IPPR NORTH

REPORT

REBALANCING (THE) BOOKS

HOW TO MAKE THE 2015 SPENDING REVIEW WORK FOR ALL OF BRITAIN

Ed Cox,
Graeme Henderson
and Luke Raikes

January 2014

© IPPR North 2014

Institute for Public Policy Research

ABOUT THE AUTHORS

Ed Cox is director at IPPR North.

Graeme Henderson is a senior research fellow at IPPR North.

Luke Raikes is a researcher at IPPR North.

ACKNOWLEDGMENTS

The authors would like to thank each of the members of the project's advisory group – Ashwin Kumar (Liverpool Economics), Kimberley Scharf (University of Warwick), Rowena Crawford (Institute for Fiscal Studies), Alastair Balls (Northern Rock Foundation/Centre for Life), Anita Charlesworth (Nuffield Trust), John Mohan (Third Sector Research Centre) and Josh Stott (Joseph Rowntree Foundation) – for their generous input throughout the project. We are also grateful for the time and input received from David Clifford and from those who attended our roundtable events in Manchester, Leeds, Newcastle and Hull and our Grantees Summit. We would like to thank Eversheds for hosting the Leeds roundtable and Involve Yorkshire and Humber, VONNE and VSNW for co-hosting with us the Grantees Summit.

We would also like to thank IPPR colleagues Tony Dolphin, Bill Davies, Graeme Cooke and Nick Pearce for their helpful comments on earlier drafts, as well as Kayte Lawton, Spencer Thompson, Ellie Geddes and Joanne Thomas, without whom there would not be a publication.

We are also grateful to Esmee Fairbairn Foundation, Joseph Rowntree Foundation and the Northern Rock Foundation for generously supporting this research.

ABOUT IPPR NORTH

IPPR North is IPPR's dedicated thinktank for the North of England. With bases in Newcastle and Manchester, IPPR North's research, together with our stimulating and varied events programme, seeks to produce innovative policy ideas for fair, democratic and sustainable communities across the North of England.

IPPR North specialises in regional economics, localism and community policy. Our approach is collaborative and we benefit from extensive sub-national networks, regional associates, and a strong track record of engaging with policymakers at regional, sub-regional and local levels.

IPPR North
3rd Floor, 20 Collingwood Street
Newcastle Upon Tyne NE1 1JF
T: +44 (0)191 233 9050
E: north@ippr.org
www.ippr.org/north
Registered charity no. 800065

This paper was first published in January 2014. © 2014
The contents and opinions expressed in this paper are those of the author(s) only.

NEW IDEAS
for CHANGE

CONTENTS

Executive summary 2
Background 2
Spending cuts and the north 3
The 2015 spending review and northern economic futures 4
The spending review process 11
Conclusion 13
1. Introduction 14
2. The impact of public spending cuts on the economy 16
2.1 Public spending 16
2.2 Impact on the economy 19
2.3 Impact of the 2013 spending round on the English regions 20
3. The geography of economic growth in the UK 25
3.1 Regional growth and productivity 25
3.2 Regional public spending 29
3.3 Relationship between public spending and regional growth 32
4. The 2015 spending review and northern economic futures 35
4.1 Principles to underpin the next spending review 35
4.2 Policy prescriptions for the northern economy 36
5. The spending review process 48
5.1 Current weaknesses and recent innovations in the spending review process 48
5.2 Improving the spending review process 49
References 52
Annex 57
The impact of spending cuts on the voluntary sector 57
Implications for the 2015 spending review 58

EXECUTIVE SUMMARY

Background

The last two spending reviews, in 2010 and 2013, focused on deficit reduction largely through public sector spending cuts as opposed to tax rises. Although the economy is now growing, deficit reduction is here to stay. Further cuts to departmental budgets are projected to be made during the first half of the next parliament and all parties are concentrating on reining in annually managed expenditure (AME)[1] by setting a cap on welfare spending.

The limits to this approach though are clear to see. With the NHS, schools and DfID aid spending ringfenced and significant parts of social security spending, such as pensions, protected from any cuts, the room for manoeuvre is becoming increasingly limited. Public sector spending cuts have presented an opportunity for significant reforms in the way the state delivers public services and configures the welfare state, but these have yet to be properly aligned with moves to tackle the root causes of the rising demands that are being placed on services and the public purse. The enthusiasm to cut out-of-work benefits and tax credits has not been matched by an economic strategy to create jobs and growth where it is most needed. As a consequence, the welfare bill continues to rise.

The government has also been indifferent about assessing the distributive impact of its spending decisions. Household decile analysis has revealed the extent of cuts to individuals and families at different points in the income distribution, but we are much less well aware of the impact of spending decisions on the different regions of the country. Cuts to council spending, for example, have hit some places much harder than others, and northern cities in particular have predicted 'black holes' in their budgets as soon as 2017 (Hastings et al 2013).

For these reasons alone, the 2015 spending review will need to be substantively different.

Last year, our Northern Economic Futures Commission (NEFC) set out a 10-year strategy for achieving economic growth in the north of England.[2] In its final report, the NEFC argued for the decentralisation of a wide range of powers to enable city-regions to drive growth and jobs in the north once again. Our mantra: northern prosperity is national prosperity. But the relationship between economic growth and public sector reform is fundamental. Unlocking growth can create the jobs that will put downward pressure on the welfare bill, and by reforming public services we can achieve greater efficiency and better results for our public spending.[3]

This report presents the building blocks of a funding settlement that will match the aspirations of our growth strategy. It is not a plea for a fairer allocation of public money. It is an argument for a more strategic spending review process that can unlock growth and drive public service reform. With Scotland, Wales and London having a growing influence on key fiscal issues, the north of England (as with other regions outside London) needs to find its voice. To this extent, the report is intended to set out broad ideas around which northern leaders can build a consensus.

1 See box 2.1 on page 17 for definitions of AME and DEL.
2 Comprised of three regions: North West, Yorkshire and the Humber, and the North East.
3 See IPPR North and NEFC 2012

Spending cuts and the north

While cuts in the whole of public spending (total managed expenditure) between 2010/11 and 2014/15 look set to reach only £20 billion in real terms,[4] this overall figure conceals much bigger changes lying underneath and a fundamental change in its composition. The area of spending outside of the government's complete control (AME) is rising, while the fixed budgets it sets for departmental spending over longer periods (DEL) is falling, in some cases dramatically.

- The largest cuts have fallen on the Department for Communities and Local Government (£25.2 billion) accounting for nearly half of all public sector spending cuts.
- Public sector net investment is projected to fall from nearly 3 per cent of GDP in 2009/10 to half that proportion in 2013/14.
- There will have been £19 billion in cuts to in-work and out-of-work tax credits and social security payments.

A further 1.1 per cent reduction in Whitehall departmental budgets for 2014/15 and 2015/16 was announced in the recent autumn statement, with existing exclusions continuing to apply, and local government, the security and intelligence agencies and HMRC also being excluded.

It is difficult to estimate with any great accuracy the impact public spending cuts have had on the wider economy. However, their effect in lowering GDP is well documented and largely accepted both in the UK – for example by the independent Office for Budget Responsibility (Chote 2013) – and abroad (for example, see Estevão and Samake 2013). The Office for Budget Responsibility (OBR) estimates that the consolidation measures put in place would have been enough to have reduced GDP in 2011/12 by approximately 1.4 per cent, and that the cumulated GDP loss due to fiscal tightening from 2010 to 2013 is approximately 5 per cent (Wren-Lewis 2013). Bagaria et al (2012) calculate that fiscal consolidation has meant a cost to economic growth of £239 billion.[5]

The impact of these cuts and their wider impact has not been evenly spread. Different councils, for example, have experienced very different cuts to their 'spending power'; welfare reforms have had a greater impact on those areas with higher concentrations of unemployed and inactive people. As a corollary, some areas have found themselves better able to cope. In our analysis of the 2013 spending round, although London looks set to receive the greatest overall cuts in departmental spending of any English region (£1.2 billion), this represents just 0.39 per cent of its forecast GVA for that year 2015/16 and 14 per cent of forecast GVA growth. The impact of cuts to the northern regional economies is projected to be more than twice this percentage (IPPR North 2013).

Regional variations in spending cuts therefore compound longstanding differences in regional economic growth and productivity. Indeed, these two factors create something of a vicious cycle. But it would be wrong to assume that such a cycle is inevitable. There is growing evidence of the potential for growth in Britain's second-tier or 'core' cities and that this has been held back by government concentrating investment in London to the detriment of the UK's other major cities (Parkinson et al 2012). This evidence shows that many regional cities were achieving impressive growth prior to the financial crisis. Indeed,

4 Unless stated otherwise, all real terms prices are for the year 2012/13, as derived from HM Treasury 2013a and 2013c respectively.

5 2010 prices

employment growth in each of England's core cities outstripped that of London between 2000 and 2007, and there is some evidence that the growth in cities such as Edinburgh, Cardiff and Glasgow was a result of devolution (ibid). Even beyond the largest cities outside London, there are a significant number of small cities which demonstrated rapid productivity growth in this period.

Some aspects of public spending are very significant for driving economic growth and levering in private investment. Spending on transport, for example, is a key driver of economic growth. However, this has been heavily skewed towards London and the South East and this remains set to be the case long into the future (Cox and Davies 2013). Spending on skills is also skewed towards London and the devolved nations. In fact, spending on all 'economic affairs'[6] is nearly 80 per cent higher in London than in any of the northern regions (IPPR North and NEFC 2012).

While it is hard to isolate its relationship with welfare spending, economic investment of this kind, if it is doing its job, should create employment and drive down the welfare bill over the long-term. It is no surprise that London is the only English region which receives more economic affairs and skills spending (nearly £1,082 per person) than it receives in unemployment benefits and tax credits (nearly £961 per person). In every other region it is the other way around: this needs to be corrected.

This will not happen by driving down benefits alone; it must come from the state working with the private sector to create investment, growth and jobs. And this should be supported by a spending review which encourages a rebalancing of the relationship between spending on growth and reform, and a rebalancing of the levels of economic affairs investment going into different regions. Even at the most basic level, there needs to be much better recognition of the relationship between public spending and economic growth at the regional level.

> **Recommendation**: As a simple first step in supporting the principle of spatial rebalancing, HM Treasury should publish a spatial analysis of each spending review along with other distributional tables. It should also publish yearly progress reports to review the impact on different areas and different household income groups.

The 2015 spending review and northern economic futures

Whoever forms the government in 2015 will need to develop a very different kind of spending review. We recommend six principles to guide this process.

- The next spending review period should cover a full five-year period from 2016/17 to 2020/21, to enable departments and service providers to undertake genuine reforms rather than simply to cope with short term cuts.
- Decisions on taxation and spending for the next parliament should be guided by a fiscal rule of reducing the debt to GDP ratio to around 65 per cent over a 10-year period, on the assumption that the ratio will be around 80 per cent in 2015. This can be consistent with eliminating the deficit on the public finances by 2020.
- Tax increases should form the same proportion of overall deficit reduction as is planned for the period up to 2014/15 – 20 per cent, versus 80 to be achieved by cuts. This is in contrast to the 3 per cent currently planned for the first three years of the next parliament.

6 See box 3.1 on page 31–32 for a full definition.

- The spending review should increase the ratio of public sector net investment to GDP to ensure increasing investment in infrastructure.
- It should aim to strengthen economic opportunities outside London and the South East, to tackle current levels of regional inequality and support the growth potential of England's core cities and beyond.
- It should introduce significant place-based budgets[7] for economic affairs and skills – such as welfare-to-work, skills and apprenticeships – for city-regions and key functional economic areas.

On top of these important principles, the 2015 spending review should introduce a range of specific measures to drive growth and opportunity in the north.

A. Decentralisation of economic development spending to city-regions

Public sector spending on economic development is currently trapped in departmental siloes. This has been a key reason why it has been so easily salami-sliced in previous spending rounds, and why the Single Local Growth Fund – the single pot proposed on the back of the Heseltine review – is just 2 per cent of the amount originally envisaged by Lord Heseltine.

It is widely acknowledged that the benefits of breaking down silos and mobilising the full range of actors is best realised at smaller geographic levels. Transport, housing, employment, skills and welfare policies have to work together to optimise local growth, and also these different policy areas can be joined up at a local level in a way that is not possible at a UK level (Heseltine Review 2012, IPPR North and NEFC 2012, London Finance Commission 2013). There is also a growing awareness that networks of business, community and public sector leaders are well positioned to tackle the big issues in a way which government alone cannot, and that these networks operate at a more local level (Katz and Bradley 2013). Linked to this, government is increasingly aware of the scope for public service reform in areas such as social care and troubled families through the pooling and aligning of key funds into very localised 'community budgets' (Cox et al 2013).

The NEFC broadly endorsed devolution of key departmental spending pots as highlighted in the Heseltine review – skills, local infrastructure, employment support, housing, business support services, and innovation and commercialisation (IPPR North and NEFC 2012). But this principle can go a lot further, for example, to include funding for IPPR's recently proposed youth guarantee, whereby funding for welfare-to-work, adult skills and apprenticeships is devolved in respect of under-25s (Cooke 2013). For the period 2011/12–2014/15, we would add to this both major capital funding for local transport infrastructure in conjunction with the Passenger Transport Executives (£1.7 billion[8]) and housing benefit and housing capital through sub-regional housing funds (an additional £75.7 billion on top of the £4.5 billion in housing capital spend already in Heseltine's 'single pot') (see Hull and Cooke 2012).

In order to introduce such significant devolution of public funding there needs to be clarity about the basis upon which this is done. There needs to be clear timetable for devolving these funding streams over the course of a parliament so that local areas know what to expect and when. The most obvious areas to begin devolving powers to in England outside London are, for reasons of accountability, those five core city-regions which have or will soon have statutory combined authorities (Greater Manchester, Liverpool City

7 Budgets devolved for a local area which are unringfenced and cut across departmental lines.
8 2010/11 prices

Region, the North East, South Yorkshire and West Yorkshire) and can therefore be given the responsibility and funding that is required.

Devolved funding needs to be allocated on a formula basis, and should take into account a combination of population,[9] levels of need and growth potential.[10] This allows for longer-term decision-making in a way that competitive bidding would not.

It is difficult to total up the overall sum or size of the proposed devolved budget, and the pace and scale of devolution may well vary from place to place. However, there is strong case to be made for a significant one-off 'offer' to combined authorities at the beginning of the new spending review period. To this extent, the offer would not be made department by department on the back of departmental settlements but rather as part of the settlement process itself, top-sliced from departmental budgets as part of the overall spending review settlement.

> **Recommendation:** The 2015 spending review should make provision for much more substantial place-based budgets for each of the five combined authorities that will exist by that time, which should be allocated for a five-year period as part of the spending review process. Due to the sizable amounts of public money involved, a wider roll-out to other LEP areas can follow over the medium term once their institutional capacity is improved and they become subject to greater levels of accountability and scrutiny.

B. Rebalancing economic investment spending

As described above, government spending on economic affairs is currently skewed towards London and the South East, and the relationship between spending on growth and spending on welfare outside London is imbalanced. This creates a negative cycle which needs to be reversed by rebalancing government spending, not least on infrastructure and innovation.

Investment in infrastructure requires long-term vision. London's success in attracting public and private investment is based upon several decades of planning for growth and bringing forward projects with ambition and scale. While there are some ambitious projects in the north, such as the Atlantic Gateway plans in the North West or ideas for HS3 to Scotland, a similar level of confidence and vision is needed, together with the capacity and resource required to work them into viable possibilities. The recent Armitt review identified a range of changes to the way the nation plans for infrastructure investment. Although they are to be welcomed, these proposals must also recognise the importance of regional rebalancing and building infrastructure for growth outside London (Armitt 2013).

