The shape of pain to come: scenarios for the Welsh Government budget to 2025-26

David Phillips (and Ben Deaner)
Introduction

• IFS funded by Wales PS 2025 to look at how the Welsh Government’s budget may change over the next 12 years
  – Compare to changes made since 2010-11
  – And put in the context of demand and cost pressures

• The size of the Welsh Budget after 2015-16 is uncertain
  – i.e. we cannot accurately predict what the budget will be
  – Depends on economy, public finances and UK government decisions

• Set out plausible range of scenarios for how much the Welsh Government will have to spend

• Explore the financial trade-offs that will be faced when setting budgets for different spending areas
The rest of my presentation...

• The cuts made so far by the Welsh Government

• Scenarios for the Welsh Government’s budget (the ‘block grant’)
  – Between now and 2017-18
  – Between now and 2025-26

• The trade-offs facing the Welsh Government when setting budgets for different service areas
  – Between now and 2017-18
  – Between now and 2025-26

• Concluding remarks
The UK’s fiscal situation

- The financial crisis and associated recession blew a £134 billion long-term hole in the UK’s public finances

- UK Government responded with plans for significant increases in taxes and reductions in spending
  - Designed to eliminate this increase in borrowing by 2017-18
  - Most planned tax rises and investment cuts already happened
  - Most cuts in day-to-day public service spending still to come

- Nascent economic recovery does not mean these cuts can be abandoned or scaled back
  - The plans set out were based on the economy recovering

- Pressure on public finances in longer term from demographic change
The cuts so far in Wales (I)

- The UK government has cut the block grant it provides to the Welsh Government
  - Welsh Government then decides what to allocate to different services
The cuts so far in Wales (I)

- The UK government has cut the block grant it provides to the Welsh Government
  - Welsh Government then decides what to allocate to different services

![Bar chart showing spending cuts 2010-11 to 2013-14](chart.png)
The cuts so far in Wales (II)

• This pattern differs substantially from England and Scotland
  – Health spending has been protected in these countries
  – Local government spending been cut relatively more

• Overall cuts have been larger in Wales than in Scotland
  – At least in part because of differences in the way business rates are treated by the Barnett formula
  – The way Barnett formula Wales looks more consistent
Looking to the future: the Welsh block grant

• The UK government has confirmed further real-terms reductions in the Welsh block grant for 2014-15 and 2015-16
  – Cuts fall on day-to-day spending
  – Capital spending has been cut much more already

• What happens after then depends upon
  – How much the UK government has to spend in total
  – The decisions the UK government makes about how to allocate that spending between benefits and different departments
  – A lot of uncertainty, especially after 2017-18

• So we look at what the block grant would be under a number of different scenarios
So far...

Welsh block grant, £s billions, 2013-14 prices

- Most pessimistic
- Baseline
The picture to 2017-18: baseline scenario
The picture to 2017-18: baseline scenario

• Baseline scenario is for real-term cuts of 5% between now and 2017-18
  – This is £800 million

• The cuts between 2010-11 and 2017-18 would total 14%
The picture to 2017-18: pessimistic scenario

Welsh block grant, £ billions, 2013-14 prices

- Most pessimistic
- Baseline
The picture to 2017-18: pessimistic scenario

- Most pessimistic scenario is for real-term cuts of 9% between now and 2017-18
  - This is £1.4 billion

- The cuts between 2010-11 and 2017-18 would total 17%

- This is not a ‘worst case scenario’ but a plausible ‘pessimistic’ scenario
The picture to 2025-26: baseline scenario
The picture to 2025-26: baseline scenario

• Under our baseline scenario, the Welsh block grant would be £17.3 billion in 2025-26
  – 16% higher than today

• 16% might seem a sizeable increase, but
  – Follows on from cuts: only 6% higher than 2010-11
  – Population growth
  – Spending pressures, especially for health, social services and schools

• Tough choices would not end if budgets start growing in 2017-18
The picture to 2025-26: pessimistic scenario

