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Analysis

# UK Spending Review 2019: the implications for Wales

Briefing Paper

GUTO IFAN & CIAN SIÔN

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# Executive Summary

- On Wednesday 4 September, the UK Chancellor Sajid Javid released details of the Spending Review 2019, which sets out spending limits for UK government departments for the next financial year (2020-21). He announced a large increase in UK government day-to-day spending on public services, amounting to an additional £11.7 billion above provisional plans set out by his predecessor at the Spring Statement in March.
- The Welsh resource block grant will grow by £600 million next year, a 2.3% real-terms increase. Last year, the Welsh budget for day-to-day spending remained around 6% below its 2010-11 peak in real terms. Next year, based on these new plans, that gap will close to nearly 1%. However, on a per person basis, funding will remain around 5% below its 2010-11 level. Some of the increase in funding is also related to increased pension costs for public sector employers in Wales.
- During the first ten years of devolution, from 2000-01 to 2009-10, annual increases to the Welsh resource block grant averaged around 4.4% in real terms. Austerity measures implemented from 2010-11 onwards led to average annual decreases of around 0.6% in the nine years to 2018-19. Increases of around 2.3% in 2019-20 and 2020-21 suggests another step-change in the path of the Welsh budget.
- The big budgetary decision for the Welsh Government in 2020-21 will still revolve around how much to allocate to NHS services. Should the Welsh Government decide to match the increase in English NHS spending for 2020-21 of 3.1%, it would leave an increase of around 1.4% in real terms for all other public services. While this budget should probably allow all public services to avoid real terms cuts next year, increases are still likely to be modest in most areas, especially in the context of rising cost and demand pressures.
- The increasing block grant next year will probably stave off any Welsh income tax rises in 2020-21, though it remains an option, especially if it allowed for slower growth in Council Tax levels across Wales. Paying into the Wales Reserve in 2020-21 may be a way of smoothing the path of the Welsh budget if the loosening of fiscal policy next year is followed by further doses of austerity down the line.
- The UK government's Spending Round commitments were made based on the OBR's March 2019 forecasts, which assumed an agreed deal with the EU and an orderly Brexit. Future forecasts for public finances are expected to be considerably weaker.
- The response of the UK government is uncertain: tax rises remain unlikely given recent pledges of tax cuts, leaving the choice of restraining the rate of growth in spending once again or abandoning the Government's fiscal mandate. It therefore remains far too early to assess the fiscal future for public services in Wales.

# UK Spending Review 2019 – the implications for Wales

## Introduction

On Wednesday 4 September, the UK Chancellor Sajid Javid released details of the Spending Review 2019, which sets out spending limits for UK government departments for the next financial year (2020-21). He announced a large increase in UK government resource spending (*day-to-day spending on public services*), amounting to an additional £11.7 billion above provisional plans set out at the Spring Statement in March by his predecessor. The main spending announcements related to English schools (£2.6 billion), English local government budgets (£1 billion ring-fenced for social care) and £750 million for the police in England and Wales.

As ever, spending in England on areas devolved to Wales has increased the size of the Welsh block grant for next year. This will allow the Welsh Government to decide on its spending priorities for the year ahead, with slightly more room to manoeuvre than has been the case for many years.

The Spending Round signals a departure from the tight fiscal policy which has characterised the UK government over the last decade, during which day-to-day spending on public services fell substantially. However, this announcement laid plans for only one year. UK governments usually conduct multi-year spending reviews but due to continued uncertainty surrounding the UK's withdrawal from the European Union, the Chancellor refrained from outlining the government's spending plans beyond 2021 in areas outside of health and education. Uncertainty around the UK's economic, fiscal and political future means we will have to wait and see whether or not this is just a temporary respite from austerity pressures for Welsh public services.

