

Cyflwynwyd yr ymateb i ymgynghoriad y [Pwyllgor Cyllid](#) ar [Cyllideb Ddrafft Llywodraeth Cymru 2025-26](#).

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The Finance Committee, Welsh Government's Draft Budget 2026-27, September 2025

Written evidence submitted by:

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I am providing a response on behalf of the Wales Productivity Forum of the Economic and Social Research Council (ESRC) funded Productivity Institute (TPI).¹ I am a Professor of Economics at Cardiff Business School, and I write in my capacity as academic lead for the Wales Forum, which is one of eight regional forums of TPI. The Wales Forum is led by Cardiff University, but members bring expertise from academic, policy, business and public sector backgrounds. Our aim is to support the implementation of research insights, including those developed by the TPI, into the design of practical interventions for policy and business practice to raise productivity in Wales. More information is available at: [Wales Productivity Forum - The Productivity Institute](#).

In January 2025 the forum released an insights paper [Wales' Productivity Challenge: A Focus on the Future](#) which sets out the scale and nature of Wales' productivity challenge, its importance for future wellbeing of the population and the practical steps that need to be taken to address it. This evidence draws on the findings of the paper which are most pertinent to the Call for Evidence, particularly relating to the fiscal consequences of low productivity in Wales.² It is, however, important to recognise the critical importance of the wider context. The Welsh Economy is not only deeply embedded within the broader UK economy, but the majority of Welsh Government funding comes from a block grant from the UK Government based on UK taxation revenue. Wales' fiscal position has therefore been heavily influenced by the UK productivity puzzle, that is, the slow down in productivity growth in the UK since the start of the 2008 financial crisis. This has constrained UK economic growth and worsened the UK fiscal position.

We argue that productivity growth provides a route to improve long-term fiscal sustainability and that policy attention and short-term public investment is required to support this.

1. What is Wales' productivity challenge?

Economic growth is driven either by increasing the quantity of inputs, for example, in terms of employment rates or hours worked, or raising productivity of given inputs. The latter can be thought of as increasing the value of goods and services produced with existing inputs. At a national level, productivity is typically measured in terms of Gross Value Added (GVA) per worker or per hour worked, where GVA is the additional value of goods and services produced relative to the value of materials. At least until the pandemic the employment rate in Wales converged towards the UK average. Despite this, Wales' relatively low economic output persisted. An important part of the explanation lies in Wales' weak productivity growth.

Wales' productivity challenge can be separated into three elements. First, Wales shares the UK's 'productivity puzzle', the slowdown in productivity growth since the 2008 financial crisis. Second, Wales' productivity is significantly below the UK average (about 17% below) and has shown little signs of convergence over time.³ Indeed, productivity in Wales is currently the lowest of all UK regions

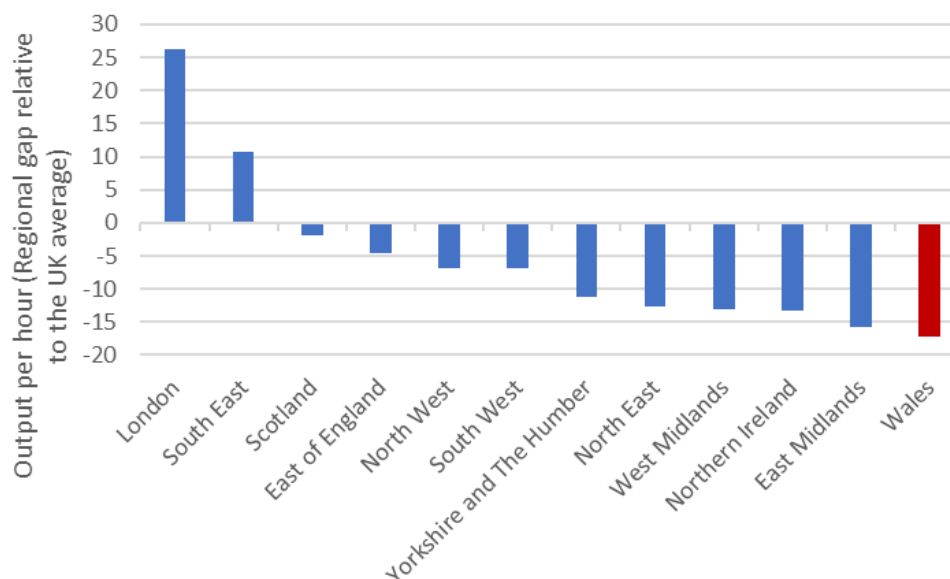
¹ See [The Productivity Institute](#) (grant number ES/V002740/1).

