolved governments a funding guarantee, based on total estimated additional spending on services in England in 2020-21. This provided the devolved governments with greater certainty around their budgets for this year, as they would not need to wait for individual spending commitments in England to be approved for the size of their budgets to be increased. This funding guarantee was revised upwards in October and November, to £16 billion between the three nations. £10.5 billion of this funding is related to additional public services spending. As shown in **Figure 2.2**, the funding guarantee amounts to an additional £5 billion for the Welsh Government budget in 2020-21, with approximately £3.3 billion of this funding guarantee related to estimated additional public services spending in England.

**Figure 2.2**

**Covid-19 related consequential for the Welsh budget by source of UK government spending in England**



*Source: HM Treasury (2020) Spending Review 2020; and authors' calculations. Note: Other measures include the cost of Business Rates reliefs and grants in England.*

The Spending Review documents also state that £2 billion of the funding guarantee has not yet been triggered through the Barnett formula. This would imply that approved spending in England would need to rise by an additional £10.6 billion for the funding guarantee to be increased again this year. Such an increase is a possibility, given that the UK government has put aside an additional £25.3 billion for a Covid-19 reserve, to allow for additional costs this year.

The UK government has also allocated an additional £55 billion for Covid-19 related costs on public services next year. This suggests the UK government assumes almost 40% of this year's departmental Covid-19 spending will carry forward into 2020-21. £34 billion of this funding has been allocated to departments, with a further £21 billion in reserve. Already allocated funding has triggered £766 million for the Welsh Government in 2021-22. This is likely to be increased significantly, depending on the composition of additional spending from reserves. A similar share of the funding as that already allocated would mean an additional £660 million for the Welsh government budget.

One area of UK government spending which may increase the size of the Welsh budget next year is Business Rates grants and reliefs. Current plans assume that the substantial support to businesses provided this year will not continue beyond March 2021. The Spending Review notes the UK government will outline its plans for 2021-22 reliefs in the New Year, which will result in additional consequentials for Wales if reliefs continue.

The Spending Review claims to provide 'the devolved administrations with the certainty they need to set their budgets for 2021-22'. However, the uncertainty over the size of the Welsh Government's budget and the large in-year revisions to funding totals are likely to persist next year and beyond.

Although the Spending Review provides greater clarity on Covid-19 related public services spending, it is not possible to exactly determine which spending programmes in England have resulted in additional consequentials for Wales. This is because some areas of additional spending, such as on vaccine procurement and a portion of the Test and Trace programme will be UK-wide and will not result in additional consequentials. The extent of such UK-wide spending programmes has not been published. This complicates comparisons between the Welsh Government's Covid-19 response with that of the UK government.

## 2.2 'Core', or business-as-usual, spending plans

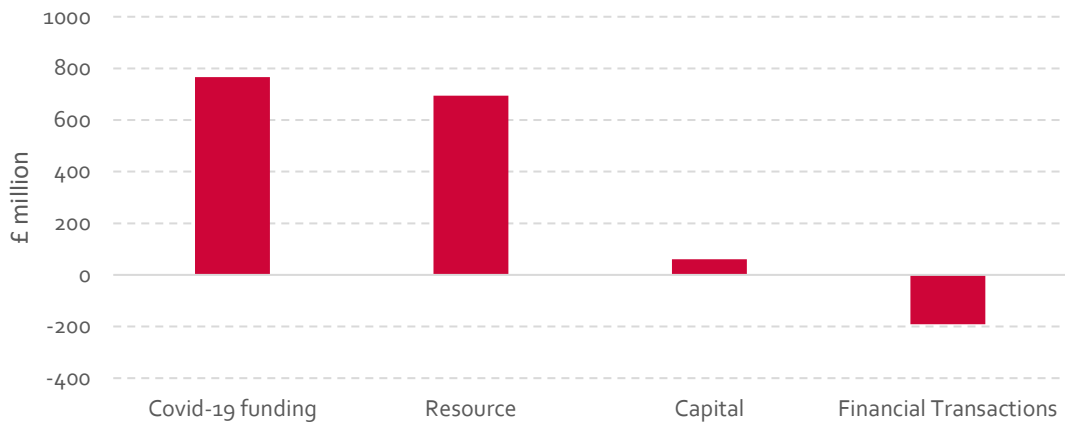
The headline announcement for consequentials for the Welsh budget from the Spending Review was of an additional £1.3 billion. As discussed above, £766 million related to additional Covid-19 spending, while core block grant funding will increase by £560 million.

A more detailed breakdown of consequentials, shown in **Figure 2.3**, reveals the resource (day-to-day spending) block grant will increase by £694 million from 2020-21 to 2021-22, to £13.5 billion. This implies real terms increases of approximately 4% per year in the resource block grant from 2019-20 to 2021-22, and for the first time, core day-to-day spending by the Welsh Government will be above 2010-11 levels in real terms. However, part of the increase in the block grant is due to funding for direct payments for farm subsidies being included in the block grant for the first time, and recent increases in funding have also been counterbalanced by the increased cost of public sector pensions since 2019-20. **Figure 2.4** shows the real terms trend in the core resource budget from 2010-11 onwards, adjusted for these two factors. On a like-for-like basis, and excluding Covid-19 funding, day-to-day spending for the Welsh budget will still

be slightly below pre-austerity levels in 2021-22. On a per person basis, it will remain 4% below 2010-11 levels.

**Figure 2.3**

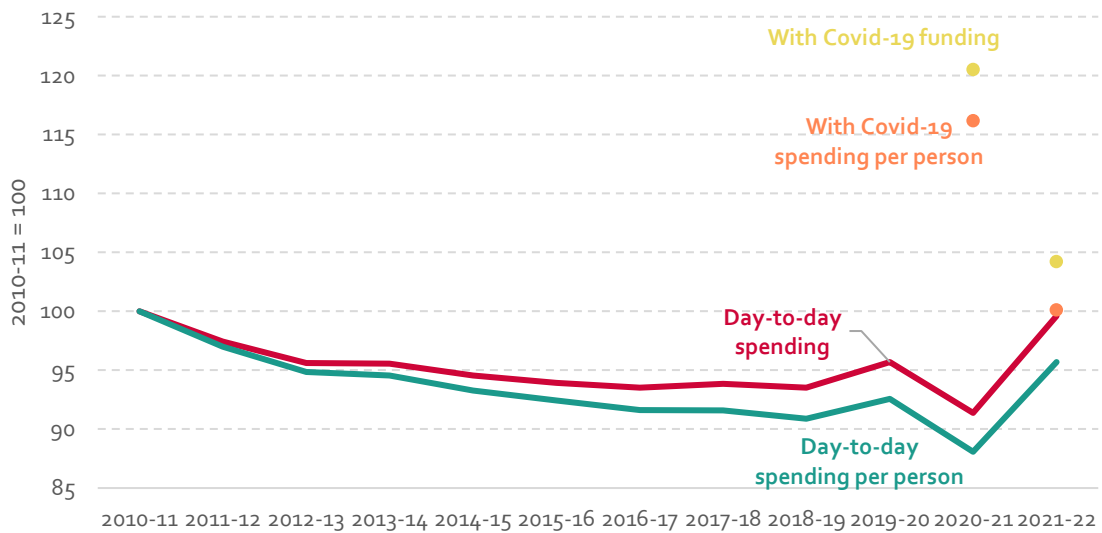
**Consequential for the Welsh Government budget in 2021-22, by type of funding**



Source: HM Treasury (2020) and authors' calculations from available information

**Figure 2.4**

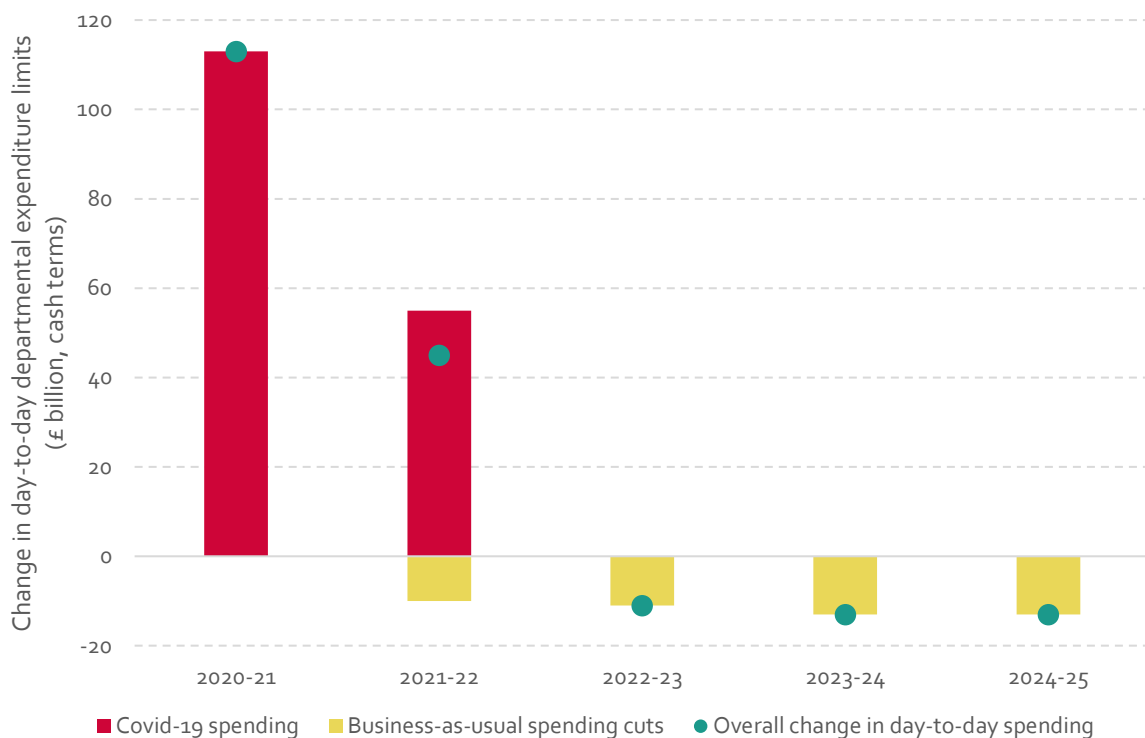
**Real terms trends in Welsh Government resource budget, 2010-11 to 2021-22**



Source: HM Treasury (2020) Block Grant Transparency data; HM Treasury (2020 and previous) Public Expenditure Statistical Analyses; and authors' calculations. Note: Figures relate to core resource DEL excluding depreciation, adjusted for the devolution of taxes, funding for farm subsidies not previously counted in RDEL from 2020-21, and increased public sector pension contributions from 2019-20 onwards. Excludes the effect of non-allocated spending or funding drawn down from the Wales Reserve

The Chancellor also revealed indicative plans for total UK government departmental spending for years beyond 2021-22. Despite increasing allocations for Covid-19 spending next year, pencilled-in increases in day-to-day spending on public services were cut back, by £10 billion in 2020-21, and by £13 billion in 2024-25, as shown in **Figure 2.5**. This leaves less room for growth in areas not subjected to existing multi-year spending plans or commitments, such as the NHS and schools spending in England. The Chancellor’s plans also assume no Covid-19 related pressures beyond 2021-22. Furthermore, there were no increases to pre-Covid-19 multi-year spending plans for the NHS and schools in England, despite the obvious increasing demands which will be placed on these services over coming years. Unless revised, these spending plans suggest a bleaker outlook for the Welsh budget over the medium term and may possibly mean a return to austerity for some areas of the budgets (as discussed in section 4.2). The reductions in planned spending on public services also set the context for the public sector pay freeze announced for non-NHS workers (discussed in section 4.1).

**Figure 2.5**  
Changes in UK government plans for day-to-day spending on public services from March 2020 Budget plans



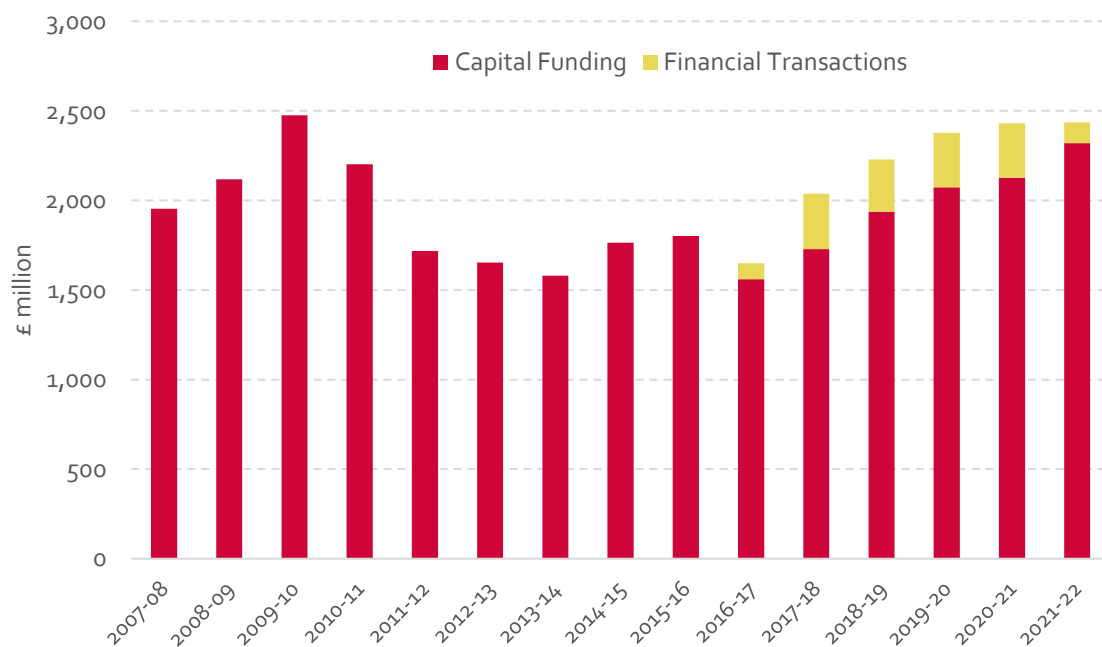
Source: Authors’ calculations using HM Treasury Budget 2020, HM Treasury Spending Review 2020, and OBR Economic and Fiscal Outlook November 2020

Meanwhile, the overall Welsh Government capital block grant will be cut in nominal terms next year. As shown in **Figure 2.3**, this is because capital funding is set to grow by only £60 million next year, while Financial Transactions funding will fall by £191 million. This means the Welsh

Government’s capital funding will increase by only 2% in real terms from 2019-20 to 2021-22. This is despite the UK government’s total capital DEL growing from £70.4 billion to £99.8 billion over the same period. Part of this discrepancy is explained by a ‘reprofiling’ of Barnett consequentials – a £100 million cut to the Welsh budget was delayed from 2019-20 to 2020-21. After correcting for this adjustment to the ‘baseline’, capital funding will grow from 7% in real terms from 2019-20 to 2021-22. **Figure 2.6** shows the path of the capital block grant from 2007-08 onwards. Capital funding in 2021-22 will remain below its 2009-10 peak, and recent increases are not as significant as those seen in response to the financial crisis of 2009-10.

**Figure 2.6**

The Welsh Government’s overall capital block grant, 2007-08 to 2021-22



Source: HM Treasury (2020) Block Grant Transparency data; HM Treasury (2020) Public Expenditure Statistical Analyses; HM Treasury (2020) Spending Review 2020; and authors’ calculations

### 2.3 Other announcements

The Spending Review 2020 also outlined some new details about the UK Shared Prosperity Fund, set to replace EU structural funding from next year. However, the allocated spending next year falls short of expectations – funding for the whole of the UK in 2021-22 amounts to just £220 million to support local areas to ‘pilot’ new approaches. The Spending Review commits to ‘ramping up’ the size of the fund to an average of £1.5 billion in future years. While this amount would eventually match average EU funding receipts from structural funding, it would still fall short of actual allocations, as well as match funding the UK government would have provided



in the past. Moreover, the Conservative Party 2019 manifesto promised to “at a minimum match the size of [EU] funds in each nation”. Rather implausibly, meeting this commitment would entail Wales receiving a quarter of all funding from the fund when it eventually reaches its full budget. Questions also remain about the administration of the fund, and the role of devolved governments, whose competences include such spending. The Spending Review however notes that the fund will operate UK-wide, under the powers contained in the UK Internal Market Bill.

The National Infrastructure Strategy, published alongside the Spending Review, also proposes to increase the UK government’s ability to invest directly in Scotland, Wales, and Northern Ireland through the UK Internal Market Bill. Details on the nature and size of funding this would entail are not clear. It should be noted that the UK government’s record of investing in Wales under the areas already in its competence is poor – Wales has received much less than a population share in capital rail transport spending and science and technology spending. On this note, the UK government has undertaken a review of the Treasury’s Green Book, which gives guidance on best-practice appraisals for infrastructure projects, though it is again unclear how this will affect future infrastructure plans.

The Spending Review also allocated £240 million for Wales (above Barnett allocations) to replace the EU Common Agricultural funding in 2021-22. The UK government claims this allocation matches the size of previous support provided by the EU. However, this appears to be the case only when including unspent funding available under the EU’s programmes from previous years, which can be carried forward future years. This has led to claims of underfunding from unions and devolved governments relative to manifesto commitments. Furthermore, there is a lack of certainty over future funding when residual EU funding from previous years will be unavailable, and for overall funding after the end of this parliament.

