Dadansoddi Cyllid Cymru
Wales Fiscal Analysis

Hey Big Spender?

Implications of the UK General Election 2019 for the Welsh Government budget

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Wales Fiscal Analysis
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Executive Summary

- Just four days after the 2019 UK General Election, the Welsh Government will publish its own Draft Budget for 2020-21. The outcome of the election will have a very significant impact on the size of the Welsh Government budget for 2020-21 and beyond, and will shape the debate over tax and spending at the next Senedd Cymru/Welsh Parliament Election in 2021. The differences in manifesto proposals and their implications for the Welsh budget could not be starker.

- Although already-planned increases to the Welsh block grant for 2019-20 and 2020-21 will reverse some of the cuts made since the start of austerity, Welsh Government day-to-day spending in 2020-21 is set to be around 3% below its 2010-11 level in real terms and 6% below on a per person basis. Based on pre-election UK government spending plans, the baseline projection is that the Welsh Government budget will grow by an average of 1.7% a year in real terms from 2019-20 to 2023-24.

- On top of pre-election plans, the **Conservatives'** manifesto spending plans imply a relatively small £159 million a year increase by 2023-24 (in cash terms) for the Welsh day-to-day budget. The Welsh budget would increase by 8% in real terms by 2023-24, bringing spending above its 2010-11 level in real terms by 2022-23 (though still below 2010-11 on a per person basis). If the Welsh Government increased spending on the NHS in line with plans for England (3.1% a year), then any significant real terms increase in spending on other devolved and local public services would need to come from increased council tax revenues or devolved income tax rates.

- The **Labour** manifesto contains the largest proposed increase to the Welsh day-to-day budget of around £3.4 billion a year by 2023-24, which would increase the size of the Welsh budget by 28% in real terms by 2023-24. The proposed increase would be faster than the average during the first decade of devolution and would bring spending as a share of the economy back to 2010-11 levels. This would allow the Welsh Government to both match health spending increases in England *and* fully reverse cuts to non-NHS spending by 2021-22.

- The **Liberal Democrats** manifesto pledges imply an increase in the Welsh block grant around halfway between Labour and Conservative plans, of around £1.6 billion a year by 2023-24. At the UK level, **Plaid Cymru** suggests an additional £20 billion of tax rises which would fund public services, which would increase spending above Conservative plans but below the Liberal Democrats. However, it is not possible to determine how much additional funding would result for Wales specifically, since UK government departmental spending is not specified and they pledge to replace the Barnett formula with an Office for Fair Funding.

- The spending plans of Labour and the Liberal Democrats are matched by pledges to increase taxes. The most significant Labour proposal is an increase in corporation tax to 26%. Income tax increases for those earning over £80,000 would affect the highest earning 1.4% of adults in Wales, though other tax proposals may affect those lower down the earnings distribution. The Liberal Democrats estimate that cancelling Brexit would lead to a £14.3 billion 'Remain bonus' for the public finances, which contributes to their spending pledges. Conversely, a relatively hard Brexit in January as signalled by the political declaration or a delayed "no deal" Brexit after December 2020 could weaken the public finances considerably. The Conservative 'triple tax lock' on income tax, VAT and national insurance rises could limit future growth in spending by a Conservative government.

- All manifestos promise a substantial increase in capital spending. The £8.1 billion boost outlined by the Conservatives would mean an additional £441 million to the Welsh Government capital budget by 2023-24. Labour announced much more ambitious plans to increase capital spending by £55 billion a year. However, it is not possible to assess what the Welsh share of this would be, given the absence of firm commitments. Plaid Cymru calls for a smaller increase in capital investment across the UK of £20 billion a year (1% of GDP), though call for Wales to receive £1.5 billion a year of this funding alongside a substantial increase in devolved borrowing powers.

- The range of additional funding for the Welsh Government being offered by the main parties at this election is significantly larger than at previous elections, and the parties differ hugely in the scale of spending commitments for both day-to-day and investment spending. Though there is uncertainty and justified scepticism surrounding the fiscal plans of all parties, the manifestos offer a useful indication of the likely scale of additional funding the Welsh Government will receive over the course of the next Westminster parliament, and the stark choice facing voters.

Hey Big Spender? Implications for the Welsh Government budget

09 DECEMBER 2019

1. Introduction

The outcome of the UK General Election 2019 will have major political, constitutional and economic implications, depending on which party forms the next government at Westminster. Alongside obvious differences on Brexit, the main parties are offering substantially different visions of the size and role of the state and the structure of the UK economy.

Just four days after the UK General Election date, the Welsh Government will publish its own Draft Budget for 2020-21. Although initial plans for 2020-21 will largely already be set, the outcome of the election could have a significant impact on the size of the Welsh Government budget for 2020-21 and beyond. The result will also shape the debate over tax and spending at the next Senedd Cymru/Welsh Parliament Election in 2021. This is because UK government spending in England is still the main determinant of changes to the Welsh budget. This briefing therefore focuses on the implications for the Welsh budget from the fiscal plans set out in the manifestos. As will be illustrated, the differences between manifesto proposals could not be starker.

