Agenda - Finance Committee

Meeting Venue:

Video Conference via Zoom

Meeting date: 13 January 2021

Meeting time: 09.00

For further information contact:

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Committee Clerk

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In accordance with Standing Order 34.19, the Chair has determined that the public are excluded from the Committee's meeting in order to protect public health. This meeting will be broadcast live on www.senedd.tv

1 Introductions, apologies, substitutions and declarations of interest

2 Scrutiny of the Welsh Government's Draft budget 2021-22: Evidence session 2

(09.00-10.00) (Pages 1 - 69)

Richard Hughes, Chairman, Office for Budget Responsibility

Andy King, Budget Responsibility Committee member, Office for Budget Responsibility

Supporting papers:

FIN(5)-02-21 P1 - Welsh taxes outlook (December 2020)

Research Brief

BREAK (10.00-10.10)

Senedd Cymru
Welsh Parliament

3 Scrutiny of the Welsh Government's Draft budget 2021-22: Evidence session 3

(10.10-11.10) (Pages 70 - 121)

Jon Rae, Director of Resources, Welsh Local Government Association

Dilwyn Williams, Chief Executive, Gwynedd Council

Darren Hughes, Director, Welsh NHS Confederation

Supporting papers:

FIN(5)-02-21 P2 - Written evidence: Welsh Local Government Association

FIN(5)-02-21 P3 - Written evidence: Welsh NHS Confederation

Research Brief

BREAK (11.10-11.20)

4 Scrutiny of the Welsh Government's Draft budget 2021-22: Evidence session 4

(11.20-12.20) (Pages 122 - 153)

Dr Ed Poole, Senior Lecturer, Wales Governance Centre (Wales Fiscal Analysis)

Guto Ifan, Research Associate, Wales Governance Centre (Wales Fiscal Analysis)

David Phillips, Associate Director, Institute of Fiscal Studies

Supporting papers:

FIN(5)-02-21 P4 - Written evidence: Wales Governance Centre (Wales Fiscal Analysis)

Research Brief

5 Motion under Standing Order 17.42 (ix) to resolve to exclude the public from the remainder of this meeting

(12.20)

6 Scrutiny of the Welsh Government's Draft budget 2021-22: Consideration of evidence

(12.20-12.30)

Agenda Item 2

Office for
Budget Responsibility

Welsh taxes outlook

December 2020

Contents

Charts and tables data are available on our website.

1 Introduction

Background

1.1 The Office for Budget Responsibility (OBR) was established in 2010 to provide independent and authoritative analysis of the UK's public finances. Alongside the UK Government's Budgets and other fiscal statements, we produce forecasts for the economy and the public finances. We publish these in our *Economic and fiscal outlook* (*EFO*).

1.2 In December 2016 the Welsh and UK Governments agreed the Welsh Government's fiscal framework. This established a mechanism for adjusting the block grant funding that the Welsh Government receives from the UK Government to reflect the devolution of tax powers. The fiscal framework also established a requirement for independent forecasting, stating that *"the Welsh Government will be able to decide whether to use the OBR's forecasts or put in place alternative independent forecasting arrangements"*.[1] In the event, the Welsh Government chose to use our forecasts to meet this requirement.[2]

1.3 We formally took on this role in April 2019, and agreed a Memorandum of Understanding, Terms of Reference and a Financial Framework with the Welsh Government in order to guide the work and ensure that we can bring all relevant information to bear in producing our forecasts. We have jointly reviewed these arrangements to ensure they reflect any lessons learnt in our first year of forecasting.[3] We published the first *Welsh taxes outlook (WTO)* alongside the Welsh Government's 2020-21 Draft Budget in December 2019.

1.4 In this *WTO*, published alongside the Welsh Government's Draft Budget, we describe our latest forecasts for three sources of revenue:

- the **Welsh rates of income tax**;
- **land transaction tax**; and
- **landfill disposals tax**, as well as how each has changed since the previous forecast.

1.5 As set out in Chapter 1 of last year's *WTO*, we focus exclusively on these devolved taxes given their role in the fiscal framework. Some areas that are therefore beyond the scope of our role include: a full macroeconomic forecast for Wales; a forecast for Welsh Government spending; and an assessment of any policy proposals (rather than stated policies).

[1] More detailed information on the relevant legislation and governance is available on our website.
[2] Written statement by the Cabinet Secretary for Finance, *Provision of Welsh tax forecasts by the Office for Budget Responsibility*.
[3] The joint review has been published on our website alongside this *Welsh taxes outlook*.

1.6 These forecasts are consistent with the central forecast for the UK economy and public finances presented in our November 2020 *EFO*. As it explained, the nature of the uncertainties around the path of the coronavirus pandemic, the public health restrictions in place across the UK to control it, the timing and effectiveness of vaccines under development, and what were at the time continuing Brexit negotiations, meant that the central forecast was best interpreted as representing an intermediate scenario rather than a median (or mean) forecast as would normally be the case.

1.7 The methodology and the forecasts represent the collective view of the three independent members of the OBR's Budget Responsibility Committee (BRC). We take full responsibility for the judgements that underpin them. All the charts and tables presented in this document, plus supplementary forecast material, are available in spreadsheet format on our website.

Forecast timetable

1.8 In order to produce the forecasts presented in this document:

- OBR officials and members of the BRC met with Welsh Government officials on 17 July, to review and update the forecast models.
- Analysts from the Welsh Government and HMRC produced draft Welsh tax forecasts, using determinants published in our November 2020 *EFO*, plus the latest available liabilities and receipts data. The BRC scrutinised these forecasts on 20 October.
- On 15 December, we finalised our Welsh taxes forecast, incorporating the impacts of UK Government policy announcements up to and including Spending Review 2020, as well as updated outturn data published since then. Our LTT forecasts also include the effects of policies announced by the Welsh Government in its Draft Budget.

Structure of the document

1.9 The rest of this document is structured as follows:

- **Chapter 2:** income tax on non-savings, non-dividend income from the Welsh rates.
- **Chapter 3:** land transaction tax.
- **Chapter 4:** landfill disposals tax.
- **Annex A:** summary of the forecasts required for the block grant adjustments.

2 Welsh rates of income tax

2.1 This chapter:

- describes the **Welsh rates of income tax** and how they are levied on non-savings, non-dividend income by tax band;
- sets out our **methodology** for forecasting UK income tax liabilities and the Welsh share of this total, before splitting this share out by tax band;
- presents our **latest forecasts** for the Welsh rates and for UK income tax liabilities; and
- outlines some of the **risks and uncertainties** around our Welsh rates forecast.

What are the 'Welsh rates of income tax'?

2.2 The Welsh rates of income tax came into effect in April 2019. They are administered and collected by HMRC. There are four important aspects of the design and operation of these rates in Wales that distinguish them from our UK-wide income tax forecasts:

- First, they apply only to Welsh taxpayers, who are defined as **individuals whose main place of residence is in Wales** for the majority of the tax year. Individuals who are classified as Welsh resident are given a 'C' flag on their HMRC tax identifier.
- Second, the Welsh rates represent only the first **10p in the pound for each tax band**. Each year, the Welsh Government is required to set the tax rates for each of the basic, higher and additional tax rates, which replace a 10p reduction in the reserved UK Government element of each tax band. For 2019-20 and 2020-21 these rates were set such that overall income tax rates paid by Welsh taxpayers remained aligned with those in England and Northern Ireland. The remaining income tax raised from Welsh taxpayers – i.e. 10p in the pound from basic rate payers, 30p from higher rate payers and 35p from additional rate payers – is reserved to the UK Government.
- Third, the Welsh rates are levied on **non-savings, non-dividend (NSND) income**. NSND income accounts for just over 90 per cent of UK-wide income tax liabilities, and around 95 per cent in Wales.
- Finally, the Welsh rates are assessed on a **liabilities basis** rather than a National Accounts basis. This means that our forecast of self-assessment (SA) income tax used for the Welsh rates will differ from the cash basis used in our UK-wide SA income tax forecast, due to the lag between liabilities being incurred and tax being paid (which is also when it is recorded in the National Accounts).

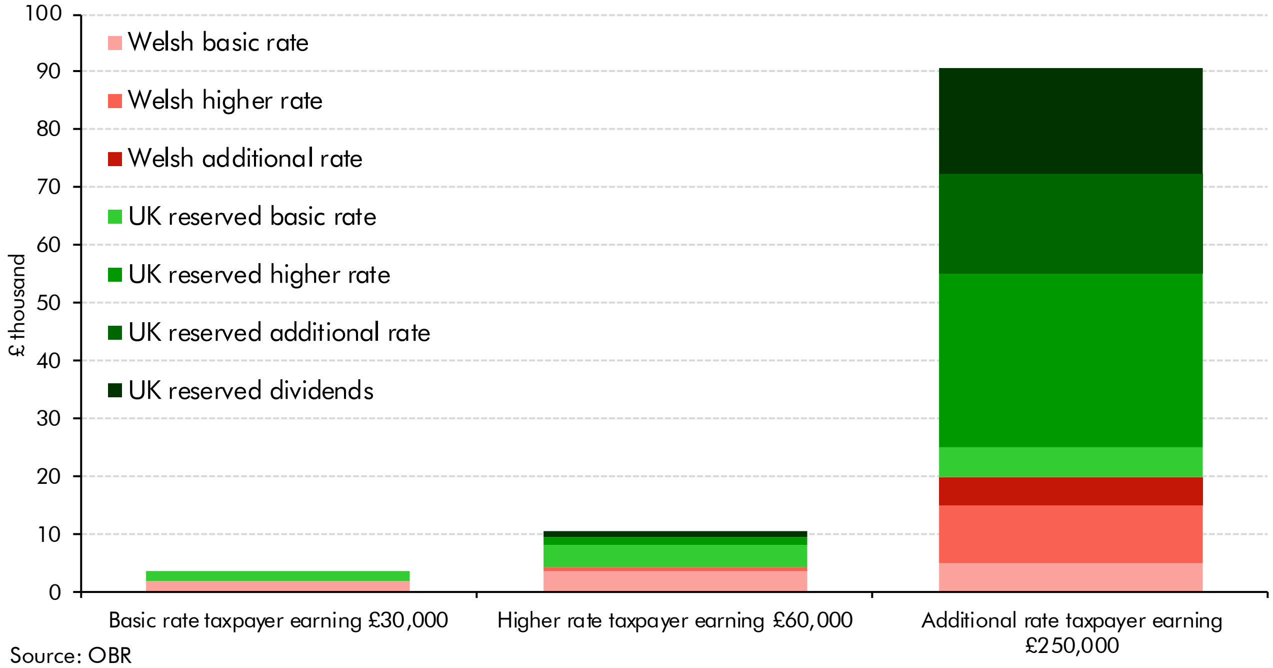
2.3 Chart 2.1 illustrates how the 2020-21 income tax liability of three specimen Welsh taxpayers would be split between the UK and Welsh Governments:[1]

- **For a basic rate taxpayer earning £30,000** from only one source of employment income, their £3,500 liability would be split equally between the two administrations. This results in an effective income tax rate paid by this individual of 11.7 per cent (lower than the 20 per cent basic rate thanks to the £12,500 tax-free personal allowance).
- **For a higher rate taxpayer earning £60,000**, with £55,000 coming from employment and £5,000 of dividends from company shareholdings, 41 per cent of their £10,475 liability would relate to the Welsh rates and 59 per cent would be reserved to the UK Government, including all the £975 due on their dividend income. The effective income tax rate paid by this individual is 17.5 per cent.
- **An additional rate taxpayer earning £250,000**, with £200,000 from employment income and £50,000 in dividends, would have a total tax liability of £90,788. Of this, only 22 per cent would relate to the Welsh rates, while 78 per cent would go to the UK Government. At this income level a taxpayer would not receive any personal allowance. The higher share for the UK Government reflects two factors: first, all earnings above £37,500 would be taxed at the higher or additional rates where the UK Government share is much larger; and second, the taxpayer has a liability of £18,288 from their dividend income, all of which is retained by the UK Government. The effective income tax rate paid by this individual is 36.3 per cent.

2.4 These examples illustrate the relative importance of higher earners for tax receipts, but that this is much less the case for the Welsh rates. The higher rate taxpayer earns twice as much as the basic rate taxpayer, but has an overall tax liability that is three times greater and a Welsh rates liability that is only a little over twice as large. The additional rate taxpayer earns four times as much as the higher rate taxpayer, but has a tax liability that is more than eight times greater and a Welsh rates liability that is somewhat less than five times greater. The UK Government's tax revenues are therefore more sensitive to changes in high-earners' incomes than the Welsh Government's revenues are.

[1] In addition to the income tax parameters reported in Table 2.2, this also reflects the personal allowance taper that withdraws £1 of personal allowance for every £2 of earnings above £100,000; the dividend allowance of £2,000; and tax rates on dividend earnings of 7.5 per cent for basic rate taxpayers, 32.5 per cent for higher rate taxpayers and 38.1 per cent for additional rate taxpayers. These specimen examples are illustrative and do not include all aspects of the income tax regime, for example the use of reliefs to lower liability.

Chart 2.1: Illustrative splits between Welsh and UK Government income tax liabilities



Source: OBR

2.5 The December 2016 fiscal framework agreement between the Welsh and UK Governments detailed how the Welsh rates would operate.[2] In doing so it placed a requirement on us to forecast income tax liabilities in Wales, and in England and Northern Ireland combined, split by tax band. This was not something that had previously been necessary or possible.[3]

Methodology

2.6 Our Welsh income tax forecasts are produced on a 'top-down' basis.[4] The main steps are:

- First, we establish the **whole of the UK NSND income tax liabilities** forecast.
- Next, we calculate the **share of NSND income tax liabilities subject to the Welsh rates**, taking into account the relevant tax base in Wales and how this maps onto the announced tax regime. Much of our analysis first looks at the total share of income tax from Wales – including amounts paid by Welsh taxpayers but reserved to the UK Government – before estimating the proportion that is subject to the Welsh rates.
- Finally, we add our estimates of the effect of **new policies** announced since our previous forecast on Welsh rates liabilities.

[2] HM Government and Welsh Government, *The agreement between the Welsh Government and the United Kingdom on the Welsh Government's fiscal framework*, December 2016.
[3] For more on our approach, see Mathews, P. *Working paper no. 14: Devolved income tax: forecasting by tax bands*, September 2018.
[4] For more detail on our forecast methodology see Chapter 2 of our December 2019 *Welsh taxes outlook* and the 'Welsh tax forecasts' page of our website.

Pre-measures UK-wide forecast

2.7 We use HMRC's latest published UK-wide NSND income tax liabilities outturn as the starting point for our pre-measures forecast. This relates to a tax year some distance in the past (currently 2017-18), given the lags between liabilities being incurred and tax being paid. To project liabilities between that outturn year and the year in progress, we produce an in-year estimate based on HMRC's most recent monthly tax receipts data.

2.8 We forecast growth in the UK income tax base in line with our wider economy forecast. The key determinants are employment and average earnings growth, which determine the amount of labour income that can be taxed, and CPI inflation, which is used to uprate tax thresholds in the absence of other stated policies.

2.9 We forecast income tax at the UK level according to the different methods by which HMRC collects the tax. PAYE income tax accounts for over 80 per cent of revenue, with nearly all the remainder collected via the SA system. PAYE income mainly represents the earnings of employees, while SA income includes profits from self-employment and income from dividends, land and property, and savings.

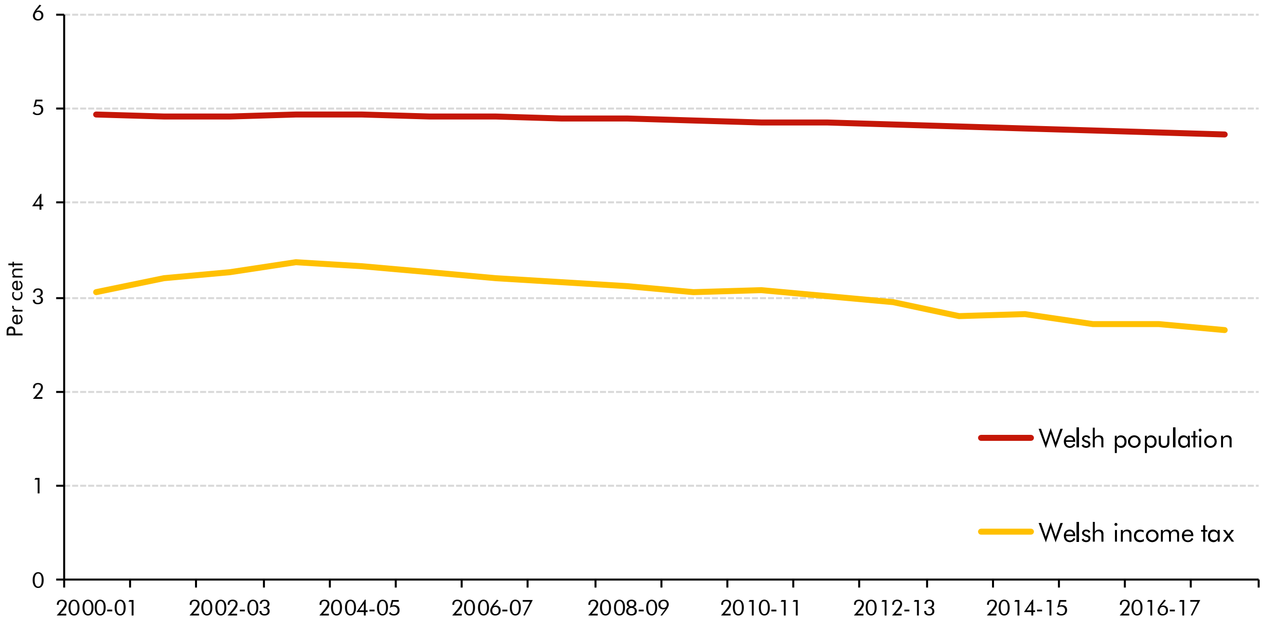
The share of UK-wide income tax liabilities subject to the Welsh rates

The overall Welsh share of UK-wide income tax liabilities

2.10 Armed with our forecast for UK NSND income tax liabilities, we then need to calculate the share that will be subject to the Welsh rates and apply this to the UK forecast. This is done in two steps. First, we calculate the overall Welsh share of income tax as captured by HMRC's survey of personal incomes (SPI). This is an annual survey based on a sample of around 745,000 individuals in contact with HMRC. It is published with a long lag, with the 2017-18 SPI being the latest year available. This pre-dates the Welsh rates coming into effect, so it refers to all income tax paid by Welsh taxpayers. HMRC expects to publish the 2018-19 SPI in early 2021.

2.11 Chart 2.2 compares the Welsh share of UK income tax liabilities with the Welsh share of the UK population. Both have been declining – the Welsh share of income tax more rapidly. Perhaps the most striking feature of the chart is how much lower the Welsh share of income tax is compared with its share of the population (2.6 versus 4.7 per cent in 2017-18). On this basis, income tax liabilities per person in Wales in 2017-18 were 44 per cent lower than in the UK as a whole (£1,539 versus £2,757).

Chart 2.2: Welsh share of UK income tax liabilities and population

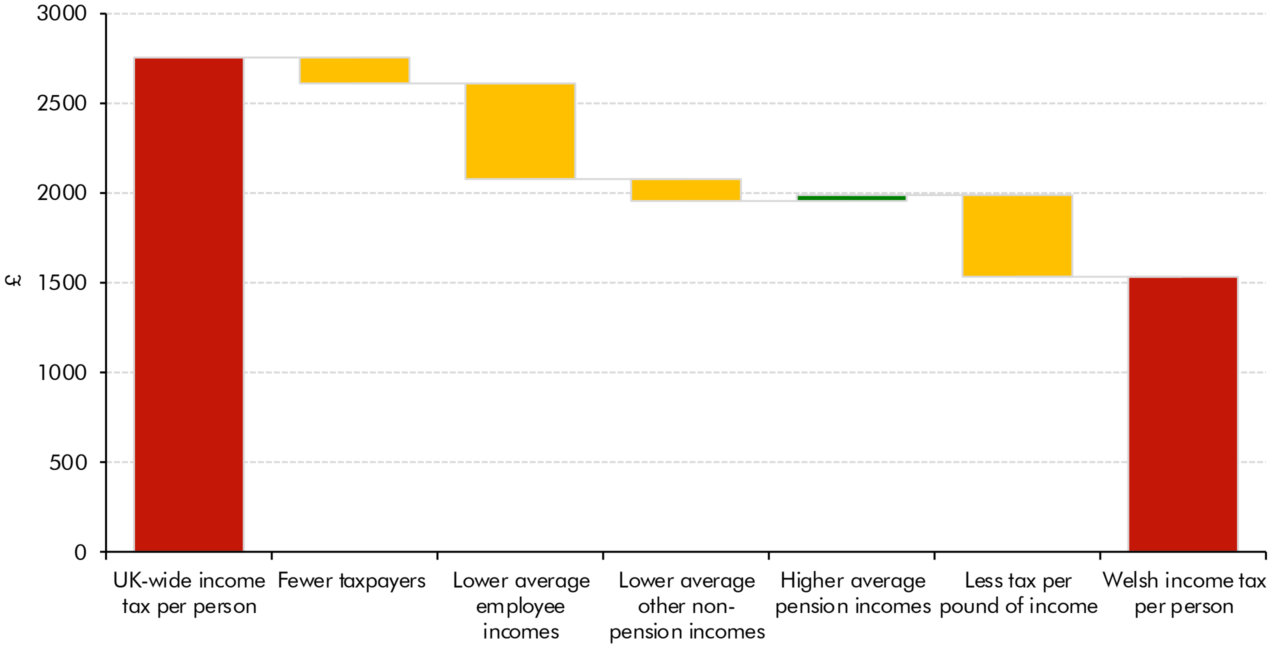


Note: Tax data unavailable for 2008-09 so the proportional shares are based on interpolation from the adjacent years.
Source: HMRC, ONS

2.12 We can readily incorporate differences in expected population growth in our forecasts as the ONS publish these, but understanding why tax per person in Wales is lower than in the UK, and how it has evolved over the past, can help inform other assumptions we make about the future Welsh tax share. To investigate this, we update the analysis from last December's *Welsh taxes outlook* and extend it to look at changes over several years (Box 2.1).

2.13 In Chart 2.3 we use the latest SPI data to show how the difference in tax liabilities per person can be attributed to three underlying factors: the proportion of the population that are taxpayers; the average incomes of those taxpayers (split into different sources); and the amount of tax paid per pound of income (i.e. the effective tax rate (ETR)). Analysing the difference in this way facilitates any forecast judgements we may wish to make about how the Welsh share of income tax will evolve.

