Local government expenditure in Wales: recent trends and future pressures

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Executive summary

The UK is part-way through significant real-terms reductions in government expenditure as it attempts to deal with the large hole in its public finances. Local government expenditure is not immune from the cuts, and in the 2012 Green Budget, IFS researchers examined the cuts made in 2010−11 and planned in 2011−12 by local authorities in England. This report focuses instead on Wales, and examines both the cuts made to date (up to and including 2012−13) and some scenarios for how much local authorities may have to spend in the period up to 2020−21. It also contains a brief discussion of the economic and fiscal situation and two other important public policy issues for the coming years: changes to the welfare system – which are also intended to reduce public spending – and demographic change.

The key findings of the analysis are:

The economic and fiscal situation

- The late 2000s' financial crisis and associated recession has been followed by only a modest economic recovery. Indeed, economic output is estimated to have shrunk between the fourth quarter of 2011 and the second quarter of 2012, putting the UK back into recession. The poor performance is indicative of a more permanent problem: the trend level of output (that is the level that is consistent with stable inflation and unemployment) is now estimated to be a full 13% lower in 2016−17 than was projected by the Treasury back in 2008, before the severity of the crisis became apparent. This means that despite a deep recession and weak recovery, there is (if these forecasts are correct) little spare capacity in the economy and therefore little scope for above-trend rates of economic growth.
- During the recession, government spending increased rapidly as a share of national income as spending rose (for instance due to more claims for jobseekers allowance) and national income fell. At the same time, there was a modest fall in tax receipts as a proportion of national income as tax-rich activities (such as property transactions and financial services) declined. The significant reduction in the long-term productive potential of the economy means that a permanent gap between spending and taxes would be implied by current policy: in the absence of any policy action after March 2008, the UK Government would be borrowing an estimated 7.6% of national income (£115 billion in today's prices) every year going forward than previously planned.
- The UK Government has responded by setting out plans for significant increases in taxes and reductions in planned spending, designed to eliminate the increase in borrowing by 2016–17. Most of the increases in taxes and reductions in investment spending are due to have happened by the end of the current financial year (2012−13), but the majority of the reduction in non-investment (current) spending on public services as a proportion of national income – over three quarters – is still to come.
- The 2010 Spending Review set out plans for spending on public services for the four years from 2011−12 to 2014−15. The Welsh Government is set to see a real-terms reduction in current spending of 8.4% between 2010−11 and 2014−15, with the capital budget falling by 42.8%. Unlike in England, where the NHS has been largely protected from planned real-terms spending cuts, the Welsh Government decided to reduce the NHS budget, allowing for smaller reductions in grants to local government than in England. The cuts due to take place in 2015−16 and 2016−17 have not yet been allocated but will very likely mean further reductions in the Welsh Government's budget, and hence further cuts in grants to local government.

Local Government spending in Wales: the period to 2012–13

- Local government net current spending on services in Wales is planned to total £6.35 billion in 2012−13 (or £2,062 per person), of which unitary authorities (UAs) account for £5.56 billion (or £1,806 per person). The three largest areas of spending are education (41% of the total), social services (23%) and police services (10%). In contrast spending on libraries represents less than 1% of the total.
- Expenditure per person varies significantly across Wales. Spending per person by UAs is considerably higher in West Wales and the Valleys (£1,871) than in East Wales (£1,694), is highest in Merthyr Tydfil (£2,018) and is lowest in Monmouthshire (£1,628).
- Local government service expenditure per person has fallen by 8.4% in real terms since its peak level in 2009−10. This reflects a reduction in grants from the Welsh Government (which have fallen by 10.1% per person) rather than discretionary policy decisions by local government. Indeed, council tax revenues per person have increased by 1.4% in real-terms during the same time period.
- The size of spending cuts has varied significantly across Welsh local authorities, in large part reflecting differences in the size of cuts to grants. The percentage cuts to spending on services by UAs in East Wales (8.4% per person) exceed those in West Wales and the Valleys (7.8%), with the biggest reduction taking place in Newport (16.5%) and the smallest in Carmarthenshire (2.9%).
- The scale of spending cuts by Welsh local authorities also differs significantly between services. Spending on regulation and safety services is set to face the largest cuts between 2009−10 and 2012−13 (24.6% per person), followed by planning and development (22.9%) and housing (20.6%), although the timing of cuts differs. Spending on social services has been relatively protected (falling by 3.8%), perhaps reflecting increasing demand for such services and councils' efforts to meet Welsh Government targets to protect spending in this area. Spending on environmental and refuse services and education have also been relatively protected, falling by 4.8% and 7.3% per person, respectively.
- In order to compare spending with England, it is necessary to exclude spending on education as in England much of this bypasses local authorities and goes straight to schools (for instance, due to the Academy programme). Local government spending in Wales is higher than the English average and all regions of England bar London, reflecting both higher relative needs and different policy priorities. Around half of the difference is explained by higher spending on social services, but it is spending on culture and leisure (excluding libraries), regulation and safety and planning and development that exceeds English levels by the most in percentage terms (91%, 72% and 63%, respectively).
- The percentage cuts between 2009−10 and 2012−13 have been significantly larger in England than in Wales, reflecting the fact that the UK Government chose not to impose cuts in spending on the NHS in England, necessitating larger cuts elsewhere. Local government net current service spending (excluding education) is planned to be reduced by 15.6% over three years in England, versus 9.3% in Wales. Spending cuts have been even larger in the higher-spending regions of England, at 19.3% in London, 18.7% in the North East and 18.3% in the North West. This reflects the fact that local government spending power in these regions is more dependent on grants from central government than other parts of England, and it is grants that have fallen most (rather than council tax revenues). Differences in the formulas used to determine grants mean that this pattern is not observed in Wales.

- The North East of England, the region of England perhaps most similar to Wales, has seen larger spending cuts in all service areas with the exception of fire services. For instance, expenditure on planning and development has been reduced by 57.4% versus 22.9% in Wales, and spending on social services has been reduced by 11.8% versus 3.8% in Wales. The fact that English local authorities have delivered such deep cuts suggests that Welsh UAs may be able to deliver further significant reductions in their spending although not necessarily without reductions in the quality and number of services provided. The experience of English local authorities also suggests that as the scope for making further cuts to areas such as planning and development diminishes, important 'core' services such as social services cannot be protected as much.
- The cuts to expenditure in the three years to 2012−13 have undone around one-third of the increase in Welsh local government expenditure per person that took place between 2001−02 and 2009−10. Around half of the increase in spending per person on planning and development has been undone, but expenditure is still 51% higher than in 2001−02 (whereas in England it is over 15% lower), again suggesting further reductions might be implementable, although the impact of further cuts on service quality would have to be carefully assessed. On the other hand, whilst only a small part of the increases in spending on social services and environmental and refuse services have been undone (around £1 in £8, and £1 in £9, respectively), these may be areas where rising demand and statutory obligations make cuts more challenging to deliver.

Local government settlements and spending: scenarios to 2020–21

- The Welsh Government has set out indicative figures for the size of the general grant it will give to UAs in 2013−14 and 2014−15. If specific grants change in line with the rest of Welsh Government expenditure, and council tax receipts grow in line with whole-economy inflation and the projected increase in household numbers, the real-terms spending power of UAs will continue to fall at a similar rate to 2012−13: by 1.4% per person in 2013−14 and 1.9% per person in 2014−15.
- The size of grants to UAs after 2014−15 will depend on the spending decisions taken by the Welsh Government, which in turn will depend on the decisions taken by the UK Government and hence, the state of the economy and public finances.
- The UK Government has announced that it plans further cuts in current expenditure in 2015−16 and 2016−17 but has not yet decided how to allocate these. If it decides to make £10 billion in further cuts to welfare (benefit and tax credit) spending, and the Welsh Government sees its budget change in line with public service spending as a whole, current spending forecasts would see the Welsh current budget fall by around 3.2% per year, on average, in 2015−16 and 2016−17. If no further cuts were made to welfare spending, the cuts increase to 4.4% per year. Both figures are significantly greater than the average reduction between 2010−11 and 2014−15 (2.0% per year).
- If the Welsh Government allocates the cuts in its budget across all services proportionally, and council tax receipts continue to grow in line with inflation and the number of households in Wales, UAs' spending power would fall by 2.9% per person per year, on average, in 2015−16 and 2016−17 if further cuts are made to welfare spending. If welfare expenditure is not cut, this figure increases to 3.8% per person per year. The reduction in spending power would be much larger if the Welsh Government chose to protect the NHS from this round of cuts (4.7% and 6.3%, respectively, per person). In each scenario, the cuts would be larger than made between 2009−10 and 2012−13, and the projected cuts in 2013−14 and 2014−15.

- The financial situation for UAs looks difficult until at least 2020–21 (the last year examined in this report), although there is much uncertainty around this as the state of the economy and public finances, and government decisions will have a significant impact on spending power. Even under the most optimistic set of assumptions for spending power used (overall public spending grows in line with the Office for Budget Responsibility's (OBR) long run forecast after 2016–17, further welfare cuts of £10 billion are found, and the Welsh Government chooses not to protect the NHS from cuts), UAs' spending power per person in 2020–21 would be 1.6% lower in real terms than in 2012–13. Under our most pessimistic set of assumptions, UAs spending power would be 18% lower (22% lower per person). The continued weakness in the economy and public finances, and the possibility that reductions in health might not be delivered, mean that such a scenario is plausible.
- Such a large reduction in spending power would represent a significant challenge for UAs. If overall spending on services was to be reduced by 18%, limiting the reductions in overall spending to half that level (9%) in areas that have so far been relatively protected – social services, environmental services and refuse, and education – would require cuts of 52% in spending on all other services. Such large cuts in addition to those already made are likely to be very difficult to achieve, meaning that other options would need to be considered in such circumstances. This may involve making significant cuts to service areas so far relatively insulated from cuts, local authorities stopping providing large swathes of services that they traditionally have and attempts to generate substantially more revenue, whether from council tax or increased fees and charges for the provision of some services.

The broader context: welfare and demography

- As well as reducing spending on public services, the UK Government is increasing taxes and cutting benefits and tax credits. These act to reduce the net incomes of households in Wales, although the average reduction by 2014–15 (2.8% of net income) is smaller than for the UK as a whole (3.0%). The largest average reductions are for households in the poorest fifth of the population (5.2% in Wales) and those households with dependent children (4.3% in Wales). This reflects the fact that such households are typically more reliant on benefits and tax credits than others. Groups impacted most by the benefit and tax credit cuts may be more vulnerable to cuts by local government or may come to rely more on local government services (e.g. housing or social services). The introduction of Universal Credit will act to offset the reduction in benefits and tax credits from 2014, especially for the poorest fifth of the population.
- The ageing population means that the UK (and by extension, the Welsh and local) Government will continue to face a difficult fiscal situation for decades to come. The OBR's *Fiscal Sustainability Report's* central estimate is that demographic change could increase spending by 5.2% of national income by 2060–61, largely driven by additional spending on health and pensions. If extra taxes cannot be raised, this may mean a significant further squeeze on other areas of spending such as local government. The central estimates are based on rather optimistic assumptions about how quickly productivity will grow in the NHS, however, and if productivity were instead to grow at the average rate since 1979, spending on the NHS would need to rise by a further 7.5% of national income, which would require major tax rises or reductions in other spending.
- The scale of demographic change varies considerably across Wales. Although the number of individuals aged 65 and over in Cardiff is projected to increase by 49% by 2033, the number per 1,000 working age residents is expected to increase only modestly

(from 191 to 221). However, areas of Wales that are already relatively old are set to see further rapid aging: the number aged 65 and over per 1,000 working age residents is expected to increase from 414 to 723 in Powys, from 439 to 660 in Conwy and from 370 to 655 in Monmouthshire. National and local government will need to plan for such varied changes in demographics (and fo r the considerable uncertainty around these estimates).

1. Introduction

The UK is part-way through significant real-terms reductions in government expenditure as it attempts to deal with the large hole in its public finances. Local government expenditure is not immune from the cuts, and in the 2012 Green Budget, IFS researchers examined the cuts made in 2010−11 and planned in 2011−12 by local authorities in England. This report focuses instead on Wales, and examines both the cuts made to date (up to and including 2012−13) and some scenarios for how much local authorities may have to spend in the period up to 2020−21. It also contains a brief discussion of the economic and fiscal situation and two other important public policy issues for the coming years: changes to the welfare system – which are also intended to reduce public spending – and demographic change.

The rest of this report proceeds as follows. Chapter 2 describes how the recent financial crisis and subsequent recession caused long-term damage to the UK public finances and sets out the planned fiscal consolidation the UK Government is currently undertaking. This provides the context to Chapters 3 and 4, which focus on local government in Wales. Chapter 3 analyses the level of local government spending in Wales in 2012−13, how this is allocated across services, how it varies across the country and how it compares to England. It also examines the real-terms reductions in spending that have taken place since 2009−10 and how these vary across service and area. Chapter 4 looks to the future and examines what the Welsh Government's indicative budget allocations to 2014−15 may imply for local government budgets. It also looks at some scenarios for how local government budgets may evolve to 2020−21 depending on the strength of the public finances and the decisions by the UK Government and Welsh Government on whether to protect certain areas or not. Chapter 5 looks at two further policy issues that are likely to impact on local government in the coming years. First, it analyses how planned changes to the tax and benefit system will affect the incomes of Welsh households, reflecting concerns that reductions in income may lead to greater demands on local services or weaken local economies. Second, it looks at how demographic change may increase public spending pressures and how demographic trends vary across Wales. Chapter 6 concludes. The report also includes three appendices. Appendix A describes the data used in this report, paying particular attention to how we calculate our measures of local government spending and spending per person. Appendix B extends the analysis of Chapter 3 to include fuller details on how local government spending has changed over a longer time period (since 2001−02). Appendix C provides information on how we project forward Welsh Government after 2014−15 and local government spending after 2012−13.

2. The economic and fiscal situation

Summary

- The late 2000s' financial crisis and associated recession has been followed by only a modest economic recovery. Indeed, economic output is estimated to have shrunk between the fourth quarter of 2011 and the second quarter of 2012, putting the UK back into recession. The poor performance is indicative of a more permanent problem: the trend level of output (that is the level that is consistent with stable inflation and unemployment) is now estimated to be a full 13% lower in 2016–17 than was projected by the Treasury back in 2008, before the severity of the crisis became apparent. This means that despite a deep recession and weak recovery, there is (if these forecasts are correct) little spare capacity in the economy and therefore little scope for above-trend rates of economic growth.

- During the recession, government spending increased rapidly as a share of national income as spending rose (for instance due to more claims for jobseekers allowance) and national income fell. At the same time, there was a modest fall in tax receipts as a proportion of national income as tax-rich activities (such as property transactions and financial services) declined. The significant reduction in the long-term productive potential of the economy means that a permanent gap between spending and taxes would be implied by current policy: in the absence of any policy action after March 2008, the UK Government would be borrowing an estimated 7.6% of national income (£115 billion in today's prices) every year going forward than previously planned.

- The UK Government has responded by setting out plans for significant increases in taxes and reductions in planned spending, designed to eliminate the increase in borrowing by 2016–17. Most of the increases in taxes and reductions in investment spending are due to have happened by the end of the current financial year (2012–13), but the majority of the reduction in non-investment (current) spending on public services as a proportion of national income – over three quarters – is still to come.

- The 2010 Spending Review set out plans for spending on public services for the four years from 2011–12 to 2014–15. The Welsh Government is set to see a real-terms reduction in current spending of 8.4% between 2010–11 and 2014–15, with the capital budget falling by 42.8%. Unlike in England, where the NHS has been largely protected from planned real-terms spending cuts, the Welsh Government decided to reduce the NHS budget, allowing for smaller reductions in grants to local government than in England. The cuts due to take place in 2015–16 and 2016–17 have not yet been allocated but will very likely mean further reductions in the Welsh Government's budget, and hence further cuts in grants to local government.

The UK Government is currently a undertaking a planned seven-year fiscal consolidation, composed of tax increases and significant spending cuts, aimed at reducing borrowing from its 2009–10 peak of 11.1% of national income back to sustainable levels by 2017–18. The large cuts in departmental spending by Westminster means large cuts in funding for Wales via the Barnett formula and, hence, reduced grants to local authorities in Wales. This section aims to provide a brief summary of the scale of the fiscal consolidation, why such a fiscal consolidation is required, both in terms of what has happened to the outlook for the economy and why this has had the effect on the public finances that it has. We then briefly discuss the implications for Welsh Government spending and the resources available to Welsh local government (Chapters 3 and 4 of this report look in more detail at local government spending in Wales). This section concludes with a brief discussion of some of the longer term pressures on the public finances that the government will need to address (with Chapter 5 of this report providing further detail).

The state of the economy

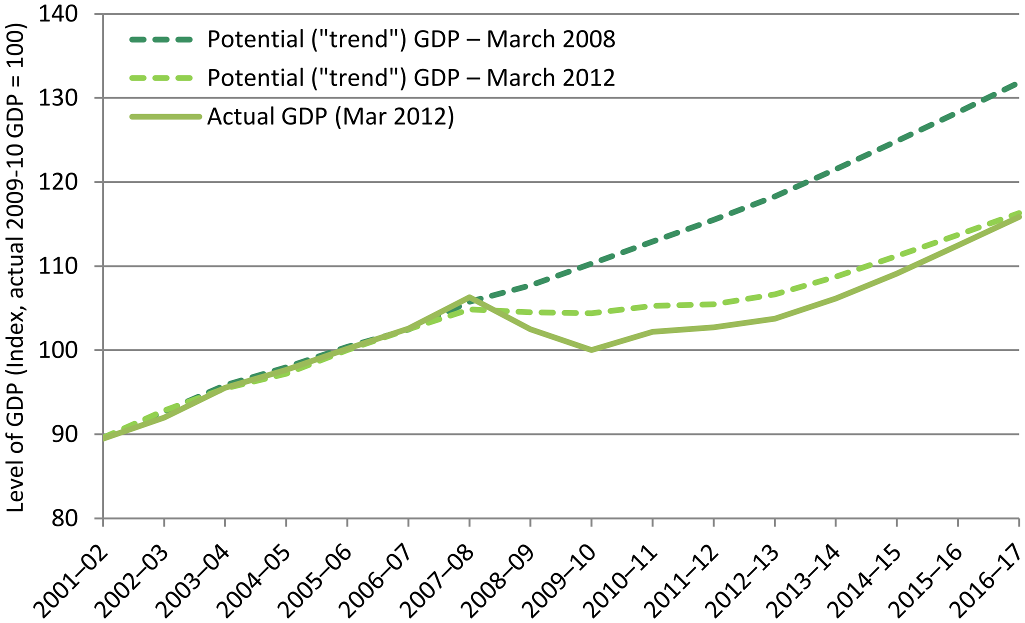
The recent financial crisis led to the UK entering recession, with the size of the economy shrinking in real terms by 6.3% between the first quarter of 2008 and the second quarter of 2009. The UK technically pulled out of recession in the third quarter of 2009 when economic growth turned positive again.[2] However, economic growth was just 1.8% in 2010 and 0.8% in 2011. The Office for Budget Responsibility in its March Budget forecast projected growth of 0.8% again in 2012. While this did not appear an unduly optimistic forecast at the time – the average of other independent forecasts that were made in March 2012 was also 0.8% – recent developments (particularly troubles in the Eurozone) have tended to cause forecasters to revise down their expectations. The OECD recently revised down its forecast of UK economic growth in 2012 to a contraction of 0.7%, while the average of independent forecasts made in September 2012 was for a contraction of 0.3%. Indeed the UK has technically been back in recession since the last quarter of 2011, and over the first half of 2012 the economy contracted in real terms by 0.7%.

The medium-term outlook for the UK economy is somewhat better, with independent forecasters predicting a return to growth in 2013 and the OBR currently forecasting average annual real growth of 2.3% between 2011 and 2015. However, even that is subject to considerable uncertainty. Illustrations of uncertainty produced by the OBR in their *Economic and Fiscal Outlook* (2012) suggest that while their central forecast for growth in 2016 is 3.0%, if the OBR's latest forecast is as accurate as previous official forecasts have been then there is still a 10% chance that growth will be at most negligible in 2016 (or, on the other hand, a 10% chance that growth could be greater than 5.7%). And arguably the current climate may be even more uncertain than in the past.

The weak economic growth currently being experienced by the UK economy is concerning because it is indicative of a more permanent problem. This is illustrated in Figure 2.1, which compares forecasts for national income and potential national income. The dark green dashed line shows the government projection for the level of potential national income that was made in March 2008 (i.e. before the financial crisis) – the assumption was for real growth of 2.5% per year.[3] The lighter dashed line shows the latest OBR projection for trend growth: they estimate that the potential capacity of the economy increased by an average of just 0.4% per year between 2007–08 and 2012–13; they currently forecast that it will grow by 2.25% from 2013–14 onwards.[4] The implication of this is that the trend level of national income by 2016–17 is now thought to be a full 13% lower than was projected by the Treasury back in 2008.

[2] A 'recession' is technically defined as a period beginning with at least two consecutive quarters of negative growth in real economic output and ending when there are two consecutive quarters of positive growth.
[3] For the purposes of the public finance projections, a lower growth in potential national income of 2.25% was assumed.
[4] The lack of growth in potential national income during the financial crisis has yet to be adequately explained. In large part it appears to be due to a lack of productivity growth in the service sector, although again this is not particularly well understood.

Figure 2.1. Forecasts for actual and potential national income



Source: Forecasts for actual GDP from OBR, Economic and Fiscal Outlook: March 2012. Outturn figures for real GDP from Office for National Statistics, series ABMI. Potential GDP figures from T. Pybus, 'Estimating the UK's historical output gap', OBR, Working Paper 1, 2011 updated using OBR, *Economic and Fiscal Outlook*: March 2012.

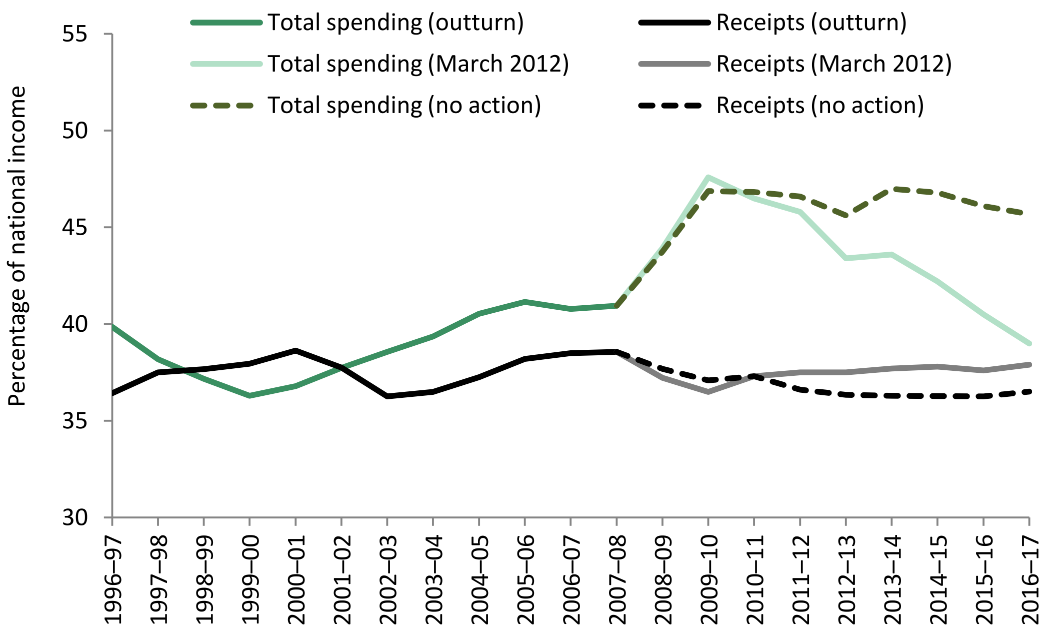
The actual level of national income is shown by the solid green line, which is an outturn as far as 2011–12 and then the latest OBR forecast thereafter. The 2008 to 2009 recession is evidenced by the fall in actual national income. However, the low forecast for growth in potential national income means that, even given the recession, the current level of national income is not forecast to be too far below the potential level of output. This so-called 'output gap' (the difference between actual and potential national income, expressed as a percentage of potential output) is estimated by the OBR to be 2.7% in 2012–13. This relatively small estimated output gap means that, if correct, there is little spare capacity in the economy and therefore little scope for above-trend rates of economic growth. The relatively slow economic growth forecast is projected to be sufficient to return the economy to return to its lower level of potential output in 2017–18.

The implications for the public finances

The problem for the public finances arises from the significant reduction in the forecast productive potential of the economy (as well as a particular decline in tax-rich activities such as property transactions and financial services). With a smaller economy, a given tax system will bring in lower revenues and therefore the amount of public spending that can be supported will be lower. The fiscal consolidation plan is essentially a seven-year transition period over which time public spending will be reduced and the tax system changed such that sufficient revenues will be brought in to finance the amount of spending being undertaken given the smaller size of the economy.

The effect of the recession and the decline in the productive potential of the economy on the public finances is shown in more detail in Figure 2.2, which illustrates what would have happened to tax revenues and public spending as shares of national income in the absence of any new policy action since March 2008.

Figure 2.2. Forecasts for spending and receipts with and without policy action



Note: 'No action' ignores the direct impact of all fiscal policy measures that have been implemented since Budget 2008.
Source: Outturn figures for revenues and spending are from HM Treasury, Public Finances Databank, April 2012. Authors' calculations using all HM Treasury Budgets and Pre-Budget Reports between March 2008 and March 2012 (up to the March 2010 Budget) are available at http://www.hm-treasury.gov.uk/budget_archive.htm; June 2010 Budget onwards available at http://www.hm-treasury.gov.uk/budget.htm) and all OBR *Economic and Fiscal Outlooks* between June 2010 and March 2012 (all available at http://budgetresponsibility.independent.gov.uk/economic-and-fiscal-outlook-march-2012/).

On the receipts side, there would only have been a slight fall in receipts as a share of national income, since the amount of tax revenue raised is generally related to the amount of activity undertaken. (In other words, a decline in national income results in a decline in cash value of tax revenues, but when expressed as a share of national income tax revenues would be largely unchanged.) There would have been much greater effects on the spending side. In the recession spending shot up as a share of national income for two reasons: first, because 'spending automatically increases in recessions even without direct policy intervention (for example, on unemployment benefits and debt interest payments); second, because the decline in national income meant that cash plans for departmental spending that were set in the Comprehensive Spending Review in 2007 turned out to represent much larger shares of national income than previously planned. The 'no policy change' assumption for public spending in 2008 was for real growth of 1.8% a year. If national income were forecast to recover to the levels previously forecast (as in an 'ordinary' recession) then over time spending would have fallen again as a share of national income. However in this case, the productive potential of the economy is now projected to be significantly smaller in every year going forwards, and therefore public spending would remain at this significantly higher level in future in the absence of direct government policy to reduce spending.