Section 2 briefly outlines the fiscal and economic context in which this election takes place and sets out the parties' proposed new fiscal rules which will govern tax and spending choices over the next parliament. Section 3 analyses the manifestos of the main parties and their implications for the Welsh Government's budget for day-to-day spending and devolved public services. Section 4 looks at some wider implications for the public finances and taxation, the Welsh capital budget, and proposals for further reform of Wales' fiscal framework, while section 5 concludes.

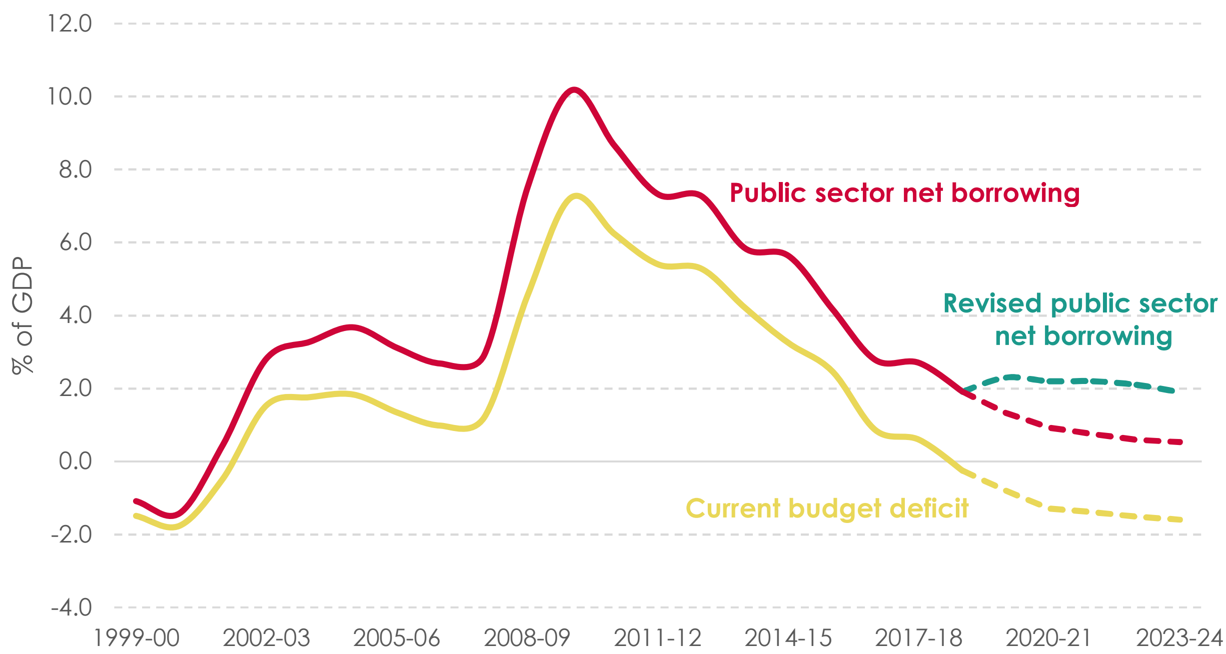
2. The fiscal and economic context

Last month, the Office for National Statistics published their quarterly estimate of GDP growth for the three months to September. Although the UK economy narrowly avoided recession, growth in economic output remains weak and was up only 0.3 per cent compared to the previous quarter. On an annual basis, the economy was 1 per cent larger than 12 months earlier, the slowest rate of growth since 2010. Perhaps unsurprisingly, the recent underperformance of the UK economy is partly attributed to the decision to leave the European Union in 2016 and the continuing uncertainty about the terms of the UK's departure. Analysis from the Institute for Fiscal Studies (IFS) suggests that UK GDP is around 2.5 to 3.0% (£55 billion - £66 billion) lower than it would have been without Brexit (Nabarro and Schulz 2019a: 42).

On top of anaemic economic growth, the most recent monitoring report published by the Office for Budget Responsibility (OBR) indicates that the deficit in 2019-20 is running at a higher level than expected (although not as high as the October figures had originally suggested). After the spending commitments made in September's Spending Round and a change in the way student loans are treated in the national accounts, the Chancellor of the Exchequer Sajid Javid was on course to breach his fiscal mandate to keep public sector borrowing, adjusted for the business cycle, below 2% of GDP in the next financial year (2020-21), as shown in **Figure 2.1**.

Figure 2.1

Public sector borrowing as share of GDP, 1999-00 to 2023-24



Source: Office for Budget Responsibility (2019) Public finances databank; Emmerson and Stockton (2019) Public finances: where are we now? IFS Green Budget.

Note: Red and yellow lines indicate OBR forecasts from March 2019. Revised public sector net borrowing figure includes effects of the reclassification of student loans, other adjustments and Spending Round 2019 commitments.

This has prompted the parties to announce new fiscal rules which would guide their tax and spending decisions after the election, as summarised in **Figure 2.2**.