This lack of certainty also extends to other areas of UK government spending plans. For example, the Levelling Up Fund for England is provisioned for in reserves, and therefore the Barnett consequential which may flow to Wales are unknown. The Chancellor also did not take the opportunity to clarify plans around other areas of spending, such as on social security (although not usually covered by Spending Reviews). **Current plans involve ending the temporary increase in Universal Credit from April next year. Unless this cut is reversed, this could leave over a third of non-pensioner Welsh households more than £1,000 a year worse off from next April and cut social security spending in Wales by around £250 million.**<sup>1</sup>

## 2.4 Changes to the Statement of Funding Policy

Accompanying Spending Reviews, the Treasury also publish a Statement of Funding Policy.<sup>2</sup> These technical documents set out the policies and procedures which govern the UK government’s funding for the devolved governments. This year’s publication is notable since

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<sup>1</sup> Wales Fiscal Analysis will be publishing further analysis of the impact on Welsh households next month.

<sup>2</sup>[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/938410/Statement\\_of\\_Funding\\_Policy\\_2020.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/938410/Statement_of_Funding_Policy_2020.pdf)

the last update was provided in 2015, before significant changes in the fiscal frameworks of both Wales and Scotland. The Statement of Funding Policy was an opportunity to revisit some of the rules governing the use of current borrowing powers and the Wales Reserve, to reflect the additional uncertainty the Welsh budget faces this year and is likely to face over future years. However, despite the huge change in circumstances over recent years, restrictions and limits agreed at the Fiscal Framework negotiations of 2016 will continue to apply.

**Figure 2.7**

Comparability factors used at Spending Round 2019 and Spending Review 2020

	2019 Spending Round	2020 Spending Review
Business, Energy and Industrial Strategy	10.5%	6.5%
Business Rates	100.0%	100.0%
Cabinet Office	6.5%	0.0%
MHCLG: Housing and Communities	99.7%	99.6%
MHCLG: Local Government	100.0%	100.0%
Digital, Culture, Media, and Sport	76.9%	67.7%
Environment, Food and Rural Affairs	99.0%	96.9%
Education	100.0%	100.0%
Transport	80.9%	36.6%
Network Rail	0.0%	(included in Transport DEL)
Health and Social Care	99.4%	99.5%
Work and Pensions	1.4%	0.0%
HM Revenue and Customs	0.0%	4.0%
HM Treasury	0.0%	0.0%
Home Office	0.0%	1.7%
Law Officers' Departments	0.0%	0.0%
Justice	0.0%	1.3%

*Source: HM Treasury (2019) Spending Review; HM Treasury (2020) Statement of Funding Policy.*

The Statement of Funding Policy also included updated departmental 'comparability factors' – these capture the extent to which services delivered by UK government departments correspond to services delivered by devolved governments in Scotland, Wales and Northern Ireland. These range from 0% where services are provided by the UK government, to 100% where services are provided by devolved governments.

As shown in **Figure 2.7**, the Welsh Government's comparability factor for the Department for Transport has fallen sharply from 80.9% in 2015 to 36.6% in 2020, meaning for every increase in the department's budget, a smaller share will now be passed on to the Welsh Government

budget. This is a result of two factors. Firstly, the HS2 project has again been classed as an 'England and Wales' project and therefore attracts a 0% programme-level comparability factor. From 2015, the annual budget for HS2 has increased from £0.8 billion to over £5 billion, which means the departmental comparability factor – a weighted average of spending over all programmes – has fallen sharply. Secondly, following Network Rail's recent classification as a part of central government, its spending has been included in the Department for Transport's budget for the first time. In calculating Barnett comparability factors, all Network Rail spending is included in the baseline Transport DEL in the case of Wales and Northern Ireland, but not in Scotland's, where both governments have agreed a funding arrangement outside of the Barnett formula. Because Network Rail spending is classed as non-devolved for Wales, its inclusion in the Department for Transport's baseline further reduces Wales' overall transport comparability factor.

To assess the impact of this fall in the comparability factors on the Welsh budget, we explore two alternative options which could have been applied: a) a 100% programme comparability factor for HS2, essentially re-classifying it as an 'England only' project, similar to other rail infrastructure projects in the past, such as Crossrail; and b) a 100% comparability factor for HS2 and treating Network Rail outside of the Department for Transport's DEL, as was previously the case, and how it's treated in the Barnett formula with respect to Scotland.

We do not yet have details of Department for Transport spending beyond 2021-22, but we have overall spending plans for the UK government to 2025-26, as well as significant multi-year capital spending plans for particular projects. We assume Department for Transport spending not subject to multi-year plans grows in line with overall UK government capital spending. **Figure 2.8** provides our estimate of the consequentials which would be passed on to the Welsh budget from Department for Transport spending in this scenario. These estimates should be viewed as broad estimates only, given the uncertainty around future spending growth. As we assume increases to the Department for Transport budget, using different comparability factors changes the amount of consequentials passed on to the Welsh budget. The difference between our alternative option a) and the Spending Review 2020 assumption amounts to £204 million of consequentials over the years 2021-22 to 2025-26. We project the Welsh budget would receive around £505 million more over these years if alternative option b) was used.

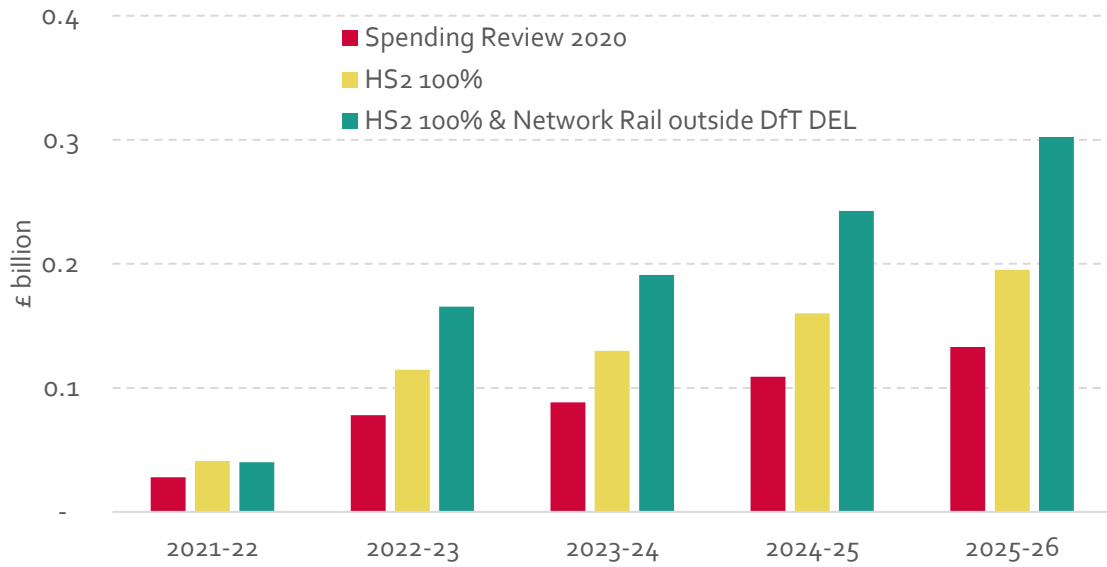
Of course, the UK government will spend additional funding on Welsh rail infrastructure over these years in the absence of rail devolution and these additional Barnett consequentials. However, Welsh Government analysis has convincingly demonstrated the historic underfunding of Wales' rail infrastructure by the UK government, relative to a population share or a share of the rail network.<sup>3</sup> Changing the way rail infrastructure is treated in the Barnett formula would have been a way of addressing this underfunding, allowing the Welsh Government to invest significant funding from its own budget into rail infrastructure, as has it has done in the past.

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<sup>3</sup> Available here: <https://gov.wales/historical-investment-rail-infrastructure-enhancements-html>

**Figure 2.8**

Illustrative impact of varying comparability factors used for Department for Transport spending through Barnett formula, 2021-22 to 2025-26



Source: HM Treasury (2020) Spending Review 2020 and authors' assumptions and calculations

# 3 The Welsh Government fiscal response to Covid-19: an update

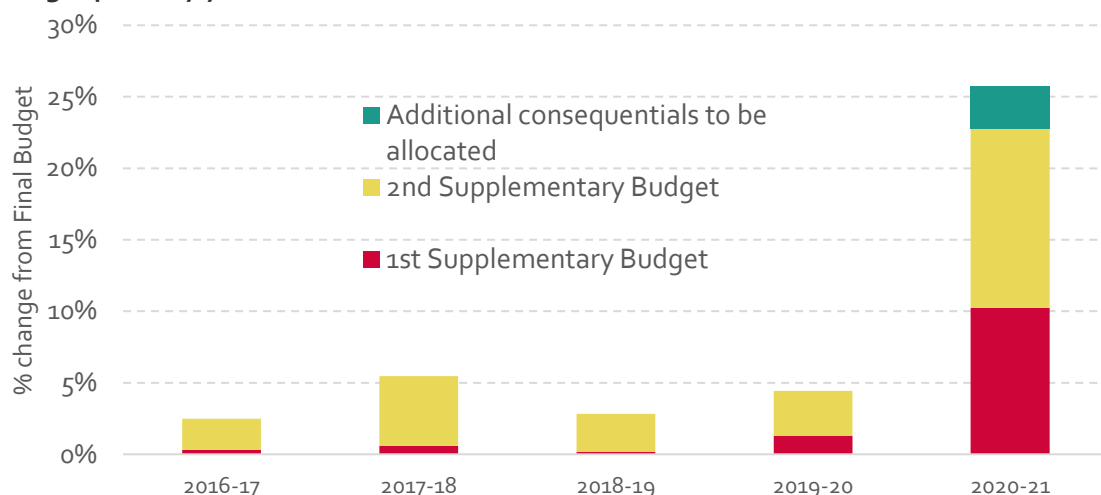
Since the Welsh Government published its Final Budget for 2020-21 in March 2020, the size and composition of the budget has changed dramatically. This section analyses the fiscal policy announcements made by the Welsh Government in response to the Covid-19 pandemic. Firstly, we analyse the spending allocations made at the 1<sup>st</sup> and 2<sup>nd</sup> supplementary budgets (published in May and October respectively). Secondly, we look at further spending announcements to be made before the end of the financial year, alongside the options and uncertainties facing the Welsh Government.

## 3.1 The Covid-19 fiscal response to date

The first and second supplementary budgets included unprecedented revisions to Final Budget plans. As shown in **Figure 3.1**, the Welsh Government budget for 2020-21 had almost grown by a quarter by the time of the Second Supplementary Budget. Additional consequentials announced by the UK government (shown in green) mean significant further allocations will need to be made at a third supplementary budget before April 2021.

**Figure 3.1**

Changes to Welsh Government funding made at supplementary budgets as share of Final Budget plans by year



Source: Welsh Government budget documents (2020 and earlier) and authors' calculations

**Figure 3.2** shows resource funding changes to the Welsh Government’s resource budget since the Final Budget. The largest funding change has been the large amounts of Covid-19 response funding consequentials announced by the UK government, amounting to £5 billion in 2020-21 (as discussed in section 3). Revisions to forecast devolved tax revenues have largely been cancelled out by projected falls in Block Grant Adjustments (see section 5 for further discussion). Meanwhile, the Welsh Government reprioritised £256 million from existing spending plans to fund its Covid-19 response. This included £114 million from the Health and Social Services MEG, £50 million from Economy and Transport, and £46 million from education. In addition, £245 million was repurposed from European Union funding this year.

### Figure 3.2

#### Funding the Welsh Government fiscal response to Covid-19, 2020-21

Funding sources in Welsh Government Supplementary Budgets				
	£ million			
	1SB	2SB	post-2SB	Total
UK March 2020 Budget consequentials	123			123
Covid-19 response funding consequentials	1,856	2,531	600	4,987
Other consequentials and adjustments	43			43
Changes in devolved tax revenues	-27	-122		-149
Changes in Block Grant Adjustment	29	128		157
Repurposed EU funding	245			245
Reprioritised funding from within budget	256			256
<b>Total amount to be allocated</b>	<b>2,526</b>	<b>2,536</b>	<b>600</b>	<b>5,662</b>

*Source: Welsh Government 1<sup>st</sup> Supplementary Budget 2020-21 (2020); Welsh Government 2<sup>nd</sup> Supplementary Budget 2020-21 (2020); and authors’ calculations. Note: Refers to fiscal resource DEL by Main Expenditure Group; £332 million NDR reliefs shows separately from Housing and Local Government. Figures gross of reprioritised funding within each MEG. Unallocated funding refers to total unallocated fiscal resource funding included in the budget (not only additions to unallocated funding). Tax revenue and BGAs not updated for latest OBR forecasts.*

From this available funding, the Welsh Government has allocated £4 billion to its Covid-19 response thus far in 2020-21. **Figure 3.3** shows the resource (day-to-day) spending allocations made by the Welsh Government in response to the pandemic. The largest allocations have been made to the Economy and Transport and Health and Social Services budget.

### Health and Social Services

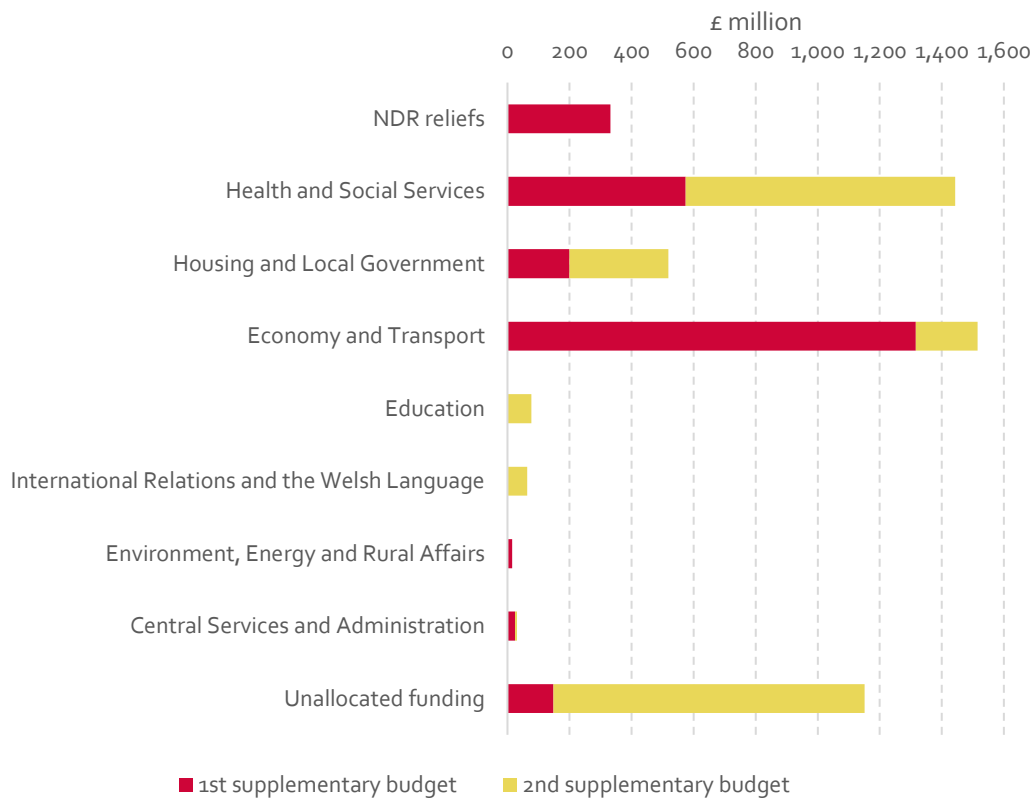
It is unsurprising a large part of the Welsh Government’s fiscal response has been to increase the Health and Social Services portfolio, with £1.44 billion of fiscal resource spending being allocated at the 1<sup>st</sup> and 2<sup>nd</sup> supplementary budgets. After accounting for some of the reprioritised funding found within the budget, this is a 17% increase in spending since Final

Budget plans, which brings the total fiscal resource DEL for Health and Social Services to £9.53 billion.

The 1<sup>st</sup> Supplementary Budget contained several large allocations for the immediate response to the crisis, primarily to increase capacity of the health service. £166 million was allocated to the opening of field hospitals, while £30 million was allocated for the use of private hospitals. £91 million was allocated to increase staff resources, to facilitate the use of healthcare students and those returning to service. Meanwhile, £100 million was allocated to provide Personal Protective Equipment (PPE) and a further £21.3 million for the procurement of equipment and consumables.

**Figure 3.3**

**The Welsh Government Covid-19 fiscal response by Main Expenditure Group**



Source: Welsh Government 1<sup>st</sup> Supplementary Budget 2020-21 (2020); Welsh Government 2<sup>nd</sup> Supplementary Budget 2020-21 (2020); and authors' calculations. Note: Refers to fiscal resource DEL by Main Expenditure Group; £332 million NDR reliefs shows separately from Housing and Local Government. Figures gross of reprioritised funding within each MEG. Unallocated funding refers to total unallocated fiscal resource funding included in the budget (not only additions to unallocated funding).

The 1<sup>st</sup> Supplementary Budget also allocated £57 million for the Welsh Government's Test, Trace, Protect (TTP) strategy. A further £45 million was made available to health boards and local authorities to cover the contact tracing workforce at the 2<sup>nd</sup> Supplementary Budget, while

a further £15.7 million has since been announced to increase contact tracing staff in Wales to 3,100.<sup>4</sup> This brings total announced spending on the Welsh Government's TTP strategy to £118 million. This is significantly less per person than the UK Government's Test and Trace system in England, which is now budgeted at £22 billion this financial year, though some of this will be UK-wide spending.<sup>5</sup>

The largest allocation made in the second Supplementary Budget was the £800 million NHS stabilisation package, to deal with the potential second wave of the virus alongside normal winter pressures.<sup>6</sup> Although details of this spending package are unknown, spending areas will include PPE procurement and health board winter plans, including additional capacity.<sup>7</sup> This funding also includes funding for the flu vaccine programme. The budget also included £33 million for a new Cardiff and Vale Covid-19 facility, following the decommissioning of the Dragon's Heart Hospital.

