

National Assembly Finance Committee

Welsh Government Draft Budget
2016-17

7th January 2016



WLGA • CLILC

Summary

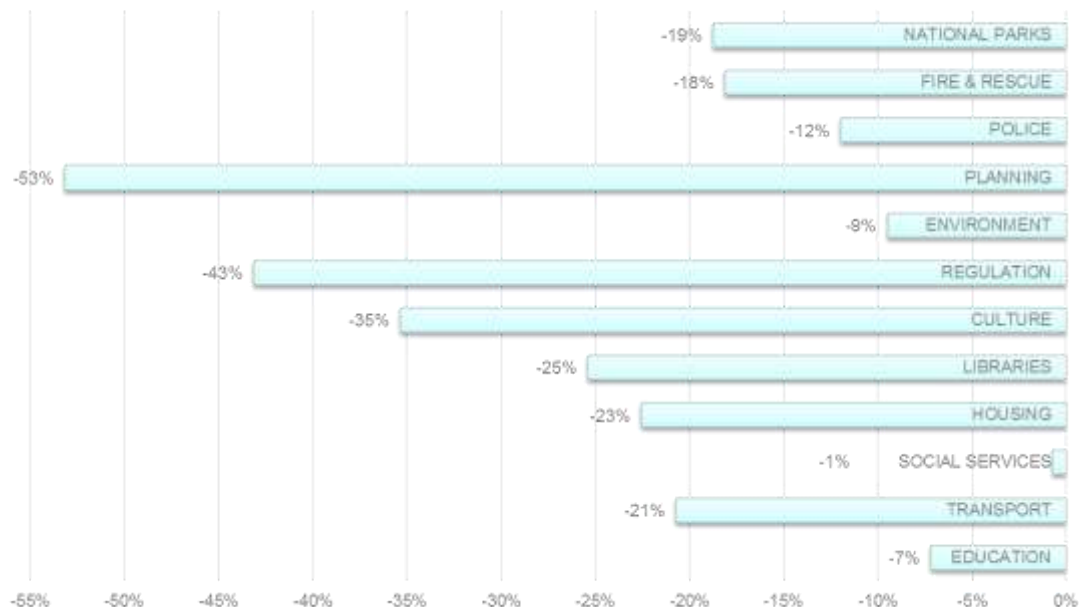
1. Local Government is a vital partner for the Welsh Government in delivering its broad social and economic outcomes. There is not one area in the Programme for Government where councils do not make a crucial contribution to outcomes. Local services support healthy people living productive lives in prosperous and innovative local economies. Local services provide the bedrock of safer, more cohesive and more equal communities. Local services make an invaluable contribution to a resilient environment and a society with a vital sense of its own culture and heritage.
2. The WLGA's response to the provisional settlement announcement for 2016-17 has been relatively positive. An average reduction of 1.4% was a lot better than the experience of the past couple of years although we are continuing to make a case for rural authorities who fared less well.
3. Councils have played their part in delivering savings so far and are continuing to bear the brunt of austerity. Continued austerity is putting local services, and the government's own objectives at serious risk, both now and in the future. Unprecedented unavoidable financial pressures facing councils next year and longer-term demographic demands are likely to 'crowd out' the smaller, discretionary local services until they hardly exist. The well-being of the current and future generations is at serious risk.
4. In May 2015 Royal Assent was granted to the Well-Being of Future Generations Act. The Act places duties on the whole public sector to demonstrate how they have applied long term, preventative, integrated and collaborative approaches in achieving the seven national well-being goals. The emphasis is now on long-term needs assessments. It signifies a step change to place sustainable development and the needs of future generations at the heart of public service delivery in Wales and the whole financial planning framework, including budget setting, needs to reflect that.

What, in your opinion, has been the impact of the Welsh Government's 2015-16 budget?

5. The 2015-16 Welsh Government Budget implied a cash reduction of 3.4% for local authorities across Wales. The announcement of the 2015-16 settlement was the third year in a row that the published indicative settlement had been significantly revised downwards. The recently published CIPFA 2015 Manifesto underlined that sound financial planning remains a concern across the public sector in the UK. Our major concern was the inability to rely on indicative figures while attempting to introduce significant reductions in funding in a planned and rational way, based on sound evidence and with an appropriate lead-in time.