Figure 2.2

Summary of proposed new fiscal rules

Fiscal rule	Conservatives	Labour	Liberal Democrats
1) Balance the current budget	Over 3 years	Over 5 years	Target a structural current budget surplus of 1% of GDP
2) Debt interest to revenue ratio	Below 6% or reassessment of debt plans	Debt interest costs to be less than 10%	Ensure overall national debt continues to decline as a share of national income
3) Public sector net investment	Average no more than 3% of GDP over the next parliament	Plans to borrow up to 4.5% of GDP and improve public sector net worth over the course of the Parliament	N/A

A familiar element within the UK fiscal framework over the past 20 years, both the Conservatives and Labour set a target to balance the current budget in the next parliament, though there are differences in the time allowed to reach these goals. The Liberal Democrats meanwhile target a budget surplus of 1% of GDP. Therefore, all these rules entail funding day-to-day spending plans by tax revenues.

Both the Conservatives and Labour have adopted a cap for the ratio of debt interest to revenue to keep borrowing sustainable, something common at local government level but a novelty at a national level (Hughes et al. 2019). Liberal Democrats are the only party which keeps the target for national debt to continue to decline as a share of national income.

The Conservative plan to limit net investment to 3% of GDP on average over the course of the parliament. By contrast, Labour's third rule takes account of both sides of the balance sheet by committing to improve overall public sector net worth (total assets minus total liabilities as a share of GDP) over the course of the parliament, and plan to borrow up to 4.5% of GDP to fund net investment. Both of these rules allow for a significant increase in capital spending over coming years.

Regardless of the result, the election will likely lead to a loosening of fiscal policy as both main parties have committed to higher levels of public spending and an end to austerity policies (as outlined in subsequent sections). The general election campaign has already impacted the scheduling of major public finance events, both in Wales and at Westminster. The UK Budget originally scheduled for November 6th was shelved after the House of Commons voted for an early general election. The OBR's restated forecast was pulled on advice of the Cabinet Secretary that its publication would "not be consistent" with the Cabinet Office's general election guidance. The Welsh Government has decided to postpone the release of its draft budget until December 16th, after the general election has concluded.

3. Implications for the Welsh Government budget for day-to-day spending on public services

Although many of the key issues of the UK General Election campaign - such as health, social care and education - are devolved issues in Wales, the spending commitments contained in the party manifestos will have a very significant impact on the Welsh Government budget. Despite fiscal devolution gathering pace over recent years, the Welsh Government still primarily relies on a block grant from HM Treasury to finance spending on devolved public services. Spending decisions made by the UK government in England largely determines changes in the size of the Welsh budget from year to year.

This section therefore outlines a 'baseline' scenario for the Welsh Government's budget for day-to-day spending based on pre-election UK government policies, assesses the implications of manifesto commitments, before analysing what these will mean for future devolved budgets.

Current UK government policy

Since 2017, there has been a notable loosening of the UK government's fiscal policy and fiscal rules, leading to significant increases in planned departmental spending. UK government day-to-day spending was set to fall in real terms to 2020-21, according to plans set out at the March 2017 Budget. Despite the UK's poor economic performance since the Brexit vote, public revenues have performed surprisingly well. At the October 2018 Budget, then-chancellor Phillip Hammond used improved forecasts for the public finances to confirm a significant increase in funding for the NHS in England. On top of existing plans, Hammond's successor Sajid Javid announced a further £13.4 billion real terms increase in departmental spending for 2020-21, including extra spending for schools and for the police, in the 2019 Spending Round. The planned increase in day-to-day spending of 2.3% in 2019-20, and 4.4% in 2020-21, would bring spending back to around 3% below the level of 2010-11 in real terms (Crawford and Zaranko 2019).

These spending commitments mean that the 2020-21 Welsh block grant for day-to-day spending (RDEL or resource departmental expenditure limit) will be £593 million higher compared to 2019-20. This represents a real terms increase of around 2.3% from 2019-20.

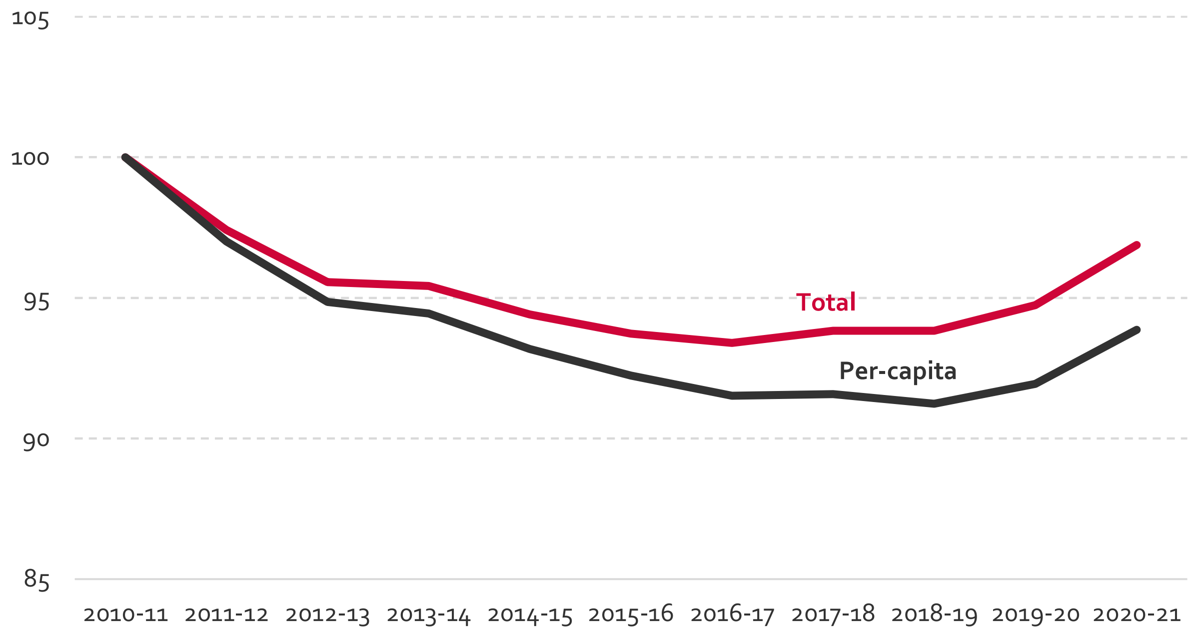
Compared to the budget plans at the time of the last 2017 general election, which were the basis for the 2017 Conservative manifesto, the Welsh RDEL is set to be around £496 million higher in 2019-20 and £837 million higher in 2020-21. In fact, planned spending more closely resembles the projected Welsh block grant under the 2017 Labour manifesto commitments.