### Economy and Transport

The largest part of the Welsh Government's fiscal response to Covid-19 has been the increase to the Economy and Transport budget to support businesses and public transport. The fiscal resource budget has grown by 271% compared to Final Budget plans, to over £2 billion.

Allocations made at the 1<sup>st</sup> Supplementary Budget included £623 million for grants of £10,000 for small businesses, as well as £214 million for grants to retail, leisure, and hospitality businesses with rateable values of up to £51,000. In addition, the £400 million was allocated to the Economic Resilience Fund (ERF) to provide grants to businesses. Alongside £100 million of loans through the Development Bank of Wales, and £332 million in Non-Domestic Rates relief, allocated support for the economy amounted to £1.7 billion.

From these budget allocations, data published by the Welsh Government in September suggested local authorities had processed £771 million in business grants, while phase 1 and 2 of the ERF had awarded £124 million and £58 million to micro businesses and SMEs respectively. Meanwhile, the Second Supplementary Budget reallocated £39.7 million from the ERF to other areas of the budget, mainly within the Economy and Transport budget.

The third phase of the Economic Resilience Fund entailed £300 million being made available for businesses in response to the firebreak lockdown announcement, including £100 million for Business Development Grants and almost £200 million for the Lockdown Business Fund. This third phase funding had distributed £43.7 million as of 10 November.<sup>8</sup> Given the size of the funding distributed or now available to businesses, and the further funding for businesses

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<sup>4</sup> <https://gov.wales/extra-ps157m-increase-contact-tracing-workforce-wales>

<sup>5</sup> [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/937529/COVID-19\\_Winter\\_Plan.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/937529/COVID-19_Winter_Plan.pdf)

<sup>6</sup> <https://gov.wales/ministers-announce-800m-stabilisation-package-welsh-nhs>

<sup>7</sup> <https://senedd.wales/laid%20documents/cr-ld13704/cr-ld13704-e.pdf>

<sup>8</sup> <https://gov.wales/summary-data-about-coronavirus-covid-19-and-response-it-12-november-2020-html#section-55444>



announced on 30 November (discussed in section 3.2), further business support will be confirmed at a future supplementary budget.

Allocations for transport included an initial £40 million to Transport for Wales to support the continued operation and maintenance of train services. This was followed by £113 million in the 2<sup>nd</sup> Supplementary Budget to continue with the emergency management arrangements, taking allocated additional support for train services to £153 million. An additional £95 million has been allocated towards bus services, alongside other interventions funded from within existing budgets.

### **Housing and Local Government**

The pandemic has had huge impacts on Welsh local authority budgets, with surging cost and demand pressures for local services coinciding with lost income from services such as car parks, leisure centres and cultural services. In the first six months of 2020-21, surveys of local authorities estimated financial costs of around £325 million due to the pandemic, comprised of a £160 million loss of income and £165 million of additional expenditure.<sup>9</sup>

In response to these pressures, the 1<sup>st</sup> Supplementary Budget allocated £189 million through the Local Government Emergency Financial Assistance fund. This was increased by a further £264 million at the 2<sup>nd</sup> Supplementary Budget, alongside a further £27.4 million for the adult social care sector and a further £15 million for the general element of the fund. This brings additional support for local authority budgets to around £495 million for 2020-21. This increase equates to 11% of Aggregate External Finance set at the Financial Local Government Settlement in February.

Based on the first six months of the pandemic, the additional funding would appear broadly commensurate with the full-year financial challenges facing local governments. However, the outlook for demands on local services and income loss for coming months remains highly uncertain, and potential future periods of restrictions will further affect budgets.

The Welsh Government also allocated a further £9.5 million (on top of funding provided through the Local Government fund), as part of its Phase 2 Homelessness plan.<sup>10</sup> The Welsh Government also increased the size of the Discretionary Assistance Fund, which provides emergency crisis payments, by £11.2 million in the 1<sup>st</sup> Supplementary Budget. This fund was again increased by a further £5 million after the 'Firebreak' lockdown announcement.<sup>11</sup>

### **Other spending allocations**

The 2<sup>nd</sup> Supplementary Budget included £27 million for higher education institutions and £24 million for further education and sixth forms. Funding for these areas have since been increased (see section 3.2). £16.8 million has been allocated under the plan to 'recruit, recover and raise

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<sup>9</sup> <https://www.audit.wales/system/files/publications/Financial%20Sustainability%20of%20LG-english.pdf>

<sup>10</sup> <https://gov.wales/written-statement-phase-2-homelessness-update>

<sup>11</sup> <https://gov.wales/extra-10-million-package-help-protect-jobs-and-those-struggling-financially>

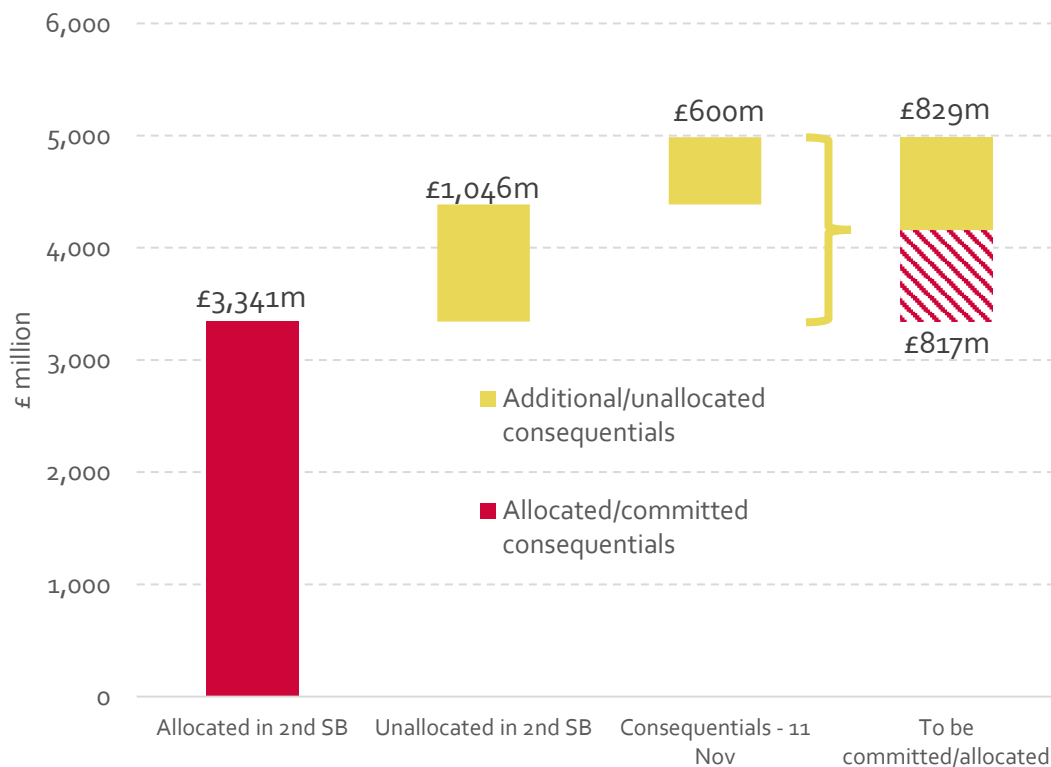
standards' in Welsh schools. Elsewhere in the budget, the Cultural Recovery Fund has been allocated £53 million (since increased by £10.7 million), while £14 million has been allocated to the Sport and Leisure Recovery Fund. The Welsh Government also allocated £24 million for the Third Sector Covid-19 Response Fund to support voluntary sector organisations.

### 3.2 Outlook for the remainder of 2020-21

Despite the huge increases in spending allocations made to date, a striking element of the Welsh Government's 2<sup>nd</sup> Supplementary Budget for 2020-21, published in October, was the large amount of unallocated fiscal resource spending. This is spending the Welsh Government will be able to allocate at later points in the financial year. **Figure 3.3** provides an illustration of the £5 billion Covid-19 funding guarantee the Welsh Government has received from the UK government (as discussed in section 3) and how much has been allocated.

**Figure 3.4**

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



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

Approximately £3.3 billion had been allocated to the Welsh Government's Covid-19 response at the point of the 2<sup>nd</sup> Supplementary Budget, with other measures being funded by consequential from the March 2020 budget and funding from within its own budget. Unallocated Covid-19 consequential (£1,046 million) combined with pre-existing unallocated spending in Final Budget plans means there was £1,151 million of unallocated fiscal resource spending in the 2<sup>nd</sup> Supplementary Budget. Since its publication, the funding guarantee from the UK government has grown by a further £600 million. As shown in **Figure 3.3**, this means there will be approximately £1,650 million of the Covid-19 funding guarantee to allocate in supplementary budgets before the end of the financial year.

The Welsh Government has itself made a series of policy announcements since October, not yet outlined in detail in supplementary budgets. These include:

- **6 October:** £320 million for Covid-19 Reconstruction package
  - £60 million for council and social housing
  - £15 million for further education
  - £9.5 million catch-up funding (years 11, 12 and 13)
  - £14 million decarbonisation
- **20 October:** Economic Resilience Fund third phase announcements – estimated £60 million on top of original budget allocations
- **22 October:** £10 million support for university students
- **23 October:** £12.5 million support for vulnerable families and children during pandemic
- **30 October:** £32 million Self-Isolation payment schemes
- **11 November:** £10.7 million addition to Cultural Recovery Fund
- **13 November:** further £15.7 million for contact tracing workforce
- Smaller allocations to mental health services and fund for carers (≈£4 million)
- **30 November:** £340 million increase in support for businesses through the Economic Resilience Fund<sup>12</sup>

The largest and most recent announcement was for further support for Welsh businesses in response to new coronavirus rules on 30 November. A £160 million Restrictions Business Fund will deliver grants of up to £5,000 to eligible businesses in the hospitality, tourism and leisure sectors which pay non-domestic rates, delivered through local authorities. A £180 million sector-specific Economic Resilience Fund grant scheme will provide grants to hospitality, tourism, and leisure businesses, through Business Wales. Grants will depend on employee numbers, with eligible small and medium-sized businesses receiving up to £100,000, and larger Welsh-based businesses receiving up to a maximum of £150,000. If this funding is entirely additional, it would mean Welsh Government support for businesses this year in grants and reliefs will now equate to approximately £2 billion.

These additional spending commitments combined amount to approximately £817 million (shown by the striped, red bar in **Figure 3.4**). However, it is not possible to determine whether all these funding announcements are additional funding or if they will be funded from within

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<sup>12</sup> <https://gov.wales/340m-support-welsh-businesses-new-coronavirus-rules-announced>

existing budget allocations. Furthermore, the breakdown between resource and capital spending for some announcements are unknown (e.g. Covid-19 Reconstruction package) and some costings included above are our own estimates based on available information.

Taking recent announcements into account, it seems possible that around £829 million of the Welsh Government's Covid-19 allocation remains uncommitted by the Welsh Government at this point, though there is significant uncertainty around this number. Another £105 million of funding was already unallocated in Final Budget plans from March. When publishing its Draft Budget for 2021-22, the Welsh Government should set out its spending commitments for 2020-21, or scrutiny of its plans may be impeded.

The size of the uncommitted funding in the Welsh budget partly reflects the late revisions to the UK government's funding guarantee given to the Welsh Government. It also reflects the unprecedented uncertainties the Welsh Government faces in planning its budget this year.

As shown in **Figure 3.1**, even in 'normal' years, it is not uncommon for around 2%-5% of the budget to be unallocated until the usual 2nd Supplementary Budget in February. This year, the cost and demand pressures for public services over the remaining months of the financial year are even more uncertain. Pressures will depend on several factors, from the severity of future waves of Covid-19, the potential roll out of a vaccine over coming months, alongside recurring winter pressures on services. The economic context and the need for further support for businesses this year is also highly uncertain. Future periods of tight restrictions would need to coincide with more grant funding for affected businesses.

Adding to this uncertainty is the looming end of the transition period with the European Union. The Welsh Government's EU Transition Fund announced in 2018 amounted to £50 million to prepare private, public and third sector organisations for the impacts of Brexit. A 'no-deal' outcome could have significant budgetary implications for the Welsh Government, on top of the economic impact.

Amplifying the uncertain outlook for the Welsh budget are the largely inflexible budgetary arrangements currently in place. While some unexpected increases in demand pressures may be covered by late increases to consequentials, the Welsh Government will be unable to borrow to cover overspending in this financial year. This means the Welsh Government may need to keep back unallocated funding in response to these uncertainties. This also impairs the Welsh Government's ability to make 'open-ended' spending commitments, such as the commitments made by the UK government to businesses in England, with grants depending on the extent of restrictions in place over coming months, and to Transport for London, whose central government support will depend on passenger number levels.

There are also restrictions on the Welsh Government's use of the Wales Reserve, which were agreed as part of the 2016 Fiscal Framework agreement. Figure 3.5 shows the evolution of amounts held in the Wales Reserve at the beginning of each financial year, by different type of funding. The Welsh Government has drawn down the maximum annual amount of resource funding (£125 million) in its budget plans for this year. This would mean it will be restricted from

accessing £107 million of resource funding from the reserve should it wish to use all remaining amounts.

### Figure 3.5

Funding in Wales Reserve by year, 2018-19 to 2020-21

Amounts at start of each financial year			
	£ million		
	2018-19	2019-20	2020-21
Resource	270	304	232
Traditional Capital	53	8	39
Financial Transactions Capital	1	14	66
<b>Total</b>	<b>325</b>	<b>326</b>	<b>337</b>

Source: Welsh Government (2020) Evidence Paper for Finance Committee Inquiry into the Implementation of the Wales Act 2014, Available from:

<https://business.senedd.wales/documents/s104646/FFWA%2005%20Welsh%20Government.pdf>

Note: Figures for starting position in 2020-21 are provisional only.

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

# 4 Outlook for the Welsh Government Budget for 2021-22 and beyond

If budget plans for the remainder of 2020-21 are still uncertain, the outlook for the Welsh Government budget in 2021-22 is even less foreseeable. On 21 December, Finance Minister Rebecca Evans will publish a budget with arguably less information about the likely size of the Welsh budget, as well as eventual spending pressures, than ever before. Nevertheless, crucial decisions will need to be made. How should costs related to Covid-19 be met next year? Which investments should be made to boost the recovery in the economy and public services? How much funding should be kept unallocated in reserve for unforeseen demands and pressures?

This section attempts to outline some of those decisions. Firstly, we look at particular areas of spending and some likely sources of cost and demand pressures. Lastly, we take a brief look at the outlook beyond 2021-22, based on the latest indicative spending plans of the UK government.

## 4.1 Outlook for 2021-22 budget

Decisions taken at the Spending Review, as well as updated forecasts for devolved taxes, suggest the Welsh Government's core fiscal resource DEL - its budget for day-to-day spending, excluding Covid-19 consequentials - will increase from £16.1 billion to £17.1 billion in cash terms, driven mainly by increases to the Welsh block grant. We assume the Welsh Government keeps tax policy unchanged and again draws down £125 million from the Wales Reserve next year. We also assume that Covid-19 related consequentials fall from £5 billion in 2020-21 to £766 million, as per Spending Review plans, though these figures remain highly uncertain. As explored in previous sections, the budget is likely to see substantial revisions to its size, both before the start of the financial year and at subsequent in-year updates to UK government plans. This projected outlook for the Welsh budget also assumes no change in the Welsh Government's fiscal framework rules or budgetary flexibilities, such as the ability to push significant amounts of funding from 2020-21 to 2021-22.

Meanwhile, the capital DEL decreases slightly (in cash terms), from £2.6 billion to £2.5 billion, driven by a fall in Financial Transactions capital funding. Traditional capital funding increases from £2.1 billion to £2.3 billion, and we assume the Welsh Government borrows the maximum amount of £150 million for capital spending in 2021-22.

## Covid-19 spending in 2021-22

One crucial question for the Welsh budget next year will be how much Covid-19 spending costs will carry forward into next year. Available funding from the UK government for Covid-19 related costs in 2021-22 equates to only 14% of the funding available for the Welsh Government's fiscal response in 2020-21. **Figure 4.1** shows the Welsh Government's fiscal response to Covid-19 this year, by various categories, alongside an illustrative allocation of the Covid-19 Barnett consequentials available for 2021-22. We firstly assume the funding will be only be used to meet additional demands on public services, as per the UK government's spending plans which have triggered the consequentials. This would imply additional spending on public services falling by over two-thirds, from £2.4 billion in 2020-21 to £766 million in 2021-22. We then assume shares for various public services follow the shares in 2020-21 allocations.

Under this illustrative scenario, the NHS would see £428 million in Covid-19 funding, with a further £61 million for other Health and Social Services spending. This funding would need to meet additional costs for PPE next year, as well as the costs of the Welsh Government's Test, Trace, Protect programme. A population-based equivalent of the UK government's "NHS recovery package" for England would also require around £170 million from this allocation.