## What does it mean for the Welsh budget?

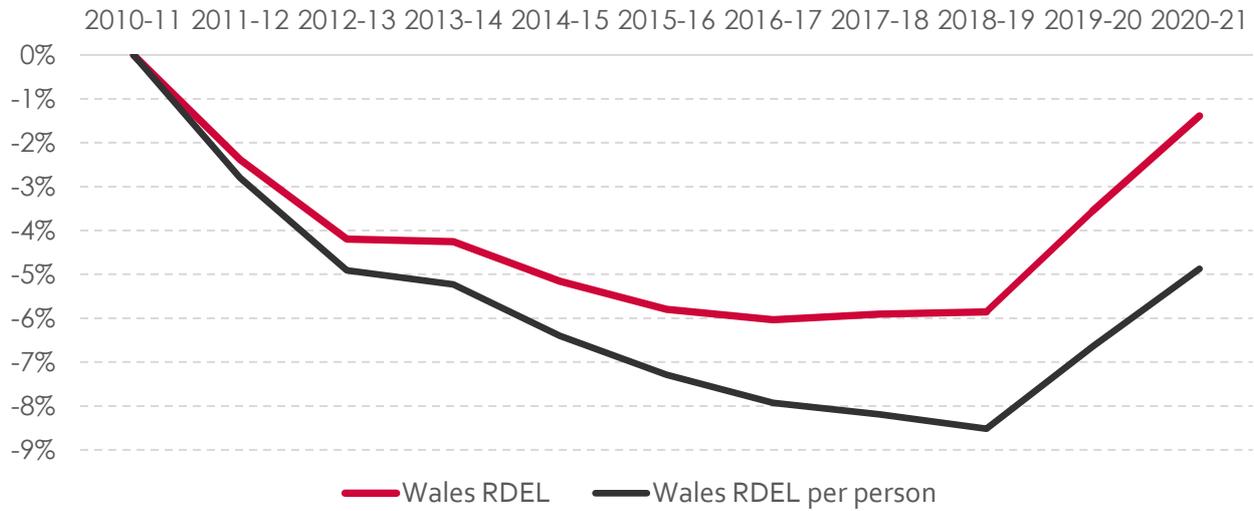
Through the operation of the Barnett formula, the spending decisions of the UK government in England mean an extra £600 million for the Welsh Government in 2020-21 compared with 2019-20. In real terms, this amounts to a 2.3% increase in funding. This comes on top of a similar increase from 2018-19 to 2019-20, following significant in-year additions made to the Welsh block grant as outlined in July by the Welsh Government's First Supplementary Budget for 2019-20.

Last year, the Welsh budget for day-to-day spending remained around 6% below its 2010-11 peak in real terms. Next year, based on these new plans, that gap will close to nearly 1%.

However, as shown in **Figure 1**, on a per person basis, funding will remain around 5% below its 2010-11 level. Some of the increase in funding is also related to increased pension costs for public sector employers in Wales – funding which will eventually find its way back to the Treasury. For 2019-20, Barnett *consequentials* resulting from higher pension costs amounted to £145 million (comparable figures for 2020-21 are not yet available but would presumably be similar in size).

**Figure 1**

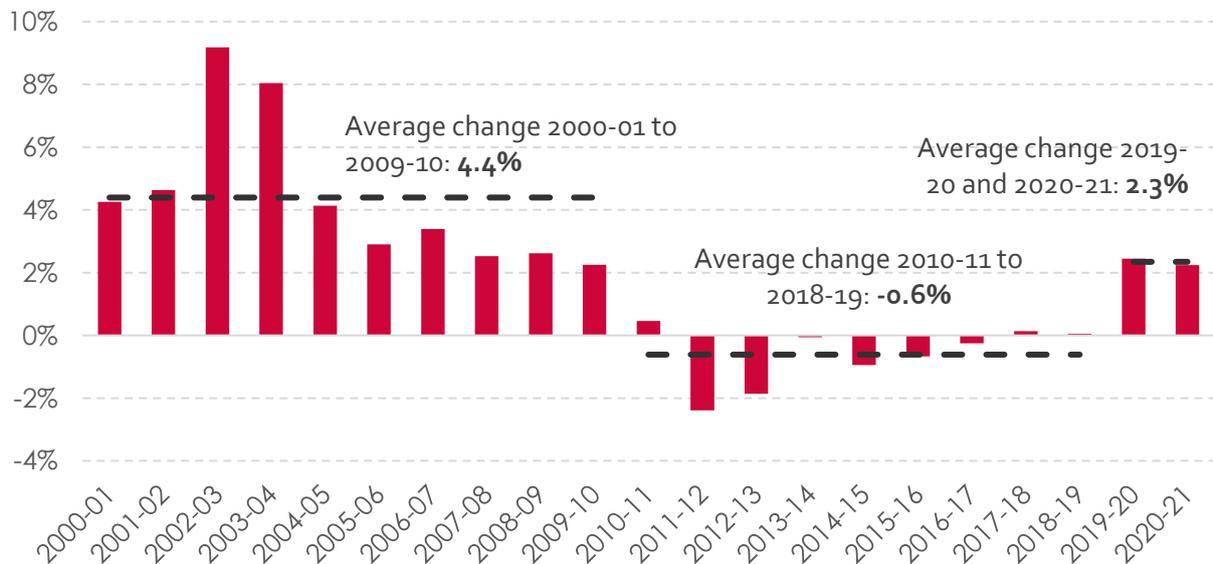
Change in Welsh Government day-to-day funding, 2010-11 to 2020-21 (real terms)