Although increases to the Welsh block grant next year will reverse some of the cuts made since the start of austerity, **Welsh Government day-to-day spending is set to be approximately 3% below its 2010-11 level in real terms**, as shown in **Figure 3.1**.[1] Accounting for population growth during this time, on a per-capita measure, funding will be around 6% lower than in 2010-11 (dark grey line).

[1] This figure accounts for the increased costs from a HM Treasury decision requiring higher pension contributions from Welsh public sector employers. For 2019-20, around £219 million was passed on to the Welsh budget as a result of this change, though the Welsh Government estimates the actual cost of the changes for the Welsh Government will amount to £255 million. For a consistent picture of Welsh Government spending power, we therefore strip out this effect in Figure 3.1 and in subsequent analysis.

Figure 3.1

Change in Welsh Government budget for day-to-day spending, real terms (2010-11=100)



Source: HM Treasury (2018) Block Grant Transparency 2018; HM Treasury (2019) Public Expenditure and Statistical Analyses; Welsh Government (2019)

Note: Planned spending excludes the effect of increased public sector pension contributions. Figures are adjusted for the abolition of the Council Tax Benefit - £222 million has been added to the reported Welsh DEL for years between 2010-11 and 2012-13 reflecting the amount transferred from AME to the Wales DEL from 2013-14 onwards. We also include non-domestic rates revenues from 2015-16, to reflect full devolution from 2015-16.

The real terms increases of 1.0% for 2019-20 and 2.3% in 2020-21 represent a step-change in the path of the Welsh resource budget, which fell by an average of 0.7% a year in real terms between 2010-11 and 2017-18. However, recent planned increases are still significantly below the 4.4% average real terms growth sustained over the first decade of devolution from 1999-00 and 2009-10.

Baseline scenario

The 2019 Spending Round commitments were made before a full budget event and without updated economic and fiscal forecasts from the Office for Budget Responsibility. A full multi-year spending review was postponed until 2020. As a baseline scenario for the Welsh budget (before manifesto commitments) over coming years, we assume that overall day-to-day department spending is increased in real terms so that it can cover the multi-year settlements announced for the NHS and schools in England, leaving other departmental budgets flat in real terms. Applying the Barnett formula to these increases and including the effect of growth in business rates revenue in England, and ignoring the parties' 2019 manifesto commitments, we project the Welsh Government budget growing by an average of 1.7% a year in real terms from 2019-20 to 2023-24.

Manifesto commitments

As is the case in every general election, alongside their different visions for public policy and the role of the state, the election manifestos published by the main parties propose varying levels of extra spending on public services.

The Conservative manifesto contains health spending commitments relating to nurse recruitment and GP appointments, as well as education spending commitments, such as on the National Skills Fund. These spending commitments however amount to only a small increase on existing spending plans, of around **£3 billion a year** by 2023-24 at the UK level.

The Labour manifesto proposes a far more radical increase in day-to-day spending on public services of around **£73 billion a year** at the UK level. This includes increasing the planned rise in NHS day-to-day spending to 3.8% in real terms, as well as introducing free personal care for over 65s. They also commit to further increases on spending for schools in England as well as expanding early years education spending. A commitment to abolish tuition fees and restore maintenance grants would increase RDEL spending by £13.6 billion, though around £6.4 billion would be saved from capital spending by this measure. There is also a significant increase in funding for local government, with an additional £5 billion through the Revenue Support Grant by 2023-24 on top of increased funding for services and social care.

The Liberal Democrats' manifesto plans would increase day-to-day departmental spending by roughly **£33 billion a year** by 2023-24 above current plans at the UK level. The largest part of this extra spending relates to spending on early years and childcare, with planned spending on childcare around five times higher than currently planned (Farquharson 2019). They also promise faster increases in schools spending and annual increases in NHS day-to-day spending of 3.7% a year to 2023-24.