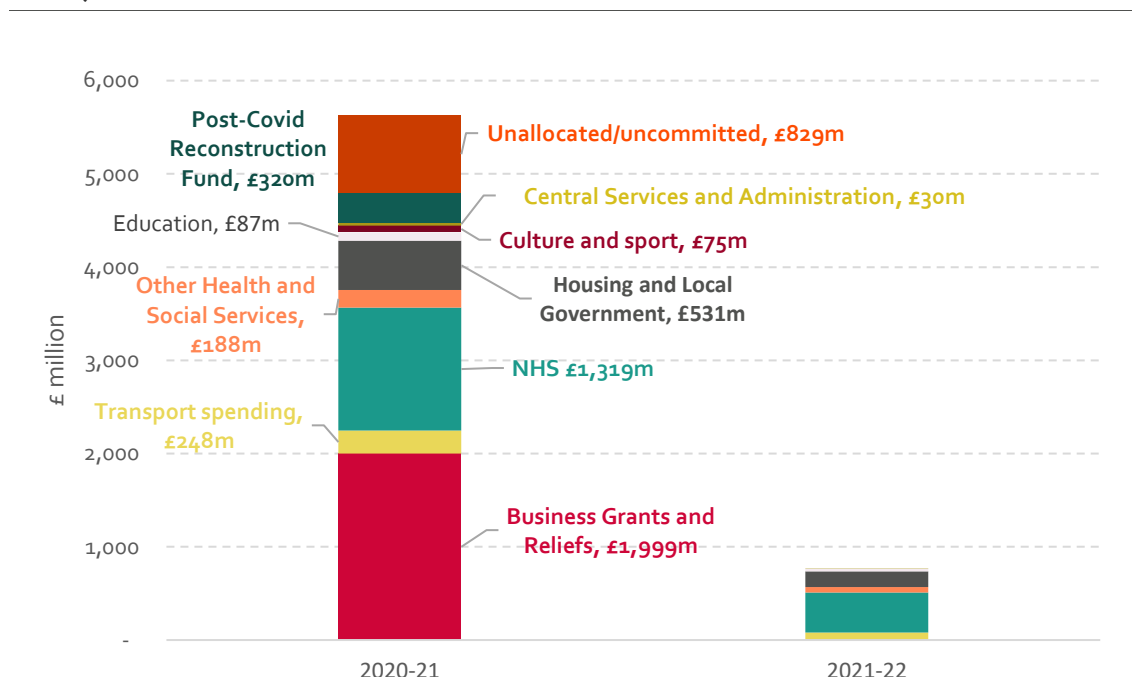
Under this scenario, some £166 million would be allocated for local government budgets, down from £500 million this year. Lost income experienced by local authorities should be smaller, if we see reduced levels of public health restrictions in place. However, cost and demand pressures related to the pandemic are still likely to be present, for example, additional PPE and staffing costs for social services. Other allocations would include £80 million to support public transport and £28 million for education.

Under this scenario, the Welsh Government would not allocate any funding for business rates reliefs or grants. This would be a huge reduction in support for businesses from the Welsh Government this year. Some of the allocations to support individuals made this year, such as additional allocations for the Council Tax Reduction Scheme and the Discretionary Assistance Fund, would also be cut back in this scenario.

It is likely the UK government will eventually need to increase allocations to support public services from its Covid-19 reserve next year, which may trigger additional consequentials for the Welsh budget. Furthermore, the Welsh Government may receive consequentials for support for businesses in England through the business rates system. However, these illustrative allocations show the difficulty the Welsh Government may have in meeting Covid-19 related spending pressures next year and will probably be the bare minimum required by public services. Under current plans, it is likely a significant portion of Covid-19 related costs will again need to be met from within the Welsh Government's own budget next year.

**Figure 4.1**

Covid-19 spending in 2020-21 and illustrative allocations for 2021-22, £ million (cash terms)



Source: Welsh Government (2020) 1<sup>st</sup> Supplementary Budget; Welsh Government (2020) 2<sup>nd</sup> Supplementary Budget; various Welsh Government announcements; authors' calculations.

Note: Figures for 2020-21 shown gross of reprioritised funding, which is not assumed for 2021-22. We assume all spending announcements not included in the supplementary budgets are additional and come from unallocated funding and assign to various categories based on available information.

### NHS spending

As ever, one of the most significant budgetary decisions will be how much to allocate to the NHS, which accounts for almost half of the Welsh Government's day-to-day budget. Allocations made to health spending has a substantial effect on the residual funding available to other areas of the budget, and vice versa. **Figure 4.2** shows two hypothetical scenarios for Welsh Government allocations. In both scenarios, we assume the distribution of Covid-19 consequential is as in **Figure 4.1**. As a benchmark scenario A, we assume the increase in core resource spending for the NHS per person matches the increase announced by the UK government for the NHS in England. That would mean an approximately £350 million additional day-to-day spending for the NHS. That would leave a significant share of the total increase in the Welsh budget for other services, of around £590 million.

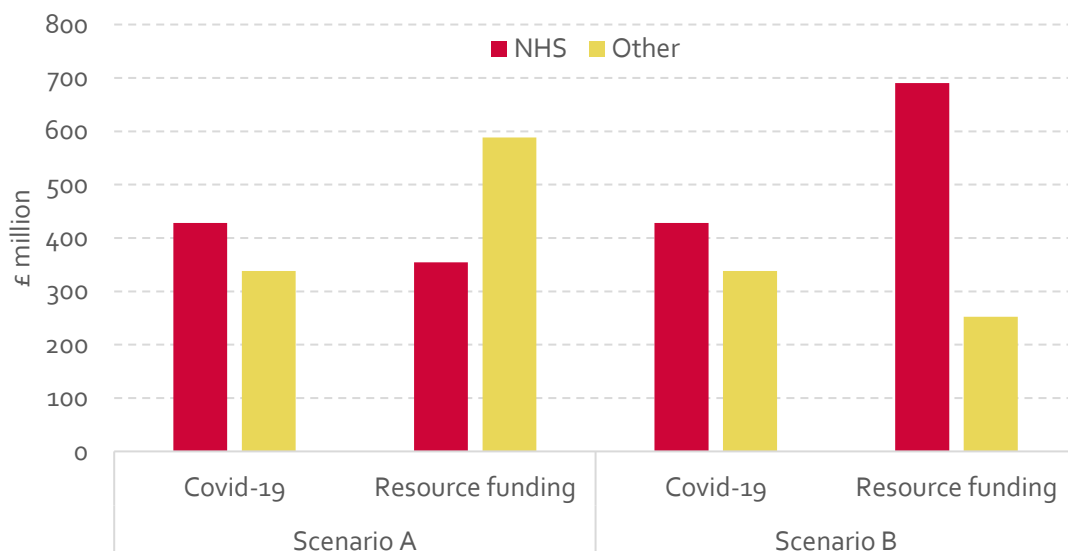
Although not related specifically for the Welsh NHS, the Health Foundation has raised concerns that the increase in funding from the Spending Review falls short of the additional demands on



hospitals next year.<sup>13</sup> They argue social distancing and infection control measures will reduce what the NHS can deliver for a given level of funding.<sup>14</sup> If productivity is 5% lower next year, that would entail costs of over £400 million for the Welsh NHS. There is of course a significant backlog of patients who were not treated in the spring, and potential over this winter, as well as new demand pressures, notably mental health. The Health Foundation argue the Spending Review allocations in England leave the English NHS some £6 billion short of meeting these additional cost and demand pressures. If these pressures were replicated for the Welsh NHS, it would require an additional £340 million next year, shown in scenario B. This would mean around £1.1 billion for the NHS between Covid-19 funding and the increase in core resource funding.

**Figure 4.2**

**Increases to NHS funding and all other day-to-day spending (cash terms)**



*Source: Authors' calculations.*

However, such an increase in the NHS budget would entail a much smaller increase in day-to-day spending on other public services, of around £252 million. These services themselves face huge demand and cost pressures, which such a funding allocation may not adequately cover.

### Social care

Social services departments have foregone income and incurred substantial additional costs as a direct result of the Covid-19 pandemic. Survey-based estimates compiled by the Welsh Local Government Association (WLGA) suggest that by October 2020, these additional costs amounted to £60 million for adult social services alone. This is largely due to purchases of

<sup>13</sup> <https://www.health.org.uk/news-and-comment/news/spending-review-leaves-nhs-england-6bn-short-next-year>

<sup>14</sup> <https://www.health.org.uk/publications/long-reads/spending-review-2020>

personal protective equipment and additional staffing costs. Local authorities have been able to reclaim this cost through the Welsh Government's Local Authority Hardship Fund.

Even in the unlikely scenario that all Covid-related costs will end in March 2021, the financial outlook for the sector remains challenging. Spending has remained broadly flat in real terms for over a decade, but cost pressures continue to mount.<sup>15</sup> There is a strong argument for improving staff remuneration given that less than half of the personal care workforce are paid less than the Real Living Wage. Residential homes operating in the independent sector whose profitability may have been impacted by lower occupancy during the Covid-19 pandemic may drive up the unit cost of care even further. And Wales' rapidly aging population, as well as the need to develop new care offers, mean that substantial investment in the sector will be required over the next decade.

The Welsh Government could opt to increase funding on a pragmatic, step-by-step basis or seek more fundamental reforms. Options might include a hypothecated increase in the Welsh Rate of Income Tax, the introduction of a social care levy as a new form of social insurance as proposed by Holtham, or a more root and branch restructuring of social care services to create a national care service.<sup>16</sup> The introduction of a free personal care offer for older adults along similar lines to Scotland might be an attractive option, but it would not be a panacea for all the challenges facing the sector.<sup>17</sup>

## Local Government

Pressures on social care services will form a large part of the pressures facing local authority budgets next year. Survey and modelling carried out by the Welsh Local Government Association find total underlying pressures will total £279 million. £174 million of this are attributable to workforce costs (including social care commissioning costs) – which may be affected by the public sector wage announcements made by the UK government last week. Social care pressures make up the bulk of the £72 million demand-related pressures identified, with further inflationary pressures of £33 million.

The Independent Review of School Spending in Wales projected that school costs per learner would grow by about 8% from 2019-20 to 2022-23, depending on growth in teacher pay levels (discussed below). This report however did not cover the potential Covid-19 related costs on schools, and the need for 'catch-up' spending for Welsh schools to deal with the effects of this year on educational outcomes and inequality.

Increasing local government funding from the Welsh Government over recent years represented a step-change compared to the previous decade of austerity. However, we

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<sup>15</sup> Siôn, Cian and Michael Trickey. 2020a. *The future of care in Wales: Resourcing social care for older adults*. Accessed 28 November 2020. [https://www.cardiff.ac.uk/\\_data/assets/pdf\\_file/0019/2427400/social\\_care\\_final2\\_aug20.pdf](https://www.cardiff.ac.uk/_data/assets/pdf_file/0019/2427400/social_care_final2_aug20.pdf)

<sup>16</sup> Holtham, Gerald. 2018. *Paying for Social Care*. Cardiff: Welsh Government. Accessed 17 July 2020. <https://gov.wales/sites/default/files/publications/2018-11/paying-for-social-care.pdf>

<sup>17</sup> Siôn, Cian and Michael Trickey. 2020b. *The cost of free personal care: lessons from Scotland*. Accessed 28 November 2020. [https://www.cardiff.ac.uk/\\_data/assets/pdf\\_file/0003/2470152/fpnc\\_briefing\\_21102020.pdf](https://www.cardiff.ac.uk/_data/assets/pdf_file/0003/2470152/fpnc_briefing_21102020.pdf)

estimated total Welsh Government support for local authorities was still around 13.5% lower than 2010-11 levels in real terms, before the pandemic hit.<sup>18</sup> Funding increases to local governments will also largely determine the need for increases to Council Tax levels across Wales (discussed in section 5).

## Public sector pay

One of the biggest announcements made in last week's spending review was the Chancellor's decision to freeze public sector pay for one year, with exceptions for NHS staff and lower paid workers (earning less than £24,000 a year). The Chancellor's announcement on pay awards only applies to some public sector occupations in Wales, and these do not neatly align with devolved responsibilities. For instance, 120,000 people employed by local authorities in Wales are covered by the Chancellor's announcement, including 30,000 school support staff and 20,000 care and social workers.<sup>19</sup> But the Welsh Government determines pay awards for the 27,000 teachers and associated professionals employed by local authorities separately, based on recommendations made by the Independent Welsh Pay Review Body.<sup>20</sup>

Others covered by the Chancellor's announcement on pay awards include police officers, fire and rescue staff, national park workers, and senior civil servants. The Welsh Government sets pay scales for doctors and dentists as well as staff covered by the Agenda for Change pay system (nurses, allied health professional and administrative staff). Medical practitioners and the NHS workforce account for the bulk (46%) of the devolved pay bill, roughly £3.6 billion of the £7.8 billion total in 2017–18.<sup>21</sup> The Welsh Government also determines pay for executive and support staff in the Welsh civil service and agrees a framework with Welsh Government Sponsored Bodies on which they must base their own pay policy statements.<sup>22</sup>

The Welsh Government adopted recommendations made by the UK pay review body of a 2.8% uplift in pay for all groups of doctors and dentists as well as primary care staff in 2020-21.<sup>23</sup> The Education Minister has also set out pay proposals for teachers, which include a 3.75% pay-rise for teachers on the Main Pay Scale, a 2.75% increase for head teachers, deputy and assistant heads, and unqualified teachers for the 2020–21 academic year. This is in addition to an 8.48%

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<sup>18</sup> This figure excludes Covid-19 related funding and the effect of the Covid-19 pandemic on the GDP deflator used to account for inflation.

<sup>19</sup> Local government workforce estimate is based on headcount numbers published by the ONS (2018) *Employment in Local Government*, by UK region:

<https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/publicsectorpersonnel/adhocs/009408employmentinlocalgovernmentbyukregionmarch2009toseptember2018>.

<sup>20</sup> Estimates of the education and social services workforce from StatsWales (2019-20) *School Workforce Annual Census* and StatsWales (2018-19) *Staff of local authority social services department*.

<sup>21</sup> Ifan, Guto and Cian Sion. 2019. *The Public Sector in Wales: An analysis of recent trends in the public sector workforce and pay bill*. Cardiff: Wales Fiscal Analysis. Accessed 24 November 2020.

[https://www.cardiff.ac.uk/\\_data/assets/pdf\\_file/0010/1517176/public\\_sector\\_june\\_final.pdf](https://www.cardiff.ac.uk/_data/assets/pdf_file/0010/1517176/public_sector_june_final.pdf)

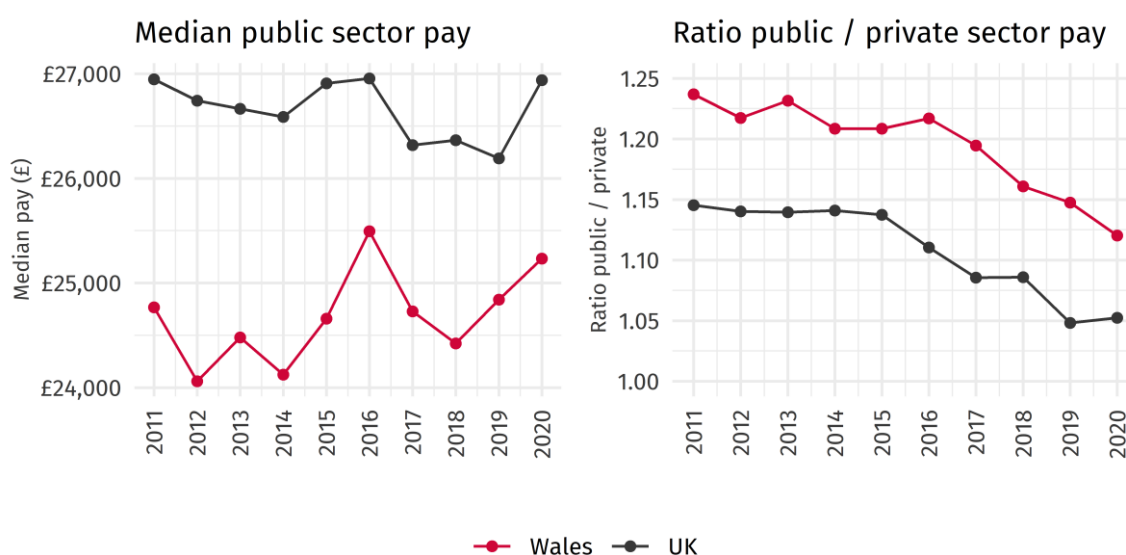
<sup>22</sup> Responsibility for setting the pay scales for Senior Civil Service staff is reserved to the UK government's Senior Salaries Review Body.

<sup>23</sup> <https://gov.wales/28-pay-increase-doctors-and-dentists-wales>;  
<https://gov.wales/wales-leads-way-pay-rise-all-staff-primary-care>

increase in starting salaries for new teachers.<sup>24</sup> The Welsh Government has not yet set out its plans for teachers' pay awards beyond September 2021, when pay will be frozen in England.

The multi-year pay-deal for NHS workers covered by the Agenda for Change agreed in 2018 expires at the end of this financial year. The Welsh Government has not yet announced their plans for pay awards in 2021–22 and beyond. The government will also need to decide on pay awards for those employed in the Welsh Civil Service and sponsored public bodies (roughly 6% of the devolved pay bill).

**Figure 4.3**  
Median public sector pay (adjusted for CPIH inflation) and ratio of median public / private sector pay, 2011 – 2020



Source: WFA analysis of ONS (2020 and previous) Annual Survey of Hours and Earnings; ONS (November 2020) CPIH Annual Rate.