As argued above, a much greater proportion of transport spending needs to be decentralised, along with arrangements to allow wider scope to leverage private investment (as Transport for London has demonstrated so successfully). But where funds are retained at the centre, current appraisal processes need to be adapted to better appreciate and calculate the wider economic benefits that can be brought by public investment in infrastructure.

9 The proportion made up by the resident population of a local enterprise partnership against the total resident population in England.

10 Economic growth potential is difficult to measure or forecast but a proxy could be used, such as average annual growth over the last decade.

Recommendations:

- Northern leaders from both public and private sectors should identify and champion up to five big infrastructure priorities for the next two decades, and work with Network Rail, the Environment Agency and other relevant partners to ensure that detailed plans and business cases are worked up for each.
- The 2015 spending review and accompanying national infrastructure plan should commit the government to investing in and commencing these major northern infrastructure priorities within the five years to 2020.
- In line with the recommendations of the Armitt review, the 2015 spending review should be accompanied by the formation of a national infrastructure commission to make strategic decisions about the UK's transport infrastructure. This body should ensure that local economic growth is one of the primary criteria for all decision-making.

As with infrastructure, there are also significant disparities in government spending on research and development (R&D). While there is a strong case that basic research funding must remain targeted on the UK's world-class universities, there is much scope for rebalancing the way in which applied research funding is allocated and for greater investment in centres of innovation in the north of England. The government's science and innovation strategy, to be published alongside the 2014 autumn statement, provides the ideal opportunity to address this.

Recommendations:

- The 2015 spending review should introduce guidelines to ensure that research councils each move towards doubling the amount of applied research funding they spend outside of London, the South East and the East of England. This funding should be conditional on regional universities aligning their research with local economic priorities and building the institutions necessary to facilitate knowledge transfer into the wider local economy.
- In line with proposals made by IPPR's Commission on the Future of Higher Education (2013), the 2015 spending review should reallocate the £1 billion that is currently spent inefficiently on R&D tax credit incentives and instead spend it on a network of 'applied research and innovation centres', especially in areas of below-average growth.

C. A growth earnback

The principle that local authorities should benefit from the return of their own investments is firmly (albeit only recently) established in the Greater Manchester city deal through its so-called 'earnback'. This seeks to identify the increased tax return resulting from infrastructure investment by measuring the increased economic growth (GVA) that results. Earnback is a form of tax increment financing (TIF), which is rare in the UK but quite prevalent elsewhere – especially in the US. In the UK, TIF has been heavily regulated – in many respects due to the failure of certain schemes in the US – but it is being used increasingly, and was recently rebranded as 'New Development Deals' by the government.

But this principle needs to be extended with a view to allowing city-regions not only to keep the direct proceeds of economic growth, as is currently the case, but also to share in the savings to the exchequer that come from employment growth and a falling benefits bill. In practice, this would mean borrowing under arrangements similar to TIF, and paying back the borrowing using the higher tax returns and lower benefit payments that

accrue to the government. This approach is already established in part by the payment by results model (which forms a basis of both Work Programme and other public sector commissioning) and the community budget model of public service reform. However, measuring direct and indirect benefits of employment savings will always be an imprecise science, and so any negotiation should emphasise the possibility of agreement over finding a foolproof measurement.

In this spirit, agreement will need to be found concerning the relative balance of risk in any growth earnback deal, with both HM Treasury and local areas agreeing to share a proportionate element of that risk. In the case of any failing authority, control would be re-centralised.

Such schemes work best where natural economic areas and administrative boundaries align. Therefore, the combined authorities, which will be ready to take on this responsibility in at least five of the core city areas before the 2015 spending review, would be the logical places to introduce a growth earnback model first.

> **Recommendation**: Building on the principle and logic of 'earnback' and existing TIF approaches, the 2015 spending review should make provision for combined authorities to finance investment in infrastructure, employment and skills based upon the potential savings from increasing employment as well as the proceeds of GVA growth. This should extend from the direct fiscal benefit of successful employment programmes and skills interventions, to the indirect employment benefits of economic growth where they can be evidenced, and cover the cost savings made via all government departments.

D. Tax and borrowing powers

While putting local government in charge of spending in its own geography would improve local economies, they would under the current system still be highly restricted by their dependency on grants from central government and still be subject to departmental spending decisions that lie largely out of their control. Genuine fiscal autonomy will require more radical measures.

In the UK, only 12.9 per cent of sub-national government expenditure is raised from sub-national taxation. (This is largely comprised of council tax, which is itself manipulated by centrally driven incentives to 'freeze' it.) This is one of the lowest rates of all EU-27 nations, and compares to an average across the EU of 40.5 per cent. While fiscal devolution can entail risks, much evidence suggests that local enterprise partnership (LEP) areas would benefit from having more revenue streams under their control (Lessman 2011, Slack 2013). It has been suggested that local government could be responsible for raising up to 50 per cent of its own revenue before equity concerns arise (ODPM Select Committee 2004). While a 50:50 split between central and local revenue-raising powers seems ambitious, there are various steps which could be taken to get closer to this target.

Recent reforms to business rates already allow for a proportion to be retained locally and for the proceeds of business rates growth to be kept by local authorities. However, as IPPR North has previously argued, local authorities should be able to set business rates within reasonable bounds. While the additional discounts, reliefs and cap introduced in the autumn statement have been welcomed by businesses, they greatly impinge upon local authorities' autonomy. The London Finance Commission (2013) has proposed the devolution of other property taxes, including council tax and, more controversially, stamp duty land tax. Also, as a result of the Silk Commission, the government has agreed to

devolve landfill and aggregates taxes to the Welsh government – these may be minor in terms of the revenues they raise but they represent a move in the right direction. In terms of population, Wales is not much bigger than Greater Manchester (and less than half the size of the North West). Government should therefore consider which minor taxes could be devolved to city-regions.

The government has in addition accepted the Silk Commission's recommendation that sharing the income tax base would significantly enhance the Welsh government and provide a relatively stable revenue stream. Subject to a Welsh referendum, the UK government is proposing to devolve equivalent powers to those legislated for in the Scotland Act 2012. Under this arrangement, 10 percentage points of each UK tax rate would be due to the Welsh government, though still collected by HMRC. The Welsh government would also have the power to vary the basic, higher and additional rates of income tax (currently 20 per cent, 40 per cent and 45 per cent respectively) up or down in step with each other.

Devolving the ability to partially set income tax rates to sub-national areas in England might seem a step too far. However, there is a strong case for government to explore the possibility of assigning a small proportion of income tax to local government and slowly tapering the grants to them accordingly. It would have to be designed so that no local authority lost out at the outset, but would further sharpen the incentives for local government to play their part in boosting economic growth and job creation over time.

The precise details of such a scheme would need detailed appraisal, not least in identifying the best method to assess where income is earned. In addition, any mechanism would have to be reset at regular intervals – perhaps every 10 years – to ensure that certain poorer-performing areas did not fall too far behind. Again, combined authorities would be the most obvious starting place for piloting such reforms: trying to introduce such a change at a lower geographical level may be less effective, as these areas would probably be too small to significantly influence economic growth and job creation. While significant, these issues are successfully addressed in many other developed nations.

This assignment of 10 per cent would mean that an extra £1.2 billion of revenue per year would be raised and retained by the five combined authority areas in total. In effect, approximately 8 per cent more sub-national government expenditure would be raised from sub-national taxation within these areas, helping to bring tax-raising powers closer to the aspiration of a 50:50 split between central and local government.

Alongside tax-raising powers, the 2015 spending review could also do more to enable borrowing for growth. The London Finance Commission has recommended that the government should distinguish between borrowing used to promote growth or reduce public expenditure (and which therefore is likely to be repaid) and other kinds of borrowing (London Finance Commission 2013). More fundamentally, sub-national levels of government borrowing should be able to take independent decisions on borrowing and investment within the limits of the prudential code and not subject to any further constraints.

Recommendations:

As part of the 2015 spending review:

- Ten per cent of the income tax take in each of the combined authorities should be assigned to those authorities with a corresponding reduction in the central government grants to their constituent local authorities.
- Combined authorities should be able to take independent decisions on borrowing and investment within the limits of the prudential code and not subject to any further constraints.
- All local authorities should be given the power to set business rates, subject to restricting the amount that business rates can be increased to RPI plus half the size of any council tax increase.
- All local authorities should have full control over setting council tax bills, with the restrictions on raises over 2 per cent a year being lifted and a commitment by government not to interfere in council tax decisions. Local authorities should in addition be allowed to introduce new additional council tax bands as they see fit.
- Government should consider which minor taxes could be devolved to combined authorities. The taxes devolved should include landfill and aggregates taxes.

Ahead of the subsequent spending review, government should:

- Carry out a radical review of all property taxes, including assessing the benefits and risks of decentralising such taxes.
- Consider the feasibility of a wider roll-out of income tax assignment to areas outside of the combined authorities.

E. Business incentive schemes

Over recent decades, government has garnered a poor reputation for implementing business incentive schemes, with evidence suggesting that they cause displacement and have high levels of deadweight costs (Sissons with Brown 2011). Enterprise zones represent one of the most notorious examples. However, more recent analysis suggests that there is still much to be learned from the mistakes of the past and that with the right geographies and the right combination of incentives there can be some significant benefits to local economies.

Recommendation: Building on this evidence, the 2015 spending review should allow LEP areas, particularly those with the highest claimant to vacancy ratios, to 'apply for' the following incentives to encourage business investment (including foreign direct investment) based on presentation of a sufficiently strong business case.

- Employer national insurance contribution (NIC) breaks and priority financing from a British Investment Bank (which would have regional structures)[11] for companies that hire harder-to-reach unemployed individuals (within terms to be defined locally).
- The responsibility for graduate retention within the natural economic area (in some but not all cases the LEP/combined authority area) and the authority to require universities to align their careers services with the local body in which they are based.

11 For more on this see Cox and Schmuecker 2013

- The authority to compulsorily purchase, levy and/or develop the sites of urban decay that do persist for both housing and business use.[12]
- UKTI support (both financial and in terms of dedicated, seconded personnel) to attract inward investment to specific areas within reach of areas of persistent worklessness, when matched by skills and transport infrastructure investment.
- In those areas where this has not been already devolved, discretion over skills funding streams and the authority to plug evidenced skills shortage vacancies and skills gaps via either direct or commissioned delivery, focused specifically on those who are out of employment for a long period, whether sustained or intermittent (low-pay no-pay cycles).

The spending review process

One of the most fundamental problems with spending reviews is the process by which they are undertaken. Our analysis of recent reviews suggests a number of weaknesses which undermine their capacity to be strategic.

- A siloed approach of settling each department individually means opportunities for greater efficiencies are missed, particularly in tackling issues that fall outside a single department's remit or where earlier intervention in one department could deliver longer-term savings across others.
- The spending review processes are closed and lack transparency, following the traditional HM Treasury approach of bilateral negotiation with departments, with impact assessments and evaluations carried out after the event.
- Even zero-based reviews tend towards grabbing the low-hanging fruit or relying on major efficiencies rather than strategically reorientating spending.

In order to improve the process a number of changes should be made.

A. Strategic oversight and governance

All political parties are committed to increasing the transparency of government decision-making, and steady improvements have been made over the past decade. However, Treasury culture is difficult to change, and budgets and spending reviews remain behind the curve. This needs to be corrected, not least to ensure that they are carried out in a more strategic fashion with an emphasis on outcomes, savings and reform rather than simple departmental cuts.

Recommendation: HM Treasury should identify a clear set of strategic outcomes for the 2015 spending review and challenge ministers and government departments to work together rather than compete in order to achieve them. Clear benefits need to be available to departments which come forward with collaborative proposals for change.

The creation of the OBR has been a significant change in this regard and since then we have seen the introduction of new analyses in the 'Red Book', such as household decile distribution graphs – but there is still some way to go, not least as regards a spatial analysis.

12 See for example Wintour 2013

Recommendations:

Alongside our previous recommendation for HM Treasury to undertake a regional analysis of spending decisions, we propose:

- The OBR's remit should be widened to include the assessment of the impact of policies on regional growth, unemployment and rebalancing the economy as part of its assessment of long-term fiscal sustainability.
- In addition, the OBR should publish regional economic forecasts of major economic statistics – unemployment, employment and GVA – as part of its economic and fiscal outlook release.

B. Impact assessment and public engagement

The government already has a range of processes in place to assess the impact of policy decisions. However, analysis tends to be done only after the decision has been made. This is particularly true of spending reviews.

Government must also extend its effort to give a more central role to public and expert engagement in the 2015 spending review – and in such a way that it can affect final outcomes. The experience of the Spending Challenge during the 2010 spending review shows that a mass engagement exercise is unlikely to work: even with better governance of the process, this kind of 'free for all' does not tend to drive high-quality responses. Instead, engagement must be done at the local or regional level – led by local government – and it must feed into the bigger picture. People should be provided with clear and accessible information such that they understand the trade-offs to be made and have a sense of what is at stake.

Recommendation: Ahead of the 2015 spending review, the government must support wider engagement in the deliberation process and carry out adequate impact assessment in advance. This should include, at the very minimum, having local government representatives at the negotiating table and engaged in direct and meaningful discussions with the chancellor and Treasury team.

C. Northern voice

It is clear that the current LEP/city 'free for all' is not giving areas of the north a sufficiently clear voice in Whitehall and Westminster. While the Core Cities grouping represents the five largest cities in the north, its influence is nothing compared to the clout of the London mayor or Scottish first minister, and even most core cities find it difficult to speak for their entire city-region, let alone their wider hinterlands. Equally, while England's biggest cities have common aspirations in terms of the devolution of more economic investment funding, they have differing priorities in terms of which large infrastructure projects to fund. On transport, innovation and inward investment, LEP areas would all benefit from more strategic planning at a pan-northern level. While some LEP collaboration is already taking place, it is to a large extent ad hoc. The NEFC proposed a Northern Leadership Convention to be held on an annual basis and supported by a small secretariat, followed by an N11 Leaders' Summit, comprising one political and one business leader from each of the 11 LEP areas in the north. We believe this would help to establish a clear and coherent 'northern voice'.

Recommendation: Political and business leaders from each of the north's 11 LEP areas should meet prior to the 2015 spending review with a view to setting out some clear spending review priorities for the whole of the north of England. This could be through an N11 Summit. They should then work together to lobby all political parties both in the run-up to the general election and in government immediately after.

Conclusion

A model of public spending which depends on revenues in one region to mitigate the consequences of unfulfilled economic opportunities in others is unsustainable. When economic growth is spread out across the country, it brings benefits in terms of equality, reliance and fiscal health (OECD 2012). The 2015 spending review represents an opportunity for the next government to reshape the fiscal framework needed for a modern state and to create the conditions for a serious attempt at rebalancing the economy.

This will require a radical change in thinking and practice. Much greater attention needs to be given by Whitehall to the geography of economic growth and the existing regional implications of apparently 'spatially blind' spending decisions. Old assumptions about the relationship between public investment and growth need to be held up to wider scrutiny – not least in the capital city. And the spending review process itself needs to be opened up to wider influence and strategic insight.

If this change in thinking can be achieved then the benefits that stand to be made are great: public investment to support growth rather than to mitigate failure; lower levels of benefit dependency in the areas most impacted by cuts; and greater incentives for city-regions to become once again the drivers of national prosperity. The proposals in this report are designed to set out the first steps in this journey.

