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Welsh Government

WELSH GOVERNMENT

Wales Economic and Fiscal Report 2024

December 2024

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Wales Economic and Fiscal Report 2024

Foreword

This is the first Wales Economic and Fiscal Report (WEFR) by the Welsh Government. It follows and replaces the previous Chief Economist Reports, first published in 2017 alongside the Welsh Government draft Budget for 2018-19.

Over the years, the Chief Economist reports have evolved to provide the economic and fiscal context for the budget, summarising the relevant issues facing the UK and Welsh economies. These reports have covered a turbulent period for the UK and Welsh economies, through the UK's departure from the European Union, the coronavirus pandemic and, most recently, the 'cost of living' crisis.

As the report has expanded and provided more in-depth insight, it is now drafted by a range of Welsh Government analysts, relying on their insights and analysis. As a result, it is now appropriate to rename the report given the wider expert contributions which are now an integral part of this report. This report aims to offer insights into the factors influencing and shaping the economic landscape in Wales. This includes an overview of trends and figures related to economic output, productivity, household living standards (including assessing the impacts of inflation), the labour market, green jobs and trade.

We hope you continue to find the report interesting and useful. We welcome any feedback on the content or format of the report.

Dr Thomas Nicholls
Chief Economist
Welsh Government

Executive Summary

- Wales' economy is deeply embedded within the wider UK economy. Many of the general trends which affect the UK are likely to be reflected or heavily influence Welsh economic conditions.
- UK economic output this year has performed better than expected from around a year ago. However, economic growth is still down compared to historical standards. The outlook for growth is also still subdued. Growth in recent years has mainly been driven by an increase in hours worked, rather than productivity.
- Wales' economic growth per person up to 2022 has been similar to other UK countries and English regions but remains lower than the UK average, comparable to the North East of England.
- The UK's relatively low economic growth in recent years is partly due to slower productivity growth compared to the pre-global financial crisis period. Wales has been similarly affected, with lower productivity levels contributing to its lower economic output per head. Evidence suggests enhancing agglomerations, improving workforce skills, and increasing investment are likely to improve productivity in Wales and the UK.
- UK public sector productivity was growing slowly before the coronavirus pandemic but fell significantly during that period and has yet to recover. Despite increased inputs in some public services, especially health, outputs have not proportionately increased. This situation likely applies to public services in Wales as well.
- Living standards in the UK, measured by household incomes, have broadly tracked economic output but have grown more slowly in recent years compared to long-term trends. Wales has maintained its relative prosperity compared to most UK regions and countries. Household incomes in Wales are estimated to be around 5% below the UK average when using the median after housing costs for 2020-21 to 2022-23.
- Inflation has continued to fall during 2024 and is now closer to the Bank of England's target of 2% per year. While forecast to be lower than in the past two years, inflation is expected to remain slightly above the target for the next couple of years. Despite reducing inflation rates, prices have risen rapidly in recent years, with energy and food prices still around 40% and 30% higher than three years ago.
- Interpreting labour market sources is challenging due to declining survey response rates, particularly affecting the Labour Force Survey. However, Wales maintains a relatively high employment rate compared to the last 20 years.

- The UK labour market is likely to have lost some momentum in 2024. Unemployment remains low by historical standards and is forecast to stay around or slightly above 4%, likely applying to Wales as well.
- The economic inactivity rate in Wales declined steadily through the 2010s but the decline has likely stopped since the pandemic, with rising rates of long-term sickness-related economic inactivity.
- In 2022, approximately 11,000 people were employed in Wales in the Low Carbon and Renewable Energy Economy, just under 1% of total Welsh employment, similar to the UK proportion. This figure has remained fairly constant since 2015. Wales has a relatively higher carbon intensity of employment than the UK average, the second highest among UK countries and English regions.
- Trade is crucial to the Welsh with Welsh goods exports equivalent to around a quarter of Wales' economic output, a relatively higher share than both Scotland and Northern Ireland. While Welsh goods exports generally follow UK patterns, 2023 data show a reduction in overall trade value, largely due to a fall in petroleum exports.
- Key developments in future Welsh economic data include improvements to labour market statistics through the ONS's forthcoming Transformed Labour Force Survey and the Welsh Government's Input-Output Tables, which will show the buying and selling relationships within the Welsh economy.
- The UK Government's Autumn 2024 Budget increased taxes and borrowing to enable increases in spending on resource ('day-to-day') and capital budgets compared to what was expected earlier in the year. As a result, this has led to an increase to the Welsh Government's financial settlement for next year from the UK Government, both compared to this year and what was expected earlier this year.
- Despite the increases in government spending on public services this year and next, the outlook for public finances beyond looks challenging. On current UK Government spending plans, increases to public service spending over the medium term are expected to be much lower.
- The Welsh Government's resource budget in 2025-26 is up 5% in real terms compared to outturn for 2023-24 on a like-for-like basis. Estimates for future years suggest more modest increases.
- The Welsh Government's general capital budget in 2025-26 is up 7% in real terms compared to the outturn for 2023-24. Estimates for future years suggest a more challenging outlook for capital budgets, with some reductions possible in 2029-30 as borrowing limits are reached.

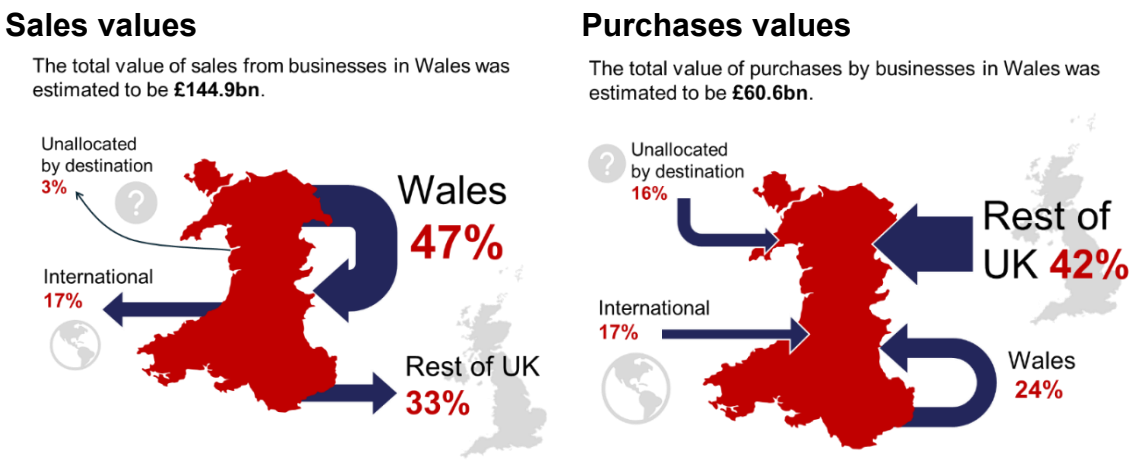
- The Welsh Government faces severe fiscal challenges, with increasing demand for public services and higher levels of need than in England. However, there is nothing in the currently available population projections to suggest that growth in demand for services will be different in Wales than in England.

Introduction

This is the first Wales Economic and Fiscal Report. This continues the series of Chief Economist reports published alongside each draft Budget since 2017. The report is a development of those reports, providing the economic and fiscal context covering for the economy in Wales and the UK.

While primarily focused on Wales, some content relates to the entire UK to set a wider context and reflect the availability of certain data. UK data trends generally apply to Wales due to its deep integration within the UK economy. For example, the latest business-to-business trade data (2022) shows that 47% of sales from businesses based in Wales are to other businesses in Wales, while 33% are to the rest of the UK. Purchases from the rest of the UK (42%) are larger than those from businesses in Wales (24%). Sales and purchases between businesses in Wales and the UK are significantly larger than international transactions.

Figure 1: The destination of sales and purchases from and to businesses in Wales, 2022



Note: *This does not include all sales from businesses in Wales as some will be to consumers. Certain sectors are also excluded from the survey.*
Source: *Welsh Government (2024) Trade Survey for Wales: 2022*

All data used in this document were the latest available as of 15th November 2024.

Economic Output

The UK economy, currently estimated to be £2.7 trillion for 2023 as measured by Gross Domestic product (GDP), has performed better this year than expected at the time of the last year's draft Budget, albeit marginally. UK headline GDP decreased moderately in both of the last two quarters of 2023 meaning the economy had entered a technical recession. The economy rebounded in the first half of 2024, expanding by 0.7% in the first quarter and then by 0.5% in the second quarter. However, GDP growth slowed in the second half of 2024 with an increase of 0.1% in the third quarter of 2024 (July to September).

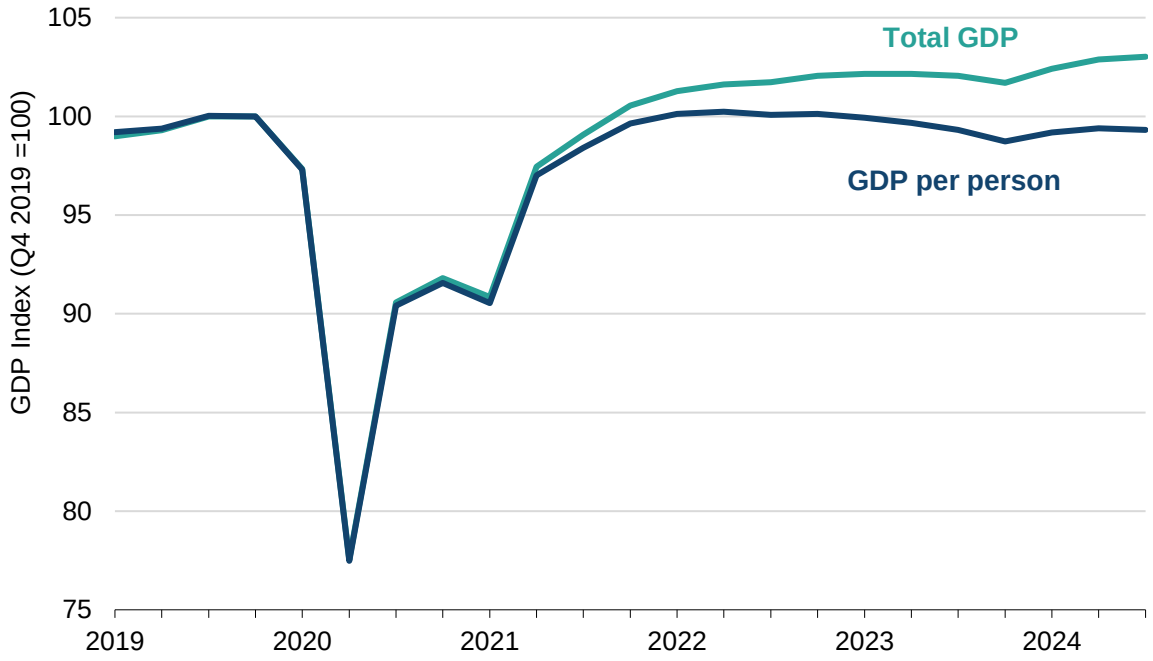
The Office for National Statistics (ONS) has suspended the publication of quarterly GDP data for Wales due to concerns about data quality.[1] As highlighted in the previous section, the economies of Wales and the UK are highly integrated, therefore the following analysis on output which draws from UK data, is highly relevant to the performance of the economy in Wales.

Taking a more medium-term perspective (see **Figure 2**), the level of UK output increased by 3.0% between the fourth quarter 2019 and the third quarter 2024 which translates to an average quarterly gain of 0.3%. This is well below the long-term pre-financial crisis (1980 to 2007) quarterly average growth of 0.6%. It is also the same as the average quarterly growth of 0.3% recorded between 2008 and 2019 which was the UK's worst economic performance in post war economic history.

Changes in headline GDP do not account for changes in population, making it a limited measure of economic progress. In contrast, GDP per person accounts for population change. The level of UK GDP per person in the third quarter of 2024 was 0.7% below the fourth quarter of 2019 (see **Figure 2**), largely explained by stronger population growth that outpaced economic growth during this period. Between 1980 and 2007 GDP per person grew at an average of 0.5% per quarter. However, the average quarterly growth rate recorded between 2008 and 2019 was just 0.1%, underlining that the decade or so before the pandemic was the worst UK economic performance since the 1940s.

[1] The latest ONS data with Wales quarterly GDP was in May 2023 for the period July to September 2022; ONS (2023) GDP, UK regions and countries

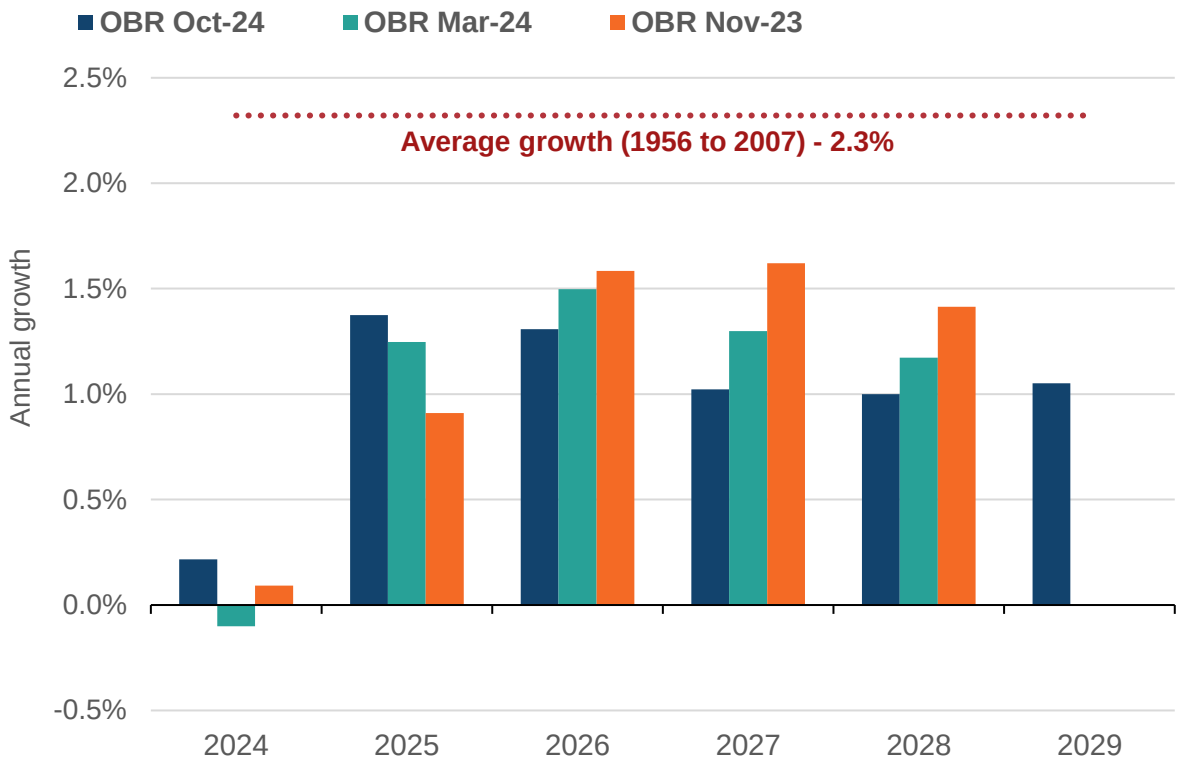
Figure 2: UK aggregate GDP and GDP per person index (quarter 4, 2019 = 100)



Source: *ONS*

The Office for Budget Responsibility (OBR) provided updated UK economic forecasts alongside the 2024 Autumn Budget. The OBR's latest forecasts UK aggregate GDP and GDP per person will increase at average rates of 1.6% and 1.0% respectively over the next five years. For GDP per head in 2024 and 2025, this is a small improvement compared with the OBR's previous forecast published in March 2024 and November 2023, the time of the last Welsh Government draft Budget. However, GDP per head is lower in later years compared to earlier forecast and well below the long-term trend, pre-financial crisis of around 2.3%.

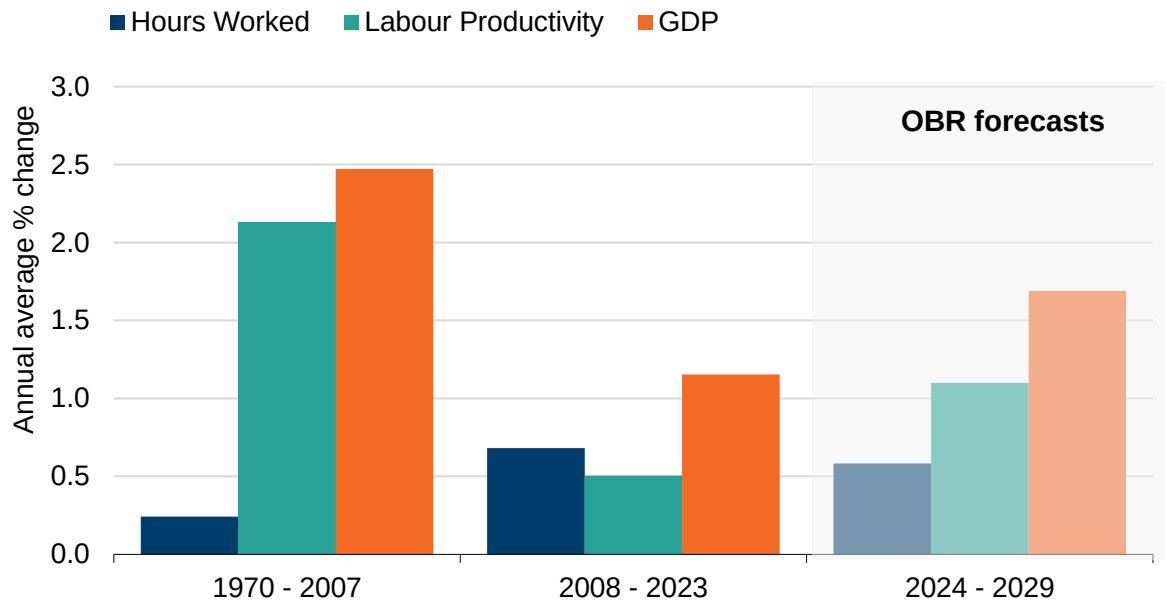
Figure 3: GDP per head forecasts, 2024 to 2029



Source: *OBR*

GDP growth is driven by increases in employment (hours worked) and labour productivity. Productivity, discussed in the next section, is crucial for sustained improvements in living standards. Since 2008, changes in GDP have been primarily driven by changes in employment, with minimal contributions from productivity gains. The OBR's latest forecasts indicate a shift towards productivity-driven growth in the coming years. However, growth in economic output and labour productivity remain below pre-financial crisis rates.

Figure 4: GDP growth components, 1970 to 2029 (forecast)



Source: *ONS, OBR*

Well-being and life satisfaction

GDP is an important measure of economic progress but as the (ONS) notes it is incomplete as a measure of well-being because '*it omits the gains or damage caused by GDP growth on society and the environment, how that growth is shared among society'* and ignores activity which sits outside the production boundary but contributes to well-being most notably household production.[2]

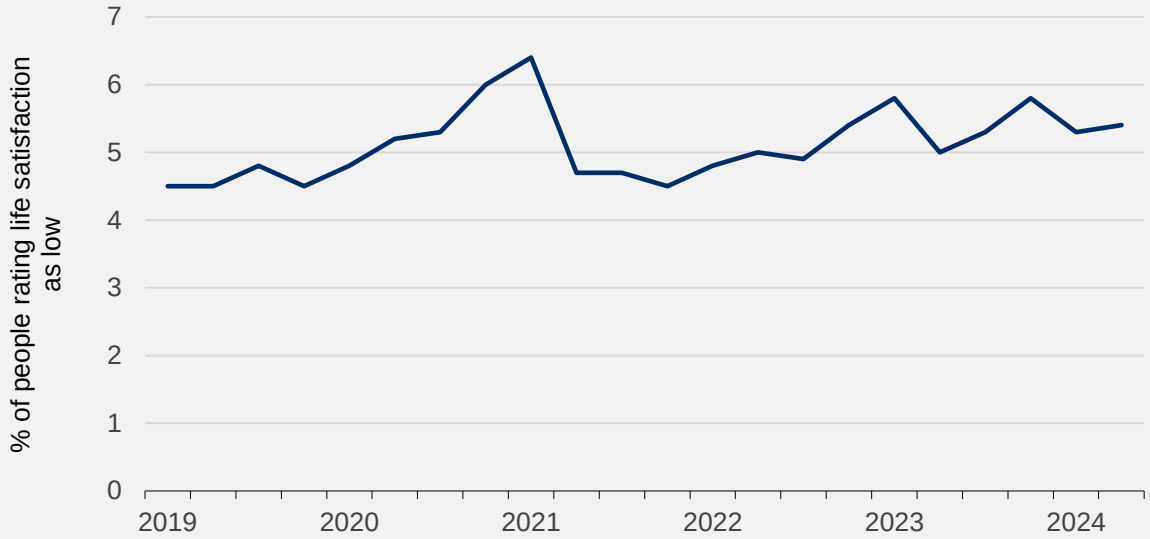
To provide "*a more holistic view of quality of life in the UK*", in November 2024 the ONS published its latest bulletin on wellbeing in the UK broken down by countries and English regions. Wellbeing is assessed across several dimensions including life-satisfaction. To measure life-satisfaction, people were asked "*Overall, how satisfied are you with your life nowadays? Where 0 is "not at all" and 10 is "completely".* Among adults in Wales, the mean score for life satisfaction in Quarter 2 2024 was 7.5, up slightly on Quarter 1 2024 (7.4) and the same as Quarter 4 2023. The mean score for life satisfaction for Quarter 2 2024 in Wales was the same as in England (7.5) and Scotland (7.5) but slightly lower than Northern Ireland (7.7). All English regions were also around 7.5, ranging from 7.3 (East of England) to 7.6 (South East). The UK figure has generally been around 7.5 since 2011, reducing slightly to 7.3 during coronavirus pandemic (COVID-19) (last quarter of 2020 and first quarter of 2021). Whilst data for Wales is not published as far back as 2011, it is highly likely to have moved around or be similar to the UK level over the period.

As with all average measures, it is important to consider the distribution, particularly monitoring those who report low levels of wellbeing. In the second quarter of 2024,

[2] See ONS (2024) Measuring progress, well-being and beyond GDP in the UK

5.4% of UK adults aged 16 years and over reported their satisfaction with their life as "low". **Figure 5** shows that this has been on a slow rise from around 4.5% in 2021. However, it is still currently lower than it was during COVID-19 when it rose to 6.4% quarter 1 2021).[3]

Figure 5: Share of UK adults reporting 'low' life satisfaction, Q1 2019 to Q2 2024



Source: *ONS*

In addition to the measures of personal (subjective) wellbeing and life satisfaction, an indicator approach can be used assess wellbeing across several dimensions or goals. Such an approach is used for the Wellbeing of Wales report.