Chart 2.3: Welsh and UK income tax liabilities per person in 2017-18



Source: HMRC, OBR calculations

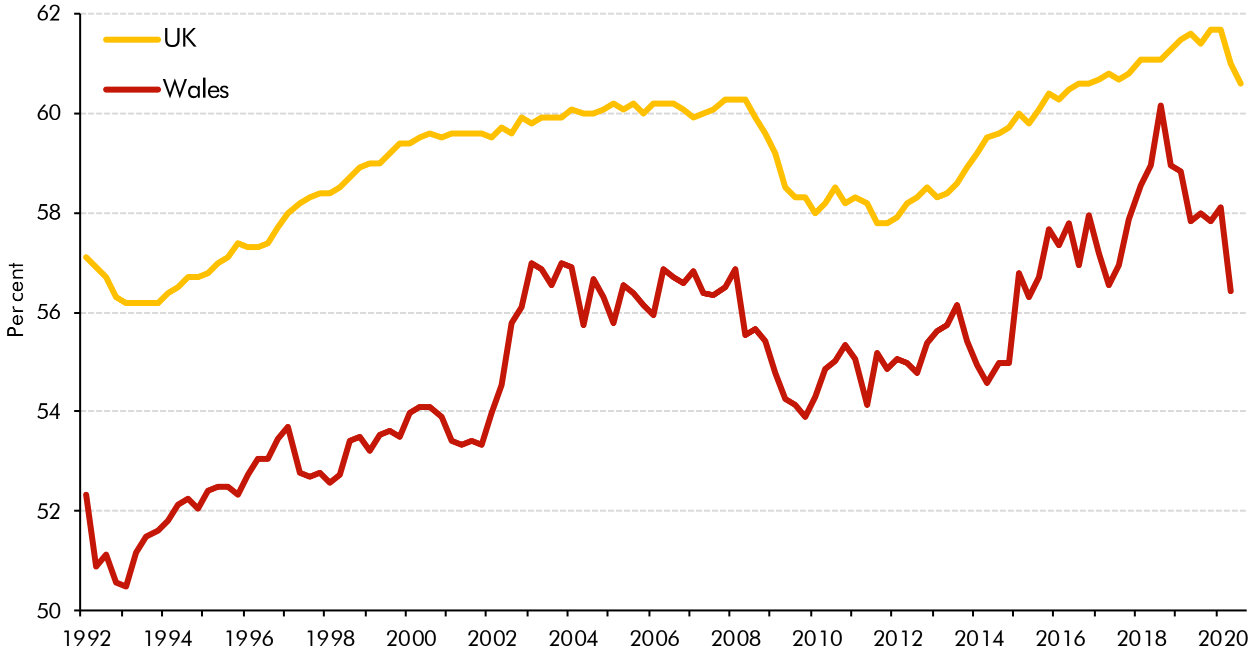
The proportion of the population that pay income tax

2.14 The likelihood of an individual paying income tax is lower in Wales than it is in the UK as a whole. According to the 2017-18 SPI, 43 per cent of the Welsh population paid income tax, compared to 48 per cent of the UK's population, accounting for around 12 per cent of the gap between Welsh and UK income tax liabilities per person.

2.15 There are two main factors that are likely to explain the lower proportion of taxpayers in the population in Wales. First, the employment rate in Wales is lower than in the UK as a whole. Chart 2.4 shows that the employment rate in Wales has been consistently below that in the UK in recent years.[5] On average since 1992, the rate in Wales has been 4.2 percentage points lower than that in the UK as a whole. In 2017-18 it was 3.7 percentage points lower.

[5] The employment rate here is the proportion of people aged 16 and over who are in paid work.

Chart 2.4: Employment rate for the UK and Wales



Source: ONS

2.16 Second, successive rises in the tax-free personal allowance – from £6,475 in 2010-11 to £11,500 in 2017-18 – are likely to have taken proportionately more Welsh residents out of income tax altogether due to differences in the earnings distribution between Wales and the UK as a whole. This helps explain why the number of taxpayers remained flat in the UK between 2010-11 and 2017-18, but dropped by 6 per cent in Wales, despite increases in the population and employment rates in both.

Average income per taxpayer

2.17 The most important reason for the gap between UK and Welsh tax per person as recorded in the SPI is that Welsh taxpayers had lower average incomes. This explains around half the shortfall in tax per person in 2017-18.

2.18 Table 2.1 displays different sources of income averaged across all income taxpayers. It shows that the vast majority of taxpayer income in both the UK and Wales comes from employee jobs, so it is not surprising that this represents the largest source of difference in tax liabilities per taxpayer (as shown in Chart 2.3). It also shows that the SPI implied average income in Wales is 19 per cent lower than in the UK as a whole, with the difference particularly marked in self-employment and other non-pension income (including savings and dividends). By contrast, the average income from pensions is 8 per cent higher in Wales. The higher proportion of the Welsh population that are of pension age (21 per cent in 2017 versus 18 per cent in the UK as a whole), and the higher proportion of public sector workers in Wales, will both contribute to this difference.

Table 2.1: Average incomes in 2017-18 by type

	UK	Wales	Difference	
	£ per taxpayer		£s	Per cent
Employee income	23,910	19,333	-4,577	-19
Self-employment and other non-pension income	5,974	3,615	-2,360	-39
Pension income	4,840	5,207	368	8
Total income	**34,615**	**28,148**	**-6,467**	**-19**

2.19 Table 2.2, which focuses just on employee income, shows that this large gap in average earnings is also reflected in other sources of labour income data. The coverage of each differs so they are not fully comparable, but while the level of average earnings reported by each is different, all show that average employee incomes in Wales are considerably lower than those for the UK as a whole.[6]

Table 2.2: Different measures of average employee earnings in 2017-18

	UK	Wales	Difference	
	£ per employee		£s	Per cent
HMRC Survey of personal incomes	31,610	26,126	-5,484	-17
HMRC Real-time information	28,214	23,563	-4,651	-16
ONS Annual survey of hours and earnings	28,193	24,479	-3,714	-13
ONS Labour force survey	31,353	27,749	-3,603	-11

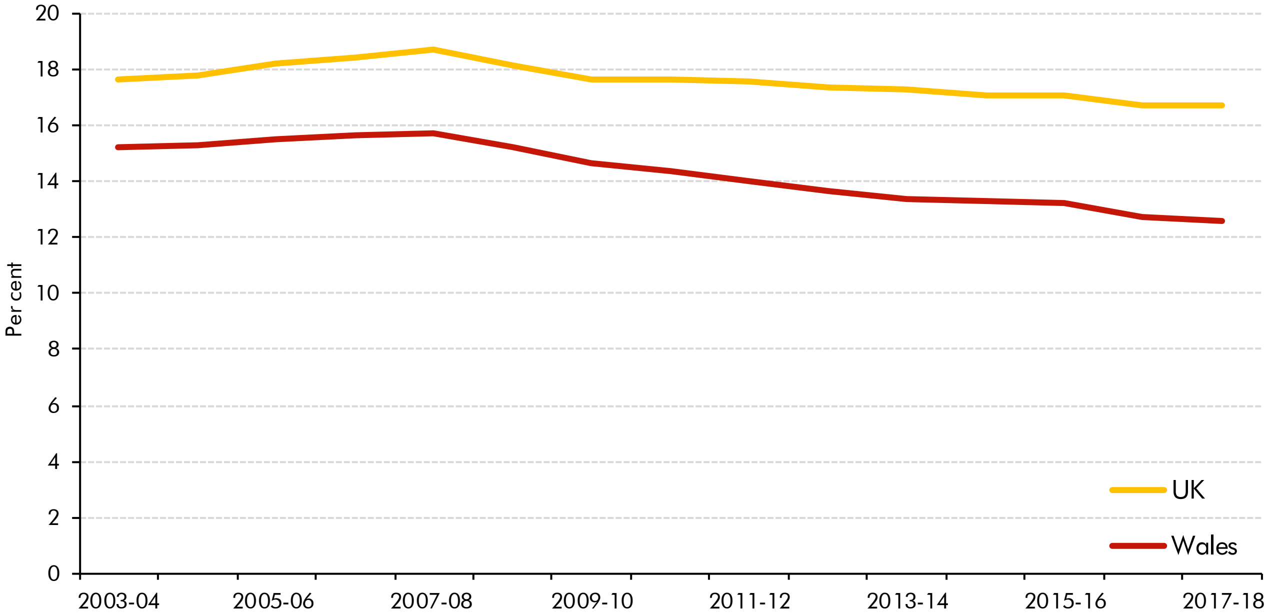
Average amounts of tax paid per pound of income

2.20 Even once we have accounted for differences in the number of taxpayers per person and the average income per taxpayer, income tax per person in Wales falls well short of that in the UK because less tax is paid per pound of income. This lower effective tax rate explains over a third of the difference. In part this reflects the progressive income tax structure interacting with lower average incomes – for example, all else equal there will be a higher share of tax paid at the basic rate in Wales than there is in the UK as a whole. But it also reflects the shape of the earnings distribution. In the UK as a whole, relatively more income tax comes from top-end taxpayers who face the highest marginal tax rates.

2.21 Chart 2.5 shows that the effective income tax rate in Wales has been considerably lower than that in the UK across the past decade. It has also declined somewhat faster, by 3 percentage points between the peak in 2007-08 and 2017-18 compared with 2 percentage points in the UK as a whole.

[6] The difference in the SPI average between Tables 2.1 and 2.2 is because the latter is only averaging across those individuals with employment income, while the former is doing so across all individuals. This explains why the average is lower in Table 2.1, since it includes some individuals, for example pensioners, with no employment income.

Chart 2.5: Effective income tax rates in Wales and the UK

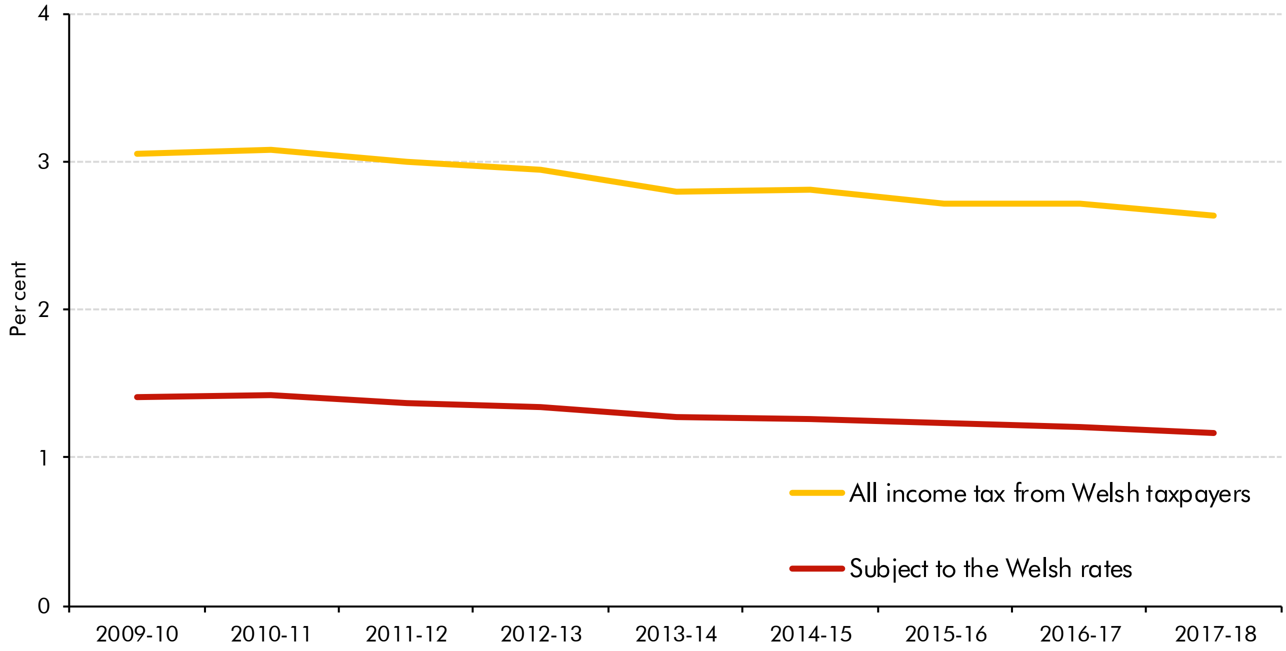


Note: Data unavailable for 2008-09 so the proportional shares are based on interpolation from the adjacent years.
Source: HMRC

The share of Welsh income tax liabilities subject to the Welsh rates

2.22 The final step in estimating the share of UK income tax liabilities that will be subject to the Welsh rates is a mechanical one. We estimate the share of Welsh NSND income that will be taxed in each tax band and then calculate the relevant fraction of it that would be covered by the first 10p – i.e. 50 per cent for income taxed at the basic rate, and so on. Chart 2.6 shows all the income tax collected from Welsh taxpayers as a proportion of total UK income tax (2.6 per cent in 2017-18) and compares it to the amount actually devolved – i.e. the share that would be subject to the Welsh rates (1.17 per cent in 2017-18).

Chart 2.6: Welsh shares of total UK income tax liabilities: all tax from Welsh taxpayers versus the Welsh rates of income tax



Source: HMRC

Forecasting the share of income tax liabilities subject to the Welsh rates

2.23 From these starting points, we adjust our forecast for the overall Welsh share in three ways:

- **RTI earnings**: we fill in the period between 2017-18 and 2019-20 using RTI data on the Welsh share of total pre-tax employee earnings (i.e. the product of employee numbers and average earnings). In the absence of timely information on other forms of NSND income, we assume that the RTI earnings data are representative of the total. Applying this approach in our Scottish income tax forecasts has suggested that it provides a reasonable guide to movements in NSND income shares.

- **Population**: beyond 2019-20, we factor in relative population growth rates based on the most recent ONS principal population projections.[7] These show the Welsh share of the UK population continuing to decline, and we would expect this to reduce the Welsh share of income tax payers.[8] We adjust for this using an index of the Welsh share of the UK's adult population.

- We include adjustments for **gift aid and those previously announced policies** that have been or will be implemented between the SPI base year (2017-18) and the end of our forecasts and that are expected to affect the Welsh share.

[7] The ONS updated its projections for Wales on 23 June, which has been incorporated in this forecast.
[8] See Box A.2 in Annex A of our 2018 *Fiscal sustainability report* for a discussion of the fiscal risks that might be associated with demographic trends in the constituent nations of the UK.

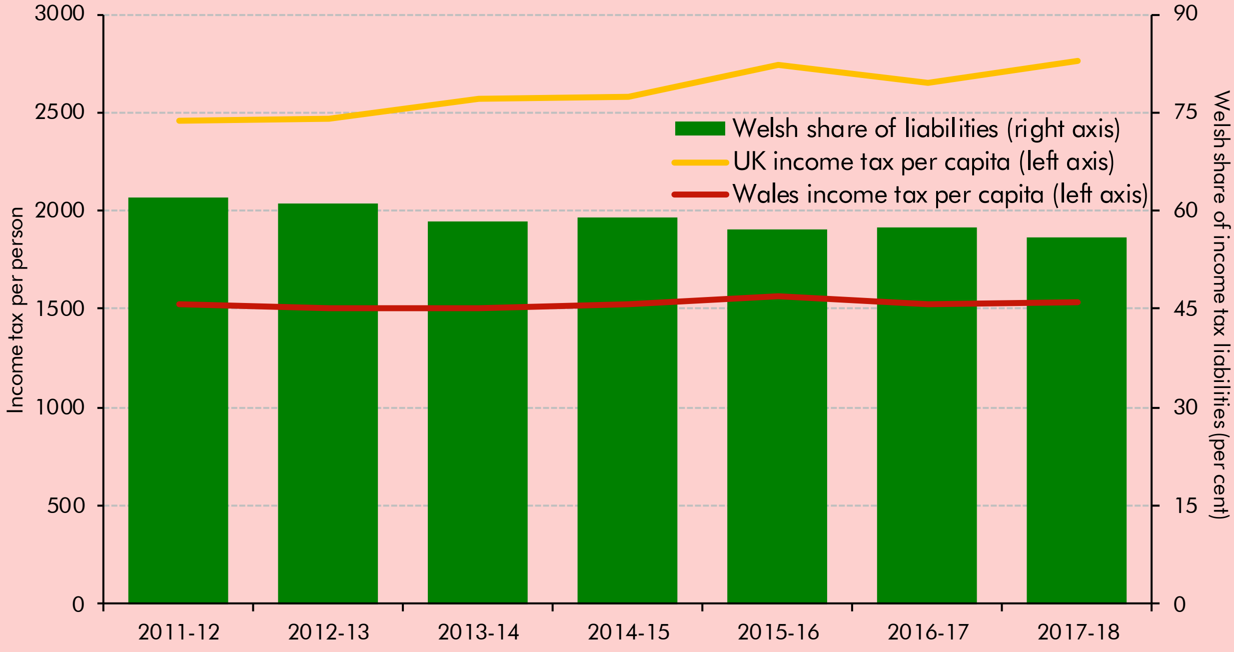
2.24 Finally, we calculate the share of all Welsh income tax subject to the Welsh rates. For the forecast years this is done via HMRC's 'personal tax model', which is based on outturn SPI data, and follows the same methodology as has been used to estimate the share subject to Welsh rates in outturn.

Box 2.1: Changes in the Welsh share of income tax liabilities over time

We can use HMRC's Survey of Personal Incomes data to investigate the drivers of changes in relative income tax per persons between Wales and the UK as a whole over time. This can help us to identify any trends that might be expected to persist and that should therefore be incorporated in our projections, over and above the population trends that are already captured.

Between 2011-12 and 2017-18, income tax liabilities per person increased by £300 (12.1 per cent) in the UK but by only £13 (0.8 per cent) in Wales (Chart A). Consequently, they fell from 62 per cent of the UK-wide average in 2011-12 to 56 per cent in 2017-18.

Chart A: Income tax liabilities per person in Wales and the UK over time



Source: OBR, HMRC

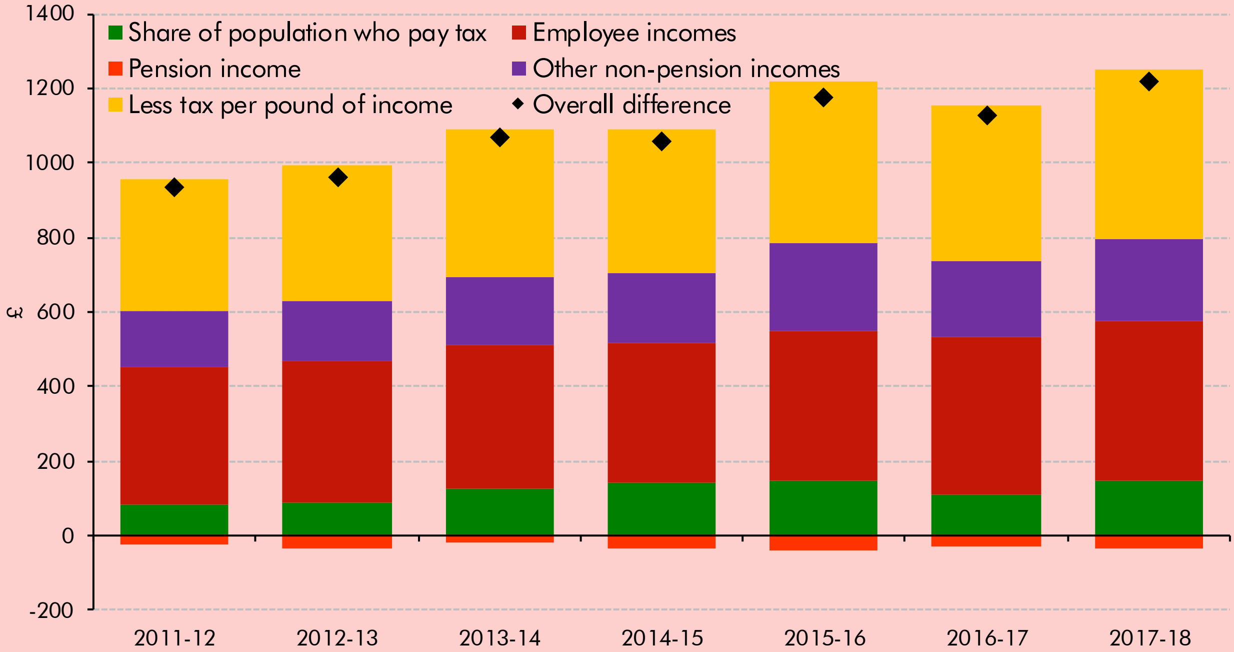
Chart 2.B breaks down the differences in income tax liabilities per person over seven years. Focusing on the £285 increase in the difference between 2011-12 and 2017-18, it shows that:

- £65 of the difference (23 per cent) relates to **the share of the population that pay tax** declining slightly faster in Wales than the UK (from 46 to 43 per cent versus 49 to 48 per cent respectively). This will reflect in part the steady rise in the tax-free personal allowance, so is not a factor that should be reflected in our forecast on current policy.
- £117 of the difference (41 per cent) relates to **average incomes per taxpayer** rising faster in the UK than in Wales for most of the components of average taxable income. The largest component relates to average employee incomes (£60 of the difference), but average self-employment incomes have also risen faster (£34 of the difference). It is not

clear the extent to which these differences represent trends that will persist. 'Other incomes', which include savings and dividends that are not subject to the Welsh rates and are therefore not relevant to our Welsh income tax forecast judgements, have also risen materially faster in the UK (accounting for £35 of the difference). Pension income has grown only marginally faster in Wales than in the UK as a whole.

- The largest source of the increased difference is **the effective tax rate**, which accounts for £103 of the rise (36 per cent). In part this is a mechanical consequences of faster income growth and a progressive tax schedule, but it also reflects faster growth in the share of higher and additional rate taxpayers in the UK than in Wales due to changes in the income distribution beyond these mechanical effects of fiscal drag. Changes in the income distribution have been a perennial source of risk to our UK-wide income tax forecasts and this analysis suggests they will be for our Welsh forecasts too.

Chart B: Explaining the difference in income tax per capita



Source: HMRC, OBR

At this stage we have not factored in any further adjustments to our forecasts for the share of UK-wide income tax that will be subject to the Welsh rates as a result of this analysis, but we will continue to use this framework to explore the drivers of changes and to understand which might be expected to persist over the coming years.

New policy costings

2.25 Our post-measures forecast is produced by adding the effects of new policies announced since our previous forecast. The introduction of the Welsh rates and the associated terms of the fiscal framework has meant that we now need to assess the effect of new policies on the individual bands of income tax rather than simply their overall cost or yield.

2.26 Many of the general sources of uncertainty around policy costings that we routinely highlight in our forecast publications are likely to be amplified as we disaggregate costings by geography and tax band. For that reason, we believe a relatively simple approach that makes sufficient allowance for asymmetric effects across countries and bands, while not seeking spurious precision, is appropriate. In part this reflects the relatively small sums involved – relative to our UK-wide forecast – and the fact that these estimates often need to be generated during the most time-pressured phase of a UK Budget forecast process.

Latest forecast

UK income tax forecast

2.27 As set out in Chapter 1, our latest forecast for UK NSND income tax is based on the economic forecast published in our November *Economic and fiscal outlook* (*EFO*). Table 2.3 shows the UK and Welsh rates and thresholds that we have used in this forecast. In line with the UK Government's stated default indexation policy assumptions, most UK tax thresholds rise in line with CPI inflation from 2021-22 onwards, but the additional rate threshold remains fixed in cash terms. The personal allowance and higher rate threshold are slightly lower than in our March forecast as the CPI inflation outturn for September 2020 was lower than expected and we have revised down our inflation forecast on average in future years.