Source: HM Treasury (2019) Public Expenditure Statistical Analysis and authors' calculations. Note: RDEL is resource departmental expenditure limit. Changes expressed before block grant adjustments for tax devolution after 2018-19 but reflect the devolution of non-domestic rates revenue from 2015-16 onwards.

**Figure 2**

Year-on-year changes in Welsh Government day-to-day funding, 2000-01 to 2020-21 (real terms)



Source: HM Treasury (2019) Public Expenditure Statistical Analysis and authors' calculations. Note: RDEL is resource departmental expenditure limit. Changes expressed before block grant adjustments for tax devolution after 2018-19 but reflect the devolution of non-domestic rates revenue from 2015-16 onwards.

**Figure 2** puts the recent increases to the Welsh day-to-day budget in a longer-term context.<sup>1</sup> During the first ten years of devolution, from 2000-01 to 2009-10, annual increases to the Welsh resource block grant averaged around 4.4% in real terms. Austerity measures implemented from 2010-11 onwards led average annual decreases of around 0.6% in the nine years to 2018-19. Increases of around 2.3% in 2019-20 and 2020-21 suggests a step-change in the path of the Welsh budget.

The Chancellor also announced a smaller increase in capital spending plans, which will add £18 million to the Welsh Government capital budget for 2020-21 over what had already been set at the 2019-20 Final Budget.

## The choices facing the Welsh Government

Sometime over coming months, the Welsh Government will set out its draft budget for 2020-21. A growing block grant next year will provide opportunity to increase funding for more of its priorities than has been the case over the last decade. The big budgetary decision will however still revolve around how much to allocate to NHS services. Spending on core NHS services makes up around 49% of Welsh Government day-to-day spending.<sup>2</sup> Should the Welsh Government decide to match the increase in English NHS spending for 2020-21 of 3.1% next year, it would mean an increase of around 1.4% in real terms for all other public services. Matching the English NHS increase on a per person basis (2.8%) would result in an increase of around 1.7% for other public services, while continuing the trend increase in Welsh NHS funding since 2013-14 (2.3%) would allow a 2.2% increase for everything else. While this budget should allow all public services to avoid real terms cuts next year, increases are still likely to be modest in most areas, especially in the context of rising cost and demand pressures. Tough trade-offs will remain; for example, fully meeting the increasing demand for social care may result in slower growth for schools spending. Local authorities will likely remain under pressure to increase Council Tax levels to meet demand.

The NHS and schools in England have been given multi-year settlements, and some will claim this will allow the Welsh Government to commit funding to these services in Wales beyond 2020-21. However, while English plans will lead to *consequential*s for the Welsh budget in future years, what matters for the Welsh Government is the sum of all UK government spending decisions (on health, schools, local authorities) in England and how they are paid for. As explained below, this is very much still unknown. It would be a risk to commit funding to these services in Wales in future years without knowing how much will be left over for everything else.

This should not however prohibit longer-term thinking. In the face of the current uncertainty, the Welsh Government will need to judge whether the increase in its block grant for 2020-21 is likely to be sustained in future years. In its response to the Spending Round, it noted that it had 'no confidence that ... spending announcements will be sustainable'.<sup>3</sup> As well as receiving the block grant from the UK government, the Welsh Government has more tax, borrowing and budget management tools than was previously the

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<sup>1</sup> Figures before 2009-10 have not been adjusted for transfers of responsibility to the Welsh Government and machinery of government changes which may overstate annual increases.