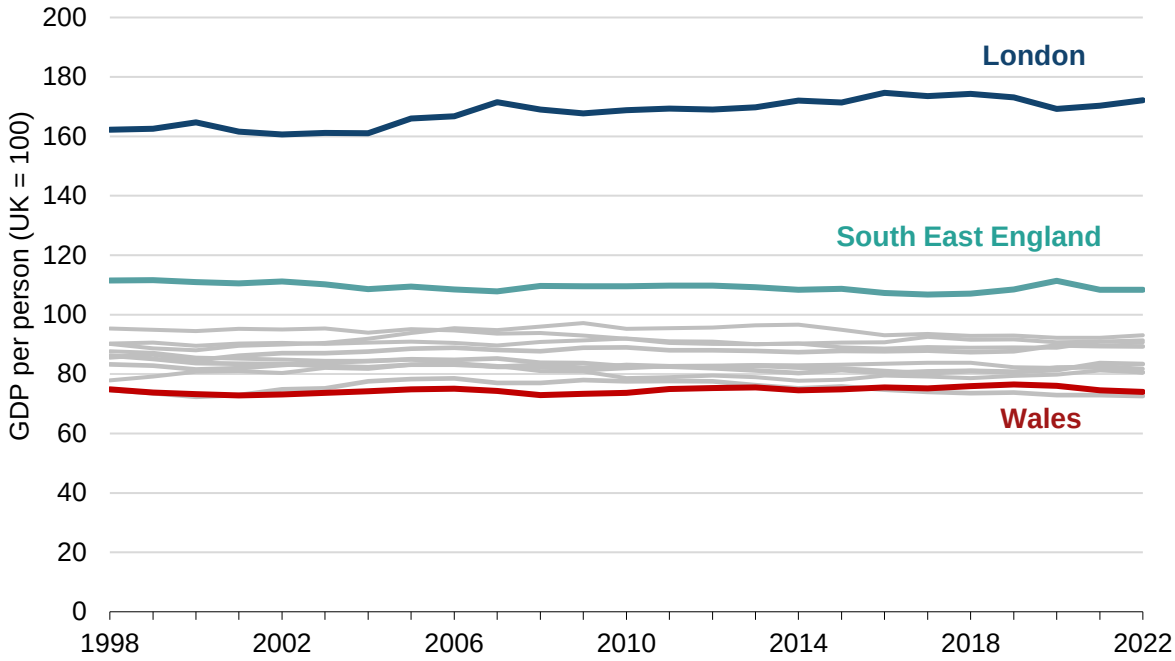
Wales' economic output

In 2022, which is the latest year of available data, GDP per person in Wales was £27,274, equivalent to 74.0% of the UK average. Of the 12 UK countries and English regions, only the North East of England had lower GDP per person than Wales. As **Figure 6** shows, over the last quarter century Wales' GDP per person relative to the UK has been consistently lower than several other parts of the UK, but consistently very close to the performance of the North East of England. Wales and the North East of England share many similar socio-economic features.

As **Figure 6** shows, London's high output per person marks it out as a regional outlier when compared with all other UK countries and English regions. When excluding London, GDP per head in Wales and all other regions are much nearer the UK average.

[3] The percentage of adults who report satisfaction with their life as "low" in Wales is not used here as the data has a very large confidence intervals.

Figure 6: UK country and English region GDP per person (UK = 100), 1998 to 2022



Source: *ONS*

Adjusted for inflation, GDP per person in Wales increased by 2.9% (UK less extra-regio increased by 3.2%) in 2022 compared with the prior year but was down 3.8% (UK less extra-regio increased by 0.1%) compared with 2019, the biggest shortfall of any UK country or English region compared with pre-coronavirus (COVID-19). Analysis of data suggests this may be due to the production sector (which constitutes a relatively larger share of Wales' economy) being more adversely affected by the pandemic, with the recovery mainly being driven by the service sector across the UK.[4]Brexit may also have had a differential impact, perhaps more negative, in Wales. It is expected to reduce trade and productivity, having a negative effect on the economy. However, quantifying those effects is challenging, as it is difficult to isolate the impact of Brexit from the range of shocks the UK and Welsh economies have experienced over recent years. The OBR still expects the total impact of Brexit to be realised several years after full implementation of the new trading relationships with the EU. It estimates Brexit to reduce the size of the UK economy by around 4%, with the full effects materialising 15 years after the new trade agreement started in 2021.[5]

[4] ONS (2024). Regional gross value added (balanced) by industry: all ITL regions
[5] See OBR March 2024 Economic and fiscal outlook – March 2024

Productivity

Why is productivity important?

As identified in the previous section, UK (and Wales) economic growth since the global financial crisis (GFC) of 2007-08 has been subdued and low compared to the previous forty years or more. Since the GFC, productivity growth has effectively stagnated for reasons debated amongst policy makers, with the phenomenon being termed a "productivity puzzle."

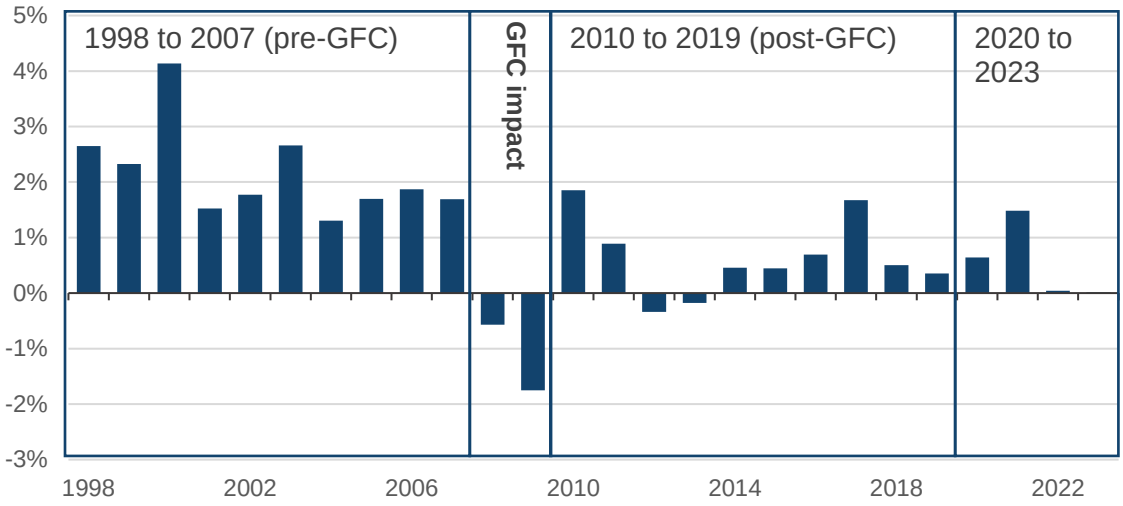
What is productivity?

Productivity is a measure of the efficiency with which inputs are used in the production of goods and services. It is typically quantified as the amount of output produced per unit of labour input. Essentially, it assesses how effectively labour is being utilised to generate economic value. In part, this is because labour is readily measurable input of production.

Productivity can be measured using several approaches. One measure is Multi-factor Productivity (MFP), which evaluates output relative to the combined inputs of labour and capital, thus giving a broader picture of productivity across all production factors. Another metric, more commonly used, is Gross Value Added (GVA) per hour worked or worker. The former focuses on the value of goods and services generated per hour of labour, making it useful for evaluating the direct impact of labour on economic output.

Figure 7 shows the difference in productivity growth since the GFC and across various intervening periods. In the nine years leading into the GFC (1998 to 2007) the average annual growth rate was between 2% and 2.5%; in the nine years following, the negative productivity shocks seen in 2008 and 2009 (2010 to 2019) the average annual growth rate was less than a third of that seen before at 0.6%. Recent data also do not provide a promising outlook as to how UK productivity has fared since the beginning of the COVID-19 pandemic and into subsequent periods. The OBR, however, has forecasted that productivity should rise to 1.25% by the end of their forecast period (2029) – notably still below the pre-GFC rate.

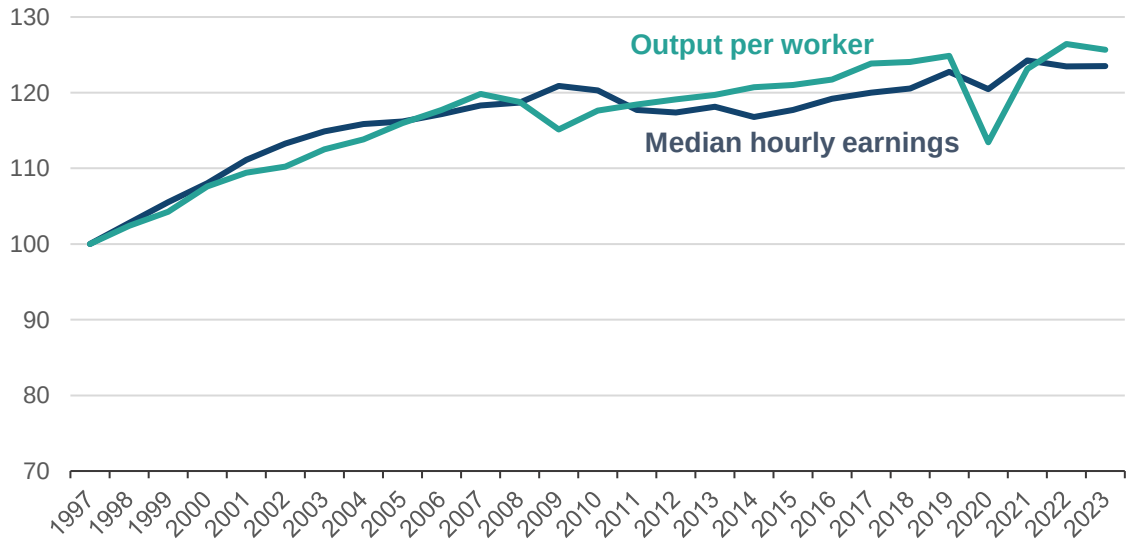
Figure 7: UK output per hour worked: year on year growth rate



Source: *Office for National Statistics (productivity flash estimate)*

Over the long term, increasing productivity is the only way to obtain (and crucially sustain) per capita higher living standards. In principle, higher productivity increases both the profitability and competitiveness of firms, which in turn should provide the financial conditions for employees to ask for, and firms to offer, higher real wages. Wages and productivity are generally thought to track each other in the UK primarily for this reason – **Figure 8** shows the relative growth of output per worker and median hourly earnings in the UK since 1997.

Figure 8: Output per worker and median hourly earnings (Index: 1997 = 100)



Source: *Welsh Government analysis of ONS ("Annual Survey of Hours & Earnings" and "Productivity Flash Estimate")*

Productivity growth also boosts the potential resources available to governments as if productivity gains result in higher earnings, it increases the size of the existing tax base, increasing tax revenues without the need for tax rate rises. This provides government with options to use the resources they can then use to invest in public

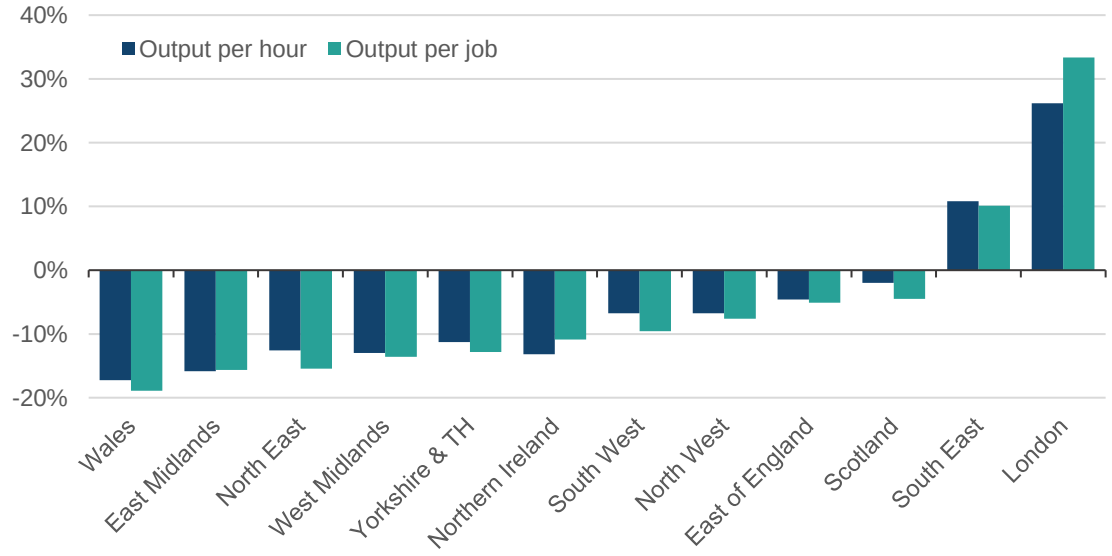
services, infrastructure, and/or tax cuts, further promoting economic growth and societal wellbeing. In analysis by the OBR in November 2023, they estimated that a 0.5 percentage point difference above/below their central estimate of 1% productivity growth year-on-year could result in as much as £40 billion less/more borrowing by the end of their five-year forecast period.[6]

How does Welsh productivity compare?

Whilst the rate of growth of productivity is important, Wales also faces the challenge that its level of productivity is lower than other UK countries and English regions. Regardless of the measure of labour productivity used, the level of Welsh productivity is significantly lower than the UK average, as illustrated in **Figure 9**. However, this average is somewhat skewed by London's exceptionally high productivity performance. There are only two regions in the UK (London and the South East of England) with average productivity above the UK average.

This section includes data related to the following national indicator: **(09) Gross Value Added (GVA) per hour worked (relative to UK average)**. More information on the indicators, along with narratives for each of the well-being goals and associated technical information is available in the Wellbeing of Wales report 2024.

Figure 9: Productivity measures relative to UK of nations and English regions (2022)



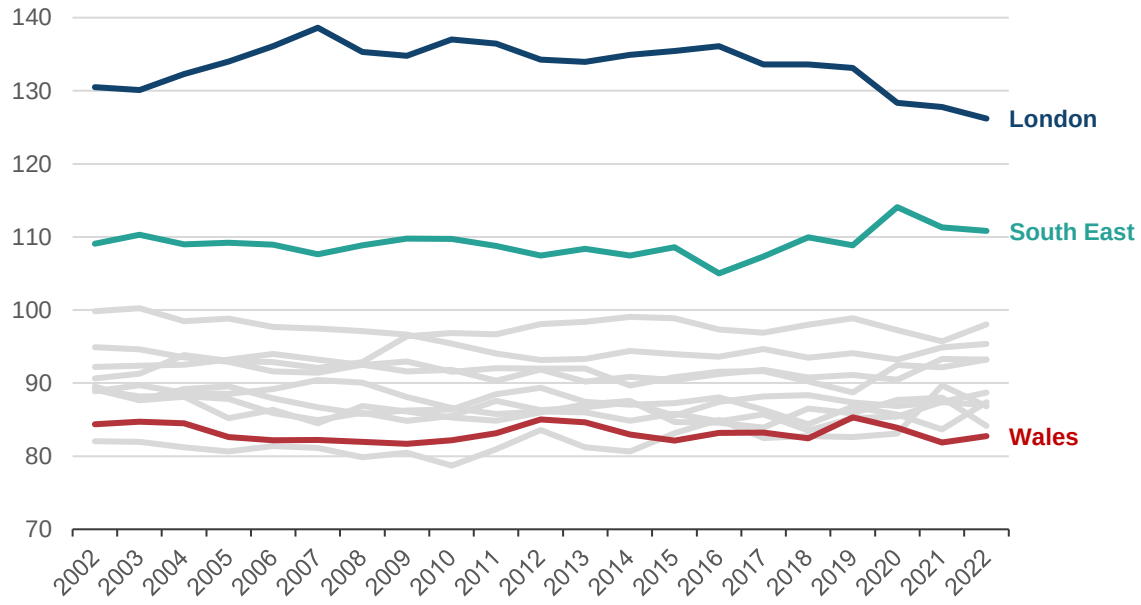
Source: *ONS (Regional Labour Productivity)*

Productivity levels in Wales have been comparatively low for much of Wales' recent history. **Figure 10** shows productivity levels (output per hour) relative to the UK average across the UK's nations over the past two decades. In 2022, Welsh output per hour worked was 82.7% of the UK average, roughly the same relative level as it had been in 2005 (when it stood at 82.6%). However, annual average productivity

[6] Office for Budget Responsibility (2023). Economic and fiscal outlook: November 2023.

(GVA per hour) growth in Wales (0.64%) has grown slightly faster than the UK's (0.56%) in the period since the GFC, so 2009 to 2022.

Figure 10: Output per hour index, UK countries and English regions (UK = 100)



Source: *ONS (Regional Labour Productivity)*

A common critique of the UK economy is that the concentration of financial services in London contributes disproportionately to national productivity figures, masking the relative underperformance of most other regions, including Wales. However, a number of studies and analysis has concluded that the UK's dispersion of productivity, which includes Wales relatively lower productivity, is due to factors within industries and not simply due to regions having different industrial structures.[7] In particular, productivity differences between the UK countries and English regions are particularly evident within the service sectors, and especially between London and all other areas. Productivity differences can therefore not be explained by London and the South East having a predominantly service based economy while manufacturing is more prominent elsewhere. For Wales at least, manufacturing is a sector where it has a relative productivity advantage compared to other areas.[8]

An important caveat to these findings is that when looking at lower levels of geography than UK nations and English regions (ITL1) – and especially for more sparse areas – industry can explain some productivity differences. For example, some areas have relatively high shares of employment in relatively low productivity

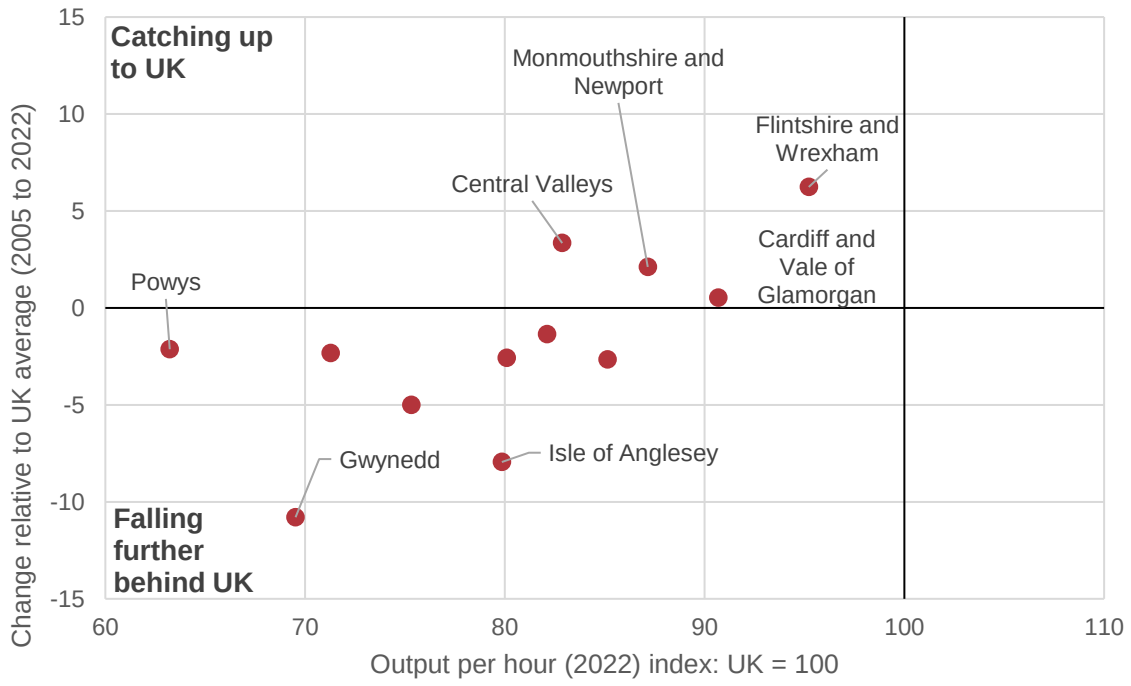
[7] ONS (2019). Understanding spatial labour productivity in the UK; R Harris & J Moffat (2021). The geographical dimension of productivity in Great Britain, 2011–18: the sources of the London productivity advantage; and, A Stansbury & others (2023). Tackling the UK's regional economic inequality: Binding constraints and avenues for policy intervention

[8] ONS (2021). Region by industry labour productivity

industries, which tend to include sectors such as agriculture, forestry and fishing, and accommodation and food services industries.[9]

While care needs to be taken looking at productivity data at lower geographical levels, data suggests that all subregions within Wales have productivity levels below the UK average; however, relative performance to the UK since 2005 has differed. **Figure 11** shows Welsh regions falling into one of two categories, those where labour productivity has converged with the UK in this period, and those who have fallen further behind. The region with the highest positive convergence is Flintshire and Wrexham (which moved 6.2 percentage points closer to UK average), home to much of Wales' advanced manufacturing firms. The region with the highest negative divergence was Gwynedd (which moved 10.8 percentage points further from UK average).

Figure 11: Output per hour: Percentage point change relative to UK average (2005 to 2022) and relative figure in 2022 for Welsh ITL3 regions



Source: *Welsh Government analysis of ONS (Subregional Productivity)*

How to improve Welsh productivity performance

As with most countries, the factors that lie behind Wales' historical productivity performance are complex and to some extent uncertain. However, there are a few attributes which are likely to explain this. Wales has a relatively high share of its population situated in sparsely populated areas and is the only UK nation or English region without a city whose population exceeds 500,000. For firms in the local service economy, sparser regions will typically have smaller market sizes from which

[9] ONS (2019). Understanding spatial labour productivity in the UK

they (firms) can achieve economies of scale. It also makes it harder for all firms to capture the benefits of 'agglomeration', which was seen as a key driver of UK sub-regional productivity prior to the pandemic.

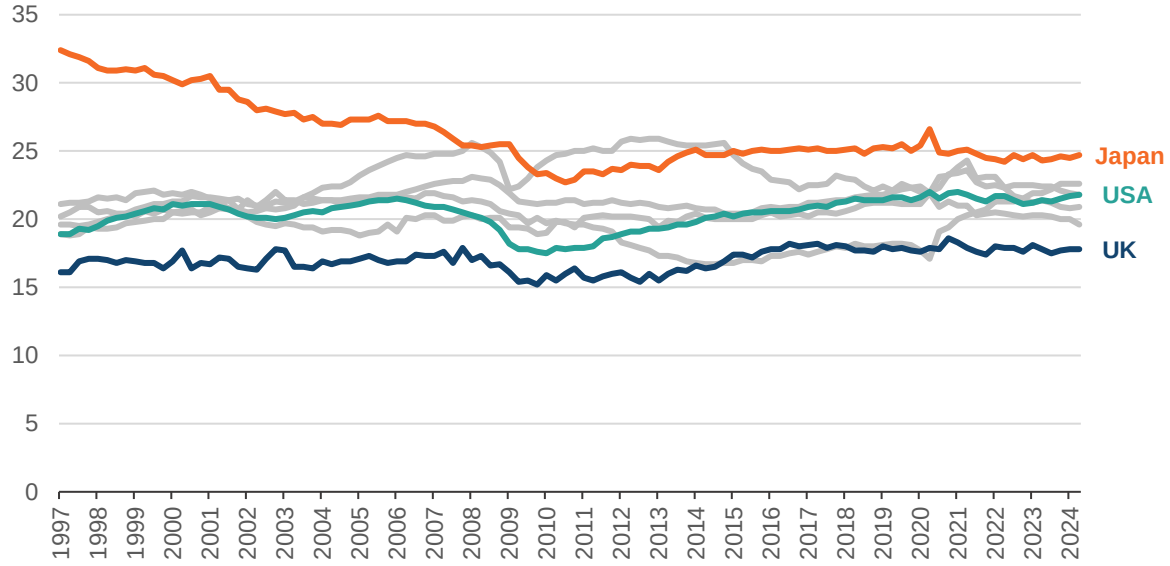
The benefits of agglomeration – or put more simply, higher firm and population density in an area – are that they provide firms and workers with the conditions that enable knowledge spillovers, pooling of resources, and better skills for workers within the local labour market. As seen in **Figure 11**, all four Welsh areas that converged with the UK average since 2005 are those areas closest to larger conurbations or cities, albeit in England.

Improving the skills of the work force (also referred to as human capital) is amongst the most important elements cited to increase productivity. Generally, a skilled workforce can carry out existing tasks more efficiently, while also being better equipped to innovate and adapt to new technologies and processes. This can be either through their existing jobs, or in new jobs. Changing jobs is also associated with positive effects on wages, another sign that they are positive for productivity and the economy.[10]

In combination with investment in human capital, economy-wide capital investment will be critical for improving productivity in Wales. Capital investment can both complement and substitute labour, freeing up resources that can be reallocated and enabling additional economic activity to occur. Gross fixed capital formation (GFCF) is a metric which captures net capital expenditure by both the public and private sector, including spending on research and development. **Figure 12** shows how GFCF (as a percentage of total GDP) has been consistently lower in the UK than most G7 nations going back to 1997. It is therefore understandable that improving levels of investment within the economy has become an increasing priority for UK policy makers.