The public services spending commitments made by Plaid Cymru in their manifesto relate to Wales rather than for overall spending at the UK level. These include a commitment to introduce free social care costing £300 million a year, doubling of mental health expenditure and an extra £300 million a year for schools and colleges. At the UK level, they propose three tax increasing measures to raise an additional **£20 billion** a year, which would fund public services.

Implications for the Welsh budget

We assess what these increases in spending would mean for the Welsh budget by assigning spending commitments specified in the manifestos to each UK department and apply the Barnett formula for Wales. For some spending lines which are not broken down fully (e.g. "other spending lines") we use the estimates of Barnett *consequentials* provided by the parties to calculate residual amounts of spending. When the profile of spending across years is not known, we assume smooth growth in spending over time. These estimates should be considered approximations based on available information in the manifestos. The additional funding for Wales implied by each manifesto is as follows:

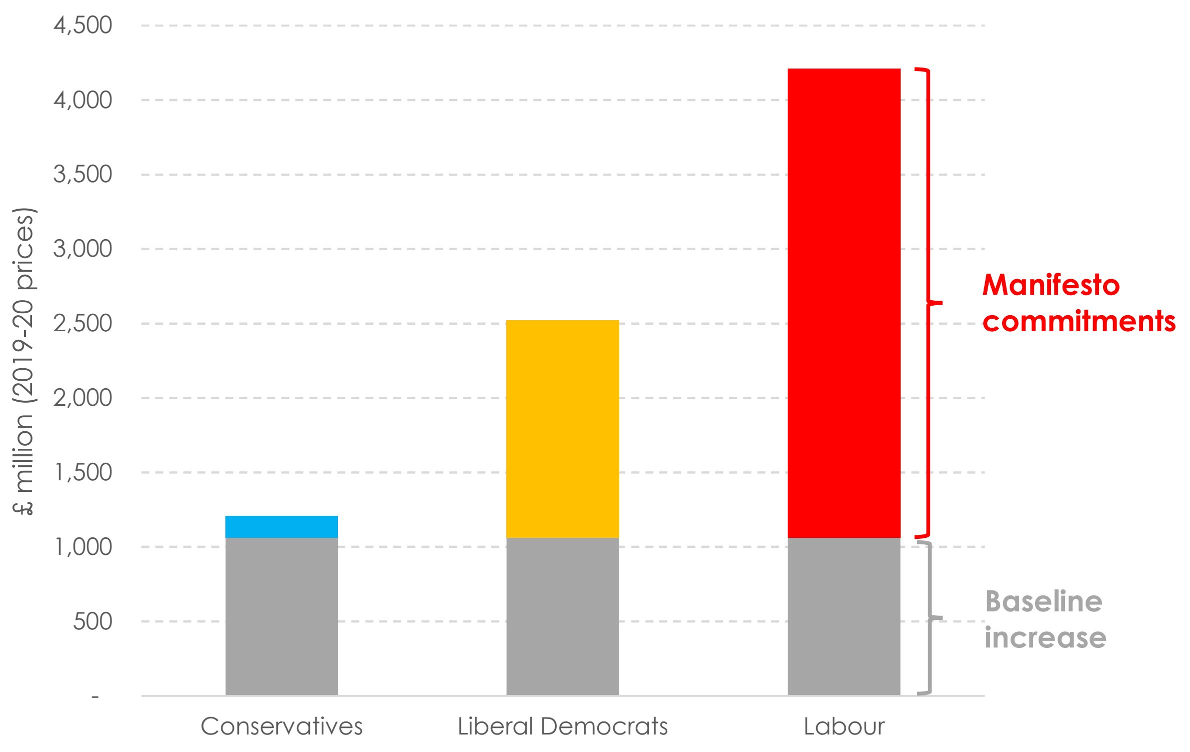
- The **Conservatives'** manifesto spending plans imply approximately an extra **£159 million a year by 2023-24** (in cash terms) for the Welsh day-to-day budget, on top of existing plans.
- The **Labour** manifesto contains the largest proposed increase to the Welsh day-to-day budget of around **£3.4 billion a year by 2023-24**.

- The Liberal Democrats' manifesto pledges imply an increase in the Welsh block grant of around **£1.6 billion a year by 2023-24**.
- It is not possible to determine how much additional funding for Wales would result from Plaid Cymru's proposals, as the breakdown for spending lines at a UK departmental level is not given. A £20 billion increase in spending at the UK level would imply a significantly greater increase in the Welsh block grant compared to current and Conservative plans, though smaller than that proposed by Labour and the Liberal Democrats. Their manifesto however notes that they would wish to replace the Barnett Formula with an Office for Fair Funding, so the Welsh share of any proposed extra spending could be greater than its population share.

Labour's manifesto therefore proposes significantly greater funding for the Welsh Government compared to the Conservatives. It should be noted however that these proposed increases in spending would be in addition to spending plans already outlined in our baseline scenario. Figure 3.2 shows the real terms increase in the Welsh Government budget for day-to-day spending implied by the manifesto proposals including the assumed real terms baseline increase. The Conservatives manifesto pledges relatively marginal increases on spending commitments already made by the UK government, while Labour's manifesto significantly increases spending above those plans.