1. INTRODUCTION

The last two spending reviews (2010 and 2013) have focused on deficit reduction largely through public sector spending cuts. Even with the UK economy beginning to improve, more decreases in departmental budgets are projected during the first half of the next parliament. With the NHS, schools and DfID aid spending ringfenced and significant parts of social security spending, such as pensions, protected from any cuts, further reductions to public spending will be much harder to find; the low-hanging fruit have been removed already. The next steps will need to be more strategic, taken in light of how different slices of public expenditure work together to grow the economy; the effectiveness of public spending as a whole over the longer term is much more important than the efficiency of individual programmes over the short term. Moreover, reductions in public spending are falling upon and impacting different areas in dramatically different ways. With this in mind, the 2015 spending review process offers the opportunity to reform how public spending is allocated.

The relationship between growth and public sector reform is at the heart of this project, as it will be at the heart of the next government's decision-making. Spending cuts of the magnitude imposed on departments – especially local authorities – are of such severity that they require a comprehensive remodelling of public service delivery and a breaking down of traditional departmental siloes. As a result, the situation presents both a requirement that services are shaped in more efficient and ideally more effective ways – tackling root causes rather than symptoms, investing in prevention not amelioration – and an opportunity to do so. This could have a profound impact on those households who depend the most on public service provision. But this reform will also depend upon stronger economic growth.

Sustained economic investment can help to drive economic growth in the longer term, reducing over time the amount spent on benefits and regeneration that is otherwise required to ameliorate the consequences of economic failure. It also can help to create good-quality jobs which don't require subsidy by the state through tax credits and housing benefit. While London's success is based on many factors, the increased economic investment it receives from government (which in turn can help to attract private sector investment), its clear regional strategy and its strong institutional voice to lobby at home and abroad certainly help. Nonetheless, it is important to remember that only one-fifth of the UK's economic output is produced in London.

Many recent major studies have shown the importance of mid-sized cities and their hinterlands in driving economic growth and highlighted how underinvestment comparative to capital cities has held them back (Parkinson et al 2012, Dobbs et al 2013, OECD 2012). Equally, with a growing amount of public service provision being outsourced, who provides that provision matters more and more. Locally based service providers can mean a greater proportion of the money is recycled within the local economy, boosting jobs and demand. Most fundamental of all, and particularly pertinent given the recent financial crisis, broader-based, inclusive growth brings nationwide benefits in terms of equality, resilience and fiscal health (OECD 2012).

Last year, our Northern Economic Futures Commission (NEFC) set out a 10-year economic strategy for the north of England. Its key message was that northern prosperity is national prosperity. The commission's report set out a strategy for growth in the north – but to achieve that we need a fiscal settlement that will enable growth and reduce dependency on public spending and welfare.

All political parties have talked about the need to rebalance the UK economy both regionally and sectorally. The type and location of public spending has a profound impact on where the future economic growth of the country will come from. The Coalition government, particularly around the budget and autumn statement, name-checks as many regions and cities as possible in its investment plans, yet in reality many of the areas which most need the economic investment receive only a small proportion of this investment. This is especially important as private sector investment, including foreign direct investment, often follows public investment. The UK can only thrive in the 'global race' if as many parts of the country as possible are performing to their potential.

Government has historically been very poor at, or even indifferent to, assessing the distributive impact of its spending rounds. In more recent times we have become familiar with a household decile analysis, but we also need to understand the sub-national impact of spending decisions. With Scotland, Wales and London having a growing influence on key fiscal issues, the north needs to find its voice. The core cities need to be at the heart of this strategy in the near term but many of these issues have a wider relevance to all English sub-regions.

This project has aimed to identify a set of spending review proposals that will stimulate northern economic potential, tackle household poverty and reduce long-term dependency on benefits and subsidies. It hopes to enable northern leaders from all sectors to better influence the spending review process to produce more socially just outcomes. It is hoped that this report can add to the evidence base for northern stakeholders who need to build up a lobby between now and the 2015 general election. Our recommendations have benefited from the insights and views expressed at four roundtables held in Manchester, Newcastle, Leeds and Hulls, and at our voluntary sector summit.

This report is not simply a plea for a fairer allocation of both public money and the levers controlling it. More importantly it is an argument for a better spending review process which makes more efficient use of limited public funds. It must look at how government money can be used as a whole to boost the UK economy and make it stronger and more resilient over the longer term. Part of this is ensuring the UK's fiscal strategy works for Hull as much as it does for Hampstead and Heathrow, for Stockport and South Shields as much as Shoreditch. Providing local areas with longer-term certainty over public investment can in turn provide private and overseas investors with the certainty they need before themselves investing in an area.

Chapter 2 analyses the impact of public spending cuts on the economy; chapter 3 sets out the geography of economic growth in the UK; chapter 4 articulates the principles and policies which would help the north of England achieve its economic potential; and chapter 5 sets out how to improve the spending review process itself.

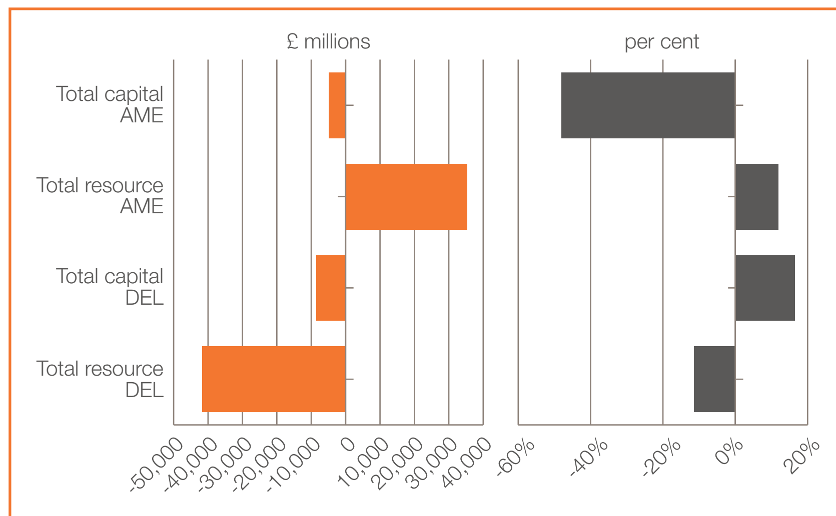
2. THE IMPACT OF PUBLIC SPENDING CUTS ON THE ECONOMY

2.1 Public spending

The current spending review period will see both a dramatic reduction in public expenditure and fundamental changes in its composition. Some departments have been disproportionately hit while others have been ringfenced; overall, public sector net investment has fallen. Between 2010/11 and 2014/15[13] total managed expenditure (TME) is forecast to be only £19.8 billion (2.7 per cent) lower in real terms.[14] However, this conceals the changing nature of spending, with the area of spending outside of the government's direct control (AME) rising while the firm budgets it sets for departmental spending over longer periods (DEL) are falling, in some cases dramatically. As figure 2.1 below summarises:

- resource DEL will fall by £41.7 billion (11.4 per cent)
- capital DEL will fall by £8.5 billion (16.4 per cent)
- capital AME will fall by £4.9 billion (48.1 per cent)
- resource AME will rise by £35.3 billion (12.0 per cent).

Figure 2.1
Real-terms changes to the composition of total managed expenditure (TME), 2010/11–2014/15



Source: HM Treasury 2013a

By looking at DEL spending for the whole spending review period (2010/11–2015/16), therefore factoring in the 2013 spending round, we can see the overall effect of DEL spending decisions made by the current government (whereas AME is more flexible and responds to economic and other conditions). Apart from the Department of Health and the Department for International Development, all departments will see real-terms cuts over the period.

In percentage terms:

- current expenditure (or resource) cuts were largest to CLG Communities (71.8 per cent) and CLG Local Government (62.7 per cent) – together, a 63.7 per cent cut – and to the Foreign and Commonwealth Office (52.2 per cent)
- capital expenditure cuts were largest in the Department for Culture, Media and Sport (81.7 per cent), CLG Communities (56.1 per cent) and the Home Office (52.0 per cent).

13 The latest data available with this level of detail.
14 All figures are in real terms, 2013/14 prices.

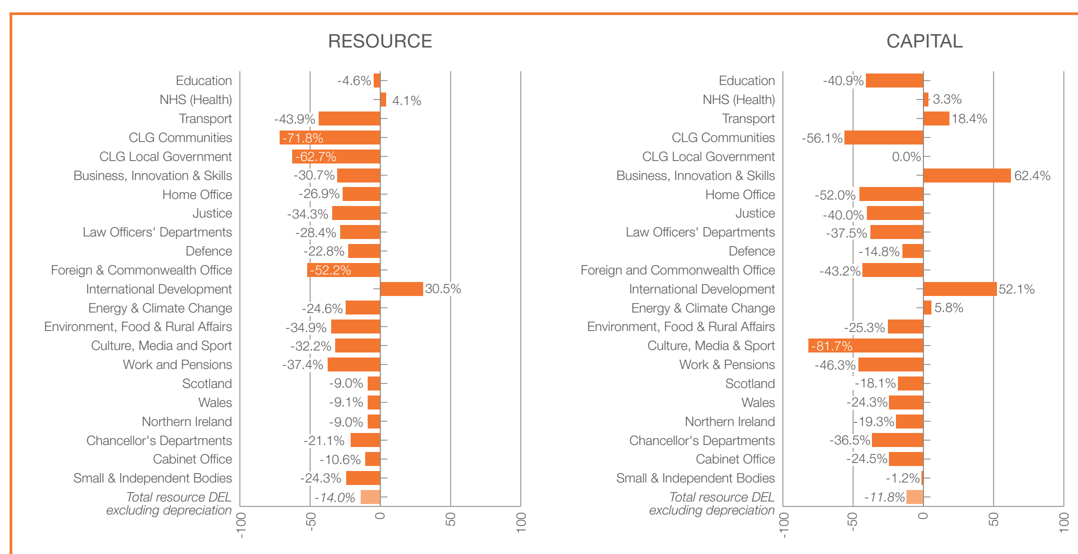
Box 2.1 AME, DEL and TME

The government budgets for public expenditure under two categories according to the purpose of the funding; together these make up its total managed expenditure (TME). The first of these two categories is department expenditure limits (DEL), which are firm settlements each department makes with HM Treasury at the time of the spending review, and which departments can only deviate from in exceptional circumstances. All spending which can be budgeted for over long periods (spending which isn't responsive to factors outside of a department's reasonable control) therefore falls under this spending. In total, DEL makes up £382 billion (56.6 per cent) of government expenditure in 2012/13.

The other form of expenditure is that which cannot be reasonably budgeted for so far in advance, and is therefore, as its name suggests, annually managed expenditure (AME). This type of expenditure includes items responsive to demand and economic conditions, such as social security benefits, tax credits and net lending to students. AME makes up the other £293 billion (43.4 per cent) of all TME.[15]

Given the importance of capital expenditure to the economy, there were also notable capital *increases* in the budget for the Department for Business, Innovation and Skills (62.4 per cent), the Department for International Development (52.1 per cent) and the Department for Transport (18.4 per cent).

Figure 2.2
Real-terms percentage changes in departmental spending, 2010/11–2015/16



Source: HM Treasury 2013a
*Excluding depreciation

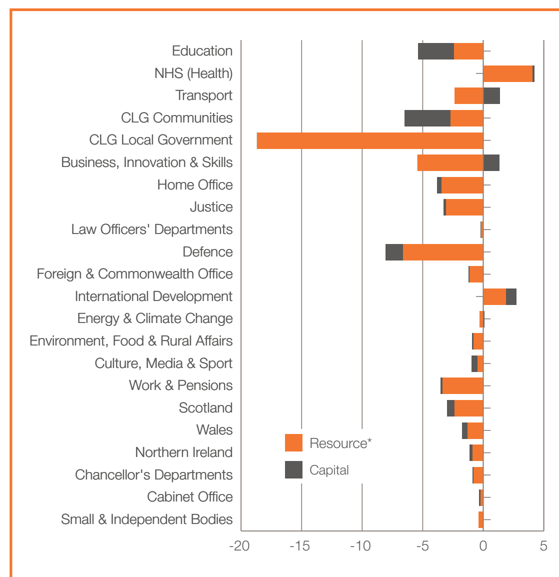
These percentage changes are undoubtedly a substantial challenge for individual departments. However, figure 2.3 shows the absolute changes to spending over the period, and therefore where the weight of total government fiscal consolidation has landed.

15 For more detail on this framework, see annex C of PESA (HM Treasury 2013b): https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/223600/public_expenditure_statistical_analyses_2013.pdf

- CLG Local Government (£18.7 billion) and CLG Communities (£6.5 billion) see a combined cut of £25.2 billion, making up almost half (46.6 per cent) of the total change in spending over the period.
- Defence (£8.0 billion), Business, Innovation and Skills (£4.0 billion) and the Department for Education (£5.4 billion) also see large cuts to expenditure.
- The largest cuts to capital budgets are in CLG Communities (£3.8 billion), Education (£3.0 billion) and Defence (£1.4 billion).

Again, however, there were some capital increases: for the Department for Transport (£1.4 billion), the Department for Business, Innovation and Skills (£1.4 billion) and the Department for Energy and Climate Change (£0.1 billion). Welcome though this spending is – and it is in the right areas to stimulate economic growth – in the context of the spending changes over the whole period it is extremely small: £3.9 billion of capital increases to offset £11.1 billion of capital cuts elsewhere, and an overall cut in DEL spending of £54.0 billion.

Figure 2.3
Real-terms absolute changes in departmental spending, 2010/11–2015/16 (£bn)

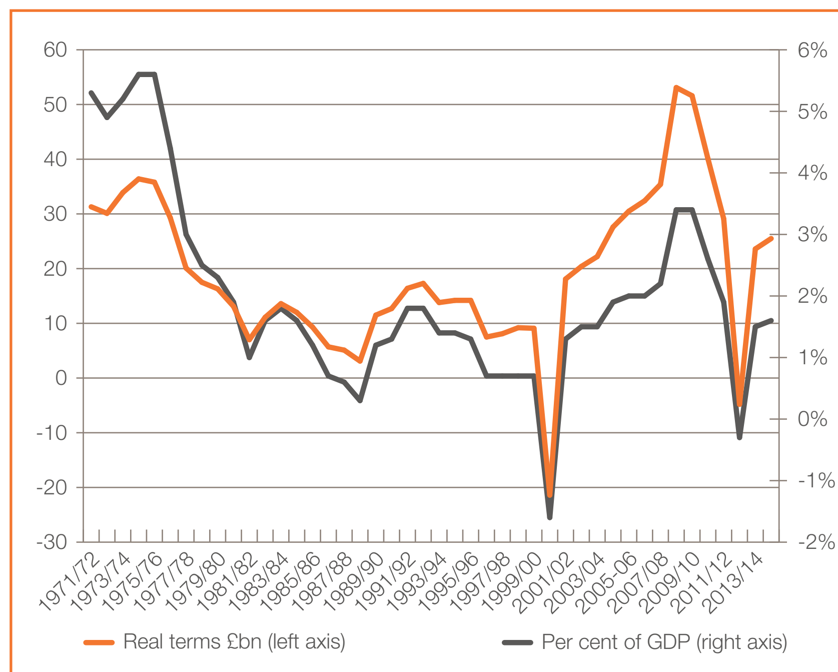


Source: HM Treasury 2013a
*Excluding depreciation

Crucially in terms of both stimulating a recovery and strengthening the economy across the country, despite more recent plans to invest in the departments as detailed above, these investments are far smaller than the cuts elsewhere, and weren't used to stimulate the economy early on – as many suggested at the time they should have been (see for example Pissarides 2010). Figure 2.4 shows how current levels of public sector net investment have fallen substantially since 2009/10 and how (despite rising) they are projected to be less than half (49.4 per cent) of the 2009/10 level in 2014/15.