Table 2.3: UK Government and Welsh income tax parameters

	Per cent					
	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
UK Government tax rates for Welsh taxpayers						
Basic rate	10	10	10	10	10	10
Higher rate	30	30	30	30	30	30
Additional rate	35	35	35	35	35	35
Welsh rates of income tax						
Basic rate	10	10	10	10	10	10
Higher rate	10	10	10	10	10	10
Additional rate	10	10	10	10	10	10
Total income tax rates						
Basic rate	20	20	20	20	20	20
Higher rate	40	40	40	40	40	40
Additional rate	45	45	45	45	45	45
	£					
Tax thresholds (reserved to the UK Government)						
Personal allowance	12,500	12,570	12,750	12,950	13,190	13,450
Higher rate	50,000	50,270	51,050	51,850	52,790	53,850
Additional rate	150,000	150,000	150,000	150,000	150,000	150,000

Note: Shaded cells represent policy baselines assumed for forecasting purposes. We assume that Welsh rates will remain unchanged until the Welsh Government states otherwise.

2.28 Table 2.4 sets out the forecast for UK NSND income tax liabilities that underpins our Welsh rates forecast. The pandemic means that receipts rise only modestly this year and fall slightly next year, but grow thereafter as the economy recovers. They are £11.6 billion lower in 2020-21 compared to our March forecast, and £20 billion (10 per cent) lower on average in subsequent years. In the near term this is driven by virus-related downward revisions to employment and earnings growth, which are greater in 2021-22 when the various 2020-21 employment support measures are withdrawn. Thereafter, receipts are depressed by weaker real earnings growth and the associated loss of fiscal drag, reflecting the assumption of 3 per cent scarring to the level of real GDP by the end of the forecast period. We have also revised down UK NSND liabilities in 2019-20, which lowers the forecast in each year.

2.29 In 2020-21 the Coronavirus Job Retention Scheme (CJRS) has supported employee incomes during the pandemic. Some of the CJRS grants return directly to the Exchequer since they cover income tax liabilities. Cash receipts paid through self-assessment are supported in 2021-22 by the UK Government's deferral scheme, which allows taxpayers to defer 2020-21 payments into 2021-22, and the Self-Employed Income Support Scheme (SEISS), the tax on which will also be due in 2021-22. The deferral scheme relates to 2019-20 liabilities and its only effect on a liabilities basis comes via the assumption that some deferred tax will not actually be paid when it comes due. The SEISS boosts 2020-21 liabilities. Liabilities are also raised by the indirect effects of the latest UK Government policies, which relate to the significant further fiscal easing that has taken place since the Chancellor's Summer Economic Update (SEU), and which boost receipts via their effects on employment and earnings.

Table 2.4: Whole UK forecast of tax liabilities on non-savings, non-dividend income

	£ billion							
	Outturn	Forecast						
	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
March forecast	174.0	176.6	187.7	197.1	206.7	214.9	223.8	
December forecast	172.3	174.5	176.2	178.1	185.9	194.3	204.0	213.8
Change	**-1.7**	**-2.0**	**-11.5**	**-19.0**	**-20.8**	**-20.6**	**-19.8**	
of which:								
UK NSND outturn alignment		-0.7	-0.7	-0.6	-0.7	-0.7	-0.8	
Pre-measures forecast[1]		-0.7	-15.5	-20.5	-22.0	-20.9	-19.8	
Direct effects of UK Government policies		-0.6	3.4	-0.1	0.0	0.0	0.1	
Indirect effects of UK Government policies		0.0	1.2	2.1	1.9	1.0	0.7	

Note: We have updated our UK NSND income tax forecast to correct an error in Table 2.1 of the *Devolved tax and spending forecasts* published on 25 November. This correction deducts £2.4 billion from our forecast in 2020-21 and alters the breakdown of changes in our forecast since March.
[1] Includes gift aid estimates.

Share subject to the Welsh rates

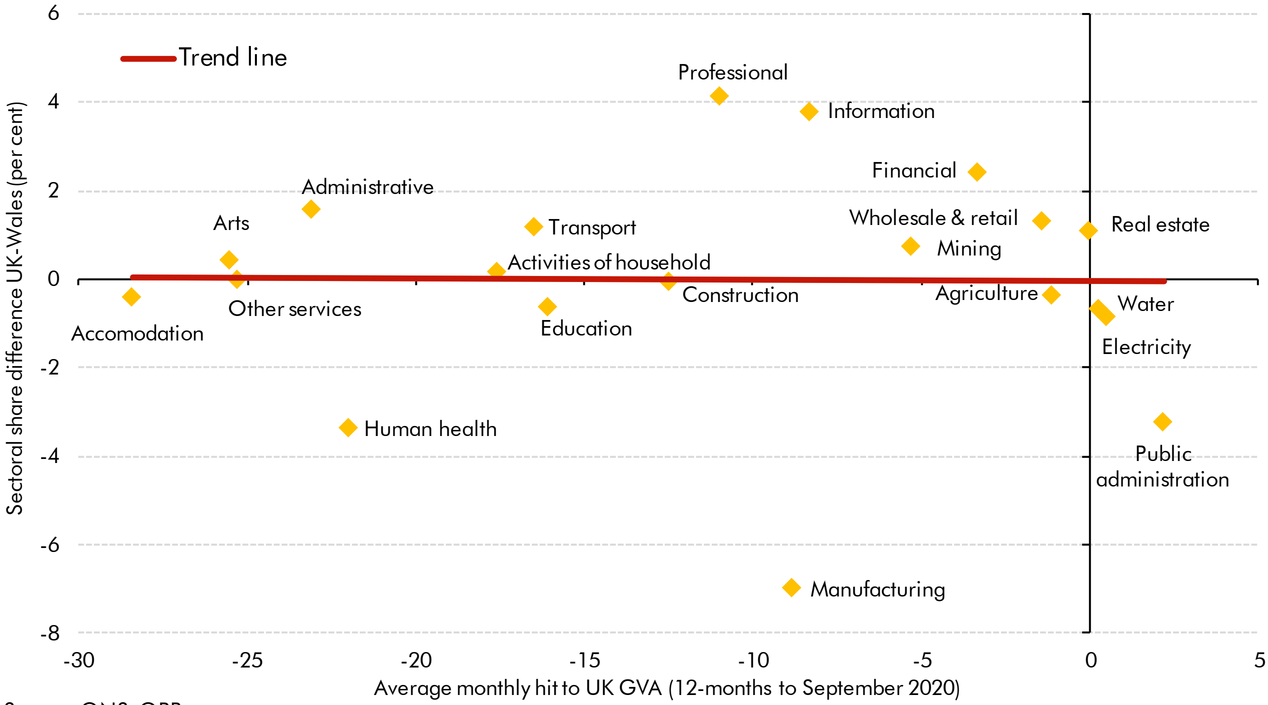
2.30 Table 2.5 shows our forecast for the share of UK NSND liabilities that will be subject to the Welsh rates, which we have revised down slightly in 2020-21 but up slightly in subsequent years, relative to our March forecast. This is largely due to the ONS's June update to its population projections for Wales, which mechanically adds an additional 36,000 taxpayers by the end of the forecast period.

2.31 We considered whether to apply a further adjustment to reflect the sectoral concentration of the coronavirus hit to UK-wide output, given differences in the sectoral composition of the Welsh economy relative to the UK as a whole. But as Chart 2.7 shows there is almost no correlation between these that would point to income tax liabilities being hit by more or less than average in Wales. In particular, the worst hit sectors such as accommodation and food services, and arts and entertainment, are of similar importance to the economies in Wales and the UK as a whole. As such we have not assumed any asymmetric effects in the Welsh shares of income tax due to the pandemic.

Table 2.5: Share of pre-measures liabilities subject to the Welsh rates

	Per cent of UK total for non-savings, non-dividend liabilities							
	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
March forecast (pre-measures)	1.16	1.16	1.16	1.15	1.15	1.15	1.14	
December forecast	1.17	1.16	1.13	1.16	1.16	1.16	1.15	1.15
Change	**0.00**	**0.00**	**-0.03**	**0.01**	**0.01**	**0.01**	**0.01**	
Memo: Population index		*100.0*	*99.7*	*99.6*	*99.5*	*99.3*	*99.1*	*98.9*
Memo: RTI index (2017-18 = 100)	*99.9*	*99.3*	*99.3*	*99.3*	*99.3*	*99.3*	*99.3*	*99.3*
Memo: Combined index	*100.0*	*99.3*	*99.0*	*98.9*	*98.8*	*98.6*	*98.4*	*98.2*

Chart 2.7: UK-Wales GVA sectoral shares against growth in GVA



Source: ONS, OBR

Latest forecast for the Welsh rates of income tax

2.32 Table 2.6 sets out our latest forecast for tax raised by the Welsh rates. Receipts are £166 million (7 per cent) a year lower on average, more than explained by the weaker pre-measures UK NSND forecast. This outweighs the combined impact of the slightly higher Welsh share and UK Government policy measures, including the CJRS and SEISS.

Table 2.6: Welsh rates of income tax forecast

	£ million							
	Estimated outturn	Forecast						
	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
March forecast	2,021	2,041	2,170	2,273	2,377	2,466	2,558	
December forecast	2,010	2,026	2,045	2,064	2,152	2,247	2,356	2,463
Change	**-11**	**-15**	**-125**	**-209**	**-225**	**-220**	**-203**	
of which:								
Welsh share		6	7	10	14	17	24	
UK NSND outturn alignment		-8	-8	-8	-8	-8	-9	
UK NSND forecast and other changes[1]		-15	-217	-236	-253	-240	-227	
Direct effects of UK Government policies		2	78	-1	0	0	1	
Indirect effects of UK Government policies		0	14	25	22	11	9	

Note: We have updated our forecast for the Welsh rates, to correct an error in Table 2.6 of the *Devolved tax and spending forecasts* published on 25 November. This correction deducts £46 million from our forecast for 2020-21 and alters the breakdown of changes in our forecast since March.

[1] Includes gift aid estimates.

Key uncertainties

2.33 Our forecast for income tax liabilities subject to the Welsh rates is subject to a number of uncertainties. We summarise some of the most important ones here.

Coronavirus pandemic

2.34 Our forecast for the Welsh rates, like our UK income tax forecast, is subject to increased uncertainty due to the coronavirus pandemic. Both are dependent on the outlook for labour income and the level of employment, which in turn reflect our assumptions about the degree to which underlying productivity and the labour market will be scarred in the medium term by the pandemic. In our November *EFO* we illustrated these uncertainties using upside and downside scenarios either side of our central forecast. These embodied different assumptions about the path of the virus, public health measures, the effectiveness of test, trace and isolate programmes, and the timing and effectiveness of vaccines and treatments. Each made different assumptions about the speed of recovery of GDP and the extent of medium-term economic scarring on productivity and employment.

2.35 Additional uncertainty is associated with the UK Government's multi-billion-pound coronavirus support policies. Under each scenario we made different assumptions about the level of support provided to households and businesses. The measures already implemented (in particular the CJRS and SEISS) has prevented a more rapid rise in unemployment, but there is considerable uncertainty over what will happen as they are withdrawn (as the range of unemployment outcomes across our different scenarios illustrated).

2.36 Further uncertainties will relate to the impact of the pandemic on internal and international migration flows and thus the relative size of the Welsh population versus the UK as a whole, and how the recession and recovery play out across sectors and the income distribution.

Brexit

2.37 Another key macroeconomic risk to our forecast relates to the next phase of Brexit. As with coronavirus, Brexit could have significant implications for the determinants underpinning our income tax forecast at both the UK and Welsh levels, depending on the trading relationship with the EU from January. Our central economy forecast, on which the Welsh rates forecast is based, assumes that the UK leaves the EU with a typical FTA, generating a 4 per cent long-run loss of output relative to remaining in the EU. In our November *EFO* we also set out the economic and fiscal implications of the UK defaulting to trading with the EU on World Trade Organization terms when the transition period ends on 31 December. This is assumed to reduce output by a further 2 per cent in the long run, which would have additional negative impacts on average earnings and employment, depressing income tax receipts. At the time of finalising the forecast, Brexit negotiations were still ongoing.

The Survey of Personal Incomes base data

2.38 The representativeness of the geographical and income distributions reported in the SPI base data is particularly important at present because there are currently no outturn data on Welsh income tax liabilities. The SPI is designed to be representative at the UK level, but the sample is not stratified by geography (i.e. smaller sample sizes in each geographical area mean it is likely to be less representative at those levels than it is at the UK level). In the latest version, the confidence interval around the SPI estimate of tax liabilities at the UK level was just 0.6 per cent, but for Wales it was a more material 4.5 per cent. Sampling variation – in particular due to the small number of observations of high-income taxpayers in Wales – is another potential source of error, although the SPI does have a relatively large sample size overall and is designed to over-sample taxpayers with higher incomes. But uncertainties around the starting point of our Welsh rates forecast remain a significant risk.

2.39 This risk is illustrated by the experience with forecasting Scottish income tax liabilities using the SPI. In July 2018, HMRC published the first NSND liabilities outturn for Scotland covering the 2016-17 tax year. The estimate was £700 million (6.1 per cent) lower than our most recent forecast at the time from March 2018. Using the postcodes reported in the 2015-16 SPI led us to over-estimate the Scottish share by 0.40 percentage points (6.68 per cent outturn versus a forecast of 7.08 per cent). Since then we have been able to calibrate our forecast to the outturn share, which meant our March 2019 forecast for Scotland's share of 2017-18 liabilities was out by just 0.03 percentage points. We have no reason to believe that Welsh outturn will differ so greatly from the SPI-derived share we have used in this forecast, but until we have outturn estimates based on actual 'C' flag administrative data this starting point will remain a risk to the forecast.

Relative performance of the Welsh and UK income tax bases

2.40 As described in this chapter we use our UK-level macroeconomic forecasts with only a few adjustments to forecast Welsh income tax liabilities. This reflects our assumption that future disparities between growth in any of the variables that determine the tax base in Wales and the UK as a whole are as likely to go in one direction as the other, so our central assumption is that they move in parallel. As the analysis of tax liabilities per person in this chapter shows, there are large differences between Wales and the UK as a whole at present that have been getting steadily, if only modestly, larger over time. Further divergence or a period of convergence would represent downside or upside risks to our forecast.

2.41 The key adjustment we make at present relates to different rates of population growth, but we do not make any further allowance for differences in the rate at which the population is ageing in Wales and the UK as a whole. We therefore capture the effect of changing numbers of taxpayers, but not any age-related changes in the distribution of taxpayers and average incomes across the different age groups. We will consider this further in the future.

3 Land transaction tax

Introduction

3.1 This chapter:

- describes the **introduction of land transaction tax (LTT)** in Wales and compares it to the stamp duty land tax (SDLT) regime in operation in England and Northern Ireland;
- outlines our **methodology for forecasting LTT** and explores trends in **property prices and transactions** in Wales that drive growth in the LTT tax base;
- presents our **latest forecasts** and explains how they have changed since the forecasts published in our March 2020 *Economic and fiscal outlook*; and
- discusses some of the key **risks and uncertainties** around these forecasts.

What is 'land transaction tax'?

3.2 Land transaction tax (LTT) replaced stamp duty land tax (SDLT) in Wales from April 2018.[1] It is an *ad valorem* transaction tax levied on the transfer of a property. It is paid by the purchaser, but its incidence is on the house price so the burden actually falls on the seller.[2]

3.3 LTT retained many of the same features as SDLT including different treatment for residential and commercial properties, a tax-free threshold, as well as a 3 per cent surcharge on additional residential property purchases. But there are also some notable differences. For example, LTT has different rates and thresholds; it does not include a relief for first-time buyers; and it is collected by the Welsh Revenue Authority (WRA) rather than by HMRC.

3.4 Both LTT and SDLT are currently subject to temporary 'holidays' that reduce the amount of tax paid on residential transactions. In Wales, the threshold below which no tax is paid has been raised from £180,000 to £250,000 with effect from 27 July 2020 to 31 March 2021. This does not apply to additional residential property purchases, which are liable to the higher rates. In England and Northern Ireland, the tax-free SDLT threshold has been raised from £125,000 to £500,000 with effect from 8 July to 31 March.[3]

[1] Both taxes are broadly based on the historical tax 'stamp duty', one of the oldest forms of taxation having been originally introduced on a range of products in 1694. The original duty required legal documents associated with a transaction to be authenticated by means of a physical 'stamp'. Stamp duty was replaced with SDLT in December 2003.
[2] Best, M. and Kleven, H., *Housing market responses to transaction taxes: Evidence from notches and stimulus in the U.K.*, June 2017.
[3] This also applies to transactions subject to the additional rates, unlike the LTT threshold change.

3.5 Under the temporary holidays the effective tax rates for residential property transactions – i.e. the pounds of tax paid per pound of house price – are higher in Wales than in England and Northern Ireland.[4]

Forecast methodology

3.6 The methodology for generating our LTT forecasts involves three steps.[5] These are:

- First, we produce an **in-year estimate** using monthly receipts outturn data from the WRA as well as relevant information about the performance of the property market and economy. Our normal approach is to gross up the year-to-date receipts by assuming the remainder of the year follows a similar path to previous years. The economic impact of the coronavirus pandemic has led us to adopt a different approach for this forecast, plotting a quarterly path for receipts that is informed by our near-term forecasts for house prices and property transactions.

- Next, we generate our **pre-measures forecast**, using four separate 'price bins' models – one each for residential main rates, the additional properties surcharge, commercial sales and commercial leases. The models aggregate transactions within relatively small 'bins', calculating the tax due on the average price in the bin, and then projecting that forward in line with our forecasts for prices and transactions.[6]

- Finally, we add estimates of the effects of any **new policy measures** to produce our post-measures forecasts.

Property market determinants of the forecast

3.7 By far the most important driver of our forecast for the growth in LTT receipts over the medium term is our forecast for growth in the value of property transactions, which in turn reflects assumptions about prospects for property prices and the volume of transactions.[7] Our LTT forecast is predicated on the assumption that Welsh property prices and transactions will move in line with our UK-wide forecasts of those variables over the medium term.[8] In other words, there is neither convergence nor divergence between the total value of property transactions in Wales and those at the UK-wide level.

Recent developments and prospects

3.8 The lockdowns imposed by the UK and devolved Governments largely shut down the UK property market for a period from late March onwards as estate agents were required to

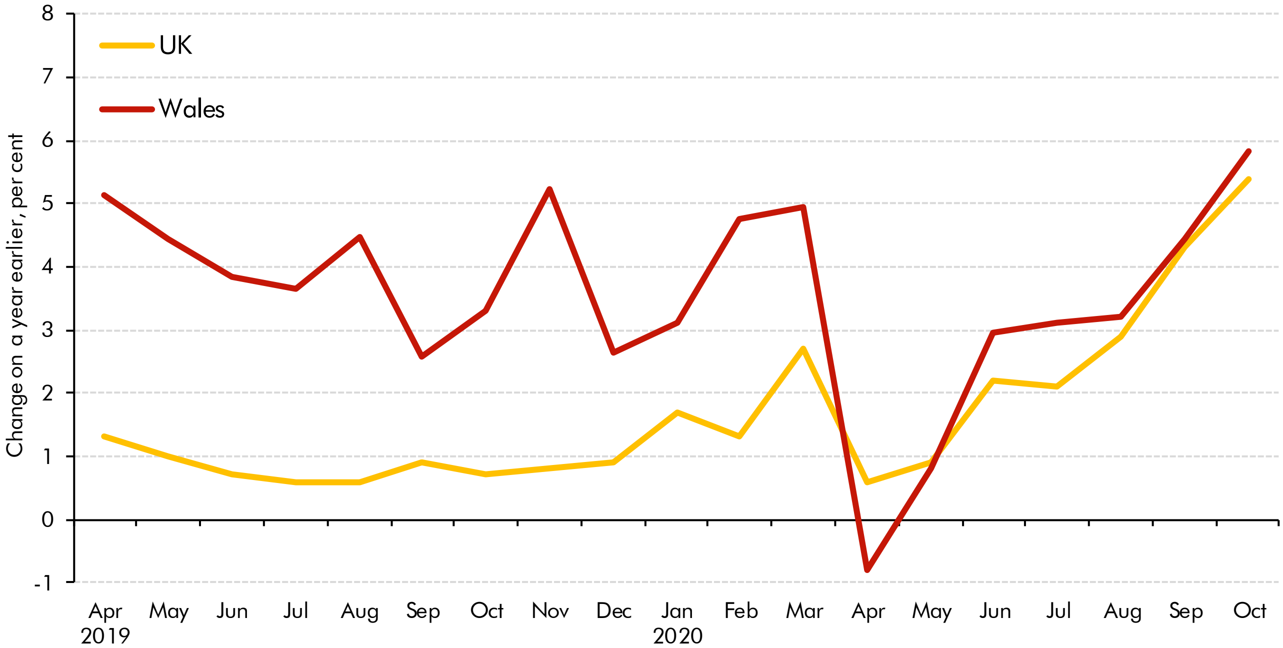
[4] Under the regimes SDLT and LTT will revert to from 1 April 2021, lower effective tax rates apply to residential transactions for under £400,000 in Wales.
[5] For more detail on our forecast methodology see Chapter 3 of our December 2019 *Welsh taxes outlook* and the 'Welsh taxes outlook' page of our website.
[6] These models are operated on our behalf by analysts in the Welsh Government, but the underlying forecast assumptions and judgements are those of the OBR's Budget Responsibility Committee.
[7] The methodology for forecasting these is set out in the 'In-depth' pages of our website.
[8] This assumption has been tested over several property cycles and is regularly monitored. For more detail see our December 2019 *WTO* and the 'Welsh taxes outlook' page of our website.

close offices and were prevented from listing new properties, with only online viewings permitted. The Welsh Government started to lift those restrictions on 22 June, around six weeks after they were lifted in England. The outlook for the remainder of 2020-21 and beyond remains closely linked to the levels of current and future restrictions that may be imposed by Governments. Activity in the Welsh property market was restricted again during the three-week lockdown imposed from 23 October. We have assumed that lost activity during this period will be made up over the remainder of the fiscal year.

Property prices

3.9 Chart 3.1 shows that UK-wide house price inflation dipped in April, while prices fell slightly in Wales. But prices have picked up again since then, partly due to the release of pent-up demand and the introduction of temporary tax holidays. House prices in Wales increased faster than those across the UK as a whole during 2019-20, but have risen at a similar rate so far in 2020-21. It is, however, important to note that there will be greater uncertainty around house price data this year due to the sharp fall in transactions during lockdown.