The upshot was therefore that the decline in the forecast productive capacity of the economy meant that the existing levels of spending represented much larger shares of national income than intended, and consequently borrowing (the difference between tax revenues and spending) that was much higher than intended. In the absence of any policy action since March 2008 the Government would have been borrowing 7.6% of national income (or £115 billion in today's terms) a year more than it had previously planned every year in the future. This would not have been sustainable and would have left the UK with an ever-increasing national debt that would have surpassed 100% of national income before the end of the decade and continued rising thereafter.

Since such a fiscal position was clearly unsustainable, the previous Labour government and current coalition government both announced a number of tax increases and spending cuts designed to bring borrowing back to sustainable levels. The forecast profiles for tax revenues and spending under current policy are also shown in Figure 2.2. Revenues will increase slightly as a share of national income, but the majority of the consolidation is on the spending side. Some justification for that could be drawn from the fact that most of the 'problem' was also on the spending side, so that in fact both spending and revenues are being brought back to roughly the shares of national income that they were before the financial crisis (2002−03 for spending and 2004−05 for revenues).

The pacing and composition of spending cuts

The UK Government's plans, if delivered, will ultimately entail (by 2016−17) 17% of the fiscal repair job to have been delivered by net tax increases and 83% to have been delivered by cuts in public spending. However, the increases in taxes have been 'front-loaded', while the cuts to public spending and especially the cuts to current public service spending have been 'back-loaded'. This can clearly be seen in Figure 2.3, which shows the contributions of reductions in spending and increases in taxes as a proportion of GDP to the fiscal consolidation for each year between 2010−11 and 2016−17.[5]

Figure 2.3 shows that only a small part of the cuts to public spending has yet taken place. For instance, by the end of the last financial year (2011−12), only around 12% of the cuts to benefits and tax credits planned had been made, which will rise to around 41% by the end of the current financial year (2012−13).[6]

Local government spending mostly falls under the 'other current spending' category, with most of the remainder in the 'investment spending' category. Cuts to government investment spending have been more rapid than cuts to current spending: around 35% of the cuts to investment spending were planned to have been made by 2011−12, with this planned to increase to 67% during 2012−13. On the other hand, only around 6% of cuts to other current service spending (including spending on public services) were planned to have been made by 2011−12,[7] rising to 23% during 2012−13. In other words, the majority of the cuts (more than three-quarters) to overall current spending on public services (and a few other items) as a proportion of GDP are yet to come.[8] Chapter 4 of this report examines how these ongoing cuts to public spending may affect the resources available to Welsh local government in 2013−14 and beyond, which depends on exactly how the cuts in future years are allocated to different types of spending by the UK and Welsh Governments, as well as whether the economy and public finances develop as expected (i.e. whether the planned fiscal consolidation needs to be extended or can be relaxed).

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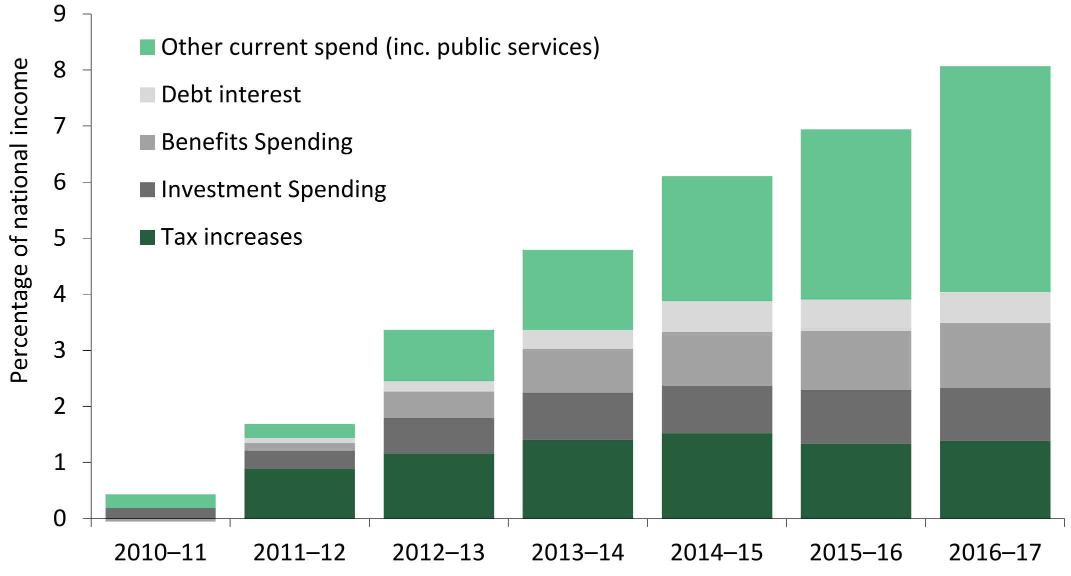
[5] Figure 1.3 shows the planned changes in spending and taxes measured as a proportion of GDP as opposed to measured in 'real terms'. This means, for instance, that a 'cut in spending' means a reduction in spending as a proportion of GDP, which may entail spending growing in real terms but by less than GDP.

[6] These figures assume that there are further cuts to benefits and tax credits in 2015–16 and 2016–17 of around £8 billion per year on top of those already announced for the period up to 2014–15. If these cuts are not made, further cuts in public service spending or investment spending, or further tax rises will be necessary meaning the fraction of the cuts already delivered would be *lower.*

[7] A significant under-spend in 2011–12 means that the proportion of cuts actually delivered by 2011–12 was actually somewhat greater than 6%.

[8] The proportion of real-terms cuts (as opposed to cuts relative to GDP) delivered is somewhat greater but a majority are yet to occur.

Figure 2.3. The fiscal consolidation over seven years



Notes: Bars represent the planned fiscal tightening (reduction in government borrowing) measured as a percentage of GDP, decomposed into tax increases and various types of spending cuts.
Source: Authors' calculations using all HM Treasury Budgets and Pre-Budget Reports between March 2008 and March 2012 (up to the March 2010 Budget) are available at http://www.hm-treasury.gov.uk/budget_archive.htm; June 2010 Budget onwards available at http://www.hm-treasury.gov.uk/budget.htm) and all OBR *Economic and Fiscal Outlooks* between June 2010 and November 2012 (all available at http://budgetresponsibility.independent.gov.uk/economic-and-fiscal-outlook-march-2012/).

The UK Government set out its plans for spending on public services for the four years from 2011–12 to 2014–15 in the 2010 Spending Review. Table 2.1 shows the planned changes to real-terms in current and capital Departmental Expenditure Limits (DELs) for each of these years, both overall and for the major Whitehall spending departments using spending outturns for 2010–11 and updated projections for 2011–12 onwards from the 2012 Public Expenditure Statistical Analysis (PESA) publication.

DELs set out the amount each department can spend on the parts of their functions subject to multi-year budgeting and account for a large majority of departments' spending on public service provision and administration. DELs for current expenditure (excluding depreciation) in 2014–15 are planned to be 8.4% below the amount spent in 2010–11 after accounting for inflation, following planned real-terms cuts of 2.0% in 2011–12, 2.4% in 2012–13, 1.3% in 2013–14 and 3.1% in 2014–15.[9] DELs for capital expenditure in 2014–15 are planned to be 27% below the amount spent in 2010–11 after accounting for inflation.

The UK Government has not cut all departments equally, however. For instance, the current and capital DELs for the NHS are set to increase slightly in real terms over this period (by 1.7% and 0.2%, respectively), while the Home Office, which provides most of the funding for the police, is set to see large falls in spending (19.7% for current DEL and 43.0% for capital DEL). The Department for Communities and Local Government, which provides most of the central government grants for local authorities in England (with the exception of schools, and police and fire services), is also set to see a large 20.3% cut in its current DEL falls of 20.3% (the cut would

[9] In fact, departments underspent in 2011–12, which means that the reduction in that year will have been larger. This means that if departments spend the planned amount in the current financial year, the percentage cuts between 2011–12 and 2012–13 will be smaller than originally planned.

have been even greater if not for a significant under-spend in 2010–11, which reduces baseline expenditure), which, together with the freeze in council tax rates in 2011–12 and 2012–13, explains the large cuts English local authorities are making (Crawford and Phillips, 2012).

Table 2.1 Real change in UK Departmental Spending Limits (selected) 2011–12 to 2014–15 (%)

Department	2011–12	2012–13	2013–14	2014–15	Total
Current					
England, NHS (Health)	1.5	-0.3	0.3	0.2	**1.7**
England, Education	-2.3	-0.6	-1.4	-0.7	**-4.9**
England CLG Local Government	-2.2	-10.2	-1.5	-7.9	**-20.3**
Defence	-4.3	-10.3	-3.6	-3.3	**-19.9**
Transport	0.0	-7.5	-3.6	-12.9	**-22.4**
Home Office	-1.0	-7.0	-7.5	-5.7	**-19.7**
Wales	-2.6	-2.5	-1.4	-2.2	**-8.4**
Total	-2.0	-2.4	-1.3	-3.1	**-8.4**
Capital					
England, NHS (Health)	3.0	-2.6	-2.3	2.2	**0.2**
England, Education	-30.7	-18.7	-24.4	0.9	**-57.1**
England, CLG Local Government					
Defence	3.8	-11.3	-1.9	-7.1	**-16.1**
Transport	2.2	1.8	-9.7	-2.0	**-7.9**
Home Office	-33.6	-3.0	-28.7	24.2	**-43.0**
Wales	-28.2	-10.1	-12.6	1.3	**-42.8**
Total	-13.1	-6.8	-10.2	0.3	**-27.0**

Source: Table 1.3a, Chapter 1, Departmental Spending, PESA 2012 (HM Treasury) available at: http://www.hm-treasury.gov.uk/pespub_pesa_budgets.htm, and authors' calculations.

The Welsh Government is funded via the Barnett formula, which determines *changes* in grants to Wales on the basis of changes to UK DELs (see Crawford et al, 2011, for a short explanation of how this formula works). Overall, the Welsh Government is set to see a cut in its current DEL of 8.4% and its capital DEL of 42.8% by 2014–15: it decides how to allocate this to the various central departments and Welsh local government.

The Welsh departmental structure differs quite substantially from that of the UK Government, making it hard to compare spending on specific services,[10] and there has been a substantial reorganisation of departments since 2011. However, it is clear that the Welsh Government has chosen to distribute the cuts more evenly than the UK Government. For instance, unlike Westminster where special priority was attached to a (small) real-terms increase in NHS expenditure, the Welsh Government decided to subject the NHS to cuts. As we shall show in Chapter 3, this means that Welsh local government has had to make smaller cuts than English local government. However, the cuts are still set to be substantial, and are likely to continue beyond 2014–15 as the UK Government seeks to cut expenditure further in 2015–16 and 2016–17 (and potentially even after this) as part of its deficit reduction plan, as is discussed further in Chapter 4.

[10] The PESA data does allow this but only retrospectively (the most recent data are for 2011–12).

3. Local government spending in Wales

Summary

- Local government net current spending on services in Wales is planned to total £6.35 billion in 2012–13 (or £2,062 per person), of which unitary authorities (UAs) account for £5.56 billion (or £1,806 per person). The three largest areas of spending are education (41% of the total), social services (23%) and police services (10%). In contrast spending on libraries represents less than 1% of the total.
- Expenditure per person varies significantly across Wales. Spending per person by UAs is considerably higher in West Wales and the Valleys (£1,871) than in East Wales (£1,694), is highest in Merthyr Tydfil (£2,018) and is lowest in Monmouthshire (£1,628).
- Local government service expenditure per person has fallen by 8.4% in real terms since its peak level in 2009–10. This reflects a reduction in grants from the Welsh Government (which have fallen by 10.1% per person) rather than discretionary policy decisions by local government. Indeed, council tax revenues per person have increased by 1.4% in real-terms during the same time period.
- The size of spending cuts has varied significantly across Welsh local authorities, in large part reflecting differences in the size of cuts to grants. The percentage cuts to spending on services by UAs in East Wales (8.4% per person) exceed those in West Wales and the Valleys (7.8%), with the biggest reduction taking place in Newport (16.5%) and the smallest in Carmarthenshire (2.9%).
- The scale of spending cuts by Welsh local authorities also differs significantly between services. Spending on regulation and safety services is set to face the largest cuts between 2009–10 and 2012–13 (24.6% per person), followed by planning and development (22.9%) and housing (20.6%), although the timing of cuts differs. Spending on social services has been relatively protected (falling by 3.8%), perhaps reflecting increasing demand for such services and councils' efforts to meet Welsh Government targets to protect spending in this area. Spending on environmental and refuse services and education have also been relatively protected, falling by 4.8% and 7.3% per person, respectively.
- In order to compare spending with England, it is necessary to exclude spending on education as in England much of this bypasses local authorities and goes straight to schools (for instance, due to the Academy programme). Local government spending in Wales is higher than the English average and all regions of England bar London, reflecting both higher relative needs and different policy priorities. Around half of the difference is explained by higher spending on social services, but it is spending on culture and leisure (excluding libraries), regulation and safety and planning and development that exceeds English levels by the most in percentage terms (91%, 72% and 63%, respectively).

- The percentage cuts between 2009–10 and 2012–13 have been significantly larger in England than in Wales, reflecting the fact that the UK Government chose not to impose cuts in spending on the NHS in England, necessitating larger cuts elsewhere. Local government net current service spending (excluding education) is planned to be reduced by 15.6% over three years in England, versus 9.3% in Wales. Spending cuts have been even larger in the higher-spending regions of England, at 19.3% in London, 18.7% in the North East and 18.3% in the North West. This reflects the fact that local government spending power in these regions is more dependent on grants from central government than other parts of England, and it is grants that have fallen most (rather than council tax revenues). Differences in the formulas used to determine grants mean that this pattern is not observed in Wales.

- The North East of England, the region of England perhaps most similar to Wales, has seen larger spending cuts in all service areas with the exception of fire services. For instance, expenditure on planning and development has been reduced by 57.4% versus 22.9% in Wales, and spending on social services has been reduced by 11.8% versus 3.8% in Wales. The fact that English local authorities have delivered such deep cuts suggests that Welsh UAs may be able to deliver further significant reductions in their spending although not necessarily without reductions in the quality and number of services provided. The experience of English local authorities also suggests that as the scope for making further cuts to areas such as planning and development diminishes, important 'core' services such as social services cannot be protected as much.

- The cuts to expenditure in the three years to 2012–13 have undone around one-third of the increase in Welsh local government expenditure per person that took place between 2001–02 and 2009–10. Around half of the increase in spending per person on planning and development has been undone, but expenditure is still 51% higher than in 2001–02 (whereas in England it is over 15% lower), again suggesting further reductions might be implementable, although the impact of further cuts on service quality would have to be carefully assessed. On the other hand, whilst only a small part of the increases in spending on social services and environmental and refuse services have been undone (around £1 in £8, and £1 in £9, respectively), these may be areas where rising demand and statutory obligations make cuts more challenging to deliver.

Chapter 2 set out the general economic and fiscal situation facing the United Kingdom and Wales, and showed the sheer scale of the ongoing cuts to real-terms expenditure on public services. Welsh local government has not escaped these cuts, and this chapter (Chapter 3) analyses spending by Welsh Unitary Authorities, Police Authorities, Fire Authorities and National Parks since 2001–02, with a particular focus on the cuts that have taken place and are planned to take place between 2009–10 and 2012–13. Chapter 4 looks to the future and examines a number of illustrative scenarios for local government settlements and spending in the period to 2020.

The main measure of spending that we focus on in this chapter is 'net current service expenditure'. This is the overall level of spending on a particular service, excluding investment, after accounting for any income obtained from providing that service. In other words it captures the amount spent by local government on running and managing local services, over and above that funded by income directly related to providing those services (for example, fees to use leisure centres or for 'meals on wheels'). Appendix A provides further information on the data used in this and the following chapter of the report.

The rest of this chapter proceeds as follows. In Section 3.1, we set out how much local government in Wales is planning to spend in 2012–13 and on what, and how this varies across

Wales. We also discuss briefly how this spending is funded. Section 3.2 examines the cuts in real-terms expenditure that have taken place since 2009−10, when expenditure on services reached its highest level in real terms; what areas of local government spending are being cut the most, and how this, and the size of overall cuts, varies across the country. In each section we compare the situation in Wales with that in England. With English local authorities forced to make larger and more rapid cuts due to a less generous local government settlement, the spending decisions of English councils may provide a foretaste of the scale of cuts ultimately required in Wales.

3.1 Local government spending in Wales: 2012–13

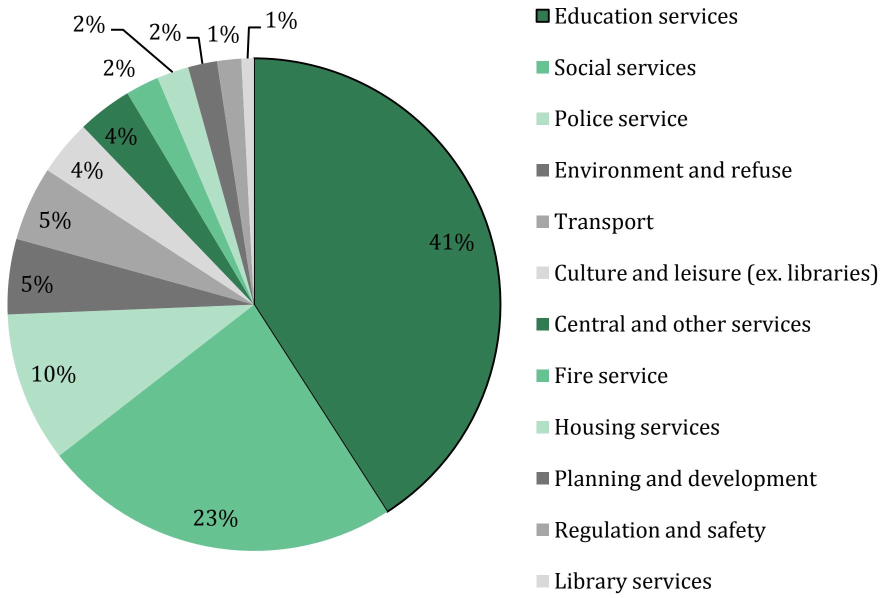
Local government is responsible for ensuring the provision of a wide range of services, either directly or indirectly by commissioning the service from providers in the private or not-for-profit sectors. In Wales, there are four main branches of local government, each responsible for different functions. ***Unitary Authorities*** provide services covering education, social services, transport, environment and refuse, and others, and in 2012−13 plan net current service expenditure of £5.56 billion (this figure excludes housing benefit payments[11]). The other branches of local government are more focused on particular services: ***Police Authorities*** provide police services, and in 2012−13 plan spending of £0.64 billion; ***Fire Authorities*** provide fire services, and in 2012−13 plan spending of £0.14 billion; and ***National Park Authorities*** manage National Parks and in 2012−13 plan spending of around £16 million. Overall, local governments plan current service spending of £6.35 billion. This is equivalent to £2,062 per person.[12]

As shown in Figure 3.1, net current expenditure on education is planned to be the largest single component of local government expenditure in Wales in 2012−13, accounting for £2.60 billion or 41% of overall planned spending in 2012−13. This is followed by spending on social services (£1.50 billion or 24% of spending) and on the police (£0.63 billion or 10% of spending). Between them, these areas of spending account for three-quarters of local government net current service spending in Wales.

[11] Housing Benefit and Council Tax Benefit payments are administered by Unitary Authorities on behalf of the Department for Work and Pensions, which funds the benefit payments managed by each local authority using earmarked grants. In Wales, Housing Benefit payments (but not Council Tax Benefit payments) are treated as part of local government current service expenditure, whereas in England they are counted as part of 'other current expenditure'. In order to ensure consistency with analysis for England, and because payments are met by matching grants, we do not include Housing Benefit payments in the definition of current service spending used in this report.

[12] Per-person expenditure figures calculated using authors' own mid-2012 population projection using the 2011 mid-year estimates and 2008-based projections for population for 2012. See Appendix A for details on how population estimates and projections are calculated for years between 2001–02 and 2021–22.

Figure 3.1. Local government net current service spending in Wales, 2012–13



Notes: Net current service spending is the overall level of spending on a service net of any income from providing that service. 'Central and other services' include corporate and democratic management and non-distributed costs.
Source: StatsWales, local government expenditure estimates, 2012–13.

Local government net current service spending varies across Wales, both in terms of its overall level and its composition. Spending on police services, which is planned to average £204 per person per year for Wales as a whole in 2012–13, varies significantly between the four police authorities: £195 per person in Dyfed-Powys; £210 per person in Gwent; £206 in North Wales; and £203 per person in South Wales. There are smaller but evident differences for fire services too: £44 in Mid and West Wales; £42 in North Wales; and £47 in South Wales.

Unitary Authorities (UAs) account for around 88% of all current service spending by local government in Wales in 2012–13, which equates to £1,806 per person per year. Figure 3.2 shows how spending by UAs varies between four 'regions' of Wales:

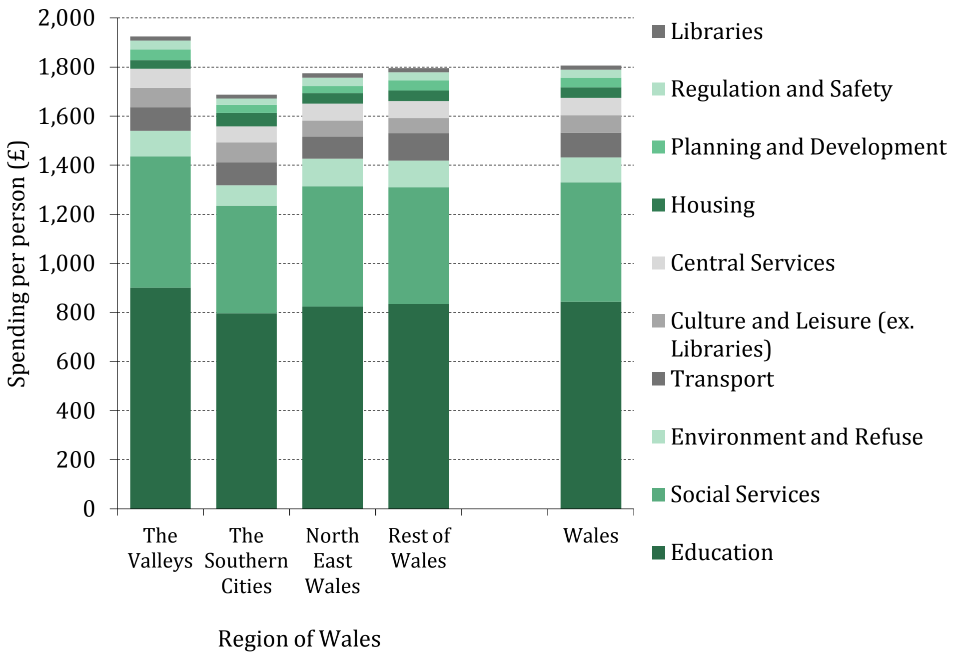
- The Valleys (consisting of Blaenau Gwent, Bridgend, Caerphilly, Merthyr, Neath Port Talbot, Rhondda Cynon Taf and Torfaen)
- The Southern Cities (consisting of Cardiff, Newport and Swansea)
- North East Wales (consisting of Denbighshire, Flintshire and Wrexham)
- Rest-of-Wales (consisting of the remaining local authority areas).

This shows that overall current service expenditure by UAs is highest in The Valleys at £1,925 per person per year, and lowest in The Southern Cities at £1,688 per person per year (in North East Wales and the Rest-of-Wales, current service expenditure per person is £1,774 and £1,795, respectively).

Net current service expenditure in The Valleys is higher than the all-Wales average for all service areas with the exceptions of transport and housing. High levels of expenditure per person on education (£900 versus £843 nationally) and social services (£535 versus £487) are the biggest drivers of higher expenditure in cash terms, while, in percentage terms, expenditure exceeds the Welsh average most for planning and development (13% higher) and regulation and safety (10%). On the other hand, net current service expenditure in the Southern Cities is lower than the all-Wales average for all service areas with the exceptions of housing and culture and leisure (ex. libraries). Low levels of expenditure per person on education (£796 versus £843 nationally) and social services (£439 versus £487) are the biggest drivers of lower expenditure in cash terms, while, in percentage terms, expenditure is lowest relative to the national average for environmental and refuse services (18% lower), regulation and safety services (17% lower), and planning and development services (16% lower).

It is beyond the scope of this report to investigate whether expenditure is appropriate to needs in the various parts of Wales. But it is worth noting that The Valleys (especially the upper Valleys) contain many of the most deprived communities in Wales, with above-average levels of unemployment, ill-health and below-average educational achievement and life expectancy. Thus greater needs are likely to play a major role in explaining higher levels of expenditure in this part of Wales (indeed, such measures of deprivation enter the funding formulas used to determine grants to local authorities). The Southern Cities are more mixed, and contain some of the most deprived and also the least deprived communities in Wales. Lower levels of expenditure in these areas may reflect the fact that the cities are densely populated, meaning that services can be provided with greater economy of scale. Differences in demographics (such as the proportion of school-age children and elderly people) will also explain some of the variation in spending across regions of Wales (and, indeed, local authorities). For instance, Valleys authorities tend to have both greater proportions of school-age children and elderly people than the cities (which have greater proportions of people of working age).

Figure 3.2. Net current service expenditure per person by UAs across regions of Wales, 2012–13



Source: StatsWales, local government expenditure estimates, 2012–13, and authors' calculations.

Of course, decisions on spending are made at the unitary authority level as opposed to the 'regional' level. And, neither are the regions defined homogenous. For instance, while the 'Rest-of-Wales' region has been defined so that it consists of the less urbanised parts of Wales; it contains both relatively affluent areas such as Monmouthshire and the Vale of Glamorgan, and relatively poor areas like Anglesey. Table 3.1 shows expenditure by service for all 22 UAs in Wales.

Overall planned net current service expenditure per person in 2012−13 is highest in Merthyr Tydfil (£2,018), Rhondda Cynon Taf (£2,018) and Denbighshire (£2,013), although the service areas driving this high expenditure differ between these authorities. Planned net current service expenditure per person in 2012−13 is lowest in Monmouthshire (£1,628), Newport (£1,645) and Cardiff (£1,672).

The rows shaded grey in Table 3.1 indicate UAs in the 'West Wales and the Valleys' region eligible for Tier 1 European Union (EU) funding, while the rows shaded white indicate UAs in 'East Wales', which is largely ineligible for EU funding. East Wales has a more productive economy than West Wales and the Valleys: Gross Value Added, a measure of economic output, was around 91% of the UK average in East Wales, and only 63% of the UK average in West Wales and The Valleys in 2009. Expenditure is less than £1,700 per person in all UAs in East Wales, with the exception of Powys, a large and sparsely populated county (a factor which, as recognised by the local government funding formulas, may necessitate higher spending per person than other parts of East Wales). Expenditure is more than £1,750 per person in all UAs in West Wales and The Valleys, with the exception of Swansea, which consists of a densely populated city and relatively affluent rural areas (factors which may mean services can be provided with lower spending per person than other parts of West Wales and the Valleys).