² The paper, and therefore this evidence, develops ideas discussed at the [Wales Productivity Forum](#) and I am grateful to all members for sharing their expertise. I am also grateful to Professor Max Munday and Dr Fari Aftab for comments on an earlier version of this submission.

³ Indeed, between 2019 and 2022, productivity in Wales actually fell while the rest of the UK grew slightly.

(see Figure 1 below). Third, there is variation in productivity *within* Wales, with productivity in areas such as Powys, Gwynedd and Conwy and Denbighshire among the lowest in the UK.⁴

Figure 1. Regional Productivity Gaps in 2022



Notes: Source: Replicated from Jones (2024) (Figure 1). Relative output per hour by UK region. Source: ONS (2024a): [Regional and subregional labour productivity, UK - Office for National Statistics](#).

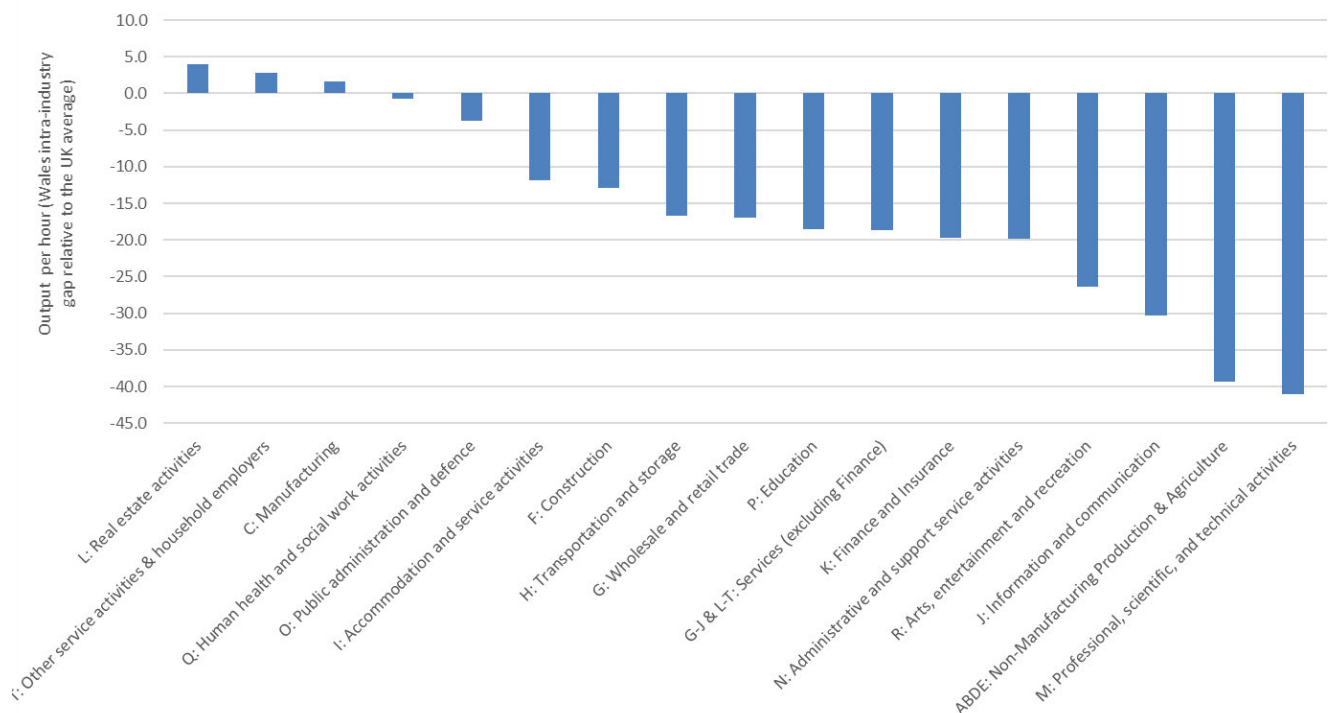
2. What explains Wales' productivity gap?