Chart 3.1: Recent trends in house prices



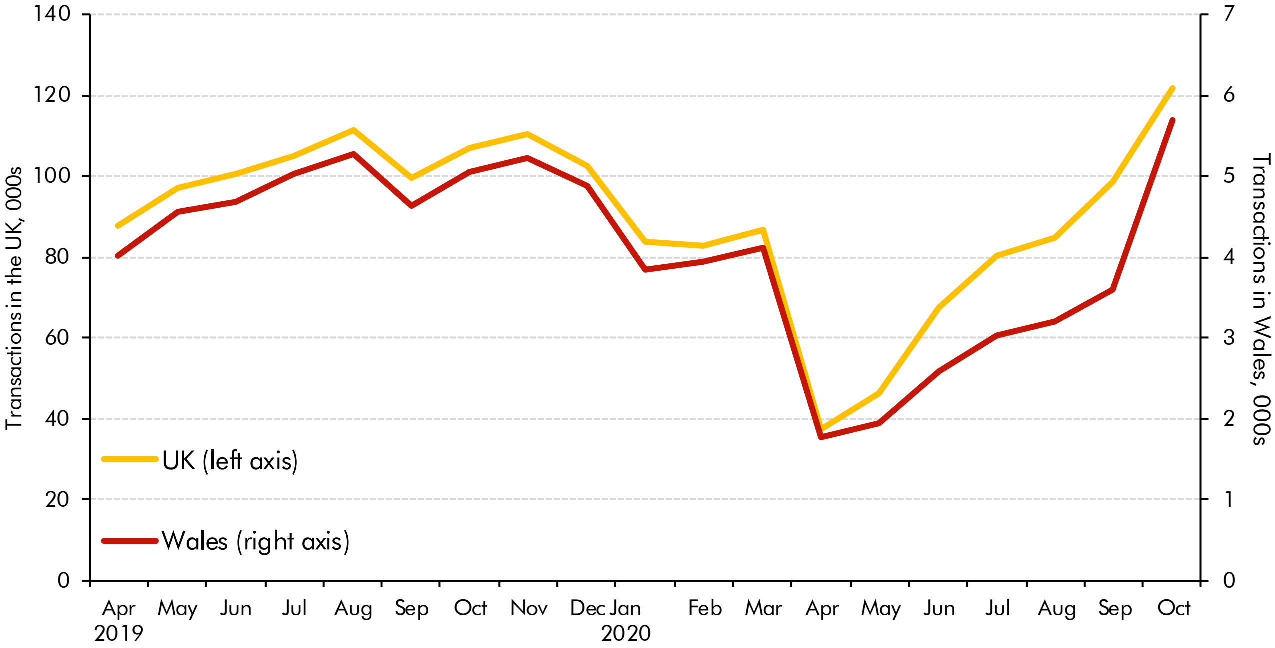
Source: ONS

3.10 Commercial property prices in Wales fell by 11 per cent on a year earlier in the first half of 2020-21. Prices fell slightly more across the UK as a whole over the same period.

Property transactions

3.11 Chart 3.2 shows how residential property transactions in Wales and the UK as a whole were affected by the lockdowns introduced in late March. Welsh transactions in April were 57 per cent lower than in March, and 56 per cent lower than in April 2019. Transactions have recovered since, though initially at a slower pace than the UK as a whole, which is likely to reflect the later easing of public health restrictions. By September both were back to 2019 levels. Total transactions in Wales in the first half of 2020-21 were 43 per cent lower than the same period a year earlier, compared to 31 per cent lower for the UK as a whole.

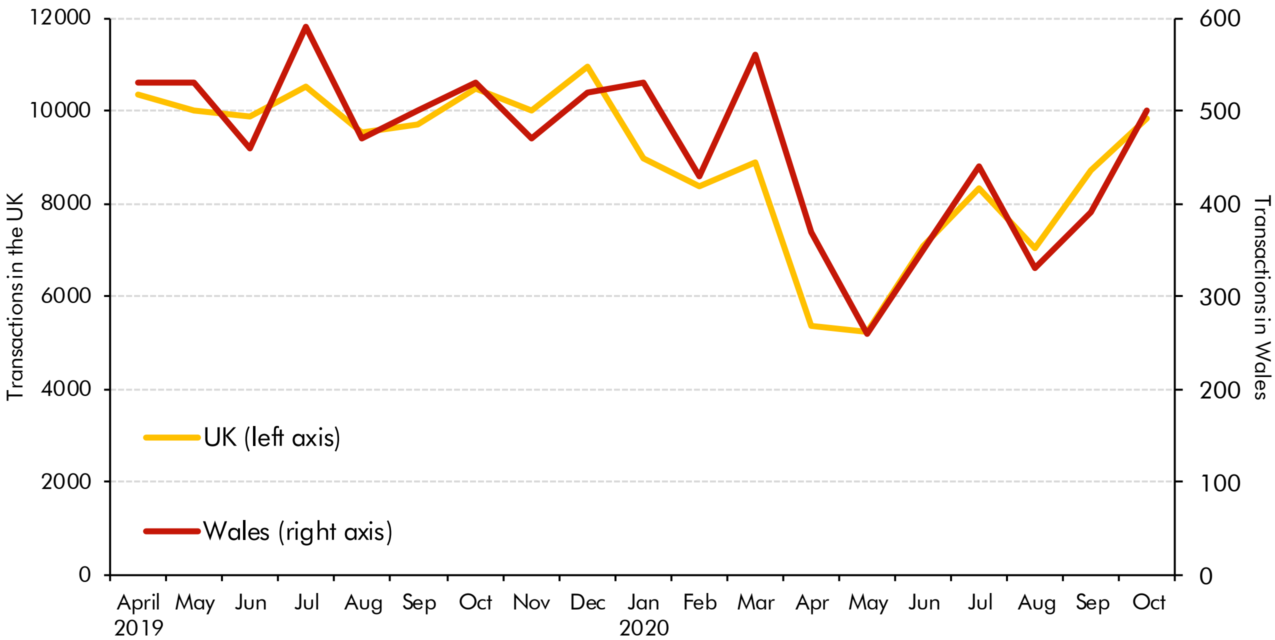
Chart 3.2: Residential property transactions



Source: HMRC

3.12 Chart 3.3 shows that commercial property transactions have followed a similar path to residential transactions. A sharp drop in April has been followed by a return to relatively normal levels by September. The recovery path in Wales has largely mirrored that in the UK as a whole. Welsh commercial property transactions during the first half of 2020-21 were 31 per cent lower than in 2019-20, compared to 30 per cent for the UK as a whole.

Chart 3.3: Commercial property transactions



Source: HMRC

Forecasts for property market determinants

3.13 Table 3.1 sets out our forecasts of the main determinants of LTT receipts. These are largely taken from our UK-wide forecast as described in November's *Economic and fiscal outlook* (*EFO*), with two exceptions. First, for our residential transactions forecast, we remove the impact of forestalling at the end of the SDLT holiday, which is specific to receipts in England and Northern Ireland. Second, we have added a 0.8 percentage point uplift to our forecast for house prices this year, based on evidence from several different house price indices.

3.14 Both prices and transactions in 2020-21 have been revised down significantly relative to our March *EFO* forecast. We still expect house prices to rise slightly in 2020-21, but they fall next year as unemployment rises. There is continued growth thereafter though at a slower pace than our March forecast. We expect the significant fall in residential transactions this year to be followed by a sharp rebound in 2021-22, followed by modest growth thereafter.

3.15 Commercial transactions and prices have fallen sharply this year, with the latter remaining subdued next year. Over the longer term we assume the commercial property market will be relatively more adversely affected by structural changes due to the pandemic.

Table 3.1: Forecasts for Welsh property prices and transactions

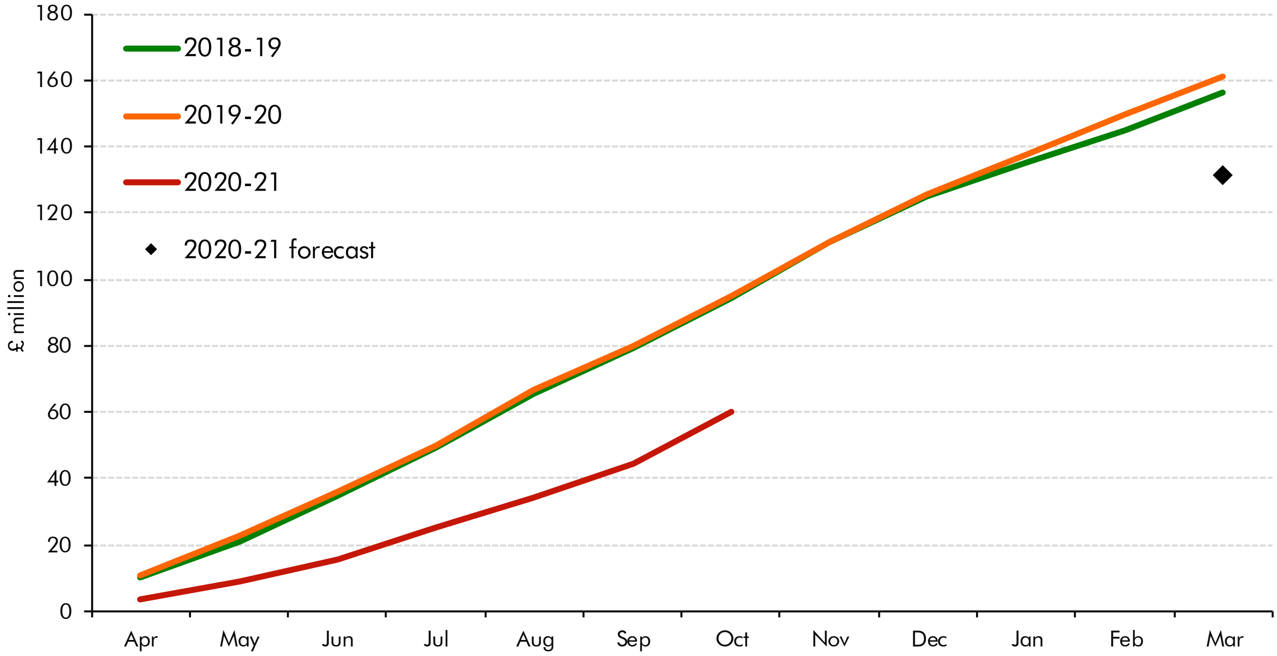
	Percentage change on previous year						
	Outturn	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Residental property prices	0.0	3.2	-5.6	0.3	6.5	6.8	5.5
Residental property transactions	-0.9	-12.1	32.1	-1.1	0.5	0.8	0.8
Commercial property prices	3.3	-9.2	-0.8	1.7	2.0	2.0	2.0
Commercial property transactions	-0.8	-22.5	9.4	5.6	5.0	5.0	4.6
	Change since March forecast						
Residental property prices		-1.5	-9.8	-4.8	1.4	-1.9	
Residental property transactions		-17.7	30.5	-4.1	-1.6	-1.3	
Commercial property prices		-7.8	-0.8	1.0	-0.1	-0.1	
Commercial property transactions		-20.8	7.7	4.2	3.8	3.6	

Trends in LTT receipts

Residential property receipts

3.16 Chart 3.4 shows that residential LTT receipts (net of refunds) so far this year are well below those during the same period in the past two years. In the seven months to October, residential LTT receipts totalled £60 million, 37 per cent lower than at the same point in 2019-20. Receipts from the main rates are down by 40 per cent while they are down by 31 per cent for the additional rates. We expect some recovery in receipts in the second half of the year, but for them to remain down 23 per cent on 2019-20 across the whole year.

Chart 3.4: Cumulative residential LTT receipts

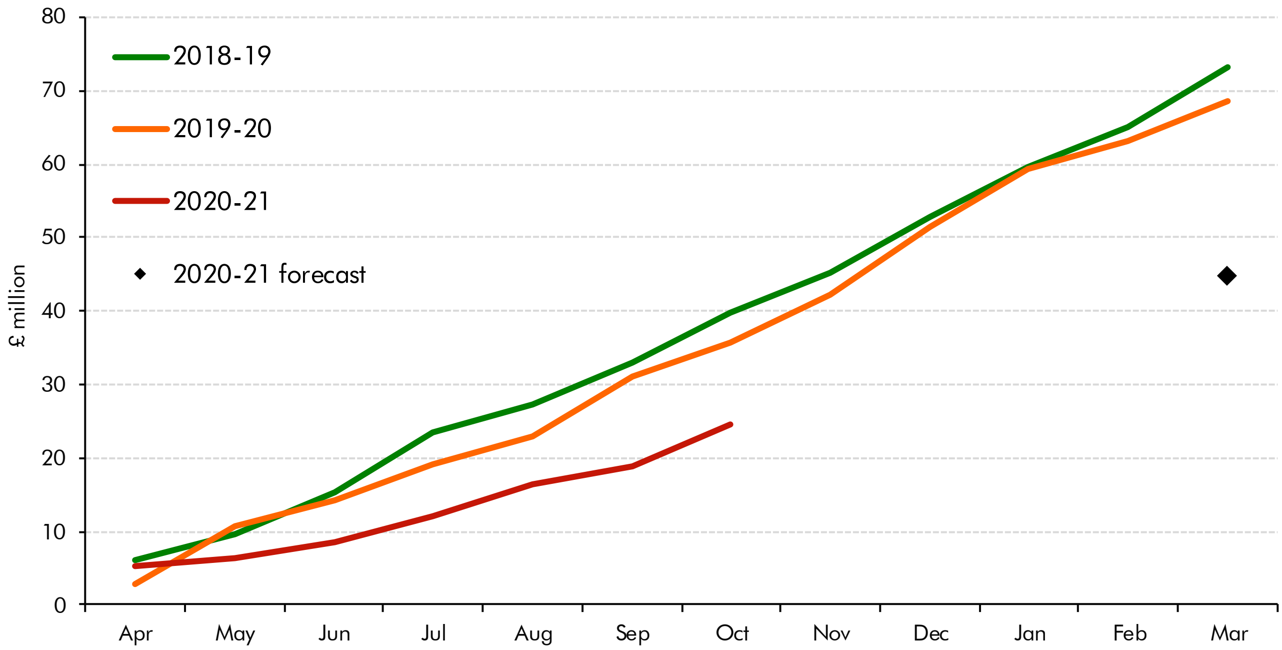


Source: WRA, OBR

Commercial property receipts

3.17 Chart 3.5 shows a similar story for commercial LTT receipts. Year-to-date receipts are £25 million, down 31 per cent on the same point last year. Again, we expect stronger receipts in the second half of the year, but for them to remain down 35 per cent on 2019-20 across the whole year.

Chart 3.5: Cumulative commercial LTT receipts



Source: WRA, OBR

Box 3.1: Evaluating our forecasts for LTT receipts in 2019-20

When evaluating our forecasts, we typically look at how those for the next fiscal year compared to the eventual outturn. As our first WTO was published last December, we can only evaluate our in-year forecasts for LTT in 2019-20. In our next WTO we will evaluate our forecasts for 2020-21; our first set of forecasts to be used in the Welsh Government's Budget process. We can expect these to be subject to larger than normal errors due to the impact of the pandemic.

Table 3.A breaks down the differences between our forecasts for LTT receipts in 2019-20 and the outturn. These are split into three sources: determinants (which shows the forecast difference that relates to differences between our forecast for average property prices and the latest outturn), subsequent policy announcements not captured by our December 2019 forecast; and the residual fiscal forecasting difference. It shows that:

- As regards our forecast for the residential main rates, receipts exceeded our forecast by just £2 million (1.7 per cent). That is more than explained by fiscal modelling differences (which are likely to relate to the composition of transactions). This is partly offset by slightly slower than expected house price inflation. (Our December 2019 forecast was for Welsh house prices to rise 3.2 percentage points faster than UK-wide house prices, reflecting the greater momentum in Welsh house price inflation at the time. This proved slightly too optimistic, but more accurate than if we had simply used our UK forecast.)
- As regards the residential additional rates, there is little difference between forecast and outturn, reflecting the largely offsetting effects of modelling and house price differences (including the 3.2 percentage point house price uplift).
- As regards commercial LTT, the £30 million difference reflects the transfer of the Core Valley Lines (CVL) from Network Rail to Transport for Wales, which was finalised after our December forecast had been published. It was reflected in the update to our WTO forecasts that was published on 25 February 2020 ahead of the Welsh Government's final Budget.

Table A: December 2019 LTT forecasts versus outturn

	£ million					
				of which:		
	December 2019 forecast	Outturn	Difference	Fiscal forecasting difference	Determinants	Subsequent policy: CVL transfer
Total LTT	**226**	**258**	**32**	4	**0**	**28**
Residential main rates	100	102	2	5	-3	0
Residential additional rates	59	60	0	-2	2	0
Commercial	66	97	30	1	1	28

Latest LTT forecasts

3.18 Table 3.2 presents our latest forecast for total LTT receipts and the changes in each component since March. Total LTT receipts are lower in each year of the forecast, by an average of £76 million (24 per cent). Around 80 per cent of this is from the drop in receipts from the residential main rates, which have been revised down by an average of £61 million (36 per cent) a year.

Table 3.2: LTT forecast

	£ million						
	Outturn	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Total LTT							
March forecast	266	254	288	319	349	379	
December forecast	260	176	231	236	266	300	335
Change	-6	-78	-57	-84	-83	-78	
Residential (excluding additional properties)							
March forecast	103	124	151	175	197	220	
December forecast	102	71	104	107	127	152	176
Change	-1	-53	-47	-68	-70	-68	
Additional properties							
March forecast	59	62	68	74	78	83	
December forecast	60	61	80	77	83	89	95
Change	1	-2	12	3	5	7	
Commercial							
March forecast	104	68	69	70	73	76	
December forecast	99	45	48	51	55	60	64
Change	-5	-23	-21	-19	-18	-17	

Residential LTT forecasts

3.19 Tables 3.3 and 3.4 set out our latest forecasts for the residential components of LTT relative to March. The fall in residential receipts this year is mostly due to lower transactions and the LTT holiday. For the remaining years of the forecast it is driven by weaker house price inflation. This reduces the effects of fiscal drag, meaning fewer transactions move into higher tax bands, lowering the effective tax rate. It also means a greater share of residential main rates transactions remain below the tax-free threshold and thus not liable to LTT. Updating the base year data in the model to 2019-20 has very little impact.

Raising the LTT threshold to £250,000 until 31 March 2021

3.20 The Welsh Government has raised the lower threshold for main rates residential property transactions from £180,000 to £250,000, with effect from 27 July 2020 until 31 March 2021. This means that transactions between £180,000 and £250,000 will temporarily pay no LTT, while all those above it will save £2,450. Around 10,000 transactions are forecast to benefit from the tax cut, at a cost of £19 million. The additional rates charged on second homes and buy-to-let properties have not been reduced, so all the tax paid by such transactions on the portion of the property valued between £180,000 and £250,000 will be recorded as revenue from the additional rates during the period of the holiday.

3.21 We expect the policy to generate forestalling – the bringing forward of transactions to avoid the higher LTT liability when it is reinstated on 1 April 2021. Based on previous episodes at the UK level, we assume that around 1,000 transactions will be brought forward, increasing revenues in 2020-21 by around £3 million and lowering them by £4 million in 2021-22.

Raising the higher rates on additional property purchases

3.22 The Welsh Government has also raised the higher rates on additional properties by a percentage point, to 4 per cent, effective from 22 December. This is assumed to reduce transactions and to lower house prices slightly.[9] Our forecast assumes that around 4,000 transactions will be affected in the remainder of 2020-21 and around 16,000 a year thereafter, raising £16 million a year on average from 2021-22 onwards.

Table 3.3: Residential main rates LTT forecast

	£ million						
	Outturn	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
March forecast	103	124	151	175	197	220	
December forecast	102	71	104	107	127	152	176
Change		-53	-47	-68	-70	-68	
of which:							
Modelling changes		0	-2	-1	-1	-1	
Price changes		-8	-48	-69	-70	-67	
Transaction changes		-21	12	7	5	2	
Raising the tax-free threshold		-25	-4	0	0	0	
Increasing the higher rates		-1	-2	-2	-2	-2	

Table 3.4: Residential additional rates LTT forecast

	£ million						
	Outturn	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
March forecast	59	62	68	74	78	83	
December forecast	60	61	80	77	83	89	95
Change		-2	12	3	5	7	
of which:							
Modelling changes		2	0	1	1	1	
Price changes		-2	-11	-15	-13	-11	
Transaction changes		-12	8	3	2	1	
Raising the tax-free threshold		6	-1	0	0	0	
Increasing the higher rates		5	16	15	15	16	

[9] The price and transactions elasticities used to estimate the behavioural response are described in our SDLT elasticities *Supplementary forecast information release*, October 2017.

Latest commercial LTT forecast

3.23 Table 3.5 shows that our forecast for commercial LTT receipts is lower for each year of the forecast compared to March. Lower transactions and prices are the main reasons, though updating the base year data in the forecast model and the fact that in-year receipts have been even weaker than prices and transactions would suggest also contribute negatively.

Raising the thresholds for commercial LTT

3.24 The Welsh Government has raised the tax-free threshold for commercial transactions from £150,000 to £225,000, effective from 22 December. It has also raised the tax-free threshold for transactions that have both a premium and lease rent net present value liable for tax. This increases the annual rent threshold for incurring a liability from £9,000 to £13,500. These measures are expected to cost around £0.3 million in 2020-21 and £1.3 million a year on average thereafter.

Table 3.5: Commercial LTT forecast

	£ million						
	Outturn	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
March forecast	104	68	69	70	73	76	
December forecast	99	45	48	51	55	60	64
Change		-23	-21	-19	-18	-17	
of which:							
Modelling changes		0	-3	-2	-1	-1	
Price changes		-16	-66	-91	-90	-86	
Transaction changes		-46	11	3	1	0	
In-year data		-2	-3	-3	-3	-3	
Raising the thresholds		0	-1	-1	-1	-1	

Risks and uncertainties

3.25 In this section we summarise some key uncertainties around our central LTT forecast.

Coronavirus pandemic

3.26 The outlook for property markets, like the wider economy, is clouded by uncertainties related to the path of the coronavirus pandemic over the coming months, and its short- and medium-term implications for social and economic life. In our November *EFO* we illustrated these uncertainties by presenting upside and downside scenarios either side of our central forecast that embodied different assumptions about the path of the virus, public health measures, the effectiveness of test, trace and isolate activities, and the timing and effectiveness of vaccines and treatments. The scenarios spanned a wide range of short- and medium-term paths for real GDP that would have implications for property markets.

3.27 The key risks to the residential property market are likely to stem from the outlook for household incomes. The commercial property market could also be sensitive to any persistent changes in the composition of economic activity, such as greater prevalence of working from home or the accelerated shift of high street retail sales online.

Conventional forecast risks

3.28 The significant uncertainties associated with the pandemic have added to rather than replaced the perennial risks associated with forecasting property taxes. We discussed these in detail in last year's report, but in summary:

- **Mapping property market determinants to the true tax base:** it is challenging to map from the whole property market to only those transactions that will be subject to LTT. Only a very small minority of all potential taxpayers will pay LTT in any given year, which differs from most other taxable activities, where taxpayers incur a liability year after year. There are around 1.4 million dwellings in Wales, but there were only around 55,000 residential transactions in 2019-20 – the base year in our LTT forecasting model. Any changes in the composition of transactions relative to the simulated tax base will generate forecast errors.

- **Tax base concentration:** LTT has a progressive tax schedule: a £200,000 residential transaction will pay £700 in tax once the temporary holiday has ended, whereas a transaction for ten times this price (£2,000,000) pays over two hundred times more tax (£171,200). In 2019-20 around a third of residential revenue came from the top 4 per cent of transactions. Our LTT forecast will also be sensitive to high-value commercial property transactions in Cardiff. In 2019-20, 320 commercial transactions (5 per cent of the total) accounted for nearly two-thirds of commercial LTT receipts.