Table 3.1. Net current service expenditure per person by UAs, 2012–13

Unitary Authority	Education	Social Services	Environment and Refuse	Transport	Culture and Leisure (ex Libs)	Central Services	Housing Services	Planning and Development	Regulation and Safety	Libraries	TOTAL
Anglesey	803	443	139	150	49	87	32	41	29	15	1,788
Gwynedd	834	507	122	146	63	62	55	45	41	16	1,892
Conwy	815	525	112	89	77	71	46	24	39	18	1,816
Denbighshire	935	552	109	96	83	99	40	37	40	20	2,013
Flintshire	811	470	96	98	59	57	32	27	28	18	1,697
Wrexham	760	470	135	75	61	63	54	27	35	16	1,695
Powys	849	507	121	125	74	51	62	29	27	17	1,864
Ceredigion	844	459	109	154	64	63	20	56	45	17	1,829
Pembrokeshire	880	453	106	97	47	47	37	48	34	16	1,765
Carmarthenshire	841	502	89	106	53	101	39	72	23	14	1,841
Swansea	768	459	81	75	74	111	75	52	28	14	1,737
Neath Port Talbot	818	636	97	108	73	81	48	65	30	20	1,975
Bridgend	873	458	88	84	61	95	47	42	24	15	1,789
Vale of Glamorgan	877	410	93	74	58	68	26	18	34	21	1,679
Rhondda Cynon Taf	973	571	108	86	84	66	27	40	47	15	2,018
Merthyr Tydfil	912	517	124	101	111	112	25	60	39	18	2,018
Caerphilly	890	465	102	113	74	68	25	26	28	23	1,814
Blaenau Gwent	860	584	115	90	106	113	29	36	48	16	1,997
Torfaen	923	518	110	101	62	47	49	54	42	16	1,923
Monmouthshire	720	438	96	100	72	63	56	31	36	16	1,628
Newport	846	460	66	71	83	36	24	16	27	16	1,645
Cardiff	795	417	91	118	84	45	53	26	27	17	1,672
All (Wales)	843	487	101	101	72	71	43	39	33	17	1,806

Source: StatsWales, local government expenditure estimates, 2012–13, and authors' calculations.

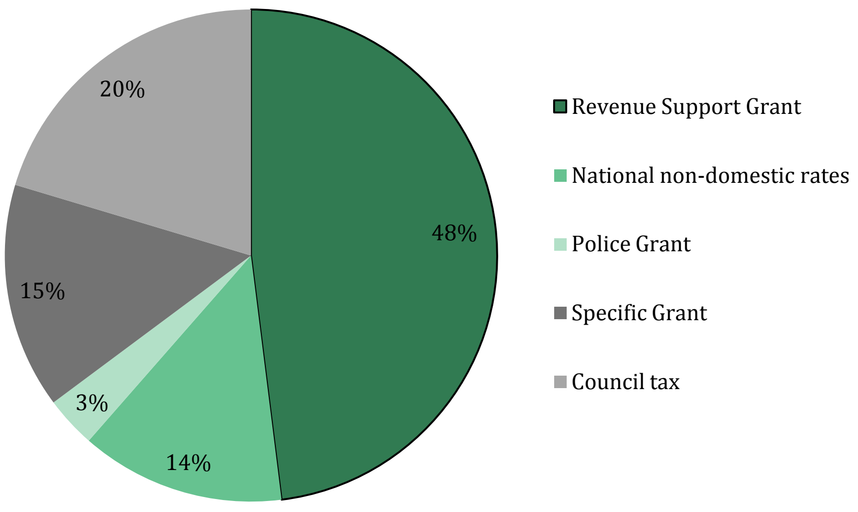
Funding local government

Welsh local government net expenditure is funded through a number of different sources, including council tax, and general and specific grants from the Welsh and UK Governments. But what is the relative importance of these different sources of funding? Knowing how important the various sources of funding are to local government is key to understanding what is driving the spending cuts discussed in the next section (Section 2.2) of this report.

In order to do this we examine the components of Welsh local government's 'spending power'. We define spending power as the amount raised in council tax, along with the amount provided to local authorities through general and specific grants (with the exception of those for housing benefit and council tax benefit).[13] This differs from the amount spent on providing current services for a number of reasons including additions to or withdrawals from financial reserves, and interest payments, but is a better measure for showing the sources of local government revenue. Figure 3.3 shows the contribution of each source of funding to total revenue expenditure in Wales in 2012–13. The majority (80% or four-fifths) comes in the form of various grants from the Welsh Goverment, with just one-fifth coming from council tax (including that paid for by council tax benefit). Among unitary authorities alone, grants are slightly more important, contributing 81% of overall spending power, with this varying between 72% in Monmouthshire and 84% in Newport.

This illustrates the fact that how much the Welsh Government decides to allocate to local authorities through grants is the key driver of their overall spending power. For instance, a reduction in grants of 5% would necessitate councils to increase their council tax revenues by just over 20%, on average, to maintain their spending power. This is an issue to which we return later.

Figure 3.3. The building blocks of local government spending power, 2012–13



Source: Local Government budget estimates, 2012-13 and authors' calculations.

[13] General grants include redistributed non-domestic ('business') rates and the Revenue Support Grant.

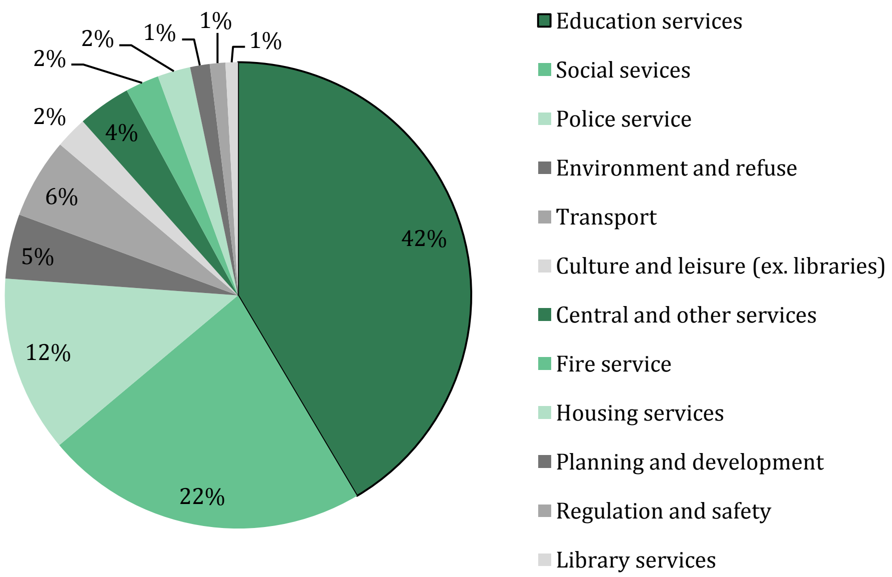
Comparing local government spending in Wales with England

It is useful to compare the levels of local government spending in Wales with that in England. Local government net current service spending in England is planned to total £94.6 billion in 2012–13, and Figure 3.4 shows how this is broken down by service area (we use the same order as Figure 3.1 to allow easy comparison with Wales).

The broad patterns are the same as in Wales. The largest single component of spending is education services, accounting for 42% of all spending. This is very much higher than in Wales, where education services account for 41% of local government spending, which may be surprising given that a large fraction of schools spending now bypasses English local government and goes directly to schools (including all funding for Academies and Free Schools). As in Wales, spending on social services (22%) and police services (12%) represent the next largest parts of overall local government spending. Overall, the three largest services account for 76% of total local government spending in England versus 74% in Wales.

Culture and leisure represents a much smaller fraction of spending in England (2%) than in Wales (4%), as does planning and development services (1% versus 2%), largely reflecting greater spending on economic development in Wales. On the other hand, spending on transport represents a greater fraction of the budget (6% versus 5% in Wales), reflecting the high levels of spending in the major metropolitan areas and especially London (net expenditure by Transport for London on the London Underground, Overground and buses – part of the Greater London Authority – is counted as part of local government spending).

Figure 3.4. Local government net current service spending in England, 2012–13



Notes: Net current service spending is the overall level of spending on a service net of any income from providing that service. 'Central and other services' include corporate and democratic management and non-distributed costs.
Source: DCLG, local government budget estimates, 2012–13.

It matters not only how the pie is split between services but also how big the pie is in the first place. Table 3.2 shows the amount spent per person for each service and in total. We also show the amount in total excluding education given the fact that a large fraction of English schools spending now bypasses local authorities completely. In the rest of this sub-section we focus on spending on services *excluding education* to allow easier comparisons between nations.

The results show that local government spending is higher in Wales for each service area with the exception of police services (where it is 94% of the English level), although spending in

England is skewed somewhat by especially high spending in London. Expenditure in the rest of England averages £184 per person, somewhat less than in Wales. Overall, local government spending (excluding education) is 18% higher in Wales than in England. This is likely to reflect additional spending needs in Wales (for instance, due to greater levels of deprivation and a more dispersed population) and differences in policy priorities, particularly during the current austerity drive (for instance the NHS is protected from cuts in England but not in Wales). In cash terms, the largest excess is for social services spending at almost £90 per person per year, perhaps reflecting the older age structure of Wales, the higher levels of poverty and welfare-reliance, and a more dispersed population.

In percentage terms, Welsh local government spending exceeds that in England by most for culture and leisure (91%), regulation and safety (72%) and planning and development (63%), with the latter largely explained by greater spending on economic and community development. Spending on transport is close to the English average (2% higher), although it should be remembered that spending in England is skewed by high spending in London and, to a lesser extent, other metropolitan areas, and outside of these areas spending on transport would be considerably lower than in Wales.

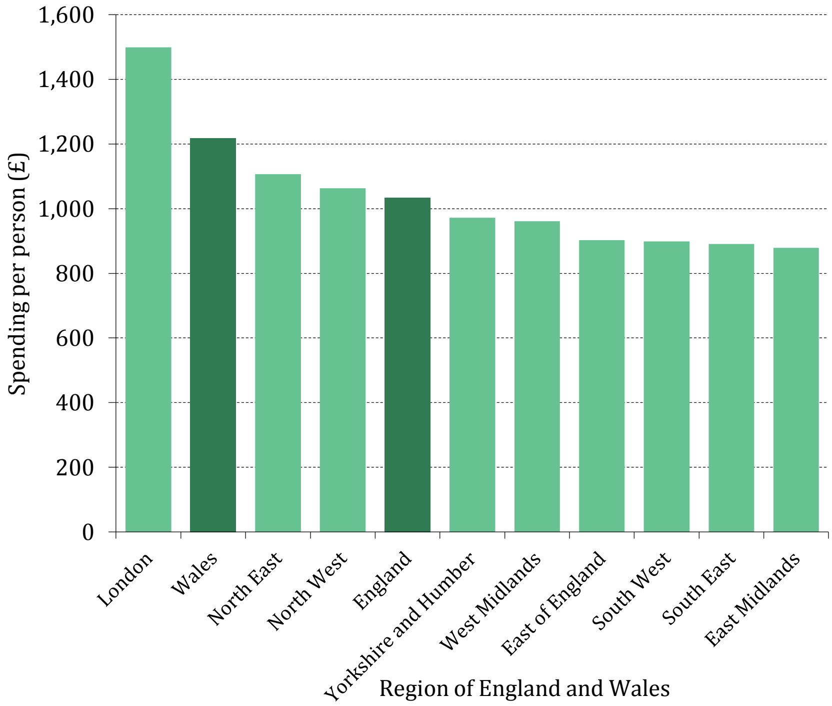
Table 3.2. Net current service expenditure per person by service, England and Wales, 2012–13

Service Area	England	Wales	Wales as % of England
Education services	734	843	**115%**
Social services	397	487	**123%**
Police service	217	204	**94%**
Environment and refuse	79	102	**129%**
Transport	98	101	**102%**
Culture and leisure (ex. libraries)	39	75	**191%**
Central and other services	65	74	**114%**
Fire service	41	45	**109%**
Housing services	40	43	**107%**
Planning and development	24	39	**163%**
Regulation and safety	19	33	**172%**
Library services	15	17	**110%**
Total	1,768	2,062	**117%**
Total (excluding education)	1,035	1,219	**118%**

Source: DCLG and StatsWales, local government budget estimates, 2012–13.

In our analysis of local government spending in England for the 2012 Green Budget we showed that levels of local government net current service spending (excluding education) varied significantly across the regions of England. Figure 3.5 shows where Wales would lie if it were a region of England: it would have the second highest level of spending after London, and £112 per person per year higher than in the North East, the region of England with the next highest spending.

Figure 3.5. Spending per person by local government (excluding education) across the regions of England and Wales, 2012–13



Source: DCLG and StatsWales, local government expenditure estimates, 2012–13

3.2 Where has the axe been falling? Cuts between 2009–10 to 2012–13

The local government spending figures for 2012–13 described in Section 3.1 follow three years of real-term cuts in both Wales and England. In this section, we examine how the cuts in Welsh local government spending vary by service and across the country and compare the situation in Wales with that in England.

Table 3.3 shows net current service expenditure by local government for each year since 2009–10, and the change in spending each year expressed as a percentage of 2009–10 spending. The first two rows show nominal expenditure and the change in nominal expenditure; the second two rows show real expenditure (measured in 2012–13 prices) and the change in real expenditure, and so account for whole-economy inflation (as measured by the GDP deflator); and the final two rows show real expenditure per person and the change in real expenditure per person, and so account for inflation and changes in population.

In nominal terms, net current service expenditure has increased from £6.32 billion to £6.35 billion between 2009–10 and 2012–13, an increase of around 0.6%. However, economy-wide inflation, which is predicted to average about 2.6% per year over these three years, means that real net current service expenditure is estimated to be reduced by 7.0% between 2009–10 and 2012–13. Population growth of around 0.5% per annum means that the fall in real spending per person is greater at 8.4%. The biggest falls took place in 2010–11 and the pace of reduction has fallen in each of the following two years: spending per person was 3.4% below its peak in 2010–11, 6.6% below its peak in 2011–12 and 8.5% below its peak in 2012–13. But it is important to note that inflation and population growth mean real-terms spending is continuing to fall in 2012–13 despite an increase in nominal spending.

Table 3.3. Net current service expenditure per person by Welsh local government, 2009–10 to 2012–13

	2009–10	2010–11	2011–12	2012–13
Expenditure (£ billion, current prices)	6.32	6.30	6.28	6.35
% change (annual, % of 2009–10 level)		-0.2%	-0.4%	1.2%
% change (cumulative)		-0.2%	-0.6%	0.6%
Expenditure (£ billion, 2012–13 prices)	6.83	6.63	6.45	6.35
% change (annual, % of 2009–10 level)		-3.0%	-2.6%	-1.4%
% change (cumulative)		-3.0%	-5.6%	-7.0%
Expenditure per person (£, 2012–13 prices)	2,253	2177	2104	2062
% change (annual, % of 2009–10 level)		-3.3%	-3.2%	-1.9%
% change (cumulative)		-3.3%	-6.6%	-8.4%

Source: StatsWales, local government expenditure outturns (2009–10 and 2010–11) and estimates (2011–12 and 2012–13) and authors' calculations.
Notes: Inflation as measured by the GDP deflator estimated at 2.84% between 2009–10 and 2010–11; 2.38% between 2010–11 and 2011–12; and predicted to be 2.7% between 2011–12 and 2012–13.

The changing funding situation: grants and council tax

The downward pressure on local government budgets during the three years since 2009–10 is very much driven by real-terms reductions in Welsh Government grants to local government. On average, general and specific grants have been reduced by 8.6% in real terms since 2009–10 (or by 10.1% per person), while council tax revenues have increased by 3.0% (or 1.4% per person) in real terms. As discussed in Section 3.1, grants contribute four-fifths of the spending power of Welsh local government, which means that when combined with a small real-terms increase in council tax revenues, overall spending power has been reduced by 6.5% (or 7.9% per person), on average. In other words, the reductions in spending power and resultant cuts to net current service expenditure are the result of cuts imposed by central government as opposed to discretionary decisions by local government.

There is significant variation in the changes in grants and spending power across Wales. For instance, the real-terms reduction in grants is as large as 16.7% (17.3% per person) in the Isle of Anglesey and as small as 1.6% in Cardiff (5.6% per person). All councils, with the exception of Caerphilly (which has implemented a council tax freeze since 2010–11), have seen a real-terms increase in council tax revenues, with the greatest increase (6.9% or 6.2% per person) being in the Isle of Anglesey. The real-terms reduction in overall spending power varies is also greatest in the Isle of Anglesey at 12.9% (13.5% per person) and smallest in Cardiff at 1.0% (5.1% per person).[14] Indeed, the correlation between the reduction in grants and overall spending power is almost perfect (the correlation coefficient is 0.99, where 1 is the maximum indicating perfect correlation). This indicates that the differences in the scale of local government spending cuts across Wales reflect, very largely, differences in the scale of cuts to grants from central government as opposed to local government spending decisions.

[14] Note that per-person reduction in grants and spending power is smaller than in Cardiff in Carmarthenshire, Flintshire, Torfaen, Wrexham and Rhondda Cynon Taf. This reflects the fact that the population is growing significantly more slowly in these areas than in Cardiff (the fastest growing UA in Wales).

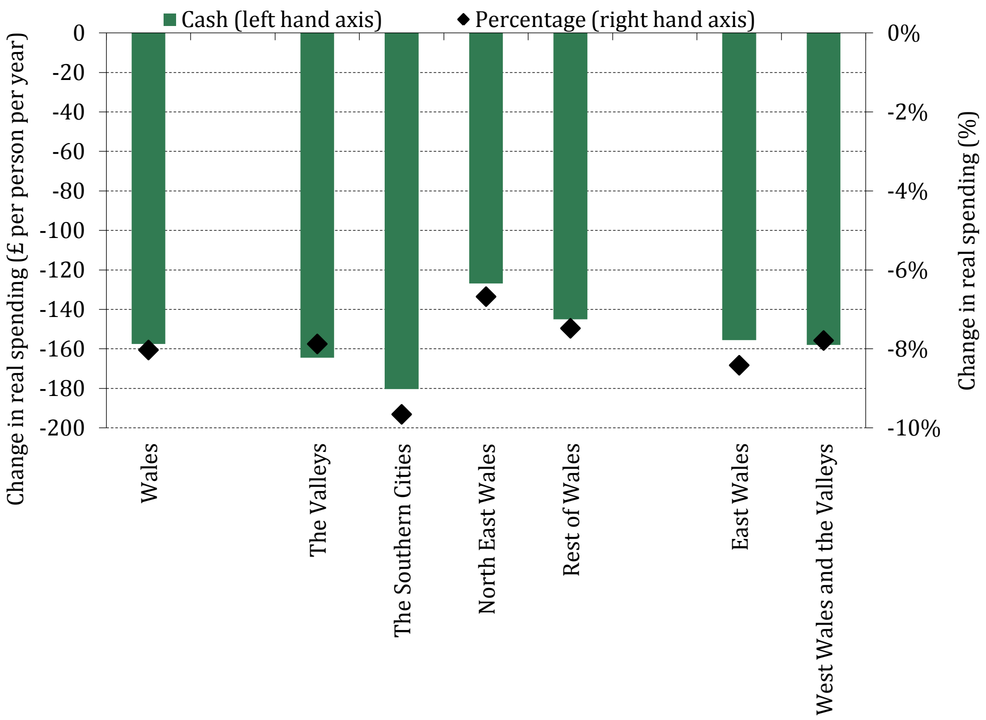
The cuts to net current service spending: variation across Wales

The fact that grants and council tax revenues have evolved differently for different local authorities means that one may expect the cuts to vary in magnitude across Wales. This is indeed what is found.

For instance, Police Authorities' real net current service spending per person is due to be cut by 11.3% between 2009–10 and 2012–13. However, the size of the cut varies between 8.3% in Gwent and 12.6% in Dyfed-Powys (it is 11.1% in North Wales and 12.1% in South Wales). The cuts in Fire Authorities' real net current service spending per person also vary across Wales: the average cut of 12.3% reflects cuts of 16.2% and 15.2% in West Wales and North Wales, respectively, but a cut of only 8.6% in South Wales.

There is also variation in the size of cuts being made by different UAs (the average cut is 8.0%). Figure 3.6 shows the size of the cuts in both cash and percentage terms for the four regions we defined, and for the two EU regions of Wales (East Wales and West Wales and The Valleys). It shows that the cuts have been largest in both cash and percentage terms in the Southern Cities (the area with the lowest spending per person in both 2009–10 and 2012–13) at £180 per person or 9.7%, and are smallest in cash and percentage terms in North East Wales at £127 or 6.7%. Cuts in The Valleys (the area with the highest spending per person in both 2009–10 and 2012–13) are planned equal to £165 per person or 7.9%, with cuts of £145 or 7.5% in the Rest-of-Wales. Planned cuts are slightly larger in West Wales and The Valleys than East Wales in cash terms (£158 versus £156 per person), but higher spending per person in West Wales means the percentage cuts are slightly smaller (7.8% versus 8.4%).

Figure 3.6. Cuts to net current service expenditure per person by UAs across regions of Wales, 2009–10 to 2012–13



Source: StatsWales, local government expenditure outturns (2009–10 and 2010–11) and estimates (2011–12 and 2012–13) and authors' calculations.

As we shall see later, the cuts in local government net current service expenditure in England were significantly larger in both cash and percentage terms in the poorer, higher-spending areas of the country. The fact that cuts are somewhat *larger* in percentage terms in the relatively affluent and lower-spending East Wales than in West Wales and The Valleys suggests such a strong pattern is unlikely to exist in Wales. Breaking down authorities into four groups[15] based on their net current service expenditure in 2009–10 allows us to gain further insights into this issue. Doing this shows that the (weighted) average cut is equal to 8.8% of spending in the five UAs with the highest initial spending in 2009–10, 7.4% in the six UAs with the next highest spending, 8.8% in the following six UAs, and 6.9% in the five UAs with the lowest initial spending in 2012–13.[16] These figures suggest that any link between the initial level of spending and the size of cuts is relatively weak in Wales.

Table 3.4 shows the size of the cuts in net current service expenditure per person being made by each of the UAs in Wales in both cash and percentage terms. This shows significant variation in the size of overall cuts, with the largest in both percentage and cash terms (£324 or 16.5%) taking place in Newport, followed by Blaenau Gwent (£270 or 11.9%) and Caerphilly (£268 or 12.9%). On the other hand, cuts are much smaller in Carmarthenshire (£56 or 2.9%), Wrexham (£78 or 4.4%) and Rhondda Cynon Taf (£95 or 4.5%). As discussed above, differences across UAs reflect, in large part, differences in the size of cuts to their grants from central government rather than discretionary changes by UAs. However, local authorities have also faced different pressures on non-service expenditure, such as repayment of debt principle and interest (which, in the short run, they may have little control over), and have taken different decisions on how to change their contributions to or appropriations from financial reserves.

[15] The UAs in each group of (1) – highest spending – to (4) – lowest spending – are: (1) Denbighshire, Rhondda Cynon Taf, Merthyr Tydfil, Caerphilly, Blaenau Gwent; (2) Ceredigion, Pembrokeshire, Carmarthenshire, Swansea, Bridgend, Newport;(3) Anglesey, Gwynedd, Conwy, Powys, Neath Port Talbot, Torfaen; (4) Flintshire, Wrexham, The Vale of Glamorgan, Monmouthshire and Cardiff.

[16] The unweighted averages are 9.4%, 7.6%, 9.0% and 7.0%, respectively.

Table 3.4. Change in net current service expenditure per person by UAs, 2009–10 to 2012–13

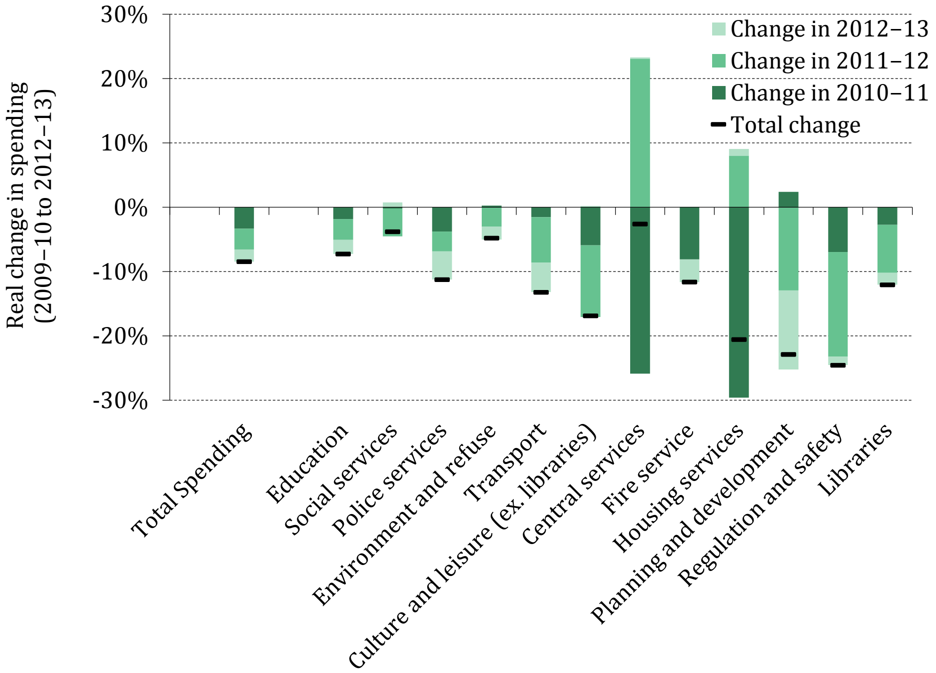
Unitary Authority	Cash	Percentage
Anglesey	-222	-11.0%
Gwynedd	-146	-7.2%
Conwy	-175	-8.8%
Denbighshire	-213	-9.6%
Flintshire	-115	-6.4%
Wrexham	-78	-4.4%
Powys	-173	-8.5%
Ceredigion	-161	-8.1%
Pembrokeshire	-163	-8.4%
Carmarthenshire	-56	-2.9%
Swansea	-163	-8.5%
Neath Port Talbot	-100	-4.8%
Bridgend	-185	-9.4%
Vale of Glamorgan	-119	-6.6%
Rhondda Cynon Taf	-95	-4.5%
Merthyr Tydfil	-178	-8.1%
Caerphilly	-268	-12.9%
Blaenau Gwent	-270	-11.9%
Torfaen	-116	-5.7%
Monmouthshire	-183	-10.1%
Newport	-324	-16.5%
Cardiff	-130	-7.3%
All (Wales)	-158	-8.0%

Source: StatsWales, local government expenditure outturns (2009–10 and 2010–11) and estimates (2011–12 and 2012–13) and authors' calculations.