Figure 3.2

Planned increase in Welsh Government budget for day-to-day spending from 2019-20 to 2023-24 (2019-20 prices)



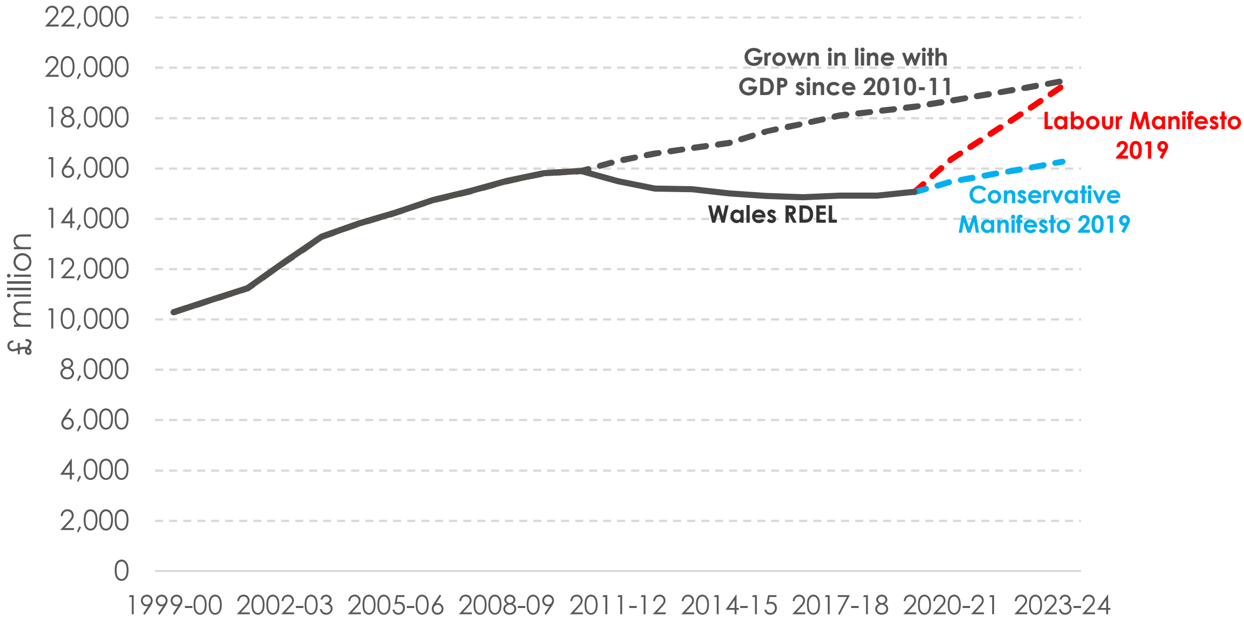
Source: Authors' calculations

Taking the Welsh Government budget for day-to-day spending as a whole (including own-sourced taxes), the Conservatives' manifesto pledges to increase the size of the budget by 8% in real terms by 2023-24.[2] This would bring spending above its 2010-11 level in real terms by 2022-23. However, after accounting for population growth, spending per capita would still remain slightly below 2010-11 levels in 2023-24.

Under Labour's proposals, the budget would grow by 28% by 2023-24, which would bring spending to over a fifth higher than its 2010-11 levels. **Figure 3.3** shows the trend in the Welsh Government's day-to-day spending from the first year of devolution, placing Labour's proposed increase in a broader, longer-term context. The proposed rate of increase would be faster than the average during the first decade of devolution. As can be seen by the dotted black line, by 2023-24 Labour's manifesto would bring spending back to the level at which spending would have grown to had it grown in line with economic growth since 2010-11. Based on current forecasts, as a share of the Welsh economy, the Welsh Government's budget would grow from around 20% this year to 24% in 2023-24.[3] In contrast, spending would broadly match economic growth under the Conservatives' plans.

Figure 3.3

Welsh Government budget for day-to-day spending, 1999-00 to 2023-24 (2019-20 prices)



Source: Authors' calculations from manifesto documents; HM Treasury (2019 and previous) Public Expenditure and Statistical Analysis; Ifan, Sion and Poole (2019) Government Expenditure and Revenue Wales for GDP figures.

Note: Planned spending excludes the effect of increased public sector pension contributions. Figures are adjusted for the abolition of the Council Tax Benefit - £222 million has been added to the reported Welsh DEL for years before 2013-14 reflecting the amount transferred from AME to the Wales DEL from 2013-14 onwards. We also include non-domestic rates revenues from 2015-16, to reflect full devolution from 2015-16.

[2] This calculation takes Wales' RDEL excluding depreciation, including non-domestic rates revenues and the effect of devolved taxes implied by the March 2019 OBR devolved tax forecasts.

[3] This calculation uses GDP forecasts from the OBR's March 2019 Economic and Fiscal Outlook. It therefore doesn't incorporate the possible effects of faster growth in spending (particularly capital spending) on economic growth under Labour's plans.

The spending plans of the main parties would present radically different options for spending for the Welsh Government over coming years. Under the Conservatives plans, if the Welsh Government increased spending on the NHS in Wales in line with current plans for England (3.1% real terms increase a year, broadly matching the increased demographic and cost pressures identified by Watt and Roberts (2016)), then all other spending in the Welsh budget would remain flat in real terms. Any increase in spending for other areas of the budget, such as local authority revenue budgets, would need to come from increased council tax revenues or increases in devolved income tax rates.