A further 1.1 per cent reduction in Whitehall departmental budgets for 2014/15 and 2015/16 was announced in the recent autumn statement, with existing exclusions continuing to apply, and local government, the security and intelligence agencies and HMRC also being excluded.

Figure 2.4
Public sector net investment in real terms (£bn, left) and as a percentage of GDP (right)*



Source: HM Treasury 2013a
Note: The surpluses (that is, negative net investment) are due to asset and liability transfers. For more information see ONS 2013g

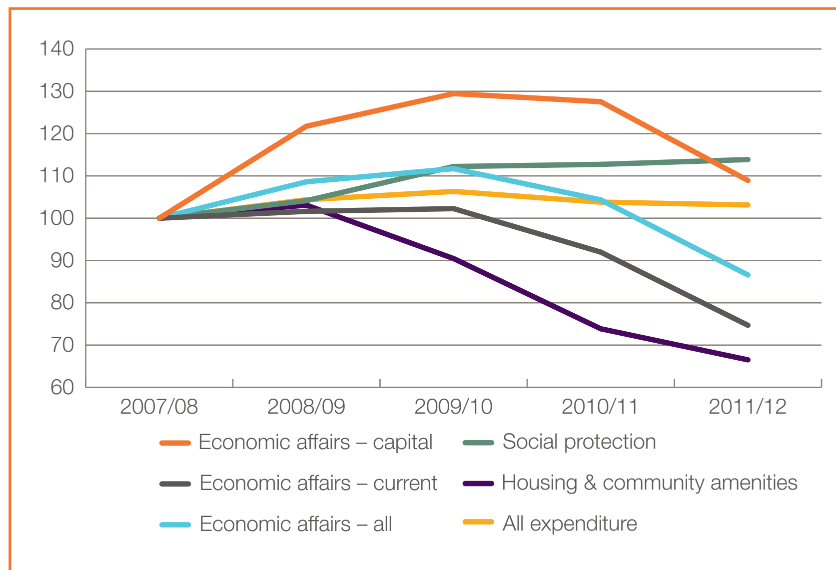
2.2 Impact on the economy

The impact of public spending cuts on the wider economy may be difficult to accurately measure. Nonetheless, their broad effect in lowering GDP is well documented and largely accepted both in the UK – for example by the independent Office for Budget Responsibility (Chote 2013) – and abroad (for example, see Estevão and Samake 2013). The Office for Budget Responsibility has estimated that the consolidation measures put in place would have been enough to have reduced GDP in 2011/12 by approximately 1.4 per cent, and that the cumulated GDP loss due to fiscal tightening from 2010 to 2013 is approximately 5 per cent (Wren-Lewis 2013). Jan in't Veld's larger estimates of the impact of fiscal consolidation in the Eurozone from 2011 to 2013, produced using the European Commission's QUEST model, suggest the real impact may have been higher still. Analysis from Bagaria et al (2012) has suggested that the UK's consolidation has had a substantial effect on the national economy, and that cutting earlier has meant a cost to economic growth of £239 billion.[16]

With cuts to the Departments for Communities and Local Government (DCLG) totalling £25.2 billion between 2010/11 and 2015/16, it is clear that local government is bearing the brunt of the cuts to public expenditure, despite wide acknowledgment that local government is highly efficient (Travers 2012, Cameron 2009). Due to the functions local authorities must execute by law and the high demand for these services (related to children's services and adult social care), spending on economic affairs, housing and community amenities has plummeted in recent years, as figure 2.5 shows.

16 2010 prices

Figure 2.5
Local government expenditure on key areas in real terms (index 100 = 2007/08)



Source: HM Treasury 2013b

But these cuts – and their economic consequences – have not fallen equally across the country. Research undertaken by Newcastle City Council shows the changes to local authority spending power per head between 2010/11 and 2014/15, as summarised in figure 2.6. For example, the average cut to spending power per head is £105 greater than the English average in the North West, and £56 below average in the South East (Butler 2013).

This has been compounded by the £19 billion in cuts to in-work and out-of-work social security payments which have been made since 2010. These have had a disproportionate impact on very similar areas to the local authority cuts. Analysis from Beatty and Fothergill (2013) has shown this, as summarised in figure 2.7. For the year 2014/15, the cuts to these benefits will be:

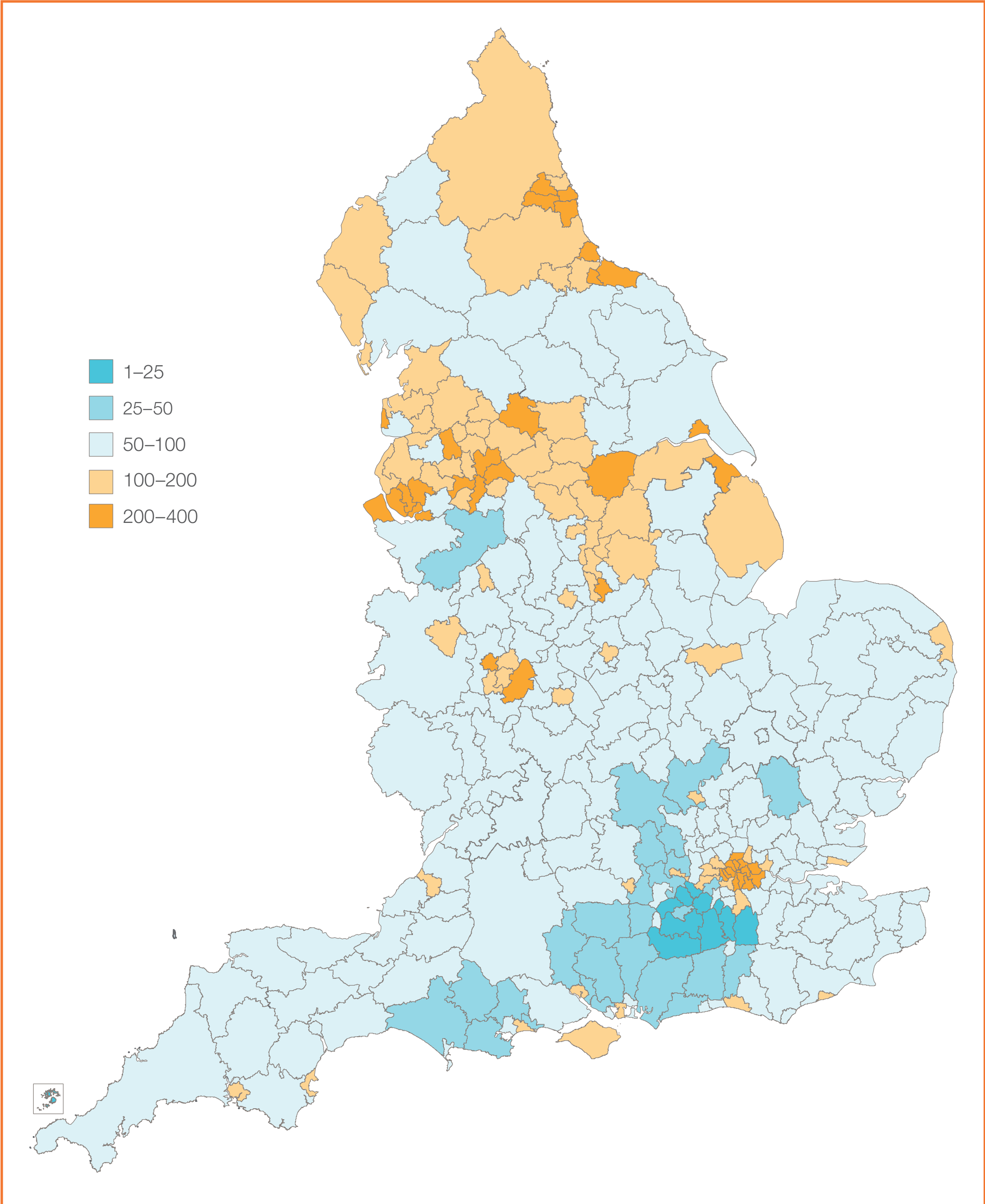
- £5.2 billion, or £538 per working-age adult in the north
- £5.0 billion, but £446 per working-age adult in London and the South East.

2.3 Impact of the 2013 spending round on the English regions

The impact of national government spending across the country is not forecast by central government, although previous patterns of expenditure are published. Using this data it is possible to estimate the geographical impact of the 2013 spending round, by applying future spending nationally to historical spending regionally; this factors in the departments in which cuts are made and the capital/current split of spending within that department.

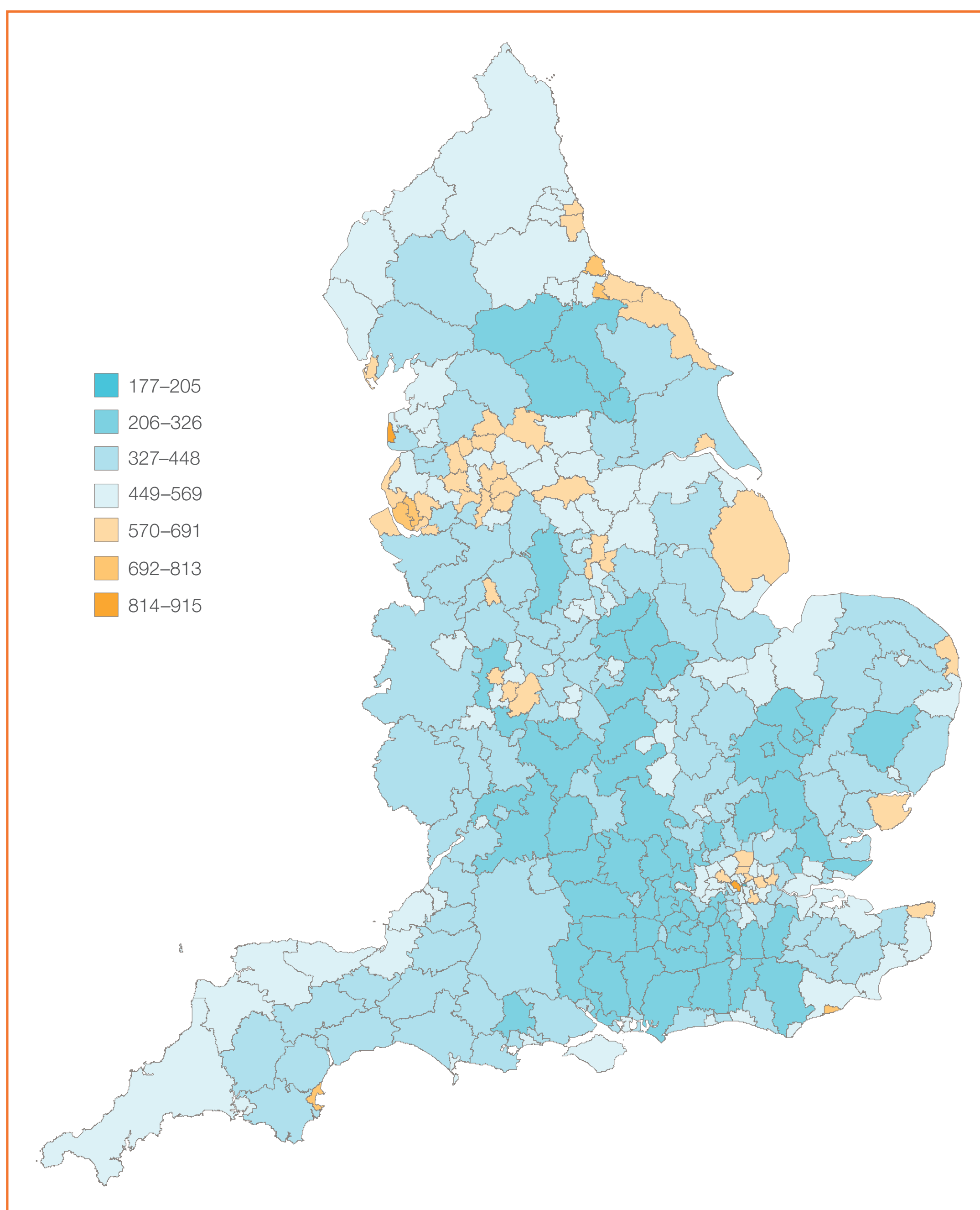
Figure 2.8 shows how the £6.3 billion of departmental spending cuts that were announced in the 2013 spending round can be accounted for in the English regions. It is clear that because of its size and the amount of spending which already occurs there, London fares worst, with a net loss of £1.3 billion from its economy. For the same reason, there are large cuts in the North West (£0.9 billion) and the South East (£0.9 billion); the north of England taken as a whole loses £1.9 billion. A focus on the economically crucial capital expenditure shows a similar regional distribution, with the largest cuts to London (£0.4 billion), the North West (£0.2 billion) and the South East (£0.2 billion).

Figure 2.6
Cumulative change to local authority spending power per head between 2010/11 and 2014/15



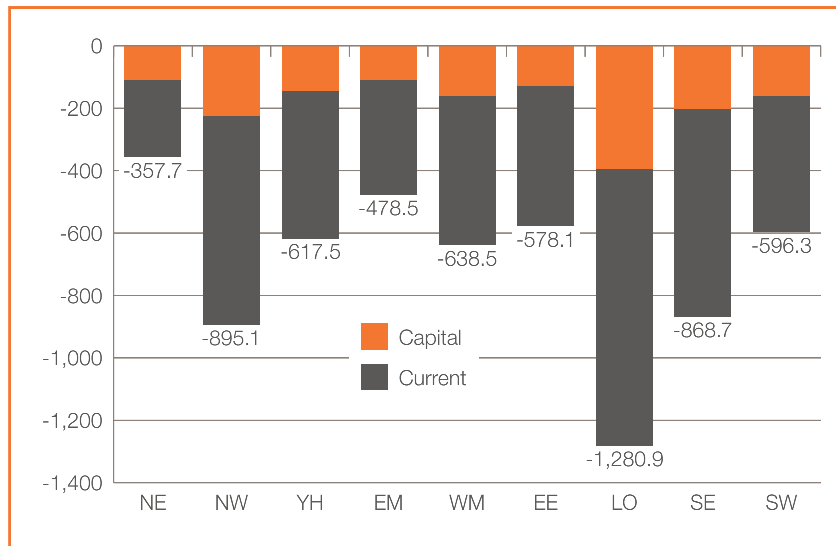
Source: Newcastle City Council 2013, via Butler 2013

Figure 2.7
Annual impact per working-age adult of welfare reforms in the year 2014/15



Source: Beatty and Fothergill 2013 via Financial Times 2013
Note: Cumulative impact of changes introduced in the 2010 emergency budget, 2010 comprehensive spending review and Welfare Reform Act 2012, in 2010/11 prices.