The cuts to net current service spending: variation by service

Differences in how much central government has decided to allocate to different types of authorities responsible for different services (for example, police authorities versus local councils) and the use of discretion by local government in setting spending priorities mean that spending cuts vary by service. Figure 3.7 shows how the spending changes made in 2010–11 (in dark green) and the changes planned for 2011–12 (in mid green) and 2012–13 (in light green) vary across services. The black lines show the change in spending planned over the three years to 2012–13. Changes are measured as a percentage of expenditure in 2009–10.

Figure 3.7. Cuts to local government current service spending in Wales by service area, 2009–10 to 2012–13



Source: StatsWales, local government expenditure outturns (2009–10 and 2010–11) and budgets (2011–12 and 2012–13) , available at http://statswales.wales.gov.uk/index.htm.
Note: Changes are measured as a percentage of expenditure in 2009–10.

Spending on regulation and safety services is set to face the largest cuts of any service area, equivalent to 24.6% over three years, with planning and development (22.9%) and housing services (20.6%) close behind. The timing of the cuts differs significantly, however:

- Net current service expenditure per person on regulation and safety services fell 7.0% in 2010–11, 16.3% in 2011–12 and is planned to be reduced by only 1.3% in 2012–13.
- Planning and development saw a small rise in spending in 2010–11 (2.3%), but cuts for 2011–12 and 2012–13 are planned to equal 13.0% and 12.3%, respectively.
- Spending on housing services fell by 29.6% in 2010–11, but local government budgeted for increases during the following two years (8.0% in 2011–12 and 1.1% in 2012–13).

Social services and environmental and refuse services have both been relatively protected from the cuts, seeing reductions in net current service spending per person of only 3.8% and 4.8%, respectively. This may reflect prioritisation of these services by local authorities, or rising demands on these budgets that mean there is less scope for spending cuts. Furthermore, the Welsh Government has stated that it expects UAs to protect spending on social services and published a set of figures for what it thought this implied for the cash-terms social service budget.[17] It is notable that the real-terms reduction in social services spending took place entirely between 2010–11 and 2011–12, the first year to which these targets applied. However, the change in spending between 2010–11 and 2012–13 was more generous than that required to meet the Welsh Government's plans. Over the three years since 2009–10, expenditure on central

[17] The suggested changes in expenditure were: in 2011–12, -0.33% in cash terms, which is equivalent to -2.65% in real terms (-3.30% per person), and in 2012–13, +1.58% in cash terms, which is equivalent to -0.78% in real terms (-1.31% per person). Suggested increase s in cash-terms spending (but reductions in real-terms spending) have also been published for 2013–14 and 2014–15.

services has also fallen by a relatively small amount: 2.6%. However, spending in this area is volatile and large cuts in 2010−11 (over 25%) were followed by large increases in 2011−12 (over 20%), and so figures for this service area should be treated with caution. It is also worth noting that 'central services' does not include all administration and management functions: much of this is charged to other service area budgets (e.g. the payroll and computing costs associated with the education service are included in education spending). Until full spending outturns are available we cannot say how the cuts within each area have been delivered (e.g. whether it is via reductions in spending in schools or in central administration).

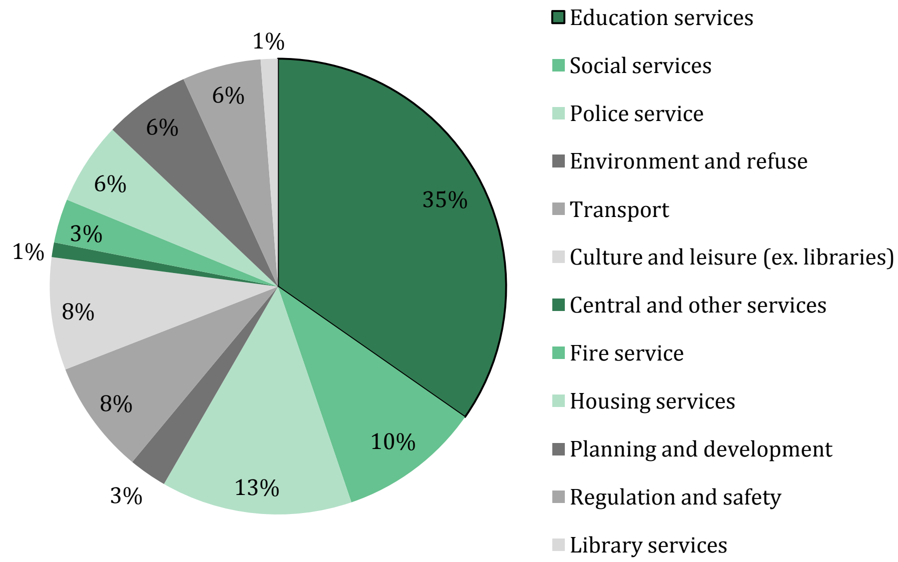
Spending on education services is planned to be reduced by slightly less than the overall cut: 7.3%, spread across each of the three years. This could suggest that education may not have been especially protected, but may also reflect the fact lower spending pressures in this area (for instance, due to the decline in pupil numbers during this period). The Welsh Government has stated that, along with social services, it also expects UAs to protect spending on education, and has suggested the same annual changes in expenditure. UAs met these targets in 2011−12 but planned budgets for 2012−13 do not meet the targets.

Of course, large cuts in the budgets of small departments (e.g. library services or regulation and safety services) might contribute a smaller fraction of the overall cut than small cuts in the budgets of large departments (e.g. social services). Figures 3.8a shows the fraction of the total cuts that have been delivered by each service area for total local government.

The largest service areas have delivered the largest *cash* contributions to the overall spending cuts, even where the *percentage* cuts have been smaller than average. For instance, cuts to education spending account for 35% of the planned reduction in overall local government net current service expenditure by 2012−13 (education represents 41% of overall planned spending in 2012−13), with cuts to police services accounting for 13% of overall cuts (police services represent 10% of planned spending 2012−13). Reductions in social service spending are the third largest contributor to the overall cuts (10%), although this is much less than the fraction of spending absorbed by social services (a planned 24% in 2012−13): this is due to the relatively small percentage cuts to this service area.

Other services areas, which together account for 26% of planned spending in 2012−13, have contributed approximately 37% of the overall cuts since 2009−10. Large percentage cuts to housing services, regulation and safety services and planning services mean that the contributions of these areas to overall cuts (each contributes 6%) is much larger than their contribution to overall spending (each contributes around 2%). On the other hand, central services and environmental services are contributing less to the cuts (1% and 3%, respectively), than they represent as a fraction of total expenditure (4% and 5%, respectively).

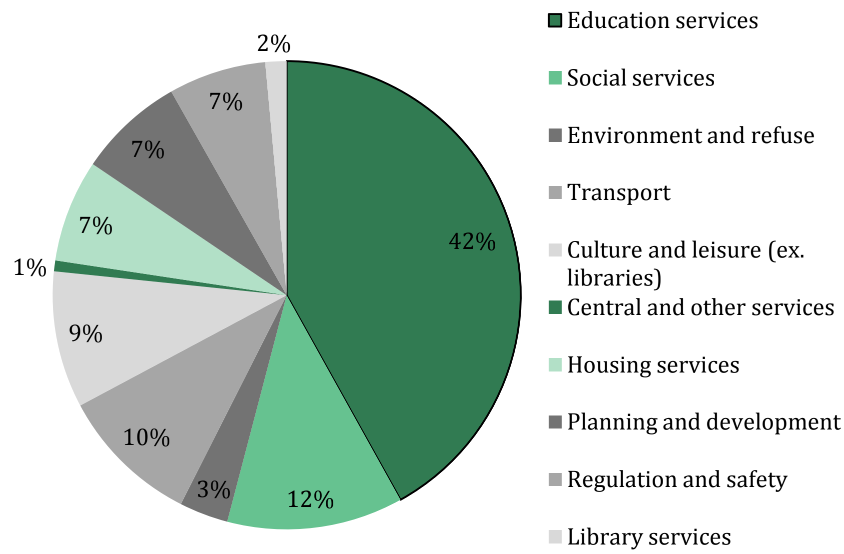
Figure 3.8a. Proportion of cuts to overall local government current service spending delivered by each service area, Wales, 2009–10 to 2012–13



Source: StatsWales, local government expenditure outturns (2009–10 and 2010–11) and budgets (2011–12 and 2012–13), available at http://statswales.wales.gov.uk/index.htm

Figure 3.8b shows the fraction of overall cuts by UAs delivered by each of the services they provide and, unsurprisingly, shows effectively the same pattern (it is included for reference purposes).

Figure 3.8b. Proportion of cuts to overall local government current service spending delivered by each service area, Wales, 2009–10 to 2012–13 (UAs)



Source: StatsWales, local government expenditure outturns (2009–10 and 2010–11) and budgets (2011–12 and 2012–13), available at http://statswales.wales.gov.uk/index.htm

Given that local authorities are facing differential cuts to their overall current service expenditure, and because they may be prioritising different services, the cuts to each service area also differ. Full details of the cuts made and planned in each service area can be found in the accompanying online spreadsheet.[18] Here we highlight four UA service areas: education services, social services, culture and leisure services, and planning and development services.

Table 3.5 shows the planned percentage change in real-terms spending in each of these areas by each UA, the overall percentage cuts by each UA, and the average figures for Wales. It shows that:

- Education spending is planned to be reduced in real terms between 2009–10 and 2012–13 in all UAs. However, the scale of the cuts varies substantially, with five UAs cutting spending by less than 5% (the smallest reduction is in Conwy where the reduction is 2.4%), and four reducing spending by more than 10% (the biggest reduction is in Monmouthshire at 13.1%).
- Social services spending is planned to be reduced in 14 out of 22 Welsh UAs, with increases in the rest. Increases in spending are largest in Pembrokeshire and Carmarthenshire (around 5%), with the largest cuts in Newport (nearly 14%). It is notable that the three Southern Cities all plan to have made major cuts to this service area and, in the case of Cardiff and Swansea, percentage cuts that exceed the average for all services (the only other UA to do this is Anglesey).
- Expenditure on culture and recreation (excluding libraries) is due to be reduced in 18 out of 22 Welsh UAs. Those planning increases in spending are Powys (10.0%), Blaenau Gwent (9.9%), Ceredigion (5.8%) and Merthyr Tydfil (2.9%). Among those cutting, many are planning very significant cuts. Cuts exceed 25% in 13 UAs, and exceed 10% in 13 UAs. Percentage cuts exceed the average for all services in 17 out of 22 UAs.
- Expenditure on planning and development services is due to be lower in real terms in 2012–13 than in 2009–10 in 18 out of 22 Welsh UAs. Those increasing expenditure are Neath-Port Talbot (38.3%), Carmarthenshire (33.7%), Torfaen (13.7%) and Swansea (3.9%). Elsewhere in Wales, the cuts are often large, at up to 75% in Blaenau Gwent, and over one-third in half (11) of all Welsh UAs. These cuts are mainly due to reductions in planned spending on economic and community development as opposed to planning control.

[18] The online appendix spreadsheet will be available from 31st October 2012 at http://www.ifs.org.uk/docs/WelshLGSpending.xlsx

Table 3.5. Change in net current service expenditure per person by UAs for selected services (%), 2009–10 to 2012–13

Unitary Authority	Education	Social Services	Culture (ex. libraries)	Planning and Development	Total
Anglesey	-9.7%	-11.4%	-29.8%	-46.0%	-11.0%
Gwynedd	-4.3%	-4.0%	-18.2%	-17.3%	-7.2%
Conwy	-2.4%	-4.3%	-6.8%	-1.4%	-8.8%
Denbighshire	-7.4%	-5.4%	-23.2%	-18.3%	-9.6%
Flintshire	-9.7%	1.3%	-9.5%	-6.5%	-6.4%
Wrexham	-6.1%	-4.1%	-6.8%	-45.2%	-4.4%
Powys	-12.3%	2.8%	10.0%	-51.7%	-8.5%
Ceredigion	-7.5%	-7.1%	5.8%	12.8%	-8.1%
Pembrokeshire	-4.9%	4.6%	-39.3%	-35.3%	-8.5%
Carmarthenshire	-6.4%	5.5%	-29.6%	33.7%	-2.9%
Swansea	-9.1%	-9.9%	-17.4%	3.9%	-8.6%
Neath Port Talbot	-9.2%	3.9%	-28.9%	38.3%	-4.8%
Bridgend	-4.6%	-5.6%	-23.2%	-20.4%	-9.4%
Vale of Glamorgan	-3.0%	-4.5%	-20.5%	-40.1%	-6.6%
Rhondda Cynon Taf	-4.7%	0.2%	-9.0%	-35.0%	-4.5%
Merthyr Tydfil	-6.6%	-7.9%	2.9%	-28.4%	-8.1%
Caerphilly	-9.2%	-7.9%	-31.6%	-26.0%	-12.9%
Blaenau Gwent	-12.4%	3.6%	9.9%	-74.8%	-11.9%
Torfaen	-6.7%	-2.6%	-41.4%	13.7%	-5.7%
Monmouthshire	-13.1%	0.5%	-21.9%	-26.4%	-10.1%
Newport	-11.1%	-13.8%	-19.8%	-59.2%	-16.5%
Cardiff	-4.9%	-9.7%	-9.0%	-34.4%	-7.3%
All (Wales)	-7.3%	-3.8%	-16.9%	-22.9%	-8.5%

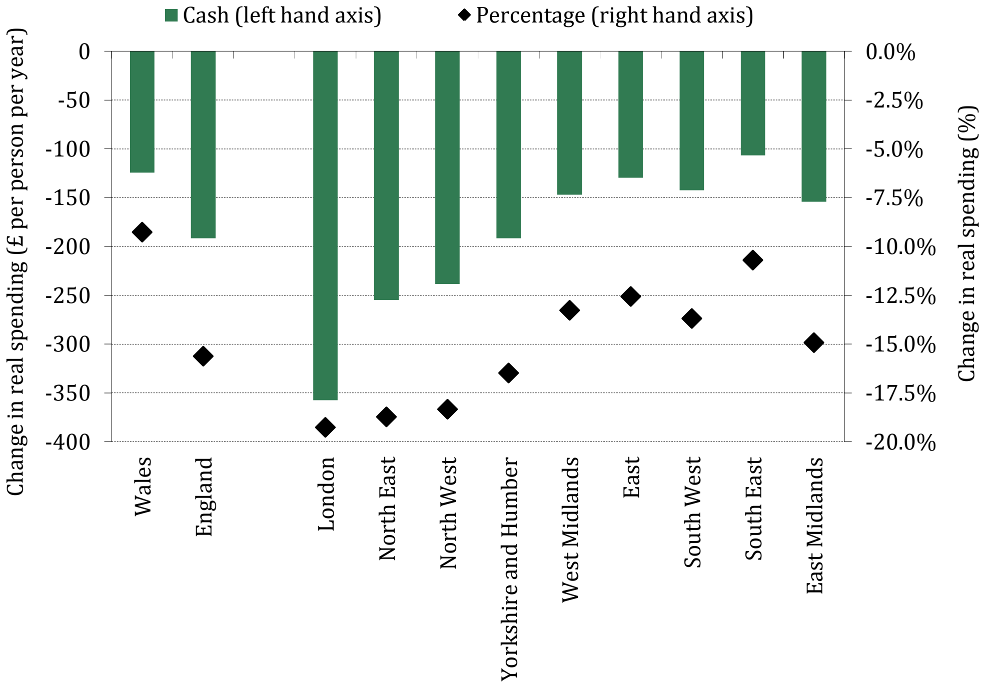
Source: StatsWales, local government expenditure outturns (2009–10 and 2010–11) and estimates (2011–12 and 2012–13) and authors' calculations.

The cuts to net current service spending: comparisons with England

English local government has also been making cuts during this period, and in this section we compare the size and nature of these cuts to those being made in Wales. As with most of our comparisons on the level of local government spending in England and Wales, this analysis excludes spending on education, a large part of which increasingly bypasses local authorities in England (due to the Academy and Free Schools programme).

Larger cuts to grants and a freeze in council tax rates in virtually all of England have meant that English local authorities have had to make larger cuts to their net current service expenditure than those in Wales. The larger cuts in grants in England reflect the fact that the UK Government has chosen to protect real-terms current spending on the NHS and schools in England, necessitating larger cuts in other budgets such as local government. The Welsh Government did not decide to prioritise spending on the NHS or schools as much, allowing it to make smaller cuts in grants to local authorities. Figure 3.9 shows the size of the cuts in cash and percentage terms for Wales, England, and each of the regions of England since 2009–10.

Figure 3.9. Cuts to local government net current service spending (excluding education), by region of England and Wales, 2009–10 to 2012–13



Source: DCLG and StatsWales, local government expenditure outturns (2009–10 and 2010–11) and budget estimates (2011–12 and 2012–13).

Cuts to net current service spending per person (excluding education) total £124 (9.3%) in Wales and £191 (15.6%) in England. This means English local government has cut spending by around 1.5 times as much per person than in Wales in cash terms, and 1.7 times as much in percentage terms. Clearly, so far, Welsh local government has fared rather better than English local government.

We saw earlier (Section 2.1) that in 2012–13, local government spending per person in Wales was between the levels in the North East of England and London. The contrast between the experience in Wales and these high-spending regions of England is even starker: spending cuts of 19.3%, 18.7% and 18.3% in London, the North East and North West, respectively, are around double the level in Wales.

Focusing on England, a clear pattern emerges, where not only the largest cash-terms cuts but also the largest percentage cuts are found in the regions of England where spending is (and initially was) highest. Because spending in England tends to be higher in urban areas with high levels of deprivation in London and the North of England, this means that the cuts in England have hit poorer parts of the country hard. This reflects the fact that, as in Wales, the cuts in local government spending in England are largely driven by reductions in grants, which make up a far larger proportion of total spending power for these poorer, more deprived local authorities than more affluent ones (revenue from council tax, which the more affluent authorities rely more upon, has been reduced in real terms due to the council tax freeze, but by significantly less). The Department for Communities and Local Government (which determines grants to local authorities in England) sets floors on how much grants could be reduced by, which were somewhat more generous for authorities that rely more on grants, but were not generous enough to ensure that they did not face significantly larger reductions in spending power than more affluent areas. This did not occur in Wales because the method for calculating grants to local authorities differs significantly.[19]

Percentage cuts in the South East of England, the area where spending was lowest in 2009–10,[20] and perhaps the least deprived region of England, have averaged just 10.7%, with the East and South West also seeing below average reductions in spending. As we saw above, it does not appear to be the case that the cuts in Wales are larger in percentage terms in the higher-spending, poorer areas of Wales: if anything the cuts are slightly *larger* in percentage terms in the more affluent East Wales than in West Wales and The Valleys.

We next examine the timing of cuts in England versus Wales. Table 3.6 shows how much of the overall cuts (excluding education) since 2009–10 were made in each year, expressed in cash terms and as a percentage of 2009–10 expenditure. The largest cuts in both countries took place in 2010–11, before the 2010 Spending Review settlements: cuts in spending per person were £58 (4.4%) in Wales and £81 (6.6%) in England in that year. Spending cuts have since slowed somewhat, especially in Wales, where the cuts to average spending per person (excluding education) were just £22 (1.6% of 2009–10 spending per person) in 2012–13.

Table 3.6. The timing of the cuts (excluding education), England and Wales, 2009–10 to 2012–13

	2009–10 to 2010–11	2010–11 to 2011–12	2011–12 to 2012–13	Total
Wales				
Cash	-58	-44	-22	-124
Percentage (annual)	-4.4%	-3.3%	-1.6%	-9.3%
England				
Cash	-81	-53	-57	-191
Percentage (annual)	-6.6%	-4.3%	-4.7%	-15.6%

Source: DCLG and StatsWales, local government expenditure outturns (2009–10 and 2010–11) and budget estimates (2011–12 and 2012–13).
Note: Percentage changes are measured as a percentage of expenditure in 2009–10.

It is also instructive to examine which services have seen the largest cuts in spending in England and compare this to Wales. We first do this for England as a whole, and then for the North East of England, a region that shares many similarities with Wales in terms of socio-economic and demographic characteristics but that, as we have seen, has had to make cuts around twice as large as those in Wales.

Table 3.7 shows the real- terms cut in net current service spending per person between 2009–10 and 2012–13 in England and Wales in both cash and percentage terms (for all services excluding education).

The cuts to police services, fire services and environmental and refuse services in England are broadly similar in percentage terms and cash terms to those in Wales (a little higher in the case of police and a little lower in the case of the other two). However, because the size of the overall reduction in spending in Wales is smaller, they contribute a considerably higher fraction of the

[19] The funding formulas in use in Wales determine the level of spending deemed necessary to provide a standard level of service given local characteristics (this is called the Standard Spending Assessment). The amount that can be raised locally from council tax (if the authority changed an 'average' level of council tax) is then subtracted from this and the amount of grant to be provided is calculated as a residual.

[20] Spending per person in the East Midlands is now below that in the South East following large spending cuts in 2011–12. In 2009–10 spending per person was between the level in the West Midlands and East of England.

total reduction in Wales than in England. These are areas that have been relatively protected in England, whereas police and fire services have both seen greater than average spending cuts in Wales.

For all other services, cuts have been considerably higher in percentage terms in England than in Wales. Spending per person on planning and development has been reduced by 50% (£24 per person) as opposed to 23% (£12), cuts to regulation and safety services have totalled 32% (£9) versus 25% (£11), and cuts to libraries have totalled 23% (£5) versus 12% (£2).

Table 3.7. Cuts in real-terms local government spending per person (£s and %), England and Wales, 2009–10 to 2012–13

Service Area	Spending cuts in Wales		Spending cuts in England	
	(£s)	(%)	(£s)	(%)
Social services	-19	-3.8%	-38	-8.7%
Police service	-26	-11.2%	-33	-13.1%
Environment and refuse	-5	-4.8%	-3	-3.5%
Transport	-15	-13.2%	-37	-27.4%
Culture and leisure (ex. libraries)	-15	-16.9%	-13	-24.7%
Central and other services	-2	-2.6%	-10	-13.7%
Fire service	-6	-11.6%	-4	-8.3%
Housing services	-11	-20.6%	-16	-28.8%
Planning and development	-12	-22.9%	-24	-49.8%
Regulation and safety	-11	-24.5%	-9	-32.2%
Library services	-2	-12.1%	-5	-23.2%

Source: DCLG and StatsWales, local government expenditure outturns (2009–10 and 2010–11) and budget estimates (2011–12 and 2012–13).

The reduction in spending on social services has been much larger in England than in Wales – 8.7% (£38 per person) versus 3.8% (£19) – and they have therefore made a larger contribution to the overall cuts (20% versus 15%). That is, while spending on social care has been relatively protected in England (the 8.7% reduction is considerably less than the 15.6% average reduction), it has not enjoyed quite the same degree of protection as in Wales, although this may reflect differential demand for social services in England and Wales. Transport spending has also been cut by considerably more in England than in Wales, although in part this is driven by the high levels of spending and subsequently large cuts in spending in London by Transport for London.

Table 3.8 repeats the analysis, this time comparing Wales and the North East of England. Local government in the North East of England has made cuts of almost 19% versus just over 9% in Wales. It has done this by making much larger cuts in a number of service areas including:

- social services, where spending has been reducing by 11.8%, or £58 per person per year, around three times the size of the cuts in Wales;
- culture and leisure (ex. libraries), where spending has been reduced by 35.7%, or £28 per person per year, over twice the percentage cuts in Wales;
- central and other services, where spending has been reduced by 22.9%, or £25 per person per year, over *ten* times the size of the cuts in Wales; and

- transport, where spending has been reduced by 22.3%, or £27 per person per year versus £15 per person per year in Wales.

Table 3.8. Cuts in real-terms local government spending per person (£s per person) and contribution to overall cuts (excluding education), North East England and Wales, 2009–10 to 2012–13

Service Area	**Spending cuts in Wales**		**Spending cuts in North East England**	
	(£s)	(%)	(£s)	(%)
Social services	-19	-3.8%	-58	-11.8%
Police service	-26	-11.2%	-33	-13.4%
Environment and refuse	-5	-4.8%	-4	-5.1%
Transport	-15	-13.2%	-27	-22.3%
Culture and leisure (ex. libraries)	-15	-16.9%	-28	-35.7%
Central and other services	-2	-2.6%	-25	-22.9%
Fire service	-6	-11.6%	-3	-5.3%
Housing services	-11	-20.6%	-20	-34.7%
Planning and development	-12	-22.9%	-37	-57.4%
Regulation and safety	-11	-24.5%	-14	-44.3%
Library services	-2	-12.1%	-6	-25.1%

Source: DCLG and StatsWales, local government expenditure outturns (2009–10 and 2010–11) and budget estimates (2011–12 and 2012–13).

While a more generous funding settlement has meant that Welsh local authorities have not had to make as drastic cuts as those in the North East, further real-terms reductions in grants over the coming years may necessitate similarly large cuts in Wales. Perhaps the North East of England provides evidence that this is possible (in that it *can* be done, although not necessarily without significant reductions in the quantity or quality of services provided), but that as the scope for cutting areas such as planning and development and regulation and safety diminishes, socially important 'core' services such as social services cannot be protected as much.

A longer run perspective on local government expenditure

Appendix B contains an analysis of local government spending in England and Wales since 2001–02. However, it is worthwhile highlighting a number of key results from this work.

Between 2001–02 and 2009–10 (and especially the first half of this period) there were significant real-terms increases in Welsh local government service expenditure (32%), of which just over one-third have been undone by the cuts planned between 2009–10 and 2012–13. The areas seeing especially large increases between 2001–02 and 2009–10 were housing services (largely the result of the 'Supporting People' initiative), planning and development, environment and refuse, regulation and safety and social care. The increases in other service areas (such as libraries or education) were substantially less.

The cuts over the last three years have also impacted different services differently. Large cuts to library services and cultural and recreational services have nearly wiped out earlier increases, meaning real-terms current service spending per person is little higher than in 2001–02.

The increase in spending on housing services remains very large at 197%, although this does mean just over one-quarter of the earlier increases to 2009−10 have since been undone. Spending per person on planning and development services is set to be 51% above its 2001−02 level in 2012−13, and although this means almost half of the earlier increases have been undone, it may mean there is scope for further substantial reductions if necessary, although as in all areas, the impact of any cuts on service quality must be examined carefully. At the very least, it is likely to be easier to identify spending cuts given that spending is still significantly higher than 12 years ago than in services that have not seen such spending increases. On the other hand, whilst only a relatively small part of the increases in spending on environmental and refuse services and social services has been undone (around £1 in £8 and £1 in £9, respectively), these may be areas where statutory obligations limit the scope for major reductions.

The appendix also compares the longer run picture in Wales with that in England. One striking finding is that local government spending per person on planning and development, culture and leisure (ex. libraries), libraries, and central and other services is over 15% below its 2001−02 level in England. On the other hand, spending on the last three of these services is at similar levels to that in 2001−02 in Wales, while spending on planning and development services remains 50% *above* its 2001−02 level. This provides further evidence that there may still be scope for further reductions to these budgets, before Welsh local authorities need to shift more of the cuts to more politically sensitive social care, environment and waste, education and housing budgets as the spending cuts continue, likely until at least 2016−17.