Wales' productivity challenge is not simply a consequence of its current industrial structure given there is evidence of productivity gaps between Wales and the UK average *within* most broad industry sectors (see Figure 2 below). Albeit these broad groupings might conceal important differences in composition within industries, Wales' productivity gap is not driven by its greater reliance on the manufacturing sector, since manufacturing productivity is higher in Wales than the UK average. Wales' intra-industry productivity gaps are most pronounced in non-manufacturing production, information and communication industries and professional, scientific, and technical activities, where productivity is

⁴ There is an East-West or urban-rural differential (see Jones, 2024, Figure 3). Productivity is less than 95% of the Welsh average in Powys, Gwynedd, Conwy and Denbighshire and, South West Wales (Ceredigion, Carmarthenshire, Pembrokeshire). Productivity in Powys (at only 63% of the UK average) is the lowest in the UK and, Powys, Gwynedd and Conwy and Denbighshire are among the five least productive local areas in the UK.

more than 30% below the UK average. In summary, aligning Wales’ industrial structure to the rest of the UK would not eliminate Wales’ productivity challenge.

Figure 2. Wales-UK Productivity Gaps by Industry in 2019



Source: Replicated from Jones (2024) (Figure 4). ONS (2021): [Region by industry labour productivity - Office for National Statistics](#).

Notes: Experimental statistics. Output per hour by industry section. Gap measured as a comparison between Wales and the UK industry average.

Instead, as we set out in the paper, Wales’ productivity gap with the rest of the UK is likely to be explained by gaps in a range of known drivers of productivity relating to individuals, businesses, and the external environment, which includes Welsh government policy and physical infrastructure. Our analysis of contemporary data shows that, relative to the UK average:

- Business spending on Research and Development (R&D) per job is lower in Wales.
- Small and Medium Sized Enterprises (SMEs) in Wales report greater barriers to accessing finance.
- A relatively high proportion of the working-age population in Wales possess low levels of education attainment (NVQ1 or lower).
- There is a higher prevalence of long-term limiting health problems among workers in Wales.
- Wales has lower levels of capital formation (which capture both public and private sector investment into tangible and intangible assets).
- The digital infrastructure, at least based on measures such as gigabit-capable internet services, is less well-developed in Wales.
- The peripheral location, relatively sparsely distributed nature of population and lack of large cities means that Wales does not benefit from agglomeration economies.

3. Why is productivity important to a Government Budget?

The importance of productivity to living standards and economic wellbeing is often neglected in the public and policy debate. Yet, productivity growth is the main determinant of long-run growth in real wages, directly affecting household incomes and living standards. Productivity growth is also important for business, affecting profitability, investment and growth. For these reasons it is a key determinant of taxation revenue and the government budget, and therefore the resources available for public service delivery.

The UK productivity puzzle has been a key constraint on the UK budget. By way of example, recent analysis by the Office for Budget Responsibility showed that a 1 percentage point difference in UK productivity growth would have a dramatic impact on levels of public sector debt.⁵ If long-term earnings growth matches productivity growth, improving productivity directly increases tax revenue and will reduce public sector debt assuming public spending remains constant.

As a sizeable sector, public sector productivity plays a direct role in driving national productivity. However, productivity of the public sector plays an additional role since it is also an important determinant of the efficiency of a given level of public spending. By producing more output with the same resources, public sector productivity growth offers a way to increase capacity and reduce overcrowding and waiting lists, and/or enhance the quality of public sector services or reduce spending. It becomes increasingly important given the current fiscal constraints and the growing demands on public services through, for example, an ageing population. In this respect, it is particularly concerning that the evidence suggests UK public sector productivity has failed to return to pre-pandemic levels.⁶

National productivity growth and higher real wages also reduce the demands on government spending, meaning the government has more opportunities to invest in long-term and social objectives. In this respect productivity growth in Wales is key to achieving many of the aims of the Well-being of Future Generations (Wales) Act 2015 and, carefully managed, can support both broader environmental and social agendas.

As set out in Ifan *et al.* (2022), the inferior economic performance of Wales relative to the UK means Wales faces a notional fiscal deficit, whereby government spending exceeds tax revenues.⁷ Indeed, the gap in living standards between Wales and the rest of the UK is narrower than the productivity gap due to this fiscal transfer, particularly greater receipt of welfare payments in Wales. This means that Wales' independent fiscal position would be substantially worse than the current situation. Wales' productivity gap with the rest of the UK is a key contributor of this.

4. How can Wales address its productivity challenge?

Our paper makes clear that addressing Wales' productivity challenge requires a long-term commitment, coordinated action and investment in people and infrastructure. The scale of the challenge should not be underestimated. Even if productivity in Wales grew 1% faster than the UK average each year, it would still take nearly 20 years to catchup.