6. There is no doubt that local public services are continuing to bear the brunt of austerity in Wales. While overall expenditure has levelled off in cash terms the impact on unprotected or discretionary services is extreme. The latest published budget data for 2015-16¹ shows environmental, cultural and community services are experiencing drastic reductions after adjusting for inflation.
7. Figure 1 shows that services that are vital to economic growth and the general well-being of communities have seen precipitous reductions since the onset of austerity. Some of the largest reductions have been in unprotected areas such as Planning and Regulatory Services which play a vital role in regeneration and preventative areas. Many other areas of LG spend have shrunk by at least a fifth in real terms. Areas that have been relatively protected include education, social services and environmental services have nonetheless being contracting.

Figure 1: Real terms reductions in service spend, 2009-10 to 2015-16



Source: IFS 2012, RO and RA returns

8. Since 2009-10 local authorities have achieved around £720m in efficiency savings. Most of this has been achieved through pay restraint and reductions in posts. Workforce surveys have shown that 15,000 posts have been lost since 2009-10. This is likely to continue through to 2019-20 on the same scale, effectively reducing the local government workforce by 20% over a 10 year period.

¹ <http://gov.wales/statistics-and-research/local-authority-revenue-budget-capital-forecast/?lang=en>

9. Many of the initiatives for addressing the budget shortfalls can be identified from local authorities' medium-term financial plans. The recent KPMG report on corporate support services identifies £33m of savings that are being reported in the last and the current financial year.
10. At the same time performance has been improving. The latest local government performance data shows how those services performed in 2014-15 compared to 2013-14. At a Wales level, 63% (26) of the 41 indicators which are comparable between 2013-14 and 2014-15 show improvement. The gap in performance (between the best and worst performing authorities) narrowed in 56% (23) of the indicators. For 39% (16) of the indicators, performance improved and the gap between the best and worst performing authorities narrowed.
11. Since the beginning of austerity Of the 43 national performance indicators in place for 2014-15, 67% (29 indicators) were comparable to 2009-10. Of the 29 comparable indicators, 86% (25 indicators) had improved.

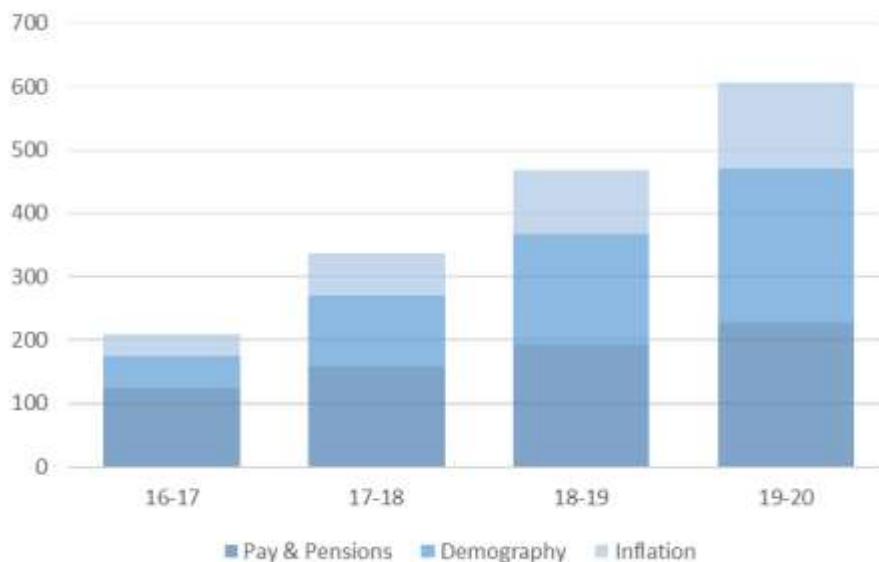
Looking at the draft budget allocations for 2016-17, do you have any concerns from a strategic, overarching perspective, or about any specific areas? / What expectations do you have of the 2016-17 draft budget proposals?