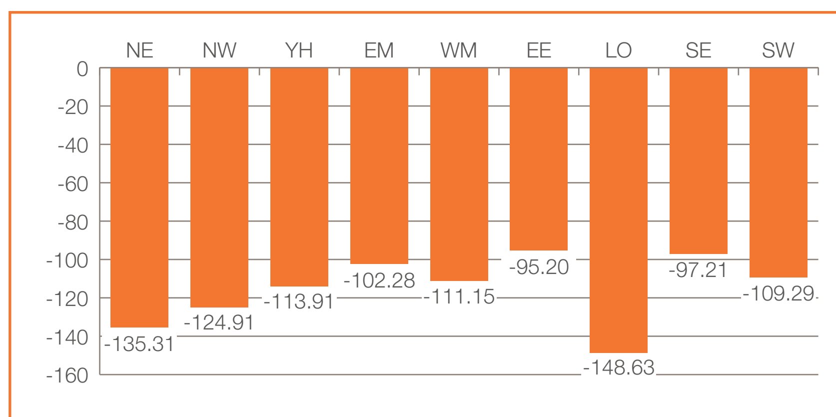
Figure 2.8
Regional impact of departmental settlement, current and capital, 2014/15–2015/16 (£m)



Source: IPPR modelling of HM Treasury 2013b and HM Treasury 2013c

However, per-capita changes draw a markedly different picture. Again, London fares worst – a proportional cut necessarily means those regions with the highest expenditure receiving the largest cut. But now the three northern regions are shown to be hit harder than the remaining regions: the North East loses £135 per head; the North West £125 per head and Yorkshire and the Humber £113 per head. From this angle, the South East becomes one of the least affected regions, losing £97 per head.

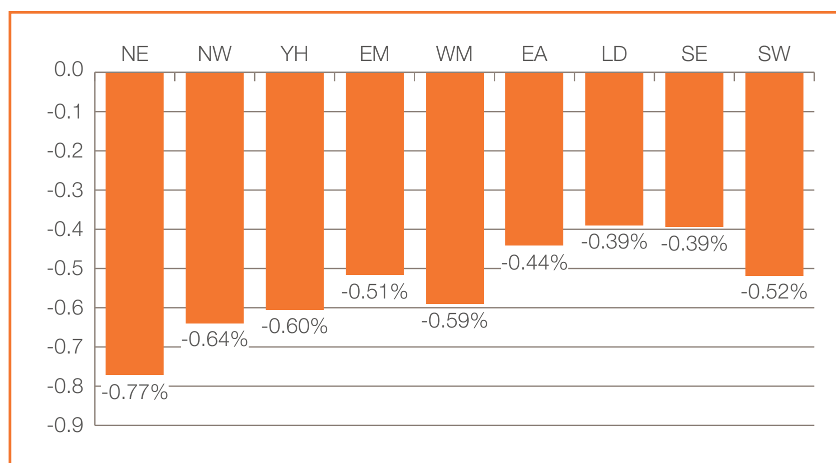
Figure 2.9
Regional impact per capita of departmental settlement, current and capital, 2014/15–2015/16 (£)



Source: IPPR modelling of HM Treasury 2013b and HM Treasury 2013c

However, as chapter 3 shows clearly, while public services in London will undoubtedly suffer, the economy in London is far stronger and more able to absorb such a cut in public spending. Taken as a proportion of forecast GVA in 2015/16 (when the cuts are due to take effect), this dramatically reverses the regional situation. These cuts are equivalent to just 0.39 per cent of London's economy, while in the North East it's almost double (0.77 per cent), followed by the North West (0.64 per cent) and Yorkshire and the Humber (0.60 per cent). Relative to the forecast change in GVA in the year these cuts actually bite, these changes amount to just 15 per cent of London's GVA growth but almost half the annual increase in GVA in the North East, for instance.

Figure 2.10
Regional impact relative to forecast GVA of departmental settlement, current and capital, 2014/15–2015/16 (%)



Source: IPPR North modelling of HM Treasury 2013b, 2013c; UKCES 2011

This chapter has shown how, in various ways, the economies in specific areas of the country – especially those described as economically weakest in chapter 3 – are being significantly and disproportionately hit by the cuts to public expenditure during the current spending period, particularly in the north of England. The likelihood is that these will exaggerate the substantial economic divide that already exists in the UK, and so will require more spending to compensate, most obviously in the form of payments to those in work (through tax credits) and out of work (through jobseekers' allowance). The challenge as the UK returns to economic growth is therefore not only to ensure that it translates into prosperity across the income distribution but across the country as well.

Building on IPPR North's modelling of the 2013 spending review, it is clear that there needs to be much better recognition of the relationship between public spending and economic growth at the regional level. Government itself should be working up and publishing analysis of how public spending and its constituent parts impact on different parts of the UK, rather than that task falling on external organisations. Moreover, such analysis needs to be updated regularly against actual impact if it is to be truly meaningful.

Recommendation: As a simple first step in supporting the principle of spatial rebalancing, HM Treasury should publish a spatial analysis of each spending review along with other distributional tables. It should also publish yearly progress reports to review the impact on different areas and different household income groups.

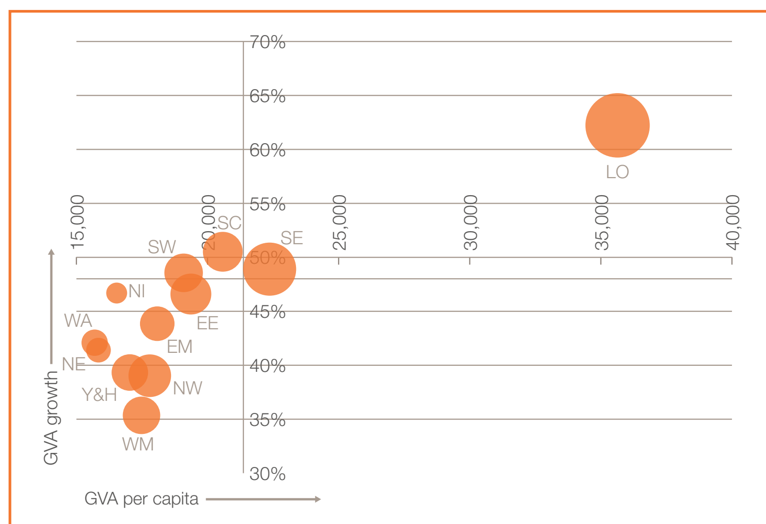
3. THE GEOGRAPHY OF ECONOMIC GROWTH IN THE UK

3.1 Regional growth and productivity

Economic growth in the UK is, as in all countries, uneven. However, the UK is almost unique in the developed world in that its growth is so highly concentrated in one place. As figure 3.1 shows, in GVA terms, the productivity of London is far larger and grew faster than all other regions in the decade to 2011. The next largest economies are the South East and the North West. In terms of both GVA per capita and 2001–11 GVA growth, it is Scotland and the South East that have the highest figures after London.

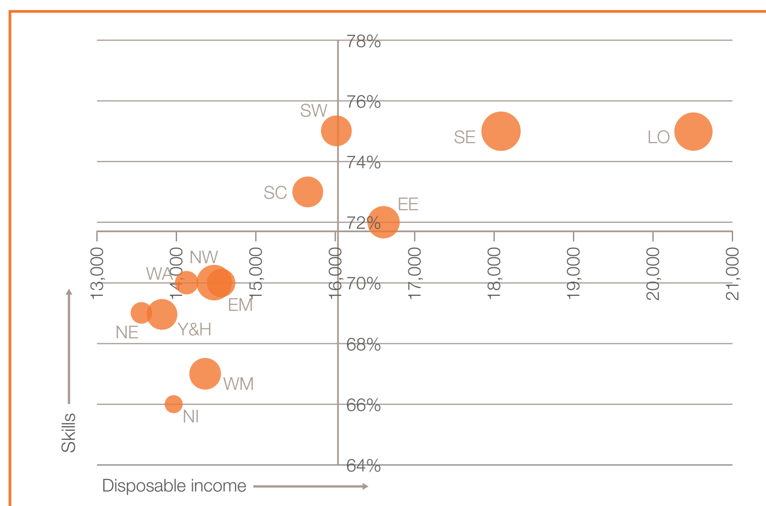
Economic growth is spread unevenly in terms of population as well as geography, as figure 3.2 shows. The South East is the most populous, followed closely by London and the North West, but income and skill levels are both heavily skewed towards London and the South East, and to a lesser extent, the South West, Scotland and the East of England.

Figure 3.1
Regional GVA (bubble size), GVA growth and GVA per capita (axes intersect at UK average)



Source: ONS 2012a; ONS 2012b
Note: Current basic prices

Figure 3.2
Regional population (bubble size), gross disposable household income per head and % of population with NVQ 2+ (axes intersect at UK average)

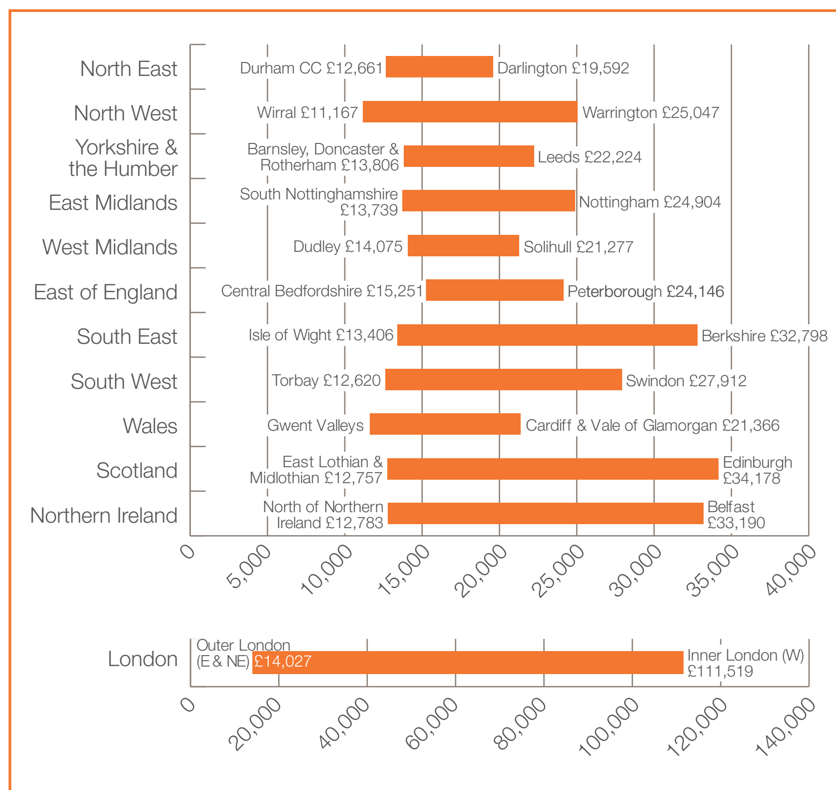


Source: ONS 2012a; ONS 2012b; ONS 2013a
Note: Current basic prices

These well documented economic divisions are particularly prevalent in the UK, which is the most geographically imbalanced economy of all EU member states, in terms the difference between the areas (at the NUTS2 level[17]) with the highest and lowest GVA per capita: figures. Inner London is wealthier than the poorest performing area by a factor of 4.7 (Eurostat 2013). Looking at sub-regional geographies, London maintains this dominance, but intra-regional disparities also become apparent. Figure 3.3 shows that productivity is varied both within and between regions. Apart from London's marked dominance, several points stand out.

- All regions have at least one and often several areas (at NUTS3 level) which are more productive than the least productive area in London.
- The core cities are some of the most productive areas.
- However, an exclusive focus on the core cities would leave out some of the most productive areas in the country, such as Berkshire, Swindon and Peterborough, as well as the Scottish and Welsh capitals, and in the north Warrington and Darlington.

Figure 3.3
GVA per head variation (most and least productive NUTS3 areas) within NUTS1 region, 2011



Source: ONS 2012c
Note: Current basic prices

17 The NUTS (nomenclature of territorial units for statistics) system of classification is used by the EU for analysis and policy. NUTS1 areas correspond to English regions and nations, NUTS2 areas are sub-regions (such as Greater Manchester) and NUTS3 areas divide these further (for example Greater Manchester south and Greater Manchester north). For more information see: http://epp.eurostat.ec.europa.eu/portal/page/portal/nuts_nomenclature/introduction

To highlight the economic potential and contribution of a diverse range of areas across the UK, table 3.1 shows GVA (in 2011) at the smallest geographical areas available (NUTS3) alongside various measures of change over the last decade. In terms of absolute GVA within a single year, London (and in particular Inner London) and the South East again do dominate, however this is far from uniform and some parts of London are not as economically strong as areas elsewhere in the country (Greater Manchester South stands out in this regard with a GVA of £32.5 billion). The picture is very similar when the share of UK growth between 2001 and 2011 is analysed. However, looking at measured as GVA per hour worked in the area (the best measure of productivity) shows some areas outside of London to be highly productive, although these are still predominantly located in the South and parts of Scotland, while the increase in productivity between 2004 and 2011 has been seen across the country, with parts of Wales, Scotland and the North West seeing some of the most substantial increases in productivity.

Table 3.1
GVA by NUTS 3 area and various measures of change – top 10 in each case

GVA in 2011		% of UK change 2001–11	
Inner London – West	127,730	Inner London – West	11.90
Inner London – East	67,359	Inner London – East	7.20
Outer London – W & NW	43,499	Outer London – W & NW	2.80
Greater Manchester South	32,507	Hampshire CC	2.50
Surrey	30,344	Greater Manchester South	2.20
Hampshire CC	28,756	Berkshire	2.20
Berkshire	28,697	Surrey	2.10
Hertfordshire	26,660	Kent CC	2.10
Kent CC	25,861	Essex CC	1.90
Essex CC	24,894	Outer London – E & NE	1.70

Nominal GVA per hour worked in 2011*		Change in nominal GVA per hour 2004–11*	
Inner London – West	£41.20	Aberdeen City and Aberdeenshire	£9.80
Berkshire	£34.90	Edinburgh, City of	£8.80
Inner London – East	£34.60	Inner London – West	£8.50
Edinburgh, City of	£33.90	Luton	£7.40
Buckinghamshire CC	£32.70	Falkirk	£7.40
Surrey	£32.20	Inner London – East	£7.10
Aberdeen City and Aberdeenshire	£32.20	Isle of Anglesey	£7.10
Outer London – W & NW	£31.00	Cheshire West and Chester	£7.10
Swindon	£31.00	East Dunbartonshire, West Dunbartonshire and Helensburgh & Lomond	£7.10
Milton Keynes	£30.20	Bournemouth and Poole	£7.00

Source: ONS 2012b, 2013b
* Current basic prices

The interaction of economy and population is complex, but it's clear that the economic and population decline which was endured by London into the mid-1980s and by some other English core cities as recently as the early 2000s has not only been arrested but dramatically reversed. As tables 3.2 and 3.3 show, some of the local authorities which saw the most absolute growth in population between 2002 and 2012 were urban areas which saw far less relative growth in the decade prior (1992–2002). The biggest changes in absolute population rank occur in Birmingham, Sheffield, Bristol and Manchester;

in terms of percentage population change, Manchester, Corby and Peterborough stand out as having turned themselves around most dramatically. This underlines the risks inherent in writing off any area of the UK, and shows that the fortunes of sub-national economies are not as predictable as is often assumed – few would have said in the 1990s that the core cities would see such a resurgence in their economic fortunes and popularity. Even now many are writing off areas which are showing signs of both economic and population growth – Sunderland, Liverpool and Hull are typical examples (see BBC News 2008).