[10] Resolution Foundation (2022). The Economy 2030 Inquiry: Changing jobs?

Figure 12: GFCF as a percentage of GDP, Q1 1997 to Q2 2024



Source: *ONS (Business investment in the UK)*

Trade is also found to have positive effects on productivity. By engaging in more open trading relationships, firms are exposed to more competition (which incentivises productivity gains to be more competitive), while also allowing them to access larger market bases from which to leverage economies of scale. The OBR continues to assume within its forecasts that UK productivity will be 4% lower than would have been the case, with the full effect felt after 15 years, because of changes to the UK's trading relationship with the EU, which took effect from 2021. [11] Trade is covered in more detail further on in this report.

[11] See OBR (March 2024) Economic and fiscal outlook – March 2024

Public sector productivity

Public sector productivity is the efficiency and effectiveness with which public sector organisations use their resources (like people, buildings and technology) to deliver public services directly to individuals, such as health, education, and social care, as well as those provided to society as a whole, such as defence.[12]

The fewer resources used to deliver the same quantity of services, the more productive that process. The public sector accounts for about one-fifth of the UK economy, so its productivity is a significant determinant of a country's overall productivity and living standards.

Measuring public sector productivity

As with the private sector, public sector productivity is defined as the ratio between outputs and inputs. In practice, however, measuring productivity is one of the more difficult challenges in economic statistics and particularly challenging in the case of the public sector.

In the private or market sector, outputs are typically sold with observable prices. However, in the UK, public sector services such as health and education are generally provided without direct charges, complicating the assessment of output value. Public services often do not have a single output but rather provide a combination of outputs. Valuing these collectively provided services is particularly challenging as their benefits cannot be attributed to individual households.

Even after identifying the outputs, obtaining consistent data capturing these outputs can be difficult, especially given the variety of different service providers across the UK. There may also be delays in the delivery or data capture of some outputs. Additionally, assessing the effectiveness or quality of public sector outputs is complex and may require qualitative assessments, which are inherently subjective. Productivity considerations must also account for equity and suitable access to public sector services, encompassing aspects such as geographical provision, language, and the mode of service delivery (online or in person).

While input costs are generally obtainable, accurately costing certain aspects can be challenging. For instance, estimating the costs of buildings and machinery used in delivering public services involves complexities, including considerations of depreciation and the duration over which investment costs should be applied. In major public services like health and education, labour costs, such as wages,

[12] In measuring public sector productivity, public services are those delivered by or paid for by government (central or local) and include publicly funded services delivered by non-government providers e.g. the provision of nursery places by the private sector, where these places were funded by the government.

constitute a significant portion of the total costs and are usually identifiable and measurable.

Notwithstanding these measurement challenges, the ONS produces estimates of UK total public service productivity as well estimates of healthcare and education productivity.[13] These include quality adjustments but as result, are produced with around a two-year lag. No data is available for just Wales as it is included as part of the wider UK estimates on public sector productivity by the ONS. However, the ONS as part of their wider work on public sector productivity are working with the devolved administrations to improve the data.[14] It is likely that the general trends and findings of UK productivity will also apply to Wales.

Public sector productivity performance

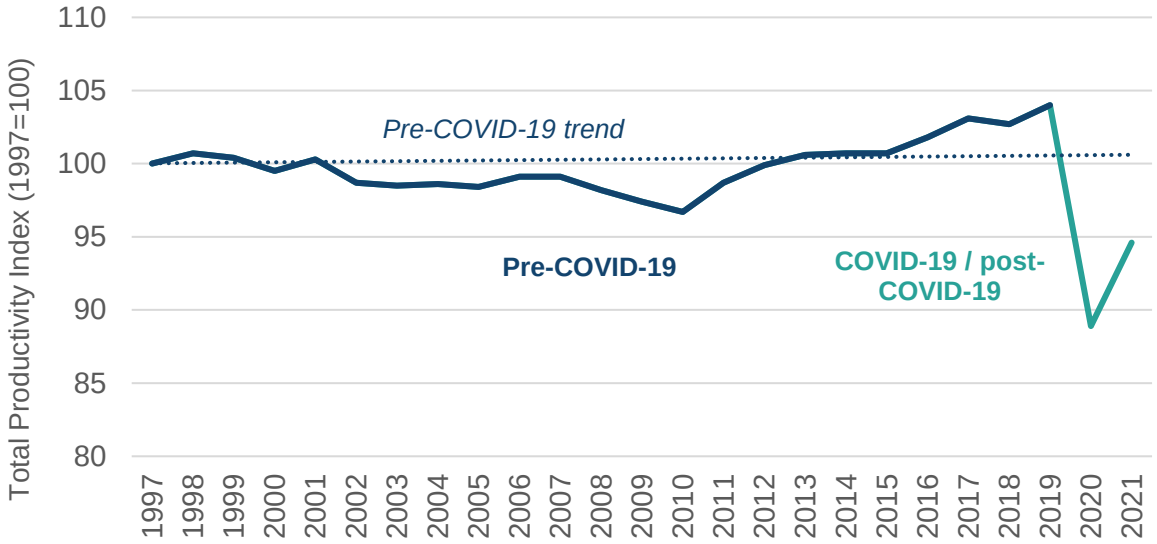
Health and education, two devolved areas, were two of the largest public sector areas which were included in the ONS data. Other devolved areas include social care provision for both children and adults (separately identified). As with a lot of economic data, public sector productivity is characterised by the trends witnessed in the periods before, during and after the COVID-19 pandemic.

ONS estimates show total UK public service productivity grew by an average of 0.2% per year between 1997 and 2019.[15] Inputs grew by an average of 2.2% per year between 1997 and 2019. Outputs also grew by a similar amount, by 2.3% per year until 2019. However, inputs grew proportionately more in the period up to 2010 than after it, which generates the overall trend, as shown in the **Figure 13**.

COVID-19 had a large negative impact on public sector productivity in the UK, especially in 2020. Public sector productivity fell by 14.5% in 2020.[16] Annual healthcare productivity fell by 25.1% in 2020 on a quality-adjusted basis, then increasing 10.8% in 2021. Education productivity, also using ONS' quality adjusted measure, fell by 18.9% in 2020, rising by 13.1% in 2021.

[14] For more information see ONS (2024) Public Services Productivity Review
[15] See ONS (2024) Public service productivity, UK: 1997 to 2022
[16] See ONS (2024) Public service productivity

Figure 13: Total Public Service Productivity, UK, 1997 to 2021



Note: *Chart axis does not start at zero.*
Source: *ONS*

Even after the post-COVID-19 rebound in activity in the public sector in 2021, the level of total public service productivity is estimated to still be 9% lower in that year than before the pandemic when using the quality-adjusted ONS measures.

The persistence of negative impacts on public sector productivity caused by the pandemic is expected to be behind performance in more recent years, according to recent ONS data. The latest ONS estimates on public sector productivity shows that public sector productivity in Quarter 1 2024 was still 6.4% below its pre-COVID-19 pandemic level (Quarter 4 2019), with relatively flat rates of growth since 2021 to the latest period Q1 2024.[17] These latest quarterly estimates covering the period since 2021 do not include quality adjustments, as more time is needed for ONS to include these adjustments into their estimates. However, given the scale of the reduction still seen in these estimates, it seems unlikely that this can all be accounted for by changes in quality and that a medium-term issue with public sector productivity remains, with it yet to return to pre-COVID-19 levels. This has potential impacts for the funding of public services, as it suggests more funding is now required to produce the same level of public sector outputs as in 2019.

With such large reductions, there is often an opportunity for catch-up growth, especially if a shock is temporary. However, the drop in productivity seen during COVID-19 has yet to recover fully, with losses still evident in the data years later. The significant decrease in health care productivity, combined with education, represents a major part of the UK's overall reduction in public sector productivity. This situation likely applies to Wales as well.

[17] See ONS (2024) Public service productivity, quarterly, UK: January to March 2024

Why has UK public sector productivity fallen?

The reduction in productivity in health care, as suggested by the ONS data, is not due to the outputs of the sector being below their 2019 levels. Except for 2020, health care is on an ever-increasing trend for output. It is more that the recent increases in inputs to health, taking them also to their highest-ever levels, have not been matched by an equivalent increase in outputs. While there is no measure for Wales which is consistent with the UK measure, as a form of proxy or illustration of the increase of inputs, the total number of full-time equivalent staff directly employed by the NHS in Wales in June 2024 is close to its highest level (which was March 2024) since 2009, the start of the data series.[18] There were 21.0% more full time equivalent staff employed in June 2024 than there were in June 2019.[19,20]

A similar trend on inputs is also exhibited with UK adult social care. However, education in the UK does differ, as output in 2021 was lower than the pre-COVID-19 period, with inputs also slightly lower.[21]

It is difficult to pinpoint why productivity has fallen since the pandemic. It is likely due a range of factors, which may vary by sector. The IFS cites evidence on health which suggests it could be due to the mix of inputs, with frontline staffing prioritised relative to spending on capital and management. [22] The IFS also cite NHS England work on productivity, which whilst using a different measure of productivity, suggests it is due to a range of other factors, some of which include temporary staffing costs and the recent periods of industrial action. [23]

Opportunities to improve public sector productivity

Evidence suggests there are no simple solutions to improve public sector productivity. However, there are few common themes which are briefly outlined below.

The evidence suggests for there to be further investment in technology, especially in digital infrastructure.[24] This may be done with the use of public-private partnerships, so the public sector can gain experience from the private sector, whilst ensuring public service objectives are prioritised.[25] Investment in digital is advocated for on the basis that it could streamline processes, reduce paperwork, and improve service delivery.

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[18] See Welsh Government (2024) NHS staff by staff group and year
[19] See Welsh Government (2024) Staff directly employed by the NHS: 30 June 2024
[20] The largest staff group, with 40% of the total workforce in June 2024, was nursing, midwifery and health visiting group had 17.3% more staff in June 2024 than there were in June 2019.
[21] See ONS (2024) Public service productivity: total, UK, 2021
[22] See Warner and Zaranko, (2022), (2023) in IFS (2024) The fiscal implications of public service productivity
[23] IFS (2024) The fiscal implications of public service productivity
[24] For example see OECD 2020, B. van Ark (2022) Making Public Sector Productivity Practical, The Productivity Institute and Capita and Institute for Government (2024) Public service productivity
[25] OECD (2020). Boosting Productivity in the United Kingdom's Service Sectors

To complement new technologies, especially digital, an emphasis should be on more innovation to help foster adoption of and embed more novel uses of new technologies. There is perhaps a further need for more learning and innovation across sectors and areas of government.[26]

Further linked to new technologies, there is also recognition that the public sector's workforce needs to play a key role. There are opportunities for the public sector workforce to become more and further enhance a culture of continuous innovation which can in turn be able to absorb and use new technologies.[27]

In addition, evidence suggests that further improvements to management practices could help to increase productivity. This has perhaps been seen as less of a priority more recently, with emphasis being placed on having more staff closer to the frontline. A mix is therefore required, especially for large organisations, such as the NHS. The importance of staff retention and workforce planning has also been cited as an important element in improving productivity within the public sector.[28] Experienced staff tend to be more productive; the loss of such staff can therefore result in reduced productivity. Some loss of experienced staff is inevitable through retirement but improving the way this is managed through better workplace planning would help to reduce the impact of this.

[26] OECD (2020). Boosting Productivity in the United Kingdom's Service Sectors
[27] B.van Ark (2022). Making Public Sector Productivity Practical, The Productivity Institute and Capita
[28] Institute for Government (2024). Public service productivity: What is public service productivity and how is it measured?

Living standards

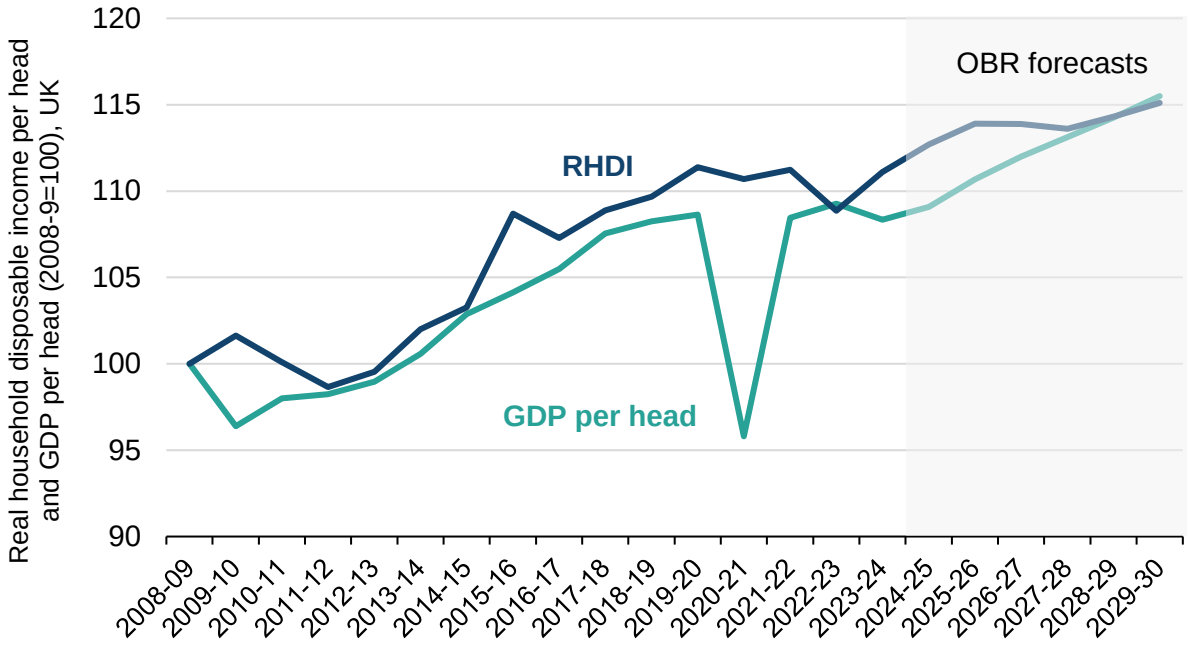
A measure of living standards or the material welfare of households can be shown by household income data. When shown as a per head measure, it provides an estimate of mean disposable household income per person. This is the amount of money that individuals on average have available for spending or saving after adjustments such as taxes, social contributions and benefits have been applied. However, this measure does have its own limitation as it makes no account of different ages of people who may require different levels of income, does not include wider household costs such as housing and has no account of the provision of public services. It also does not account for the distribution of income, showing only the mean. Some of these aspects can be overcome with alternative or complementary measures.

UK living standards and economic output (GDP per head) are linked. **Figure 14** shows how they have moved together (and are forecast to move) over the period 2008-9 to 2029-30. The main exception is during COVID-19 when the economy contracted but UK household incomes were maintained through very large government interventions and transfers, such as the Coronavirus Job Retention Scheme. That the growth of GDP per head has been subdued compared to previous periods – as discussed in a previous section – also means that UK household income growth has been lower than in previous periods. The OBR also forecast it to grow by an average of just over 0.5% a year between 2024-25 and 2029-30.[29] Growth is stronger in the first two years of the OBR's forecast at between 1% and 1.5%, mainly driven by the expectation that on average wages will grow slightly faster than inflation. However, like productivity trends, UK living standard are forecast to grow well below the long-term trend before the financial crisis of around 2.5% per year. Over the medium-term, Wales' household income and living standards are likely to replicate the UK trends.

Compared to the OBR's previous forecast (March 2024), household income per person is over 2% higher at the start of the forecast period, but this is due to ONS data revisions. However, by the end of the forecast it is around 1.25% lower by the start of 2029. This is mainly due to UK Government policies announced in the UK Budget 2024, where taxes were increased to increase the funding for public services, the latter of which is not reflected in this measure.

[29] OBR (2024). Economic and fiscal outlook: October 2024

Figure 14: UK Real Household Disposable Income (RHDI) and GDP per head, 2008-9 to 2029-30

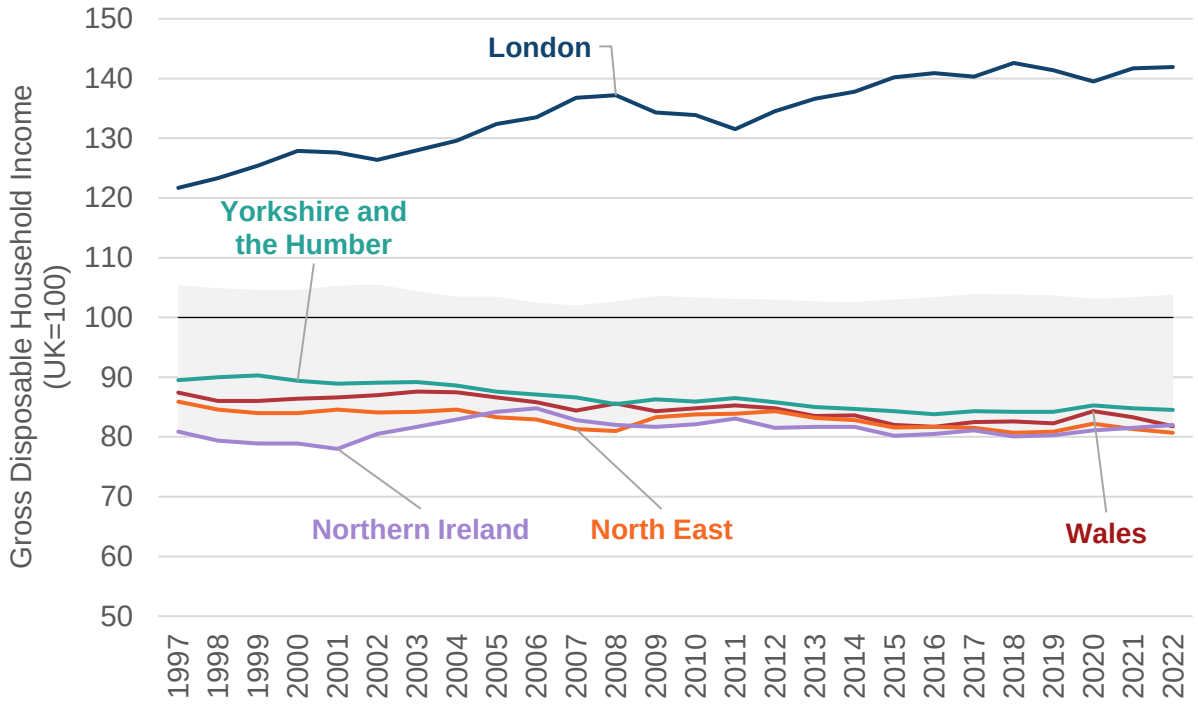


Source: *OBR*

Living standards within the UK

As mentioned in the previous section, living standards in the long run are determined by productivity. Given that productivity is relatively lower in Wales compared to the UK, this is likely to be at least partially reflected in living standards. **Figure 15** shows living standards by country and English regions compared to the UK as measured by ONS' Gross Disposable Household income (GDHI) per head. For the most recent available period, 2022, GDHI per head in Wales (82% of the UK) was the second lowest amongst UK countries and regions, higher than the North-east of England (81%), and similar to Northern Ireland (also 82%). Wales' GDHI per head relative to the UK, at 82%, is therefore very similar to its productivity (GVA per hour) relative to the UK at 83%.

Figure 15: GDHI per head (UK=100) by UK country and English region, 1997 to 2022



Note: *Chart axis does not start at zero. Shaded area is the range of UK countries & English regions excluding London & South East.*
Source: *ONS*

The gap between Wales and the UK on GDHI per head has widened over the longer term. Comparable regions to Wales have performed similarly. Most UK countries and English regions are below the UK average, with only London, the South East of England and the East of England above that figure. London has performed most differently, increasing relative to the UK over the period. As a result, Wales' GDHI per head is 90% relative to the UK figure when you exclude London and the South East of England. The difference between Wales and the UK (when excluding London and the South East of England) has remained around that same level for around the last ten years. This shows that Wales has maintained its relative level of prosperity compared to most regions and countries of the UK over the medium term.

The measure GDHI at the Wales level is also a national indicator: (10) Gross Disposable Household Income per head and also reported in the Well-being of Wales report A Prosperous Wales chapter and is used as one of the national indicators (to improve GDHI per head by 2035).

Alternative measures of household income

The Family Resource Survey (FRS) is an alternative source of information on household incomes in Wales and the UK. The measure includes all sources of income from all household members, including dependents, and is adjusted ('equivalised') to allow for household composition. It therefore reflects the experience

of a typical household and is widely seen as the most representative single measure of material living standards.

A further adjustment can also be made using the median, rather than mean, to show differences in income between those who live in Wales and the UK around the middle of the income distribution. It is therefore considered a more representative value for income levels, where some measures can be distorted by extreme values.

Why is mean income measure by the Family Resource Survey different to the mean measure of Gross Disposable Household Income?

GDHI is part of the household sector accounts published by the Office for National Statistics (ONS). A regional version of GDHI is published annually and is derived from the UK version. It does not take account of mortgage capital repayments or payments of rent (except as income of private landlords). Compliance with national accounts concepts means it includes the imputed rental of owner-occupiers as income, intended to reflect the benefit that owner occupiers get from living in the dwelling that they own. Detailed investigation of the regional accounts data indicates that slower relative growth in the notional income of owner occupiers and the rental income from letting dwellings over the most recent ten years or so appear to have driven a large part of the relative decline in Welsh GDHI. This issue was explored more fully in the 2021 Chief Economist's report.[30] As it comes from aggregate estimates it is likely to include households which may not be captured through survey-based methods.

The FRS is survey based, constructed from micro-data with individuals providing their income and household circumstances. As it is survey based, there is the potential for some sampling error resulting in some uncertainty around central reported values. As the data samples are relatively small below the UK level, the data for Wales is of a three-year average (latest being 2020-21 to 2022-23). The FRS estimates underpin DWP's Households Below Average Income (HBAI) series, which is the UK's official source of poverty estimates. It is the UK's main source on household and individual incomes.

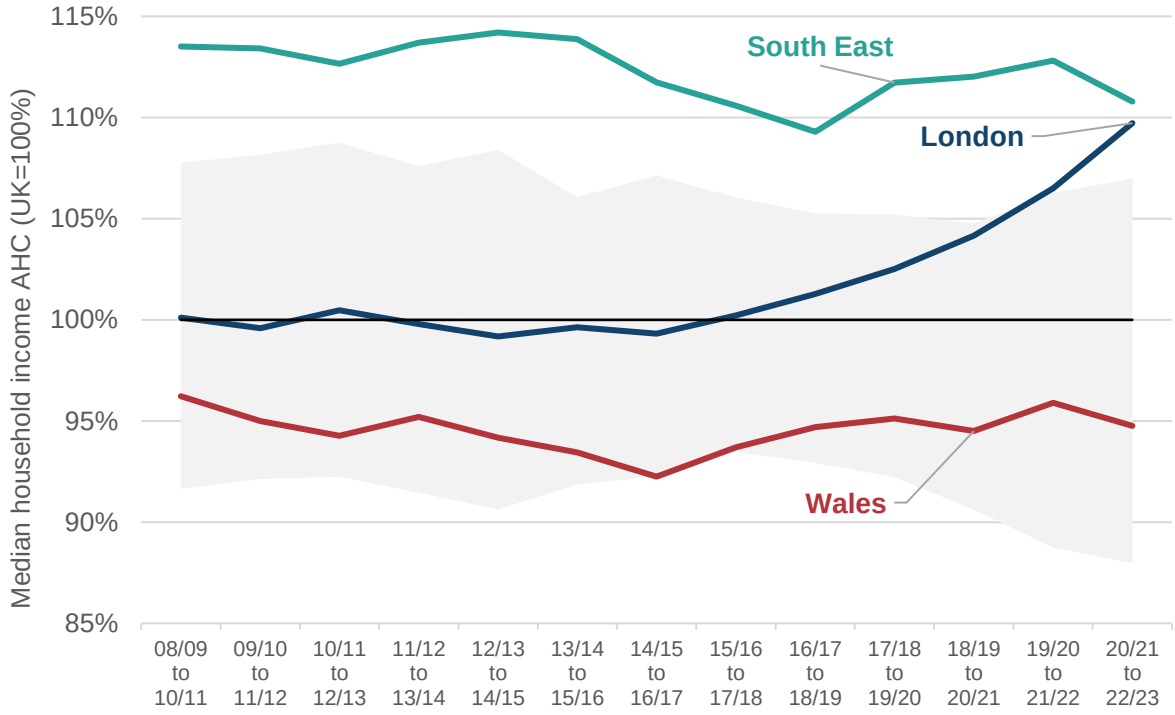
In the most recent period, 2020-21 to 2022-23, the median weekly equivalised household income (before housing costs) in Wales stood at £578.[31] This is 93% of the equivalent figure for the UK as a whole (£623) and is the third lowest for all UK countries and English regions with only the North West (£570) and West Midlands (£553) being lower.[32] London had the highest median weekly equivalised household income at £735.