12. The WLGA Council met at the end of November 2015. In the run up to the budget announcement and provisional local government finance settlement, Leaders wanted to emphasise the preventative nature of local services especially social services. The letters set out in the annex received a positive response. The backdrop to the correspondence was the ongoing pressures that local authorities will experience over the next 5 years, not just 2016-17.
13. This derives from the increased demand for local public services and the increased cost of providing them. Some of these may arise from national or devolved government policy. Demand pressures are largely demographic and are most acute in the larger budget areas of social services and education. The work done for Wales Public Services 2025² demonstrated that pressures in social services budgets drive around 2.9% growth each year, which is around £43m annually up to 2019-20. This includes increases in Looked After Children as well as the elderly population
14. Within education budgets, increased birth rates are starting to feed through to growth in pupil numbers. From 2015 to 2019, the ratio of growth of school-aged children to the general population will increase nearly threefold from 0.8 to 2.3. The resultant annual pressure increases from £9m in 2016-17 to £24m in 2019-20.

² Future Pressures on Welsh Public Services, WPS 2025
(<http://www.walespublicservices2025.org.uk/new-report-by-mark-jeffs-wales-public-services-2025/>)

15. On the cost side there are unavoidable workforce costs that, left unfunded, means that the local services would be cut in order to fund them. By far the largest element is a pressure of £60m is due to loss of the National Insurance rebate as a consequence the introduction of Single Tier Pensions in 2016-17. For the education sector there is an additional pension pressure due to the part-year effect of increased employer contributions to the Teacher's Pension Scheme which is £13m for 2016-17 alone. A modest 1% pay award for teaching and non-teaching staff adds around £35m in 2016-17 and compounded thereafter.
16. There is also more general inflation and pressure generated through the Council Tax rises on the Council Tax Reduction Scheme. The former may be lower to due to systemic deflationary effects in the economy but there is a case for identifying the specific inflationary impact of contractual obligations and landfill charges. Overall these will account for £20m of pressure in 2016-17 and the CTRS scheme adds a further £13m.
17. Figure 2 below shows the total expenditure pressure in 2016-17 to be £208m over half of which is the unavoidable financial pressure of pay and pensions. By 2019-20 this rises to £607m when demographic pressure becomes the largest cumulative pressure.

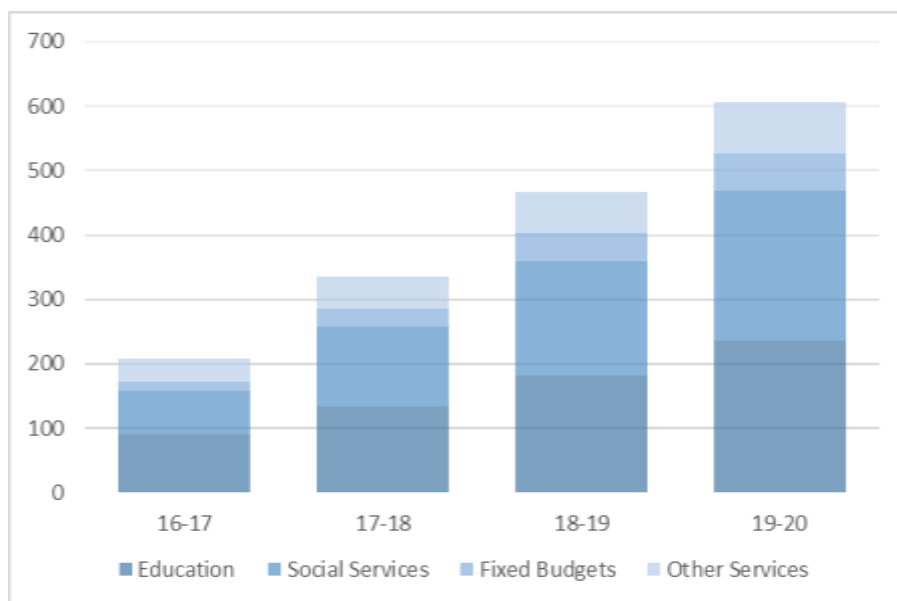
Figure 2: Cumulative impact of pressures up to 2019-20, by type, £m



Source: Base estimates: RO and RA returns (2013-14 to 2014-15), NI impact: SWT Survey (2015)

18. An alternative way of looking at these pressures is to base them on services and other elements of the overall budget. Figure 3 shows the pressures broken down in this way. Just under three quarters of the pressures are attributable to the largest services of social services and education, a proportion that remain consistent through to 2019-20.