Table 3.2
Top 10 local authorities for absolute population change, 2002–12

		Change in population			
		2002–12		1992–2002	
	2012 population	Change	Rank	Change	Rank
Birmingham	1,085,400	95,000	1	-13,900	401
Manchester	510,800	82,600	2	700	300
Newham	314,100	58,800	3	36,100	2
Tower Hamlets	263,000	56,000	4	39,700	1
Bradford	524,600	49,400	5	5,700	144
Leicester	331,600	46,300	6	3,400	212
Brent	314,700	44,800	7	29,600	6
Barnet	364,000	43,400	8	23,700	12
Sheffield	557,400	43,200	9	-6,600	385
Bristol, City of	432,500	42,800	10	-900	336
Top 5 in the north of England					
Manchester	510,800	82,600	2	700	300
Bradford	524,600	49,400	5	5,700	144
Sheffield	557,400	43,200	9	-6,600	385
Leeds	757,700	41,300	12	6,000	137
Kirklees	425,500	33,400	28	12,000	49

Source: IPPR analysis of ONS 2013c

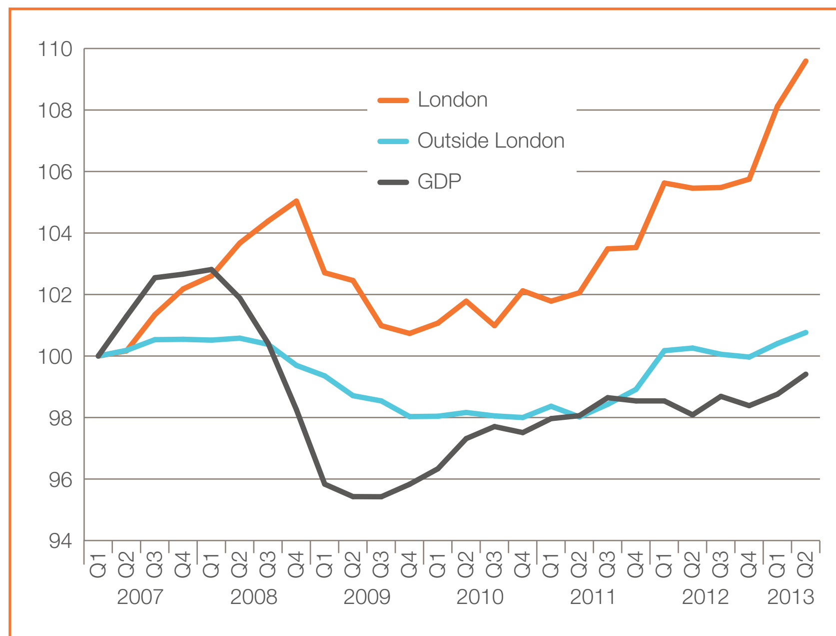
Table 3.3
Top 10 local authorities for relative population change, 2002–12

		Change in population			
		2002–12		1992–2002	
	2012 population	Change	Rank	Change	Rank
Tower Hamlets	263,000	21.3%	1	23.7%	3
Newham	314,100	18.7%	2	16.5%	8
Dungannon	58,800	17.9%	3	5.7%	146
Hackney	252,100	16.3%	4	13.0%	21
Hounslow	259,100	16.3%	5	7.4%	91
Manchester	510,800	16.2%	6	0.2%	316
Corby	63,100	15.4%	7	0.6%	301
Greenwich	260,100	14.8%	8	4.5%	182
Peterborough	186,400	14.8%	9	2.2%	264
Milton Keynes	252,400	14.8%	10	19.2%	6
Top 5 in the north of England					
Manchester	510,800	16.2%	6	0.2%	316
Richmondshire	53,900	11.3%	50	5.3%	158
Bradford	524,600	9.4%	85	1.2%	284
York	200,000	9.0%	98	6.1%	130
Salford	237,100	8.8%	101	-5.9%	399

Source: IPPR analysis of ONS 2013c

Just as growth and employment were concentrated heavily in London before the crash, as the recovery begins London again looks set to recover faster than the rest of the UK (Oxford Economics 2012). This has for some time been reflected in the number of workforce jobs generated in the capital. Increasingly, job growth in London has diverged from the rest of the country, as figure 3.4 shows: in Q2 of 2013, as the number of jobs in the rest of the country only just returned to pre-recession level, the number of jobs in London was 9.6 per cent higher.

Figure 3.4
GDP and workforce jobs in London and outside of London (index 100 = Q1 2007)



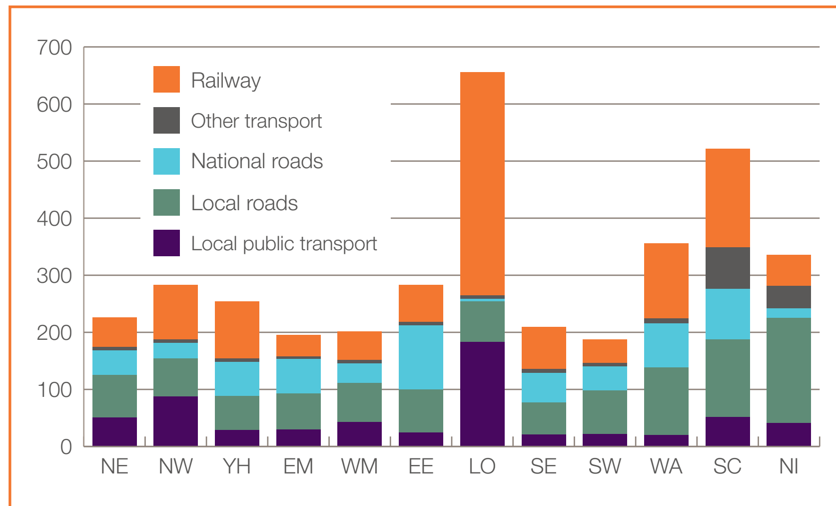
Source: ONS 2013d, 2013e
Note: GDP at market prices (chained volume measure ABMI)

3.2 Regional public spending

The population and productivity increases detailed above mean that more infrastructure is needed in urban areas (Eddington 2006). However, to this point, this has been skewed heavily towards London, as figure 3.5 shows. Historical public spending on all forms of transport was £656 per capita in London in 2011/12 but less than half this in the north, at £263 per capita. And analysis of the November 2012 national infrastructure pipeline, as presented in figure 3.6, shows that this pattern of spending is likely to continue (Cox and Davies 2013).

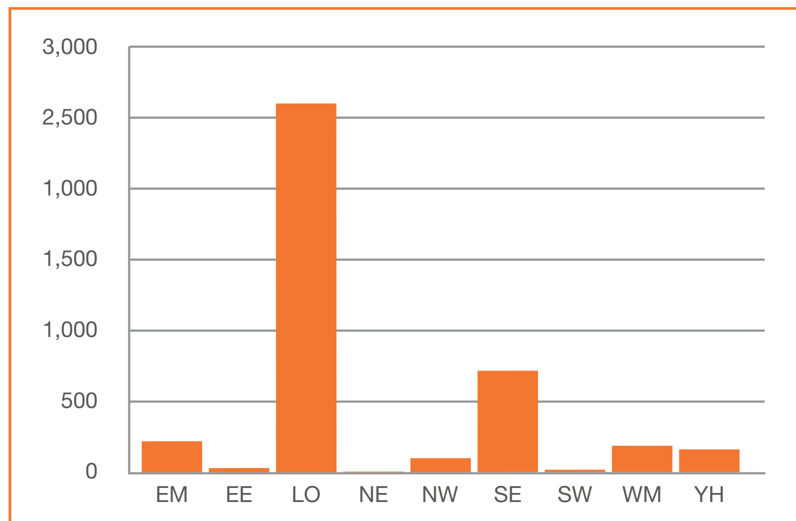
According to the most recent iteration of the national infrastructure plan, produced ahead of the 2013 autumn statement, some £375 billion of public and private funding is scheduled to be invested in 646 different projects. These new figures need further careful analysis, but in headline terms it appears London and the South East will together receive three-quarters of all transport investment in England in the years ahead, for projects where public funding is involved. This is less than the 86 per cent that we have seen in past analysis. Nonetheless, it equates to £4,893 per person in London, compared with just £215 per person in the South West, £246 per person in the North East and £303 per person in Yorkshire and the Humber.

Figure 3.5
Historical public spending on transport (capital and revenue) per capita, 2011/12 (£)



Source: HM Treasury 2013b

Figure 3.6
Planned spending on transport projects (wholly or partly public-funded) per capita (£)



Source: HM Treasury 2012

Compared to the previous plan, these latest figures represent a significant boost in every region. However, in London's case the per-capita figures have nearly doubled, apparently as a result of £11 billion of investment in the Underground as well as a £1.5 billion increase in the costs of Thameslink. The Thameslink boost alone is equivalent to the whole of planned spending in Yorkshire and the Humber and more than twice the total investment in the North East. Furthermore, nearly 80 per cent of all of London's projects are 'active programmes or 'in construction', compared with just one-third of those in the North West and half in Yorkshire and the Humber. In other words, London's construction programmes are much further ahead, which means the benefits will arrive sooner.

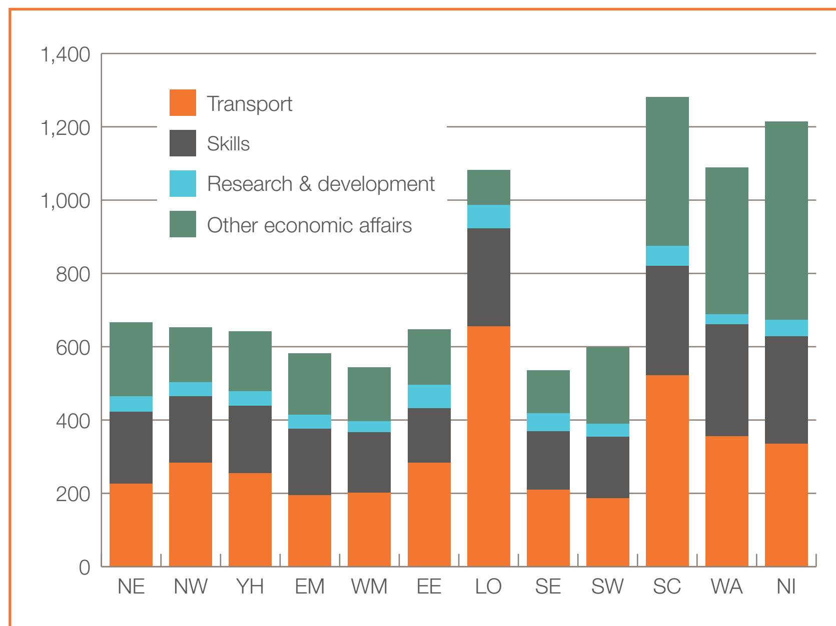
As well as responding to congestion and increased user demand, transport infrastructure spending also has the capacity to stimulate short-term growth and raise long-term productive capacity in economies (Travers 2012, Mulhern 2013). Capital expenditure in general tends to have a large multiplier effect in local economies, but expenditure on transport is especially effective, as it increases the connectivity of businesses and potential employees with one

another. Research commissioned by the previous Labour government found that spending on capital infrastructure can result in a return of £5–10 for each pound spent (Eddington 2006). If the increase predicted by the national infrastructure pipeline figures occurs then it should be no surprise when local economies grow at an increasingly rapid pace, driven by the increased connectivity of businesses and people; in turn, the additional opportunities that arise will attract more people and more investment, in a virtuous cycle.

One of the other key areas of spending which impacts on economic growth is skills – these are of particular importance to so-called 'lagging regions' (OECD 2012) and accounted for a fifth of annual UK economic growth between 1975 and 2002 (Bell et al 2005). Another key area is R&D, which can have a positive impact on local economies also (Simmie and Carpenter 2008).

Spending on these two crucial areas, along with the economic affairs (which includes agriculture and other smaller spending areas – see box 3.1) is also skewed towards the devolved nations and London, as figure 3.7 shows.

Figure 3.7
Spending on economic affairs and skills per capita, 2011/12 (£)



Source: HM Treasury 2013b

> **Box 3.1 Economic affairs and skills**
> The definition of economic affairs and skills we've used in this report is built on the classifications for public expenditure used and published by HM Treasury, which conform to the United Nations Classifications of the Functions of Government (COFOG) definitions also. The economic affairs element is exactly that used by the government, and covers spending which relates closely to the economic performance of a country – such as transport, communication, fuel and energy. To this we've added several elements from the education section of the COFOG definitions, to reflect the well-evidenced importance of skills to economic growth.

BOXED TEXT CONTINUED

These sections include post-secondary non-tertiary education, education not definable by level, and higher education. There is perhaps a case for including areas such as secondary education in this category also, as it contributes substantially to economic growth. However, it is clear that – unlike the forms of skills which fall under the above three classifications – decisions on funding this policy area should not be based on the impact they could have on regional economic growth.[18]

Table 3.5
Economic affairs and skills spending breakdown

	Spending in 2011/12 (£m)
4.1 General economic, commercial and labour affairs	£3,377
4.2 Agriculture, forestry, fishing and hunting	£5,926
4.3 Fuel and energy	£366
4.4 Mining, manufacturing and construction	£250
4.5 Transport	£20,509
4.6 Communication	£426
4.7 Other Industries	£433
4.8 R&D economic affairs	£3,638
4.9 Economic affairs, not elsewhere classified (nec)	£506
9.3 Post-secondary non-tertiary education	£567
9.4 Tertiary education	£11,563
9.5 Education not definable by level	£730
Total economic affairs and skills	£48,291
Total expenditure on services (TES)	**£677,609**

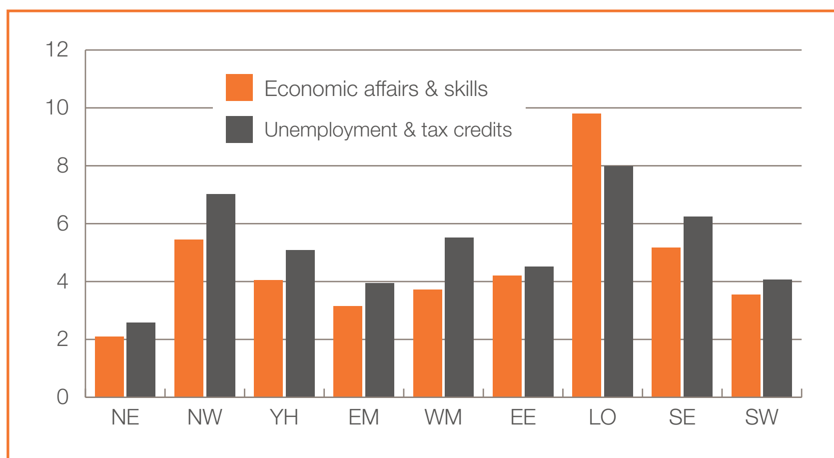
3.3 Relationship between public spending and regional growth

In England, as figure 3.8 shows, more is spent in every region except London on unemployment and tax credits (to ameliorate the lack of work or work paid an insufficient wage) than on economic affairs and skills, which would create the economic growth and well-paid jobs that are needed.

Economic investment of this type, if it is doing its job, should over the longer term drive down the amount of money spent by the exchequer on benefits and regeneration to ameliorate the consequences of economic failure. It also can help to create good-quality jobs which don't require subsidy by the state through tax credits and housing benefit. While London's success is based on many factors, the increased economic investment it receives from government (which provides the basis for attracting in further private sector investment) certainly helps. Many recent major studies have shown the importance of mid-sized cities and their hinterlands in driving economic growth, and how underinvestment comparative to capital cities has held them back (Parkinson 2012, Dobbs et al 2013, OECD 2012). Rebalancing the UK economy requires rebalancing economic affairs and skills spending across the country.