These pay restraints were justified according to the Chancellor because of the deepening disparity between public and private sector wages caused by the Covid-19 pandemic.<sup>25</sup> Whereas a significant proportion of private sector workers have had their hours or wages reduced by the furlough scheme, public sector workers are much less likely to have been impacted in this way. However, when taking a longer view, the ratio of public to private sector pay has already reduced considerably since the last economic crisis. In 2011, the median wage in the public sector in Wales was around 23% higher than median wage in the private sector. Since then, the difference has almost halved to 12% (Figure 4.3). Having controlled for the different characteristics of the respective workforces (including age, education, experience and region, all interacted with sex), the IFS estimate that there is now no pay differential between

<sup>24</sup> <https://gov.wales/education-minister-proposes-31-overall-pay-award-teachers>

<sup>25</sup> <https://www.gov.uk/government/speeches/spending-review-2020-speech>

average public and private sector hourly pay in the UK (excluding pensions).<sup>26</sup> This is primarily because growth in private sector pay has outpaced the public sector in recent years. Previous caps and controls on public sector pay mean that, having adjusted for inflation, median public sector pay in the UK has remained flat for a decade, and broadly flat in Wales.

A key consideration for the Welsh Government when setting devolved pay awards will be the potential impact on retention and recruitment. In an ordinary recession, the relatively greater security afforded by public sector employment might be enough to ensure that these jobs remain competitive, even if pay curbs are imposed. However, the impact of Brexit and the new migration regime after the transition period may impair on employers' ability to recruit workers from abroad – the social care sector could be particularly impacted by the new arrangements.<sup>27</sup>

Carers employed by local authorities will likely see their pay increase by up to £250 because of the Chancellor's exemption for low paid workers. But for a residential care worker in Wales earning the median hourly rate of £9 an hour and working 35 hours a week, this increase represents, **at most**, a 1.5% uplift in pay. And if the experience of the last recession is anything to go by, the wages of carers employed in the independent sector will follow. This will likely mean that the median hourly pay for care workers falls even further behind the Real Living Wage.

### **Economic support spending – supporting businesses and skills**

The majority of the fiscal support being provided to the Welsh economy this year will be through UK-wide schemes. However, a key part of the economic support on offer has been provided through the Welsh Government budget, with up to £2.1 billion of grants, reliefs and loans being made available to businesses. Barring significant changes in the flow of consequentials next year, the prospect of similar support being provided next year is unlikely. Although the economic conditions for businesses may improve, with fewer public health restrictions in place, the knock-on effect of the pandemic on the financial position of businesses will still be substantial. Returning to scenario A in **Figure 4.2**, even providing half of the level of reliefs offered to business in 2020-21 in 2021-22 would take around a third of the additional funding available for non-NHS funding increases next year. The reduced economic support through the Welsh budget next year will also be in the context of many UK-wide schemes ending in April 2021.

With forecasts suggesting a rise in unemployment in Wales to around 110,000 next year, support provided for those out of work will become hugely important. Skills related spending was set to be around £157 million in 2020-21 and increased to £186 million in the 2<sup>nd</sup> supplementary budget.<sup>28</sup> There is a strong argument for increasing this spending next year. In

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<sup>26</sup> Institute for Fiscal Studies. 2020. Spending Review 2020: IFS analysis. (Online Event) 26 November 2020. Accessed 26 November 2020. <https://www.ifs.org.uk/events/1871>

<sup>27</sup> Portes, Jonathan, Elsa Oommen and Craig Johnson. 2020 UK migration policy and the Welsh NHS and social care workforce. Accessed 23 November 2020. <https://www.wcpp.org.uk/publication/uk-migration-policy-and-the-welsh-nhs-and-social-care-workforce/>

<sup>28</sup> This includes day-to-day spending related to Work Based Learning, Skills Policy, and Careers Wales.

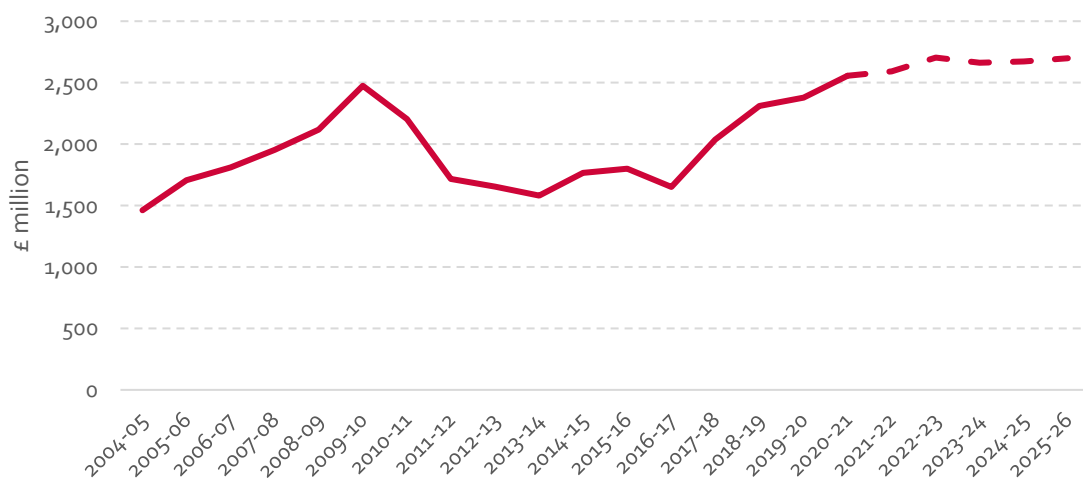
the Spending Review, the UK government announced a new UK-wide scheme to help the long-term unemployed to find work, called Restart. The Welsh Government could decide to allocate funding towards complementing schemes in Wales, similar to the ProAct and ReAct schemes implemented following the financial crisis.

### Capital spending

A key part of the recovery in the Welsh economy and in the resilience of public services will be shaped by the Welsh Government’s capital budget. As described previously, there will be an increase in the traditional capital funding element of the budget, though this will be offset by reductions in Financial Transactions funding, mainly used for the housing capital budget.

The Welsh Government does have some £200 million of traditional capital funding unallocated in its supplementary budget plans for 2020-21. It is unclear how much of that funding the Welsh Government will be able to carry forward into future years. This increases the need for an increase in the cap on the total size of the Wales Reserve, as well as the annual limit for capital drawdowns over future years (currently £50 million). This is especially the case given the uncertain outlook for the Welsh Government’s capital budget.

**Figure 4.4**  
Welsh Government Capital Budget, 2020-21 prices



Source: HM Treasury (2020 and previous) Public Expenditure Statistical Analyses; HM Treasury (2020) Block Grant Transparency; HM Treasury (2020) Spending Review 2020 and authors’ calculations and assumptions. Note: Assumes Welsh Government borrows the maximum amount of £150 million a year, as per 2021-22 plans. We project capital spending not subject to multi-year plans will increase in line with all ‘other’ spending to 2023-24, and that all department capital spending plans grow in line with all UK Government capital spending from 2024-25.

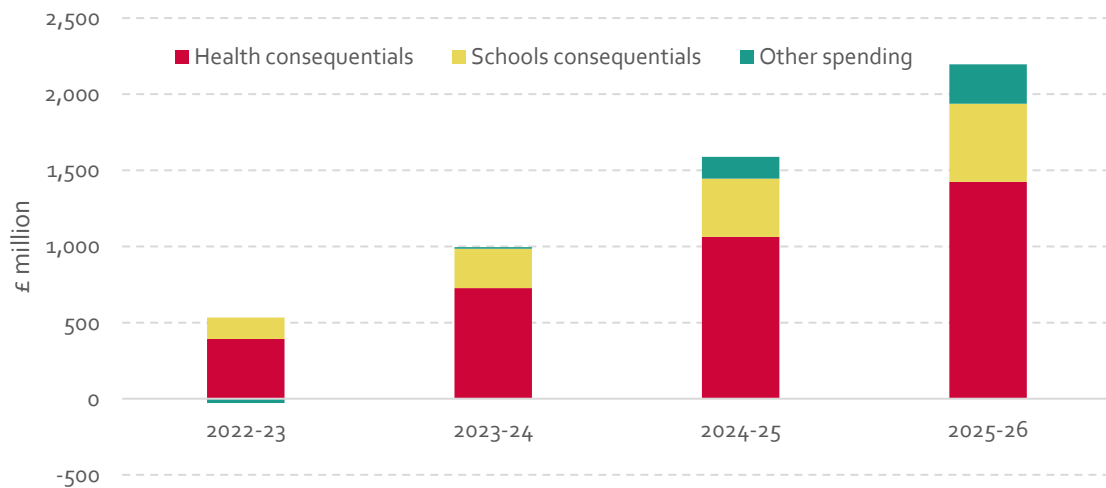
The Spending Review did provide multi-year funding commitments for key UK Government infrastructure projects. However, for the second year in a row, the Welsh Government will not know the size of the capital block grant beyond the next budget year. This situation is far from

ideal when planning which capital projects to fund. **Figure 4.4** provides a crude projection of the likely size of the Welsh Government’s capital budget to 2025-26, making various assumptions about the composition of UK government capital spending not subject to multi-year plans. Under these projections, the capital budget is set to increase by less than a fifth from 2019-20 to 2023-24 in real terms. However, a part of this increase will be down to the assumed rise in Welsh Government capital borrowing (of £150 million a year). The projected increase over this period is less than half the planned overall increase in the UK government’s capital budget.

## 4.2 Outlook beyond 2021-22

This section attempts to provide some insight into the outlook for the Welsh Government budget beyond 2021-22, for which plans for the Welsh Government’s block grant have not been set. Although clearer plans will presumably be published at some point next year, the indicative plans laid out in the Spending Review set the context for the Welsh parliamentary elections in May, and have implications for the feasibility of manifesto commitments and tax policy options.

**Figure 4.5**  
Consequentials for day-to-day spending, by source of UK government spending in England (cash terms)



Source: HM Treasury (2020) Spending Review 2020; and authors’ calculations.

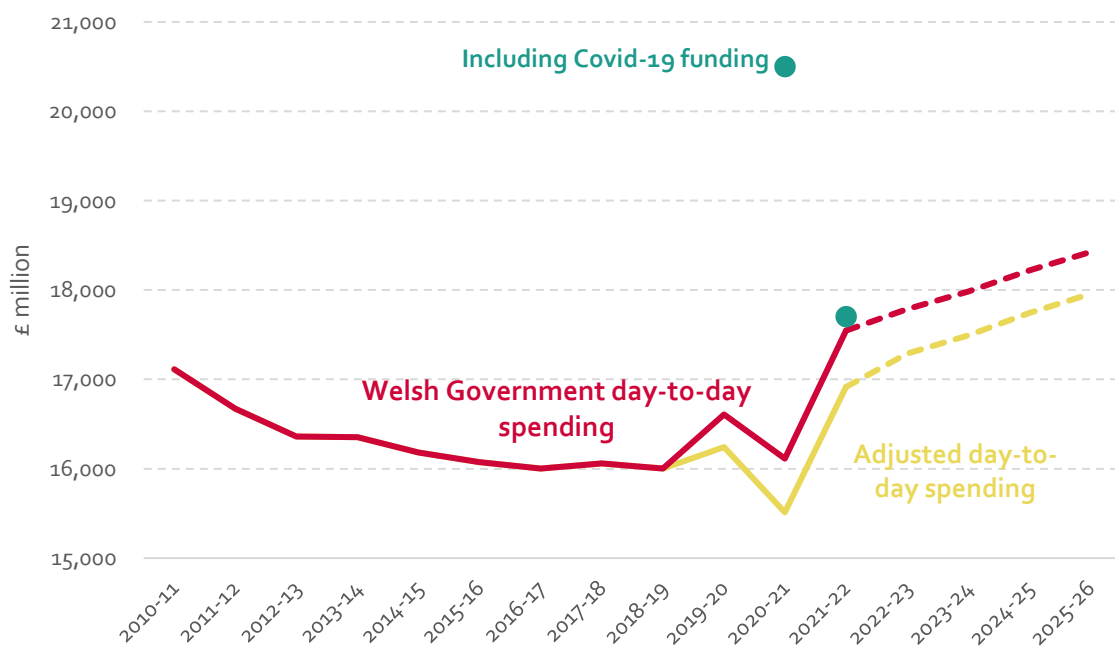
From 2022-23, the UK government has made no allocation for Covid-19 related costs. It also re-committed to pre-Covid plans for the NHS in England to 2023-24 and for schools spending in England to 2022-23. After the periods covered by these plans, we assume health and schools spending in England grows in line with all departmental spending. We assume all other departmental spending grow in line with ‘non-protected’ UK government spending. The

projection of the additional consequentials passed on to the Welsh budget (by source of UK government spending in England) is shown in **Figure 4.5**.

The annual additional consequentials for the Welsh budget under this projection is approximately £550 million a year from 2022-23 to 2025-26 (in cash terms). For the years 2022-23 and 2023-24, almost all the additional consequentials come from the multi-year spending plans for health and schools in England. Indeed, for 2022-23, all other departmental spending will attract negative consequentials for the Welsh budget.

The projection shown in **Figure 4.6** combines these projected consequentials with the latest forecasts for devolved taxes and block grant adjustments (discussed in the next section). The Welsh Government budget is set to grow over the course of the next Welsh Parliament. However, even by the middle of the next parliamentary term, per person spending on a consistent basis will still be lower than 2010-11 levels. If consequentials from health spending in England are passed on to the Welsh NHS, this could leave non-NHS day-to-day spending in the Welsh budget still around 8% below pre-austerity levels.

**Figure 4.6**  
Welsh Government day-to-day spending (Fiscal Resource DEL), 2020-21 prices



Source: As described for Figure 2.4, and authors' calculations and assumptions.

Note: Adjusted (yellow) line excludes the effect of increased public sector pension contributions from 2019-20 and the inclusion of farm payments into the budget from 2020-21. Excludes the effect of non-allocated spending or funding drawn down from the Wales Reserve.



In the aftermath of the Covid-19 pandemic, debates over UK government fiscal policy, public spending and tax rises are likely to intensify over coming years. This austere outlook for the Welsh budget in the face of huge spending pressures should also set the context for a debate about the future of Welsh public services and the devolved tax powers ahead of the election next May.

# 5 Welsh tax policy

April 2021 marks the second anniversary of the partial devolution of Income Tax powers to Wales, and the third anniversary of setting up the Land Transaction Tax (levied on property transactions) and Landfill Disposals Tax (paid on waste sent to landfill). It is a mark of the strength of the current Fiscal Framework that, despite a turbulent year for tax receipts, Wales only bears the risks of asymmetric shocks to its devolved tax revenue. The net effect on the Welsh budget will be determined by the *relative* change in revenues compared to England and Northern Ireland.

The deductions to the Block Grant are expected to exceed revenues from Welsh Rates of Income Tax by around £40 million next year, reflecting an expected decline in the Welsh share of UK non-savings, non-dividend (NSND) Income Tax due to slower population growth. The Office for Budget Responsibility has not assumed any asymmetric effects resulting from the Covid-19 pandemic or the associated economic fallout.<sup>29</sup> Nevertheless, the sizeable increases to the Block Grant since March does mean that devolved tax revenue now accounts for a relatively smaller share of the Welsh Government's total spending power.

In the short term, the UK government is arguably well placed to finance additional spending by continuing to borrow at low cost and through the Bank of England's quantitative easing programme. This does not make Welsh Rates of Income Tax (WRIT) redundant as a policy mechanism, however. Despite calls for additional borrowing powers and other budgetary flexibilities, the Welsh Government is subject to a hard budget constraint. It must fund its day-to-day spending using the Block Grant, in-year consequential arising from spending decisions in England, own-sourced revenue or by making limited drawdowns from its reserves. If the Welsh Government wishes to fund additional spending over and above its current budget constraint, increasing WRIT rates remains one of the most effective way of doing so.

The interaction of WRIT with other taxes, including local taxes, must also be a key consideration when setting devolved Income Tax rates. It should not be inferred that leaving Income Tax rates unchanged will also leave households' overall tax burden unchanged relative to their income. For instance, if the funding settlement offered to local authorities is not sufficient to cover cost pressures, councils could be under pressure to propose further large increases to Council Tax – which places a proportionately greater burden on low income households.

This section sets out what we know – and what we do not know – about revenues from devolved and local taxes, the implications for the Welsh Budget, and provides an analysis of various tax policy options.

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<sup>29</sup> Office for Budget Responsibility. 2020. *Devolved tax and spending forecasts (November 2020)*. London: Office for Budget Responsibility. Accessed 30 November 2020. <https://obr.uk/download/november-2020-devolved-tax-and-spending-forecasts/>

## 5.1 Devolved taxes and the block grant adjustments

The three devolved taxes impact the Welsh Budget indirectly through the operation of the Block Grant Adjustments (BGAs). A separate adjustment exists for each of the devolved taxes and for each of the three WRIT bands. Whereas revenue raised through devolved taxes increase the Welsh Government's spending power, the BGAs reduce it. Each BGA represent a deduction to the Block Grant, reflecting the year-on-year change in comparable per person tax revenue in England and Northern Ireland. Put simply, if per person devolved tax revenue grows quicker in Wales than England and Northern Ireland, then the tax take will exceed the Block Grant Adjustment, thereby having a positive net effect on the Welsh Budget. Meanwhile, if tax revenues in Wales grow at a relatively slower pace, the deduction to the Block Grant will exceed the tax revenue raised, thus negatively impacting the Welsh Budget.<sup>30</sup>

It follows from this that the Welsh Budget is only exposed to volatility in the tax base insofar as an economic shock is felt asymmetrically across the UK. The extent to which the Income Tax base is asymmetrically impacted will be determined by whether Wales is disproportionately hit by a reduction in employment numbers and earnings.