Figure 3: Cumulative impact of pressures up to 2019-20, by budget, £m



Source: Base estimates: RO and RA returns (2013-14 to 2014-15), NI impact: SWT Survey (2015)

19. While Council tax continues to be an important source of income for local authorities, future increases are nowhere near enough to fund the pressures highlighted above in figures 3 and 4. It makes a contribution and this varies from authority to authority. Even if every local authority sets future levels at the 5% threshold historically accepted it can only raise £56m in 2016-17. So it barely pays for its own CTRS implication (£13m) plus social services demography (£43m). In short, it accounts for little under a quarter of next year's pressure without taking into account any funding reduction.
20. The combined effect of the funding reduction, additional pressures and council tax increases means that, on average, local authorities will be looking at absorbing a budget shortfall of £200m in 2016-17. This will involve making similar decisions to those made in the past about service prioritisation and transformation.
21. At authority level the funding formula determines the settlement for each authority and continues to deliver a range of reductions. The range in grant reductions was extreme this year. With Cardiff receiving a 0.1% reduction and Powys receiving a 4.1% reduction, the range was 4%. For grant allocations the range is driven by three factors: needs equalisation, resource equalisation (both of which are driven by the funding formula) and, finally, the damping mechanism.
22. Those authorities at the bottom of the range clearly come out worst from a combination of all three of these factors. The WLGA supports the views of

the independent members of the Distribution Sub Group that the funding formula is due for a fundamental review. In their report, the independent members continue to state that:

The reasons for a review of the formula were outlined in previous reports and they remain as already stated.

- *The continuing need to amend aspects of the formula and to bring historical data up to date suggests that the current formula is still far from stable.*
- *Reliance on historical data and spending patterns in a period of austerity and significant change is likely to have implications for the appropriateness of the existing distribution mechanism and brings with it a danger of loss of consensus but also the possibility of direct challenge.*
- *The current formula mechanism is based on a methodology that does not meet established standards of statistical practice. Regression analysis of only twenty-two cases (i.e. the Welsh local authorities) is susceptible to over-fitting of the data and to influential cases skewing the estimates. This issue is likely to become even more pressing if the number of authorities reduces further.*
- *Finally, given the reliance on collaboration for the delivery of many key services across Wales, there is a need to consider in what ways joint production of services might need to be incorporated within the formula.*

23. The Committee should also be aware that WLGA and CIPFA have joined forces to appoint an Independent Commission to look at the future of Local Government Finance³ in Wales which is chaired by Professor Tony Travers. The Commission is not tasked with evaluating the formula directly but is taking a broader view of the system and whether funding may be better incentivised or even localised. A balance needs to be struck between a system that better incentivises and one that fully equalises and reflects need. In the WLGA manifesto⁴ we make a case for more localisation and the corollary to this is greater fiscal devolution.

³ <http://www.cipfa.org/partners/independent-commission-on-local-government-finance-wales>

⁴ <http://www.wlga.gov.uk/local-government-policy-priorities-for-the-national-assembly-for-wales>

How financially prepared is your organisation for the 2016-17 financial year, and how robust is your ability to plan for future years?

24. The question posed by the Committee really is a key one for public services as a whole in Wales. For local authorities, the WAO has recognised that 'financial planning is generally getting better' but there are challenges for local authorities in addressing their own short termism. While local authorities can make sound estimates of future expenditure pressures, second guessing the scale of funding reductions in the future has become a quest for the grail. This is not helped by the Welsh Government's approach to its own budget setting.
25. The WG has retreated from a sound medium-term approach which it had at the outset of the 2010 Spending Round. The budget cycle has returned to an annual incremental approach accompanied by a complete withdrawal of the system of multiyear settlements for local government that had been developed as far back as 2007.
26. In England, local authorities now have a clear picture of their funding trajectory over the lifetime of the Parliament. Furthermore, the Office for Budget Responsibility has published its own forecast of local authority funding and spending up to 2021.
27. This is summarised in table 1 below where increase in central government current grants to local authorities between 2015-16 and 2020-21 are set to rise by 7% in Wales, 8% in Scotland (including business rates) and 4% in England (including retained business rates). Spending increases are even more generous.