4. Local government settlements and spending: scenarios to 2020

Summary

- The Welsh Government has set out indicative figures for the size of the general grant it will give to UAs in 2013–14 and 2014–15. If specific grants change in line with the rest of Welsh Government expenditure, and council tax receipts grow in line with whole-economy inflation and the projected increase in household numbers, the real-terms spending power of UAs will continue to fall at a similar rate to 2012–13: by 1.4% per person in 2013–14 and 1.9% per person in 2014–15.
- The size of grants to UAs after 2014–15 will depend on the spending decisions taken by the Welsh Government, which in turn will depend on the decisions taken by the UK Government and hence, the state of the economy and public finances.
- The UK Government has announced that it plans further cuts in current expenditure in 2015–16 and 2016–17 but has not yet decided how to allocate these. If it decides to make £10 billion in further cuts to welfare (benefit and tax credit) spending, and the Welsh Government sees its budget change in line with public service spending as a whole, current spending forecasts would see the Welsh current budget fall by around 3.2% per year, on average, in 2015–16 and 2016–17. If no further cuts were made to welfare spending, the cuts increase to 4.4% per year. Both figures are significantly greater than the average reduction between 2010–11 and 2014–15 (2.0% per year).
- If the Welsh Government allocates the cuts in its budget across all services proportionally, and council tax receipts continue to grow in line with inflation and the number of households in Wales, UAs' spending power would fall by 2.9% per person per year, on average, in 2015–16 and 2016–17 if further cuts are made to welfare spending. If welfare expenditure is not cut, this figure increases to 3.8% per person per year. The reduction in spending power would be much larger if the Welsh Government chose to protect the NHS from this round of cuts (4.7% and 6.3%, respectively, per person). In each scenario, the cuts would be larger than made between 2009–10 and 2012–13, and the projected cuts in 2013–14 and 2014–15.
- The financial situation for UAs looks difficult until at least 2020–21 (the last year examined in this report), although there is much uncertainty around this as the state of the economy and public finances, and government decisions will have a significant impact on spending power. Even under the most optimistic set of assumptions for spending power used (overall public spending grows in line with the Office for Budget Responsibility's (OBR) long run forecast after 2016–17, further welfare cuts of £10 billion are found, and the Welsh Government chooses not to protect the NHS from cuts), UAs' spending power per person in 2020–21 would be 1.6% lower in real terms than in 2012–13. Under our most pessimistic set of assumptions, UAs spending power would be 18% lower (22% lower per person). The continued weakness in the economy and public finances, and the possibility that reductions in health might not be delivered, mean that such a scenario is plausible.

- Such a large reduction in spending power would represent a significant challenge for UAs. If overall spending on services was to be reduced by 18%, limiting the reductions in overall spending to half that level (9%) in areas that have so far been relatively protected – social services, environmental services and refuse, and education – would require cuts of 52% in spending on all other services. Such large cuts in addition to those already made are likely to be very difficult to achieve, meaning that other options would need to be considered in such circumstances. This may involve making significant cuts to service areas so far relatively insulated from cuts, local authorities stopping providing large swathes of services that they traditionally have and attempts to generate substantially more revenue, whether from council tax or increased fees and charges for the provision of some services.

In this section of the report we look to the future and ask how the amount of money available to local government in Wales may change in the coming years. Unfortunately, the data available and method used (which involves projecting forward central government spending allocations and council tax receipts as described in more detail in Appendix C) mean that we cannot project forward *net current service expenditure*, the definition of spending used in the previous chapter. Instead we show various scenarios for a measure of spending by Welsh UAs that accounts for that funded by council tax, general grants and specific grants (excluding housing and council tax benefit grants). This is similar to what is termed r*evenue expenditure* in England (note that the Welsh definition of *revenue expenditure* is somewhat different and less meaningful for the analysis of trends in local government spending) and, as in Chapter 3, we call this the *'spending power'* of local government. Note that unlike in Chapter 3 our focus here is exclusively on unitary authorities, and the figures presented from now on exclude the budgets of police, fire and National Park authorities.

The rest of this chapter proceeds as follows. In Section 4.1 we briefly examine what planned changes in the Welsh Government's local government budget item (which is effectively the general grant to local government), together with a number of assumptions about other grants and council tax revenues, imply for the resources available to Welsh local government to 2014−15. We then look beyond the period covered by the UK Government's 2010 Spending Review and look at how different economic prospects, decisions by the UK Government and by the Welsh Government could affect the cash available to UAs in Wales. Section 4.2 sets out a number of scenarios for the overall resources available to the Welsh Government based on different paths for the overall level of public spending (for instance due to a stronger or weaker performance in the macro-economy) and whether the UK Government makes further cuts to welfare expenditure. Section 4.3 then examines what these scenarios may imply for the spending power of Welsh local government, given that the Welsh Government may wish to protect certain parts of its budget going forwards (e.g. the NHS).

4.1 The Welsh draft budget: spending to 2014–15

The UK Government's 2010 Spending Review has set the budget of the Welsh Government as far as 2014−15, and the Welsh Government has now published draft budgets for each year to 2014−15. Furthermore, the Local Government Financial Settlement for 2012−13 includes indicative figures for how much the Welsh Government plans to allocate to local government through general grants (termed 'Aggregate External Finance').

This is only part of the resources available to local government, however, with specific grants to fund particular services or meet specific needs, and council tax providing the rest. In order to estimate the overall resources available to unitary authorities in 2013−14 and 2014−15 we need to make some assumptions about how these evolve. We assume that:

- specific grants change at the same rate as the Welsh Government's current expenditure on things other than general grants to local government;
- council tax receipts grow by the rate of inflation (GDP deflator) plus the rate of household growth, proxying an increase in council tax rates in line with inflation.

Table 4.1 shows each of these components of local government's spending power in real terms (2012−13 prices) for each year between 2010−11 and 2014−15, together with the percentage change in spending power and spending power per person in each year. **Remember this is a projection based on budgeted spending and the authors' assumptions.**

Table 4.1. Local government spending power, Wales, 2010–11 to 2014–15, in 2012–13 prices (scenario)

Unitary Authority	2010–11	2011–12	2012–13	2013–14	2014–15
Level (2012–13 prices)					
General Grant	4,246	4,104	4,017	3,970	3,895
Specific Grants	1,103	950	961	941	919
Council Tax	1,147	1,159	1,160	1,173	1,186
Spending Power (Total)	6,460	6,213	6,138	6,085	6,001
% Change					
Spending Power		-4.4	-1.2	-0.9	-1.4
Spending Power per Person		-5.0	-1.7	-1.4	-1.9

Source: Specific grants and council tax in 2010–11 to 2012–13 from StatsWales, projections based on OBR (2012) and Welsh Government Budget 2012. General Grant from Welsh Local Government Financial Settlement, 2012. Authors' calculations and assumptions.

The results show that the spending power of Welsh UAs would continue to fall in real terms in 2013−14 and 2014−15 at broadly the same rate as in 2012−13, driven by falls in the real-terms level of the general grant and specific grants, only partially offset by anticipated growth in real council tax receipts (driven by growth in the number of households).[21] It is true that the pace of cuts has moderated substantially since 2011−12 (and 2010−11), but local authorities may still need to take difficult decisions on service provision as budgets fail to keep pace with inflation. The Local Government Financial Settlement for 2013−14 is due to be published before the end of 2012, providing final figures for grants in 2013−14 and updated indicative figures for 2014−15.

4.2 Scenarios for Welsh Government spending to 2020

The current UK Government Spending Review period covering the years up to 2014−15 involves significant cuts to the Welsh Government's budget. Welsh Government DEL is to be reduced by an average of 3.2% per year in real terms (or 12.2% in total) from £15.9 billion in 2010−11 to £13.9 billion in 2014−15 (both measured in 2012−13 prices). The reduction is greatest for the capital budget, which is being reduced by an average of 13.0% per year (although these cuts were front loaded), while the Welsh Government's current DEL is being reduced by an average of 2.0% each year.

[21] Under this scenario, UAs' spending power in nominal terms (i.e. unadjusted for inflation) is set to increase from £6,138 million to £6,304 million in 2014–15.

But in order to examine the prospects for the spending power of Welsh local government in the years to 2020−21, one must also examine scenarios for the resources available to the Welsh Government in the period 2015−16 to 2020−21. These resources will depend on how much the Welsh Government is allocated by the UK Government going forwards, which in turn will depend on the state of the economy (which determines how much there is to spend overall), and the UK Government's tax and spending decisions.

The UK Government announced it would make further cuts in current expenditure in the years 2015−16 and 2016−17 in the 2011 Autumn Statement when it became clear that its initial plans to eliminate the structural budget deficit by 2014−15 were not sufficient to do so (it now plans to do so by 2016−17, and according to the latest OBR forecast it is on track). However, it has yet to decide whether these cuts will take the form of reductions in spending on benefits and tax credits (welfare spending) or spending on public services, let alone which departments will be cut. Furthermore, plans for public spending for 2017−18 and beyond have yet to be announced by the UK Government. Hence, in order to proceed we examine a number of scenarios for the path of the economy and government spending. In particular we have two alternative assumptions about overall public spending:

- Overall public spending follows the path set out by the UK Government in its 2012 Budget until 2016−17, and then grows in line with the OBRs' long-term GDP forecast (2.4% per year in real terms). This can be seen as the **central** scenario.
- Alternatively, overall public spending follows the path set out by the UK Government, but remains at its 2016−17 real-terms level in 2020−21, perhaps reflecting further weakness in the economy and public finances. This can be seen as a **pessimistic** scenario, although ongoing weakness in the economy (see Chapter 1) means it is entirely possible that further downward pressure on public spending is required after 2016−17.

We also need to make an assumption about how the UK Government allocates overall spending between benefits and tax credits and public services, and different departments after 2014−15, and we use the following two variants:

- Further spending cuts in 2015−16 and 2016−17 are allocated between public service spending and welfare spending such that £10 billion further welfare cuts are made. In 2017−18 and beyond, social benefits rise in line with the OBR's fiscal sustainability report, with public service spending calculated as a residual. The Welsh Government DEL changes in line with overall public service spending during the entire period.
- Further spending cuts in 2015−16 and 2016−17 are allocated entirely to public service spending. In 2017−18 and beyond, social benefits rise in line with the OBR's fiscal sustainability report, with public service spending calculated as a residual. The Welsh Government DEL changes in line with overall public service spending during the entire period.

Together, this gives four scenarios, with the least favourable scenario being that which combines the real freeze post 2016−17 with the allocation of cuts to public service spending only prior to that (and the most favourable settlement being the one that combines overall spending growth post 2016−17 and welfare cuts prior to that). **In doing this it should be noted that these scenarios are indicative only and do not put upper or lower bounds on the amount Wales might receive.** Because we are unable to project the allocation across public service departments (e.g. Department of Health, Department for Work and Pensions), we are unable to simulate the workings of the Barnett formula, which tends to mean Wales gets smaller percentage rises in spending than England (and likewise smaller cuts when spending is being reduced). This is another reason to see the results as indicative only.

Table 4.2 shows the budgets for the devolved Welsh Government under each of the four scenarios. Four years are shown: 2010–11, 2014–15 (both unaffected by the scenarios), 2016–17 and 2021-22. Information on the calculations underlying these figures can be found in Appendix B.

Table 4.2. Some scenarios for Welsh Government DEL (capital and current) 2010–11 to 2020–21, £s million, in 2012–13 prices

Scenario	2010–11	2014–15	2016–17	2020–21	% change per annum 2014–15 to 2016–17	% change per annum 2016–17 to 2020–21
Economy in-line with OBR post 2016–17						
Welfare spending cut	15,887	13,945	13,132	14,722	-3.0%	2.9%
Welfare spending not cut	15,887	13,945	12,833	14,393	-4.1%	2.9%
Economy performs poorly						
Welfare spending cut	15,887	13,945	13,132	12,536	-3.0%	-1.2%
Welfare spending not cut	15,887	13,945	12,833	12,238	-4.1%	-1.2%

Source: Public Expenditure Statistical Analysis Budget tables, OBR Economic and Fiscal Outlook, OBR *Fiscal Sustainability Report* and authors' calculations.

The first thing to notice is that the period between 2014–15 and 2016–17 is likely to involve significant real reductions in the Welsh Government DEL, irrespective of whether further cuts are made to the welfare budget. If welfare spending is cut by a further £10 billion per year by 2016–17, and the Welsh DEL is reduced in real terms at the same rate as public service spending as a whole, the Welsh Government will see a reduction in its budget of, on average, 3.0% per year in 2015–16 and 2016–17. Given that capital spending has already been cut so drastically, the UK Government has pledged to protect it from further cuts,[22] which would imply that the Welsh Government's current DEL would need to be reduced by 3.2% per year, on average. This is more than one-and-a-half times as large as the average falls between 2010–11 and 2014–15 (2.0%). Because Welsh Government grants to support local government current spending are financed from the current DEL, we use this figure in the next section when examining the implications for the budgets of Welsh unitary authorities.

If, on the other hand, no further cuts are made to the welfare budget, spending on public services would need to fall by an average of 4.1% a year in real terms in 2015–16 and 2016–17. If the Welsh Government's DEL was reduced at the same rate, this would imply a reduction of spending of around £1.1 billion in real terms between 2014–15 and 2016–17, around £0.3 billion more than if welfare expenditure were further reduced (both in 2012–13 prices). Again, protection for capital budgets implies an even larger reduction in the current DEL of 4.4% a year, on average, which is more than twice as much as the average annual reduction between 2010–11 and 2014–15.

The picture after 2016–17 depends crucially upon the overall resources available to the UK Government. If overall public spending grows in line with the long-run forecast for growth in

[22] Here, we interpret that to mean there will be no further real-terms reductions in capital expenditure as opposed to no further reductions as a proportion of GDP.

potential GDP (2.4% growth per year in real terms), the forecasts for welfare spending and debt interest imply that spending on public services would be able to increase by 2.9% per year in real terms, on average. If Welsh Government DEL followed this path, this would mean the Welsh Government having more to spend in 2020–21 in real terms than in 2014–15 (£13.9 billion), whether benefits share some of the pain between 2014–15 and 2016–17 (in which case the 2020–21 budget is an estimated £14.7 billion) or not (in which case the 2020–21 budget is an estimated £14.4 billion). The same is true for Welsh Government current DEL under these scenarios: £13.6 billion or £13.3 billion, respectively, compared to £12.9 billion in 2014–15. But both total and current Welsh Government DEL would remain below the real-terms 2010–11 level of £15.9 and £14.0 billion. This shows that even with relatively robust growth in budgets after 2016–17, the resources available to the Welsh Government will be less than they were prior to the fiscal retrenchment.

If, on the other hand, total government spending is held constant in real terms between 2016–17 and 2020–21 (for instance, if the economy continues to perform poorly and the Government's revised target of eliminating the structural deficit by 2016–17 is not met), the picture looks much bleaker. Anticipated growth in interest payments and welfare expenditure during this period would require spending on public services to be cut by 1.2% in real terms per year, on average. Under this scenario Welsh Government DEL in 2021–21 could be 23% below its 2010–11 level and 12% below its 2014–15 level, in real terms, if welfare spending is protected from further cuts between 2014–15 and 2016–17. This shows that if further austerity is required beyond 2016–17, the Welsh Government is likely to face a very tough budget settlement that will have major ramifications for Welsh unitary authorities.

4.3 Scenarios for Welsh local government spending to 2020

We now examine what these scenarios for Welsh Government DEL may mean for Welsh local government given two possible allocations of Welsh Government resources (there are, of course, many other possibilities). Again, it is important to note that these scenarios are indicative only and the Welsh Government may decide to allocate resources differently across departments. The two scenarios we examine are:

(1) the Welsh Government allocates the cuts proportionally across services; or

(2) the Welsh Government protects the NHS from any further cuts post 2014–15 and allocates cuts proportionally across other services.

Table 4.3 shows how UA's spending power may change between 2014–15, 2016–17 and 2020–21, given the scenarios for Welsh Government current DEL if the cuts are allocated proportionally across all services (scenario (1)). Note that, together with the assumptions in Section 4.2, this implies that grants to Welsh UAs change at the same rate as overall current public service spending for the UK as a whole. We maintain the assumption that real council tax revenues increase in line with the projected growth in the number of households in Wales.

The first thing to note is that irrespective of whether the UK Government further reduces welfare expenditure, under our assumptions, Welsh UAs would see substantially larger year-on-year reductions in their spending power in 2015–16 and 2016–17 than are planned for the period 2013–14 and 2014–15 (see Table 3.1). The reduction in spending power would also exceed those made between 2009–10 and 2012–13, which have averaged 2.0% per year for UAs (2.2% per year for local government as a whole). However, whether the UK Government makes further cuts to the welfare budget does make a significant difference to the size of the cuts required of current public service expenditure, and hence, potentially, the cuts to the UAs' spending power. With £10 billion of further cuts to welfare spending, under our assumptions, the cuts would amount to 2.3% per year versus 3.3% per year if no further cuts were made to welfare. These reductions are somewhat smaller than the projected cuts in Welsh Government current DEL (3.2% and 4.4%, respectively), because our assumption is that there will be modest growth in real-terms council tax receipts (driven by growth in the number of households).

What happens after 2016–17 will depend crucially on whether further austerity is required beyond that already planned by the UK Government (e.g. if the economy continues to perform poorly). If the economy performs in-line with the OBR's long-run forecast, under our assumptions, the spending power of Welsh UAs would increase by 2.5% per year, on average, between 2016–17 and 2020–21. This is somewhat slower than the growth in the Welsh Government's current DEL under our assumptions, reflecting the fact that council tax revenues are projected to increase only slowly. If UAs' spending power followed this trend, it would exceed its current (2012–13) level by 2020–21, whether or not further cuts to welfare are made between 2014–15 and 2016–17.

If, on the other hand, the economy performs poorly, necessitating public spending to be held constant between 2016–17 and 2020–21, spending power could come under further pressure. Under this scenario, Welsh UAs would see their spending power reduced by 0.7% per year between 2016–17 and 2020–21, with small increases in council tax revenues only partially offsetting declining grants from the Welsh Government. This means under the scenarios we investigate, spending power in 2020–21 would be between 9% and 11% below its 2012–13 level.

Table 4.3. Some scenarios for Welsh local government spending power, 2012–13 to 2020–21, in 2012–13 prices (constant share of Welsh current DEL), £ millions

Scenario	2012–13	2014–15	2016–17	2020–21	% change per annum 2014–15 to 2016–17	% change per annum 2016–17 to 2020–21
Economy in-line with OBR						
Welfare spending cut	6,138	6,001	5,722	6,321	-2.3%	2.5%
Welfare spending not cut	6,138	6,001	5,611	6,199	-3.3%	2.5%
Economy performs poorly						
Welfare spending cut	6,138	6,001	5,722	5,566	-2.3%	-0.7%
Welfare spending not cut	6,138	6,001	5,611	5,455	-3.3%	-0.7%

Source: Specific grants and council tax in 2010–11 to 2012–13 from StatsWales, and general grant is from Local Government financial settlement 2012. Projections based on Public Expenditure Statistical Analysis Budget tables, OBR Economic and Fiscal Outlook, OBR *Fiscal Sustainability Report*, Welsh Government Budget 2012 and authors' assumptions and calculations.

Table 4.4 shows how the scenarios for UAs' overall spending power translate into spending per person. Projected growth in the Welsh population between 2014–15 and 2020–21 means that the change in the UAs' spending power per person is around 0.6 percentage points lower per year than the change in their aggregate spending power. The key point to take from this table is that even under the most optimistic scenario we examine (where welfare expenditure is reduced and the economy grows in line with the OBR's forecasts), spending power per person would be lower in 2020–21 than 2012–13. In the context of an ageing population (see Chapter 5), which is likely to put pressure on areas such as social services, this means the next eight years, at least, are likely to be financially very challenging for local government.

Table 4.4. Some scenarios for Welsh local government spending power, 2012–13 to 2020–21, in 2012–13 prices (constant share of Welsh current DEL), £ per person

Scenario	2012–13	2014–15	2016–17	2020–21	% change per annum 2014–15 to 2016–17	% change per annum 2016–17 to 2020–21
Economy in-line with OBR						
Welfare spending cut	1,993	1,927	1,817	1,962	-2.9%	1.9%
Welfare spending not cut	1,993	1,927	1,781	1,924	-3.8%	1.9%
Economy performs poorly						
Welfare spending cut	1,993	1,927	1,817	1,727	-2.9%	-1.3%
Welfare spending not cut	1,993	1,927	1,771	1,693	-3.8%	-1.3%

Source: Specific grants and council tax in 2010–11 to 2012–13 from StatsWales, and general grant is from Local Government financial settlement 2012. Projections based on Public Expenditure Statistical Analysis Budget tables, OBR Economic and Fiscal Outlook, OBR *Fiscal Sustainability Report*, Welsh Government Budget 2012 and authors' assumptions and calculations.

As mentioned previously, unlike England, Wales chose to apply real-terms cuts to the NHS current expenditure budget, and this is the main reason why Welsh local government is seeing smaller cuts than English local government in the period to 2014–15. However, if the performance of the Welsh NHS deteriorates significantly in the context of falling budgets and an ageing population, there may be pressure to protect it from further cuts going forward.[23] Given that the NHS takes up a large fraction of the Welsh Government's overall budget this would imply significantly larger cuts in other departmental budgets (such as local government) as shown in Tables 4.5 and 4.6, which investigate the implications of scenario (2).

If the Welsh NHS is protected from further cuts after 2014–15, our assumptions mean that Welsh UAs would face a reduction in spending power of 4.1% per year, on average, in 2015–16 and 2016–17 if further welfare cuts are made, or 5.7% per year if no further welfare cuts are made. These falls are very substantial and mean the UAs' spending power would be 10% or 13% below its 2012–13 level by this date (or 12% or 15% less, per person). A 4.1% average cut per year would be around twice as fast as that faced over the last three years, and more than three times as far as the cuts planned for the next two years. It would also be 1.8 percentage points per year greater than if the NHS were not protected, showing just how much of a difference such protection makes to the budgets of other departments.

[23] Rising costs of medical care and an ageing population mean that even a real-terms freeze in spending is likely to be a challenging funding settlement for the NHS.

Table 4.5. Some scenarios for Welsh local government spending power, 2012–13 to 2020–21, in 2012–13 prices (Welsh NHS protected post 2014–15), £ millions

Scenario	2012–13	2014–15	2016–17	2020–21	% change per annum 2014–15 to 2016–17	% change per annum 2016–17 to 2020–21
Economy in-line with OBR						
Welfare spending cut	6,138	6,001	5,515	6,088	-4.1%	2.5%
Welfare spending not cut	6,138	6,001	5,327	5,881	-5.7%	2.5%
Economy performs poorly						
Welfare spending cut	6,138	6,001	5,515	5,218	-4.1%	-1.4%
Welfare spending not cut	6,138	6,001	5,327	5,031	-5.7%	-1.4%

Source: Specific grants and council tax in 2010–11 to 2012–13 from StatsWales, and general grant is from Local Government financial settlement 2012. Projections based on Public Expenditure Statistical Analysis Budget tables, OBR Economic and Fiscal Outlook, OBR *Fiscal Sustainability Report*, Welsh Government Budget 2012 and authors' assumptions and calculations.

Table 4.6. Some scenarios for Welsh local government spending power, 2012–13 to 2020–21, in 2012–13 prices (Welsh NHS protected post 2014–15), £ per person

Scenario	2012–13	2014–15	2016–17	2020–21	% change per annum 2014–15 to 2016–17	% change per annum 2016–17 to 2020–21
Economy in-line with OBR						
Welfare spending cut	1,990	1,925	1,749	1,887	-4.7%	1.9%
Welfare spending not cut	1,990	1,925	1,690	1,823	-6.3%	1.9%
Economy performs poorly						
Welfare spending cut	1,990	1,925	1,749	1,618	-4.7%	-1.9%
Welfare spending not cut	1,990	1,925	1,690	1,559	-6.3%	-2.0%

Source: Specific grants and council tax in 2010–11 to 2012–13 from StatsWales, and general grant is from Local Government financial settlement 2012. Projections based on Public Expenditure Statistical Analysis Budget tables, OBR Economic and Fiscal Outlook, OBR *Fiscal Sustainability Report*, Welsh Government Budget 2012 and authors' assumptions and calculations.

Protection of the NHS budget would mean that even with public spending growing in line with the OBR's long-run economic forecast after 2016−17, Welsh UAs' spending power in 2020−21 would be below its 2012−13 level. For instance, even under the most optimistic scenario we investigate (where welfare expenditure is reduced), spending power would be around 1% below its 2012−13 level (around 5% per person). If the economy performs poorly and total public spending is held constant in real terms between 2016−17 and 2020−21, protection of the Welsh

NHS budget from the necessary cuts to current public service spending would imply deeper cuts to other budgets such as local government. Under our assumptions, Welsh UAs would face reductions in their spending power of 1.4% per year (or 1.9% per person per year), roughly double the 0.7% reductions if the Welsh NHS were not protected. Under the most 'pessimistic' (but plausible) scenario where no further welfare cuts are found, public spending is frozen in real terms between 2016–17 and 2020–21 and the Welsh NHS is protected from cuts, the spending power of Welsh UAs in 2020–21 would be around 18% below its 2012–13 level. This equates to a reduction of 22% per person over eight years, and means that the 7.5% reduction in spending power per person that UAs have faced between 2009–10 and 2012–13 would represent only one-quarter of the overall reduction faced by 2020–21.

Summary and discussion

Three clear messages emerge from this analysis. First, is the fact that even if the economy grows reasonably robustly, further welfare savings can be found, and grants to local government changes in line with overall current public service spending (our most optimistic scenario), Welsh UAs are likely to face a difficult financial situation until at least 2020–21. Second, is the overriding importance of how the economy, public finances and overall public spending evolve in the coming years. If further spending cuts are required after 2016–17, which is plausible given the ongoing weakness in the economy and public finances, Welsh UAs are likely to share in that pain. Third, is the impact of decisions to protect other budgets from further cuts. If, for instance, the welfare and/or NHS budgets are protected, Welsh local government may face significantly larger cuts. The UK and Welsh Governments therefore face clear and difficult trade-offs when deciding whether to protect such budgets.