18 For detailed breakdowns of these classifications see here: http://unstats.un.org/unsd/cr/registry/regcst.asp?Cl=4&Lg=1

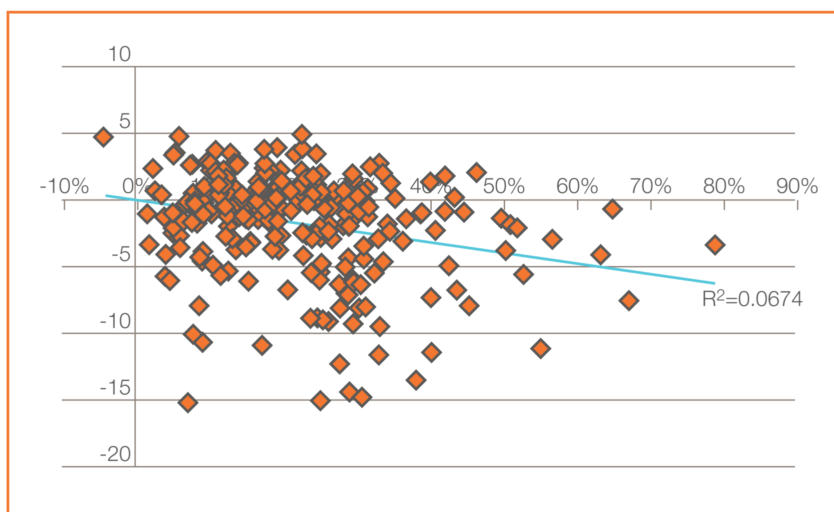
Figure 3.8
Spending on economic affairs and skills compared to unemployment and tax credits, by region, 2011/12 (£bn)



Source: HM Treasury 2013b

But this is not as simple as spending more on strengthening the economy than on compensating for its failure – London, which enjoys high levels of public spending on this area – has some of the worst poverty in the country, with a large concentration of inactivity and unemployment. Economic growth in Canary Wharf isn't even reaching Londoners who live within walking distance. Public money spent on economic investment has to attempt to link the disadvantaged and the areas they live in with the opportunities for employment and economic growth available elsewhere in their city-region or functional economic area.

Figure 3.9
Change in growth and unemployment, 2000–2007 – percentage point change in unemployment (y-axis) and percentage change in real GDP (x-axis)



Source: OECD 2013a, 2013b
Note: Real GDP: at constant PPP in the 261 OECD TL2 regions for which data is available.

There is a limited amount of evidence, albeit heavily contested, for 'trickle down' within a city (Morretti 2010). But it is conceded that this is a localised effect and will not 'trickle out' across the country. As figure 3.9 shows, the debate about the nature of growth and its impact on poverty has never been more pertinent: looking at the economic growth between 2000 and 2007, it is found to correlate poorly if at all with falling unemployment. Looking forward, research has found that economic growth is unlikely to have a significant positive impact on the incomes of low and middle earners (Brewer et al 2013).

It is clear that in order to re-gear the economy and reform public spending, the economic affairs and skills spending that is done needs to both drive growth across the country and support a type of growth capable of providing better-paid jobs. In doing so, not only will economic growth be made to benefit more people but the public finances will benefit from lower expenditure on unemployment benefits and in-work tax credits.

Moreover, growth that is more broad-based and inclusive brings benefits at a national level in terms of equality, resilience and fiscal health (OECD 2012). Regional variations in spending cuts compound longstanding differences in regional economic growth and productivity, creating something of a vicious cycle. But it would be wrong to assume that such a cycle is inevitable. There is growing evidence of the potential for growth in Britain's second-tier or 'core cities', and that this has been held back by government concentrating investment in London to the detriment of the UK's – especially England's – other major cities (Parkinson 2012). This potential is on top of the impressive growth that already was being achieved in our cities prior to the financial crisis. Indeed, Edinburgh, Sheffield, Bristol, Leicester, Newcastle and Belfast all achieved faster growth than London between 2000 and 2007. Employment growth in each of England's core cities as well as Edinburgh, Glasgow and Cardiff outstripped that of London in that period (ibid). Even beyond the largest cities outside London, a significant number of small cities demonstrated rapid productivity growth in the years leading up to the financial crisis.

An increasing reliance on London for economic growth is not inevitable, but if the capital continues to obtain the lion's share of the government's economic investment – which in turn can attract substantial private sector investment – England's regions will be hard-pressed to keep up. An overdependence on London not only makes the UK economy more vulnerable to economic shocks, it will also lead to an increasing strain on the public finances over coming decades.

4. THE 2015 SPENDING REVIEW AND NORTHERN ECONOMIC FUTURES

Whoever forms a government in May 2015, the subsequent spending review is likely to define a generation. It must somehow combine much more effectively than it has to date the primary importance of fiscal prudence with the capacity to improve public services and drive more balanced and sustainable economic growth. In this chapter we highlight six key principles which should form the backbone of the spending review process, before outlining specific policies which would help to unleash the potential of the English regions, particularly those in the north.

4.1 Principles to underpin the next spending review

By 2015 the public sector will already have endured five years of significant consolidation. Public money will be very tight, and so a continuation of cuts along the lines pursued by the current and previous governments will simply not achieve the savings required. Wariness around cuts to spending on health, schools, international development and pensions – which is likely to continue – will make this task all the more difficult. The government will therefore need to take a strategic view, focus on specific priorities and look to make sensible spending decisions that can deliver the best possible outcomes over a reasonable timeframe. This will require a clear framework, which should operate on the following principles.

1. **Five-year period:** The next spending review should cover a five-year period, from 2016/17 through to 2020/21. A settlement with a longer horizon allows organisations to spend to save, or at least to look past short-term cuts, and to undertake genuine reforms. It would provide greater certainty for bodies across the public sector looking to deliver the best possible services in very tight economic circumstances.
2. **Debt reduction over a decade:** On the assumption that the ratio of public debt to GDP will be around 80 per cent in 2015, there should be a fiscal rule that the ratio is reduced to around 65 per cent over a 10-year period. This should be consistent with eliminating the deficit on the public finances by 2020. The rule would need to be kept under review so that it was sensitive to, and subject to adjustments in accordance with, the strength or weakness of the economic recovery.
3. **80:20 split between cuts and tax increases:** During the financial crisis and subsequent recession, tax revenues in the UK fell further than in many other advanced economies. This resulted in a large structural fiscal deficit, which the Coalition government has tried to reduce through a combination of spending cuts and tax increases. The Coalition's plans for deficit reduction were based on achieving an overall 80:20 split between public spending cuts and tax increases. However, the ratio of spending cuts to tax increases currently planned for the first three years of the next parliament is approximately 97:3. With further cuts becoming much harder to identify, tax increases should form a greater part of measures to reduce the deficit, moving the balance between spending cuts and tax increases to 80:20 over the review period.
4. **Increasing capital spending:** The current government has realised, albeit belatedly, the importance of capital spending in creating sustaining economic growth. The spending review should increase the ratio of public sector net investment to GDP to ensure increasing investment in infrastructure over the spending review period.
5. **Strengthening geographical rebalancing:** Spending review measures should aim to strengthen economic opportunities outside London and the South East and tackle current levels of regional inequality. This needs to include, but not be limited to, ensuring more government economic investment money reaches areas beyond the M25.

6. **Decentralisation to city-regions:** The spending review should introduce significant place-based budgets for economic affairs and skills – such as welfare-to-work, skills and apprenticeships – for city-regions and key functional economic areas. The small amounts already earmarked to be devolved provide the precedent and practical guide for this.

4.2 Policy prescriptions for the northern economy

A. Decentralisation of key areas of economic development spending to city regions

Government spending decisions have different impacts on different parts of the UK. For some areas, the key priority for spurring on economic potential is greater investment in skills and infrastructure; for other areas, limited access to finance or low investment in innovation are what's holding them back (OECD 2012). Empowering local areas with funding for skills (including the vital lower-level skills and welfare-to-work provision) and economic development is crucial in making sure that public money is put to the best use and that spending decisions take into account the strengths and weaknesses of different areas.

Public sector spending on economic development is currently trapped in departmental siloes. This has been a key reason why it has been so easily salami-sliced in previous spending rounds, and why the Single Local Growth Fund – the single pot proposed on the back of the Heseltine review – is just 2 per cent of the amount originally envisaged by Lord Heseltine.

The benefits of breaking down silos and mobilising the full range of actors can be better realised at smaller geographic levels. Transport, housing, employment, skills and welfare policies have to work together to optimise local growth, and also these different policy areas can be joined up at a local level in a way that is not possible at a UK level. There is also a growing awareness that networks of business, community and public sector leaders are well positioned to tackle the big issues in a way which government alone cannot, and that these networks operate at a more local level (Katz 2013).

Rather than funding departments, as is traditional, spending decisions could be improved by putting funding behind objectives instead. This would reflect the complexity of some of the challenges the government now faces, and an increased understanding of how public services interact to deliver outcomes, good or bad. This is already being trialled with the single pot of money set aside for social care and has been attempted at the local level with Whole Place Community Budget pilots. Previously, this principle underpinned the now-abandoned public service agreements of the Blair-led Labour government. However, their biggest weakness was that there was no attempt to track spending against objectives, undermining any claim for the effectiveness of that spending.

Many outcomes will be beyond the reach of government alone to achieve, and central government will not necessarily be best placed to manage interventions. On many occasions, this may be best achieved at a city-regional or local level. Moving towards an outcomes-based approach with city-regions and local areas taking the lead is sensible, but it will require great improvements in the collection and sharing of intelligence at those levels. Place-based budgets will only be effective to the extent that there is robust and up-to-date evidence of the most effective policy interventions in terms of achieving any given policy objective.

The NEFC broadly endorsed devolution of key departmental spending pots as highlighted in the Heseltine review – skills, local infrastructure, employment support, housing, business support services, and innovation and commercialisation (IPPR North and NEFC 2012). But this principle can go a lot further, for example, to include funding for IPPR's recently proposed youth guarantee, whereby funding for welfare-to-work, adult skills and apprentice-

ships is devolved in respect of under-25s (Cooke 2013). For the period 2011/12–2014/15, we would add to this both major capital funding for local transport infrastructure in conjunction with the Passenger Transport Executives (£1.7 billion[19]) and housing benefit and housing capital through sub-regional housing funds, which would remove £4.5 billion of the housing capital spend from Heseltine's single pot (as indicated in table 4.1) and merge it with the projected housing benefit budget for England of £80.2 billion.[20]

Table 4.1
Division of single pot by functional spending area over four-year spending review period as proposed by the Heseltine review (£m)

Function	Contribution
Skills	17,435
Local infrastructure	14,821
Employment support	5,466
Housing	6,800
Business support services	2,939
Innovation and commercialisation	1,611
Total	**49,073**

Source: Heseltine Review 2012

In order to introduce such significant devolution of public funding there needs to be clarity about the basis upon which this is done. There needs to be clear timetable for devolving these funding streams over the course of a parliament so that local areas know what to expect and when. Devolved funding needs to be allocated on a formula basis, and should take into account a combination of population,[21] levels of need and growth potential.[22] This allows for longer-term decision-making in a way that competitive bidding would not.

The question remains as to which areas should receive these devolved powers and responsibilities. Local enterprise partnerships (LEPs) have made varying degrees of progress; equally, the areas they cover vary considerably. Not all would be in a credible position at this stage to take on greatly increased responsibility. Even the ones that are, with the exception of the Greater Manchester combined authority, are not subject to sufficient levels of democratic accountability and wider scrutiny. While the core cities urban areas on the whole have access to the greatest resources, they too are subject to this criticism. While Liverpool and Bristol now have directly elected mayors, they only speak for the cities themselves and not for their wider city-regions. In April 2014, Greater Manchester should be joined by four other combined authorities (Liverpool City Region, North East, South Yorkshire and West Yorkshire). These five bodies have the strongest case for receiving devolved powers and funding, and have sufficient democratic underpinning to make it work. If further devolution in England was to stop with these five combined authorities, that would be insufficient. Nonetheless, it is the right place to start.

It is difficult to total up the overall sum or size of the proposed devolved budget, and the pace and scale of devolution may well vary from place to place. However, there is strong case to be made for a significant one-off 'offer' to combined authorities at the beginning of the new spending review period. To this extent, the offer would not be made department-by-department on the back of departmental settlements but rather as part of the settlement process itself, top-sliced from departmental budgets as part of the overall spending review settlement (see chapter 5 for more proposals about departmental collaboration).

19 2010/11 prices
20 See analysis in IPPR North and the NEFC 2012 of Cooke and Hull 2012.
21 The proportion made up by the resident population of a LEP area against the total resident population in England.
22 Economic growth potential is difficult to measure or forecast but a proxy could be used, such as average annual growth over the last decade.

Recommendation: The 2015 spending review should make provision for much more substantial place-based budgets for each of the five combined authorities that will exist by that time, which should be allocated for a five-year period as part of the spending review process. Due to the sizable amounts of public money involved, a wider roll-out to other LEP areas can follow over the medium term once their institutional capacity is improved and they become subject to greater levels of accountability and scrutiny.

B. Rebalancing economic investment spending

Economic affairs and skills spending is the type of spending government classifies as having an impact on the economy in various ways. As was shown in chapter 3, the comparative weakness of many local economies in the north is compounded and reinforced by that fact that these crucial public spending streams are concentrated on and around London. This negative cycle must be reversed by rebalancing government spending on economic investment, particularly on infrastructure and research.

Infrastructure

As IPPR North has highlighted for a number of years, the component of economic investment which is most concentrated on the capital is infrastructure spending. It is this which needs to be remedied most urgently, given not only its stark geographical imbalance but also its unrivalled potential to bolster economic growth, particularly in urban areas (Eddington 2006). Transport infrastructure spending has been targeted mainly at relieving congestion rather driving balanced growth across the country.

As laid out in the previous chapter, analysis of the national infrastructure pipeline shows that the London-centricity of government spending on capital projects is set to continue. A common criticism of this analysis is that it doesn't account for the lack of demand or 'shovel-ready' projects in the rest of the country. However, there are many substantial economic assets in the north that need investment and support from the government: the Trans-Pennine rail connection; Manchester and other regional airports; high-speed rail links to Scotland; transport infrastructure improvements to support the North East's unrivalled export industry; and Atlantic Gateway in the North West, to name but a few. It is therefore crucial that where there are proposals at early stages of development they are supported and progressed by the government, and that government works with local authorities and LEPs to identify which improvements will be needed in the future.

Beyond this, existing appraisal processes do not adequately account for the wider economic benefits that might be derived from public investment in key transport infrastructure projects outside London, tending to focus on the more narrowly defined user-benefits assessment that often disadvantages the regions. Areas of high population density and with higher average wages do better in cost-benefit analyses focusing, for instance, on how many people will benefit from a certain reduction in journey time. If the government is serious about rebalancing the UK economy, it needs to rebalance public spending on infrastructure.

Much of the money for planned projects, however, has already been committed. Therefore, rebalancing infrastructure spending (both in transport and other areas) will take time. The Armitt review proposed a new national infrastructure commission with statutory independence to ensure both that the long-term strategic decision-making necessary for infrastructure planning is done and cross-party consensus (Armitt 2013). It is envisaged that once every 10 years this body would undertake an evidence-based assessment of the UK's infrastructure needs over a 25–30-year horizon. It would mainly concern itself

with 'nationally significant' infrastructure, as defined by the Planning Act 2008, consult fully with all relevant stakeholders, and seek parliament's approval, once the assessment had been completed. This proposal offers an opportunity to place rebalancing at the centre of decision-making on infrastructure planning and to ensure that local areas receive adequate infrastructure funding to support local growth.

Alongside this, a much greater proportion of transport spending needs to be decentralised, along with arrangements to allow wider scope to leverage private investment (as Transport for London has demonstrated so successfully). But where funds are retained at the centre, current appraisal processes need to be adapted to better appreciate and calculate the wider economic benefits that can be brought by public investment in infrastructure.