Table 1: OBR Forecasts of LG Spending and Funding in Wales, England and Scotland, £bn

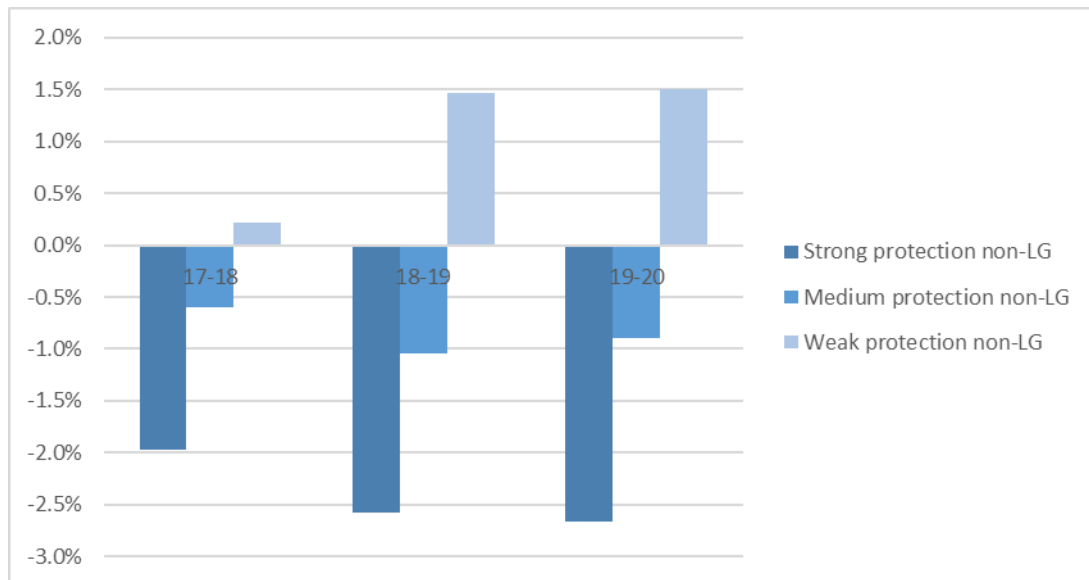
| | 2015-16 | 2016-17 | 2017-18 | 2018-19 | 2019-20 | 2020-21 | Increase % | Annualised increase % |
|--|---------|---------|---------|---------|---------|---------|------------|-----------------------|
| Net Current Expenditure | | | | | | | | |
| Wales | 7.1 | 7.3 | 7.4 | 7.5 | 7.6 | 7.9 | 11% | 2.2% |
| Scotland | 11.7 | 11.8 | 12.0 | 12.2 | 12.4 | 12.8 | 9% | 1.8% |
| England | 109.1 | 110.2 | 111.6 | 112.7 | 114.7 | 118.9 | 9% | 1.7% |
| Central Govt current grants | | | | | | | | |
| Wales | 4.3 | 4.4 | 4.4 | 4.4 | 4.5 | 4.6 | 7% | 1.4% |
| Scotland (inc business rates) | 9.7 | 9.7 | 9.9 | 10.0 | 10.2 | 10.5 | 8% | 1.6% |
| England (includes retained business rates) | 69.2 | 69.1 | 69.0 | 68.9 | 69.4 | 72.1 | 4% | 0.8% |

Source: Office for Budget Responsibility [Table 3.31 in the Economic and Fiscal Outlook Supplementary Fiscal Tables](#)

28. However the Spending Review documentation does provide estimates for the Welsh Block Resource DEL which along with assumptions about growth in business rates can assist in modelling a number of scenarios for the Welsh

Government Budget and the impact on local government's core grant in the remaining years of the Spending Review.