- **Frequent policy changes:** The property transaction tax regime has been subject to large policy changes in recent years. These changes, especially when they are pre-announced, add uncertainty to our forecasts in respect of how taxpayers will respond to the new tax incentives they face. This applies to the temporary raising of both the LTT and SDLT thresholds during 2020-21.

- **Forestalling:** Where rises in property taxes are pre-announced it allows for purchases to be brought forward in order to be taxed at the existing lower rate. It can be difficult to gauge the strength of this response and therefore the quantity of transactions that will be brought forward from future periods. Our latest forecast assumes that forestalling ahead of the LTT holiday ending in April 2021 will be commensurate with the evidence from past episodes, but this is particularly uncertain given the virus-related unknowns clouding the outlook for household incomes and property markets.

4 Landfill disposals tax

Introduction

4.1 This chapter:

- describes the **landfill disposals tax** levied in Wales;
- sets out our **methodology** for forecasting receipts; and
- presents our **latest forecast** and some **key uncertainties** around it.

What is the 'landfill disposals tax'?

4.2 Landfill tax was introduced in the UK in 1996. It applies to all waste disposed of by way of landfill at a licensed site unless the waste is specifically exempt. In Wales it was replaced with landfill disposals tax (LDT) from April 2018. The Welsh Government has said that LDT is designed to "*promote positive environmental behaviours through greater prevention of waste to landfill sites and to encourage the reuse, recycling and recovery of waste*".[1]

4.3 LDT is charged per tonne of waste disposed of at a landfill site. It is payable by landfill site operators, who are expected to pass the costs onto those making the disposals. A small number of disposals are exempt from LDT while some reliefs and discounts are also available. The tax is collected by the Welsh Revenue Authority (WRA). The Welsh Government has thus far set rates that match those in the rest of the UK.

4.4 Our forecast is driven by the amount of waste sent to landfill and the effective tax rate that will be paid. The latter largely depends on policy decisions on rates, but also on the composition of waste sent to landfill as there are three different rates – a 'standard rate', a 'lower rate' and an 'unauthorised disposals rate'. In 2019-20 revenue from standard rate waste accounted for 97 per cent of total revenue from LDT.

Forecast methodology

4.5 The LDT forecast uses a bottom-up model operated on our behalf by analysts in the Welsh Government. The assumptions and judgements that are fed into it are those of the Budget Responsibility Committee. The forecast methodology is straightforward – the main steps are:

[1] Welsh Government, *Landfill Disposals Tax (Wales) Bill 2016: Impact Assessments*.

- establishing an **in-year estimate** drawing on the latest administrative data (and other relevant sources) to estimate the level of receipts in the current year in progress;
- producing a **pre-measures forecast** by using the LDT forecast model to multiply the amount of liable waste sent to landfill (the tax base) by the relevant duty rate; and
- generating a **post-measures forecast** by adding the effects of any new policy measures.

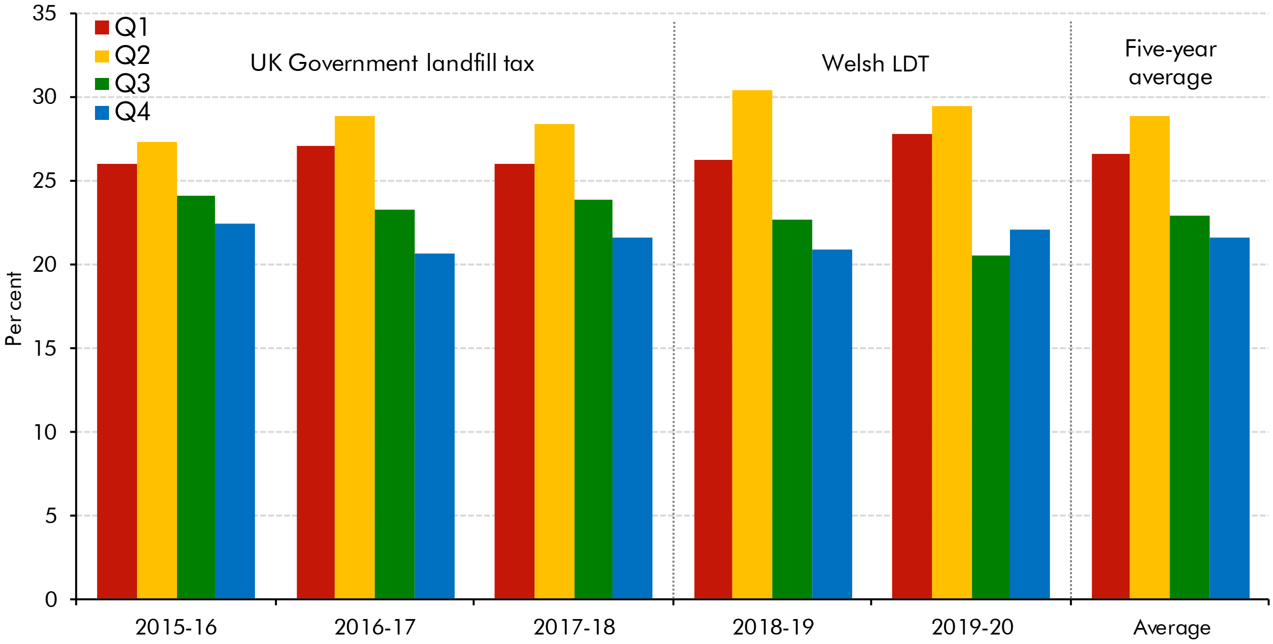
We discuss each step in turn.

Establishing an in-year estimate

4.6 Most landfill site operators have a calendar year annual accounting period, so most LDT returns are received by the WRA at the end of April, July, October and January (returns must be sent by the last working day of the month following the end of the accounting period). The WRA publishes LDT receipts outturn data on a quarterly basis.[2]

4.7 Our in-year judgement is based on outturn data from the first two quarters of 2020-21. Chart 4.1 suggests there is some seasonality in the amount of waste that is disposed of at landfill sites each quarter. It shows the percentage of annual tax receipts in each quarter of the fiscal year, for the UK Government's landfill tax from 2015-16 to 2017-18 and then for LDT from 2018-19 onwards. In both 2018-19 and 2019-20 each quarter contributed at least a fifth of full-year LDT receipts, though with a slightly higher share in the first half of the year, as was the case with landfill tax in the preceding years.

Chart 4.1: Percentage of annual landfill taxes receipts from each quarter



Source: HMRC, WRA

[2] A smaller number of site operators use different accounting periods, which means that monthly data releases could be disclosive. We do not draw on the WRA's unpublished monthly administrative data when preparing our in-year estimates.

4.8 The sharp drop in receipts in the early part of 2020-21 (Chart 4.3 below) has necessitated a departure from our standard approach to producing an in-year estimate. Since receipts early in the year are unlikely to be representative of those later in the year, we have lowered our forecasts for the remaining quarters in line with revisions to our UK-wide consumer spending forecast between our March and November *Economic and fiscal outlooks*.

The pre-measures forecast

Tax base: the volume of waste sent to landfill

4.9 The volume of waste sent to landfill is estimated by calibrating data from Natural Resources Wales (NRW) with outturn data from the WRA. Our model sorts these data by 'European waste catalogue' code into tonnages liable to the standard and lower rates of LDT. This allows us to remove waste that is exempt from LDT. The LDT-liable tonnages are then projected forward using information on local authority waste management plans, waste infrastructure developments, and an assumption about the future path of other waste.

4.10 There are several alternatives to sending waste to landfill sites, including:

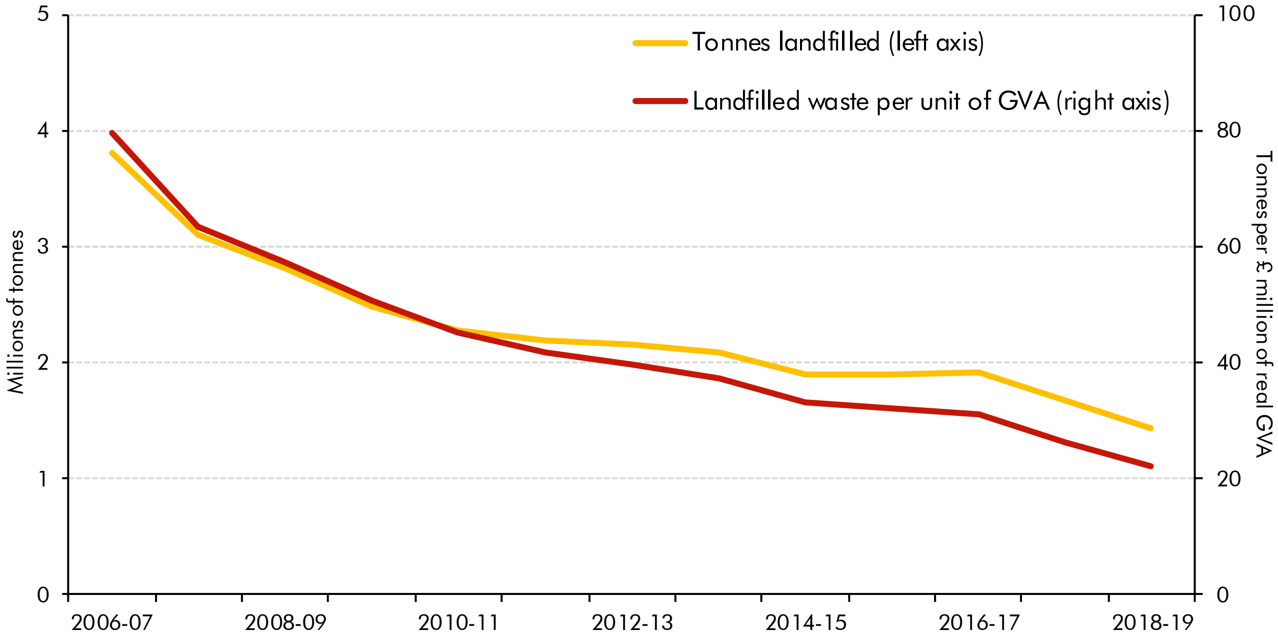
- **Recycling and incineration**, the levels of which depend on the capacity of available Welsh infrastructure. Given the much smaller tax base in Wales, changes in alternative waste treatment infrastructure can lead to proportionally larger effects on LDT receipts than an equivalent change in England would have on UK landfill tax receipts.

- **Exporting waste**, which can be cheaper than sending it to landfill. There are currently two external factors that may limit the volume of exports over the medium term – the UK's future trading relationship with the EU and the Chinese Government's ban on the imports of solid waste. Each could increase the amount of waste sent to landfill (including waste generated in England) and represent an upside risk to LDT receipts. If these or other factors have already affected LDT receipts then this would be captured implicitly in our in-year estimate rather than via an explicit forecast adjustment.

4.11 We do not explicitly model the use of these alternatives. Instead, we assume they provide sufficient headroom to accommodate future growth in waste arising without affecting the volume of landfilled waste. The granular level of information available to us on Welsh infrastructure means that we can factor in expected changes when we need to.

4.12 The volume of waste sent to landfill in the UK has been trending down for over two decades, and Chart 4.2 shows a similar pattern in Wales. The volume of waste sent to landfill has fallen by around two-thirds between 2006-07 (3.8 million tonnes) and 2018-19 (1.4 million tonnes). Chart 4.2 also shows that waste sent to landfill per unit of gross value added (GVA – a measure of economic activity) has followed a similar downward path.

Chart 4.2: Landfill waste tonnage in Wales relative to Welsh economic activity



Source: ONS, NRW

The effective rate of landfill disposals tax paid

4.13 There are two main rates for LDT – a 'standard' rate and a 'lower' rate. The lower rate applies to waste that is 'inert' – i.e. less hazardous or less polluting materials such as bricks, concrete and sand. The standard rate applies to everything else that is neither exempt (see below) or unauthorised.[3] In this Budget the Welsh Government has kept rates aligned with those in the UK for 2021-22, setting a **standard rate of £96.70 per tonne** of waste and a **lower rate of £3.10 per tonne**.[4] Our forecast assumes that both rates rise in line with RPI inflation in future years (based on the UK Government's default indexation assumption). The Welsh Government has not set out its policy for future years and would be free to set other rates if it so wished.

4.14 As with UK landfill tax, LDT legislation allows for both exemptions and reliefs. Where a disposal is exempt, for example within a pet cemetery, there is no tax liability and the site operator does not need to record it on a tax return. Where a disposal is eligible for a relief, such as when it contains material removed from water by dredging, it does need to be accounted for by the site operator, but the relief can be claimed via the tax return. The effective rate paid depends not just on statutory rates and exemptions, but also the composition of waste disposals. In 2019-20 the effective rate paid was £38.46 per tonne of waste sent to landfill.

[3] The Welsh Government has also introduced a third 'unauthorised disposals' rate that applies to all disposals that are made outside of authorised landfill sites, regardless of whether they would have qualified for the standard or lower rates. The 2021-22 rate for such disposals has been set at £145.05 per tonne of waste.
[4] All rates are subject to approval by the Senedd.

Post-measures forecast

4.15 The final stage in our forecast process is to add the effect of new policy measures that have been announced since our previous forecast was published. For landfill tax and LDT these are typically small, although they can still be subject to some uncertainty. For example, the UK Government's decision to extend landfill tax to illegal sites started six months later than planned due to delays in implementing the health and safety procedures required to safeguard the new compliance staff that were taken on to police it.

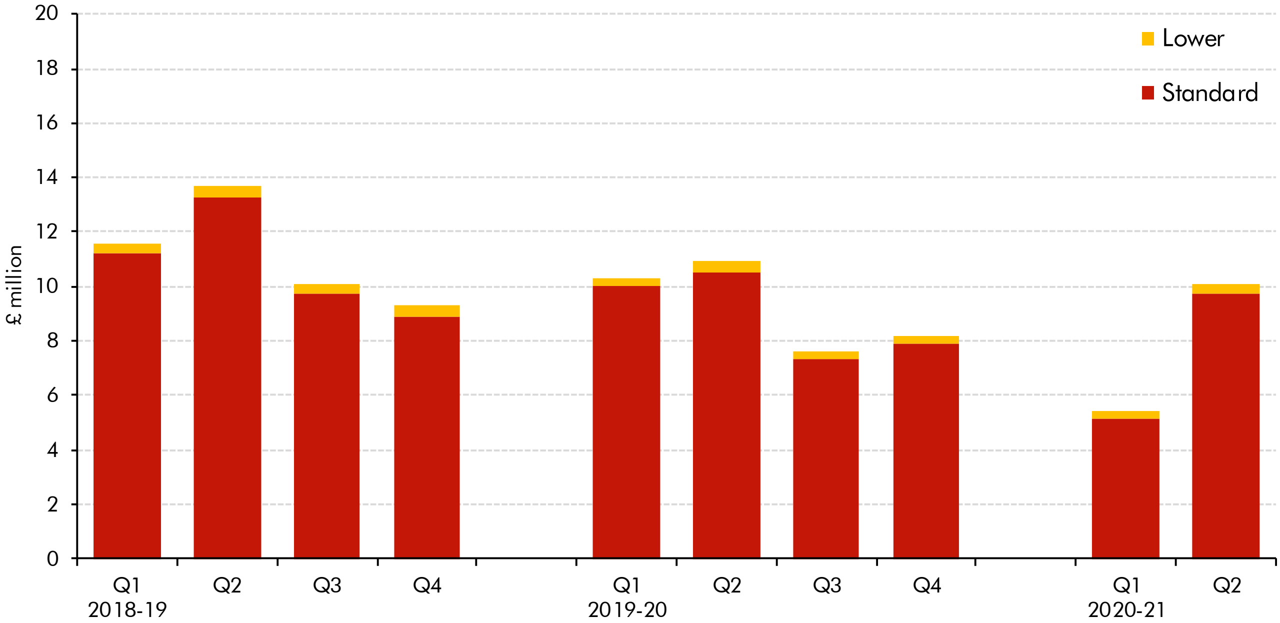
Landfill disposals tax forecast

4.16 Using the methodology described above and based on LDT outturn data for the first two quarters of 2020-21, this section describes our latest forecast and changes since March.

Receipts outturn

4.17 Chart 4.3 shows that receipts in the first half of 2020-21 are down 27 per cent (£5.7 million) on last year, mostly driven by the reduction in economic activity caused by the national lockdowns in response to the pandemic. First quarter receipts were nearly 50 per cent (£4.9 million) down on last year. Despite the easing of public health measures in the second quarter, receipts were still 7 per cent (£0.8 million) down on last year.

Chart 4.3: Quarterly LDT receipts



Source: WRA

Latest forecast

4.18 Table 4.1 sets out our latest LDT forecast. Receipts in 2020-21 are £6 million (17 per cent) lower than we expected in March, largely reflecting the weakness in receipts at the start of the year. Thereafter receipts are expected to recover towards the levels forecast in March, as the effects of the pandemic on consumption, and thus the amount of waste being sent to landfill, diminish. The forecast also reflects downward revisions to our RPI inflation forecast.

Table 4.1: LDT forecast

	£ million						
	Outturn	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
March forecast	36	34	33	33	33	32	
December forecast	37	28	33	33	33	33	32
Difference		**-6**	**-1**	**0**	**0**	**0**	
of which:							
Data and modelling		-6	-1	1	1	1	
RPI inflation		0	0	-1	-1	-1	

Risks and uncertainties

4.19 This section summarises some of the main uncertainties around our central LDT forecast. We would not expect the risk posed by any of these to be particularly large. They include:

- The **net volume of waste arising** is assumed to remain constant over the forecast period. Changes in Welsh infrastructure, such as increases in incineration capacity, mean that the forecast for tonnes of waste sent to landfill trends down. As Chart 4.2 showed, waste sent to landfill has fallen reasonably steadily, but the rate of decline slowed in 2015-16 and 2016-17 before accelerating again since 2017-18. This illustrates the scope of the tax base to surprise us on either side of our central forecast.

- All taxes are subject to a degree of **non-compliance**, ranging from simple errors to deliberate criminal activity. HMRC uses statistical techniques to measure the difference between the theoretical tax liability and what is actually paid, the 'tax gap'. Its latest estimate of the tax gap for the UK landfill tax is 28.4 per cent or £275 million.[5] There is no estimate yet for the LDT tax gap, but if the gap were the same in percentage terms, then this would imply that around £15 million of potential receipts in 2019-20 were not collected. We do not yet have sufficient information on the WRA's LDT compliance activities to take a firm view so, for now, our forecast implicitly assumes no change in the (currently unknown) rate of non-compliance in future years. Any changes in that rate would pose a risk to receipts.

- LDT on **unauthorised disposals** is not a self-assessed tax, with the tax liability instead arising from the WRA identifying suitable cases and issuing charging notices. WRA's scoping work around this was delayed because of the impact of coronavirus and they note that a reliable estimate for next year is challenging.[6] There is an upside risk if WRA were to resume their activities, which could lead to additional tax revenue. The amount collected would be dependent on resources, planning and risks of litigation.

[5] This relates to 2018-19. For more detail see HMRC's *Measuring tax gaps 2020 edition.*
[6] Welsh Revenue Authority, *Annual Report and Accounts 2019 to 2020*, October 2020.

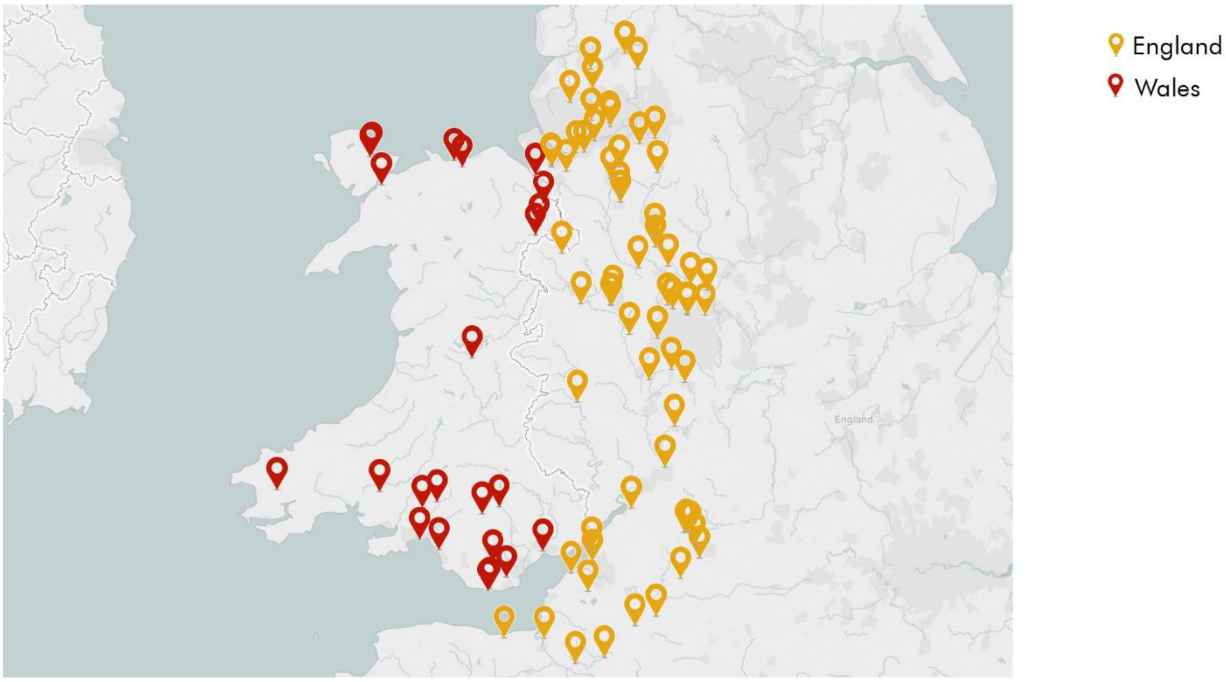
- Our forecast implicitly assumes that there is sufficient **incineration and recycling capacity** in Wales to absorb any increase in waste arising. These assumptions would need to be revisited if there were problems with infrastructure capacity, for example if a large incinerator were to be offline for a significant period or new capacity failed to come online as quickly as expected. Such events would imply a higher share of total waste being sent to landfill than implicitly assumed in our forecast and therefore higher LDT receipts.

- It is possible that non-Welsh Government policies could affect LDT receipts. The **UK's exit from the EU** could make exporting waste to Europe less attractive, at least in the short to medium term. For now, we have not assumed any waste-specific impediments to the UK's future exports to the EU. Were any to materialise, more waste could be sent to landfill representing an upside risk to LDT receipts. Similarly, the **Chinese ban on the import of solid waste**, also due to start on 1 January 2021, could divert waste that would otherwise have been exported (either from Wales or England) to landfill in Wales, also raising LDT receipts.[7]

- **Behavioural responses to policy changes**. The Welsh Government has so far aligned LDT rates with those for landfill tax. If those rates were to diverge then we would expect some waste to be diverted across the border to the sites that were subject to the lower rates. A significant share of waste being sent to landfill in Wales originates in England[8] and, as Figure 4.1 shows, there are numerous landfill sites relatively close to either side of the Welsh-English border, so there would clearly be scope for such behavioural responses to take place.[9] The degree to which they did would depend on how the potential tax saving compared to transport and other costs associated with sending waste to a landfill site subject to the lower tax rates.

