Public Sector Spending

The public sector in Wales, as across the UK, is in the midst of a considerable sea change, one which the much awaited Beecham report into local service delivery has described as '*a fundamental transformation from the model inherited from the post-war years to one sustainable in the early twenty first century*' (Beecham, 2006; p. 3). The report notes that this transition is characterised by two major features.

The first of these is the changing relationship between services and the public. This is largely a product of the explosion in consumer choice and spending power in the private consumer market place which is transforming public expectations about the quality of public services and the extent to which they are tailored to their particular needs. However, it also reflects the shift from a public service model whereby the public were passive recipients of services to one where they are engaged consumers who work with service providers to achieve desired outcomes.

The second feature in this transformation follows from the first and relates to the requirement for greatly enhanced efficiency in the use of resources in order to improve services. As well as resources being stretched because people demand more from them, consumers are much less willing to tolerate high levels of taxation – or *direct* taxation at least - to help pay for services. The upshot is that public services have to adjust to a new era of reduced growth in public expenditure after a period in which rapid expansion in spending has not seemed to achieve anything like enough improvement in services on the ground to satisfy the public.

This is thus the context which will dominate public sector spending debates for the foreseeable future and certainly for the duration of the forthcoming third term of the Welsh Assembly Government. But there are also additional challenges in Wales provided by its unique demography and socio-economic conditions, as well as the demands associated with running the machinery of devolved government, all of which will make for some exacting times ahead.

The stringency of the future public spending environment in Wales cannot be underestimated. The Assembly will have £14 billion at its disposal in 2007-08, with the projected annual growth in the budget for the period 2008-09 to 2010-11 predicted to be around 2.7%. On present plans nominal growth in devolved spending in Wales will thus slow down from a peak of 11.5% in 2002-03 to 5.2% in 2008-09 and beyond. In real terms, the slowdown is even more stark: real growth will slow from 9% in 2002-03 to under 3% in 2008–09 (IWA, 2006).

The spending slowdown will be more acute in Wales than the rest of the UK as a consequence of the continued operation of the Barnett formula – the formula used to help determine annual changes in the size of the block grant given from Whitehall to Wales. In the long run, the formula should eventually lead to convergence towards equal levels of per capita public spending in all four countries of the UK. This is because the original 1979 baseline, under which each country got more spending per head than England, becomes swamped by the successive increments added each year, until spending per head is identical in all four countries.

The long run has, however, been much longer than anyone anticipated when the formula was introduced in 1978. Up until 1999 there was no perceptible convergence in levels of per capita spending across the four countries even though the Barnett formula supposedly operated throughout. The reasons for this are largely political and reflect the considerable formula bypass sanctioned in favour of Scotland in particular, to reduce the threat to the Union. The election of the New Labour government in 1997 caused no immediate change because of Gordon Brown's decision not to increase the Conservatives' planned spending totals. With no increase in spending in England, there is nothing for the Barnett formula to bite on. The formula only began to bite when the Labour Government started to increase public spending in England. This grew most in the Spending Reviews of 2000 and 2002, and less but still substantially in the Spending Review of 2004. During this period, Scotland, Wales and Northern Ireland were getting their population share of the extra largesse. But, as a proportion of the baseline that they were getting before, the extra was less than in England. This is the so-called 'Barnett squeeze' and is clearly inequitable if one believes that public spending should reflect differences in need.

It has been estimated that over the five years between 1999 and 2005 the Barnett Squeeze has cost Wales approximately £1 billion (ap Gwilym, 2006). Relative expenditure per head on devolved services in Wales compared with the corresponding increase in England declined from 115% in 1999-00 to 112% in 2004-05. If it had not been for formula bypasses (as noted above), the squeeze effected by the formula would have been considerably more severe.

Two other points are worthy of note here. Firstly, the Barnett squeeze has become more significant since 1999 because the effect is greater when there are high nominal increases in public expenditure on services in England, which, in the case of Wales, are devolved. In short, the higher the increase, the greater the squeeze. Thus the UK Labour Government's increased spending on health and education in England has increased the severity of the squeeze on devolved spending in Wales. The effect of the squeeze is such that spending per head on health in Wales has declined from 109% of the UK average in 1999-00 to 100% in 2005-06. Secondly, Wales is in effect subject to a double squeeze caused by the need to find match funding from within the block grant for the EU Objective One programme and its replacement, the Convergence Programme, which commences this year. This inevitably means reducing spending on other programmes such as health and education.

In addition to the issues discussed above, there is an added complication associated with the dominance of the public sector in Wales. A considerable proportion of workers in Wales are employed by the public sector and these employees will expect their wages and salaries to increase in real terms to cover inflation and also to parallel the growth in private sector productivity and thus salaries. Unless public sector productivity rises proportionately, this will impose a tighter squeeze on the resources for Welsh public services.

These trends inevitably increase the urgency of improvements in public sector efficiency – already acknowledged to be central to the Assembly's *Making the Connections* and *Delivering the Connections* agendas and given further support in the Beecham Review. There are indeed growing clamours for a step-change in the approach to public sector efficiency savings in Wales which are likely to need to be significantly greater than are at present envisaged. Other more radical options that the new administration may wish to consider include increased use of private finance for capital spending and more innovative forms of revenueraising by public sector organisations within Wales. What is clear is that the new Assembly Government will be forced to make increasingly difficult choices between spending priorities and will have to carefully manage public expectations about service delivery and improvement.

References

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