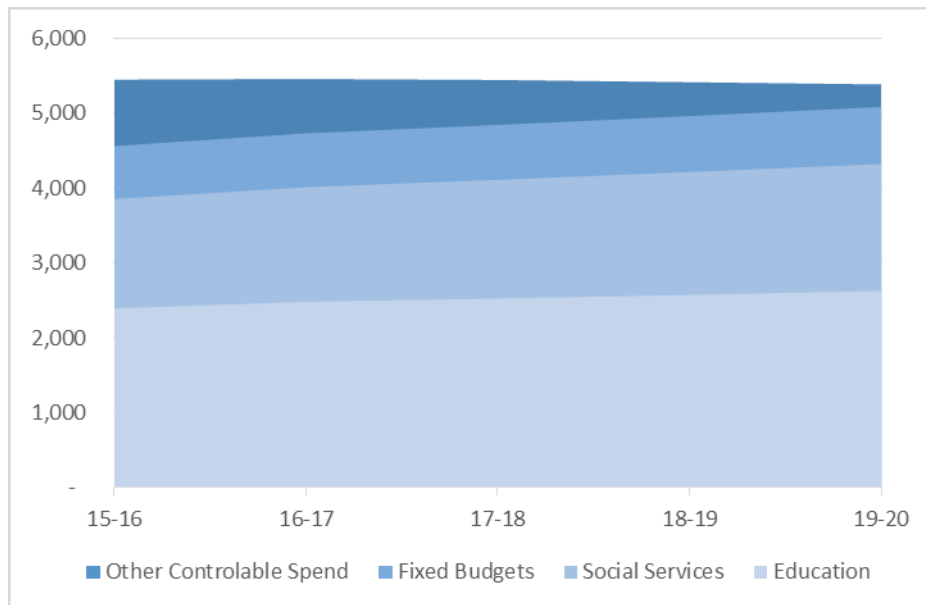
Figure 4: Modelled changes to Aggregate External Finance (AEF) to 2019-20, under 3 scenarios



29. Under the most optimistic scenario there is 'weak' protection for non-Local Government Budgets. Under this scenario, the NHS receives future increases based on a 'consequential' of the increase to the English NHS through the lifetime of the Parliament. All other budgets are held cash flat, allowing AEF to increase by 0.2% in 2017-18, 1.5% in 2018-19 and 1.5% in 2019-20. This scenario roughly aligns with the OBR forecast.
30. A less favourable scenario is to assume that there is 'medium' protection for non-Local Government Budgets. This time the NHS receives more generous uplifts based upon general (GDP) inflation over the SR period. All other budgets are held cash flat, allowing AEF to reduce by 0.6% in 2017-18, 1.0% in 2018-19 and 0.9% in 2019-20.
31. An even more pessimistic scenario could be envisaged where, as above, the NHS is protected for inflation, and so are all other non-LG budgets. AEF reduces by 2.0% in 2017-18, 2.6% in 2018-19 and 2.6% in 2019-20.
32. During the summer of 2015, the WLGA summarised the funding and spending projections, known at the time and concluded that there would be a cumulative budget shortfall of £941m by 2019-20, assuming current policies remain unchanged. The current estimate based on the most pessimistic assumption in the paragraph above predicts a budget shortfall of £670m.

33. The impact on controllable budgets will continue to see expenditure on discretionary services hollowed out. Figure 5 shows that budgets on other services shrink to a third by 2019-20.