Conversely, under Labour's proposals, the Welsh Government could match the party's proposed higher spending increases in England (of 3.8% a year), and still grow all other areas of spending by over a third by 2023-24. Under this scenario, non-NHS spending would be higher than its 2010-11 level in real terms by 2021-22. The party's Welsh Manifesto offers some idea of how this additional funding may be spent, such as extending free social care and increasing schools funding.

4. Other implications for the Welsh Government budget

Public finances and taxation

Commitments to a balanced current budget means that the Labour, Liberal Democrats and Plaid Cymru proposals for increased day-to-day spending are matched by pledges to increase taxes.

Labour's tax proposals include an increase in the main rate of corporation tax to 26%, increased taxes on capital gains and dividend income and income tax increases for those earning over £80,000. Only the highest-earning 3% of Welsh income taxpayers currently earn over this amount, and only the highest-earning 1.4% of all adults in Wales. These new tax rates and bands would apply to the reserved portion of income tax from Welsh taxpayers. The creation of a new 45% band starting at £80,000 would however affect the Welsh Government's income tax powers. As the Welsh Rates of Income Taxes levied by the Welsh Government is charged on the thresholds and bands set by the UK government, so the Welsh Government would need to decide what rate to set for taxpayers in this band.

The Liberal Democrats propose a smaller increase in corporation tax rates to 20% and a 1p rise in income tax rates. As would be the case with a similar rise in the Welsh Rates of Income Tax, such an increase would be progressive despite a small tax increase for lower earners. Liberal Democrats propose to replace Business Rates in England with a Commercial Landowner Levy. Increases in Business Rates in England trigger negative Barnett *consequentials* for the Welsh Government budget, so any change in revenues received could have an influence on the size of the Welsh budget.

The tax proposals in Plaid Cymru's manifesto include cancelling the planned cut to corporation tax and to remove the tax relief given to the pension contributions of higher and additional rate taxpayers.

The Liberal Democrats estimate that cancelling Brexit would lead to a £14.3 billion a year 'Remain bonus' for the public finances, which contributes to their spending pledges. This estimate is based on the relatively poor economic performance seen since the EU referendum vote.

Conversely, a relatively hard Brexit in January as signalled by the political declaration will likely significantly weaken the public finances, and the commitment not to extend the transition period beyond December 2020 again risks an economically damaging "no deal" Brexit. In recognition of the limited scope for tax cuts, the Conservative manifesto promises to cancel the proposed cut in the corporation tax rate from 19% to 17% and only increases the national insurance threshold to £9,500, rather than to their 'ultimate ambition' of £12,500, which would have proved prohibitively expensive. The Conservative manifesto also includes the 'triple tax lock' policy which promises no increase in income tax, VAT or national insurance rate. With little scope for tax increases, a worsening of the public finances may limit future growth in current spending by a Conservative government or risk a breaking of their new fiscal rules.

Looking to future Welsh budgets, the Conservatives' more modest plans for day-to-day spending may make the option of increasing devolved income tax rates more appealing. Otherwise, Welsh public services may continue to rely on increases in Council Tax to fund increasing cost and demand pressures.

Capital spending

As well as proposing increases in day-to-day spending, all manifestos promise a substantial increase in capital spending.

The Conservatives plan to increase net investment to 3% of GDP (from 2%), allowing £80 billion additional capital spending over four years to 2023-24 (approximately £20 billion a year). Actual commitments made in the manifesto though fall well short of this target, although the document doe propose an £8.1 billion boost to capital spending by 2023-24. Based on the spending commitments outlined in the manifesto, this would mean approximately an additional £441 million to the Welsh Government's capital budget by 2023-24. The Welsh Government's capital budget would be approximately 18% higher than would have been expected under plans for capital spending pencilled in at the budget last year. A significant commitment in the Conservative manifesto is that the Shared Prosperity Fund, which is to replace EU Structural Funds, will "at a minimum match the size of those funds in each nation". This would mean either a maintaining of Wales' large share of funding (around four times its population share), or a significant increase in overall spending.

The Liberal Democrats have pledged a larger increase in capital spending of around £26 billion a year. It is difficult to estimate what this might mean for the Welsh capital budget, though it does suggest a larger increase than under Conservative plans.

The Labour manifesto proposes much more ambitious plans for capital spending of around £55 billion a year, which would double net investment. The IFS have pointed out that delivering such an uplift in capital spending over this timescale could prove difficult. It is therefore impossible to assess what this will mean for the Welsh capital budget. As well as promises of major infrastructure projects in Wales, such as rail electrification and the Swansea Bay Tidal Lagoon, the manifesto suggests giving the Welsh Government control of a Local Transformation Fund and funding for a Development Bank. It is unclear however how much funding will be allocated to Wales. The Labour manifesto does provide examples of funding being allocated to Scotland, for example, £20 billion for a Scottish National Investment Bank, compared with £250 billion for the UK's National Investment Bank (over ten years). While the Barnett formula appears to have been used to determine the Scottish share of this funding, the population-based formula may not be ideal to allocate such a massive increase in spending if one of the purposes is regional economic convergence, given that Wales has the lowest productivity rates of the countries and regions of the UK.