⁵ Office for Budget Responsibility (2024) Fiscal risks and sustainability, September 2024.

⁶ The devolved nature of government provides an opportunity to evaluate the relative productivity of the public sector in Wales. While there has been considerable investment in data collection on productivity in the public sector, which is particularly hard to measure given the absence of explicit prices for services, to our knowledge, such data is not yet available for Wales separately from the rest of the UK.

⁷ Ifan, G., Siôn, C. and Wincott, D. (2022) Devolution, independence and Wales' fiscal deficit, *National Institute Economic Review*, 261(1): 16-33.

We repeat the core recommendations from the report below in italics. Policy should focus on the gaps identified in Section 2 above which include core areas of devolved policy, including improving levels of basic educational attainment and, transport and digital infrastructure. We argue the Welsh Government has an important leadership role, but that success will depend on support from the UK government as well as other stakeholders including businesses, public service delivery providers and citizens more broadly. For productivity growth in Wales to improve relative to the UK average requires that UK growth policies do not disadvantage Wales relative to other UK regions. To engage necessary stakeholders, we recommend a national conversation on productivity, including improving understanding of what it is, why it is important, and the proactive steps stakeholders can play. In relation to this, we argue there is a need to promote productivity growth both among businesses and within the public sector. In terms of enhancing public sector productivity, it can be useful to distinguish budget efficiency (reducing input costs) from organisational productivity (how inputs translate into outputs within organisations) and overall public sector effectiveness (achieving the outcomes desired).⁸

This policy agenda requires leadership by the Welsh Government, with clear accountability and ownership and an explicit ministerial responsibility for productivity. This would be supported by establishing a Welsh Productivity Commission comprised of independent experts who could provide external scrutiny and guidance in relation to informing, and evaluating, policy and progress. This would also serve as a long-term public commitment to improving productivity in Wales.

Our Core Recommendations

- *The Welsh Government needs to establish a long-term commitment to improving productivity, with independent guidance and assessment of performance.*
- *A national productivity growth plan should identify short, medium, and long-run priorities to support productivity growth.*
- *Wales needs a national conversation on productivity. Collaboration between policymakers, businesses, public sector service delivery providers, and individuals is essential to address the scale of the challenge.*
- *Business support should include advice, guidance, and best practice on how to achieve productivity growth, and the benefits of this.*
- *There should be a focus on public sector productivity growth as a means of supporting future public service delivery.*
- *Addressing Wales' productivity challenge is a long-term and intergenerational project. It will require significant government investment in people and infrastructure.*

5. Why is the Welsh Government Budget important in addressing Wales' productivity challenge?

Public spending and taxation policy have a key role to play as a determinant of many of the drivers of productivity identified in Section 2 above. While many of these decisions depend on the UK budget,

⁸ Discussion within the public sector has focused on the role for measurement, innovation, workforce agility, collaboration, data and technology see: B. van Ark (2022) Making Public Sector Productivity Practical, TPI and Capita.

devolved public services like health and education provide the foundation for investment in human capital, a key determinant of individual and national productivity. Spending within the Welsh Budget also influences business support and advice, as well as the broader transport and digital infrastructure in which businesses operate, all known determinants of productivity.

Low levels of public and private investment have been identified as a key determinant of the poor UK productivity performance and investment is lower in Wales than in the rest of the UK. The Welsh Budget has both a direct and indirect role in this. It determines the balance between investment and day-to-day spending, as well as generating confidence and incentives for business innovation and investment. Productivity growth requires policymakers to consider the long-term and prioritise support for investment over short-term consumption.⁹ The focus and design of public sector investment is also key. To maximise its impact, it needs to crowd-in (encourage) rather than crowd-out (displace) private investment.¹⁰ The spatial distribution of investment has a further potential role in narrowing productivity gaps between local areas in Wales. Indeed, more generally, investment can be targeted towards achieving multiple objectives, for example, green productivity investment.

In summary, investment in the future productive potential of Wales will not only improve future economic wellbeing but is self-reinforcing and will increase future taxation revenue, generating resources for future investment in Wales.

⁹ The Wales Forum of the Productivity Institute welcomed the emphasis on economic growth and long-term investment in the Welsh Government Budget 2024-2025.

¹⁰ See: [Insights on productivity growth and fiscal policy from the Welsh Government Tax Conference 2025 - The Productivity Institute](#)