[30] See Welsh Government (2021) Welsh Budget 2021: Chief Economist's report
[31] The most recent data is for the three-year period 2020-21 to 2022-23.
[32] Adjusting for the lower cost of living in Wales would reduce this gap.

Over the same period and after deducting housing costs (see **Figure 16**), the West Midlands still had the lowest median weekly income at £483 (88% of UK figure), while the South East had the highest at £608 (111% of the UK figure). The high cost of housing in London means incomes are lower than in the South East once these have been taken into account. Median weekly equivalised household income (after housing costs) in Wales stood at £520, which is 95% of the level for the UK as a whole (£549). Therefore, the after housing costs measure has a relatively small impact on Wales compared with other UK countries and English regions.

As **Figure 16** shows, over the last 15 years, median household income (AHC) in Wales has been consistently lower than that for the UK as a whole and many other English regions and UK countries. Other UK countries and English regions also with a median household income consistently lower than the UK's and around the same as Wales over the same time period are the North East, North West, Yorkshire and the Humber, and the West Midlands.

Figure 16: Median weekly equivalised household income for all individuals by UK country and English region, after housing costs (UK=100%)



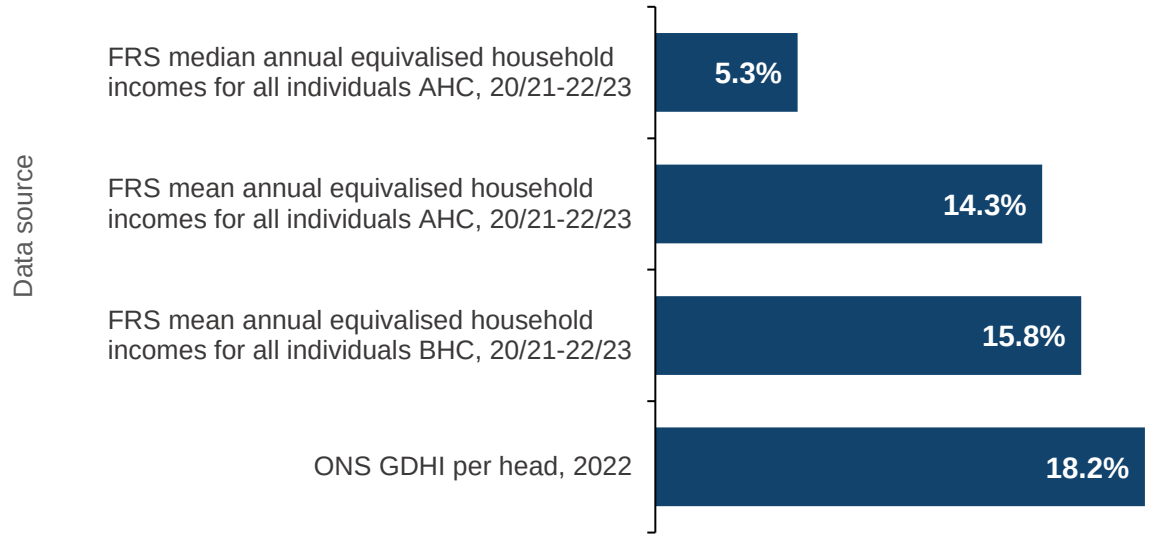
Note: *Shaded area shows the maximum and minimum of the UK countries and English regions excluding London and the South East.*
Source: *HBAI, DWP*

In summary, using the FRS's mean household income measure before housing costs (BHC), Wales is 16% lower than the UK.[33] This is close to the difference between

[33] Housing costs include rent or mortgage interest payments, water rates, structural insurance payments, ground rent and service charges.

Wales and the UK from the ONS's GDHI, despite being estimated in very different ways and not being wholly consistent in their definition of disposable income. Still using the mean measure, but after housing costs (AHC), the difference between Wales and the UK is around 14%. The gap between Wales and the UK then reduces further to around 5% when median household income is used. This likely reflects that Wales has a smaller share of its population earning very high incomes compared to the UK. Whilst there is likely to be some uncertainty around this measure, as it uses survey data, it is probably a more representative measure of the approximate difference in living standards and household income in Wales compared to the UK for the average household. All of these measures also do not reflect the value and provision of public services. The value of these may also differ in Wales compared to the rest of the UK, which may further reduce some of the differences in living standards.

Figure 17: Percentage gap Wales is lower by when compared to UK household income figures



Note: *AHC = After housing costs; BHC = Before housing costs.*
Source: *ONS and DWP*

Relative income poverty

As well as data on median household income, to further examine how the distribution of household income compares in Wales, particularly those towards the lower end, it's insightful to consider data on the percentage of people who are in poverty.

Data for relative income poverty comes from the Households Below Average Income (HBAI) report published by the Department of Work and Pensions (DWP).[34] HBAI data defines a person to be living in relative income poverty if they live in a

[34] Department for Work & Pensions (2024). Households Below Average Income: an analysis of the UK income distribution: FYE 1995 to FYE 2023

household where the total household income from all sources is less than 60% of the average UK household income (as given by the median).

Between the financial year ending (FYE) 2021 and FYE 2023, 21% of all people in Wales were living in relative income poverty (after housing costs)[35] - see **Figure 18**. The percentage of people living in relative income poverty has been relatively stable in Wales for over 18 years.

In England, the percentage of people living in relative income poverty (after housing costs) was slightly higher than in Wales at 22% between FYE 2021 and FYE 2023. In Scotland and Northern Ireland, the figures were 21% and 17% respectively. Compared to the English regions, the relative income poverty rate (after housing costs) in Wales was the same as the North East; lower than the North West, Yorkshire and the Humber, West Midlands and London; and, higher than the East of England, South East, South West, and the East Midlands. Out of all UK countries and English regions, Wales ranks in the middle using the after housing costs measure. On a before housing costs measure, the ranking for Wales is less favourable (with only three English regions and UK countries having higher rates compared to five regions/countries on an AHC basis).[36] This reflects relatively high housing costs in other areas of the UK compared to Wales.

[35] Other data breakdowns are available, for example, children/working-age adults/pensioners in relative income poverty, relative income poverty by age group, housing tenure, economic status and type of employment, family characteristics, ethnicity and disability.
[36] HBAI (2024) Relative income poverty: April 2022 to March 2023

Figure 18: Percentage of all individuals living in relative income poverty by UK country and English region, FYE 2021 to 2023

Source: *HBAI, DWP*

Inflation

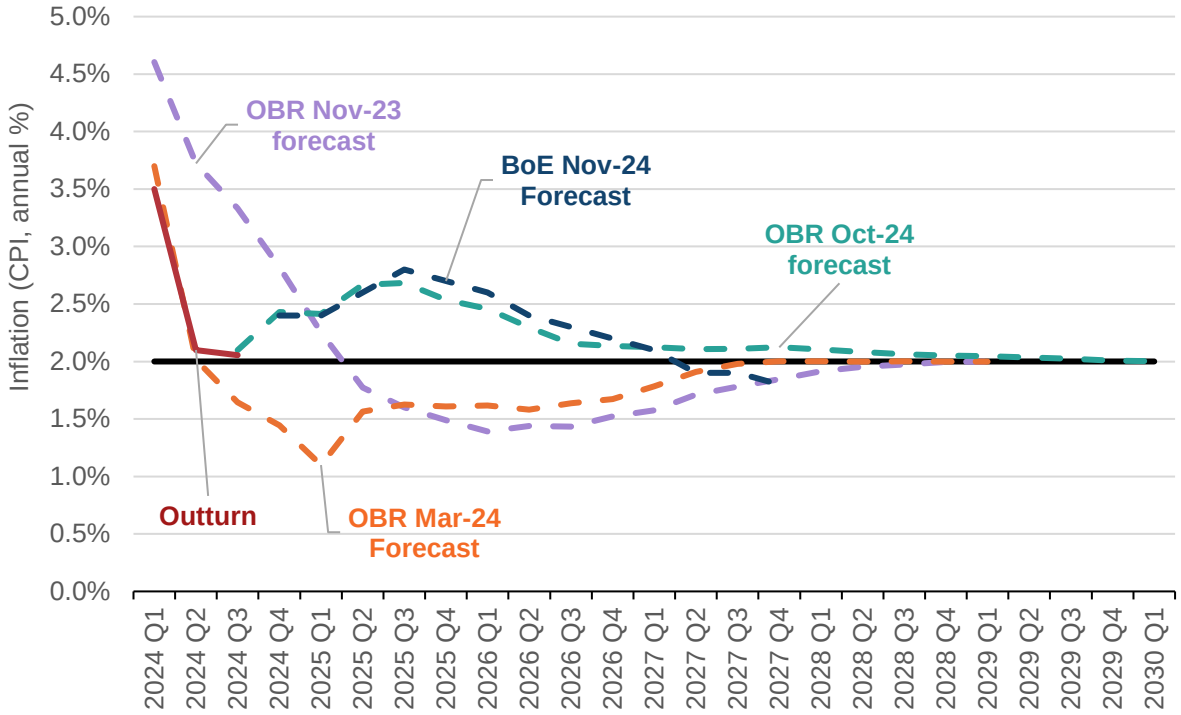
Inflation, the rate at which the prices of goods and services *increase* over time,[37] has been one of the most significant and noticeable economic features in recent years. Consumer price inflation, the inflation experienced by individuals and households peaked at 11.1% in October 2022 - the highest in rate in over 40 years. Driven by the surge in energy prices following the Russian invasion of Ukraine, supply chain disruptions caused by the COVID-19 pandemic and increased demand for goods and services, as countries removed restrictions designed to deal with the pandemic.

Over the course of 2024, inflation has returned to more typical rates, with the Consumer Price Index (CPI) back around the Bank of England's inflation target of 2% (see **Figure 19**). The fall in inflation over the last year has happened at a faster pace than was expected last year by the OBR in its November 2023 forecast,[38] which were the latest forecasts at the time of last year's Welsh Government draft Budget (for 2024-25).

The latest CPI inflation forecasts by the OBR and the Bank of England suggest that UK inflation will stay generally above the annual target of 2% in the short term, before gradually moving towards the target of 2% in 2026. The OBR inflation forecast for 2025 onwards is higher than their November 2023 and March 2024 forecasts. The OBR cite a number of domestic and global factors which make this forecast particularly uncertain with some upside risk. As a result, they estimate that there is around a one-in-five chance of inflation being above 4.5% (or below 1.1%) in 2025.

[37] If those prices fall, it is known as deflation.
[38] For further information on the OBR's forecast performance see OBR (2024) Forecast evaluation report – October 2024

Figure 19: Inflation rate (CPI) and forecasts, 2024Q1 to 2028 Q4



Source: *ONS, OBR, BoE*

High and prolonged inflation has eroded living standards across the UK, including in Wales. The OBR shows that rising prices decreased real household incomes by nearly 9% in 2022-23, which resulted in the largest year-on-year drop in living standards (2.2%) since records began in the 1950s.[39]

Despite a reduction in inflation, service inflation has been high for a prolonged period, running at 4.9% in September. As a result of this, the Bank of England's Monetary Policy Committee is being cautious with any potential interest rate reduction, as inflation in that area of the economy may reflect pay growth and underlying inflation persistence.[40]

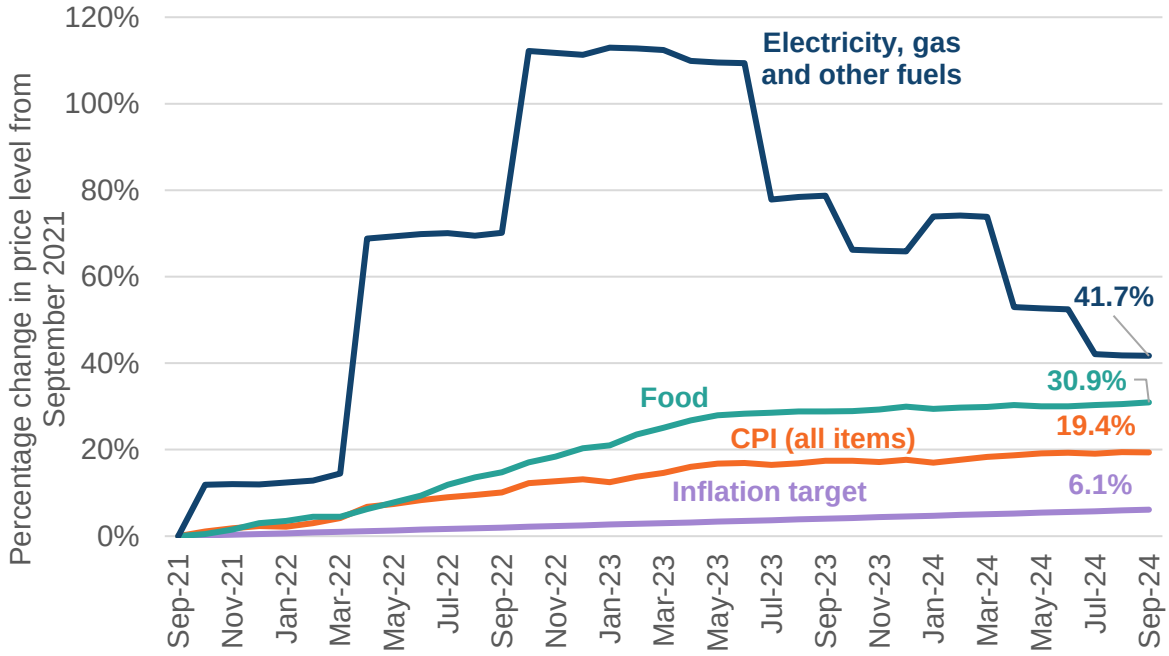
While the official index shows the average price rises for a basket of goods and services that a typical household might consume, people have different expenditure patterns and, therefore, different experiences of inflation. A person who habitually spends more on items that have risen faster in any period may indeed feel their personal inflation rate is greater than the official index shows.

Whilst the rate of inflation has reduced, the prices of most key consumer goods and service types are substantially higher than they were a few years ago. Compared to three years ago, food prices in September 2024 were 30.9% higher and energy

[39] See Chart 2.16 from OBR (March 2024) Economic and fiscal outlook – March 2024
[40] For example, see the speech by the Bank of England's Chief Economist (October 2024) Given at the Institute of Chartered Accountants for England and Wales annual conference 'Building an Economy Fit for the Future', London

prices (electricity, gas and other fuels) up 41.7% having been as high as 113% in January 2023, over double the level in September 2021. To aid comparison, the overall CPI is also shown. This shows that the overall basket of goods and services has increased by 19.4% between September 2021 and September 2024. If prices had grown by the inflation target (2% per year), prices would have been on average around 6% higher over the three years. Therefore, overall prices have grown over three times higher than the target rate or 13.3 percentage points more. However, the price level for certain goods and services, such as food and fuel, are still higher than the overall price level and much more so than if it had grown in line with the target inflation rate.

Figure 20: Percentage change in price levels of by selected consumer goods and service groups, September 2021 to September 2024



Source: *ONS*

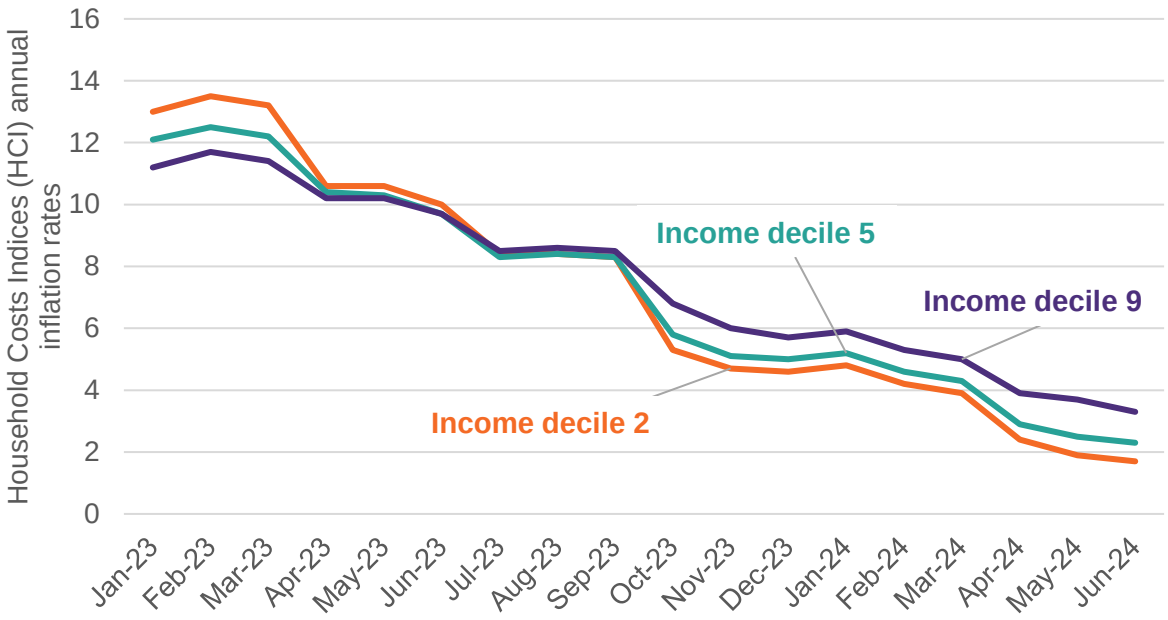
Whilst there is no inflation data for Wales, it is highly likely to be the around the same as the UK rate. Analysis by different types of households suggests Wales, or at least certain households in Wales, may have faced relatively higher levels of inflation. This can be informed by Household Cost Indices.

In addition to what is happening to inflation, the ONS' Household Costs Indices (HCIs) are informative to show how the prices of goods and services consumed by different household types in the UK have changed over time, including changes in mortgage interest rates, which are not included in measures of inflation.[41] The ONS's HCIs show that inflation for lower-income families has fallen sharply over the past year (**Figure 21**). Unlike during the peak of inflation (during late 2022 to early 2023), higher-income families are now facing higher inflation. This is because, while both

[41] See ONS (2024) Household Costs Indices for UK household groups

high and low income households are now facing lower energy bills, which generally benefits lower income households more, higher income households are now facing higher costs of mortgage repayments due to higher interest rates.

Figure 21: Household Costs Indices (HCI) annual inflation rates, by income decile, January 2023 to June 2024, UK



Note: *The decile two is used to represent low-income households and decile nine for high-income households. Decile five is in the middle of the income distribution.*
Source: *ONS*

Labour market

The official and most timely source of data describing labour market conditions in Wales for many years has been the Labour Force Survey (LFS). The Wales estimates have always had a degree of volatility due to a relatively small sample size. However, that volatility has recently become markedly more pronounced as response rates have dropped so much that it has resulted in a reduction in the robustness and reliability of the data for Wales and the UK. Consequently, Welsh Government analysts recommend that consideration should be given to the trends exhibited by other labour market data sources to understand recent labour market trends and conditions. These other sources include the Annual Population Survey (APS), HMRC's Pay As You Earn (PAYE) Real Time Information (RTI) and the Claimant Count which is the number of people claiming unemployment-related benefits (Jobseeker's Allowance or those receiving Universal Credit, for unemployment reasons). Taking these data together provides a more well-rounded picture of how the labour market in Wales has been evolving. In the meantime, ONS are seeking to improve UK labour market statistics through their upcoming Transformed Labour Force Survey (TLFS).[42]

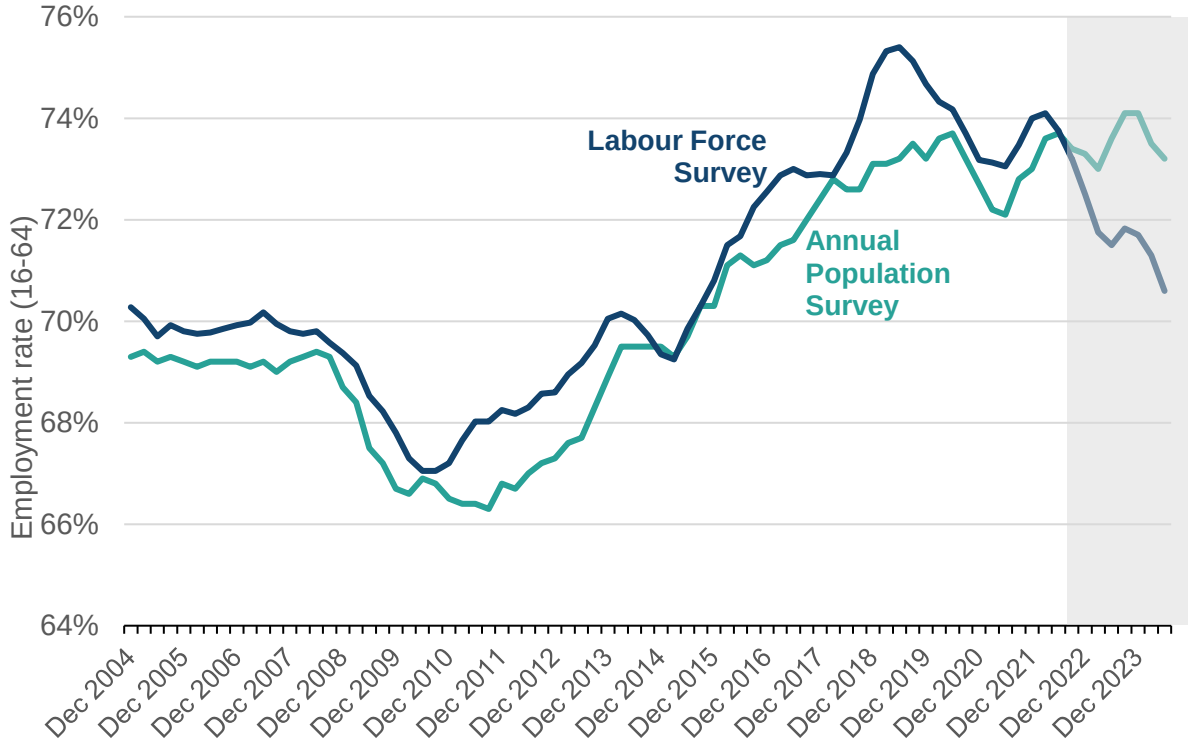
Employment

Figure 22 shows LFS employment data for and APS data over comparable periods. The APS shows a higher and more stable employment rate in Wales than the LFS during 2024, maintaining an employment rate which is relatively high compared to the rates over the last 20 years for Wales. The APS also currently reports a gap of around two percentage points to the UK employment rate, which likely is a more reliable gap than the approximate five point gap reported in the LFS due to the APS' relatively larger sample size and therefore lower volatility.

The data in this relates to the following wellbeing national indicator: (21) percentage of people in employment. More information on the indicators, along with narratives for each of the wellbeing goals and associated technical information is available in the Wellbeing of Wales report.

[42] For further information see the 'developments in economic data' section of this report.