### Trends in employment and earnings

HMRC publishes data on earnings and employment from Pay as you Earn (PAYE) real time information. This does not cover Income Tax paid on pensions or self-employed income, but since tax paid by PAYE employees constitutes a majority share of the non-savings, non-dividend tax revenue collected through WRIT, this can give an indication of trends in devolved tax revenue and the labour market in Wales. The latest data on payroll staff covers the month of October, so it is too early to tell whether the new regulations introduced in recent weeks – including the “fire-break lockdown” in Wales and the month-long lockdown in England – will impact the figures. Nevertheless, this real time information offers a preliminary indication of whether the impact on employment and earning has been evenly felt across the countries and regions of the UK during the first months of the pandemic.

**Figure 5.1** presents two graphs showing the trends in the number of PAYE employees and mean pay, indexed to April 2019, when Income Tax powers were devolved to Wales. The lines represent the time series for each of the twelve NUTS<sub>1</sub> regions of the UK, with the red line representing Wales.<sup>31</sup> Though growth in the number of PAYE employees lagged behind other parts of the UK in the run up to the pandemic, the Welsh figures have followed a broadly similar trajectory to the rest of the UK since March. Wales appears to have experienced a smaller decline in the mean value of employee pay. The average PAYE award fell below its April 2019

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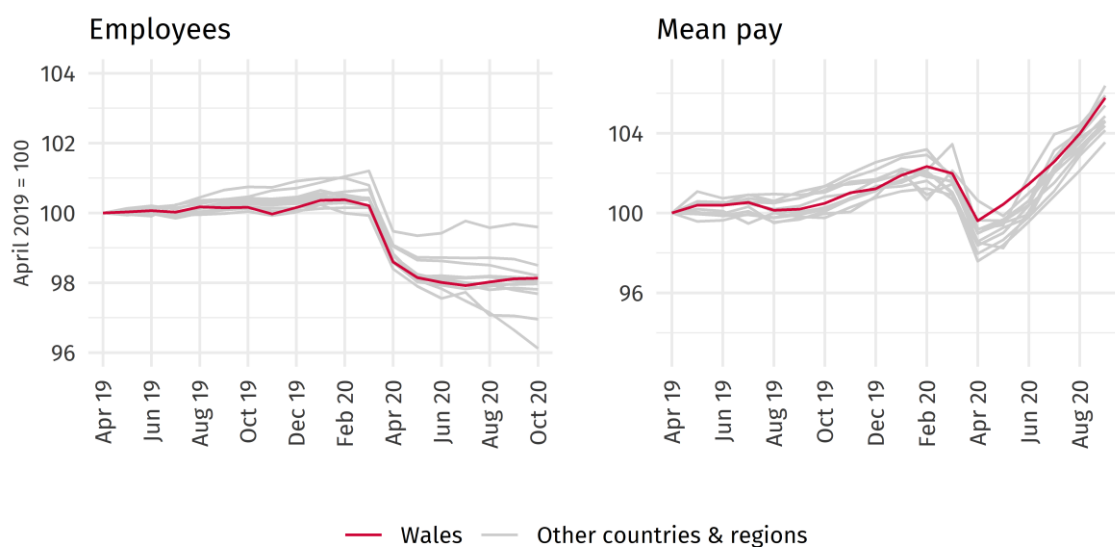
<sup>30</sup> See Poole, Ifan and Phillips (2017) for a fuller account of the block grant adjustment mechanism, available at: <https://www.cardiff.ac.uk/wales-governance-centre/publications/finance>

<sup>31</sup> The Nomenclature of Territorial Units for Statistics (NUTS) is the geocode standard by Eurostat for referencing the subdivisions of the UK for statistical purpose. There are 12 first level (NUTS<sub>1</sub>) regions within the UK: Wales, Scotland and Northern Ireland as well as 9 English regions: North East England, North West England, Yorkshire and the Humber, East Midlands, West Midlands, East of England, London, South East England and South West England.

level at the start of lockdown but has since recovered, likely reflecting the flow of employees onto the furlough scheme, when they were liable to pay Income Tax on 80% of their wages, and then back into full employment or unemployment (with the latter being reflected by the reduction in the number of employees on the PAYE register). In July 2020, there were 25,000 fewer PAYE employees in Wales, compared to April 2019. But after this initial reduction, the number of employees on the PAYE register has remained broadly stable at 2% below its pre-Covid levels, suggesting that most furloughed employees have in fact been kept on.

**Figure 5.1**

**Pay as you Earn (PAYE) Real Time Information (seasonally adjusted), Wales & NUTS1 regions**



Source: HMRC (November 2020) Earnings and employment from Pay As You Earn Real Time Information, and authors' calculations.

Since March 2020, over 400,000 employments have been furloughed in Wales. The latest official data from HMRC showed 130,400 employments still furloughed by the end of August. Our own estimate based on more timely data from the *Business Impact of Coronavirus Survey (BICS)* suggests that this number had fallen to around 80,000 by mid-October, equivalent to 8% of the Welsh workforce (down from 26% in May). And in a recent tweet, the Chancellor Rishi Sunak implied that this figure had fallen further to 68,000 by the start of November.<sup>32</sup>

The reduction in the number of workers furloughed has not been accompanied by a similarly sized increase in unemployment, suggesting that most furloughed workers have in fact been brought back onto the payroll.<sup>33</sup> Of course, it remains to be seen how many of the estimated

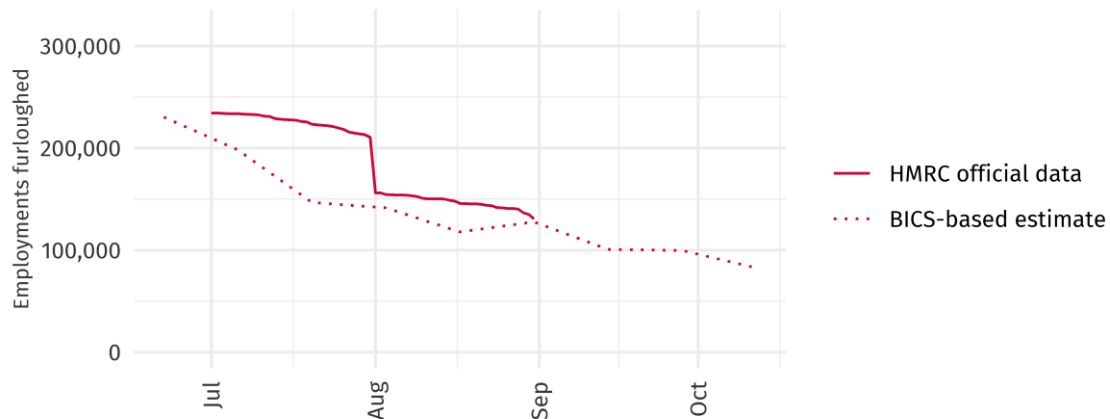
<sup>32</sup> <https://twitter.com/RishiSunak/status/1323261714197106688?s=20>

<sup>33</sup> Rodríguez, Jesús and Cian Siôn. 2020. *In Charts: Covid-19 and the Welsh labour market*. Thinking Wales (Blog). 16 November 2020. Accessed 18 November 2020. [https://blogs.cardiff.ac.uk/thinking-wales/2020/11/16/covid19-and-welsh-labour-market/?\\_thumbnail\\_id=1234](https://blogs.cardiff.ac.uk/thinking-wales/2020/11/16/covid19-and-welsh-labour-market/?_thumbnail_id=1234)

80,000 Welsh workers still partly or fully furloughed will return to full employment once the scheme ends.

**Figure 5.2**

**Estimated number of employments furloughed in Wales, July – October 2020**



*Source: WFA analysis of HMRC (October 2020) Coronavirus Job Retention Scheme Statistics; ONS (June – October 2020) Business Impact of Coronavirus Survey & Labour Force Survey. Assumes that employments furloughed in Wales represent 4.4% of total UK employments furloughed (the average for July – August).*

### Devolved tax forecasts

In November 2020, the Office for Budget Responsibility (OBR) published their devolved tax forecasts on behalf of the Welsh Government. Despite differences in the sectoral composition of the Welsh economy relative to the UK as a whole, there is little evidence to suggest that Income Tax liabilities in Wales are expected to be hit by more or less than the UK average due to the pandemic, according to the OBR.<sup>34</sup> The decision not to assume an asymmetric impact on the Welsh share of Income Tax is supported by the Real Time PAYE Information discussed earlier, which points to a remarkably uniform geographical impact, at least across NUTS1 geographies.

This means that revisions to the WRIT forecast since March by and large reflects the UK-wide hit to tax revenues. Any divergence between the forecasted growth in Income Tax revenues for Wales and the UK is the result of different assumptions about population growth, earnings, and previously announced policies.

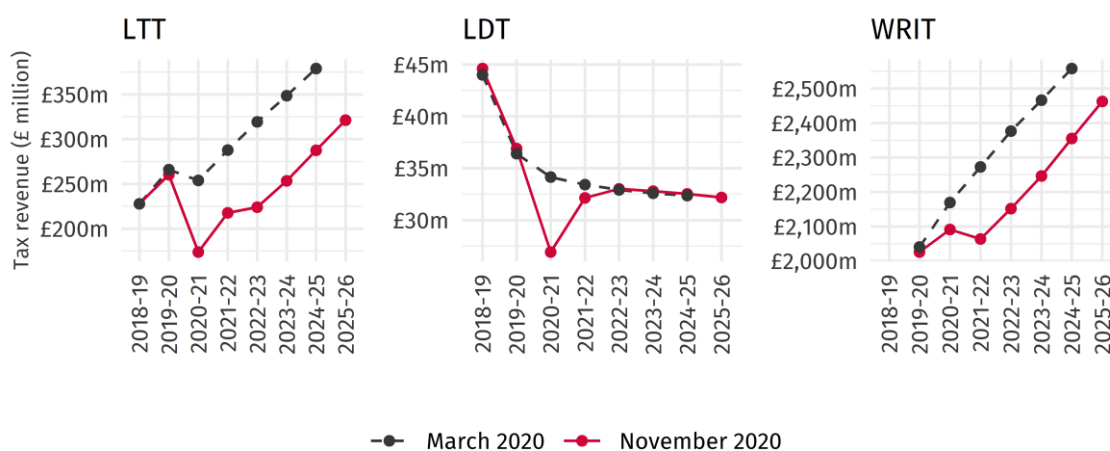
**Figure 5.3** compares the March and November forecasts for each of the devolved taxes. Land Transaction Tax (LTT) revenues are expected to fall by 33% this year compared to 2019–20, reflecting the shutdown of the property market in the early months of the pandemic and the

<sup>34</sup> <https://obr.uk/download/november-2020-devolved-tax-and-spending-forecasts/>

Welsh Government's subsequent decision to implement an LTT holiday. Revenues are expected to remain depressed for the next two years due to forestalling and an expected decline in property values. Revenue from Landfill Disposals Tax (LDT) is forecast to be 27% lower this year, though this is expected to recover quickly. WRIT revenues are forecast to decline next year, as unemployment peaks, before resuming their pre-Covid trajectory. Nevertheless, by 2024–25, revenues from WRIT are set to be £200 million lower than what was previously forecast in March.

**Figure 5.3**

**OBR devolved tax forecasts for Wales (March and November 2020)**



Source: OBR (March and November 2020) Devolved tax forecasts.

Devolved tax revenues are not expected to be disproportionately impacted by the pandemic, but a forecast decline in the Welsh share of UK non-savings, non-dividend (NSND) Income Tax means that the Block Grant Adjustments for WRIT are set to grow faster than tax revenues over the next four years, thus negatively impacting the Welsh Budget. This is true to a smaller extent for Land Transaction Tax, but slightly offset by the net effect of revenue from Landfill Disposals Tax and its associated BGA (Figure 5.4).

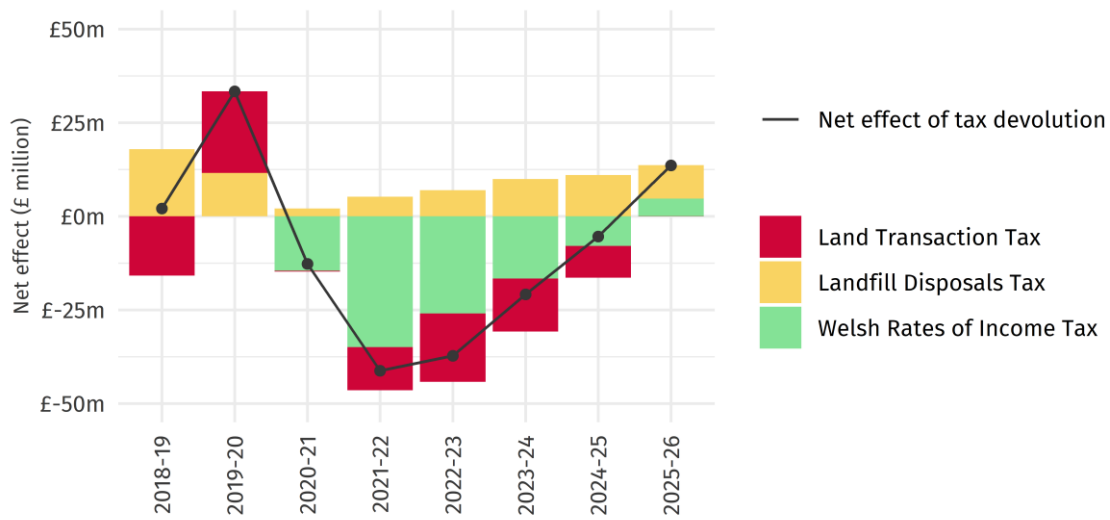
Although it was revised upwards on the March forecast, the declining share of Welsh Income Tax is primarily the result of slower population growth. This effect is expected to become less pronounced towards the forecast horizon, with WRIT revenues exceeding the BGAs by 2025–26. Of course, the picture may change with future forecast revisions and once the first year of outturn data becomes available.

Nevertheless, the Welsh Government will set their 2021–22 draft spending plans based on these set of forecasts. This means that they will have to account for the larger than expected deductions to the Block Grant relating to WRIT when setting out their overall spending power. For LTT and LDT, the Welsh Government can adjust their supplementary budgets to account for an in-year update to the forecast; but for WRIT, any difference between the forecast at the beginning of the financial year and the outturn for Wales and England & Northern Ireland will

not be resolved until the reconciliation exercise. This can only occur after outturn data has been made available, normally around 15 months after the end of the financial year. This means that WRIT outturn data for 2021–22 will not be available until Summer 2023, with the reconciliations being applied to the Welsh Government’s budget for 2024–25.

**Figure 5.4**

**Forecasted net effect of devolved taxes and the Block Grant Adjustments, 2018–19 to 2025–26**



Source: WFA analysis of OBR (November 2020) Devolved tax forecasts.

### Property transaction tax holiday

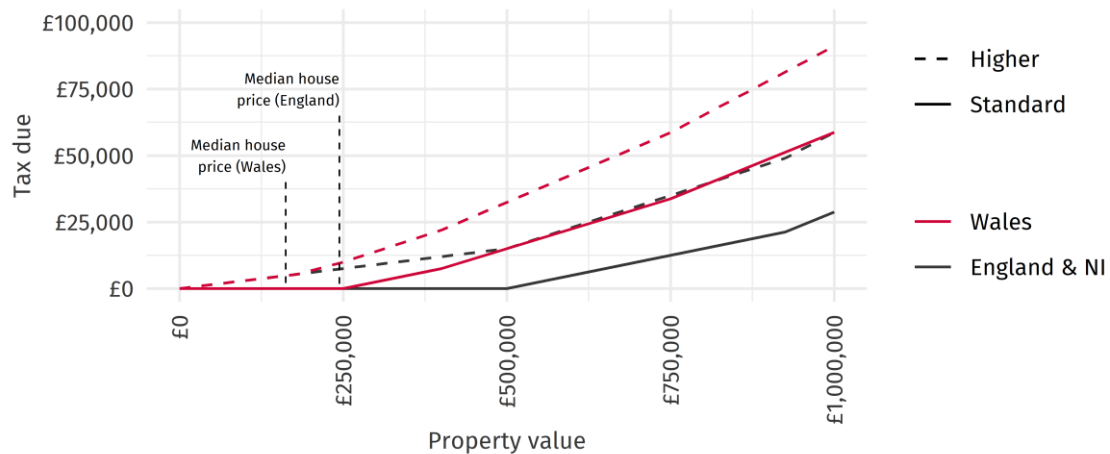
In July 2020, the Welsh Government made temporary changes to the Land Transaction Tax schedule, following the UK government’s decision to introduce a Stamp Duty holiday for properties valued below £500,000. This marks the first occasion when the Welsh Government has adjusted devolved tax rates in the middle of a financial year. The 0% threshold for standard property transactions in Wales was extended from £180,000 to £250,000. The OBR estimates that around 10,000 transactions are expected to benefit from the tax cut, at cost of £18 million, with 1,000 transactions being brought forward from next year.