<sup>2</sup> Figure adjusted to reflect the Welsh Government's 1<sup>st</sup> Supplementary Budget 2019-20, from Ifan and Sion (2019) *Spring Statement Briefing*, March 2019. Available at:

[https://www.cardiff.ac.uk/data/assets/pdf\\_file/0005/1458572/spring\\_statement\\_mar19\\_briefing.pdf](https://www.cardiff.ac.uk/data/assets/pdf_file/0005/1458572/spring_statement_mar19_briefing.pdf)

<sup>3</sup> <https://gov.wales/uk-governments-spending-round-pre-election-distraction-says-finance-minister>

case. The Welsh Government has committed to a pre-election pledge not to increase the Welsh Rates of Income Tax during this Assembly term. The increasing block grant next year will probably stave off any Income tax rises in 2020-21, though it remains an option, especially if it allowed for slower growth in Council Tax levels across Wales. 2020-21 will also be the first year in which trends in the Welsh income tax base will affect the size of the Welsh budget. Faster relative growth in revenues (compared with England and Northern Ireland) will provide a slight boost to the Welsh budget, and vice versa.

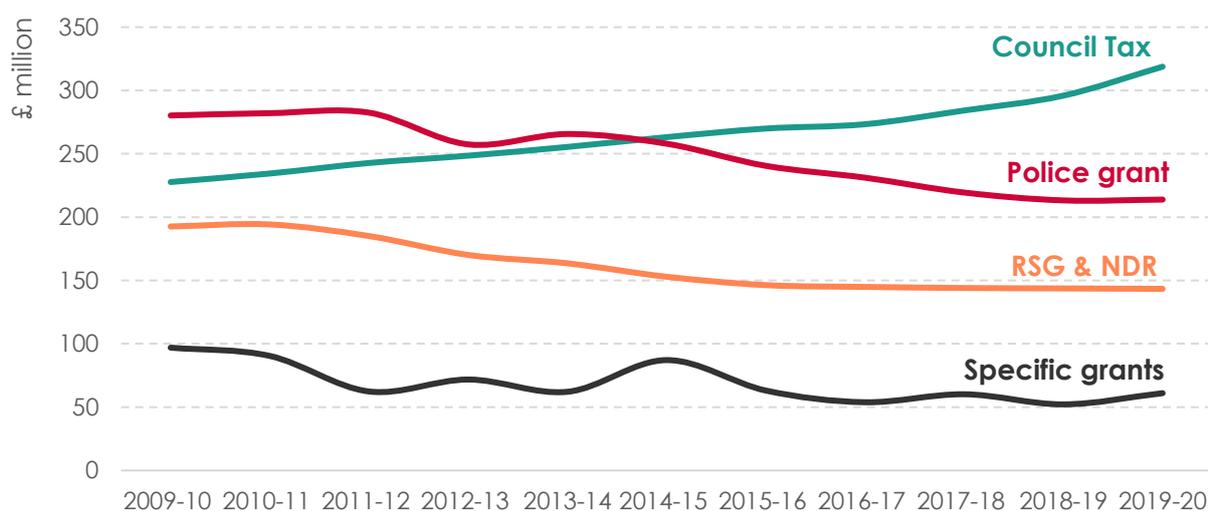
With the prospect of this being only a temporary respite from austerity, the Welsh Government will also need to consider whether to make use of the Wales Reserve, agreed as part of the fiscal framework agreement in 2016, which can hold up to £350 million a year. In 2019-20, the Welsh Government will draw-down the maximum amount of £125 million from the reserve. Paying into the reserve in 2020-21 may be a way of smoothing the path of the Welsh budget if the loosening of fiscal policy next year is followed by further doses of austerity down the line.

## Policing and justice spending for Wales

There were other announcements on non-devolved public services which will have an impact in Wales. Most prominent was a £750 million allocation for policing to deliver the government’s commitment for an additional 20,000 officers across England and Wales by 2023. The Police Grant to Wales’ four police forces has fallen by nearly a quarter in real terms since 2010-11. Although not a devolved area of competence, funding of police services has diverged significantly in Wales from England over the last decade.<sup>4</sup>

**Figure 3**

Gross revenue expenditure of Welsh police forces by source (real terms, 2019-20 prices)



Source: StatsWales (2019) *Financing of Gross Revenue Expenditure*. Note: RSG is the revenue support grant and NDR is re-distribute non-domestic rates revenue. Figures exclude adjustments and appropriations from/to reserves.