Figure 5: The budget shortfall implications for controllable budgets, £m



Conclusion

34. Local Government recognises that the Welsh Government is also faced with real terms reductions in its budgets, and is not simply seeking to achieve greater funding, but rather to seek a new relationship with WG where the gravity of the situation is recognised, accurate and transparent information is reported and flexibility is maximised. There are a number of ways in which this can be achieved (and is argued in the WLGA manifesto):

- Link any protection for schools more directly with Aggregate External Finance (AEF)
- Greater equity of consideration of the preventative services provided by local government such as social care and housing
- De-hypothecation of all specific grants into the RSG
- Greater coordination across Welsh Government departments in any aspects of policy making that affect local government
- A thorough review of the costs and benefits of audit and regulation
- A review of the impact of universal benefits and subsidised service delivery where these are proving unsustainable for councils
- Full consideration of the devolution of powers to councils, including the retention of business rates growth
- Greater clarity for the future with the issue of multiyear settlements
- Recognition that at a time of increasing financial risk, a council making cuts also needs to increase reserves to reflect the increased volatility of its budget

ANNEX I

Our Ref/Ein Cyf:
Your Ref/Eich Cyf:
Date/Dyddiad:
Please ask for/Gofynnwch am:
Direct line/Llinell uniongyrchol:
Email/Ebost:

JR/AS HD

30 November 2015

Jon Rae

[REDACTED]
[REDACTED]



Leighton Andrews AM
Minister for Public Services
Jane Hutt AM
Minister for Finance and Government Business
Mark Drakeford AM
Minister for Health and Social Services
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Dear Ministers

Spending Review

We were pleased last Friday to welcome to the WLGA council the Minister for Public Services, Leighton Andrews AM who highlighted the issues facing Welsh Government in light of the Chancellor's recent Spending Review announcement and in advance of the Welsh Draft Budget. We thank him for taking and answering an extensive range of questions from members primarily related to the forthcoming provisional settlement.

It was the view of members following this debate that it is important that we set out a compelling case to help protect the NHS through investment in preventative local public services. Equally, it is important to recognise some of the difficulties faced by the Social Care sector. This includes residential and domiciliary care coming to grips with the financial implications of the living wage and, of course, the scale of demographic challenges.

We understand that the Chancellor has delivered a settlement for the Welsh Government where the revenue budget falls by 4.5% in real terms over the four-year period. We recognise that this presents a difficulty in how to fully passport a £220m health consequential when other negative consequentials have netted out to produce smaller cash increases of around £100m a year for the Welsh Block over the SR period.

Our concern is around the need to invest in key preventative services like social care. Recently at our Joint WLGA and Welsh Government Finance Seminar we heard how council funding is on a

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downward spiral and is possibly two years behind England. It begs the question what has happened across the border in that period?

There is a calamity in progress in England at the Health and Social Care interface which the Westminster Government contends can be answered by local authorities raising council tax by an additional 2% with the money raised spent only on adult social care. This is understandably being vigorously contested by the English LGA. The Leader of Newcastle City Council, Nick Forbes has argued that "This is a sticking plaster over a gaping wound. The fundamental problem is that there is not enough money in the care system. As a result, the NHS will come under increasing pressure". Of more than 1.8m people whose requests for care and support were assessed by English councils in 2014-15, 59% received no direct services at all. Furthermore figures on delayed transfers of care are worsening. In September the number of delays hit record levels while in Wales they have remained stable and recently reduced.

Our focus in Wales is to see social care as a tool to enable and empower people whereas in England it is increasingly portrayed as an act of charity for the vulnerable. We are all working under the banner of "Prudent Health Care" to shift the system radically towards prevention and focus on wellbeing rather than ill-health. As the Finance Minister's recently pointed out the "...UK Government continues to look at NHS services in isolation".

In light of the experiences above we are urging you to consider continued and increased investment in protecting core funding for social services through the RSG and other mechanisms such as the Intermediate Care Fund which has shown significant benefits over the recent period. We have all noted the recent comments by Simon Stevens Chief Executive of the NHS England on the impact that the dramatic cuts to social care are having on the English NHS and we understand he urged Government for the protection of social care to alleviate this.

We are seeking your continued support to invest in preventative services. We fully recognise the scale of challenges in the NHS and the fact that this will be the channel for the majority of resources from Welsh Government in the next period. But if more resource is channeled to one part of the system without changing anything else, it is likely to result in a similar crisis to that in England.

Thank you for your active consideration of the issues in this letter which we written on behalf of our colleagues across the 22 councils.

Yours sincerely



Councillor Aaron Shotton
**WLGA Spokesperson for
Finance and Resources**



Councillor Huw David
**WLGA Spokesperson for
Health and Social Care**