Figure 5.5 presents a graphical representation of the (truncated) tax schedule. The UK government’s decision to also allow higher rate purchases to benefit from reduced tax rates means that the tax liability on standard transactions in Wales closely mirrors the tax liability of higher rate transactions in England and Northern Ireland for properties valued between £500,000 and £1 million. No tax is currently payable on standard property transactions at or below the median house price in England and Wales. The forestalling effect, whereby property

buyers bring forward their purchases before the 31 March 2021 cut-off, is expected to increase revenues by £3 million in 2020-21 and lowering them by £4 million in 2021-22.

**Figure 5.5**

**Land Transaction Tax (Wales) and Stamp Duty (England & Northern Ireland) tax schedules, (late July 2020 – present)**



Source: ONS (July 2020) House Price Statistics for Small Areas & authors' calculations. Omits the effects of First Time Buyers' Relief in England & Northern Ireland. Tax schedule has been truncated.

## 5.2 Local taxes

Revenues from local taxes – Council Tax and Non-Domestic rates are also set to be impacted by the economic downturn. However, the rules governing how in-year tax collection interacts with the amount available to finance revenue expenditure is not immediately intuitive. Local authorities pay the Council Tax collected in-year into a separate Collection Fund. The amount that can be drawn down from the Collection Fund in any given financial year is determined by the amount budgeted for collection, as set out in the local authority's budget at the start of the year.<sup>35</sup> If there is a deficit (surplus) on the account at the end of the financial year (i.e. if the in-year tax collection is greater or less than the amount originally budgeted for collection), an adjustment will be applied to the amount available to draw down from the Collection Fund in the following year. Put simply, if collection rates turn out to be lower than originally budgeted in 2020-21, this will only impact the amount available for local authorities to spend in the following financial year (2021-22).

Likewise, if councils are less successful at collecting non-domestic rates (NDR) from businesses this year, this will impact the amount available for redistribution as part of the local government settlement in 2021-22. The Welsh Government is providing additional grant funding to local

<sup>35</sup> The budgeted amount includes a standard allowance for losses in collection.



authorities to cover any reduction in tax revenue directly resulting from the non-domestic rates relief and grants made to businesses. But under the current setup, local authorities will bear the risk of any reduction in collection rates – and this will impact the amount they have available to spend in future years.

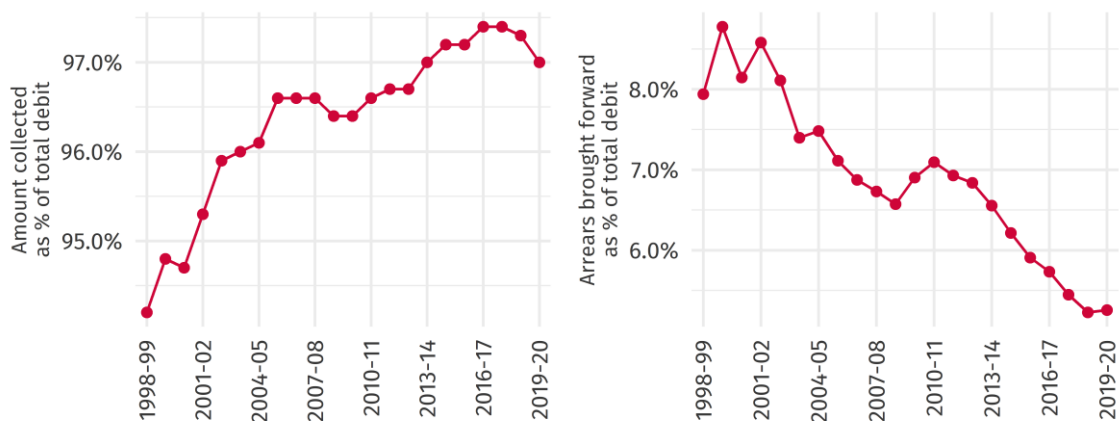
### Council Tax collection rates

Local authorities typically collect a very large share of the amount debited for Council Tax collection, aided by significant legal powers to pursue debt arrears. These powers include the ability to use bailiffs. The Welsh Government has removed the sanction of imprisonment for non-payment of Council Tax.

In 2019–20 the national in-year collection rate stood at 97.0%, though the picture varies across Wales (Blaenau Gwent had the lowest collection rate at 93.9% whilst Neath Port Talbot had the highest at 98.0%).<sup>36</sup> The total amount collected across Wales represented 99.5% of the budgeted amount – this is higher than the headline collection rate as it includes an allowance for losses in collection. But only a small percentage of debt arrears is written off at the end of the financial year. In 2019-20, councils brought forward £89.7 million in arrears from previous years. Of this debt, £25.4 million (28.3%) was repaid during the year, only £5.4 million (6.0%) was written off, whilst £58.8 million (65.6%) was carried forward to future years.

**Figure 5.6**

Council Tax collection rate (Wales), and arrears brought forward, 1998–99 to 2019–20



Source: StatsWales (2020) Arrears of Council Tax. Total debit includes in-year debit and arrears debited in-year.

Official statistics on Council Tax collection for this year are not expected to be published until the financial year has ended. But historical data on collection and arrears suggest that labour

<sup>36</sup> Council Tax collection and arrears data obtained via StatsWales (2020) Arrears of Council Tax, by billing authority.

market shocks may only have a marginal impact on collection rates. As shown in **Figure 5.6**, there has been a consistent increase in the Council Tax collection rate, from 94.2% in 1998–99 to 97.0% in 2019–20. Over time, the amount of arrears brought forward as a share of the total debit has decreased. The increase in the collection rate slowed briefly in the aftermath of the global financial crisis in 2008–09, with a relative increase in the amount of arrears carried forward – though this effect appears to have been small.

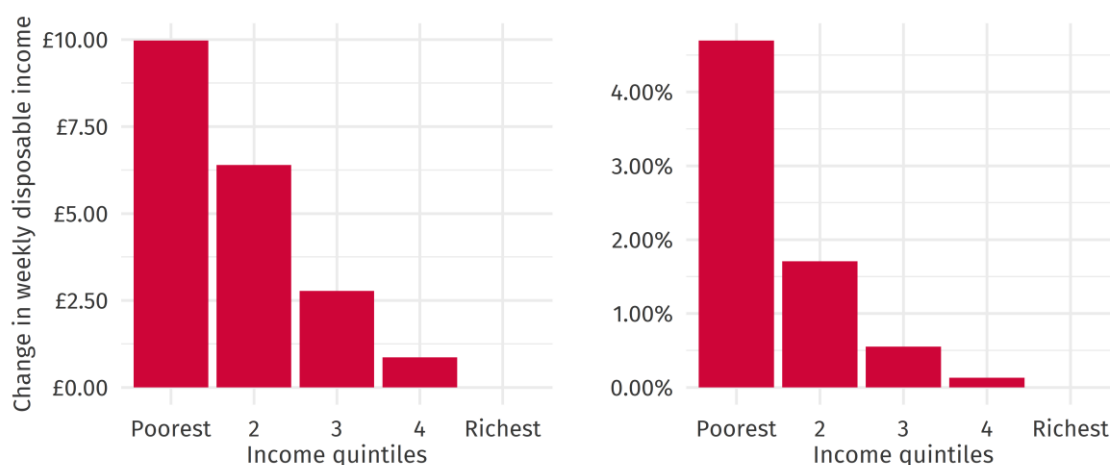
Households that have seen a sharp reduction in income and fallen behind on payments may be eligible for relief under the Council Tax Reduction Scheme. In some cases, a claim can be backdated, but unless the applicant has a good reason for not applying earlier, this is typically granted at the discretion of the local authority.

### Council Tax Reduction Scheme (CTRS)

The incomes of poorer households are protected to some extent by the Council Tax Reduction Scheme (CTRS). This benefit was devolved to Wales in 2015 and replaced Council Tax benefit as it was previously known. The scheme, originally estimated to cost £250 million in its first year, is more generous than its English counterpart, despite continuing concerns about falling claimant rates and the impact of Universal Credit on eligibility and awareness of the scheme.<sup>37</sup>

**Figure 5.7**

Distributional impact of the Council Tax Reduction Scheme (CTRS) on households



Source: WFA analysis based on UKMOD A2.0+ using ONS (2016–18) Family and Resources Survey input data.<sup>38</sup>

<sup>37</sup> <https://gov.wales/sites/default/files/statistics-and-research/2020-01/understanding-impact-universal-credit-council-tax-reduction-scheme-rent-arrears-wales-interim.pdf>

<sup>38</sup> The results presented here are based on UKMOD version A2.0+. UKMOD is maintained, developed, and managed by the Institute for Social and Economic Research (ISER) at the University of Essex. The process of extending and updating UKMOD is financially supported by the Nuffield Foundation, based on the annual update of the UK component of EUROMOD funded by the European Union Programme for Employment and Social Innovation “EaSI” (2014–2020). The results and their interpretation are the authors’ responsibility.

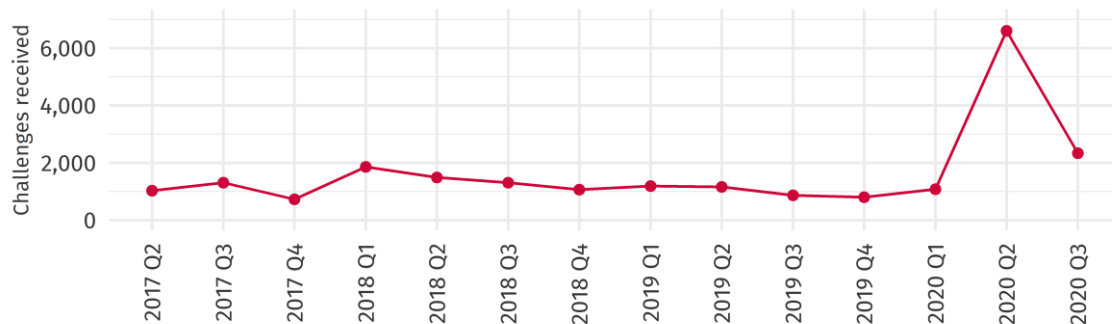
As illustrated in **Figure 5.7**, this scheme plays an important role in mitigating the costs of Council Tax for poorer households. Households in the poorest quintile are £10 a week better off because of the scheme (representing more than 4% of household income). The distributional effect is calculated for all Welsh households – not just those claiming the CTRS. This means that for those benefitting from the scheme, the impact on their household income will be much greater. The concentration of winners among the poorest households suggests that the CTRS is a well-targeted for ameliorating the effects of Council Tax bills on the poorest households – though as discussed later, the overall impact of Council Tax and the CTRS remains regressive with respect to income.

Since March 2020, the Welsh Government have announced an additional £5.5 million to cover additional demand and costs incurred by the scheme in 2020-21.

### Non-domestic rates

The cost of providing additional grants or mandatory non-domestic rates reliefs for businesses will be met in full by the Welsh Government. In supplementary budgets for 2020-21, the Welsh Government has directed £1.2 billion in reliefs and grants for businesses through the non-domestic rates system, with the payments administered by local authorities, with further support announced in October and November (discussed in section 3.2). The Welsh Government will need to decide how much of that support will carry forward into 2021-22.

**Figure 5.8**  
Number of challenges against the 2017 Local Rating List, Wales



Source: Valuation Office Agency (October 2020) *Challenges and Changes against the 2017 Local Rating List (Wales)*

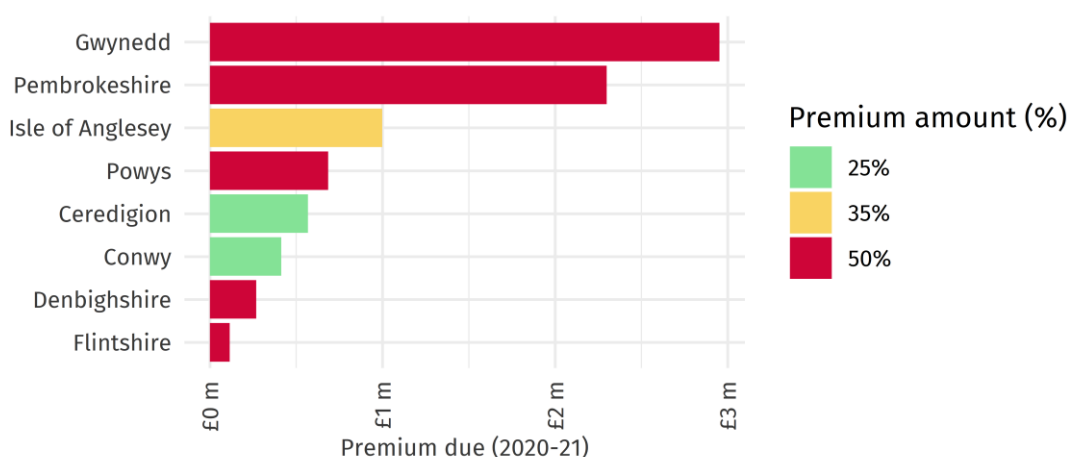
Another way non-domestic rates revenue could be impacted is if the Valuations Office Agency (VOA) grants businesses whose profitability has been affected by Covid-19 a temporary reduction in their rateable value. This in turn would reduce their tax liability. Business ratepayers can appeal to the VOA if the rateable value of their property has been impacted by a 'material change of circumstances'. For instance, a shop-owner might be granted an appeal if

it can be proven that roadworks had significantly impacted their turnover.<sup>39</sup> There was a sharp increase in the number of businesses submitting a 'check' to the VOA in the first quarter of 2020-21, when businesses in many sectors were barred from trading. In Wales, 6,600 'checks' were submitted between April and June, a six-fold increase on the previous quarter (Figure 5.8). It is not yet known whether the VOA will consider the government restrictions imposed as a way of managing the spread of Covid-19 will constitute a "material change of circumstances".

### Council Tax Premiums

Since 2017, local authorities have been able to apply a premium (or discount) of up to 100% of Council Tax bills for second homes and long-term empty homes. In 2020-21, eight local authorities opted to levy a premium on second homes: Gwynedd, Denbighshire, Flintshire, Powys and Pembrokeshire each apply a premium of 50%, the Isle of Anglesey applies a premium of 35% whereas Conwy and Ceredigion both apply a premium of 25%.

**Figure 5.9**  
Additional revenue budgeted to be raised through the Second Homes Premium, 2020–21



Source: WFA analysis of StatsWales (2020) Council tax dwellings, by CT1 row description; StatsWales (2020) Council tax levels by billing authority and band.

Though the total amount of revenue raised via the second home premium is relatively small (£8 million in 2020-21), it has become an increasingly important source of revenue for some local authorities, as illustrated in Figure 5.9. Gwynedd nets an additional £3 million from its application of the premium – equivalent to just under 1% of the local authority's gross revenue expenditure.

<sup>39</sup> Ogden, Kate, David Phillips and Jean-Christophe Spiliotis. 2020. *Covid-19 and English council funding: what is the medium-term outlook?* London: Institute for Fiscal Studies. Accessed 31 October 2020. <https://www.ifs.org.uk/publications/15041>

### 5.3 Tax policy options

The First Minister Mark Drakeford recently reaffirmed his commitment not to increase Income Tax rates before the end of the current Senedd term.<sup>40</sup> But with the 2021 Senedd election fast approaching, several of the parties have started to outline their position on the issue ahead of the next Senedd term. Although the First Minister has not ruled out using the Income Tax varying powers if Labour is again in power, he has said that the party would focus on jobs rather than taxes in the early period after the election.<sup>41</sup> The Shadow Minister of Finance and Conservative MS Nick Ramsay has said that it is far too early to make tax and spend commitments because of Covid, but expresses a long term aim to reduce Income Tax rates when it is prudent to do so.<sup>42</sup> Meanwhile Plaid Cymru leader Adam Price has previously outlined more ambitious proposals to abolish Council Tax and Non-domestic rates and replace them with a new property tax, whilst using some of the proceeds to reduce the basic rate of Income Tax.<sup>43</sup> These proposals are not yet party policy.

Of the three devolved taxes, WRIT is by far the largest source of revenue, bringing in over £2 billion in 2019–20. The Welsh Government can set its own tax rates on this devolved share of non-savings, non-dividend (NS-ND) Income Tax. So far, the devolved rates have been left unchanged at 10p for each band. Effectively, this means that Welsh taxpayers are paying the same rates of income tax as English and Northern Irish taxpayers: 20% on the basic rate, 40% on the higher rate and 45% on the additional rate. However, in Wales, 10% on each band is retained by the Welsh Government to directly fund devolved public services in Wales.

Unlike Scotland, Wales does not currently have powers to adjust thresholds or introduce new income tax bands – it can only adjust the rates set on the three existing bands. **Figure 5.10** illustrates the mechanical effect on the Welsh Budget of increasing or decreasing each band by 1 penny. This excludes any resultant behavioural response – but since only a portion of Income Tax is devolved, the Welsh Government would be relatively shielded from the behavioural response of taxpayers.<sup>44</sup> Given that the Welsh tax base is relatively more skewed towards lower earners compared to the UK average, if the Welsh Government wants to materially alter the size of its budget, it is – to all extent and purposes – limited to adjusting the basic rate.<sup>45</sup>

Excluding behavioural effects, putting a penny on the basic rate of income tax would generate around £180 million in additional revenue. Conversely, cutting the basic rate by 1p would cost £180 million. Putting a penny on the higher rate would raise an additional £25 million while putting a penny on the additional rate would raise a relatively modest £4 million.