<sup>4</sup> [https://www.cardiff.ac.uk/data/assets/pdf\\_file/0005/1549094/Public-spending-on-the-justice-system-for-Wales-Final.pdf](https://www.cardiff.ac.uk/data/assets/pdf_file/0005/1549094/Public-spending-on-the-justice-system-for-Wales-Final.pdf)

The Welsh Government has policy control over Council Tax precepts and has generally decided against placing a cap on increases, unlike the UK government in England. Council Tax precepts have therefore risen much faster in Wales than in England, from £234 million in 2010-11 to a budgeted £319 million in 2019-20, partially offsetting the fall in central government support. This divergence in funding has had a noticeable effect on police numbers in Wales: while police officers per person fell by almost a fifth in England from 2010 to 2018, the equivalent reduction in Wales was 10%. The Spending Round announcement will boost central government funding for Police Forces in Wales which should ease pressure on Council Tax precept payers.

There was also a real-terms increase of 4.9% to the Ministry of Justice resource budget for 2020-21. The UK government's funding for the justice system as a whole for Wales fell by a third from 2009-10 to 2017-18. The Spending Round continued a trend of reversing these cuts in the face of deteriorating performance.<sup>5</sup>

## An end to austerity for good?

The Chancellor claimed that this week's Spending Round had been delivered within the current fiscal mandate which requires the structural deficit – excluding temporary effects of the economic cycle – to be below 2 per cent of GDP in 2020-21. However, this claim was predicated on forecasts published by the Office for Budget Responsibility in March 2019. These forecasts themselves were underpinned by the assumption that the UK would leave the European Union with a deal and enter a two-year transition period, during which time, there would be no change to the terms of trade between the two partners. Although the next set of forecasts from the OBR are not expected until later this year, key economic indicators suggest that the public finances have deteriorated considerably since then, casting doubt over whether the government is on course to meet its fiscal mandate.

The UK economy contracted by 0.2% in the second quarter of 2019, sparking fears of an imminent recession.<sup>6</sup> In response, the Bank of England revised down its growth forecast for the UK economy over the next two years.<sup>7</sup> On top of anaemic economic growth, the most recent monitoring report published by the OBR indicates that the deficit in 2019-20 is running at a higher level than expected, largely due to a sharp rise in government borrowing. This could make it more difficult for the Chancellor to meet his supplementary target of keeping debt falling as a fraction of national income.

As has been the case for the past three years, the Brexit process looms large and the precise manner by which the UK leaves the European Union will have a substantial effect on the health of the public finances. In a recent report published by the OBR, it was forecast that even a relatively mild no deal scenario would lead to a recession, make the UK permanently poorer and lead to higher borrowing.<sup>8</sup> This is despite the £6.3 billion in additional funding already allocated towards preparations for leaving the EU,<sup>9</sup> with yet further allocations made in the Spending Round announcement.

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<sup>5</sup> For example, see Jones (2019) *Sentencing and Imprisonment in Wales: 2018 Factfile*. Available at:

[https://www.cardiff.ac.uk/\\_data/assets/pdf\\_file/0004/1547914/WGC-Report-SentencingandImprisonment04.pdf](https://www.cardiff.ac.uk/_data/assets/pdf_file/0004/1547914/WGC-Report-SentencingandImprisonment04.pdf)

<sup>6</sup> <https://www.theguardian.com/business/2019/aug/09/uk-economy-contracts-on-back-of-brexit-uncertainty>

<sup>7</sup> <https://www.bbc.co.uk/news/business-49189376>

<sup>8</sup> See Chapter 10, <https://obr.uk/frr/fiscal-risks-report-july-2019/>

<sup>9</sup> <https://www.ifs.org.uk/uploads/BN254-Spending-Review-2019.pdf>, p.16

Although this week's Spending Round offered a much-needed cash boost to UK departments and the Welsh Government's budget, the UK government's decision to abandon the multi-year Spending Review in favour of a single-year Spending Round casts doubts on whether this increase in spending can be sustained beyond 2020-21. Much will depend on what happens to the Brexit process, its economic impact and the potential policy responses.

The response of the UK government to weaker forecasts for public finances in 2020-21 and beyond is uncertain. Tax rises remain unlikely given recent pledges for tax cuts, leaving open the choice of once again restraining the rate of growth in spending or abandoning the Government's fiscal mandate by allowing higher debt and borrowing levels. The latter option may reveal that much of the spending restraint seen over the last decade was a political choice rather than a necessity and would be yet another indication of a fundamental change in UK politics from only a few years ago. Of course, the actual UK Budget for 2020-21, yet alone the Spending Review 2020, could be set by a completely different government following a UK General Election. It therefore remains far too early to assess the fiscal future for public services in Wales.

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