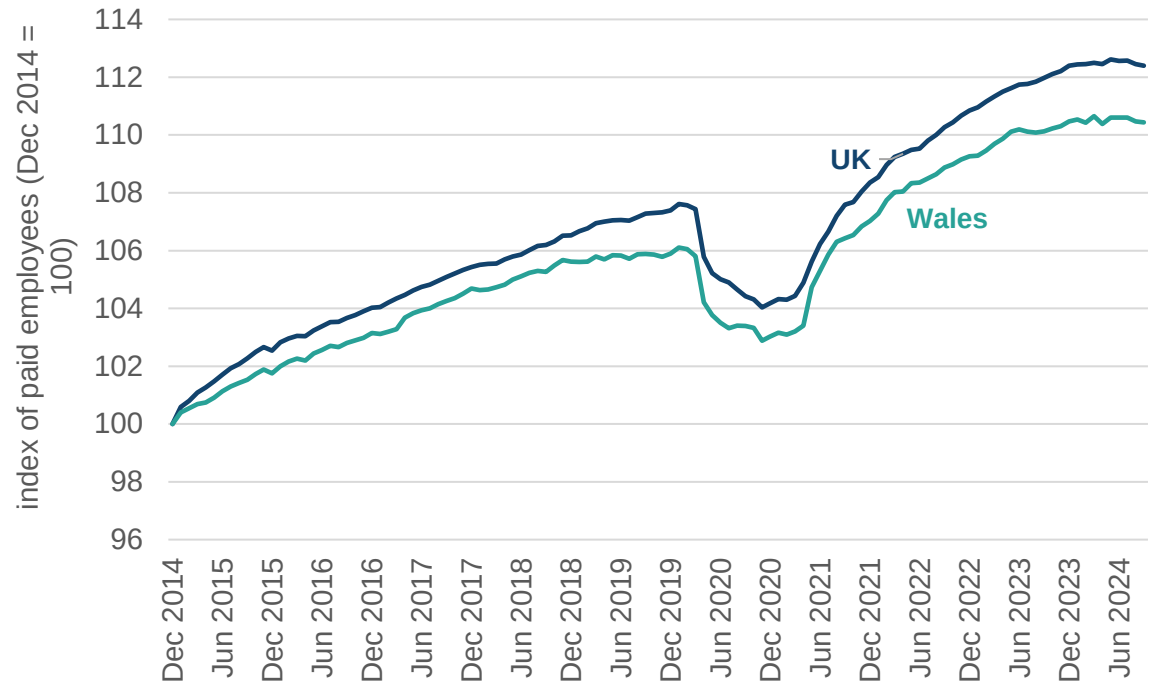
Figure 22: Percentage of 16- to 64-year-olds in Wales who are in employment, year ending December 2004 to year ending June 2024



Note: *Data is for the 12-month period ending in the month shown. LFS data presented is a rolling 12-month period so it is on a consistent basis as the APS data. The grey area represents the period for the LFS when it has been re-weighted.*
Source: *ONS*

One way to avoid the current issues with low response rates to surveys is to use administrative sources of data. **Figure 23** shows that the trend in the number of paid employees (excludes self-employed) from PAYE data in Wales and the UK has been highly synchronised. The most recent periods also show a flattering curve, which suggests a cooling in the labour market across the UK, as the number of employees grows more slowly than in previous periods.

Figure 23: Index of paid employees, 2014 to 2024



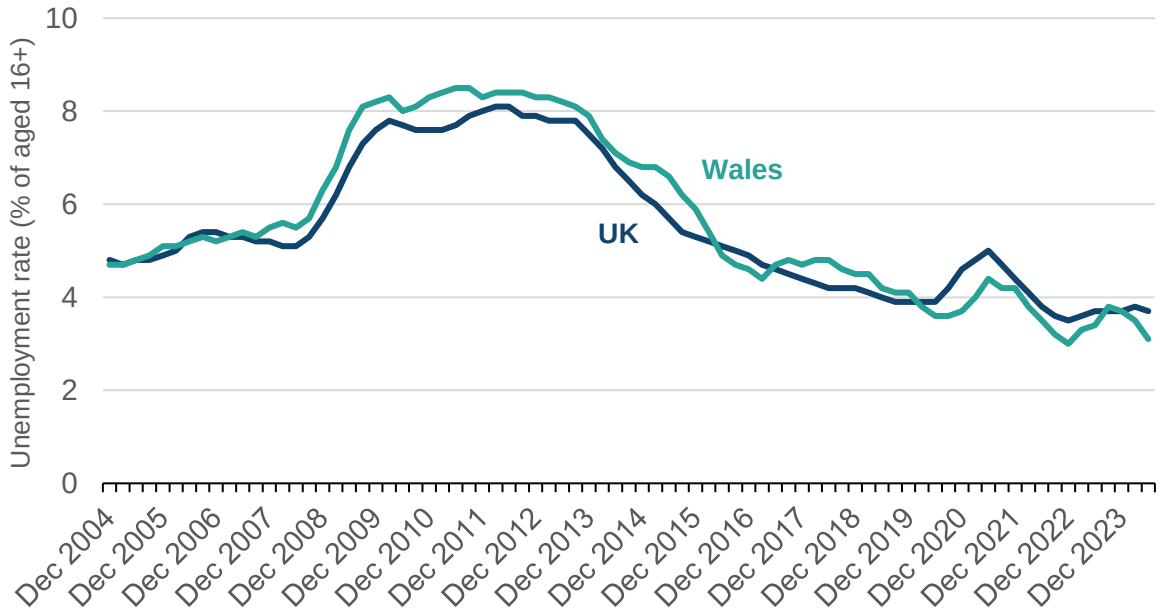
Source: ONS

The main conclusion to be drawn from various employment data sources is that the labour market across the UK lost momentum over the course of 2024. To some extent, this is not surprising given the rapid increase in employment following the pandemic. PAYE data suggest that the loss of momentum in the labour market was perhaps more pronounced in the private sector where employee numbers were actually declining in the second half of the year. In contrast, the number of public sector employees continued to increase.

Unemployment

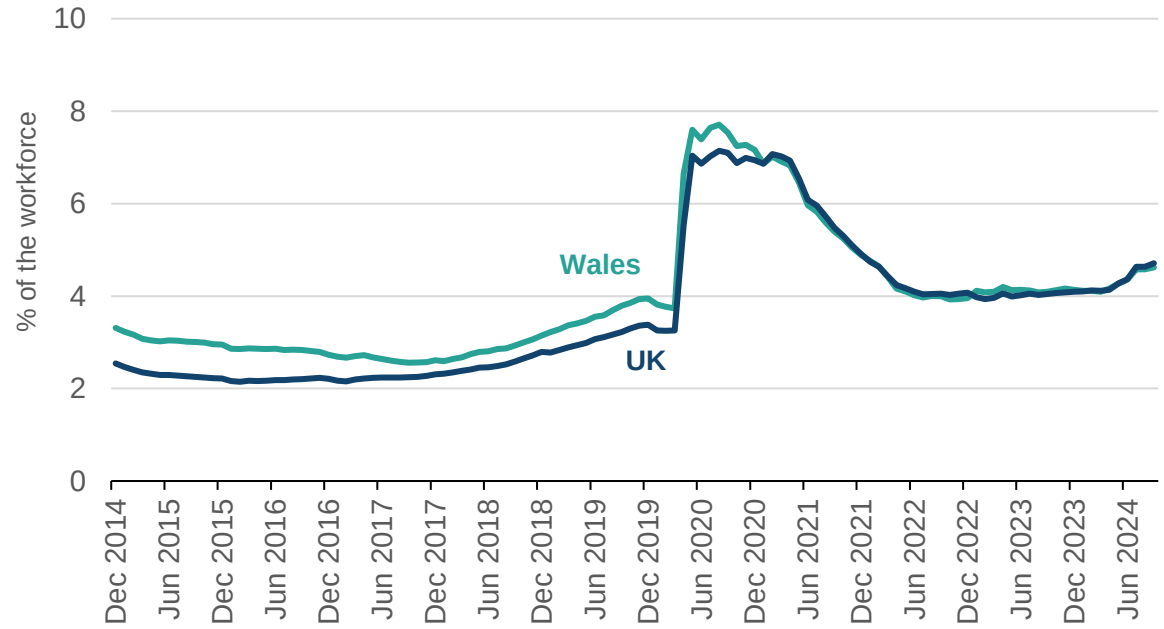
The unemployment rate in Wales, as shown by the APS, has tended to track the UK, albeit being slightly above, for around the last 20 years, as shown in **Figure 24**. In more recent periods, the unemployment rate in Wales has been slightly below the UK rate. The proportion of the workforce claiming benefits tracks very closely between Wales and the UK, again likely reflecting that the rate of unemployment is essentially the same in both countries (see **Figure 25**).

Figure 24: Unemployment rate aged 16+, December 2004 to June 2024



Note: *Data is for the 12-month period ending in the month shown.*
Source: *APS, ONS*

Figure 25: Claimant count rate as percentage of workforce, December 2014 June to 2024



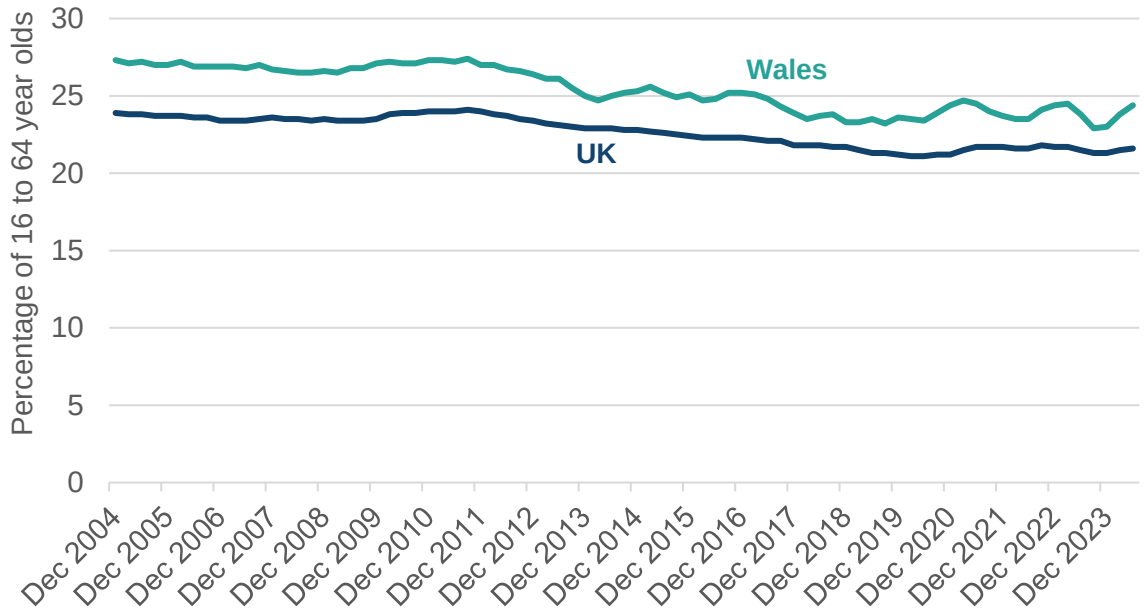
Source: *ONS*

As the unemployment position is very similar in Wales and the UK, it follows that the differences in employment rates will be being driven by relatively higher rates of economic inactivity in Wales – this is explored further below.

Economic Inactivity

The proportion of working-age people in Wales who are neither in work nor looking for work is called the economic inactivity rate.[43] In Wales, the inactivity rate declined steadily through the 2010s, as shown in **Figure 26**. This is part of a convergence of labour market performance in Wales and the UK shown across a range of measures.

Figure 26: Percentage of 16 to 64 year olds in Wales and the UK who are economically inactive, 2004-2024



Note: *Data is for the 12-month period ending in the month shown.*
Source: *APS (ONS)*

However, this decline in the economic inactivity rate stopped and has partially reversed since the start of COVID-19. Rising economic inactivity occurred across all G7 countries[44] after lockdown restrictions were introduced. However, this has largely reversed in all countries except the UK. This is despite a period in the UK of the labour market being relatively is very tight, with relatively low unemployment and high job vacancies.

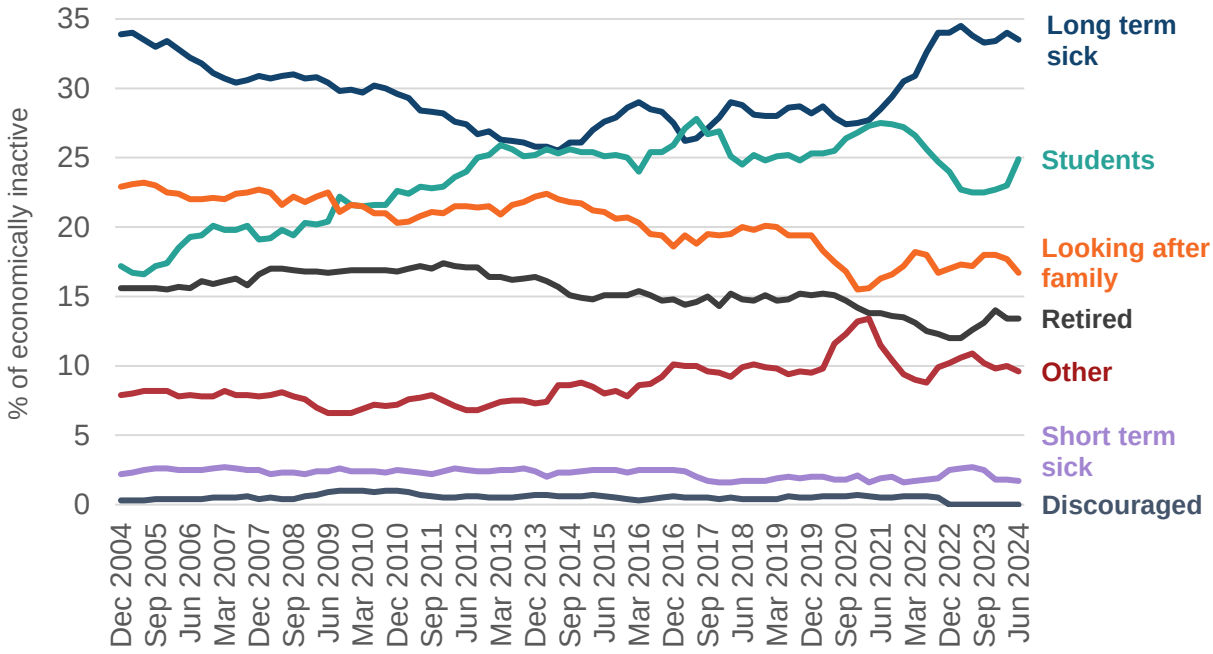
The latest ONS' APS data, covering the period from July 2023 to Jun 2024, show there were around 470,000 economically inactive people aged between 16 and 64 years in Wales; around 20,000 higher than before the onset of the pandemic.[45]

[43] For the purposes of economic statistics, economically inactive people are those who are neither employed nor unemployed; they're not in paid work, but they're also not looking for a job or available to start work.
[44] Canada, France, Germany, Italy, Japan, the United Kingdom and the United States.
[45] There are two data sources used to produce estimates of economic inactivity for the UK - the Labour Force Survey (LFS) and the Annual Population Survey (APS). The LFS is published monthly for the UK countries and English regions and contains quarterly estimates. The APS is published quarterly for the UK countries, English regions and areas within Wales and contains annual estimates. The APS figures are quoted here. These estimates were previously classed as national statistics. The Annual Population Survey (APS) has seen a fall in sample sizes over recent years, given this and the

Wales' economic inactivity rate of 24.4% is not unlike other, more similar areas of the UK, including Scotland, Northern Ireland and the northern regions of England.

People can be economically inactive for several reasons. **Figure 27** shows that long-term sickness has largely been the leading cause of economic inactivity in Wales since comparable records began in 2004. Long-term sickness is also the main cause of economic inactivity in the other parts of the UK noted above.

Figure 27: Primary reason for economic inactivity amongst 16- to 64-year-olds in Wales, 2004-2024



Note: *Data is for the 12-month period ending in the month shown.*
Source: *APS, ONS*

The pre-COVID-19 decline in economic inactivity and share of it driven by long-term illness is partly the result of a cohort of individuals leaving the 16- to 64-year-old group. This is perhaps a legacy of the higher concentration of heavy industries in Wales compared to many other parts of the UK.

Since the COVID-19 pandemic, other potential issues such as mental health, long COVID, and other chronic conditions may have led to a partial reversal of the decline in the economic inactivity rate in Wales and the UK. There is also evidence to suggest a decline in the overall health of the UK population. The most recent estimates of life expectancy in the UK show that improvements in life expectancy at birth have slowed over the past decade. Other ONS measures of national wellbeing suggest a decline in self-reported assessments of health.

fact that the survey has not been reweighted to latest population estimates, the Office for Statistics Regulation (OSR) has agreed that this accreditation should be suspended and that the estimates should be re-designated as official statistics (OSR).

Elevated rates of economic inactivity can have several significant impacts. Economic inactivity, particularly among working-age individuals, reduces the workforce, hindering economic growth and productivity, and contributing to lower economic output per person compared to the rest of the UK. It is also found to negatively impact wellbeing, especially when individuals move from employment to inactivity due to ill-health, with the reverse improving wellbeing.[46] Fiscal implications include fewer people earning and paying taxes, placing pressure on public finances. Additionally, reduced labour supply can drive inflationary pressures as businesses raise wages to attract workers, leading to higher prices. Economic inactivity is more prevalent among specific groups, such as young people, older adults, those with disabilities, and individuals with lower educational attainments, affecting the distribution of income, wealth, and opportunities.

Outlook for the labour market

The OBR's forecast for UK employment rate for the 16+ population by 2028 is expected to be 60.0%[47], down from the latest LFS estimate of 60.4% and also down from the March forecast rate of 60.2% (**Figure 28**). Similar to the UK position, the employment rate in Wales will likely be lower in 2028 both compared with 2023 and compared with the OBR's last forecast. Given that changes in employment in Wales closely follow UK changes, this suggests that the number of people in employment in Wales will increase by around 30,000 by 2028, around 1,500 fewer than implied in the March forecast.

The OBR's forecast of the employment rate is expected to decrease due to a range of factors. In part this reflects the latest UK Government policy measures, where higher employer national insurance contributions reduce employment slightly. However, in its March forecast, the OBR also included a reducing employment rate for the 60+ population reflecting demographic factors and health-related economic inactivity (the OBR does not publish a forecast for working age employment). The OBR has not changed its views materially on the prospects for inactivity.

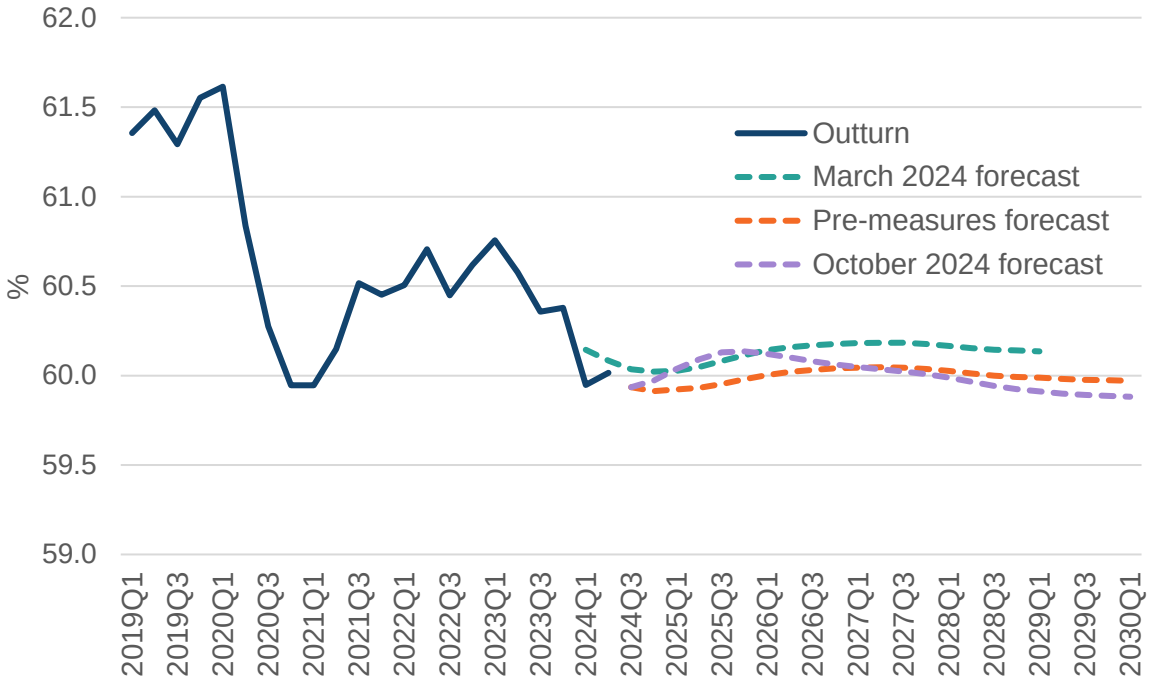
The OBR also forecasts the UK unemployment rate (**Figure 29**). Given the degree to which the UK and Wales unemployment rates are correlated – as shown above, it is highly likely that the two will continue to track each other over the forecast period and Wales will follow the OBR's forecast. In addition, the UK Government measures which affect unemployment will also apply in Wales. The OBR's latest forecast is for the unemployment rate to fall from 4.3% in 2024 to 4.0% in 2026. Measures in the UK Government Budget 2024 are estimated to increase demand and reduce the unemployment rate by 0.3 percentage points. At the UK level this is equivalent to around 90,000 people, on average in 2025 and 2026 or equivalent to around 3,000 to 4,000 people in Wales on average in 2025 and 2026. The unemployment rate is

[46] See G. Bangham (2019). Happy now?: Lessons for economic policy makers from a focus on subjective well-being, Resolution Foundation

[47] Note this is a lower employment rate than that shown in Figure 22, as the OBR forecast those aged 16+, whereas the headline measure and that shown earlier is for those aged 16 to 64.

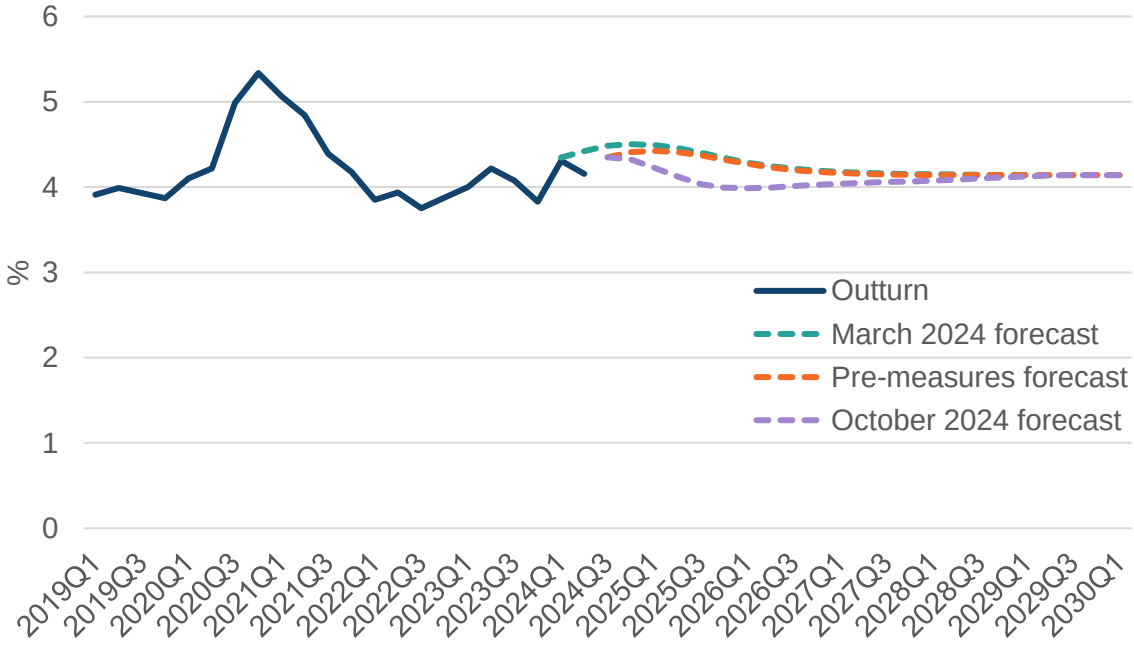
then forecast to return to a long term rate of 4.1% in 2028. This is a lower unemployment rate across most of the five years than forecast in March by the OBR.