Finally, it is worthwhile briefly discussing what the reductions on the scale of our most pessimistic (but still plausible) scenario may mean for UAs' spending on different public services. The cuts that UAs have made so far have differed by service with planning and development, housing and regulation and safety facing much larger cuts than areas such as social services, environmental and refuse services and education. What if these latter areas continue to be protected? Because spending on these services makes up nearly 80% of all spending by UAs, it would not be possible to protect these areas from any further real-terms cuts: delivering a reduction in overall net current service expenditure of 18% would require cutting net spending on other services by 87%. Indeed, even limiting the real-terms cuts in spending on social services, environmental and refuse services and education to half the average cut (9%) would imply cuts of 52% for the non-protected services. This illustrates that if Welsh UAs do see such large reductions in their grants, very difficult choices must be faced. This may involve making significant cuts to service areas so far relatively insulated from cuts, local authorities stopping providing large swathes of services that they traditionally have and attempts to generate substantially more revenue whether from council tax or increased fees and charges.[24]

[24] The Local Government Association has recently published a report (LGA, 2012) suggesting that local government in England faces very similar challenges.

5. The broader context: welfare and demography

Summary

- As well as reducing spending on public services, the UK Government is increasing taxes and cutting benefits and tax credits. These act to reduce the net incomes of households in Wales, although the average reduction by 2014–15 (2.8% of net income) is smaller than for the UK as a whole (3.0%). The largest average reductions are for households in the poorest fifth of the population (5.2% in Wales) and those households with dependent children (4.3% in Wales). This reflects the fact that such households are typically more reliant on benefits and tax credits than others. Groups impacted most by the benefit and tax credit cuts may be more vulnerable to cuts by local government or may come to rely more on local government services (e.g. housing or social services). The introduction of Universal Credit will act to offset the reduction in benefits and tax credits from 2014, especially for the poorest fifth of the population.

- The ageing population means that the UK (and by extension, the Welsh and local) Government will continue to face a difficult fiscal situation for decades to come. The OBR's *Fiscal Sustainability Report's* central estimate is that demographic change could increase spending by 5.2% of national income by 2060–61, largely driven by additional spending on health and pensions. If extra taxes cannot be raised, this may mean a significant further squeeze on other areas of spending such as local government. The central estimates are based on rather optimistic assumptions about how quickly productivity will grow in the NHS, however, and if productivity were instead to grow at the average rate since 1979, spending on the NHS would need to rise by a further 7.5% of national income, which would require major tax rises or reductions in other spending.

- The scale of demographic change varies considerably across Wales. Although the number of individuals aged 65 and over in Cardiff is projected to increase by 49% by 2033, the number per 1,000 working age residents is expected to increase only modestly (from 191 to 221). However, areas of Wales that are already relatively old are set to see further rapid aging: the number aged 65 and over per 1,000 working age residents is expected to increase from 414 to 723 in Powys, from 439 to 660 in Conwy and from 370 to 655 in Monmouthshire. National and local government will need to plan for such varied changes in demographics (and fo r the considerable uncertainty around these estimates).

The previous two chapters analysed the spending decisions made by local government to date, and the prospects for the funding available to local government up to 2020. In this chapter we look at the broader policy context and discuss two issues that may impact upon local government finances: the ongoing cuts to benefits and tax credits; and the long-term issue of demographic change.

5.1 The impact of tax and benefit changes on household incomes in Wales

Net increases in taxes are planned to contribute around 25% of the overall fiscal consolidation planned by 2014–15 (which is around three-quarters of the full consolidation planned by 2016–17), with net reductions in the generosity of benefits and tax credits providing a further

15%.[25] This increased takeaway from and giveaway to household budgets may mean significant reductions in disposable income for many households. This section details the scale and distributional impact of the tax and benefit changes in Wales and shows that poorer households and households with children will be hit harder than other parts of the population.

Tax and benefit changes up to 2012–13

A number of changes have already come in to effect by the current tax year, including a majority of the tax increases, and a number of cuts to benefits and tax credits particularly affecting families with children.

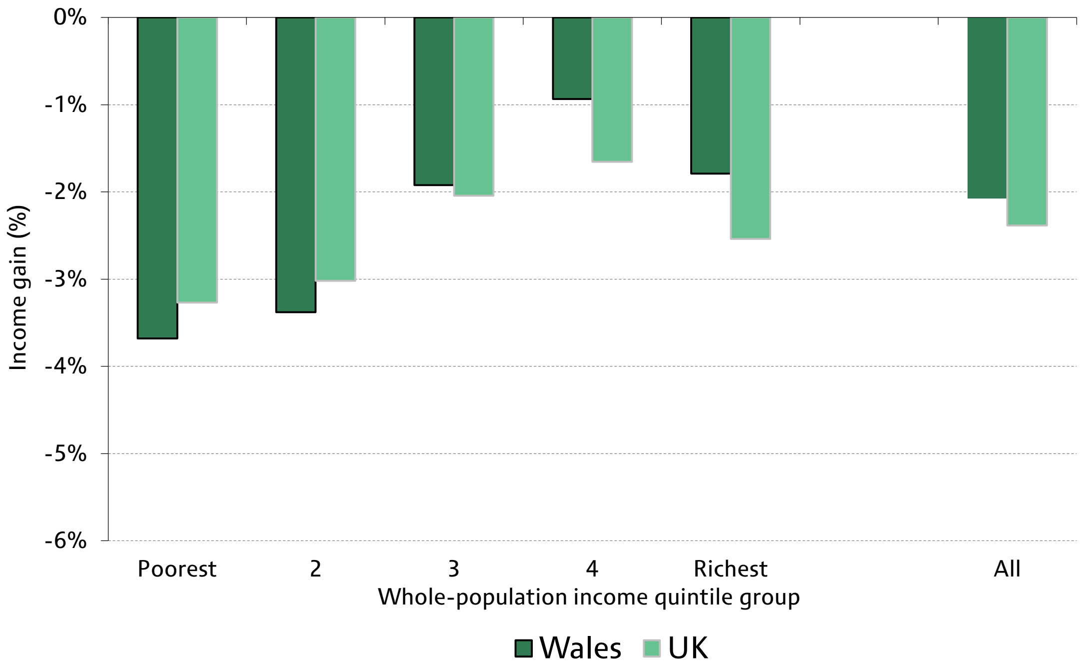
The main rate of VAT increased from 17.5% to 20.0% in January 2011, and employer, employee and self-employed National Insurance (NI) rates increased by 1 percentage point (to 14.8%, 12.0% and 9.0%, respectively), although there were also increases in the point at which employees and employers start paying NI, which means that some lower paid workers would have seen their NI bill cut. Together these tax rises are predicted to raise £4.2 billion in 2012−13 across the UK as a whole. In terms of income tax, the personal allowance was increased in both April 2011 and April 2012 by more than indexation, costing £4.8 billion, including the impact of some reductions in the higher rate threshold to limit the gains to higher rate taxpayers. Further reductions in the higher rate tax threshold are set to raise £0.9 billion. There have also been increases in alcohol and tobacco duty.

In terms of benefits, the main reforms to have taken place so far include: a reduction in the generosity of many benefits through the switch to CPI-uprating (CPI inflation is generally lower than RPI inflation);[26] reductions in the generosity of child benefit, and the child, childcare and working tax credits for many families (although there have been increases in the generosity of the child tax credit for the poorest families with full entitlement); and reductions in the generosity of local housing allowance, which helps low income private sector tenants pay their rent.

Figure 5.1 shows the distributional impact of the tax and benefit changes to date for Wales and for the UK as a whole for five groups of households from richest to poorest.

[25] By 2016–17, net tax rises are set to account for 17% of the overall fiscal consolidation if no further tax rises are announced. If the UK Government makes a further £10 billion of cuts in 2015–16 and 2016–17, net cuts to benefits/tax credits expenditure will account for 14% of the overall fiscal consolidation.
[26] This change also applies to public service pensions and certain tax thresholds.

Figure 5.1. Impact of tax and benefit reforms introduced by current government up to April 2012, by income quintile group



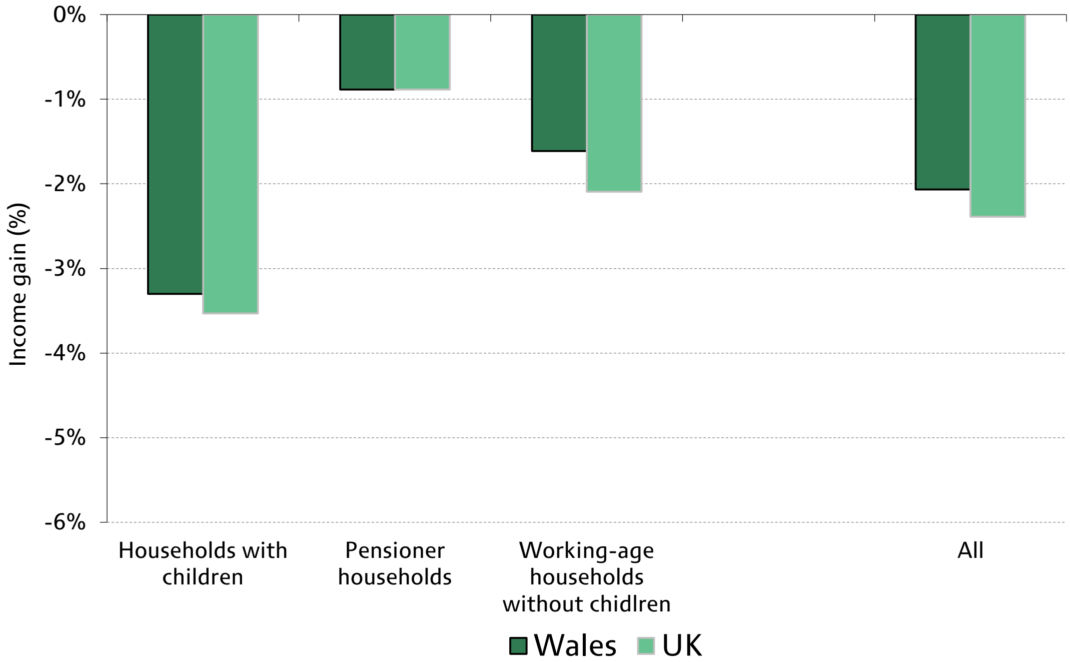
Source: Author's calculations using TAXBEN, the IFS tax and benefit microsimulation model, run on uprated 2009–10 Family Resources Survey data.

Overall, the tax and benefit reforms implemented since June 2010 are estimated to reduce household incomes by around 2.1% in Wales slightly less than the 2.4% reduction for the UK as a whole. Due to their lower incomes, Welsh households benefit, on average, from the reforms to income tax and NI during this period (by around £2 per week), while across the UK as a whole there are small losses, on average (around 36p per week). Welsh households lose slightly more from the benefits changes during this period (£8.10 per week versus £7.40), partly reflecting their greater reliance on disability benefits. The increases in indirect taxes (largely VAT) cost Welsh households £5.17 per week versus £6.67 a week in the UK as a whole, reflecting lower household expenditure.

Losses are largest towards the bottom of the income distribution: 3.7% for Welsh households among the poorest fifth of the population (3.3% UK), and 3.4% for the next poorest fifth (3.0% UK); versus 0.9% and 1.8% for the second richest and richest fifth, respectively (1.7% and 2.5% UK). Large losses for poorer households are explained by the fact that they are heavily reliant on benefits and tax credits for their income, and therefore have lost a larger fraction of their income as benefits and tax credits have been cut. The increase in VAT has taken up a relatively large fraction of their income, and such households often contain no income tax payers and therefore have not benefited from the increase in the personal allowance (conversely, they are unlikely to have been hit by the increase in NI either). That losses are proportionally larger for the 5th quintile group than the 4th quintile group is likely to reflect the reductions in the higher rate tax threshold, increases in NI rates and changes in tax relief on pensions that particularly affect households towards the top of the income distribution.

Figure 5.2 shows the impact by type of household and shows that pensioner households have been hit much less hard, on average, than households with children: tax and benefit changes have reduced the incomes of households with children in Wales by around 3.3% (3.5% in the UK as a whole) versus around 0.9% for pensioners in Wales. This reflect the fact that many of the benefit cuts to date have affected benefits claimed exclusively or overwhelmingly by households with children (e.g. child benefit and tax credits), while pensioners have been protected from the benefit cuts (for instance the switch to CPI uprating does not affect the state pension).

Figure 5.2. Impact of tax and benefit reforms introduced by current government up to April 2012, by household type



Source: Author's calculations using TAXBEN, the IFS tax and benefit microsimulation model, run on uprated 2009–10 Family Resources Survey data.

Tax and benefit changes up to 2014–15 (without Universal Credit)

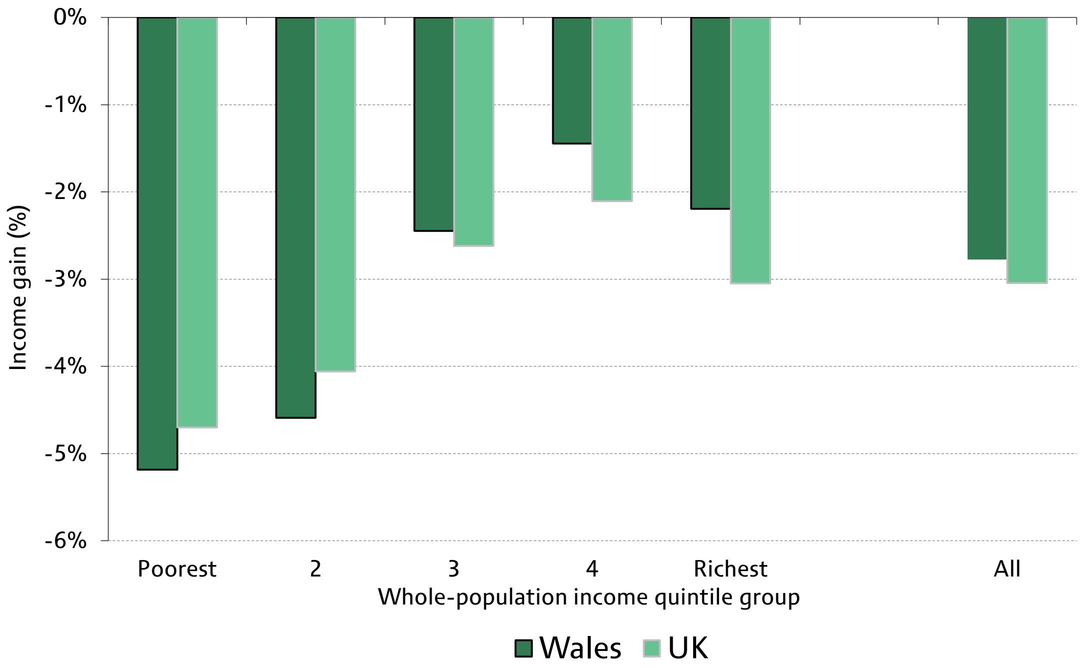
Further changes to the tax and benefit system are planned in 2013−14 and 2014−15 which will, on average, further reduce net incomes.

On the tax side, there will be a further increase in the income tax personal allowance in April 2013 benefiting basic-rate taxpayers, although this will be mostly offset for higher-rate taxpayers by a reduction in the higher-rate threshold. The biggest change is a reduction in the additional rate of income tax (payable on incomes over £150,000) from 50% to 45% in April 2013, although we do not model that here (the data used in our simulations does not capture the very top of the income distribution well).

From October 2013, Universal Credit will begin to replace a number of means-tested benefits for working-age people. However, the roll-out is not expected to be complete until the end of 2017, and many existing claimants will still be receiving the existing set of benefits and tax credits in 2014−15. However, other changes are planned between now and 2014−15 including: ongoing reductions in generosity due to the shift to CPI uprating; further reductions in the generosity of housing benefit; withdrawal of child benefit from families with someone with an income of over £50,000; a tightening of the eligibility criteria for disability benefits; and a £500 per week cap on benefits for out-of-work working-age families.

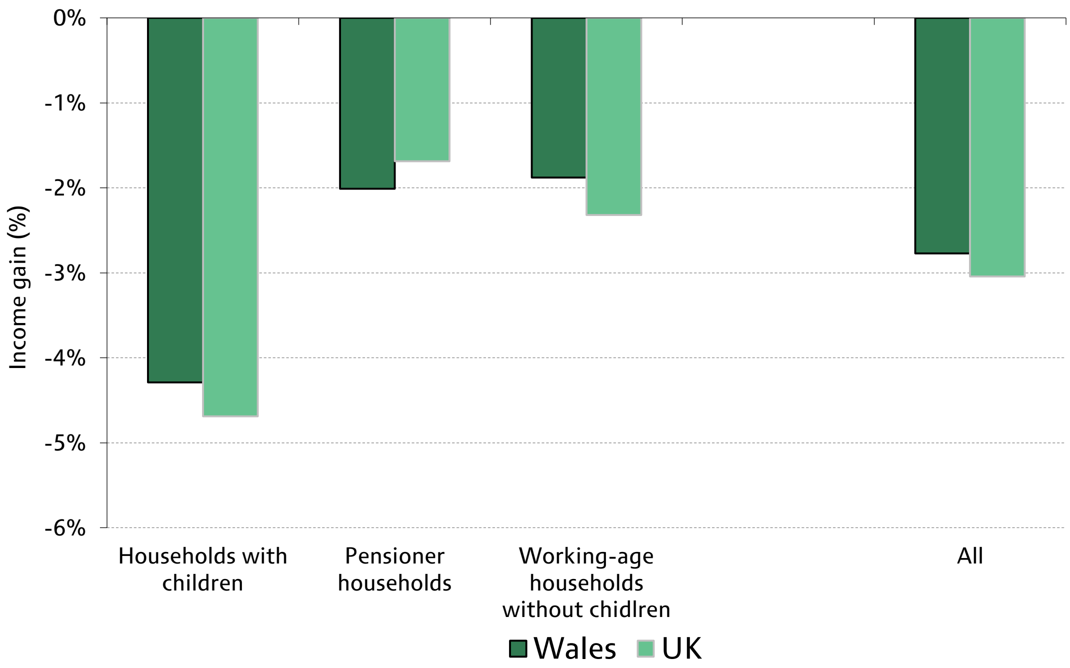
Figure 5.3 shows the distributional impact of the tax and benefit changes due by 2014−15 (excluding the introduction of Universal Credit) for Wales and for the UK as a whole for five groups of households from richest to poorest. Figure 5.4 shows the impact by type of household.

Figure 5.3. Impact of tax and benefit reforms introduced or planned by current government up to April 2014, by income quintile group (ignoring Universal Credit)



Source: Author's calculations using TAXBEN, the IFS tax and benefit microsimulation model, run on uprated 2009–10 Family Resources Survey data.

Figure 5.4. Impact of tax and benefit reforms introduced or planned by current government up to April 2014, by household type (ignoring Universal Credit)



Source: Author's calculations using TAXBEN, the IFS tax and benefit microsimulation model, run on uprated 2009–10 Family Resources Survey data.

By 2014, losses due to tax and benefit reform will have increased to around 2.8% of net income in Wales and 3.0% of net income for the UK as a whole. This reflects gains from changes to direct taxes that increase household incomes in Wales by £3.24 a week (£0.60 per week for the UK as a whole), cuts to benefits and tax credits amount to an average £12.39 a week (£11.57 for the UK as a whole), and increases in indirect taxes that cost Welsh households £5.93 a week (£7.41 for the UK as a whole). This means while the benefit cuts hit Wales slightly harder – due to its higher levels of welfare dependency – the tax changes hit Wales slightly *less* hard than the UK as a whole.

As with the changes, to date, poorer households and households with children look set to see the biggest percentage falls in their income as a result of the tax and benefit changes. Welsh households among the poorest fifth of the population are set to see tax and benefit reforms up to 2014−15 reduce their income reduced by 5.2% on average (4.7% for the UK as a whole) relative to the 2010 tax and benefit system, with the next poorest fifth being 4.6% worse off as a result of reforms (4.1% for the UK as a whole). Households in the 4th quintile group will lose the least, proportionally (1.4% in Wales, 2.1% in the UK as a whole).

Interestingly, unlike for the UK as a whole, pensioner households in Wales look set to lose a slightly larger fraction of their income than working-age households without children, although it must be noted that among those in receipt of benefits and tax credits, the losses are considerably higher for working-age households without children (relatively few of whom are in receipt of benefits and tax credits).

Tax and benefit changes up to 2014–15 (with Universal Credit)

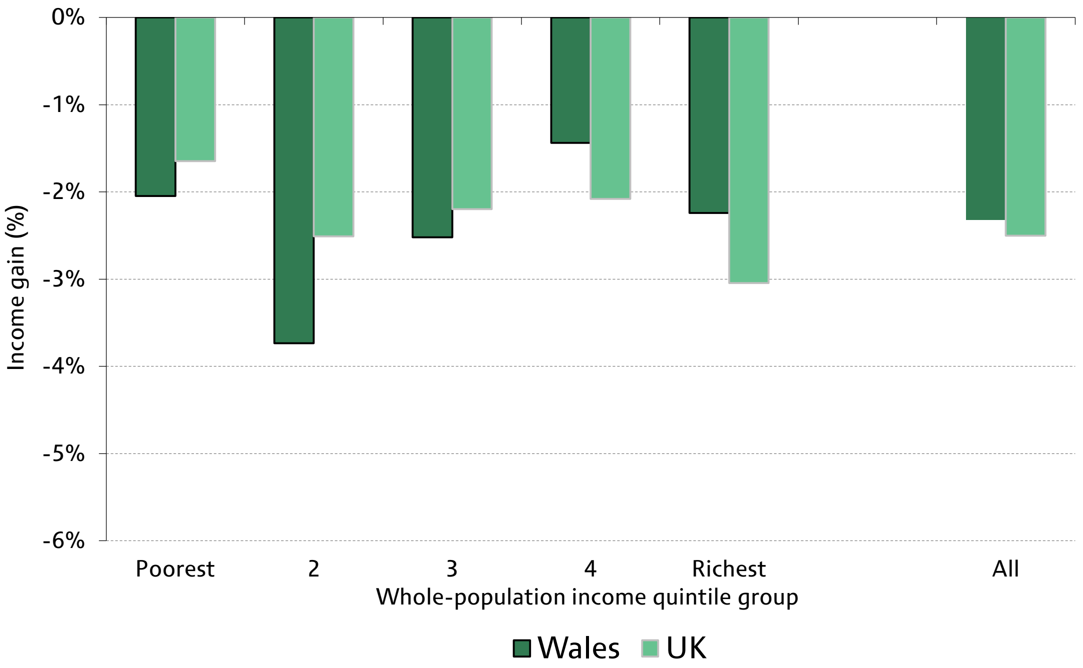
Universal Credit is designed to increase work incentives for those currently facing the weakest incentive to enter work or progress in work and does this by increasing income disregards, reducing the rate at which benefits are withdrawn as income increases, by increasing the stringency of work conditions and simplifying the claims process. One feature of Universal Credit is increased entitlements for many households with small levels of employment income, which acts to offset a large part of the reductions in the average incomes of households in the poorest fifth (and to a lesser extent the 2nd quintile group) resulting from the earlier reforms.

Figure 5.5 shows the impact of reforms up to 2014−15, assuming Universal Credit was fully in place by then across the income distribution.[27] This will reduce the average loss to Welsh households to 2.3% of net income (reflecting the increased generosity of Universal Credit to those with small amounts of earned income).

With Universal Credit fully in place, reforms to the tax and benefit system since 2010 are set to result in a 2.0% reduction in income, on average, for Welsh households in the poorest fifth of the population (this compares with 5.2% without Universal Credit). Those in the next poorest quintile group see a reduction in the size of their losses from tax and benefit reforms after accounting for Universal Credit: 3.7% versus 4.6% without Universal Credit. Interestingly, however, Universal Credit makes a much smaller difference to the incomes of households in the second quintile that live in Wales (0.9% increase) than in the UK as a whole (1.6%). It is again noteworthy that pensioner households in Wales look to be hit harder by the changes to the benefit and tax credit system than working-age adults, in contrast to the UK as a whole (Figure 5.6).

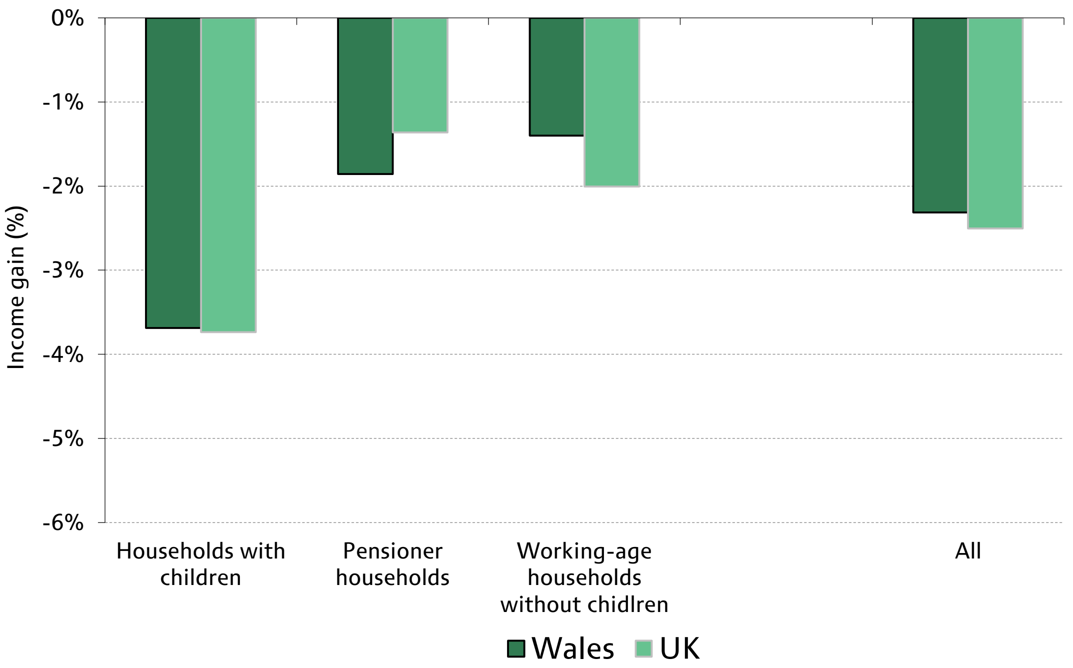
[27] Universal Credit will be fully in place by the end of 2017. The purpose of modelling it as if it were fully in place in 2014 is to show how Universal Credit will affect the distributional impact of reforms once it is fully in place.

Figure 5.5. Impact of tax and benefit reforms introduced or planned by current government up to April 2014, by income quintile group (Universal Credit fully in place)



Source: Author's calculations using TAXBEN, the IFS tax and benefit microsimulation model, run on uprated 2009–10 Family Resources Survey data.

Figure 5.6. Impact of tax and benefit reforms introduced or planned by current government up to April 2014, by household type (Universal Credit fully in place)



Source: Author's calculations using TAXBEN, the IFS tax and benefit microsimulation model, run on uprated 2009–10 Family Resources Survey data.