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<sup>40</sup> <https://www.bbc.co.uk/news/uk-wales-politics-54161630>

<sup>41</sup> <https://www.bbc.co.uk/news/uk-wales-politics-54161630>

<sup>42</sup> <https://gwydir.wales/2020/07/31/intelligent-spending-needs-intelligent-taxation/>

<sup>43</sup> <https://www.bbc.co.uk/news/uk-wales-politics-51140739>

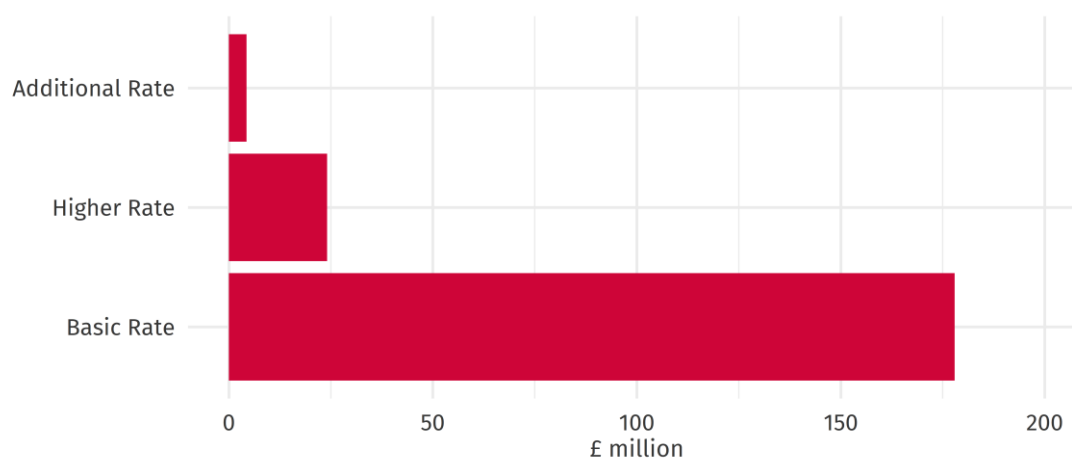
<sup>44</sup> Wales Fiscal Analysis. 2020. *Modelling behavioural responses to changes in Welsh Rates of Income Tax*. Written evidence submission to National Assembly for Wales' Finance Committee inquiry into the 'Impact of variations in national and sub-national income tax'. Accessed 18 November 2020.

[https://www.cardiff.ac.uk/\\_data/assets/pdf\\_file/0019/2413261/Income\\_Tax\\_Inquiry\\_Submission\\_22012020.pdf](https://www.cardiff.ac.uk/_data/assets/pdf_file/0019/2413261/Income_Tax_Inquiry_Submission_22012020.pdf)

<sup>45</sup> See, Poole & Ifan (2018) for a detailed analysis of the Welsh taxbase.

**Figure 5.10**

**Mechanical effect of increasing each rate of devolved Income Tax by 1p, 2021–22**



Source: WFA analysis of OBR (November 2020) Devolved tax forecasts.

Although the current arrangements are more constraining than in Scotland, they benefit the Welsh Government by allowing them to raise additional revenue in a very progressive way if they wished to do so. **Figure 5.11** shows the distributional effect on mean equivalised household income of putting a penny on the basic rate of income tax. Welsh households in the lowest quintile would be largely unaffected by changes to the basic rate. Households in the top quintile would see the largest fall in their income, both in absolute and in percentage terms, seeing a £7.30 (6.6%) reduction in their weekly disposable income.

These charts only show whether a household is better or worse off with respect to their household income. Should an increase in tax rates lead to an improvement in the availability or reduce the costs of accessing government-subsidised services (e.g. public transport, social care provision), some households are very likely to benefit.

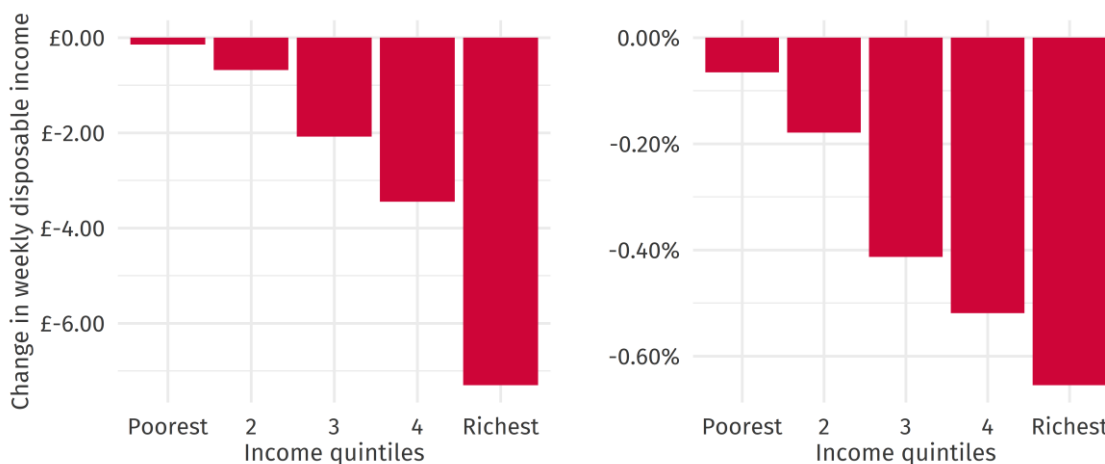
Even when applied to the basic rate, any increase to the devolved portion of Income Tax would be a very progressive way of raising additional revenue for the Welsh Budget. The reasons for this are two-fold. First, the design of Income Tax means that the average tax rate increases as earnings increase. Second, the UK government's decision to substantially increase the generosity of the personal allowance since 2010 means that many of the lowest earners are exempt from paying any Income Tax. In Wales, an estimated 45.7% of adults do not pay any Income Tax, although many are still liable to make National Insurance contributions and pay other direct taxes such as Council Tax.<sup>46</sup>

<sup>46</sup> Ifan, Guto, Cian Siôn and Ed Gareth Poole. 2020. *Wales' Fiscal Future: A path to sustainability*. Cardiff: Wales Fiscal Analysis. Accessed 01 November 2020.

[https://www.cardiff.ac.uk/\\_data/assets/pdf\\_file/0004/1767424/Wales\\_Fiscal\\_Future\\_FINAL.pdf](https://www.cardiff.ac.uk/_data/assets/pdf_file/0004/1767424/Wales_Fiscal_Future_FINAL.pdf)

**Figure 5.11**

**Distributional impact on households of a 1p increase in the Welsh basic rate of income tax, 2021–22**



Source: WFA analysis based on UKMOD A2.0+ using ONS (2016–18) Family and Resources Survey input data. Change in weekly disposable income calculated before housing costs. Assumes that the Job Support Scheme comes to an end before April 2021 and that Covid-related unemployment shocks persist.

### A 'fairer' approach to Council Tax?

Arguably the overarching trend in Welsh fiscal policy over recent years – though not an explicit policy aim – has been the increasing reliance on Council Tax to fund local authority expenditure. Our previous research has shown that in 1999-00, Council Tax accounted for 3.6% of total public sector revenue collected in Wales and that by 2017-18, this had risen to 5.5%.<sup>47</sup> Council Tax is regressive both in terms of income and property value. First, let us look at its effects on household income.

**Figure 5.12** shows the distributional impact of increasing Council Tax rates by 4.78% in April 2021 (the average increase for 2020-21) against a baseline scenario where Council Tax is frozen in cash terms. The nominal tax burden falls relatively equally on households across the income distribution – with households in the lowest quintile partially shielded by the Council Tax Reduction Scheme (CTRS).

But when expressed as a percentage of income, the effect of the Council Tax increase disproportionately impacts those households with lower income levels. The effect on the incomes of households in the second quintile would be nearly three times greater than the

<sup>47</sup> Ifan, Guto and Cian Siôn. 2019. *Trends in local government finance: October 2019*. Cardiff: Wales Fiscal Analysis. Accessed 12 November 2020.

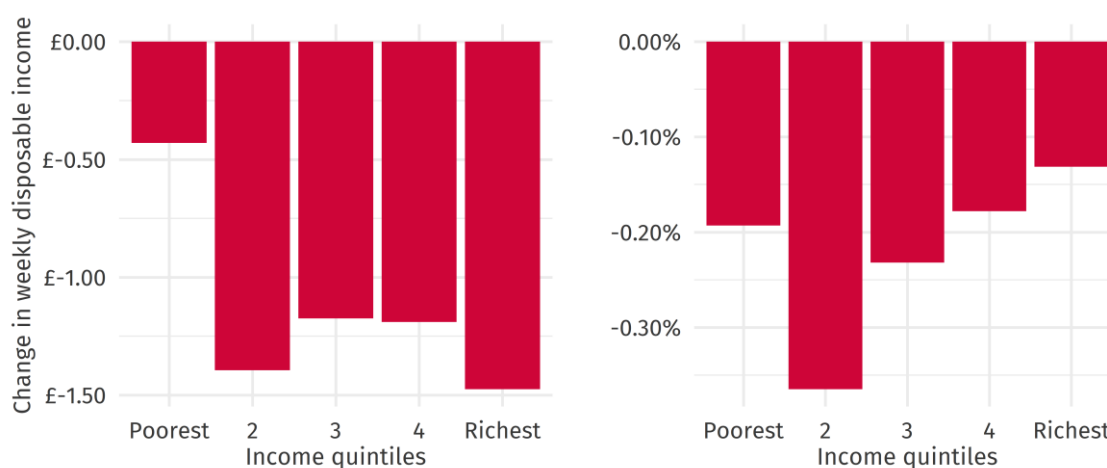
[https://www.cardiff.ac.uk/\\_data/assets/pdf\\_file/0003/1709904/Local\\_Government\\_Briefing\\_Oct19.pdf](https://www.cardiff.ac.uk/_data/assets/pdf_file/0003/1709904/Local_Government_Briefing_Oct19.pdf)

richest quintile. Even those in the poorest quintile would see a larger proportional drop in their income compared with the 50% of households with the highest income.

Of course, it is well documented that Council Tax is regressive with respect to income. The Welsh Government has committed to working with local government to review Council Tax to make it fairer and has recently commissioned work to explore potential replacements to Council Tax and non-domestic rates. It is also regressive with respect to property value, with residents of higher-valued properties paying a smaller Council Tax bill as a proportion of their property value compared to those living in lower-valued properties. This makes it difficult to justify Council Tax as a tax on assets – not least because the tax burden falls on the resident and not the property owner.

**Figure 5.12**

**Distributional impact on households of another 4.78% increase in Council Tax, 2021–22**



*Source: WFA analysis based on UKMOD A2.0+ using ONS (2016–18) Family and Resources Survey input data. Change in weekly disposable income calculated before housing costs. Assumes that the Job Support Scheme comes to an end before April 2021 and that Covid-related unemployment shocks persist.*

The regressive effects of the tax with respect to income have been amplified by the fact that increases in Council Tax bills have outpaced growth in earnings in every single year since 2009. Between 2009 and 2019, the average Band D Council Tax bill in Wales grew by 45%, whereas median earnings grew by only 20% over the same period (Figure 5.13). Working age households would have been most adversely affected by laggard earnings growth over this period.

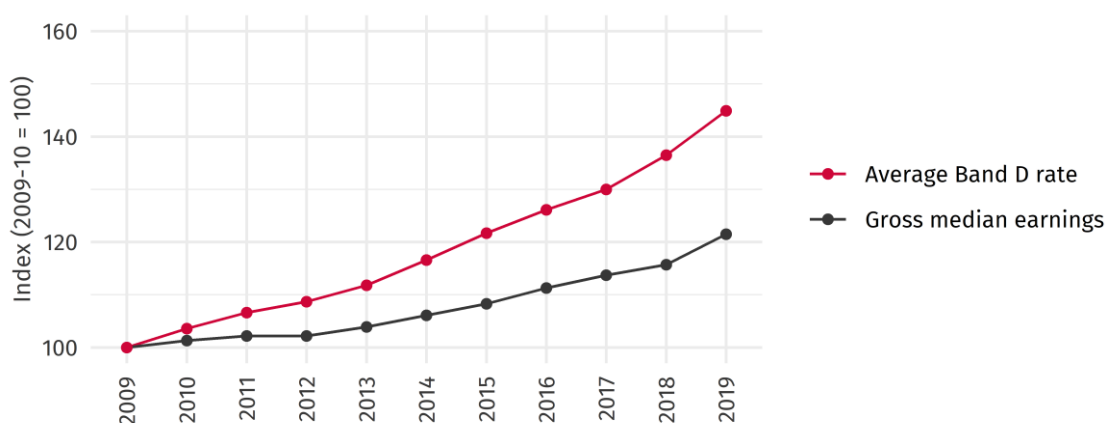
Several options for reforming or replacing Council Tax have been mooted in recent years. The Institute for Fiscal Studies has analysed different ways of changing the banding structure and



the distributional effects of a revaluation across households and regions.<sup>4849</sup> The Welsh Government recently published a report examining the practicalities of local income tax as a replacement for Council Tax.<sup>50</sup> And research published by Bangor University, and commissioned by the Welsh Government, found that a 1.41% tax on residential land value could raise sufficient revenues to replace Council Tax in Wales.<sup>51</sup> Though it is beyond the scope of this report to assess the merits of these alternative proposals, it is worth taking a closer look at the possibility of using the Welsh Government’s newly devolved powers over Income Tax to raise additional revenue and limit increases to Council Tax. While this would not address any of the underlying weaknesses of Council Tax as a revenue tool, it does provide a pragmatic way of mitigating the tax’s regressive effects.

**Figure 5.13**

**Growth in average band D rate and growth median earnings in Wales**



Source: Authors’ calculation based on StatsWales (2020) *Average Band D Council Tax*; ONS (2019) *Annual Survey of Hours and Earnings*. Average Band D rate excludes police precepts but includes community precepts.

Given that the Welsh Government has the tools to raise considerable amounts of revenue in a progressive way, it is worth asking whether this could be used to supplement revenues raised through Council Tax. We can show the distributional effects of such an approach by constructing an alternative policy. To illustrate, we compare a baseline scenario where Council Tax increases by 4.8% in 2021-22 (the average increase in 2020-21) with an alternative scenario

<sup>48</sup> The last revaluation in England took place in 1991, when Council Tax replaced the Community Charge – more commonly known as the Poll Tax. A revaluation was conducted in Wales in 2003.

<sup>49</sup> Adam, Stuart, Louis Hodge, David Phillips and Xiaowei Xu. 2020. *Revaluation and reform of council tax in Wales: impacts on different councils and household types*. London: Institute for Fiscal Studies. Accessed 31 October 2020. <https://www.ifs.org.uk/publications/14760>

<sup>50</sup> Bunt, Jennie. 2020. *An assessment of the feasibility of local income tax to replace council tax in Wales*. Cardiff: Welsh Government. Accessed 17 November 2020. <https://gov.wales/local-income-tax-scoping-feasibility>

<sup>51</sup> ap Gwilym, Rhys, Edward Jones and Helen Rogers. 2020. *A technical assessment of the potential for a local land value tax in Wales*. Cardiff: Welsh Government. Accessed 21 October 2020. <https://gov.wales/sites/default/files/statistics-and-research/2020-03/technical-assessment-of-the-potential-for-a-local-land-value-tax-in-wales.pdf>

where Council Tax is frozen in cash terms, with the cost of this policy funded by a rise in the basic rate of Income Tax. Though the cost of the policy is subject to additional uncertainties given the current fiscal context, results derived from the UKMOD tax-simulation model suggest that the cost of freezing Council Tax in cash terms for one year at 2020-21 levels could be met in full by levying an additional 0.37 pence (£0.0037) on the basic rate of Income Tax, raising the tax rate from 20.00% to 20.37%. The cost of implementing the policy is partially financed by savings in operating CTRS. **Figure 5.14** outlines the distributional impact of implementing this cost-neutral policy.

Though the costings are subject to uncertainty, the illustrative effect is clear. In contrast to the previous scenario, this policy would generate winners as well as losers. Households in the top two quintiles would be marginally worse-off compared to the baseline. Meanwhile, the poorest 60% of households would be better-off. Although households in the top quintile would see a fall in their absolute levels of income, this decrease would amount to less than 0.11% of their weekly income. This reduction is only a third of the reduction in income faced by the worst-off households in the previous scenario.

**Figure 5.14**  
Distributional impact on households of funding a Council Tax freeze using a 0.37p increase in the Basic Rate of Income Tax, 2021–22



*WFA analysis based on UKMOD A2.0+ using ONS (2016–18) Family and Resources Survey input data. Change in weekly disposable income calculated before housing costs. Assumes that the Job Support Scheme comes to an end before April 2021 and that Covid-related unemployment shocks persist.*

The scale of any changes in distributional effect is small and the effects would vary across local authorities which set different rates of tax. Nevertheless it does point to the fact that leaving the devolved income tax rates unchanged (retaining the *status quo*) could *itself* be a political decision if it directly results in local authorities to propose steeper increase to Council Tax levels in order to meet any funding gap. The UK Chancellor’s decision to allow English local authorities to propose steeper increases to Council Tax could be a step in this direction. If this is the case,

the overall distributional effect on household income could be regressive. And if the progressivity of taxes with respect to income is a marker of fairness, it would not be the fairest way of funding government expenditure either.

These scenarios highlight some of the fiscal tools that tax devolution has made available. It is important that the Welsh Government takes a holistic approach to taxation, one that considers both devolved and local taxes, how they interact, and how both can be conducive to realising policy outcomes. Though the Welsh Government's tax powers are limited, they can still be used to fund higher levels of spending in a progressive manner, or to shield poorer households from less progressive elements of local taxes and the reserved tax system.

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