Figure 28: Employment Rate for people aged 16 and over years in the UK, 2019-2030



Source: *ONS, OBR*

Figure 29: Unemployment Rate for people aged 16 and over years in the UK, 2019-2030



Source: *ONS, OBR*

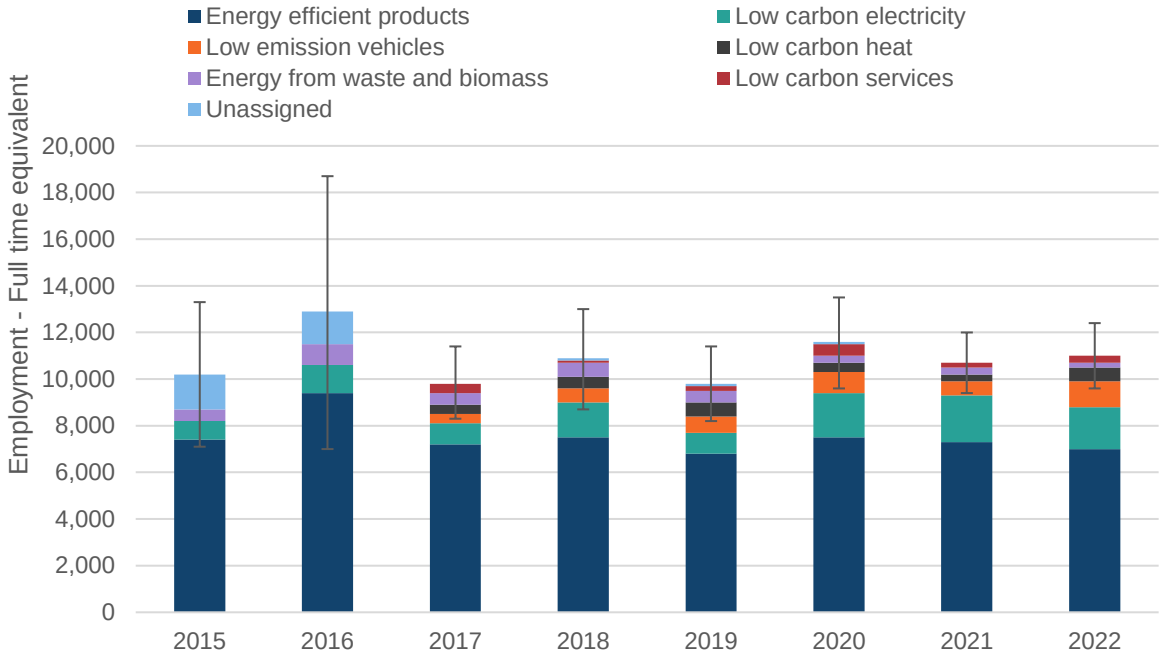
Green jobs

The transition to net zero in Wales is well underway, with Welsh emissions having fallen by around 36% since the base year in 1990. This shift, along with wider economic trends, has focused attention on the importance of 'green jobs' in Wales.

An estimate for the number of green jobs in Wales is provided by the ONS' Low Carbon and Renewable Energy Economy (LCREE) survey data.[48] The ONS estimates that Wales has approximately 11,000 people employed in the LCREE in 2022, see **Figure 30**. For context, this accounts for just under 1% of total Welsh employment, a similar proportion to the UK. This figure has been fairly constant since estimates began in 2015, and Wales has yet to experience a statistically significant increase in LCREE employment since the survey began. Over the same period, turnover for firms operating in the LCREE in Wales has increased, which suggests that recent growth in the low-carbon economy has been largely capital-intensive. The vast majority of jobs in the LCREE in Wales are within the 'energy efficient products' sector (which includes efficient lighting and energy monitoring and saving services), followed by 'low carbon electricity' (which includes including wind and solar energy generation).

[48] More details from ONS (2024) Low carbon and renewable energy economy, UK

Figure 30: Employment in the Low Carbon and Renewable Energy Economy (LCREE) in Wales



Notes: *The figures collected by the ONS are survey-based estimates and gather information from a sample rather than the whole population; confidence intervals are included to account for uncertainty. The 'Unassigned' category reflects that due to insufficient sample sizes and/or data suppression for confidentiality purposes in 2015 and 2016, this portion of employment is unable to be allocated to one of the six groups.*

Source: *LCREE (ONS)*

Green Jobs Definitions

An issue with measuring green jobs is how to define them. There is no single definition, which makes comparisons across different sources and countries challenging.

There are two broad approaches to defining green jobs: narrow and expansive. A narrow approach, as used with the ONS LCREE definition, focuses on jobs directly related to the green economy – for example, those working in the offshore wind sector. A more expansive approach looks to also account for green jobs outside these industries. Some jobs that are currently not green will become green over time; and there are also jobs that, albeit not green themselves, support or underpin green jobs (for instance, jobs found within the supply chain of green-related activity).

With the LCREE data, any jobs situated within the narrowly defined subset of industries are counted as green jobs, whilst those outside their scope are not. However, there will be jobs within LCREE industries that are not green but are counted towards the green jobs figure; and likewise, jobs outside of these industries that are green, but excluded. This categorisation approach means the estimates of

green jobs in LCREE could be an under- or over-estimation, depending on which effect is greater.

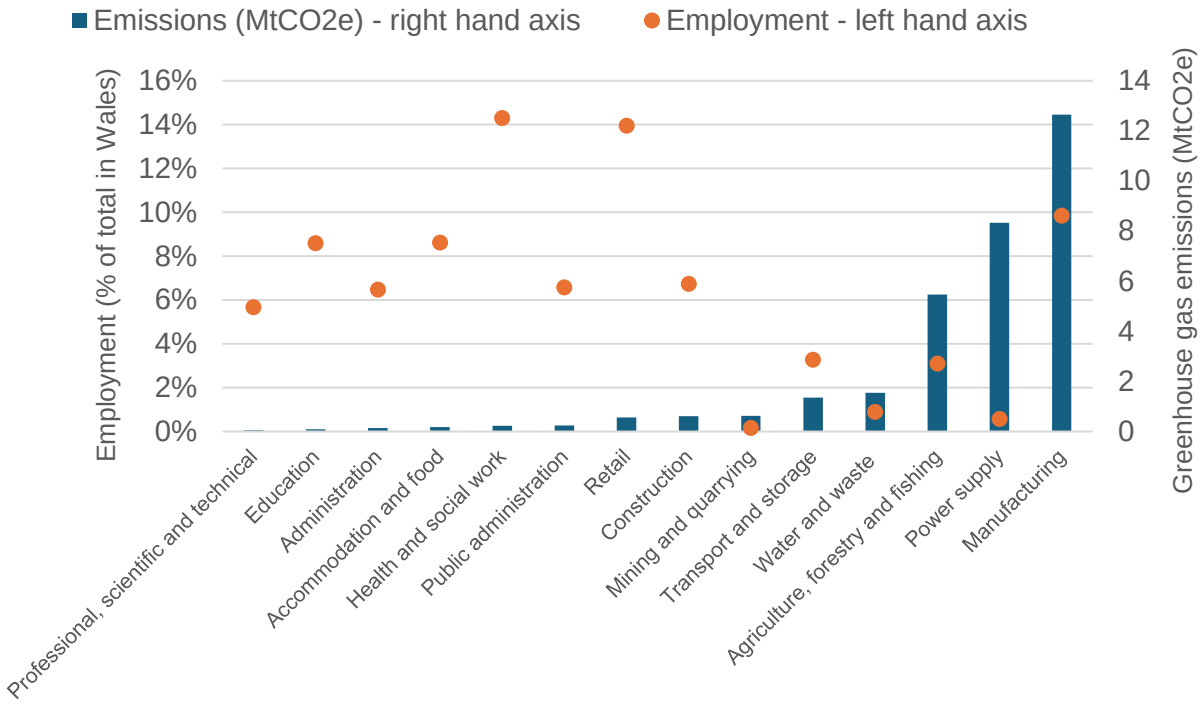
A more expansive approach, counting jobs across industries is conceptually difficult and has more practical challenges than a narrower approach. It is timely and resource-intensive to obtain data on the greenness of jobs across the economy. There is also the concern around whether some jobs are 'green' or not. For example, the ONS have paused regional estimates for their occupation-based experimental green jobs statistics, as further tests implied individuals – given their understanding of what a green job was – may have overestimated the degree to which their jobs were green.

Industry sector emissions and jobs in Wales

An alternative, or complementary, way of looking at the potential implications of reducing greenhouse gas emissions and the potential jobs associated with it are to look at emissions and jobs by industry sector. Jobs within high-emitting sectors[49] account for a relatively small overall share of Welsh employment (roughly 20%), as shown by **Figure 31**. Whilst this may seem like a high proportion, many workers in high-emitting sectors may experience minor or no changes to their work as emissions are reduced, due to the possibility there are only minor shifts required in tasks completed and/or technologies utilised (see section below). A large portion of existing 'green' jobs currently fall within these industries, such as in power supply and manufacturing. The vast majority (over 80%) of the Welsh labour force are in what can be considered 'neutral' jobs – jobs which are neither 'green' (using a narrow definition) nor high-emitting.

[49] High-emitting sectors are defined here as sectors with emissions (on a resident basis) over 1 million tonnes of CO2e in 2019.

Figure 31: Emissions and employment by sector in Wales, 2019



Note: *This chart includes only the top 14 emitting industries, which accounts for 89% of total employment.*

Source: *Welsh Government analysis using Air Emissions and Energy accounts for Wales,[50] and the ONS Business Register Employment Survey (BRES).*

The Welsh economy has a greater proportion of total output and employment in manufacturing and agriculture compared to the UK. As a result, Wales has a higher carbon intensity of employment when compared to the UK average, and the second highest out of the UK countries and English regions.[51]

Implications about the future of green and brown jobs

In the literature, there is a wide range of estimates and views as to how the net zero transition will impact employment in the future. This reflects the uncertainty around the transition and its net impact on jobs.

Analysis by the International Monetary Fund (IMF) suggests the overall size of job shifts due to the net zero transition may be relatively low over time compared to other shifts, for example from industrial to service sectors, or general job churn expected in a market-based economy.[52] Nevertheless, the transition will still need to be well managed, as positive and negative impacts may be distributed unevenly across localities and demographics.

[50] Oliver, D; Solis, E; Miller, N; (2024) Research into the Decarbonisation of industry and business. Welsh Government, GSR report number 16/2024
[51] PwC (accessed 2024) Green Jobs Barometer
[52] IMF (2022) World Economic Outlook, April 2022: War Sets Back The Global Recovery

The CCC (2023) also suggests the majority of UK workers will not see major impacts.[53] It estimates that in the UK, only around a fifth of workers will see the largest impacts from the transition. Within this group, future job impacts can be broadly categorised into three areas:

1. Areas which may experience significant **job growth** as a result of the net zero transition. This may include areas such as land use (particularly afforestation and peat), buildings construction and retrofit, energy supply (especially renewable energy), and the automotive industry (for example installing electric vehicle charging points and battery production). Within this group, the extent of job growth in Wales will depend on building comparative advantage and Wales' ability to capture future opportunities for domestic economic activity, where effective policy will be an important enabler.
2. Areas which may have to **phase down production** as a result of changes in demand due to the net zero transition. It is widely evidenced that this will likely constitute a very small portion of overall jobs (the CCC estimates 0.3% of total jobs fall into this category UK-wide, though this figure may be different in Wales), and any sectors phasing down production will need to be managed carefully.
3. Areas which may have to **redirect** production or processes to adapt to a low-carbon economy. This may include areas such as energy-intensive industries, vehicle maintenance, waste management, agriculture and aviation and shipping.

[53] Available at Climate Change Committee (2023) A Net Zero workforce

Trade

International exports provide an important market for Welsh firms, whilst imports provide inputs to businesses and goods for consumers, typically keeping prices down and increasing consumer choice. Businesses which trade have also been found to achieve higher productivity levels (as noted in the section on productivity earlier in this report).[54]

Historically, goods exports have generally accounted for a higher proportion of GDP for Wales than most other parts of the UK. According to latest data, Welsh goods exports made up 24% of GDP. Higher than other UK counterparts, Scotland and Northern Ireland, where exports made up 19% and 16% respectively. This implies Wales may be more exposed to economic shocks from changes in trading relationships than elsewhere in the UK.

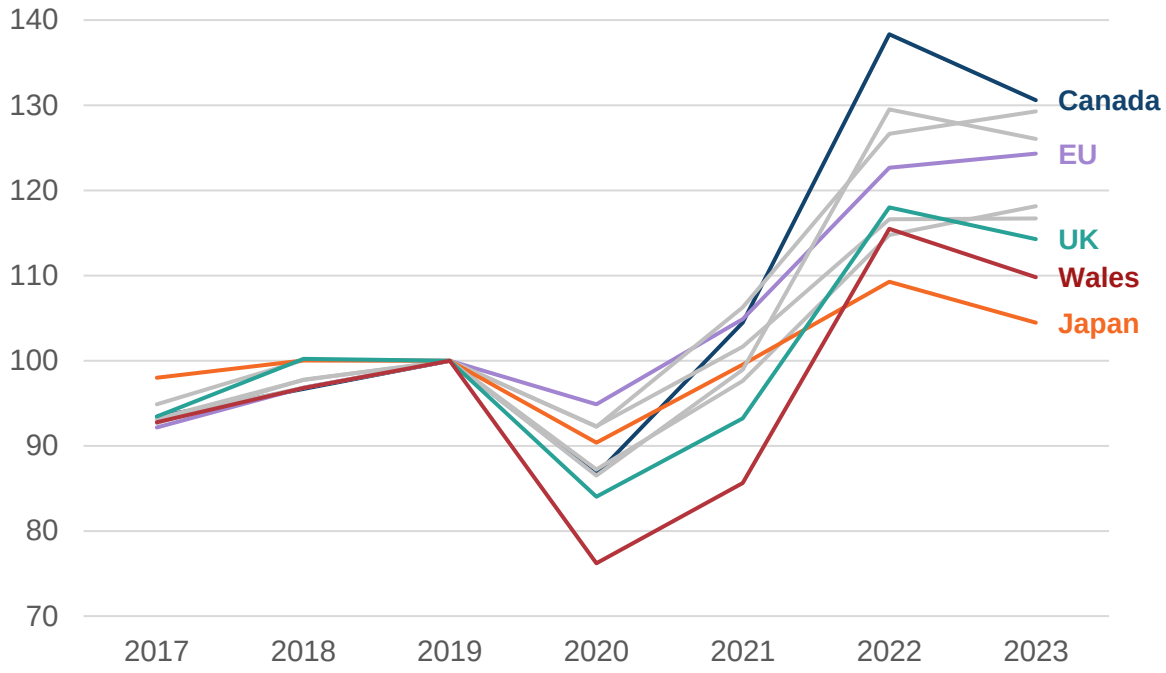
Despite recent years proving to be challenging for global trade, and even more so for the UK, the Organisation for Economic Co-operation and Development (OECD), IMF and World Trade Organisation (WTO) forecast a sharp rebound in global trade in 2024. In particular, the WTO's global trade outlook forecasts world merchandise trade volumes to grow by 2.6% in 2024 and 3.3% in 2025.

The OBR's latest forecasts (October 2024) show they continue to expect that leaving the EU will reduce the UK's trade intensity (exports plus imports as a share of GDP) by 15% in the long term. The OBR noted that at the end of 2023, UK goods trade was around 10% below 2019 levels.[55] Meanwhile, a different story can be seen for UK services, with services trade growth being the strongest in the G7, at just over 12% above 2019 levels.

Figure 32 shows total goods exports performance of Wales and the UK against other G7 countries over time. Following a relatively slow recovery to pre-pandemic levels Welsh goods exports went on to peak in 2022 before falling again in 2023. Latest data shows that in 2023, Welsh exports fell by -4.9%, the second highest fall apart from Canada. This was largely due to a fall in the value of petroleum exports driven by deflationary pressures on oil prices.

[54] See for example LSE's Trade Policy Hub (2023) The relationship between trade and productivity
[55] See OBR (March 2024) Economic and fiscal outlook – March 2024

Figure 32: Wales, EU and G7 countries total goods exports, 2017-2023 (2019=100)



Source: *UN Comtrade and HMRC Regional Trade in Goods Statistics (RTS)*

The strong recovery from the pandemic shown in **Figure 32** is likely to have been impacted by price volatility across a broad range of products, with inflationary pressures driving up prices in 2022. As a key export market for Wales, the petroleum sector was particularly affected; however, the latest data shows this impact is now unwinding as global oil prices have been declining. Over the latest four quarters, the value of Welsh exports of petroleum has been falling at a faster rate than the volume of exports contributing towards a deflationary impact on trade figures.

Wales continues to be deeply embedded in the UK economy, latest data from the Trade Survey for Wales found that around a third of sales from Welsh businesses went to the rest of the UK, compared to 17% which went to international destinations. Whilst 42% of all business' purchases came from the rest of UK, highlighting the importance of intra-UK trade for Welsh businesses.

The EU also continues to be a key market for Wales with the latest data showing that 58.6% of total good exports are destined for the EU, compared to 50.3% for the UK. Wales was therefore more dependent on the EU for goods exports than the UK as a whole. However, this importance has decreased slightly over recent years from 60.8% in year ending June 2019, a likely consequence of the change in trading terms with the EU.

Developments in economic data

Welsh Input-Output Tables

Analysts at Welsh Government have been developing Input-Output Tables (IOTs) for Wales covering the year 2019, that are due for publication soon. These tables will be similar to those published by Scotland and Northern Ireland.

Input-Output Tables show the buying and selling relationships over a year between all parts of an economy. For example, businesses, households, the Government, non-profit institutions etc. They will enable analysis of the impacts of policies and interventions that affect demand in particular industries on the Welsh economy and how they could affect things like supply chains, employment and household spending.

We are interested in feedback on how you use the IOTs, as well as any future developments you would like to see.

Transformed Labour Force Survey (TLFS)

The current labour market statistics are classified by ONS as 'official statistics in development'. The ONS are continuing their work to improve their labour market estimates, with a more robust data source expected to be provided through its Transformed Labour Force Survey. For more information on the TLFS see Transformed Labour Force Survey – user guidance - Office for National Statistics (ons.gov.uk). A further update by the ONS on the Transformed Labour Force Survey is expected in early 2025.

Areas of priority for future research and analysis

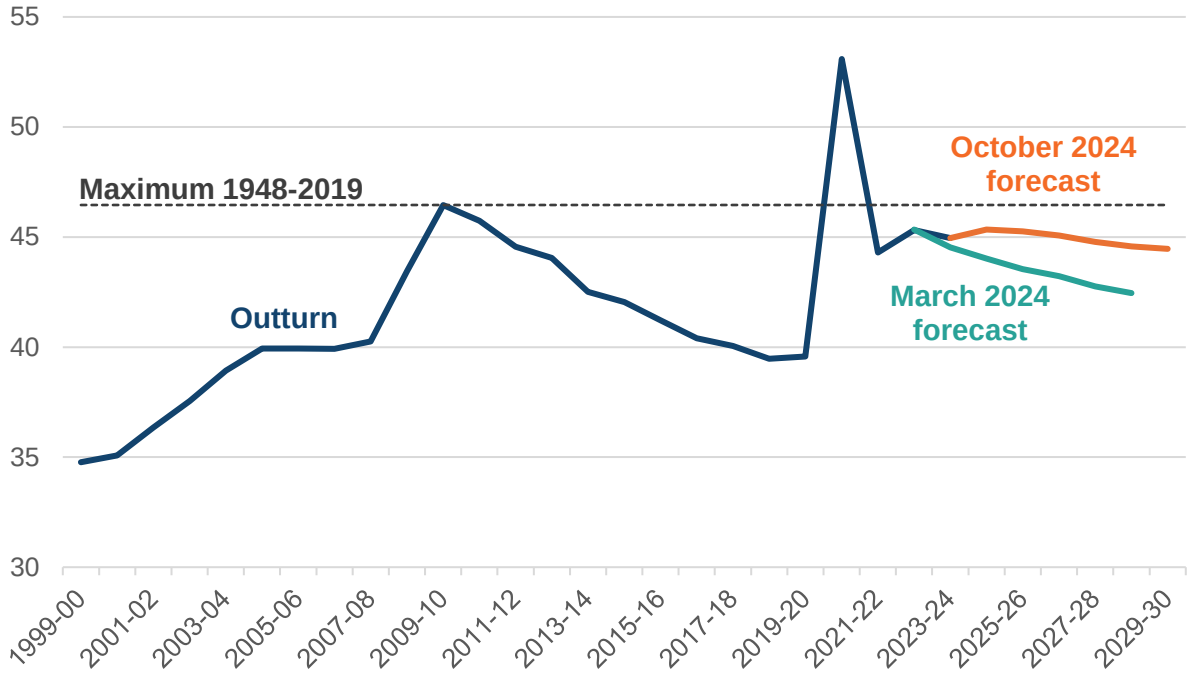
The Welsh Government welcomes opportunities to collaborate with researchers on any of the topics raised in this report and on economic issues relevant to the Welsh Government more generally. For further information please contact: Economic.Research@gov.wales

Fiscal prospects

The OBR forecasts UK spending as a share of UK GDP to rise from 44.9% last year to 45.3% this year (**Figure 33**). It then falls slightly to 44.5% in 2029-30. This is 4.9 percentage points higher than pre-pandemic. Spending increases as a percentage of GDP this year and next are partly driven by substantial additions to departmental spending. Decreases in spending as a share of GDP over the remainder of the OBR's forecast is then partly from departmental spending growing more slowly than the UK economy.

Increases to UK government spending in the 2024 Budget are financed by increases to borrowing and taxation. These are summarised in the next two sections.

Figure 33: UK public spending as a share of UK GDP, 1999-2030



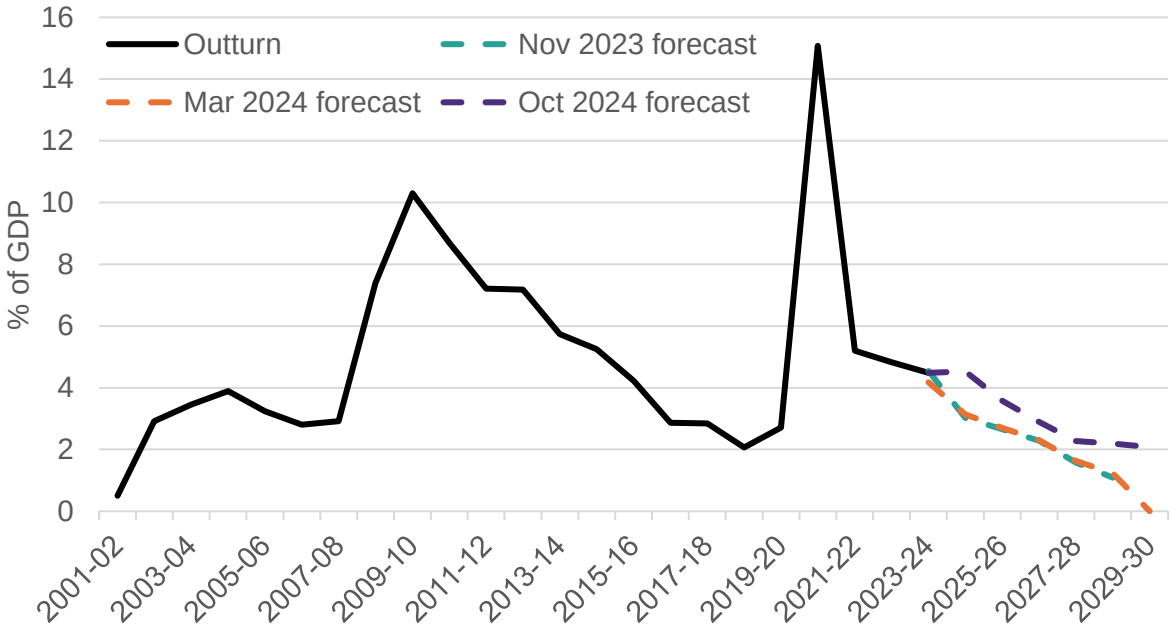
Source: *OBR*

Borrowing

UK public sector net borrowing is forecast by the OBR to maintain its level as a share of GDP (around 4.5%) into next year (but rise in cash terms) before falling steadily to 2.1% of GDP in 2029-30, see **Figure 34**. Overall, borrowing is 0.9% of GDP a year higher on average over the forecast compared to the March forecast, which was also similar to the November 2023 forecast. The main reason for the increase in borrowing over the medium term is due to the UK Government's Budget 2024 policy changes. The policy measures increase borrowing by around 1% of GDP a year on average from 2025-26 to 2029-30.