Summary

Changes to the tax and benefit system are set to reduce the disposable incomes of households substantially in the next few years. However, not all types of households will be hit equally hard: those with children, and at least until Universal Credit is substantially rolled-out, those towards the bottom of the income distribution, see their incomes fall by a larger percentage as a result of reforms than other types of households. These are groups that are already more likely to rely on local government services (e.g. schools and social services), and reductions in income may increase the importance of such services to them. Local authorities might also want to consider the differential reductions in household incomes when determining which services to cut back and which services to increase charges for. However, when considering spending and policy decisions, it is important that local government recognises that these aggregate distributional analyses can provide only a limited amount of information. Some households will lose much more than average (e.g. those with especially high housing costs who lose housing benefit, or those who are deemed to be no longer entitled to disability benefits) while others will gain. And the reforms also entail substantial changes in conditionality and claims processes that are designed to encourage work. IFS researchers are currently undertaking a research project for the Welsh Government, which will estimate the impact of welfare reforms on the labour market participation rate and hours of work of people in Wales. A fuller understanding of the potential effects of welfare reform on local government needs a detailed assessment of all these factors, along with an analysis of the determinants of the demands for local authority services that is beyond the scope of this report.

5.2 Demography: the changing population and spending pressures

The government's fiscal consolidation plan would be sufficient, at least on current forecasts, to return borrowing back to sustainable levels by the end of the forecast horizon, currently 2016–17. The cyclically adjusted current budget (government revenues less non-investment spending, adjusted for the ups and downs of the economic cycle) is forecast to be 0.5% of national income in surplus in 2016–17, thereby satisfying the Chancellor's fiscal mandate that it would be balanced or in surplus by the end of the forecast horizon.

However, unfortunately, the difficult choices facing the UK (and, by extension, the Welsh and local) Government do not stop there. Increasing longevity, and the relatively large cohorts of the late 1940s, 1950s and 1960s, means that the coming decades will see a significant increase in the fraction of the population aged 65 or over, and a decline in the fraction of working-age adults and children. The proportion of the population aged over 65 is forecast to increase from 17.2% to 25.7% by 2061, with the proportion aged over 85 forecast to increase from 2.4% to 7.1%.[28] This change in the age structure of the population will put greater pressure on the public finances. This section discusses the magnitude of these spending pressures and examines how demographic change is projected to differentially impact different parts of Wales.

The impact of demographic change on the UK public finances

An ageing population will tend to increase government spending on areas that are exclusively or disproportionately benefit older people, for example state provided pensions, healthcare and social care. The OBR in its recent *Fiscal Sustainability Report* estimated that spending on these

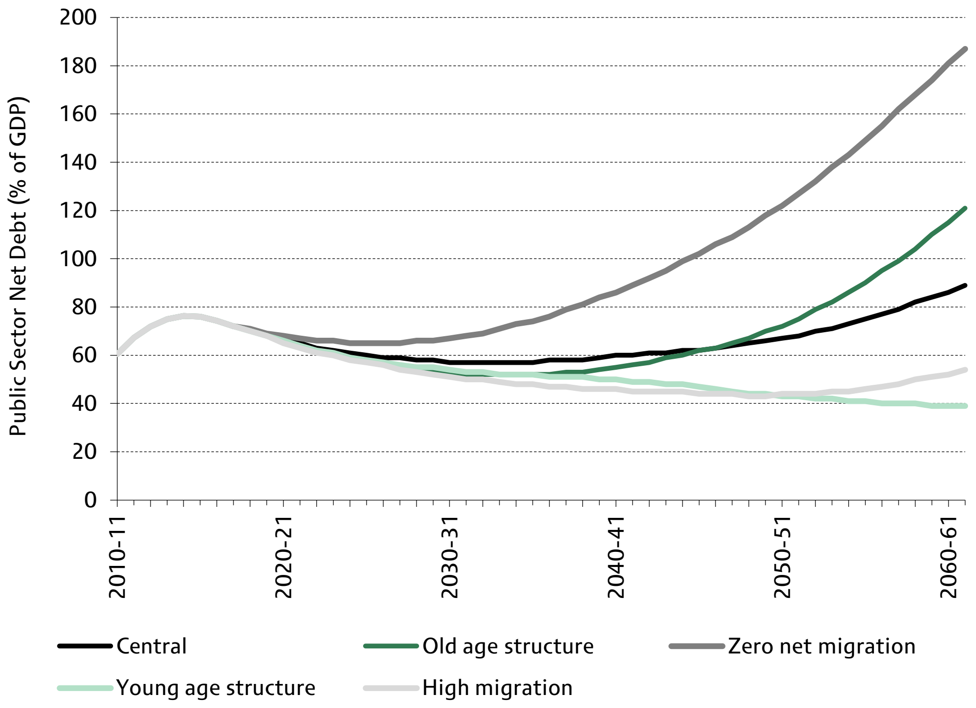
[28] National Office for Statistics 2010-based population projections available at: http://www.ons.gov.uk/ons/publications/re-reference-tables.html?edition=tcm%3A77-229866

three areas would increase from 5.6%, 6.8% and 1.1% (respectively) of national income in 2016–17 to reach 8.3%, 9.1% and 2.0% by 2061–62. On the other hand older individuals tend to contribute lower tax revenues than working-age people, since their incomes tend to be lower and they no longer pay national insurance contributions. The implication of this is that, without any policy action, the ageing population will tend to increase government borrowing and worsen the state of the public finances. Indeed the OBR estimated in their FSR that, just as a result of demographic changes, public spending could increase by 5.2% of national income between 2016–17 and 2061–62, while revenues increase by only 0.9% of national income – leaving borrowing potentially 4.3% of national income higher than it would be without any demographic pressures. Such higher borrowing would not be a sustainable position for the UK economy. The OBR's central projections based on these figures show that, in the absence of any policy changes to address this, public sector net debt would be on an upwards trajectory from the 2030s.

The OBR's *Fiscal Sustainability Report* emphasises the significant uncertainty around the central projections made and examines a number of different assumptions.

First, it examines what would happen if demographic or economic trends differ from its central projections (which are the same as the Office for National Statistics 2010-based projections and productivity growth of 2.2% per year). Figure 5.7 shows how changes in the demographic assumptions affect the path of public sector net debt, which can be seen as a summary measure of the effects of the different assumptions on public spending and revenues.

Figure 5.7. Public sector net debt (% of GDP) for demographic variants, UK



Source: OBR, *Fiscal Sustainability Report* 2012

It shows that:

- With an older age structure due to fewer births and higher life expectancy, the path for net debt would be somewhat stronger until the mid 2030s with taxes a slightly higher proportion of GDP and spending a slightly lower proportion. Beyond this, however, the older population adds significantly to spending pressures, increasing total managed expenditure as a fraction of GDP by just over 2% by 2051–52 and by almost 5% by

2061–62 relative to the baseline scenario. This pushes public debt above 120% of national income (GDP) by 2061–62 and would necessitate a much larger fiscal tightening.

- With a younger age structure driven by higher fertility, higher migration and lower life expectancy, the path for net debt would be stronger from the 2030s onwards with total managed expenditure as a fraction of GDP 3.4% lower than under the baseline assumptions by 2051–52 and 5.5% lower by 2061–62. This reflects both lower demand for spending on health, pensions and personal care (due to smaller fraction of old people) and higher output due to a larger working-age population.
- Zero net migration would lead to a significantly weaker picture for the public finances, especially after 2030–31, with debt approaching 200% of GDP by 2061–62. This is because migrants tend to be fairly young, and hence, without them, the population would age much more rapidly, leading to relatively higher demands for age-related spending (spending would be 1.2% of GDP higher than under the baseline assumptions by 2031–32, rising to 5.6% by 2051–52 and 8.2% by 2061–62).
- Conversely, higher net migration would improve the public finances as the younger population held down the relative costs of ageing. This shows clearly that net migration of younger working-age people in to the UK can help ameliorate the effects of an ageing population quite substantially, although allowing large net inflows will result in a significantly larger population, which may entail costs not accounted for in these projections (e.g. a more urban county).

Productivity growth half a percentage point lower or higher is shown to result in spending being 2.6% higher or 2.0% lower as a proportion of GDP by 2061–62, showing that the rate at which the economy grows over the long run will have a substantial effect on the size of fiscal adjustment needed to cope with demographic change.

The OBR's report then examines what would happen if productivity in the NHS did not keep pace with in the rest of the economy (its central assumption), but either stalled or grew by a slower 0.8% per year (one estimate of the average growth in productivity since 1979). For instance, if productivity were to grow by 0.8% versus 2.2% per year in the economy as a whole, in order to increase the quantity of health services provided at the same rate as other output (2.2% per year), real terms spending on health would need to increase by 3.6% per year: that is 2.2% plus an additional 1.4% (2.2%–0.8%) to ensure wages in the health sector keep up with those in the rest of the economy despite lagging productivity (if wages do not keep up then it would become difficult to recruit doctors, nurses etc.). Of course, the quantity of health care required is expected to grow by more than other output as the older population puts greater strain on the NHS. The OBR forecasts that if healthcare productivity does grow by only 0.8% a year, an additional 7.5% of GDP would need to be allocated to healthcare by 2061–62 in addition to the 2.3% additional amount needed to cope with ageing under the central projections. In other words, if productivity in providing public services does lag behind private sector productivity, a larger fraction of income would need to be paid in taxes to support these services. And if this is politically difficult to implement, either the path of public borrowing and debt becomes rapidly unsustainable or swingeing cuts in other public spending must be made.

Finally, the OBRs report examines the prospects for revenues and finds evidence that certain existing taxes such as North Sea taxes, corporation tax and fuel duties will come under pressure in coming years, meaning additional revenue streams may need to be found. Without this, the path of public debt would again look even worse in the long-run, or cuts to spending would be necessary (difficult given the demands caused by ageing).

Taken together, these findings mean that the key messages from the OBR's report are that:

- Ageing will have a significant impact on the public finances in the coming decades, with a need to increase spending on health, pensions and long-term social care of the elderly. This may put pressure on other types of spending unless significant new revenues (above and beyond the increases needed to fix the current poor state of the public finances) are found.
- The exact impact is highly uncertain and could be very major if the population ages more quickly than expected (due to lower birth rates and/or higher life expectancy and/or lower net immigration), or if productivity improvements in the NHS continue to lag behind that of the economy more generally.
- If additional revenues cannot be found to fund the necessary increase in the NHS and state pensions, grants to local government may come under further significant pressure well beyond 2020−21. This is at the same time as local authorities face rising demand for social care services.

Demographic change in Wales

The demographic pressures facing the UK will be felt in Wales and by Welsh local government. Wales is older and ageing at a similar rate to the rest of the UK: the fraction of the population aged 65 or over is projected to increase from 19.3% in 2012 to 27.6% in 2061, while the fraction of the population aged 85 or over is expected to increase from 2.5% to 7.6%.

Demographic change is not set to affect all parts of Wales equally, however. Table 5.1 shows the number of adults aged 65+ and the number of children aged 15 or under per 1,000 'working-age adults' (aged 16–64) as projected for 2012 and 2033, the most distant date for which we have local authority level projections, as well as the percentage change in the population of these groups during that period. [29]

The first thing to note is that different age groups are not equally represented across Wales in 2012. The ratio of children per 1,000 working-age adults ranges from 232 in Ceredigion to 325 in Newport, with most UAs (13) having a ratio between 290 and 310. Cardiff also stands out as an area with a low ratio (259) reflecting its large population of students and younger working-age people. The ratio of over-65s to 1000 working-age adults varies even more dramatically, with Cardiff recording the lowest figure of 191, and Conwy recording the highest of 439. A clear pattern of higher ratios of over-65s to working-age adults in more rural counties, and lower ratios in the major cities and urban areas of South and North East Wales can be seen.

The table also shows that some areas will be more affected by demographic change than others. Most parts of Wales will see a small increase in the ratio of children to working-age adults (the only exceptions being Pembrokeshire, Rhondda Cynon Taf and Caerphilly), as the number of children increases, or at least falls less quickly than the number of working-age adults. This may suggest a need to prioritise spending on children over spending on the shrinking number of working-age adults. Dramatic projected increases in the number of children in Cardiff and, to a lesser extent, Swansea, mean these districts need long-term plans to expand schools capacity and the provision of other services for children.

[29] The state pension age is set to increase to 66 in 2020, 67 between 2026 and 2028 and 68 between 2046 and 2048. We use a fixed definition of the 'working-age' population here to show more clearly the pure effects of ageing over time as opposed to changes in pension-age policy. Projections are 2008-based and are consistent with the local authority population figures used in Chapter 2 of this report.

Across Wales as a whole though, the big story is the rise in the number of older people. However, some areas will be affected more than others. Cardiff, for instance, is expected to see an increase of 49% in the number of elderly people during this period, but sizable growth in the working-age population too means an increase in the old-age dependency ratio of only 30 from 191 to 221. Increases in the ratio of elderly people to working-age adults are much greater in the rest of Wales. However, those UAs with the oldest populations already are, with some exceptions, set to see the largest increases in this ratio: from 414 to 737 in Powys; 439 to 660 in Conwy; and 370 to 655 in Monmouthshire, for instance. On the other hand: Newport will see an increase from 275 to 382; Swansea from 294 to 365; and Rhondda Cynon Taff from 277 to 402. All local authorities will have to plan for greater demands placed on services by elderly residents going forwards. Most obvious are services such as residential and social care, but other services such as libraries or recreational services may need to change to better reflect the needs of older people. But it is clear that these pressures will affect some local authorities more than others. The Welsh Government should also take this into account (along with variations in the change in child population) when setting grant allocations to UAs in Wales.

Table 5.1. Child and old-age dependency ratios and population changes (%) for Welsh UAs, 2012 and 2033

Unitary Authority	**Children (under 16)**			**Elderly (65 or over)**			**Overall % change in population**
	2012	2033	% change in population	2012	2033	% change in population	
Anglesey	301	329	0%	395	605	40%	4%
Gwynedd	275	292	3%	344	462	31%	5%
Conwy	294	304	-4%	439	660	39%	5%
Denbighshire	297	314	4%	378	593	54%	12%
Flintshire	294	307	-8%	299	514	51%	1%
Wrexham	295	303	4%	288	439	54%	11%
Powys	286	309	-2%	415	737	60%	9%
Ceredigion	232	246	2%	355	535	45%	8%
Pembrokeshire	307	307	-4%	387	595	48%	8%
Carmarthenshire	295	308	6%	360	540	53%	14%
Swansea	271	298	19%	294	365	35%	15%
Neath Port Talbot	287	304	2%	314	489	50%	8%
Bridgend	303	308	2%	303	470	55%	11%
Vale of Glamorgan	313	334	9%	313	473	54%	13%
Rhondda Cynon Taf	294	293	-4%	277	402	40%	4%
Merthyr Tydfil	315	346	3%	278	419	41%	4%
Caerphilly	308	307	-5%	278	439	49%	4%
Blaenau Gwent	292	319	2%	305	449	37%	3%
Torfaen	300	319	-7%	316	506	40%	-2%
Monmouthshire	292	321	-3%	370	655	57%	5%
Newport	325	360	10%	275	382	38%	9%
Cardiff	259	293	46%	191	221	49%	34%
All (Wales)							

Source: 2008-based population projections, available from StatsWales website

Summary

Projected demographic change over the coming decades means local government finances are likely to face continuing long-run pressure. In particular, increasing demand for social care, and especially long-term care by elderly people, will take place at the same time as central government may be tempted to reduce grants to local government as it struggles to fund additional spending on health and state pensions. Hence, without reforms to increase tax revenues at either the central or local level, local authorities may need to seek alternative sources of finance (e.g. increased user charges) or face further pressure to limit spending on services in the decades after 2020. This means it will be important for the UK, Welsh and local governments to work together to plan how they will address the spending pressures caused by the major demographic changes just beginning,

6. Conclusion

This report has examined the cuts made by Welsh local government since 2009−10 and placed these in the context of the wider economic and fiscal situation, and policy environment. Net spending per person has been reduced by 8.4% in real terms, undoing over one-third of the increase in spending that had taken place over the previous nine years, and back below its 2005−06 level. Not all services have been equally as hard hit, with spending on areas like regulation and safety, planning and development and housing services being reduced by more than 20%, whilst spending on social services and environmental and refuse services has been reduced by less than 5%. This shows clearly that local government has been prioritising some areas over others – perhaps in part due to room for manoeuvre being constrained by rising demand and statutory obligations. This may also reflect the fact that the Welsh Government informed local authorities that it expected them to protect, at least in relative terms, spending on social services (along with education).

The most important lesson from the analysis is that the spending cuts look set to continue for at least the next four years and, perhaps, even longer. Even under the most optimistic set of assumptions outlined in this report, the unitary authorities' (UAs) spending power per person would be 9% lower in real terms in 2016−17 than in 2012−13; it would still be 1.6% lower in real terms in 2020−21 even if government spending grew in line with the OBR's long term forecasts for economic growth after 2016−17. In the context of rising demand for key services (such as social services), this means the financial situation for UAs looks challenging for at least the next eight years.

However since the OBR's March 2012 Budget forecast the economy has underperformed expectations and borrowing in 2012−13 is on course to be greater than projected. This means the probability that further cuts in government spending will be required after 2016−17 has increased; we may find out if this is expected in the Chancellor's Autumn Statement. The scenarios we examine where total public spending remains at its 2016−17 real-terms level in 2020−21 are therefore a real possibility, and not necessarily "worst case scenarios". If this happens, and both welfare spending and the Welsh NHS are protected from further reductions in spending, under the assumptions we make, UAs spending power would be 18% lower (22% lower per person) in 2020−21 than in 2012−13.

It is beyond the scope of this report to examine how local authorities could and should respond to the likely financial challenge lying ahead: this would require a detailed study of the demands facing each service area, the scope for cost-cutting and efficiencies, and the statutory obligations faced by local authorities. However, an analysis of expenditure figures can help inform such detailed qualitative work.

First, it is informative to examine how English local government has allocated the considerably bigger cuts in overall spending across services. The North East of England, the region of England most similar to Wales, has seen a reduction in overall spending (excluding education) around twice as large as that in Wales (18.7% versus 9.3%). This has involved larger spending cuts in all service areas with the exception of fire services. The cuts in some areas have been very great indeed. For instance, expenditure on planning and development has been reduced by 57.4% versus 22.9% in Wales, and spending on regulation and safety has been reduced by 44.3% versus 24.5%. This suggests that Welsh UAs may be able to deliver further significant reductions in spending in such areas although not necessarily without reductions in the quality and number of services provided. However, local authorities in the North East have also had to make much larger reductions in spending on social services (11.8% versus 3.8% in Wales), suggesting that as the scope for making further cuts to areas like planning and development diminishes, important 'core' services such as social services cannot be protected as much.

An examination of longer-run trends in local government spending can also be helpful. This shows that despite significant cuts, local government spending on planning and development in Wales remains around 50% higher than its level in 2001–02. This again suggests that there may be scope for reductions in spending in this area, although the contribution to overall spending cuts is limited given the fact that this area accounts for less than 2% of local government expenditure. However, one must be careful to consider the demands and obligations that local government faces. For instance, whilst only a small part of the large increases in spending on social services and environmental and refuse services have been undone (around £1 in £8, and £1 in £9, respectively), these may be areas where rising demand and statutory obligations may make cuts more challenging to deliver.

Simple calculations also show that if cuts on the scale of our "pessimistic" scenario are required, UAs and national government face very difficult trade-offs. For instance, limiting the real-terms cuts in spending on social services, environmental and refuse services and education – those areas which have been relatively protected thus far – to half the average cut (9%) would imply cuts of 52% for the non-protected services (such as housing, transport, culture and planning and development). If, as seems likely, these were not deemed feasible, other difficult changes would need to be made. This may involve making significant cuts to service areas so far relatively insulated from cuts, local authorities stopping providing large swathes of services they traditionally have and attempts to generate substantially more revenue whether from council tax or increased fees and charges.

The report has also argued that the longer-term challenges to the UK public finances caused by demographic change could mean that local government faces a difficult financial situation for decades to come. The OBR's *Fiscal Sustainability Report's* central estimate is that demographic change could increase spending by 5.2% of national income by 2060–61, largely driven by additional outlays on health and pensions. If extra taxes cannot be raised, this may mean a significant further squeeze on other areas of spending such as local government. The central estimates are based on rather optimistic assumptions about how quickly productivity will grow in the NHS, however, and if productivity were to instead grow at the average rate since 1979, spending on the NHS would need to rise by a further 7.5% of national income (well over £100 billion in today's prices). Dealing with this would require some combination of major tax rises, large reductions in other areas of spending, a radical change in the way healthcare is funded, or a decline in healthcare service quality. How government chooses to address these long-term issues is not yet clear. But what is clear is that demographic change will present local and national government with a significant financial challenge far beyond 2020.

Appendix A. Constructing consistent data on local government spending in England and Wales

This appendix describes the data used in this report and how we construct consistent data on net current service expenditure for England and Wales, and how we have adjusted historical population figures and projections in the light of the recently announced 2011 Census results when calculating expenditure per person.

Local government expenditure statistics

This report uses local government expenditure outturns data for years between 2001–02 and 2010–11, the last year for which data are available at the time of analysis, and local government budget estimates for 2011–12 and 2012–13. Final expenditure in these last two years may differ from estimates as resources are shifted across spending areas and/or if contributions or withdrawals from reserves differ from what was planned. Data for Wales are available from the StatsWales website (http://statswales.wales.gov.uk/index.htm) and for England are available from the Department for Communities and Local Government's (DCLG) website (http://www.communities.gov.uk/localgovernment/localregional/localgovernmentfinance/statistics/revenueexpenditure/). However, readers should note that we obtained the spreadsheets underlying the StatsWales website from the Welsh Government, which contained exactly the same data, but in an easier-to-use format.

The data on spending outturns includes detailed information on expenditure by detailed sub-category of expenditure, and breaks down expenditure in to various components (e.g. teacher's salaries, other running costs and administration costs in the case of education). In addition to net expenditure it also includes information on gross expenditure and income received from fees, charges and other sources. In this report we make use of only information on overall net expenditure on particular broader service items.

As there are too many sub-categories to meaningfully analyse, we aggregate spending in to a number of aggregate categories:

- Education
- Social services
- Police services
- Environmental and refuse services
- Transport
- Culture and leisure (excluding libraries)
- Central and other services
- Fire services
- Housing services
- Planning and development
- Regulation and safety
- Library services

These categories were chosen to reflect broad functional areas that are of policy interest. However, they differ somewhat from the aggregate categories used by the Welsh and UK

Governments. In particular, library and other cultural and leisure services are generally one category (cultural services), as are environmental and refuse services and regulation and safety (environmental and regulatory services). We chose to split these categories because we considered there to be particular interest in expenditure on libraries and on environmental and refuse services.

The split between libraries and other culture and leisure is self evident. However, it is worthwhile identifying the sub-categories of spending that make up environmental and refuse services and regulation and safety. The items listed are the category names for Wales in 2012–13, and although names may differ in England and/or for earlier years, we have been careful to ensure that we are consistent across years.

Environmental and refuse services consist of:

- Coast protections
- Street cleansing
- Flood defence and land drainage
- Agriculture and fisheries services
- Waste collection
- Waste disposal
- Trade waste
- Recycling
- Wage minimisation
- Climate change costs
- Conservation of the natural environment

Regulation and safety services consist of:

- Cemetery, cremation and mortuary services
- Regulatory services – Environmental Health
- Community safety (safety services)
- Community safety (CCTV)
- Community safety (crime reduction excluding CCTV)
- Regulatory services – trading standards

In order to make comparisons across years we deflate expenditure by the GDP deflator (a measure of whole-economy inflation) and express amounts in 2012–13 prices. In order to ensure, as far as possible, we are comparing like-for-like expenditure across time and between areas, we exclude spending on magistrates courts for those years in which it was counted as part of local government, and exclude education from much of our comparative analysis of expenditure in England and Wales.

Adjusting historical population figures and population projections

In order to provide figures on expenditure per person we divide expenditure by the estimated mid-year population of the relevant geographic unit. For instance, spending per person by Cardiff council in 2001–02 is calculated by dividing expenditure by Cardiff council in 2001–02 by an estimate of the population in Cardiff in mid-2001.

Official mid-year estimates exist for each year between 2001 and 2011, and projections based on 2008 mid-year estimates in Wales (2010 in England) are available for each year to 2020 (and beyond). However, the 2011 census found approximately 40,000 more people in Wales and more than 400,000 more people in England than expected. This suggests that the mid-year estimates for 2010 and earlier under-estimated the English and Welsh populations (although the size and even direction of the discrepancy varies by local authority),and hence, forecasts for future years based on the these earlier estimates also appear to be too low. If this is true, use of the unadjusted mid-year estimates and forecasts would lead to inaccurate estimates of expenditure per person. In particular, it would lead to a jump in the assumed population in 2011−12 and a fall in 2012−13 which would act to overstate the cut in expenditure per person in 2011−12 and understate the cut in expenditure per person in 2012−13.

For this reason, we adjust the official mid-year estimates population figures for 2002 to 2010 and the projections for 2012 onwards on the following basis:

- First, we assume that the mid-year estimates for 2001 and 2011 are correct (these are based on the census conducted in that year).
- We then calculate a projection for mid-2011 based on the mid 2010 population estimate. This is done by assuming that the population would have increased at the same percentage rate between 2010 and 2011 as in the official 2008-based projections.
- Next, we calculate the discrepancy between this projection for 2011 and the actual mid-year estimate for 2011. This gives an estimate of how 'inaccurate' the previous mid-year estimates were.
- We then update the mid-year estimates for 2002 to 2010 by assuming that the discrepancy grew at a constant rate over time between 2001 and 2011. Hence, if the mid year estimate for 2011 is 1% more than our 2010-based projection for 2011, we assume that the population was (approximately) 0.1% higher than initially estimated in 2002, 0.2% higher in 2003, 0.3% in 2004 and so on.
- Projections for 2012 onwards are updated by taking the mid-year estimate for 2011 and assuming that the population grows at the same percentage rate between then and future years as in the official 2008-based projections. In other words, we update the baseline level of the population but not subsequent growth rates.

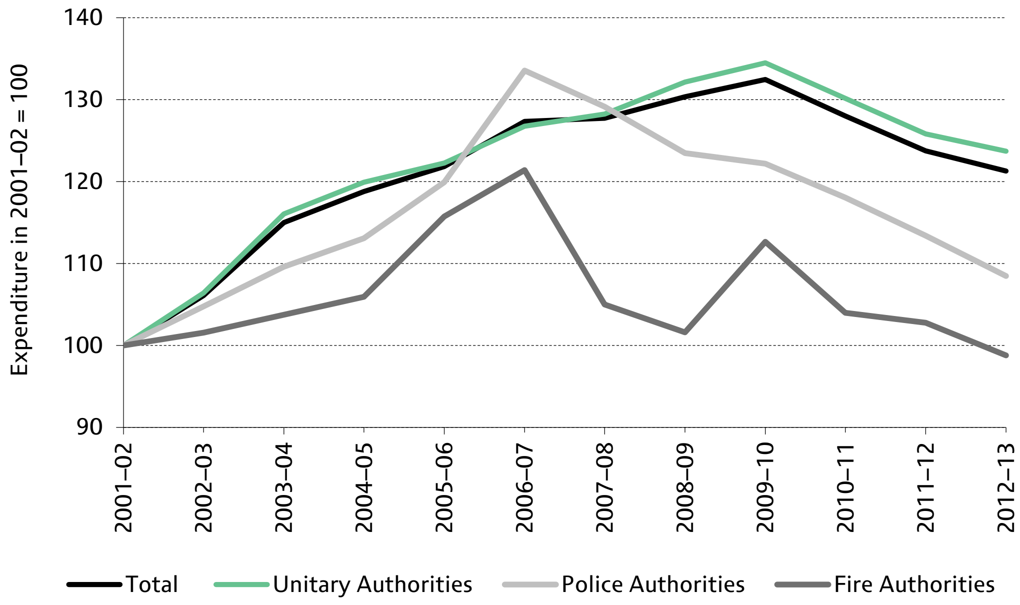
It is important to note that this is an ad-hoc method of adjustment, and that updated mid-year estimates for past years and projections will be produced by the Office for National Statistics in due course. Further details of the calculations are available from the authors on request.