[7] Trade data suggest that some of this impact might have already materialised, with the amount of solid waste imported by China falling sharply since 2017.
[8] Data from Natural Resources Wales show that in each year from 2015-16 to 2019-20 waste from England accounted for over 20 per cent of standard-rated waste sent to landfill in Wales.
[9] The 60-mile corridor from the border is purely illustrative.

Figure 4.1: Landfill sites in Wales and within 60 miles of the border with England



A Forecasts required for the block grant adjustments

A.1 The block grant is a mechanism for transferring funds from the UK Government to the devolved administrations, as allocated from within the departmental spending limits set by the Treasury. The block grants for the Welsh and Scottish Governments are adjusted in accordance with their respective fiscal frameworks.[1] The OBR has no direct involvement in these spending decisions or block grant negotiations, but the spending settlements do draw on our tax forecasts.

A.2 This annex presents those forecasts, which largely relate to the UK Government's revenue from the taxes equivalent to those that have been devolved. For the three taxes covered in this report, the corresponding UK Government tax is (non-savings non-dividends) income tax, stamp duty land tax and landfill tax, all from England and Northern Ireland.

A.3 The forecast methodologies for the Scottish and UK Government taxes are largely the same as those described in Chapters 2 to 4. We first establish an in-year estimate using the latest administrative data to estimate the level of receipts in 2020-21. We then project over the five-year horizon using the respective forecast models and our own judgements. The economic determinants that we use are from our November *Economic and fiscal outlook*.

A.4 Tables A.1 to A.4 compare our current forecasts for the devolved Welsh (and Scottish) taxes to their UK Government equivalents (which relate to England and Northern Ireland). The near-term growth rates for all taxes are heavily affected by the coronavirus pandemic and the associated lockdowns imposed across the UK. Our income tax forecasts for 2020-21 also reflect the package of coronavirus measures announced by the UK Government. In the longer term, differences in our income tax forecasts will mainly reflect assumptions about relative population growth, while differences in our forecasts for property transaction taxes derive from the more progressive structure of the Welsh and Scottish tax schedules, which delivers greater revenue gains from fiscal drag as house prices rise.

[1] *The agreement between the Welsh Government and the United Kingdom Government on the Welsh Government's fiscal framework*, December 2016, and *The agreement between the Scottish Government and the United Kingdom Government on the Scottish Government's fiscal framework*, February 2016.

Table A.1: Income tax on non-savings, non-dividend income

	£ billion							
	Outturn	Forecast						
	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Whole UK NSND income tax	**172.31**	**174.70**	**176.25**	**178.08**	**185.87**	**194.27**	**204.05**	**213.82**
of which:								
Welsh Government income tax (WRIT basis)	2.01	2.03	2.05	2.06	2.15	2.25	2.36	2.46
UK Government NSND income tax from Wales	2.62	2.61	2.63	2.66	2.77	2.90	3.05	3.22
Scottish income tax[1]	11.56	11.78	11.84	11.95	12.44	12.98	13.61	14.28
England and Northern Ireland NSND income tax	156.12	158.29	159.74	161.41	168.50	176.14	185.03	193.85
Whole UK NSND income tax excluding Scottish income tax	160.75	162.92	164.41	166.13	173.42	181.29	190.44	199.53
UK Government NSND income tax[2]	158.74	160.90	162.37	164.07	171.27	179.04	188.08	197.07
	Percentage change on a year earlier							
Whole UK NSND income tax		**1.4**	**0.9**	**1.0**	**4.4**	**4.5**	**5.0**	**4.8**
of which:								
Welsh Government income tax (WRIT basis)		0.8	1.0	0.9	4.2	4.4	4.8	4.6
UK Government NSND income tax from Wales		-0.4	0.8	1.1	4.4	4.7	5.3	5.3
Scottish income tax[1]		1.9	0.5	0.9	4.1	4.3	4.8	5.0
England and Northern Ireland NSND income tax		1.4	0.9	1.0	4.4	4.5	5.0	4.8
Whole UK NSND income tax excluding Scottish income tax		1.4	0.9	1.0	4.4	4.5	5.0	4.8
UK Government NSND income tax[2]		1.4	0.9	1.0	4.4	4.5	5.0	4.8

Note: Shaded cells represent notional estimates for years when tax devolution has not occurred.
Note: We have updated the income tax forecasts in this table to correct an error in Table B.1 of the *Devolved tax and spending forecasts* published on 25 November. This correction deducts £2.4 billion from our UK NSND forecast, £170 million from our Scottish forecast and £46 million from our forecast for the Welsh rates in 2020-21.
[1] Currently outturn data is only available for 2018-19, and 2019-20 remains a forecast.
[2] Whole UK NSND income tax excluding Scottish income tax and Welsh Government income tax (WRIT basis).

Table A.2: Welsh rates and England and Northern Ireland equivalent income tax by band forecasts

	£ billion							
	Outturn	Forecast						
	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
England and Northern Ireland NSND income tax (WRIT basis)[1]	**57.8**	**59.0**	**59.9**	**60.6**	**63.1**	**65.8**	**69.0**	**72.0**
of which:								
Basic rate	39.3	40.7	41.6	42.2	43.9	45.6	47.6	49.4
Higher rate	11.4	11.0	11.3	11.5	11.7	12.1	12.6	13.2
Additional rate	7.1	7.3	7.0	6.9	7.5	8.2	8.8	9.4
Welsh Rates	**2.0**	**2.0**	**2.0**	**2.1**	**2.2**	**2.2**	**2.4**	**2.5**
of which:								
Basic rate	1.7	1.7	1.8	1.8	1.9	1.9	2.0	2.1
Higher rate	0.2	0.2	0.2	0.2	0.2	0.3	0.3	0.3
Additional rate	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.1
	Percentage change on a year earlier							
England and Northern Ireland NSND income tax (WRIT basis)		**2.1**	**1.5**	**1.2**	**4.1**	**4.3**	**4.8**	**4.4**
of which:								
Basic rate		3.6	2.2	1.5	3.8	4.0	4.4	3.8
Higher rate		-4.1	2.5	1.9	2.0	3.0	4.2	5.2
Additional rate		3.9	-4.5	-1.5	9.4	8.1	7.8	6.5
Welsh Rates		**0.8**	**1.0**	**0.9**	**4.2**	**4.4**	**4.8**	**4.6**
of which:								
Basic rate		1.7	1.0	0.8	4.2	4.3	4.6	4.1
Higher rate		-6.6	2.0	2.1	3.0	4.3	5.6	7.0
Additional rate		5.4	-5.8	-0.9	12.9	11.2	11.2	9.8

Note: Shaded cells represent notional estimates for years when tax devolution has not occurred.
Note: We have updated the income tax forecasts in this table to correct an error in Table B.2 of the *Devolved tax and spending forecasts* published on 25 November. This correction deducts £0.9 billion from the forecast for England and Northern Ireland (WRIT basis) and £46 million from our forecast for the Welsh rates in 2020-21.

Table A.3: Property transaction taxes

	£ million						
	Outturn	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Whole UK property transaction taxes	**12,549**	**9,113**	**12,030**	**12,703**	**14,063**	**15,599**	**16,966**
of which:							
Land transaction tax (Wales)	260	176	231	236	266	300	335
LBTT (Scotland)	598	431	578	597	671	753	830
SDLT (England and Northern Ireland)	11,691	8,505	11,220	11,871	13,127	14,545	15,802
UK excluding Scottish LBTT	11,951	8,682	11,451	12,106	13,392	14,846	16,136
	Percentage change on a year earlier						
Whole UK property transaction taxes		**-27.4**	**32.0**	**5.6**	**10.7**	**10.9**	**8.8**
of which:							
Land transaction tax (Wales)		-32.2	30.9	2.1	12.6	13.1	11.4
LBTT (Scotland)		-27.9	34.2	3.2	12.4	12.2	10.2
SDLT (England and Northern Ireland)		-27.2	31.9	5.8	10.6	10.8	8.6
UK excluding Scottish LBTT		-27.4	31.9	5.7	10.6	10.9	8.7

Table A.4: Landfill taxes

	£ million						
	Outturn	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Whole UK landfill taxes	**732**	**684**	**751**	**719**	**622**	**578**	
of which:							
Landfill disposals tax (Wales)	37	28	33	33	33	33	32
Scottish landfill tax	119	91	101	91	76	66	53
Landfill tax (England and Northern Ireland)	576	565	618	594	513	479	524
UK excluding Scottish landfill tax	613	593	650	628	546	512	557
	Percentage change on a year earlier						
Whole UK landfill taxes		**-6.5**	**9.8**	**-4.4**	**-13.5**	**-7.0**	**5.5**
of which:							
Landfill disposals tax (Wales)		-23.6	16.1	1.7	-1.5	-0.8	-1.0
Scottish landfill tax		-23.0	10.4	-10.0	-16.5	-12.5	-19.5
Landfill tax (England and Northern Ireland)		-2.0	9.4	-3.8	-13.7	-6.6	9.4

Index of charts and tables

By virtue of paragraph(s) vi of Standing Order 17.42

Document is Restricted

WLGA EVIDENCE TO FINANCE COMMITTEE WELSH GOVERNMENT BUDGET 2021-22 02/12/20

CLlLC • WLGA

INTRODUCTION

1. The Welsh Local Government Association (WLGA) represents the 22 local authorities in Wales, and the three national park authorities and three fire and rescue authorities are associate members.

2. The WLGA is a politically led cross-party organisation, with the leaders from all local authorities determining policy through the Executive Board and the wider WLGA Council. The WLGA also appoints senior members as Spokespersons and Deputy Spokespersons to provide a national lead on policy matters on behalf of local government.

3. The WLGA works closely with and is often advised by professional advisors and professional associations from local government, however, the WLGA is the representative body for local government and provides the collective, political voice of local government in Wales.

4. This evidence is drawn from our submission to the Finance Sub Group (FSG) on 2 November. The FSG is chaired by the Minister for Housing and Local Government and attended by 8 Local Authority Leaders. Other ministers attend regularly.

5. In order to inform the 2021-22 Welsh Government budget round the WLGA carried out a survey of the 22 local authorities. The resulting paper builds on last year's survey but is also informed by work carried in this financial year to quantify and analyse the impact COVID-19 on local government. This has meant that the responses from local authorities have been heavily impacted by the need to deal with the implications of the pandemic.

6. There is now a considerable body of survey data on the pressures faced by the sector. This financial year FSG has received two quarterly reports providing the results of the two surveys setting out the estimated financial impact of the ongoing response to the COVID-19 emergency. These have set out the impact on local authority income and the

pressures on revenue expenditure. In the same context the second report looked at emerging issues and COVID-19 announcements made by UK Government that will have consequential funding allocations for devolved administrations including Welsh Government. This report also covers the impact of COVID-19 and the inevitable legacy impact of the pandemic on local government finances.

7. This paper summarises the results of the survey of all 22 local authorities commissioned by the WLGA to collect more detailed information on the estimated impact of various financial scenarios over the next three years. It is worth noting that each of the 22 authorities has a robust annual financial planning process enabling them to set a balanced budget.

8. The unprecedented crisis saw an immediate response by local authorities. This has meant the Medium Term Financial Plans agreed as part of the 2020-21 budget process are no longer valid because of the unprecedented pressure. Even though the pandemic remains councils are now seeing the recovery phase as a key issue for financial planning. Financial certainty and support will be key to the success of this phase.

9. The survey sought to look at the future impact on services under differing assumptions up to 2023-24 where settlements included workforce inflation, demand and other inflationary pressures. It also sought to gain views about the level of confidence that services could be protected and where the greatest level of concern existed for services.

10. This year's survey also sought information on the impact of Covid-19 on social care finances. The close link between health outcomes and social care is well known and in 2020-21 this has caused further Covid-related financial pressure in the care sector beyond associated demographic factors. The inclusion of this aspect is an attempt to gain a whole system perspective by collecting information so that local government's role and the resulting financial pressure is noted a part of the whole system approach when funding decisions are made that affect the health and social care sector.

Summary

11. Local Government is working at the forefront of the current emergency to meet the unprecedented challenge of COVID-19. This has also been a notable and significant demonstration of the partnership with Welsh Government and the wider public sector. The commitment of staff to support the most vulnerable has been a key factor in

responding to the crisis. Councils' response has been greatly assisted by in year additional funding from Welsh Government. This welcome and necessary financial support to the COVID-19 has brought temporary stability to allow councils to respond to the pandemic.

12. The unprecedented response has understandably redirected local authority efforts to dealing with the impact of the pandemic and to deliver their community leadership role. Despite the challenge and financial circumstances, local authorities continue to provide a wide range of services and this has often gone unnoticed at this unprecedented time.

13. Survey responses indicate the impact of the pandemic on local priorities and council finances. Demand led services in the social care sector have been particularly badly affected and real concern about service continuity and the on-going impact on finances is evident in councils' responses. The responses also highlight the key role played by council commissioned private care providers many of whom are small and lack the financial resilience of larger providers.

14. Reports in previous years to FSG have often commented that local services were reaching a tipping point because of austerity. The potential impact of COVID-19 is of another order of magnitude.

15. Councils raised significant concern about the future funding position. Unexpected financial pressures when coupled with the struggle to deliver 2021-22 budget savings agreed pre COVID is putting pressure on councils. Some savings agreed for this year are complex and transformation-based meaning that there is doubt about when, and indeed if, these will now occur because of the need to respond to the crisis. This adds another layer of uncertainty to local authority finances and future financial planning that may require deeper cuts to services.

16. The following table shows the financial gap calculated from our own modelling. The underlying pressures for 2021-22 total £279m and similar patterns are evident in the next two years. This aligns with local authorities' own estimates from our survey. The cumulative pressure rises to £822m by 2023-24.

Figure 1: Local Government Spending Pressures

Source: Base estimates: RO and RA returns (2019-20 to 2020-21)

17. As in previous years, the greatest proportion, 63% or £174m, is attributable to workforce costs (including social care commissioning costs). Demand pressures amount to £72m which is mostly down to social care, and other inflationary pressure of £33m.

18. In the large service areas there are two sources of additional evidence confirming the scale of pressures in those specific areas. Firstly, the recent report commissioned by WG from Luke Sibieta identifies the school workforce pressures. These form the basis of the underlying education pressures. Secondly the work of LE Wales reported to the Finance Sub Group last year and form the basis of demographic and workforce pressures for social care.

Survey Responses

19. The survey asked Councils how confident they were about protecting services from further cuts under differing conditions. There was a recognition that last year's uplift of £184m or 4.3% was a step-change from the previous decade and protected services and jobs.

20. In assessing the impact of various future scenarios, a settlement that covered workforce inflation would give little respite from the years of austerity and no entire service area could be guaranteed full protection from cuts.

21. The covering of workforce inflation and demand pressures would provide considerable additional assistance, but concern was evident about the ability to meet all cost pressures particularly in schools, adult services and children's services given the COVID-related impact on demand.

22. All council service areas featured in the responses as causes of concern but those consistently seen as the most concerning were:
    - Adults Services
    - Schools;
    - Children's Services; and
    - Homelessness.

Settlements that include Workforce Inflation

23. A funding scenario that included workforce inflation gave councils some respite but still left a considerable gap in financial plans. It opened up the possibility of some scope to limit cuts to Education and Social care but the overriding response was that this scenario would still require painful decisions about services levels, whether some areas could be protected and also ceasing some services entirely.

24. The survey responses noted that the protection of Education and Social care budgets would be extremely challenging. Even protecting one of these areas would be unrealistic.

25. The issue of underinvestment is also of concern. Surveys were aware of the need to move to a recovery phase and individual local authorities stressed the importance of trying to support the local economy. Key to delivering recovery and growth is the ability to fund capital investment. A settlement that only includes workforce inflation undermines the scope for investment unless other areas are cut to fund borrowing costs. For some local authorities, the 21st Century Schools Programme will see capital investment requirements continue to rise with the borrowing costs absorbing a greater percentage of the revenue budget. Under this scenario the issue of affordability of these programmes is a concern.

26. Councils have been remarkably successful to date when looking for operational efficiencies. There was an acknowledgement that the pandemic may provide some additional opportunities around asset savings and travel costs, but these would fall far short of closing any funding gap.

27. An ageing population and other demographic factors would not be covered by funding increases in this scenario. For some councils this is an on-going issue. In other local authorities Living Wage increases create financial pressure.

28. To avoid cuts under this scenario and to meet the funding gaps outlined by councils would still require a large and unacceptable council tax increase. Respondents noted this would have the same issues as outlined under a cash flat scenario. In other words, there would not be an option to pursue this route.

Settlements that include Workforce Inflation and Demand Pressures

29. This scenario provides the greatest protection to services. The responses varied depending on the level of demand pressures and expectations faced by councils. It would give some support to all councils when seeking to avoid the deepest cuts in service. The ability to protect Education and Social care is enhanced.

30. Whilst some authorities felt budget cuts would not be required to meet demand pressures the underlying concern is this would 'only' maintain existing services and meet demographic pressures. Service improvements and any future additional impact of COVID-19 would not be funded.

31. Even under this scenario some councils felt they would have a budget gap because of commitments to fund service improvements. Local policy priorities around Economic Development and Regeneration would still need compensating budget savings from other services to meet these requirements.

32. One response noted confidence that the main services provided would be protected from cuts based on this funding scenario but added the caveat that this would only happen if coupled with Welsh Government continuing to support the additional costs associated with COVID-19.

33. Services will need to continue to become more efficient and take savings that result from changes working arrangements made because of Covid-19. Targeted savings in specific areas (e.g. back-office functions) would need to be delivered to produce further investment in frontline services, local priorities and on-going transformational change.

34. Some authorities felt this scenario would give scope to reflect on planned council tax levels. This was not a universal feature but is evidence of a willingness to support local communities where it would be a possible to look at reducing the planned level of increases.

35. The issue of collection rates for council tax is a concern. The picture across Wales is one of reduced collection rates because of the pandemic's impact on household income. When coupled with the potential for increase in council tax reduction scheme costs this increases as risk factor for council budgets.

Service Areas Causing the Greatest Concern

36. The survey sought views on services where there was the greatest concern under all three scenarios.

37. All council service areas featured as causing concern. However, there was a consistent theme that indicated all councils are concerned about major service blocks that have been affected by COVID-19.

38. To date Schools may have been relatively protected from the worst of the funding reductions but the picture presented by survey responses indicates a relatively poor settlement will impact on improving standards and support for vulnerable and disadvantaged learners. Responses indicated that whilst this area is a priority it would not be possible to provide protection against funding reductions in some scenarios. When coupled with some authorities having schools in licensed deficit positions there is growing concern about the impact of a flat cash or pay inflation only settlement at a time when one authority has seen a 37% increase in the numbers of learners eligible for free school meals.

39. Unsurprisingly Adult Social Care featured as a key concern. Responses noted the need to continue to deliver the Social Services and Wellbeing (Wales) Act but also highlighted the on-going COVID-19 pressures currently being funded through Welsh Government's Hardship Fund. This has been a significant financial support mechanism but currently only covers the 2020-21 financial year. Demographic pressure means that costs are rising at a time when there is increasing concern about market fragility. Claim data coming from the hardship fund shows the monthly claims of between £8m and £12m are needed for the sector. This will amount to £96m and £144m annually.

40. Children's Services was already under pressure before the impact of COVID-19. Responses noted the concerns around the impact on children's wellbeing during lockdowns and this issue is likely to see financial pressures arising from COVID-19 in the longer term. Demand for placements, high placement costs and a high percentage of social work posts being filled with agency staff continue to add to the financial pressures in this area. Whilst numbers of 'looked after children' have increased trends suggest these have not yet reached the maximum and are likely to increase further. The number of looked after children has increased over the period of the pandemic and placements are increasingly difficult to source. This is creating an additional pressure on the financial position.

41. Housing and homelessness financial pressure is a significant concern. To date the revenue funding made available for COVID-19 has helped address rough sleeping. Funding from Rough Sleeping Grant and Housing Support Grant has also assisted but additional issues and challenges will arise due to the new legal duties under section 75(3) of the Housing (Wales) Act 2014. This area that is likely to see demand rise in the medium to longer term because of the increase in unemployment levels.

42. The fragility of Public and School transport, particularly bus services, has been mitigated by using Welsh Government Hardship funding in 2020-21 to give short-term support to transport providers. There is now concerns about the viability of providers affected by the continuing reduction in passenger numbers. There is the potential for contract costs to increase due to fewer providers existing and the impact of providing safety measures to manage COVID-19.

43. The most significant concern in Culture and Sport is the decline in income levels. This area has lost income from theatres, concert halls and large events, all of which also attract visitors who also provide income for local businesses.

44. There is demand pressure particularly in Environmental/Public Health and other Regulatory Services. There is evidence of increased responsibilities and workload from managing enforcement of COVID-19 regulations.

45. Councils have also been affected by a loss of fees and charges income. This is a source of significant funding for services and in 2020-21 shortfalls have been met by the Hardship Fund. The reduced income levels are likely to continue in 2021-22 and this key component of local authority funding is unlikely to return to historic levels for some time. Without on-going support for loss of income compensating service cuts will be

required because there is uncertainty about when (and if) demand will return to pre COVID-19 levels.

Impact of Covid-19 on Social Care Services

46. This year's survey sought information on the impact of COVID-19 on social care. The national response to the crisis has highlighted the close link between health outcomes and the delivery of social care services. The overall response has caused Covid-related financial pressure in the care sector over and above the annual pressure faced by demographic changes.

47. A consistent response from councils has been that the WG Hardship Fund has been utilised to support social care at this challenging time with some noting its role propping up the provider market and maintaining a sustainable service moving forwards.

48. The close working between the Health Service and local authorities in response to the pandemic has demonstrated how important the care sector is in terms of providing health services across Wales and improving the performance of the health service as a response to the pandemic. Some authorities stressed the need for any additional NHS Wales funding to recognise the role played by councils so that local government receives a fair share of any health consequential funding from UK government that may come to Wales.

49. Responses indicated the importance of ensuring private sector care providers were able to continue their important role in not just meeting council commissioned care for the most vulnerable in society but also freeing up resources in hospitals. The current pandemic has placed significant financial strain on care providers due to increasing costs (staffing, sickness, PPE etc.) but has also impacted on their income generating ability from full fee-paying clients. Market failure would leave Councils looking for care capacity further afield. This would come at a significant increased cost.

50. The survey found that the additional WG funding that is currently being directed to providers has kept some providers trading and it will be difficult for them to continue to the future without this additional funding.

51. The concern about market failure of local providers was also matched by pressures that will be felt beyond the end of the pandemic:

- Specific areas om Adults Services such as occupational therapy and general social work will need to catch up with non-priority work which continues to meet statutory thresholds. In practice this will result in additional costs for some time.
- Mental Health services will have to deal with additional pressure to support an additional tranche of individuals affected by the pandemic's impact on levels of isolation.
- During the pandemic sourcing placements for Looked After Children has been challenging. As a result, there will be an increase in costs particularly with high cost out of county placements to manage post the pandemic.
- Day care services may not resume using the same model as the pandemic eases. Emerging new service models may require additional finances to support them

52. In response to the pandemic there has been a refocussing of operations and day to day management. This has affected transformation agendas meaning that some councils have delayed significant changes that are also tied to budget saving programmes. Authorities recognise that there is a need to develop and remodel services to meet current and increased need but lack the capacity needed to do so.