Overall, compared to the OBR's previous forecasts in November 2023 and March 2024, borrowing is forecast to decline less quickly over the forecast period. The decline in borrowing is mainly driven by taxes rising as a share of GDP, rather than by spending falling as a share of GDP as in the previous forecasts. In part the UK Government has been able to increase its borrowing to finance additional spending through changes to its fiscal rules (see box for details).

Figure 34: Public Sector Net Borrowing, outturn and forecasts (per cent of GDP)



Source: *OBR*

The UK Government's new fiscal rules

The Chancellor confirmed plans to update the Charter for Budget Responsibility to reflect the UK Government's new fiscal targets. The new rules are as follows:

1. A '**fiscal mandate**' that requires the current budget to be in surplus in 2029-30, until 2029-30 becomes the third year of the forecast period. From that point, the current budget must then remain in balance or in surplus from the third year of the rolling forecast period, where balance is defined as a range: in surplus, or in a deficit of no more than 0.5% of GDP. If the range is used between fiscal events, the current budget must return to surplus from the third year at the following fiscal event.

2. A **supplementary target** to have debt, defined as public sector net financial liabilities (PSNFL), falling as a share of the economy in 2029-30, until 2029-30 becomes the third year of the forecast period. Debt should then fall from the third year of the rolling forecast period.

3. A **supplementary target** to ensure that expenditure on welfare (excluding the state pension and payments closely linked to the economic cycle) is contained within a predetermined cap and margin in 2029-30.

The new fiscal mandate means that day-to-day spending on public services will be matched by revenues. Currently, day-to-day spending outstrips revenues and the OBR expects that to remain the case for the next two years. By 2027-28 the gap is forecast to be eliminated. In other words, the current budget is expected to be in balance two years in advance of the mandate's requirement. To close the gap, the Chancellor will increase the tax take in the economy.

The supplementary debt target is a departure from the previous mandate in that the debt measure being targeted nets off financial assets such as student loans. It is a broader measure of the government's balance sheet than that used by the last UK Government. The new target has enabled the Chancellor to fund an increase in investment spending that would not have been possible had the target measure remained unchanged, and, at the same time meet the requirement that debt, in the OBR's judgement, is more likely than not to be falling as a share of income in five years time. Many independent experts have previously indicated support for the new arrangement.

Debt

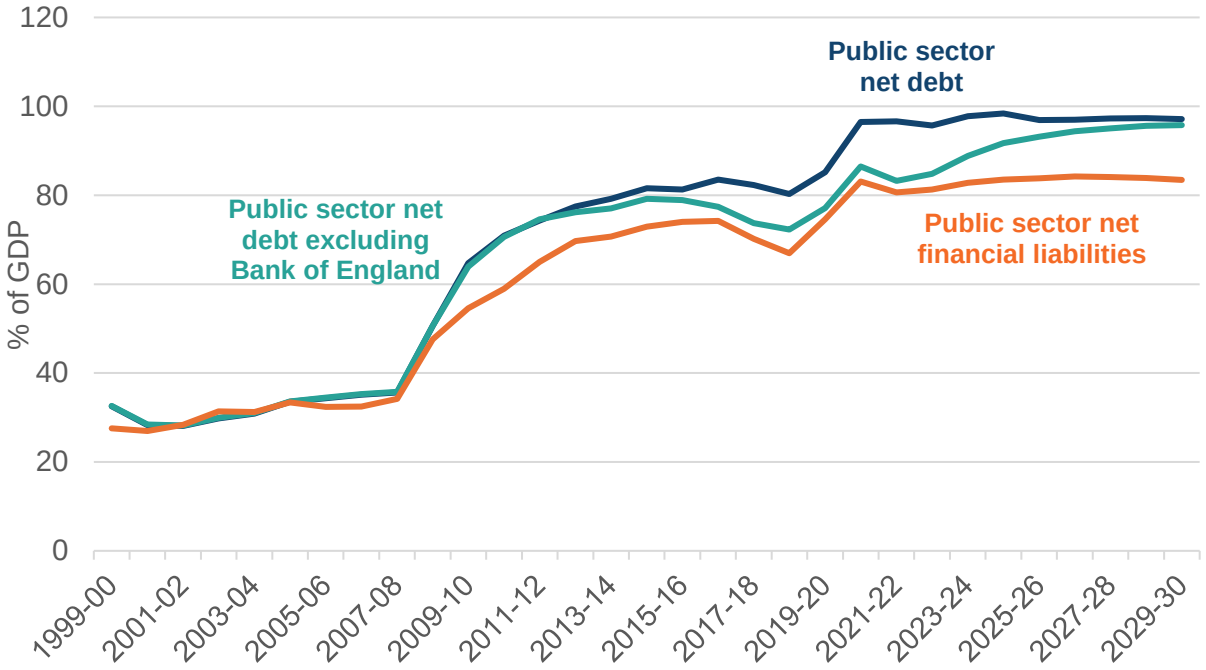
UK Government borrowing means that that the stock of debt is being added to in cash terms. The OBR forecast net debt falls as a share of GDP from 98.4% this year to 97.1% by the end of the forecast period in 2029-30, see **Figure 35**. Due to the additional borrowing in the UK Government's latest Budget, debt is 3% of GDP higher in 2028-29 than the OBR projected in March.

Debt excluding the Bank of England is forecast to rise as a share of GDP in every year of the forecast, from 91.8% of GDP this year to 95.8% in 2029-30. This would have broken one of the fiscal rules under the previous UK Government.

Public sector net financial liabilities (PSNFL) is a wider measure of the UK's balance sheet as it includes all financial assets (but not physical assets such as hospitals, schools, and infrastructure). PSNFL is forecast by the OBR to increase from 83.5% of GDP this year to 84.2% in 2026-27, to then slowly fall to 83.4% in 2029-30, thereby meeting the UK Government's new fiscal rules.

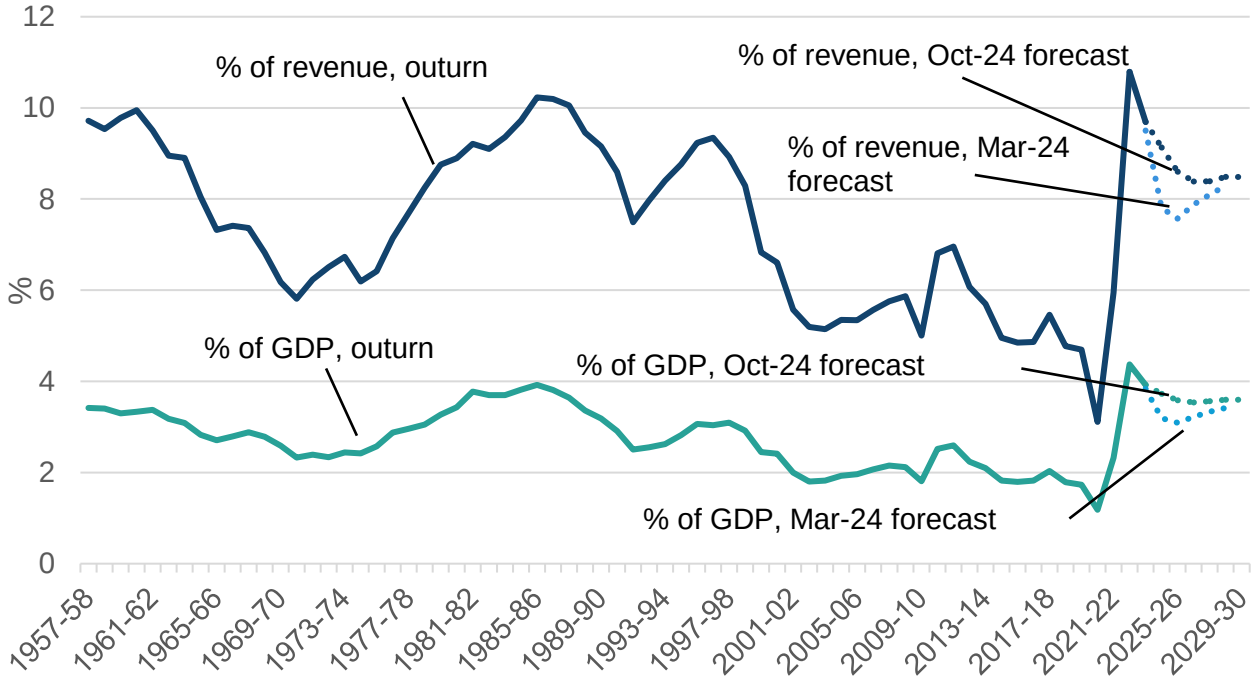
Higher debt levels means that changes to UK debt interest rates have a relatively larger impact to the UK's public finances. OBR reported that UK Government debt interest spending was at a post-war high of 4.4% cent of GDP in 2022-23, see **Figure 36**. It is forecast to decrease to 3.5% of GDP by 2026-27, remaining around that rate to 2029-30. In cash terms, debt interest is £104.9 billion this year but then increases year-on-year to £122.2 billion in 2029-30. This is more than is spent on education in England or around the same as total UK corporation tax revenues.

Figure 35: UK public sector balance sheet measures, 1999-00 to 2029-30



Source: *OBR*

Figure 36: UK Debt interest spending relative to GDP and revenues, 1957-2030



Source: *OBR*

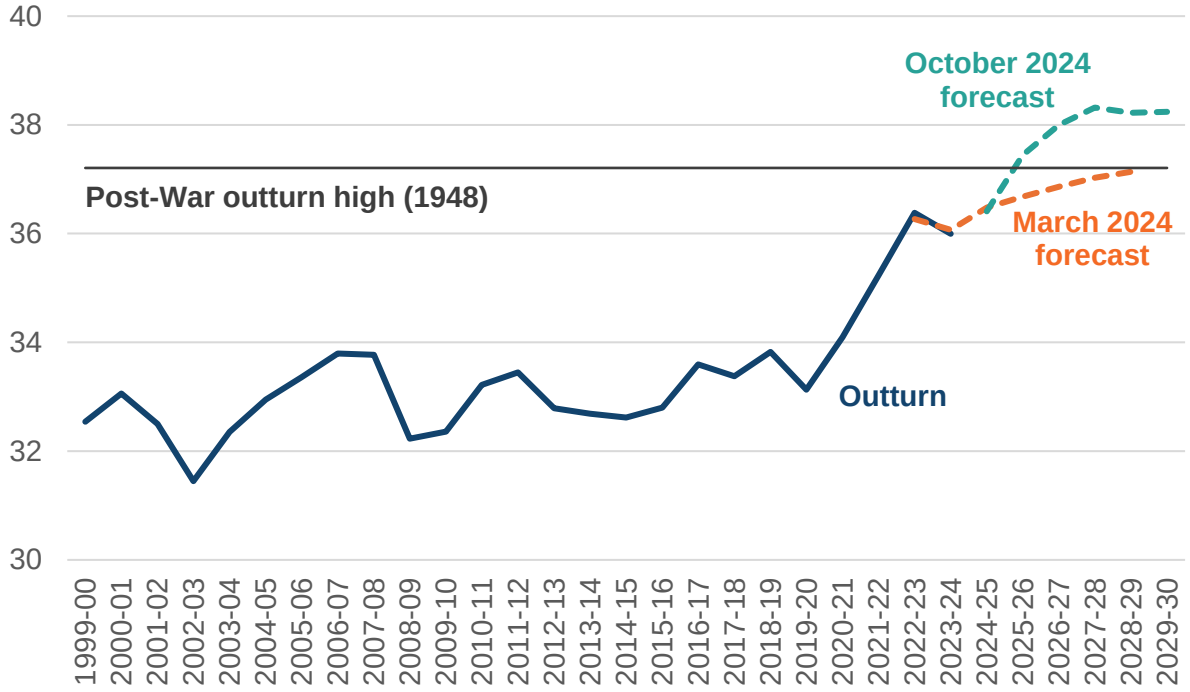
Taxation

Increases to taxation were also used by the UK Government in the 2024 Budget to increase spending. The tax share in the economy is expected to rise from 36.4% this year to 38.2% in 2029-30, up from 32.7% ten years ago, see **Figure 37**. This is also

1.1% of GDP higher in 2028-29 than in the OBR's March forecast. The increase over the forecast period is estimated to come from personal taxes (caused by the mix of rising earnings with frozen National Insurance and income tax allowances and thresholds) rise in employer NICs and capital taxes (caused by rising equity and property prices, as well as UK Government policies in the 2024 Budget).

Whilst UK tax as a share of GDP is high by historical standards, it is around average by international standards accordingly to the OBR, even after the recent measures. The OBR also finds that tax has been rising as a share of GDP across advanced economies in recent years.

Figure 37: Tax as a share of GDP in the UK, 1999-2030



Source: *OBR*

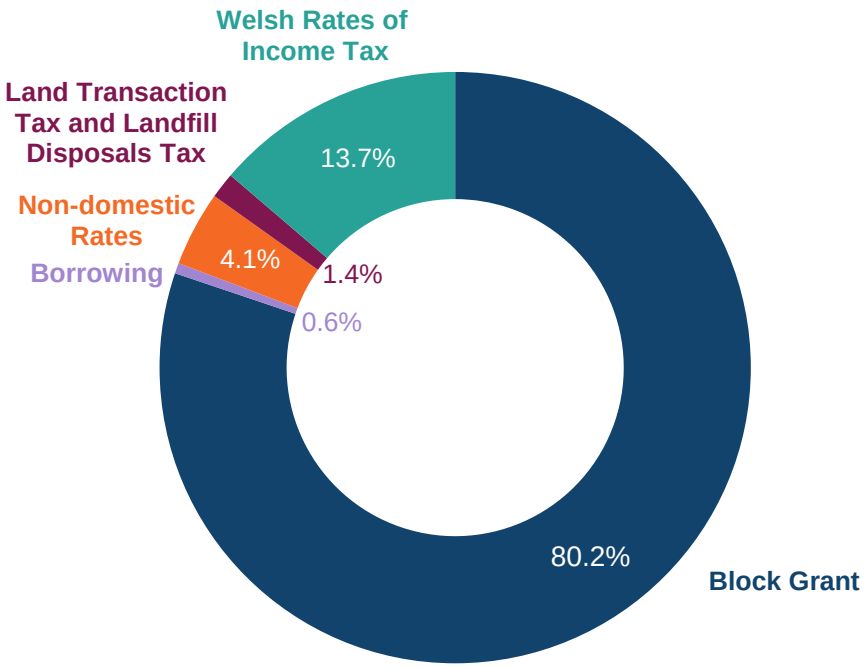
Welsh Government's Settlement and financing

The UK Government's October 2024 Budget provided the Welsh Government with a block grant settlement for 2025-26 for the first time. The UK Budget also included measures which provide additional funding in 2024-25. The overall block grant settlement in 2025-26 is over £1bn higher in 2025-26 than would have been expected, based on growth in UK discretionary public expenditure assumed in the March 2024 UK budget.

As well as the block grant, the size of the Welsh Government budget also depends on revenues from non-domestic rates, the devolved taxes, and the block grant adjustments that accompany those taxes. Overall, the block grant accounts for 80% of the budget in 2025-26 (after deducting the block grant adjustments). The devolved taxes fund 15% with the rest accounted for by non-domestic rates and capital borrowing (**Figure 38**).

A separate distributional analysis showing the impact of Welsh Government resource spending programmes in 2025-26 across the income distribution is published separately alongside the Draft Budget.

Figure 38: Financing of Welsh Government Draft Budget 2025-26



Source: *Welsh Government*

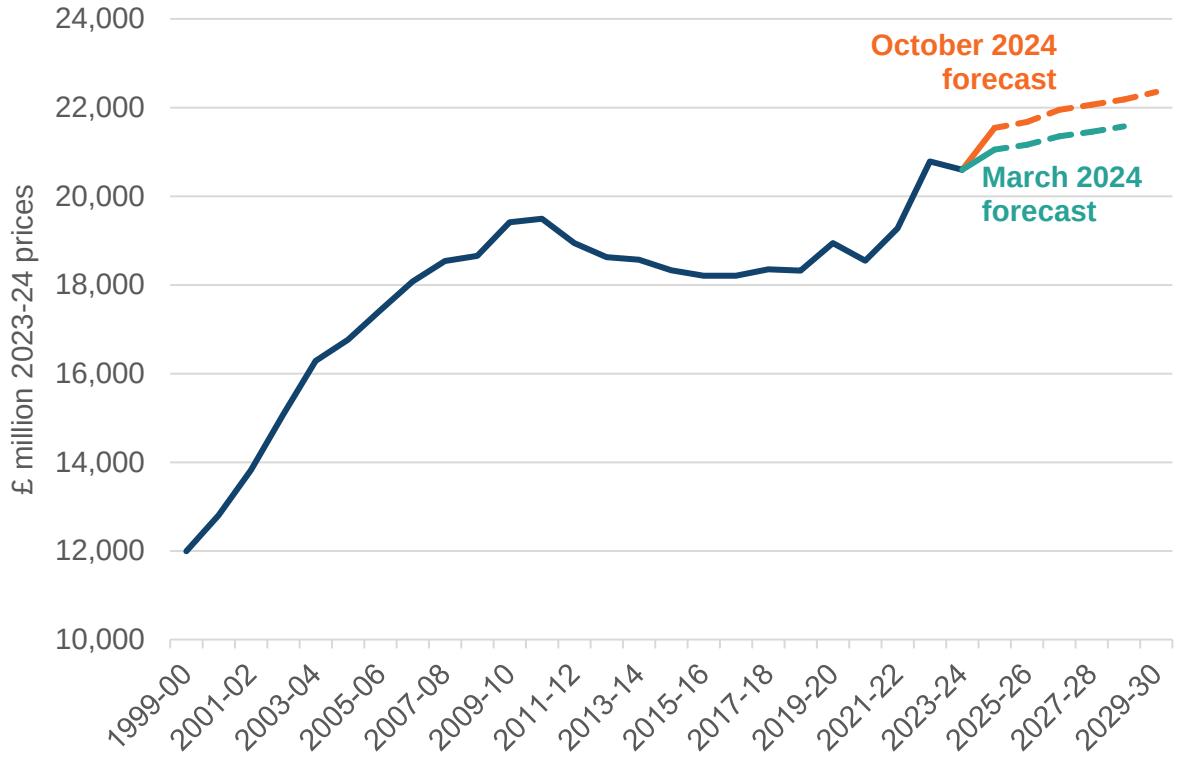
Medium Term Outlook for the Welsh Government's Funding

The resource budget in 2025-26, including all elements listed above, is up 5% in real terms compared to outturn for 2023-24 on a like-for-like basis. Based on OBR tax forecasts and the trajectory for overall discretionary resource expenditure published in the UK October budget, it will increase in future years at a rate of just under 1% a year in real terms. The projected path for the resource budget for years after 2025-26 is similar to that expected previously although, as noted above, it starts from a higher base (**Figure 39**).

The general capital budget in 2025-26 is up 7% in real terms compared to the outturn for 2023-24. The future path for overall UK capital expenditure published in the UK budget suggests that there won't be further big increases after 2025-26. The projected budget shown in **Figure 40** assumes that the Welsh Government continues to use its full annual capital borrowing limit of £150m. However, this would mean the overall £1bn limit would be reached in 2028-29, explaining some of the projected reduction in the budget in 2029-30. Overall, the big increase in 2025-26 keeps the budget projection well above that based on the overall UK capital projections published in the previous UK Government's March 2024 budget.

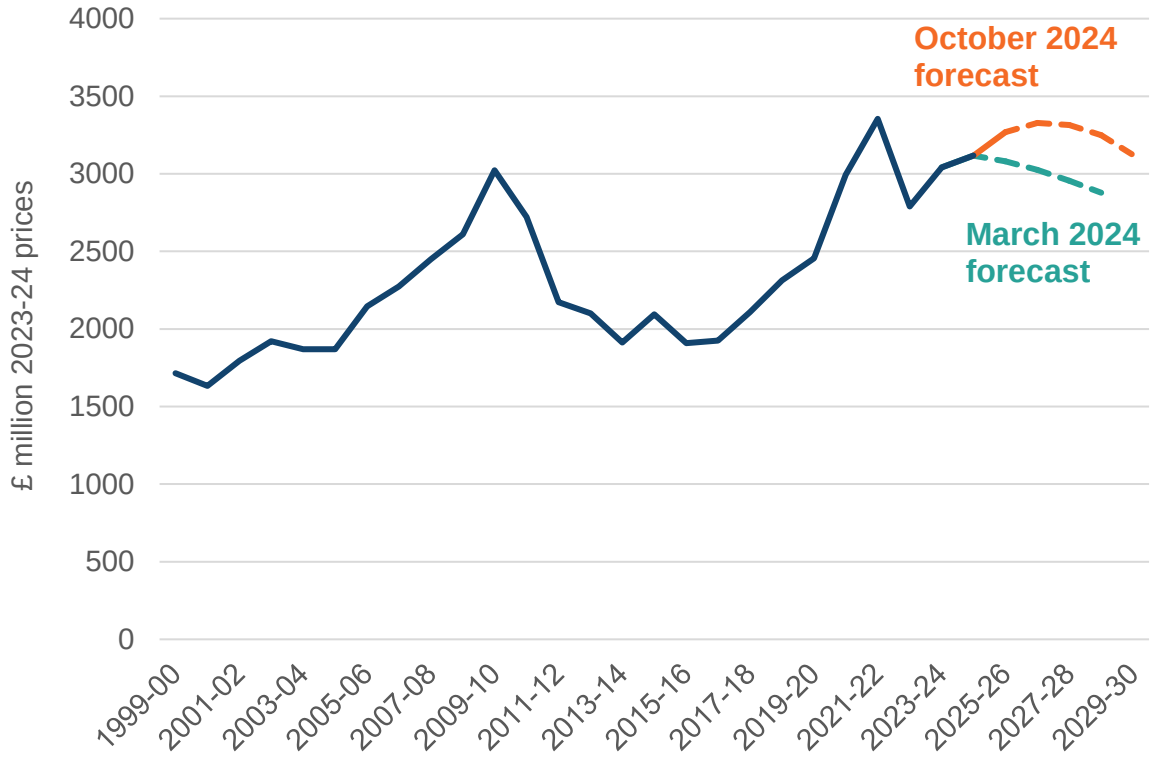
The real terms gaps between the latest projections and those from March 2024 shown in **Figure 39** and **Figure 40** are lower than the cash gaps would be because the forecast for the GDP deflator in 2024-25 and 2025-26 has been revised up since March. The October forecast for the deflator shows growth of 4.8% over the two years 2023-24 to 2025-26, compared to 2.2% over that period in the March forecast.