Plaid Cymru's manifesto proposes a smaller increase in capital investment of £20 billion a year. However, they argue funding should be allocated on a needs basis, with Wales being allocated at least an additional £1.5 billion a year to fund its investment programme. On top of this, Plaid Cymru calls for an extension of Wales' borrowing powers to £5 billion over five years, up from the current limit of £1 billion over 7 years.[4] This would allow additional capital spending of £850 million a year. They also advocate that Wales receives a full *Barnett* share of capital funding for HS2 and Heathrow Airport expansion in England. Taken together, Plaid Cymru's manifesto calls for an increase in the Welsh Government capital budget of a similar order of magnitude to a population-based share of Labour's plans.

Regardless of the result of the General Election, the Welsh Government capital budget is likely to grow substantially over the course of the next parliament, reducing the need for the Welsh Government to use

[4] The current annual limit for capital borrowing stands at £150 million.

its capital borrowing powers. Identifying the best capital projects in which to invest this additional funding will be a key task at future Welsh budgets.

Reforming Wales' fiscal framework

The manifestos also contain pledges to modify Wales' fiscal framework. Plaid Cymru's manifesto calls for significantly further fiscal devolution including the devolution of corporation tax, the devolution of Air Passenger Duty and the assignment of VAT revenues (similar plans for Scotland are currently on hold). The Liberal Democrats also commit to the devolution of Air Passenger Duty, at the same time as proposing substantial reform to the current system.

There are also significant pledges that relate to how the Welsh block grant is determined. Plaid Cymru calls for the replacement of the Barnett Formula with an Office for Fair Funding, which would have a "statutory obligation to deliver geographic wealth convergence across the UK" and would act as an arbiter in funding disputes. The Labour Party also commits to "long-term reform of how the UK allocates public expenditure" to reflect needs, though the Barnett formula is retained in their spending commitments for the next parliament. The Liberal Democrats also commit to maintaining the Barnett formula, though in recognition of the findings of the Holtham Commission, they pledge to update its analysis and would seek over a parliament to increase the Welsh block grant to an equitable level. This is unlikely to yield substantially additional funding for Wales given that relative funding levels is currently above the estimated level of need.[5]

However, rapid increases in funding as proposed by Labour and the Liberal Democrats would mean a return of the infamous Barnett squeeze – the property inherent in the Barnett formula which causes a convergence of spending per person in Wales to the level in England over time. Even with Wales' slower growing population and the 105% needs-based factor in place, Wales' relative funding per person under Labour's plans is likely to approach 116% of England's level by 2023-24, from the currently estimated 120%.[6] Though this would be within the estimated bounds of 'relative need' identified by the Holtham Commission in 2009, a more updated estimate of relative need may yield a different result.

[5] See Poole, Ifan and Phillips (2016) *Barnett Squeezed? Options for a Funding Floor after Tax Devolution*.
[6] This calculation only assesses relative funding for day-to-day spending – if the Welsh Government's capital budgets are increased significantly over time

5. Conclusion

The range of additional funding for the Welsh Government budget being offered by the main parties at this election is significantly larger than at previous elections. The parties' manifestos differ hugely in the scale of spending commitments for both day-to-day and investment spending.

Although modest in comparison with the other parties, the Conservative manifesto proposes funding small increase over the levels assumed in the current baseline projection for the Welsh budget. In contrast to the last ten years, the Welsh budget would increase steadily in real terms over the next parliament. On the other hand, Labour's plans - and to some degree, those of the Liberal Democrats and Plaid Cymru – not only end but *reverse* austerity, by increasing spending as a share of GDP towards 2010-11 levels and enabling a reversal of cuts to non-NHS spending. In terms of investment spending, all party manifestos point towards a substantial increase in the size of the Welsh Government's capital budget over coming years.

These spending commitments are being made at a time of heightened economic uncertainty. A disruptive Brexit, or indeed the next recession, could have a significant effect on the public finances and spending plans. There are also uncertainties around the effects on growth and tax revenues the substantial changes being proposed by Labour to tax and the structure of the UK economy will have. Changing economic circumstances over the next few years will require a different fiscal response from what is outlined in the manifestos.

There will also rightly be a degree of scepticism over the fiscal plans set out in the manifestos. For example, the Conservatives could overspend their manifesto proposals, like they did after the 2017 General Election. They have significant unfunded promises. For example, a promise to "fix" social care is not costed in their manifesto, and the pledge to exempt housing from social care means testing would require significantly greater funding than their spending plans. However, their commitment not to raise the main taxes could hinder their ability to fund increased public services spending if the public finances deteriorate, which is likely given their Brexit policy. The Labour manifesto costings also omit substantial commitments, such as compensation for WASPI pensioners, which may require further tax rises to keep within their fiscal rules.

The 2019 General Election manifestos present radically different visions for the future – for Brexit, the size and role of the state, and for public policy. In turn, these visions imply radically different paths for the additional funding the Welsh Government will receive to spend on Welsh public services over the term of the next Westminster parliament. The fiscal plans of the parties at this election could not offer a starker choice for voters.

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