Locking in transformational change due to COVID 19

53. On 8th August the Minister for Housing and Local Government wrote to Leaders to acknowledge the loss of income across all local authorities and to recognise the efforts Councils had made to innovate to keep services going and to deliver new or additional services in response to COVID 19. The letter also noted the strong desire and need to build in and build on the positive service changes Councils have introduced in response to the pandemic. The Minister was keen to hear about what changes have been made and what positive outcomes have been achieved and the responses from the 22 authorities covered areas such as administration, governance, flexible working property and the use of digital scrutiny.

    - Since the beginning of the pandemic all local authorities have a significant proportion of the workforce working remotely. This change has seen travel and energy cost savings. The longer-term impact is likely to see a reduction in overall office accommodation needs. Councils report an increased digital literacy across their organisations including elected members.

- Local authorities have seen traditional methods of paying and contacting the Council (such as face-to-face at Customer Service Offices) shift to either telephone or web-based engagement. Some councils have used Post Office cards to collect housing rents from tenants. This has reduced the level of cash handling.

- The use of mechanisms to accelerate culture shift has accelerated. Technology has enabled staff and elected members to conduct meetings and discussions without the need to travel to a specific location. The reduction in travel time has produced savings, reduced carbon impact and improved productivity.

- Following lockdown services such as libraries and Household Waste Recycling Centres were brought back into public use by on-line booking systems that efficiently and safely managed access. Some councils are moving to electronic library catalogues so that residents can safely access a service. Digital library services have been implemented very successfully and councils intend to provide a 'click and collect 'service permanently.

- The use of AI technology has accelerated to maintain services by freeing up resources in front line care as well as administrative areas by automating processes.

- There has been considerable flexibility demonstrated by the workforce from supporting free school meals to operating Track, Trace and Protect (TTP). Redeployment to support vital services has been underpinned by agreements made with Trade Unions. From the outset of the pandemic one council took the decision to deliver Free School Meals to the homes of all eligible FSM Pupils. Not only did this support vulnerable households but also benefited local businesses. The operation showed how the whole workforce supported the local community.

- One council reports that the establishment of an intensive and highly valued community support and engagement scheme for those that were shielding (and those also in need of support) has also produced valuable community feedback and intelligence. This will help shape their priorities during the recovery stage and beyond.

- The use of virtual meetings for Child Protection Conferences has been a positive development. One council states it has consistently been able to achieve 100% quoracy meaning significantly more effective meetings to safeguard children.

- Councils quickly established childcare hubs to support those working on the front-line as well as the most vulnerable children, this provision was seven days a week and throughout the school holidays. One council introduced a 'team around the hub' to provider informal access to named professions, this multi-agency model was so successful it has been continued.

- In one council Sheltered Housing Wardens have been issued with laptops. This will reduce the amount of paperwork that has to be completed and collected. It will also free up time for Senior wardens who must collate and check it monthly.

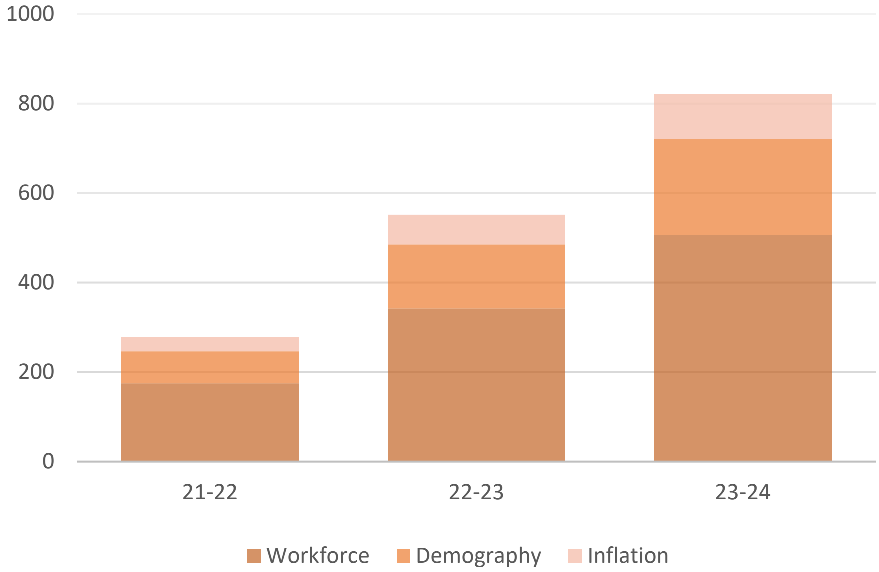
54. There is no doubt dealing with the pandemic has been incredibly challenging for local authorities but councils report that some of the changes that have taken place during the pandemic will be incorporated into a permanent way of working. This will see a focus on improving service delivery, enhancing staff well-being, and locking in productivity improvements.

Core Pressures in the Medium Term

55. Figure 2 below summarises the expenditure pressures for local government based our model that uses centrally collected returns as the baseline and then factors in what we know about pressures over the next 3 years. Total expenditure pressure for 2021-22 is £279m which is higher than previous years reflecting the higher pay settlements. Unavoidable workforce pressure accounts for 64% of this. By 2023-24 this is estimated to rise to £822m with workforce pressures (£507m) higher than demographic and other inflationary pressures combined (£315m).

56. The pressure next year aligns with closely with the data from all 22 authorities have provided through the Spending Review Survey. This aggregates to £274m so around £5m less than the modelling suggests.

Figure 2: Cumulative pressures up to 2023-24, by theme, £m



Source: Base estimates: RO and RA returns (2019-20 to 2020-21)

57. Figure 3 below shows that a greater proportion of future pressure is still building up in the large services. In summary the key features are:

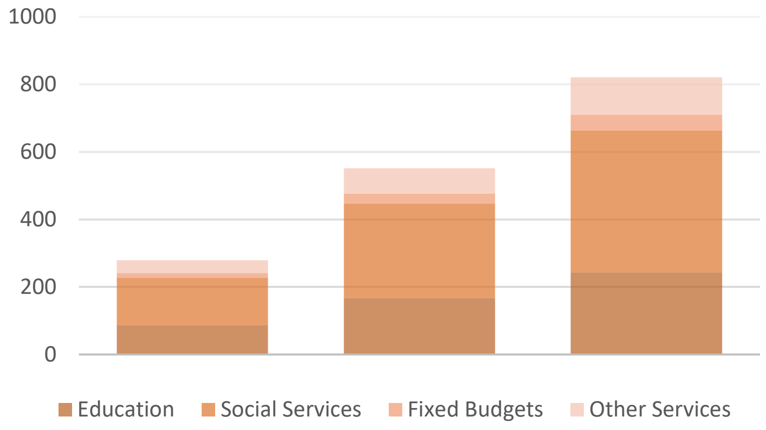
- An additional pressure of £140m for social care in 2021-22 becomes £420m by 2023-24 which is consistent with the unpublished study by LE Wales commissioned by Welsh Government (this should provide more precise estimates).

- The pressures on schools are less rising from £87m to £244m over the same period. Again, these estimates are well aligned to the those recognised by Welsh Government commissioned work. The recent Report from Luke Sibieta estimates workforce inflation (teaching and non-teaching) between 6.4% and 8.4% over a three year period.

- Fixed elements of the budget – capital financing, fire levies and the Council Tax Reduction Scheme – rise from £15m to £46m by the end of the period.

- The remaining non-statutory services, which are some of the most visible to and valued by communities and those that make a positive contrition to people's wellbeing are the ones most at risk and areas that have borne the brunt of austerity to date.

Figure 3: Cumulative pressures up to 2023-24, by service, £m



Source: Base estimates: RO and RA returns (2019-20 to 2020-21)

58. Finally, while most of this paper has been about revenue spending, the importance of capital investment should not be overlooked. Local Government has welcomed the additional capital funding that has been made available in recent years to fund transport, schools, housing and other local infrastructure. As in previous years we hold the line that eventually we would like to see local government's capital expenditure reinstated to 2009-10 levels.

59. Last year the Future Generations Commissioner has published a ten-point plan to fund Wales' response to the climate emergency. As the Commissioner points out, in previous and current budgets the Welsh Government spend on decarbonisation has been around 1% which is nowhere near enough to fund the challenges that a climate emergency presents. WG has set an ambition for the public sector to be carbon neutral by 2030. Local government can play a vital role in helping to pursue these goals but will need to be resourced adequately if it is to be able to rise to the challenge.

60. In the aftermath of COVID, as part of the recovery, we will continue to make the case for a series of co-ordinated, Wales-wide programmes of investment in local authority services. Details of the economic stimulus package were set out in a letter to Ministers back in July. With Welsh Government funding, local authorities could borrow and invest in several significant capital programmes. These could contribute, rapidly and significantly, to a wider economic stimulus package whilst also helping to improve performance and outcomes in relation to a range of other important shared policy objectives. They would also help to 'lock in' and build upon positive, transformational changes already introduced to these services in response to COVID 19.

61. Local Government is best placed to deliver improved transport, housing, renewable energy projects and nature-based solutions. Local government is also best placed to ensure that decarbonisation is a key principle and driver for decision making within the planning system, public sector procurement and the responsible investment of over £17bn of pension fund assets.

Conclusion

62. Last year's report to the FSG, concluded Local Authorities had been relatively resilient despite the prolonged period of real terms budget reductions. The challenges this year are of another order of magnitude because of the unprecedented impact of COVID-19.

63. The substantial in year support from Welsh Government coupled with an approach based on working in partnership has provided significant service continuity at a time of crisis. However, a fair 2021-22 settlement will be needed to avoid deep cuts in key areas of local government so that councils not only continue to play a key role providing on-going support but also lead the recovery phase for our communities as we return to a more 'normal' position.

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THE WELSH NHS CONFEDERATION
CONFFEDERASIWN GIG CYMRU

	The Welsh NHS Confederation response to the Finance Committee's scrutiny of the Welsh Government's 2021-2022 Draft Budget proposals.
Contact:	**Callum Hughes**, Policy and Public Affairs Officer Callum.Hughes@welshconfed.org
Date:	November 2020

Introduction and background

1. The Welsh NHS Confederation welcomes the opportunity to respond to the Finance Committee's scrutiny of the Welsh Government's 2021-2022 Draft Budget proposals.

2. The Welsh NHS Confederation represents all the organisations that make up the NHS in Wales: the seven Local Health Boards, three NHS Trusts and Health Education and Improvement Wales (HEIW). We also host **NHS Wales Employers**.

3. Since the beginning of March, our priority has been supporting and representing our members to respond to COVID-19. Our engagement with members has focused on the active support of Executive Director Peer Groups' response to COVID-19, including NHS Chairs, Chief Executives, Assistant Medical Directors and the Workforce and Organisational Development (W&OD) Directors.

4. In addition to supporting our members, we have been working closely with partners across the health and care system to ensure we provide a 'whole system' perspective. Throughout this time, we have continued to engage and work with our stakeholders, including Royal Colleges, WLGA, third sector and social care organisations, to respond to the pandemic so that we can highlight any issues and offer potential solutions to the Welsh Government.

5. In September 2020, the Welsh NHS Confederation published our Senedd election briefing, *Valuing, Engaging and Delivering: A health and care system for future generations*, which sets out a number of key calls for the next Welsh Government. The briefing was developed following extensive engagement with our members and called for the next Welsh Government to develop a 5-year investment plan in service change to reshape the NHS estates and infrastructure, including digital, making them more sustainable, reducing carbon emissions and maximising public assets. While recent increases in funding to respond to the pandemic have been welcomed, finances remain extremely tight. This will continue to be the case as demand on the NHS and social care continues to grow, the costs of providing care increase and the impact of a potential economic recession following the COVID-19 pandemic is felt by Welsh communities.

6. Our response has been developed through engaging closely with NHS Wales Executive Directors of Finance and Assistant Directors of Finance.

What, in your opinion, has been the impact of the Welsh Government's 2020-21 budget including recent funding related to COVID-19?

7. The Welsh Government 2020/21 budget provided additional support to NHS Wales in recognising the need to stabilise the health system. In response to the COVID-19 pandemic and its impact on NHS Wales finances, the Welsh Government has provided significant additional financial support which has supported Health Boards and NHS Trusts as they continue to respond to the challenges that face the health and social care system, including the financial challenges.

8. NHS Wales organisations welcomed the additional growth funding provided by Welsh Government in the 2020/21 budget as well as the additional support to cover the Agenda for Change pay deal. This has provided the opportunity for NHS Wales organisations to stabilise or improve their financial positions. The pay deal has also been particularly important in terms of supporting the recruitment and retention of NHS staff at a time when the demand on the NHS Wales workforce has increased.

9. Service transformation was further supported in the 2020-21 budget with the directed financial allocation for primary care clusters and the additional ring-fenced funding for mental health services and Regional Partnership Boards (RPBs).

10. Cross border funding provided to Health Boards allowed for the stabilisation of funding streams with providers in England, which maintained long-standing care pathways for patients.

11. The funding has enabled many Health Boards and Trusts in Wales to implement changes to support innovative service models by joining up and integrating services across sectors and shifting services upstream and taking a preventative approach to design and delivery.

12. The additional funding has also supported financial sustainability with more NHS organisations managing to operate within their resource limits, with the forecast deficits reducing in a year when continued strain has been placed on NHS Wales services and their associated costs.

13. Clearly, the COVID-19 pandemic has since significantly affected this position. NHS Wales organisations welcomed the Welsh Government's decision, announced on the 7th July 2020, to write off the £470 million of strategic cash support owed by four NHS Wales organisations since 2014. This decision has provided these organisations with greater certainty, supporting them to focus on the immediate challenges brought about by the COVID-19 pandemic while also planning for the future.

14. NHS organisations welcomed the additional funding allocated to the NHS and social care to support the response to the pandemic. Under the First Supplementary Budget tabled in May, £2.4 billion was allocated to health and social services to support the response to COVID-19, bringing the total allocation to the health and social services budget to over £9.4 billion (£9,439,762,000). Under the Second Supplementary Budget, which was laid in the Senedd by the Minister for Finance and Trenfydd on 20th October, this allocation increased to over £10.3 billion (£10,341,215,000), an increase of over £900 million. The increased

allocation includes an £800 million stabilisation package, which was announced in August, to help NHS Wales organisations respond to and recover from the COVID-19 pandemic.

15. NHS Wales organisations welcomed the additional funding provided by the Welsh Government. The funding has been used primarily to tackle challenges in the following areas:
    - COVID surge
    - Field hospitals to provide increase in capacity – set up and decommissioning
    - Additional pay costs
    - The ‘Test, Trace, Protect’ programme
    - Mental health support
    - Care homes
    - Primary care
    - Cross-border impacts on activity flow
    - Personal protective equipment (PPE)
    - Independent sector hospital support for elective sustainability
    - Increased ability to enable collaborative and mobile working underpinned by digital and accelerated 365 roll-out programmes.

16. The additional funding has allowed Health Boards and Trusts in Wales to amend their forecast for 2020/21. However, the forecast remains fluid in terms of COVID-19 response requirements for future months and the impact on the delivery of savings.

17. The NHS in Wales response to COVID-19 created a need to radically rethink and accelerate the way the service interreacts with patients and deliver care. The Welsh financial response has been supported by upscaling, accelerating and adopting new digital solutions, capitalising on the data, software and functionality that already existed but which now incorporates greater flexibility and reporting. The ability of the Welsh Government to adopt agile and front-footed approaches to funding, especially with digital solutions, supported the delivery of a new national and functional ‘Test Trace Protect’ solution in record time and minimal cost. The investment in the National Data Resource (NDR) in 2019/20 and expertise has helped support this process. However, it has also highlighted the need for increases in digital investment around system integration, design space and an accelerated move to cloud platform.

18. The delivery of savings remains a challenge across Health Boards and Trusts in Wales and a significant proportion of planned recurring savings assigned to improve the underlying position are currently not forecast for delivery in 2020/21. Therefore, further efficiency savings are required to help secure financial sustainability and support service and quality improvements going forward.

19. Short term opportunities to secure further savings in 2020/21 will continue to be progressed, noting the challenges presented by the current operating environment and COVID pressures. These discussions will also inform savings for 2021/22.

20. Opportunities will continue to focus on improving the efficiency of services; providing a safe, secure and healthy NHS estates environment; and the effective use of resources.

How do you think Welsh Government priorities for 2021-22 should change to respond to COVID-19?

21. The 2020/21 budget provided NHS Wales with sufficient resources to stabilise and sustain services.

22. The COVID-19 stabilisation-funding package for the NHS has brought financial stability for 2020/21. However, the recurrent impact of ongoing costs associated with PPE, field hospitals, the 'Test, Trace, Protect' programme, the negative impact on Health Boards' underlying positions and the need to recover planned care activities in 2021/22 will significantly impact individual Health Board financial stability for 2021/22.

23. For 2021/22, Health Boards and NHS Trusts in Wales would like to see funding levels that support the COVID recovery in the future. However, these funding levels also need to reflect the impact on individual organisations' underlying positions. That said, NHS Wales organisations are acutely aware that increased funding in 2021/22 will be subject to many competing demands. Cost pressures across the public sector, and the implications of managing those pressures, are recognised in the context of existing resource constraints, a forecasted economic downfall as a result of the COVID-19 pandemic and the potential of a no-deal Brexit (or an agreement that fails to adequately protect the UK and Welsh economies). Wales needs clarity on the structures and governance arrangements that will replace EU Structural Funds – funds where Wales has historically received, proportionally speaking, the most financial support of all four UK nations. It is important that the NHS receives as much clarity as possible, as soon as possible, about how much Wales will receive, how it will be targeted and how it will be administered.

24. COVID-19 has highlighted the opportunities across the health and care system that are afforded by digital technology. It's availability, dependency, access, resilience and security are now essential to ensure the continuity of services and NHS organisations are committed to building on the progress made. The Track and Trace system has demonstrated the art of delivering a minimal product on a national scale safely, quickly and efficiently. There are future opportunities to accelerate the shift to data driven, value-based and locally delivered models of care. It is important that the Welsh Government's investment priorities in 2021-22 include a significant digital aspect. This means safeguarding and developing the infrastructures that NHS Wales organisations have already developed nationally and locally, but also ensuring that transformations in patient pathways continue to

support not only the COVID-19 recovery, but also the transition more generally to a healthier Wales.

25. NHS Wales organisations also recognise that partners across the public sector are facing acute financial challenges due to COVID-19. To enable health and wellbeing systems to operate effectively, the whole system needs to be appropriately resourced, including social care. Some of the lessons we've learned from COVID-19 pandemic to date provide us with an opportunity to focus more specifically on areas that need to operate at a higher performance level and optimise the use of public funds. This means having a greater focus on health protection and prevention, improved digital technology, and the need to recruit and maintain a workforce that has the experience, capacity and skills to meet the challenges of the future.

26. NHS Wales organisations note that the Welsh Government will announce the outline and detailed draft Budgets in December 2020. It is anticipated that, due to the ongoing uncertainty, Health Boards will be required to submit a one-year Operational Plan for 2020/21 only. The ability to plan for more than one year will depend on robust and sustainable service and workforce plans, and this will continue to be the case while the system continues to address the immediate challenges when responding to COVID-19.

27. Until NHS Wales organisations have an indication on the planning assumptions for 2021/22, the extent to which any additional financial resources will be available to NHS organisations remains unclear. While we appreciate the difficulties the Welsh Government face in outlining their detailed draft Budget for 2021/22 due to the UK Government's Comprehensive Spending Review being delayed until the 25th of November, an early indication of what these assumptions might be would be hugely beneficial and helpful to NHS organisations. This would support organisations on an individual level to confirm their resource planning assumptions, and where necessary, make refinements.

28. In particular, the need to sustain the 'Test, Trace, Protect' programme and the roll-out the COVID-19 vaccination programme will have a significant financial impact on NHS Wales organisations. NHS Wales organisations will continue to engage in an ongoing dialogue with the Welsh Government as these developments progress. Until NHS Wales organisations receive clarity from the Welsh Government around what the financial position over the next 12 months is likely to look like, the priority must be to stabilise the system as much as possible and ensure that individual organisations can deliver as many essential services as possible.

29. Finally, the NHS Wales Education Commissioning and Training Plan for 2021/22 has been submitted for consideration by the Welsh Government. The plan proposes to continue the increase in the number of students and trainees across a range of professional groups and identifies the workforce need to do so. The plan also identifies the cost of providing the additional training and the resources

required in total for each of the three years of the plan. Increasing investment in student training and staff education not only provides a financial benefit to the health system - the benefit to patient experience, quality and continuity of care, a reduction in complaints and adverse incidents are also well-recognised as key benefits of investing in a system that is less reliant on temporary staff.

30. Health Education and Improvement Wales (HEIW) has undertaken work which shows that investing in additional nurse student placements can be repaid in a little over a year of those students graduating and working within the health system and social care system in Wales through reducing reliance on agency staff. It is also evident that investment in educating and training existing staff to acquire new skills and expertise is essential to support NHS Wales' drive to deliver new ways of working and adopt innovative technology, both to support the sustainability of the system, but also to support patients to maintain physical and mental wellbeing at home. This is of particular relevance given the immediate and medium-term challenges brought about by the COVID-19 pandemic, including rehabilitation.

How financially prepared is your organisation for the 2021-22 financial year, and how can the budget give you more certainty in planning and managing budgets given the ongoing volatility and uncertainty?

31. Whilst NHS Wales organisations welcome the additional funding provided by Welsh Government, there is a concern that the ongoing impact of the COVID-19 pandemic will significantly hinder NHS organisations' ability to recover services, shift the focus to achieving sustainability and delivering transformation.

32. Investments planned to support patient services as part of medium term plans have been redeployed to manage the COVID-19 pressures and this deferment will have an impact on future delivery, recognising that the pandemic has acted as a catalyst for change in some circumstances e.g. digital and agile working. These changes need to be consolidated and capitalised upon to maintain the good practice for patient care.

33. It is also difficult to assess the extent to which ongoing costs associated with new services, such as the 'Test, Trace, Protect' programme, will impact individual organisations' financial positions. While the roll-out of the programme has been a standout example of how effectively NHS organisations can work with local government partners, and wider partners, to deliver national programmes at scale and pace when required, uncertainty around how this will impact organisations' financial positions in the long-term remains.

34. As operational services focus rightly on meeting the challenges brought about by the COVID-19 pandemic, particularly with regard to the impact on the NHS Wales workforce, it will be challenging to focus attention on the delivery of transformational services. The delivery of savings will remain a challenge across NHS Wales organisations. As a consequence, the underlying financial position across NHS Wales as a whole will remain a significant challenge.

The Committee would like to focus on a number of specific areas in the scrutiny of the budget, do you have any specific comments on any of the areas identified below, particularly in light of the COVID-19 situation and how these should be reflected in the 2021-22 budget?