Figure 39: Welsh Government Resource Budget in real terms



Note: *March 2024 adjusted for 2024-25 Main Estimates. excluding COVID funding in 2020-21 and 2021-22*
Source: *Welsh Government*

Figure 40: Welsh Government Capital Budget in real terms



Note: *March 2024 adjusted for 2024-25 Main Estimates*
Source: *Welsh Government*

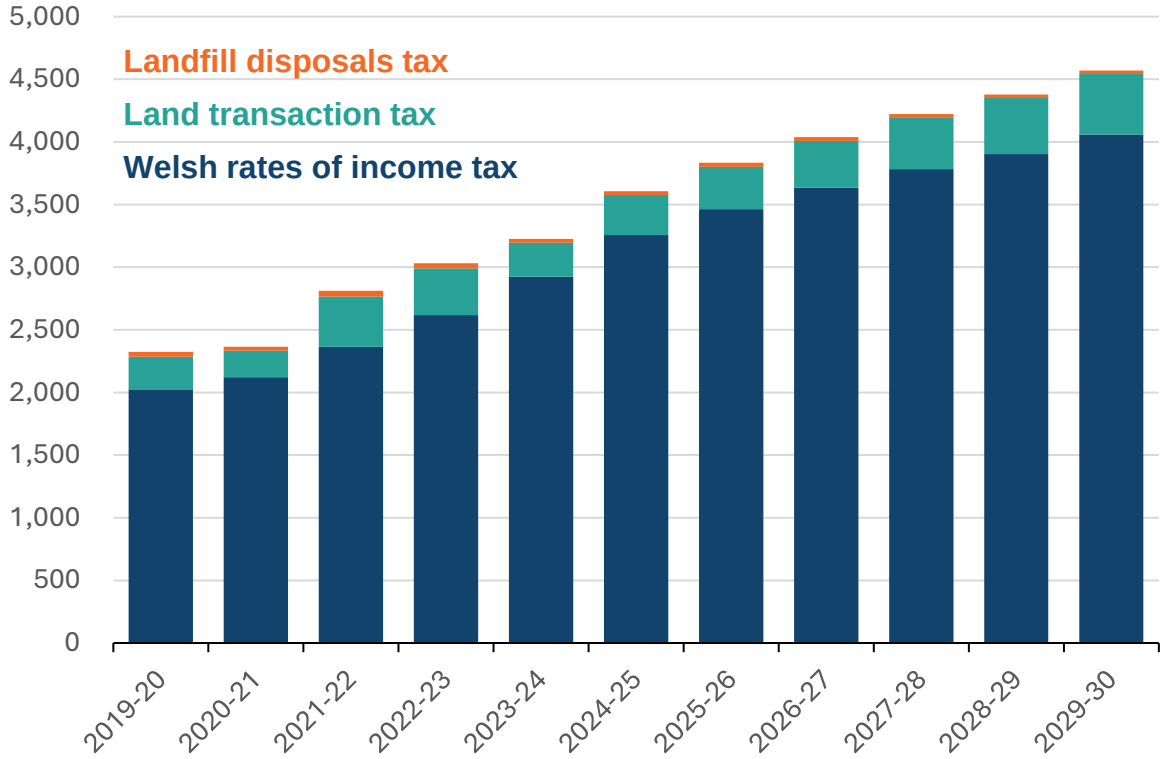
Devolved taxes

The projected resource budget figures above include the forecast net impact of the devolved tax revenues. This section provides more detail on those forecasts.

The OBR's October Economic and Fiscal Outlook included new forecasts for the devolved taxes and for the equivalent UK taxes which are used to derive the associated block grant adjustments. An updated revenue forecast for landfill disposals tax and further detail on the other forecasts is included in the OBR's Welsh Taxes Outlook published alongside the Welsh Government's draft budget.

The latest forecasts show strong growth in revenues from the Welsh rates of income tax (**Figure 41**). Over the outturn years between 2019-20 and 2022-23 WRIT revenue grew by 9% a year on average and is forecast to continue growing at a similar rate for the next few years. Land transaction tax revenues in 2024-25 are expected to recover from a relatively low level in 2023-24 and grow strongly through the remainder of the forecast period.

Figure 41: Devolved tax revenues (£ million)



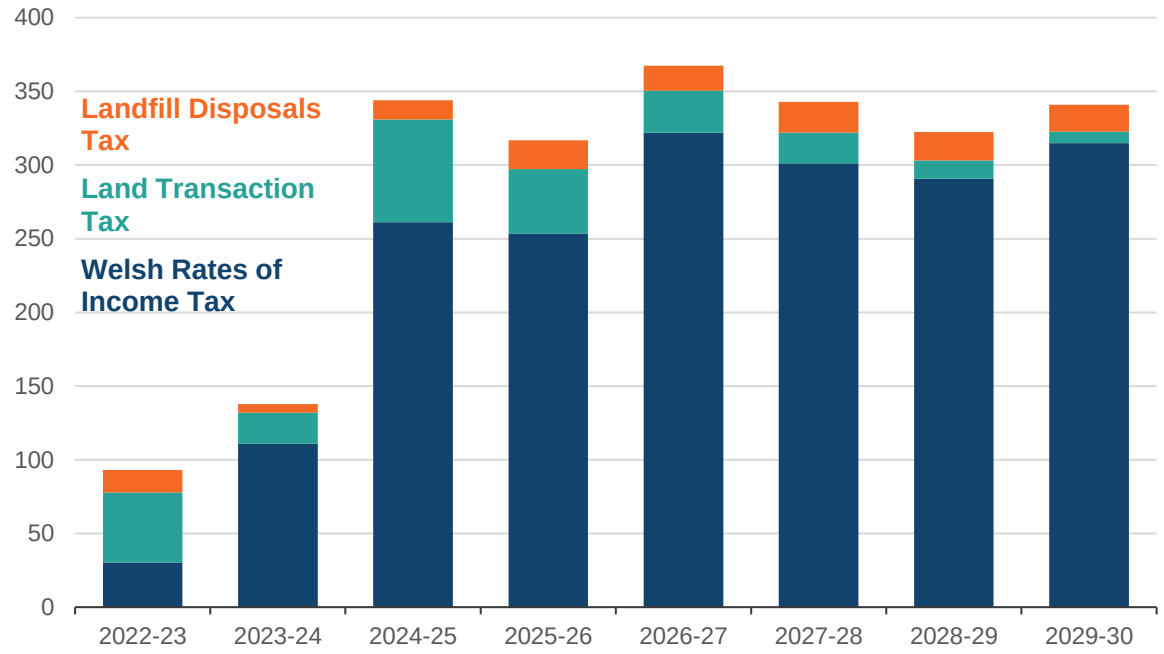
Source: *HMRC, OBR*

The OBR's forecast for UK equivalent taxes also affects the Welsh Government's budget via the block grant adjustments.

The net position between the devolved taxes and the associated block grant adjustments is shown in **Figure 42**. The net position includes the impact of reconciliation amounts in respect of forecast errors in previous years. More detail is provided on these amounts in Annex D to the main Draft Budget narrative. Overall, the devolved taxes are expected to continue making a positive contribution to the Welsh Government's budget, with an annual net position of +£300m or more from the current year to the end of the forecast period.

The net position is sharply up in 2024-25 compared to earlier years. This is driven by expected net improvements across all three taxes and by the inclusion of positive reconciliation amounts in respect of previous years. The net position is forecast to fall between 2024-25 and 2025-25, from £340m to just over £300m. This reduction is explained by smaller (but still positive) reconciliation amounts in 2025-26. The net position increases again in 2026-27 before declining slowly over the remainder of the forecast period.

Figure 42: Net position between devolved tax forecasts and block grant (£ million)



Source: *Welsh Government*

The WRIT block grant adjustment and the WRIT revenue forecast for 2025-26 are now both fixed for budgetary purposes. Outturn will be published in Summer 2027 and any resulting reconciliation amounts will be applied in 2028-29. Block grant adjustments for Land Transaction Tax and Landfill Disposals Tax in 2025-26 will be revised following OBR's Economic and Fiscal Outlook in Autumn 2025.

A ready reckoner showing the revenue impact of changing the Welsh rates of income tax is published alongside the Draft Budget. The tax-related migration estimates included in the ready reckoner have been improved with the inclusion of estimates from HMRC's new longitudinal dataset covering the incomes and location of UK taxpayers over a 12-year period.

Long term fiscal sustainability

The OBR's Fiscal Risks and Sustainability report (September 2024) points out that the UK economy has faced significant shocks over the past two decades, including a global financial crisis, a pandemic, and an energy crisis. These events have strained public finances, with deficits averaging nearly 5% of GDP since the early 2000s. As a result, public sector debt has increased sharply - to 98.1% of GDP by March 2024. Public spending reached nearly 45% of GDP in 2023-24, the highest sustained level since the mid-1970s, driven by increased spending on public services, welfare, and interest costs.

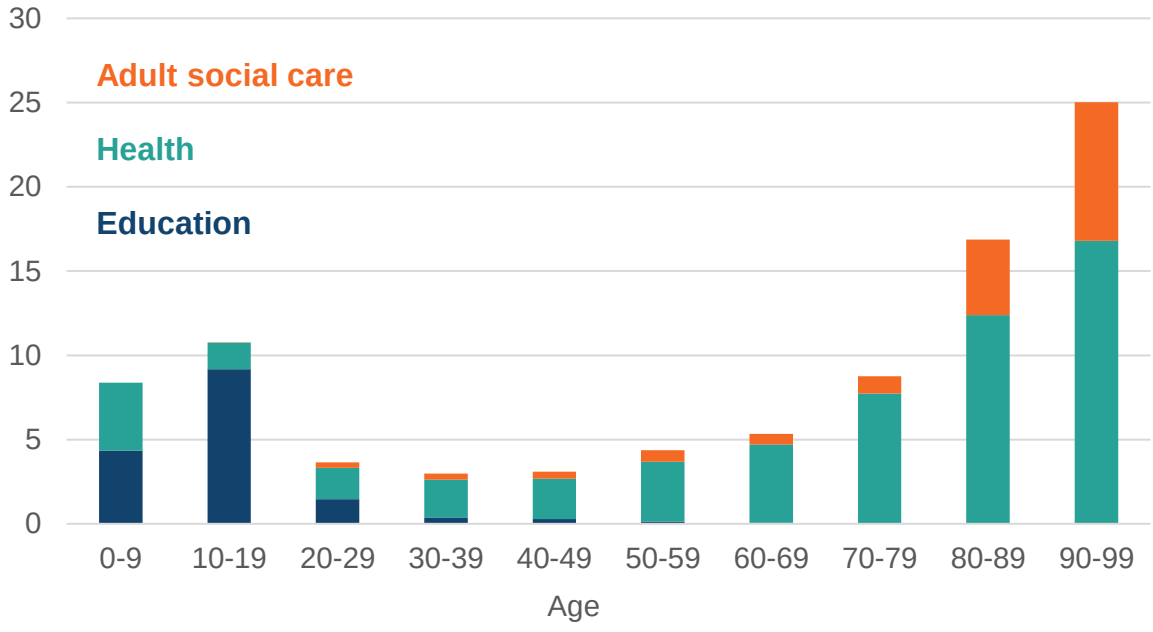
Looking ahead, the UK faces long-term pressures such as an ageing population, climate change, and rising geopolitical tensions, which are expected to put further strain on the public finances. Projections indicate that public spending could rise to

over 60% of GDP in the next 50 years, while revenues remain around 40% of GDP, leading eventually to an exponential increase in the debt-to-GDP ratio. These pressures and the increase in public debt could be mitigated by improvements in economic conditions, otherwise policy actions to increase taxes or reduce spending will be required.

The Welsh Government's block grant is driven by changes in UK Government funding for public services in England. Given the importance of the block grant to the Welsh Government's overall finances, the OBR's spending projections are highly relevant to the Welsh Government's longer term fiscal sustainability.

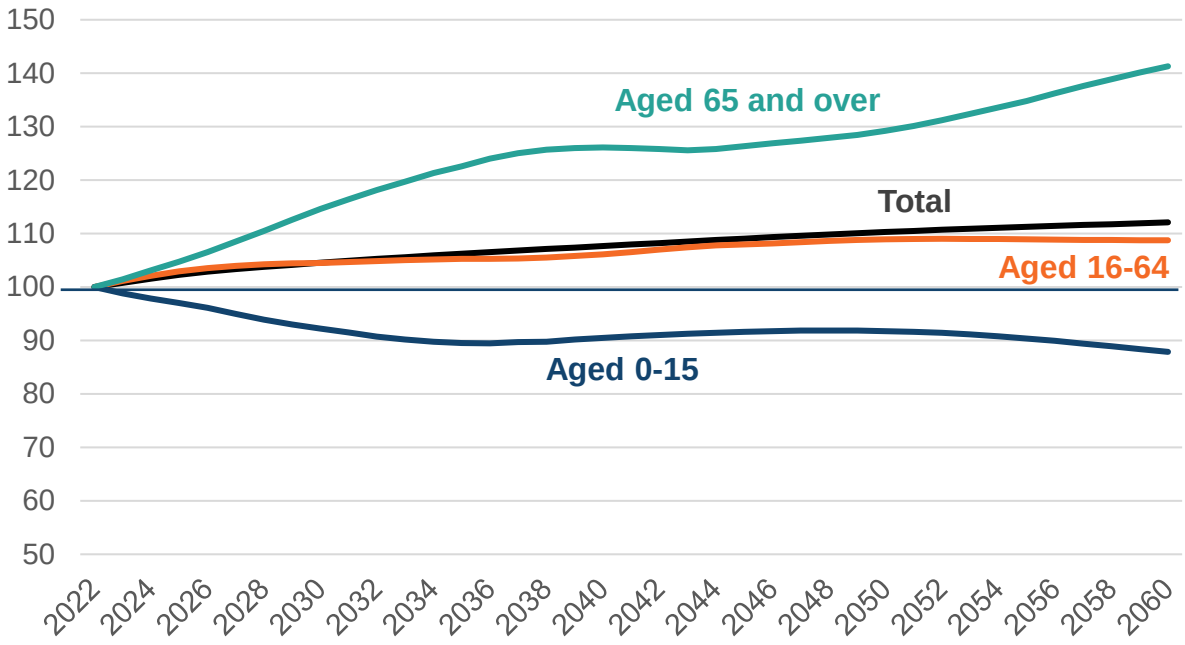
Three of the key areas of spending for the Welsh Government are affected by demographic change: health, education, and adult social care. UK spend on these functions by age group is shown in **Figure 43** and population projections for Wales are shown in **Figure 44**. With an increasing older population in the UK and Wales, health and adult social care expenditure are both projected to increase as a share of GDP. By contrast, education spending is projected to fall slightly as a share of GDP, due to low birth rates and a migrant population that is skewed toward those of working age. There are other non-demographic pressures on health spending which further increase the projected expenditure in that area.

Figure 43: UK aggregate spending per person by age on education, health and adult social care in 2028-29 (£ 000s)



Source: *OBR*

Figure 44: Wales population projections, 2022-2060 (2022=100)



Source: *ONS*

Table 1 below shows the change in UK public spending as a share of GDP for these main public services over the OBR projection period.

Table 1: UK projected change in public spending as a share of GDP

	2028-29 to 2033-34	2033-34 to 2043-44	2043-44 to 2053-54	2053-54 to 2063-64	2063-64 to 2073-74
Health	+1.3	+1.1	+1.3	+1.5	+1.8
Adult social care	+0.1	+0.2	+0.2	+0.2	+0.2
Education	-0.2	-0.1	0.0	-0.1	-0.1
Other current services	-0.1	-0.1	0.0	0.0	0.0

Source: *OBR*

Wales' Fiscal Outlook

The longer-term projections in **Figure 45** use the medium-term outlook illustrated in **Figure 39** as a starting point. Three scenarios are then considered for the period from 2027-28 to 2032-33.

Scenario one: OBR spending projections

- Based on the OBR's baseline projections described above. UK Government spending relevant to block grant funding grows faster than GDP throughout its

projection period. As noted above, without mitigation, this scenario eventually leads to an exponential increase in net public sector debt.

Scenario two: Spending grows with GDP

- UK Government spending relevant to Welsh Government block grant funding for day-to-day spending grows at the same rate as the UK economy. This scenario reflects a situation where the UK Government is happy to broadly maintain the fiscal situation at the end of the current medium term forecast period.

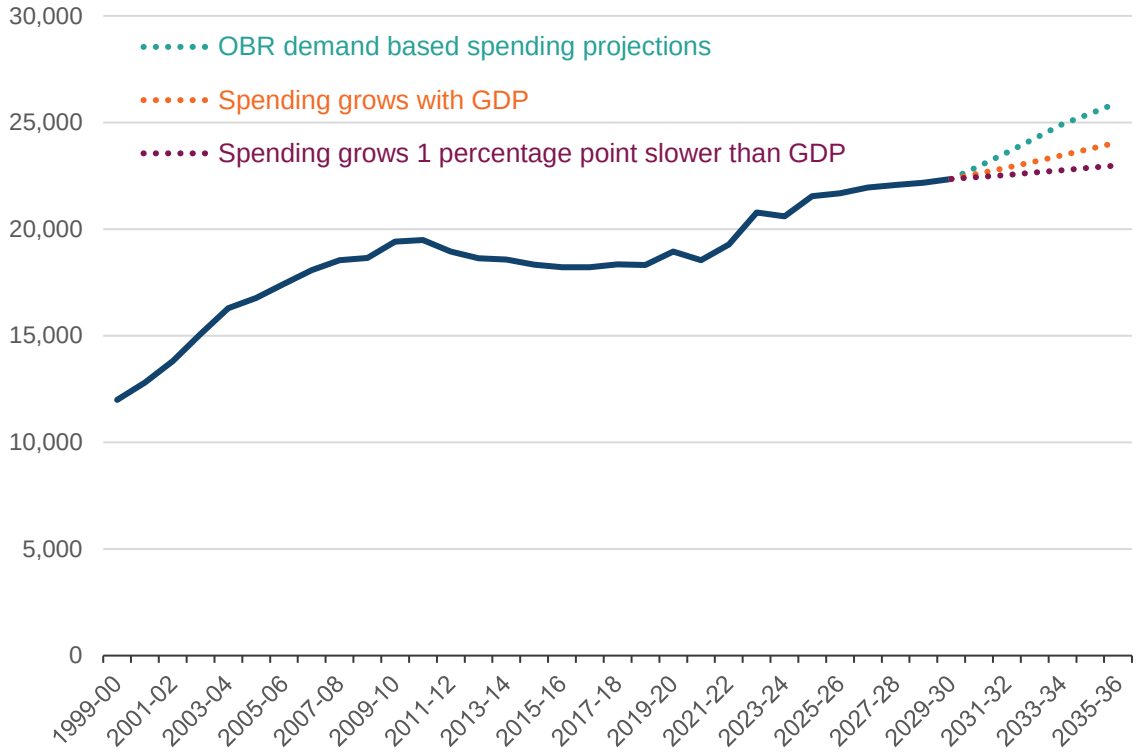
Scenario three: Growth one percentage point less than GDP

- Relevant UK Government spending grows one percentage point slower than the UK economy. This reflects a scenario where there are demands to reduce debt more rapidly or other elements of UK spending – such as pensions or debt interest – are growing more quickly.

The OBR spending scenario has the Welsh Government resource budget growing at a similar rate to that seen during the 2000s. This scenario is most likely to provide the necessary resources to meet future demand for public services but, given the OBR's conclusion that this leads to exponential growth in net public sector debt without tax increases, it may not be the most likely.

The middle scenario suggests the resource budget will grow a little faster than over the next five years, while the lower scenario sees a continuation of that growth in the longer term.

Figure 45: Long-term projections for Welsh Government day-to-day spending (resource budget excluding COVID-19) in real terms, under three scenarios (£m, 2023-24 prices)

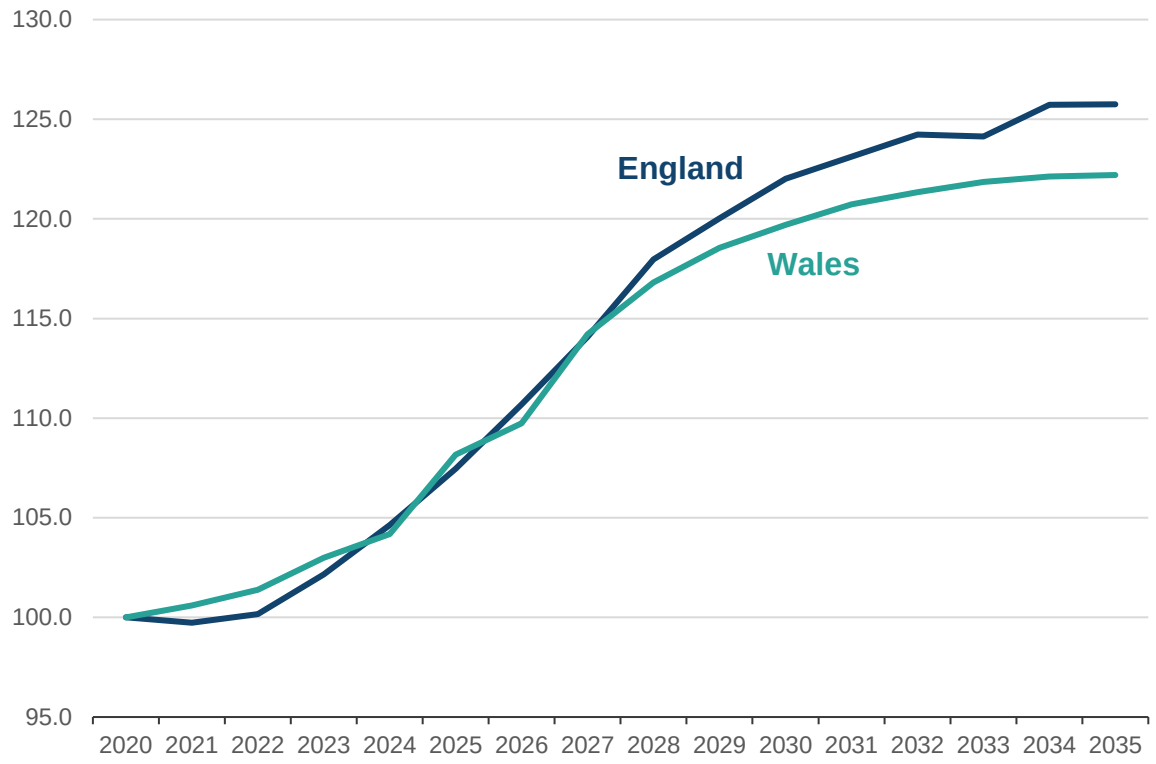


Source: *Welsh Government*

Given the dominance of the block grant in the Welsh Government budget, sustainability of the budget to meet public service needs in future will depend to a large extent on UK Government spending decisions relating to public services in England. If the equivalent services in England are adequately funded, then the future adequacy of funding in Wales will depend on whether the demand for those services is growing at a different rate to that in England. The relative performance of the devolved taxes will have a smaller but still important impact.

As illustrated by **Figure 44**, the increasing population of older people is expected to be a key driver of the growing demand for public service spending across the UK. Wales has a higher proportion of older people than England – part of the reason it has a higher relative need to spend on public services – but it is the growth in that population that will drive change in demand. **Figure 46** shows the projected growth in the population with remaining life expectancy of 10 years or less, a group which is likely to generate some of the highest future demand for public services. This population is expected to grow quickly, but at around the same rate in England and Wales until the late 2020s, followed by slightly faster growth in England after that. On the basis of these projections, the demographic impetus for increasing spend on public services for older people in Wales should be no greater than in England.

Figure 46: Projected population with remaining life expectancy of 10 years or less (Index 2020 = 100)



Source: *ONS*

The Welsh Government faces severe fiscal challenges, with increasing demand for public services and higher levels of need than in England. However, there is nothing in the currently available population projections to suggest that growth in demand for services will be different in Wales than in England.