Appendix B. A longer run perspective: Local government spending since 2001–02

In this appendix we discuss how local government spending in Wales has changed over the last 11 years and the extent to which recent cuts have undone previous increases in spending.

Figure B.1 shows real terms current service spending per person by local government in Wales, indexed to 100 in 2001–02. It also separately shows spending by UAs, police authorities and fire authorities, also indexed to 100 in 2001–02.

Figure B.1. Real terms local government spending per person in Wales since 2001–02 (indexed so that 2001–02 level = 100)



Source: StatsWales, local government expenditure out-turns (2001–02 to 2010–11) and budgets (2011–12 and 2012–13) , available at http://statswales.wales.gov.uk/index.htm

Overall local government spending per person increased by 32% between 2001–02 and 2009–10 (from £1,700 per person to £2,253 per person), with the most rapid increases – almost half of the total – taking place in between 2001–02 and 2003–04. The cuts undertaken and planned for between 2009–10 and 2012–13 undo just over a third of this increase and will leave real-terms local government spending per person 21% higher than in 2001–02.

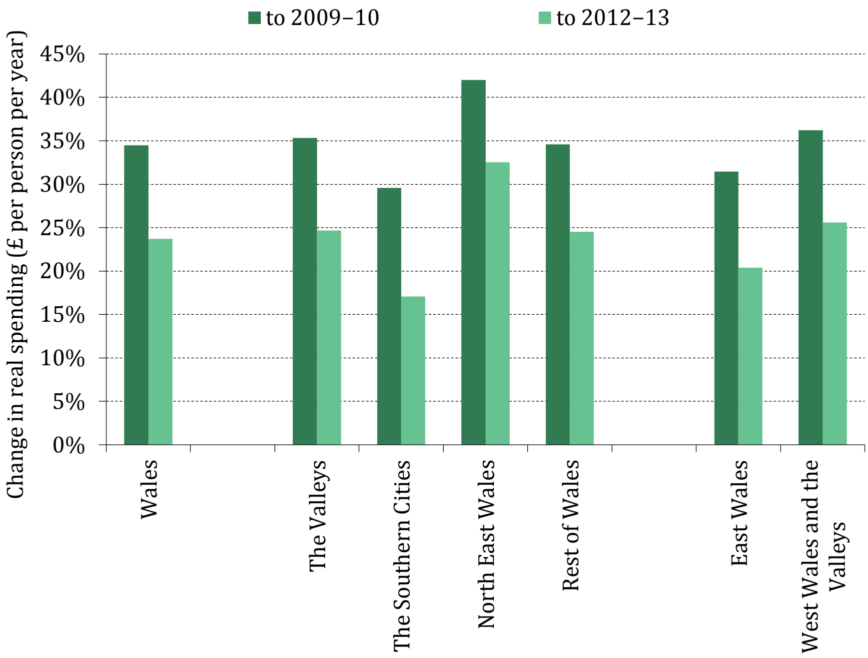
The trends in overall local government spending have been driven by changes in spending by UAs (remember these account for around £7 out of every £8 of local government spending). Real-terms spending per person by UAs increased each year between 2001–02 and 2009–10, peaking at 34% above its 2001–02 level. Subsequent cuts mean that UA spending per person in 2012–13 is planned to be 24% above its 2001–02 level.

The trends for expenditure by fire and police authorities are quite different: slower increases initially (especially for fire authorities), followed by large increases in 2005–06 and 2006–07. 2006–07 was, in fact, the year when spending by both the police and fire services reached their highest levels (34% and 21% above the 2001–02 levels, respectively), and since then, both have fallen substantially. Police expenditure per person has fallen in real-terms each year, whilst fire service expenditure has been more volatile. By 2012–13, around three-quarters of the increase in police authorities net current service spending per person between 2001–02 and 2006–07 is planned to have been unwound, leaving spending 8% above its 2001–02 level. Fire authorities have fared even worse with planned spending per person around 1% *lower* in 2012–13 than in 2001–02.

The longer run picture: variation across Wales

The increases in spending since 2001–02 are not equal across Wales as shown in Figure B.2.

Figure B.2. Changes in net current service expenditure per person by UAs across regions of Wales, since 2001–02



Source: StatsWales, local government expenditure outturns (2001–02 to 2010–11) and estimates (2011–12 and 2012–13) and authors' calculations.

The percentage increases in spending, both to 2009–10 and 2012–13 are fairly similar to the Welsh average in The Valleys and Rest of Wales regions: increases similar to the average have been followed by cuts similar to the average. The Southern Cities saw smaller increases in spending per person than Wales as a whole up to 2009–10 (29% versus 34%), and larger-than-average cuts mean spending per person is planned to be only 17% above its 2001–02 level in 2012–13 (versus 24% nationally). On the other hand, North East Wales saw larger increases in UA spending per person up to 2009–10 (42%) and smaller-than-average cuts mean this has fallen back by less than in Wales as a whole (to 33% above its 2001–02 level).

Looking at the NUTS-2 regions of Wales, local government spending per person rose more over the 8 years to 2009–10 in West Wales and the Valleys (36%) than East Wales (31%). Slightly higher percentage cuts in spending in East Wales mean that this difference is maintained when looking at the 11 years to 2012–13: a 26% increase in spending per person in West Wales and the Valleys versus a 20% increase in spending per person in East Wales.

As can be seen in table B.1, below, these differential changes mean the relative levels of spending across Wales have changed. For instance, spending in North East Wales has caught up a long way with the Welsh average: UA spending per person was less than 2% below the Welsh average in 2012–13, versus over 8% below the Welsh average in 2001–02. On the other hand, spending in the Southern Cities has fallen from less than 2% below the Welsh average to almost 7% below the Welsh average during the same period.

Table B.1. Net current service expenditure per person by UAs (£s per year, 2012–13 prices), 2001–02 and 2012–13

Region	2001–02	2012–13
The Valleys	1,544	1,925
The Southern Cities	1,441	1,688
North East Wales	1,339	1,774
Rest of Wales	1,442	1,795
East Wales	1,407	1,694
West Wales and the Valleys	1,489	1,871
Wales	1,460	1,806

Source: StatsWales, local government expenditure outturns (2001–02 to 2010–11) and estimates (2011–12 and 2012–13) and authors' calculations.

There is even more variation in spending trends when one looks at UAs as opposed to regions of Wales. Table B.2 shows spending per person by each UA in 2001–02 and 2009–10 and 2012–13, along with the overall percentage change in spending between 2001–02 and 2012–13. It shows that:

- Five UAs have increased their spending by less than 20% per person since 2001–02, whilst four have increased their spending by 30% or more during the same period.
- Large increases in North East Wales reflect above-average increases in all three UAs (Denbighshire, Flintshire and Wrexham). Denbighshire has seen the largest per-person increases during this period (over 40%), with spending per person now over £200 per person above the Welsh average versus £26 below the Welsh average in 2001–02.
- Small increases in the Southern Cities reflect below-average increases in all three UAs (Swansea, Newport and Cardiff), with Cardiff and Newport seeing the smallest percentage increases of any Welsh UAs over the 11 year period (although it must be noted Newport's figures show an increase up to 2009–10 a little above the Welsh average, followed by very substantial cuts). Indeed, Cardiff has gone from having a level of spending per person roughly equal to the Welsh average to over £140 per person below it (the gap was an even-greater £167 in 2009–10).

Table B.2. Levels (£s per annum, 2012–13 prices) of and changes (%) in net current service expenditure per person by UAs

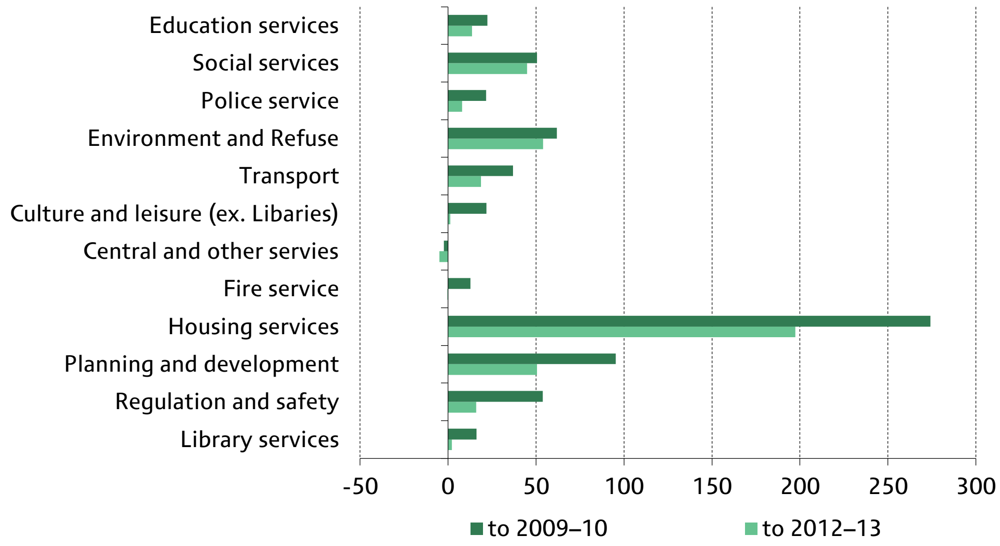
Unitary Authority	2001–02	2009–10	2012–13	% change 2001–02 to 2012–13
Anglesey	1,500	2,010	1,788	19.2%
Gwynedd	1,573	2,038	1,892	20.3%
Conwy	1,381	1,991	1,816	31.5%
Denbighshire	1,434	2,226	2,013	40.4%
Flintshire	1,306	1,812	1,697	29.9%
Wrexham	1,307	1,773	1,695	29.7%
Powys	1,576	2,037	1,864	18.3%
Ceredigion	1,425	1,990	1,829	28.4%
Pembrokeshire	1,393	1,928	1,765	26.7%
Carmarthenshire	1,437	1,897	1,841	28.1%
Swansea	1,413	1,900	1,737	22.9%
Neath Port Talbot	1,591	2,075	1,975	24.2%
Bridgend	1,450	1,974	1,789	23.4%
Vale of Glamorgan	1,347	1,798	1,679	24.7%
Rhondda Cynon Taf	1,591	2,113	2,018	26.8%
Merthyr Tydfil	1,664	2,196	2,018	21.2%
Caerphilly	1,483	2,082	1,814	22.3%
Blaenau Gwent	1,630	2,267	1,997	22.5%
Torfaen	1,463	2,040	1,923	31.5%
Monmouthshire	1,314	1,811	1,628	23.8%
Newport	1,442	1,970	1,645	14.1%
Cardiff	1,462	1,802	1,672	14.4%
All (Wales)	1,460	1,963	1,806	23.7%

Source: StatsWales, local government expenditure outturns (2009–10 and 2010–11) and estimates (2011–12 and 2012–13) and authors' calculations.

The longer run picture: variation across services

As with geography, there is variation in the longer-run trends across service areas. Figure B.3 shows the percentage change in net current service spending per person for each service area between: 2001–02 and 2009–10 (dark green), a period when spending was broadly increasing; and 2001–02 and 2012–13 (light green) which includes subsequent declines. This again allows us to examine what fraction of the increase in spending up to 2009–10 has since been unwound.

Figure B.3. Increase in real terms local government spending per person (%) by service since 2001–02, Wales



Source: StatsWales, local government expenditure out-turns (2001–02 to 2010–11) and budgets (2011–12 and 2012–13) , available at http://statswales.wales.gov.uk/index.htm

The first thing to notice is that certain service areas saw much greater increases in expenditure than others during the 'good times' up to 2009–10. Housing services in particular saw a very large increase: spending per person increased by 274% in real terms between 2001–02 and 2009–10, reflecting the introduction of the 'Supporting People' initiative in the intervening period. Other areas to see large increases in spending including:

- Planning and development (95%), largely as a result of increased spending on economic development;
- Environment and refuse services (62%), perhaps reflecting the additional costs associated with a drive for recycling and the landfill tax;
- Regulation and safety (54%), and;
- Social care (51%), perhaps reflecting increasing demands from a growing elderly population (although this is expected to impact more in coming years)

On the other hand, increases in net current service spending per person on culture and recreation (22%), libraries (16%), police (22%) and fire (13%) services were much smaller, and spending on central services *fell* slightly (2%). Perhaps surprisingly, education spending also increased considerably less than the average, increasing by 22% per person between 2001–02 and 2009–10. But it should be borne in mind that this period corresponded to a significant reduction in the school-age population in Wales (by 6.6% from 510,178 to 476,363), that means education spending per student looks to have increased by rather more.

Section 2.2 of this report showed that spending cuts varied by services, and together with previous varied rates of increases, this means changes in spending between 2001–02 and 2012–13 also vary significantly across services.

The increase in spending on housing services remains very large at 197%, although this does mean just over one-quarter of the earlier increases to 2009–10 have since been undone. Spending per person on planning and development services is set to be 51% above its 2001–02 level in 2012–13, and although this means almost half of the earlier increases have been undone, it may mean there is scope for further substantial reductions if necessary (and at the very least, it will be easier to identify spending cuts given that spending is still significantly higher than 12 years ago than in services that have not seen such spending increases). On the other hand, whilst only a relatively small part of the increases in spending on environmental and refuse services and social services have been undone (around £1 in £8 and £1 in £9, respectively), these may be areas where statutory obligations limit the scope for major reductions.

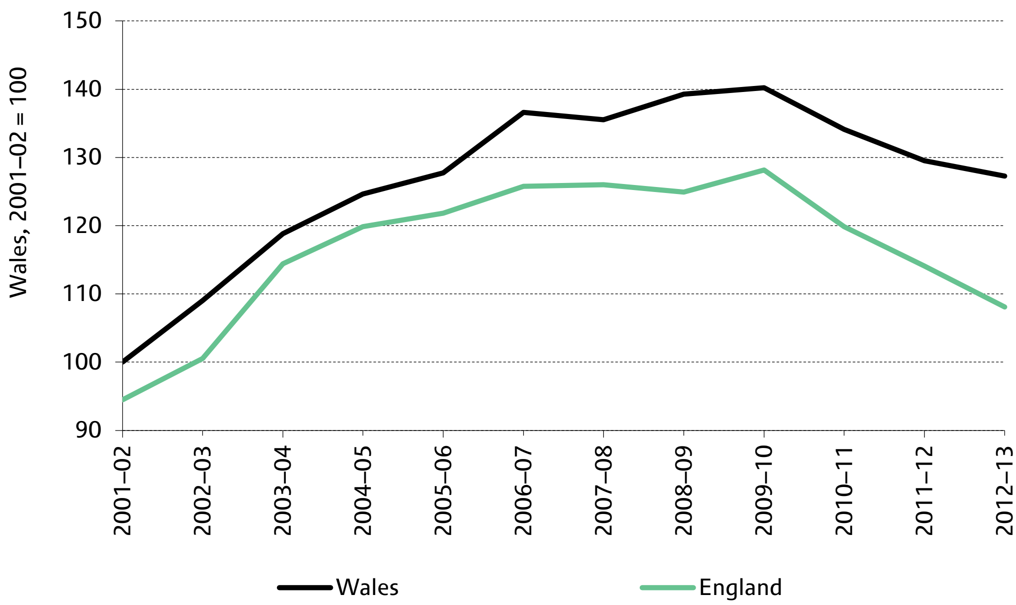
Large cuts to library services and cultural and recreational services have nearly wiped out earlier increases, meaning real-terms current service spending per person is little higher than in 2001–02. Finally, cuts to education budgets mean that spending per person is now only 13% higher than in 2001–02, although again, the picture looks somewhat rosier for spending per school pupil. But it is worth noting that if cuts to education spending continue at the same pace, spending per person will be little higher in 2016–17 (the last year of planned cuts to overall public spending, see Chapter 1) than in 2001–02.

The longer run picture: comparison with England

How has local government spending in England fared over a longer time period and how does this compare to Wales? This is the question we now turn to.

Figure B.4 shows how local government spending (excluding education) has evolved in England and Wales since 2001–02, indexing the real-terms level of spending per person in Wales in 2001–02 to 100 (this allows us to compare both growth rates and relative levels). This shows that local government net current service spending per person (excluding education) was around 6% above the English average in 2001–02. Following strong increases in local government spending in both England and Wales over the four years to 2005–06, this gap was around 5%. Since then it has widened somewhat. First, relatively stronger growth in local government spending in both 2006–07 and 2008–09 in Wales meant that this gap increased to around 9% by 2009–10. Significantly larger spending cuts in England since 2009–10 have increased this gap to almost 18% in 2012–13.

Figure B.4. Real terms local government spending per person in Wales since 2001–02 (indexed so that 2001–02 level in Wales = 100)



Source: StatsWales and DCLG, local government expenditure out-turns (2001–02 to 2010–11) and budgets (2011–12 and 2012–13) and authors calculations.

This means that while local government net current service spending (excluding education) was only around £50 per head higher in Wales than in England in 2001–02 (£957 versus £905 in 2012–13 prices), the gap is planned to be over £180 per head in 2012–13 (£1,219 versus £1,035).

It is also instructive to compare how the amount spent on different services has changed in England relative to Wales. Figure B.5a shows the percentage change in spending per person for each service in England and Wales between 2001–02 and 2009–10, while Figure B.5b covers the longer period from 2001–02 to 2012–13, allowing us to examine whether the cuts have more-than-undone earlier increases.

Figure B.5a. Increase in real terms local government spending per person (%) by service between 2001–02 and 2009–10, England and Wales

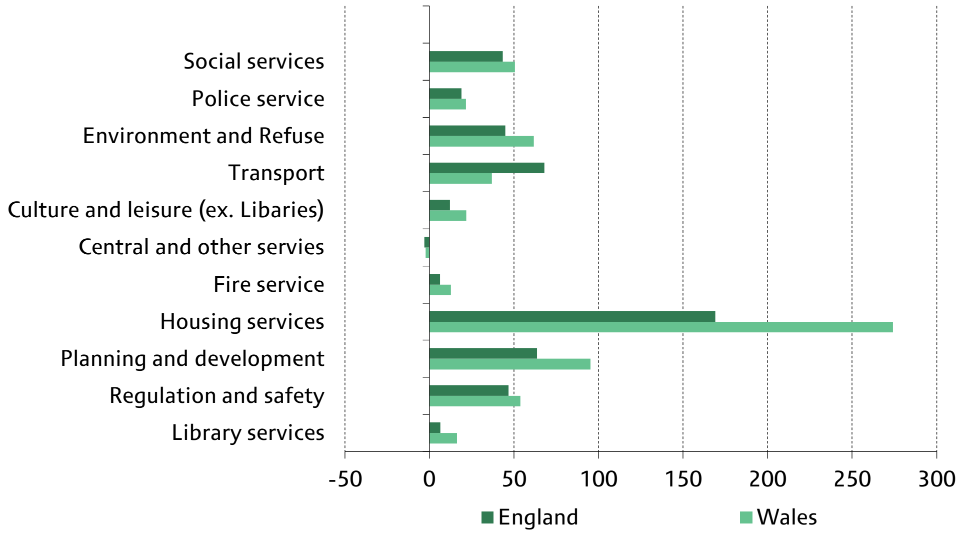
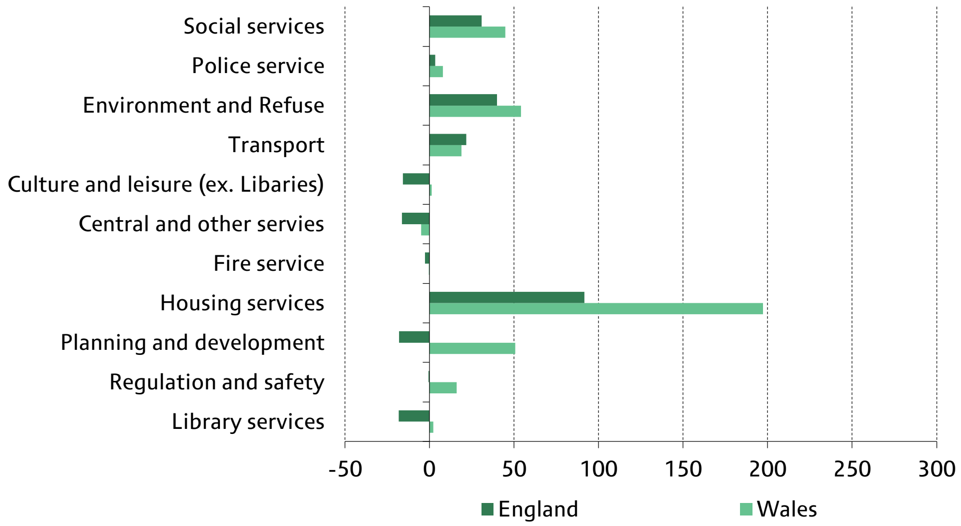


Figure B.5b. Increase in real terms local government spending per person (%) by service between 2001–02 and 2012–13, England and Wales



Source: StatsWales, and DCLG local government expenditure out-turns (2001–02 to 2010–11) and budgets (2011–12 and 2012–13)

Between 2001–02 and 2009–10, the pattern of spending changes in England was similar to that in Wales. Housing saw the largest increases in both nations (169% in England versus 274% in Wales), in part reflecting spending under the 'Supporting People' programme. Social services, environmental and refuse services, planning and development and regulation and safety also saw increases in spending per person of over 40% in both nations (the increases were somewhat larger in Wales than England), whilst spending on transport rose by over 35% in Wales and over 65% in England (although spending in England is skewed by Transport for London). On the other hand, per-person net current spending on central services was reduced in both countries, and spending on the libraries and the fire service barely grew.

How do the cuts since 2009–10 change this picture? The first thing to notice is that in both England and Wales, spending on social care, environmental and refuse services, housing services, and to a lesser extent, transport services, remains well above the levels of 2001–02. Perhaps the most striking finding is that local government spending per person on planning and development, culture and leisure (ex. libraries), libraries, and central and other services is over 15% below its 2001–02 level in England. On the other hand, spending on the last three of these services is at similar levels to in 2001–02 in Wales, while spending on planning and development services remains 50% *above* its 2001–02 level. This provides further evidence that there may still be significant scope for further reductions to these budgets, before Welsh local authorities need to shift more of the cuts to more politically sensitive social care, environment and waste and housing budgets as the spending cuts continue, likely until at least 2016–17.

Appendix C. Projecting Welsh Government expenditure and local government spending power to 2020–21

This appendix provides further explanation of how we project unitary authorities' (UAs) spending power to 2020–21 and identifies the data sources used.

The first task is to calculate UAs spending power in 2010–11, 2011–12 and 2012–13 and project it for the period covered by the current UK Government spending review (i.e. 2013–14 and 2014–15). To do this we make use of the following data sources:

- The Welsh Local Government Revenue and Capital Settlement's 2012–13 and 2011–12 (http://wales.gov.uk/topics/localgovernment/finandfunding/settlement/?lang=en).
- Local government expenditure outturns for 2010–11 and local government budget estimates for 2011–12 and 2012–13 (http://statswales.wales.gov.uk/index.htm)

Spending power in 2010–11, 2011–12 and 2012–13 is calculated by adding the general grants (termed aggregate external finance or AEF) and specific grants (excluding those for housing benefit) outlined in the Local Government Settlement to the actual or expected council tax receipts listed in the local government expenditure tables.

The 2012–13 Settlement includes indicative allocations for the general grant (AEF) for 2013–14 and 2014–15. We assume that specific grants change in line with Welsh Government current expenditure on items other than general grants to local authorities (available at http://wales.gov.uk/funding/budget/suppbudget1213/?lang=en). Council tax receipts are expected to grow in line with inflation plus the change in the number of households in Wales (http://wales.gov.uk/topics/statistics/theme/housing/estimate/hsehold-proj/?lang=en).

We then examine various scenarios for local government's spending power post 2014–15 (see Chapter 4). In order to do this we use data on planned public expenditure available at (http://budgetresponsibility.independent.gov.uk/pubs/March-2012-EFO1.pdf) which includes estimates of spending on welfare, debt interest and public services to 2016–17. We use these forecasts to project how Welsh Government DEL would change during this period if it followed the path of overall public service spending (total spending minus welfare spending and debt interest) both if no further cuts to welfare are made and if they are not made.

To project the level of Welsh Government DEL in 2020 under our various scenarios, we use the OBR's long run forecasts of economic growth, welfare expenditure (available at http://budgetresponsibility.independent.gov.uk/fiscal-sustainability-report-july-2012/). We assume that total public service expenditure either grows in line with the long-run real-terms growth rate (2.4%) contained in the OBR's Fiscal Sustainability Report or is fixed in real terms at its 2016–17 level. Welfare expenditure is assumed to grow in line with the forecasts contained in Table 1.1 of the Supplementary tables to the OBR's report (suitably adjusted for whether the scenario assumes welfare spending is cut between 2014–15 and 2016–17) and debt interest payments are assumed to increase from £65.5 billion 2016–17 to £80.0 billion in 2020–21.

Welsh Government DEL is assumed to change in line with overall public service spending but any cuts after 2014–15 are assumed to hit current as opposed to capital DEL (which the UK Government has said is protected). We take figures for Welsh Government DEL from tables 1.3a and 1.6 of the Public Expenditure Statistical Analysis (PESA) budget tables (available at http://www.hm-treasury.gov.uk/d/pesa_2011_tables_chapter1.xlsx).

Finally, we project Welsh Government grants to UAs and add on projections for council tax revenue (which is assumed to continue to grow in line with inflation and household growth) to calculate UAs' spending power. This is relatively simple under the assumption that the Welsh NHS is not protected from further cuts: in that case the change in grants after 2014–15 is the same as the change in the Welsh Government current DEL. If the Welsh NHS is protected from further cuts, we need to work out how much larger cuts to other areas (such as grants to the UAs) would need to be in order that overall spending is reduced in line with the fall in the current DEL. To do this we use draft figures for spending on the NHS and other areas in Wales in 2014–15 from the 2012 Budget (http://wales.gov.uk/funding/budget/suppbudget1213/?lang=en).

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For information on data sources see appendices A and C.