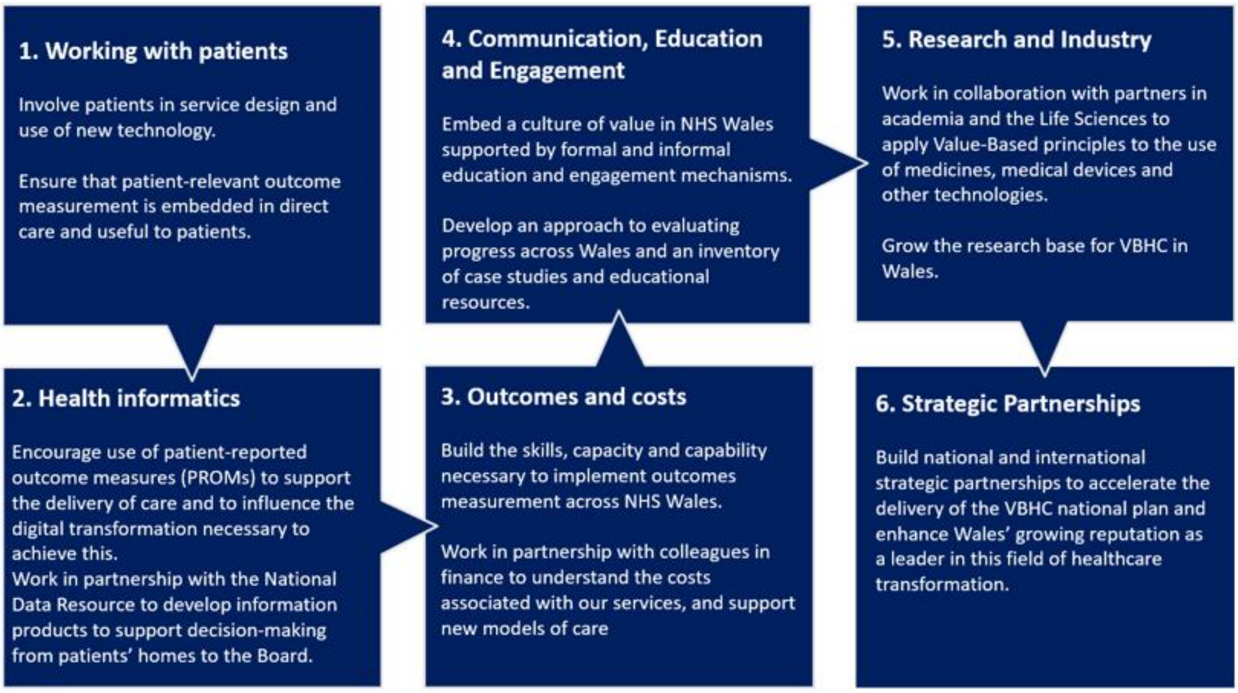
Value-Based Healthcare

35. According to the vision put forward by the Welsh Government in '***Putting Value at the Centre of Health and Care in Wales: A Three Year Action Plan 2019 -2022'***, the vision for value-based healthcare in Wales is to:

> *"Seek to improve the health outcomes that matter most to the people in Wales.*
>
> *"We will support this by asking people about their outcomes and creating a data-driven system which seeks to provide the timely information to citizens, clinical teams and organisations to inform the decision-making that leads to those outcomes in a way that is financially sustainable."*

36. While NHS Wales organisations will strive to achieve these vision aims, the 2021/22 financial year is certain to be one of sustaining core services and recovery.

37. The diagram below sets out the National Action Plan for Value-based Healthcare. NHS Wales organisations are committed to delivering on this plan, which as the headings suggest, will require a multi-pronged approach that engages the entire health and social care system.



38. Preventative spending competes with immediate care cost pressures to support patients. The shift to increasing preventative spending therefore needs to be supported with very clear evidence and data to demonstrate a cause and effect relationship between these competing factors along with a clear impact timeframe. This will provide confidence to the public and patients of Wales that the improved future health state is worth investing in now in comparison with short term investment in treatments. NHS Wales organisations are committed to delivering on the vision set out in the Well-being of Future Generations (Wales) Act 2015 too, which supports new ways of working across the health and social care system and acts as a framework for considering how the impact of decisions made in the here and now will likely impact the health and wellbeing of future generations.

39. There are a number of ways in which NHS organisations can support the sustainability (which is both an immediate and future risk) of the system through adopting the value-based healthcare approach and continuing to align with the principles within the Well-being of the Future Generations Act. The following paragraphs will outline some of these approaches.

40. Firstly, there is a need to promote, on all levels, a data-informed approach to allocating resource to where it will most improved outcomes e.g. through targeted investment in prevention of adverse outcomes. Given that most adverse outcomes are driven by inequalities in health, this will require disproportionate investment in essential prevention, diagnostic, and support services in less advantaged communities.

41. Secondly, through a data-informed and evidence-based approach, there needs to be a willingness to ensure that low value interventions do not resume in Wales.

42. Thirdly, there is a need to support new models of care across the system, particularly in light of the COVID-19 pandemic**.** Emerging evidence from the ways in which the pandemic has been managed in Wales, and elsewhere, demonstrates that achieving meaningful digital communication with patients receiving care is a vital part of delivering these new models. Targeted, effective investment in digital technology that centres around the patient not only enables the healthcare system to engage with patients about the outcomes that matter most to them – it also supports flexible access to services that reduce face-to-face contact, which in the medium to long-term, could lead to achieving greater sustainability across the system. Investment in this space also supports cross-sector working in ways that make a positive contribution to health and wellbeing e.g. education.

43. NHS Wales organisations are clear that the increased number of patients waiting for NHS treatment cannot be addressed in traditional ways or, arguably, by individual organisations. Therefore, a combination of radical new approaches to meet patient need should be considered. Firstly, new models of care need to be implemented across the system, as highlighted in the previous paragraph. Secondly, value-based principles would suggest that separating elective care from

unscheduled care at a regional level would enable targeted and more sustainable investment towards tackling the backlog without creating adverse outcomes across the health and care system.

44. Finally, the response from NHS Wales organisations to the challenges of the pandemic serve to demonstrate that the system can respond quickly and effectively to challenges when the resource framework supports the direction of travel and organisations and aiming to achieve the same outcomes. From intensive care units to ambulance crews, staff across the system are working in different ways to keep people safe and keep non-COVID services open. In many cases, this has been achieved through an increased use of digital technology and establishing new partnerships across the public sector that support population wellbeing. The NHS is clear: when the financial and resource backing is there, the NHS can evolve quickly and effectively to respond to the challenges it faces.

Digital

45. As highlighted within our recent briefing, **Transforming NHS Wales services through digital developments**, since the beginning of the pandemic, digital services have supported the delivery of safe, person-centred care and enabled faster clinical decision-making across the system. NHS Wales organisations are committed to building on these developments as the system shifts to a post-pandemic environment, but this will require additional investment.

46. Developing and enhancing the digital architecture in a way that supports people to maintain their independence also underpins the value-based healthcare transformation process by increasing opportunities for involving patients in service design and supporting a culture of value across the NHS.

47. It is worth noting also that in 2021 a new Special Health Authority will be established, Digital Health and Care Wales. The organisation will cement the importance of digital innovation across the NHS and strengthen governance and accountability arrangements through the appointment of an independent Chair. NHS Wales organisations support the establishment of the new organisation but recognise that there remain a number of areas of uncertainty. For example, it is not clear how the new organisation will discharge its supplier responsibility to customer organisations. Moreover, given that the consultation document, which is currently open for responses, proposes that the new organisation will have a supplier/service provider role alongside a responsibility as a regulator, this has the scope to create confusion in terms of accountability and autonomy, not only in relation to the new organisation, but also in relation to how this aligns with existing structures on a Health Board/Trust level.

Social care

48. It is not possible to consider the long-term future of health and social care in Wales without considering the issue of how, and to what level, the social care system should be funded in the future. We need to work towards achieving a consensus

that the NHS and social care services are interdependent. Care home sector stability is vital to our health and care system. In recent years, there have been significant pressures around capacity and demand for care services and COVID-19 has exacerbated this problem.

49. The pandemic has once again demonstrated the need for a new settlement for social care and highlighted the critical role the sector plays in the delivery of health and care services. The challenges facing social care services include vulnerabilities in funding and market stability, the increased demand on the sector, growing unmet need, staff vacancy issues, contingency planning and the need for consistent standards and quality measures between health and social care. For the future sustainability of the health and care system, it is vital that social care is reformed to ensure a sustainable social care system, backed up by long-term funding.

50. NHS Wales organisations support an approach to further protect funding for preventative measures that recognise the importance of improving population health outcomes and sustainability of services in the longer term. Some examples of how this could be enacted include:

- Providing Local Authority allocations that are ring-fenced for social care funding to support system wide health and wellbeing sustainability, this could be expanded to elements of education and housing budgets as appropriate; and
- Setting a nominal proportion of health and social care funds which should be spent on preventative activities and to hold spending bodies to account for the use of these monies. In this approach, the variation in underlying need for preventative activities is taken into account in the allocation formula.

NHS Wales as an employer and economic player

51. It must also be recognised that the impact the NHS has on people's health and wellbeing extends well beyond its role as a provider of treatment and care. As large employers, purchasers, and capital asset holders, NHS Wales is well-positioned to use its spending power and resources to address the adverse social, economic and environmental factors that widen inequalities and contribute to poor health. It is for this reason that NHS Wales should be considered an 'anchor institution'. The term usually refers to large, typically non-profit organisations whose long-term sustainability is tied to the wellbeing of the populations it serves. For example, NHS Wales organisations are often the largest employers in local areas, with nearly 100,000 people employed by the NHS in Wales. As the link between employment and wellbeing is so well-established, increasing the amount of hiring an NHS organisation does locally may be an opportunity to increase the impact that it has on the wellbeing of local communities.

52. In addition, NHS Wales is a key purchaser of goods and services, and a capital estate holder and developer. Both of these functions mean that NHS Wales, directly or indirectly, has an impact on the conditions and wellbeing of workers that are not employed directly in the health and social care sector. We would emphasise

that the NHS needs to be viewed in this way, as a force for good for economic regeneration, so that it can best support population health and play a key role in keeping the Welsh population happy, active and healthy.

Conclusion

53. Healthcare, and reducing health inequality and maintaining people's mental health and wellbeing, should be at the heart of the Welsh Government's draft budget. NHS Wales organisations do not underestimate the significant challenges of public service budget-setting in a time of unprecedented challenges as a result of the COVID-19 pandemic. Health Boards and Trusts across Wales are committed to doing the very best they can to deliver high-quality, timely and safe care to the people of Wales. Our members also recognise the importance of improving population wellbeing by supporting an environment that enables people to maintain good physical and mental health for as long as possible. Finally, we need to emphasise the importance of working with partners across the public sector so that we may rise collectively to the challenges we face.

By virtue of paragraph(s) vi of Standing Order 17.42

Document is Restricted

Agenda Item 4

Dadansoddi Cyllid Cymru
Wales Fiscal Analysis

Welsh Government Draft Budget proposals for 2021-22

Written Response to Finance Committee Call for Information

Wales Fiscal Analysis
DECEMBER 2020

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

03 DECEMBER 2020

1. Introduction

1.1 The Finance Committee of the Welsh Parliament is seeking information to inform their scrutiny of the Welsh Government's 2021-22 Draft Budget proposals. This written response draws upon Wales Fiscal Analysis' *Welsh Budget Outlook 2020* report, published by Cardiff University's Wales Governance Centre on the 3 December 2020. The full report can be found here.

1.2 This written response contains an update on the Welsh Government's Covid-19 response in 2020-21 to date, analyses the implications of the UK Government's Spending Review 2020 for the Draft Budget 2021-22, and discusses some of the choices facing the Welsh Government.

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

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

2.2 Available funding for the Welsh Government's Covid-19 fiscal response amounts to £5.6 billion, funded mainly by a funding guarantee from the UK government, repurposed funding from the European Union and reprioritised funding from within the budget.

2.3 The Welsh Government has so far allocated £4 billion of this funding in two supplementary budgets. The largest allocations have been made to the Health and Social Services budget (£1.4 billion) and the Economy and Transport (£1.5 billion).

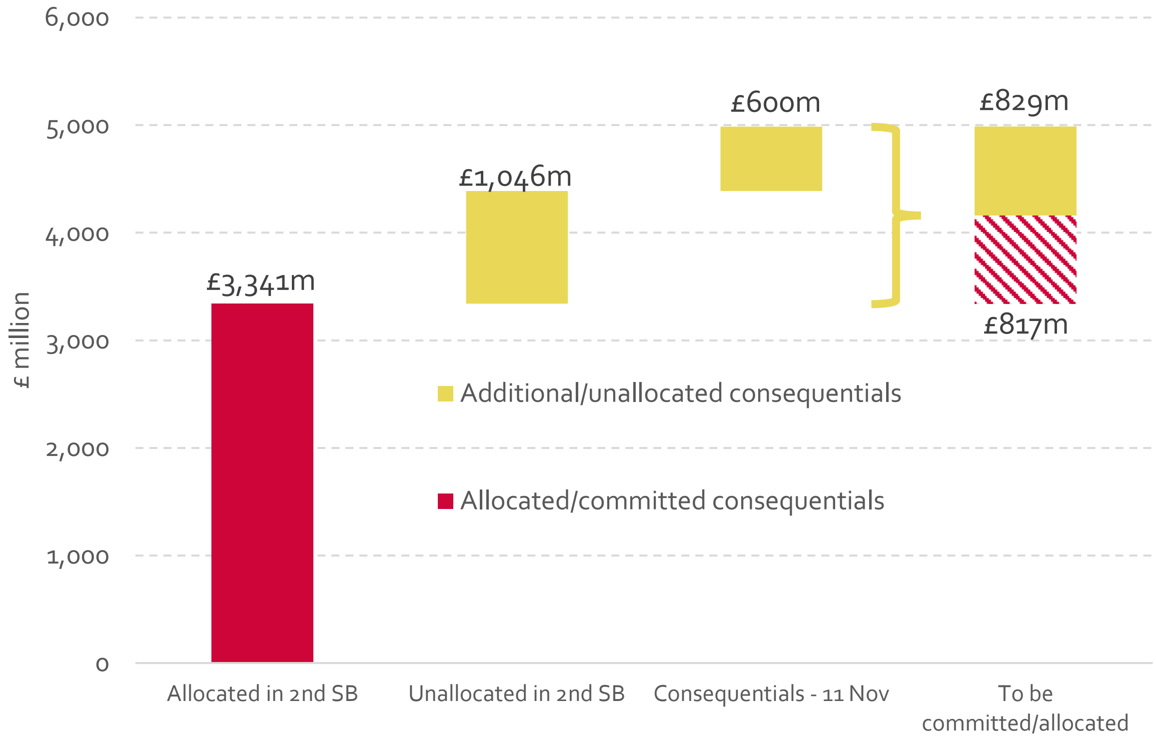
2.4 Spending announcements not yet included in supplementary budgets include the £320 million Covid-19 Reconstruction Fund and a £340 million increase in support for businesses through the Economic Resilience Fund, to support businesses affected by tougher restrictions being introduced in December. This suggests Welsh Government support for businesses this year in grants and reliefs will equate to approximately £2 billion.

2.5 Taking recent commitments into account, it seems plausible that around £829 million of the Welsh Government's Covid-19 allocation remains uncommitted at this point. **Figure 1** shows how much of the Welsh Government's £5 billion funding guarantee remains uncommitted at this stage. However, there is significant uncertainty around this number, as it is not possible to determine whether all funding announcements are entirely additional or if they will be funded from within existing allocations.

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

Figure 1

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



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

2.7 The size of the uncommitted funding in the Welsh budget partly reflects the late revisions to the UK government's funding guarantee to the Welsh Government. It also reflects the unprecedented uncertainties the Welsh Government faces in planning its budget this year. Even in 'normal' years, its is not uncommon for around 2%-5% of the budget to be unallocated until the usual 2nd Supplementary Budget in February.

2.8 This year, the cost and demand pressures for public services over the remaining months of the financial year are even more uncertain. Pressures will depend on several factors, from the severity of future waves of Covid-19, the potential roll out of a vaccine over coming months, alongside recurring winter pressures on services. The economic context and the need for further support for businesses this year is also highly uncertain. Future periods of tight public health restrictions would need to coincide with more grant funding for affected businesses. These uncertainties are amplified by inflexible budgetary arrangements currently in place (discussed in section 5).

3. Impact of Spending Review 2020 on the Welsh budget

3.1 The Spending Review 2020 provided the first detailed breakdown of additional spending on public services planned by the UK government, which influences the amount of funding available for the Welsh Government. The £113.5 billion of additional public services spending by the UK government this year includes £22 billion for the Test and Trace system and £15 billion on Personal Protective Equipment (PPE) procurement this year.

3.2 Although the Spending Review provides greater clarity on Covid-19 related public services spending, it is not possible to exactly determine which spending programmes in England have resulted in additional 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. This complicates comparisons between the Welsh Government's Covid-19 response with that of the UK government.

3.3 In July, the UK government gave the devolved governments a funding guarantee, based on total estimated additional spending on services in England in 2020-21. This provided the devolved governments with greater certainty around their budgets this year, as they would not need to wait for individual spending commitments in England to be approved for the size of their budgets to be increased. The funding guarantee amounts to an additional £5 billion for the Welsh Government budget in 2020-21, with approximately £3.3 billion of this funding guarantee related to estimated additional public services spending in England.

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

3.5 The UK government has allocated £55 billion for Covid-19 related costs on public services in 2021-22. £34 billion of this funding has been allocated to departments, with a further £21 billion in reserve. Already allocated funding has triggered £766 million for the Welsh Government in 2021-22.

3.6 The Welsh Government's core, or "business-as-usual", day-to-day block grant will increase by £695 million from 2020-21 to 2021-22, to £13.5 billion. Despite recent growth, on a like-for-like basis, day-to-day funding for the Welsh budget in 2021-22 will still be slightly below pre-austerity levels.

3.7 The Chancellor cut back on previously pencilled-in increases in day-to-day spending, by £10 billion in 2021-22, and by £13 billion in 2024-25. These spending plans suggest a bleaker outlook for the Welsh budget over the medium term and set the context for the public sector pay freeze announced for non-NHS staff.

3.8 Meanwhile, the Welsh Government's capital block grant will be cut in nominal terms next year, due to a fall in Financial Transactions funding. Capital funding will remain below its 2009-10 peak, and recent increases are not as significant as those seen in response to the financial crisis of 2009-10. This suggests the Welsh Government should make full use of its capital borrowing limit in 2021-22 (of £150 million).

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

4.1 On 21 December, the Welsh Government will publish its draft budget for 2021-22, facing significant uncertainties around the size of its budget and spending pressures. Crucial decisions will need to be made around responding to the Covid-19 pandemic and funding public services.

4.2 Available funding from the UK government for Covid-19 related costs in 2021-22 equates to only 14% of the funding available for the Welsh Government's fiscal response in 2020-21. If spent exclusively on public services, as per the UK government's spending plans in England, additional public services spending on Covid-19 pressures next year would fall by two-thirds relative to 2020-21.

4.3 Under current plans, a significant portion of Covid-19 related costs will need to be met from within the Welsh Government's own budget next year. Plans also leave no funding to allocate for business rates reliefs or grants, at a time other UK-wide economic schemes are also coming to an end.

4.4 As ever, allocations made to the NHS next year will have a big impact on funding available for all other services. Matching the NHS share of Covid-19 spending this year, as well as matching the per person increase in NHS spending in England, would mean around £430 million of Covid-19 related funding and a £350 million increase in the core NHS budget. This would mean £340 million of Covid-19 related funding for all other areas of the budget, as well as £590 million for their core budgets.

4.5 Social distancing and infection control will reduce what the NHS can deliver for a given level of funding. There is also a significant backlog of patients who were not treated in the spring, as well as new demand pressures, notably on mental health services. However, increasing NHS allocations would entail smaller increases in spending for other public services which may not adequately cover the huge demand and cost pressures they too face.

4.6 Surveys and modelling carried out by the Welsh Local Government Association find underlying pressures for local government budgets will total £279 million, most related to workforce costs (including social care commissioning costs), which may be affected by the public sector wage announcements made by the UK government last week.

4.7 The position of these services going into the Covid-19 crisis should also be considered. Total Welsh Government support for local authorities was still around 13.5% lower than 2010-11 levels in real terms, before the pandemic hit. Older age social care spending has remained broadly flat in real terms for over a decade, and there is a strong argument for improving staff renumeration given that less than half of the personal care workforce are paid less than the Real Living Wage. Per pupil schools spending fell by 6% in real terms from 2009-10 to 2018-19, according to the Independent Review of School Spending in Wales.[1]

4.8 A key part of government economic support this year has been provided through the Welsh Government budget, with up to £2.1 billion of grants, reliefs and loans being made available to businesses. Barring significant changes in the flow of consequentials next year, the prospect of similar support being provided next year is unlikely. Even providing half of the level of reliefs offered to businesses in 2020-21 (£332 million) in 2021-22 would take around a third of the additional funding available for non-NHS funding increases, in the scenario outlined in paragraph 4.4.

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

5. Budget management and borrowing rules

5.1 The system of funding guarantees introduced by the UK government in July provided some welcome certainty for the devolved government budgets and increased transparency on the additional funding being made available. However, with large amounts of Covid-19 funding being held in reserve by the UK government, uncertainty over the size of the Welsh budget and large in-year revisions are likely to persist next year and beyond.

5.2 While some unexpected increases in demand pressures this year may be covered by late increases to consequentials, the Welsh Government will be unable to borrow to cover overspending in this financial year. This means the Welsh Government may need to keep back unallocated funding in response to these uncertainties. This also impairs the Welsh Government's ability to make 'open-ended' spending commitments, such as the commitments made by the UK government to businesses in England, with grants depending on the extent of restrictions in place over coming months.

5.3 There are also restrictions on the Welsh Government's use of the Wales Reserve, which were agreed as part of the 2016 Fiscal Framework agreement. The Welsh Government has drawn down the maximum annual amount of resource funding (£125 million) in its budget plans for this

[1] Available here.

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

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

6. Devolved taxes in the Draft Budget 2021-22

6.1 A key strength of the fiscal framework is that the Welsh Budget is only exposed to volatility in the tax base insofar as an economic shock is felt asymmetrically across the UK. The net effect on the Welsh budget will be determined by the *relative* change in revenues compared to England and Northern Ireland.

6.2 In November 2020, the Office for Budget Responsibility (OBR) published their devolved tax forecasts on behalf of the Welsh Government. Despite differences in the sectoral composition of the Welsh economy relative to the UK as a whole, there is little evidence to suggest that Income Tax liabilities in Wales are expected to be hit by more or less than the UK average due to the pandemic.

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

6.4 For LTT and LDT, the Welsh Government can adjust their supplementary budgets to account for an in-year update to the forecast. For WRIT, any difference between forecast at the beginning of the financial year and the outturn for Wales and England & Northern Ireland will not be resolved until a reconciliation exercise after outturn data becomes available (normally around 15 months after the end of the financial year). This reconciliation process may introduce some volatility to the Welsh Budget over future years.

6.5 Given the relatively austere outlook for the Welsh Budget over coming years (as described in our section 4.2 of our main report), debates over the use of devolved tax powers should intensify. Increasing the basic rate of Income Tax could allow the Welsh Government to fund higher levels of spending in a progressive manner or shield poorer households from less progressive elements of the local and reserved tax system.

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