Welsh block grant, £ billions, 2013-14 prices

- Most pessimistic
- Baseline

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The Welsh block grant: summary

• A lot of uncertainty about the size of the Welsh block grant in future years
  – Especially after 2017-18

• Will depend on UK economy and public finances and UK government decisions

• If further austerity is required after 2017-18, may still not have regained current spending levels by 2025-26
  – Let alone undo the cuts already made

• Even if budget can grow after 2017-18 and is higher than now tough choices will still be required
The trade-offs when setting departmental budgets

• The Welsh Government will have to decide how to allocate its budget between different service areas
  – Where to cut or protect while the budget is falling
  – Where to increase when the budget is rising

• Lots of different choices it could make

• We look at a number of options to illustrate the trade-offs
  – We are not recommending what it should do
The trade-offs between now and 2017-18

Baseline Scenario

-5% 
0% 
-10% 
-15%
-20%
-25%
-30%

Cut to social services and schools

Cut to other services

Average cut

Pessimistic Scenario
The trade-offs between now and 2017-18

Baseline Scenario

- Protect health only
- Protect health, social services and schools

Pessimistic Scenario

- Protect health only
- Protect health, social services and schools

% real terms cut, 2013-14 to 2017-18

- Cut to social services and schools
- Cut to other services
- Average cut
The trade-offs between now and 2017-18

Baseline Scenario

- Protect health only
- Protect health, social services and schools

Pessimistic Scenario

- Protect health only
- Protect health, social services and schools

% real terms cut, 2013-14 to 2017-18

-5% to -30%

- Cut to social services and schools
- Cut to other services
- Average cut
The trade-offs between now and 2017-18

Baseline Scenario
- Protect health only: 0%
- Protect health, social services and schools: -5%

Pessimistic Scenario
- Protect health only: 0%
- Protect health, social services and schools: -15%

% real terms cut, 2013-14 to 2017-18
- Cut to social services and schools
- Cut to other services
- Average cut
The trade-offs between now and 2017-18

• Clear that the cuts to ‘unprotected spending’ will depend on
  – Overall budget cut
  – How much of spending is ‘protected’

• Some areas like the economy, culture, housing already seen cuts of around 20%
The trade-offs between now and 2025-26

• Will discuss two options here to illustrate the trade-offs

• Choice 1
  – Health is protected from cuts
  – Once budget is growing, same % increase for all budgets

• Choice 2
  – Health, social services and schools protected from cuts
  – After 2017-18, increase spending on health (5% per year), social services (4.5%) and schools (2%)
  – 5% increases per year for health are substantial, but follow cuts and freezes
  – Would mean average growth of 2% per year 2010-11 to 2025-26, which is relatively small by historical standards
The trade-offs between now and 2025-26

Baseline Scenario

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% real terms change, 2013-14 to 2025-26

- Change to Health
- Change to social services
- Change to schools
- Change to other services
- Average change
The trade-offs between now and 2025-26

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The trade-offs between now and 2025-26

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% real terms change, 2013-14 to 2025-26

- Change to Health
- Change to social services
- Change to schools
- Change to other services
- Average change

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The trade-offs between now and 2025-26

• Increasing spending on health, social services and schools to ‘undo’ earlier cuts and cope with rising costs/demands would but significant pressure on other services
  – Budgets for other services could be substantially below today
  – And still falling

• In our pessimistic scenario, trade-offs are difficult to comprehend
  – Substantial increases for health, social services and education would be implausible in this case
Concluding remarks

• Tough choices will not end in 2017-18 even if the Welsh Government’s budget can start to grow again
  – Rising demand/costs for healthcare, social care and schools
  – Spending other areas may still face cuts even after 2017-18

• In our most pessimistic scenarios the trade-offs between different services are difficult to comprehend

• Difficult choices will have to be made
  – What services to prioritise
  – And what services to cut back

• But focus on reducing demand and cost pressures is also needed
  – Challenges over next 12 years and beyond need to be planned for now