Recommendations:

- Northern leaders from both public and private sectors should identify and champion five big infrastructure priorities for the next two decades, and work with Network Rail, the Environment Agency and other relevant partners to ensure that detailed plans and business cases are worked up for each.
- The 2015 spending review and accompanying national infrastructure plan should commit the government to investing in and commencing these five major northern infrastructure priorities of the north within the five years to 2020.
- In line with the recommendations of the Armitt review, the 2015 spending review should be accompanied by the formation of a national infrastructure commission to make strategic decisions about the UK's transport infrastructure. This body should ensure that local economic growth is one of the primary criteria for all decision-making.

Research and development

As with infrastructure, there are also significant disparities in government spending on research and development (R&D).

The UK as a whole underinvests in R&D compared to other developed countries, spending £22.7 billion (1.8 per cent of GDP) from all sources, compared to the EU average of 2.0 per cent of GDP. Businesses spend by far the largest share of this (64 per cent of total R&D spending) followed by higher education institutions (25 per cent), research councils (9 per cent) and private non-profit organisations (2 per cent) (ONS 2013f). Government R&D expenditure is summarised in table 4.2.

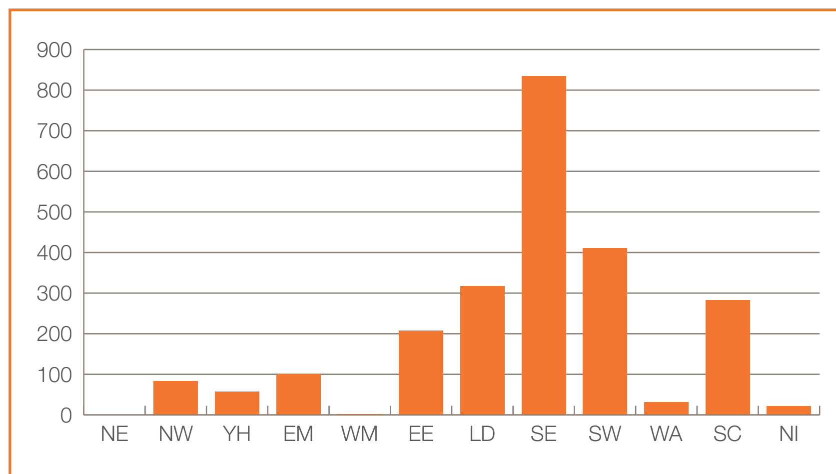
Table 4.2
Net government R&D expenditure by Frascati type of research activity, 2011/12 (£m)

		Research councils	Civil departments	Defence	Total
Basic:	pure	707	108	0	815
	orientated	1,211	163	0	1,373
Applied:	strategic	914	680	17	1,611
	specific	275	1,022	536	1,833
Experimental development		54	329	753	1,136
Total		**3,160**	**2,303**	**1,306**	**6,768**

Source: BIS 2013
Note: Figures include NHS, but exclude research councils' expenditure for pensions/other costs and higher education funding councils.

In addition to departments' own spending, the publicly funded research councils allocate spending via a peer-review process across all academic disciplines. However, as figure 4.1 shows, public R&D expenditure as a whole is very uneven across the country: in 2011, none of this expenditure went to the North East or to the West Midlands, while almost half (49.0 per cent) was spent in London and the South East.

Figure 4.1
Government R&D spend by region, 2011 (£m)



Source: ONS 2013f

As with infrastructure, this is another key area which could be used far more effectively by government. Government departments clearly need to base more of their R&D outside London and the South East. With regards to the research councils, the spending pattern follows a pattern of excellence, based on the peer-reviewed awards system, and so tends to become increasingly concentrated around specific institutions. There is clearly a degree of tension between having globally competitive, high-quality higher education institutions and distributing this crucial funding stream in more equitable ways; it would therefore be ill-advised to propose that all of this funding follows economic need. However, there are centres of excellence outside of London and the South East, and so there needs to be a mechanism in place to counter this inequality of funding without compromising on excellence.

Within Government R&D expenditure, there are three types of R&D (as broken down in table 4.2): basic research is primarily theoretical; applied research is directed toward a particular aim; and experimental development looks to improve materials or processes (University of Oxford Research Support 2011). From an economic development perspective, applied research is key. Government expenditure in this area totals £3.4 billion, consisting of spending by the primarily departments of Business, Innovation and Skills, Environment, Food and Rural Affairs, and Health. Hypothecating a proportion of this budget (in respect of the applied research component) to be spent outside of London and the South East would balance the need to rebalance funding geographically while ensuring that excellence is not compromised (Adams et al 2003). The government's science and innovation strategy, to be published alongside the 2014 autumn statement, provides the ideal opportunity to address this.

Recommendations:

- The 2015 spending review should introduce guidelines to ensure that research councils each move towards doubling the amount of applied research funding they spend outside of London, the South East and the East of England. This funding should be conditional on regional universities aligning their research with local economic priorities and building the institutions necessary to facilitate knowledge transfer into the wider local economy.
- In line with proposals made by IPPR's Commission on the Future of Higher Education (2013), the 2015 spending review should reallocate the £1 billion that is currently spent inefficiently on the R&D tax credit incentives and instead spend it on a network of 'applied research and innovation centres', especially in areas of below-average growth.[23]

C. Growth earnback

The principle that local authorities should benefit from the return of their own investments is firmly (albeit only recently) established in the Greater Manchester city deal through its so-called 'earnback'. This seeks to identify the increased tax return resulting from infrastructure investment by measuring the increased economic growth (GVA) that results. This is no simple task – measuring, let alone attributing economic growth at this level is particularly difficult – however, within the framework of city deals, financial agreements can be (and have been) made based on shared assumptions and the provision of sufficient evidence.

Earnback is a form of tax increment financing (TIF), which is rare in the UK but quite prevalent elsewhere – especially in the US, where it has been in use since the 1950s (see London Finance Commission 2013). This allows a local authority to borrow against the tax returns (business rates) it will make in future, by the increase in properties' rental values that results. This has clear risks – if the scheme is unsuccessful the debt will have to be repaid from other sources, and it is vulnerable to exogenous factors which affect rents (such as recessions and financial crashes). As such, the mechanism is inherently more favourable to areas which are resilient to economic shocks and have strong economic potential already.

In the UK, TIF has been heavily regulated – in many respects due to the failure of certain schemes in the US – but it is being used increasingly, and was recently rebranded as 'New Development Deals' by the government (see HM Government 2012). The Newcastle city deal allowed for Newcastle and Gateshead to benefit from the higher business rates that result from development, and similar projects have been granted in Sheffield and Nottingham. The case of Greater Manchester is unique, however, as taxation collected nationally (as opposed to local business rates only in the other schemes) is also factored in – up to £1.2 billion of investment will be rewarded up to a maximum annual 'earnback' of £30 million (GMCA and HM Government 2012). Recently, the London Finance Commission (2013) recommended that the government should reduce current restrictions on TIF and relax the conditions on local authority borrowing so that they can invest in infrastructure.

Given that the cities which have the greatest potential for growth also have the most dire poverty and unemployment (not least in London) the financing of growth could also be geared toward the relief of poverty. In the context of earnback, this means incentivising local government to achieve both the economic growth that results from investment, and

23 This would build on the development of 'catapult centres' by the Technology Strategy Board.

the employment growth that results from that. In practice, this would mean borrowing under arrangements similar to TIF and paying back the borrowing using the higher tax returns and lower benefit payments that accrue to the government.

In order to earn back, local government would have to provide evidence that their investment is working to support the unemployed into work in return for a payment from the government equivalent to the social security savings made. This approach is already established in part by the payment by results model (which forms a basis of both Work Programme and other public sector commissioning) and the community budget model of public service reform.

Given that investing in human capital – raising skill levels, particularly among the lowest-skilled – is recognised as one of the best ways to drive growth (OCED 2012), this provides the rationale for local involvement in the commissioning and delivery of the Work Programme or other forms of welfare-to-work activity. The community budgets approach is already being pursued in Greater Manchester with the ESA cohort of Work Programme participants, for whom the system of prime provider commissioning has demonstrably failed (Little 2013).

However, measuring the direct and indirect benefits of employment savings will always be an imprecise science, and so any negotiation should emphasise the possibility of agreement over finding a foolproof measurement. In this spirit, agreement will need to be found concerning the relative balance of risk in any growth earnback deal, with both HM Treasury and local areas agreeing to share a proportionate element of that risk. In the case of any failing authority, control would be re-centralised.

TIF-type schemes work best where natural economic areas and administrative boundaries align, therefore the combined authorities, which will be ready to take on this responsibility in at least five of the core cities' urban areas by the time of the 2015 spending review, would be the logical places to introduce a growth earnback model first.

Recommendation: Building on the principle and logic of 'earnback' and existing TIF approaches, the 2015 spending review should make provision for combined authorities to finance investment in infrastructure, employment and skills based upon the potential savings from increasing employment as well as the proceeds of GVA growth. This should extend from the direct fiscal benefit of successful employment programmes and skills interventions, to the indirect employment benefits of economic growth where they can be evidenced, and cover the cost savings made via all government departments.

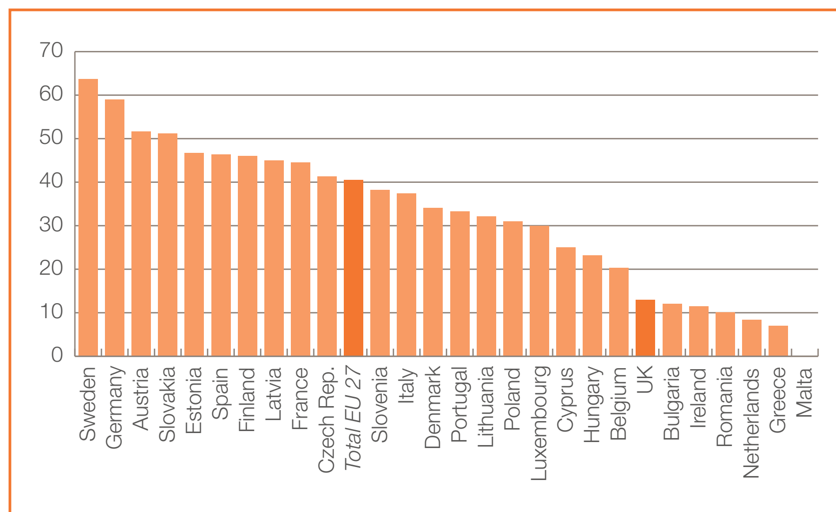
D. Tax and borrowing powers

While putting local government in charge of spending in its own geography would improve local economies, they would under the current system still be highly restricted by their dependency on grants from central government. The system of hypothecated grant-giving would ensure that this continues to be the case even if public expenditure was to increase, but the extremely difficult situation which local government has been put in by the government's spending decisions means that this issue is more urgent now than ever before. As such, the power to both levy taxes and borrow prudentially would greatly empower local government to improve their local areas over the long term, as well as provide the short-term flexibility which they need simply to remain viable.

In terms of local or regional taxation, the UK is something of an outlier: only 12.9 per cent of sub-national government expenditure (largely comprised of council tax, which is itself manipulated by centrally driven incentives to 'freeze' it) is raised from sub-national

taxation. This is one of the lowest rates of all EU-27 nations, and compares to a rate of 40.5 per cent across the EU 27 as a whole, as is summarised in figure 4.2. While the 'devolution dividend' is difficult to measure, the evidence suggests that aligning economic decision-making with natural economic areas will achieve more efficient and effective interventions (Cheshire and Magrini 2005, Steeples 2010). If decision-making and revenue-raising powers were more closely aligned, the sense of fiscal and social responsibility and accountability would be more direct. This creates stronger incentives to boost economic performance to increase revenue in turn.

Figure 4.2
Sub-national revenue as a proportion of sub-national tax, 2011 (%)



Source: IPPR North analysis of CEMR and Dexia 2013

Data points to local government doing a better job in the UK at controlling its expenditure than central government – local government is legally required to pass a balanced budget, and many are undergoing dramatic structural change in response to the financial settlement they have received. There is evidence to suggest that local government has a better track record on investment, whereas central government has chosen to favour consumption over investment (Travers 2012). In fact, David Cameron has acknowledged that:

> **'Local government is officially the most efficient part of the public sector. Councils achieve well in excess of the sector's spending review targets, beating central government savings by a country mile. That shouldn't surprise anyone – a pound spent closer is a pound spent wiser.'**
> Cameron 2009

While devolving significant place-based budgets and rebalancing economic investment spending would greatly benefit the north, greater tax-raising and borrowing powers at a sub-national level would provide much-needed flexibility and help to ensure that sub-national authorities are not quite so vulnerable to shrinking central government grants. While fiscal devolution can entail risks, the evidence suggests that LEP areas would benefit from having more revenue streams under their control (Slack 2013). It has been suggested that local government should be responsible for raising up to 50 per cent of its own revenue before equity concerns arise (ODPM Select Committee 2004). While a 50:50 split between central and local revenue-raising powers seems ambitious, there are various steps which could be taken to get closer to this target.

Recent reforms to business rates already allow for a proportion to be retained locally and for the proceeds of business rates growth to be kept by local authorities. However, as IPPR North has previously argued, local authorities should be able to set business rates within reasonable bounds, specifically, by restricting the amount that business rates can be increased to RPI plus half the size of any council tax increase. While the additional discounts, reliefs and cap for business rates introduced in the 2013 autumn statement have been welcomed by businesses, they greatly impinge upon local authorities' autonomy.

Currently. local authorities need to hold a referendum if they wish to raise bills by more than 2 per cent in any year. In a survey of chief executives and chief finance officers from 130 English councils, 80 per cent wanted to have full control over setting bills for the 2014/15 tax year (LGIU and the Municipal Journal 2013). Interference of this sort by DCLG limits not just local authorities' options but also their accountability to their respective electorates.

Elsewhere, the London Finance Commission has proposed the devolution of other property taxes, including council tax and, more controversially, stamp duty land tax (London Finance Commission 2013). The Silk Commission looking at which fiscal powers should be devolved to the Welsh government, among other measures, recommended the devolution of smaller taxes. Landfill and aggregates taxes may be minor terms of the revenues they raise but this represents a move in the right direction (Silk Commission 2012). The devolution of both of these taxes has been agreed to in the UK government's response to the Silk Commission (HM Treasury and the Wales Office 2013). In terms of population, Wales is not much bigger than Greater Manchester (and less than half the size of the North West). Government should therefore consider which minor taxes could be devolved to city-regions.

However, these smaller taxes are not particularly sensitive to the state of the local economy, and as a result will not work so well as incentives to city-regions to promote growth. The government has also accepted the Silk Commission's recommendation that sharing the income tax base would significantly enhance the Welsh government and provide a relatively stable revenue stream. Subject to a Welsh referendum, the UK government is proposing to devolve equivalent powers to those legislated for in the Scotland Act 2012. Under this arrangement, 10 percentage points of each UK tax rate would be due to the Welsh government, though still collected by HMRC. The Welsh government would also have the power to vary the basic, higher and additional rates of income tax (currently 20 per cent, 40 per cent and 45 per cent respectively) up or down in step with each other.

Devolving the ability to partially set income tax rates to sub-regional areas in England would be a step too far. However, there is a case for government to explore the possibility of assigning a small proportion of income tax to local government and slowly tapering the grants to them accordingly. It would have to be designed so that no local authority lost out at the outset, but would help sharpen the incentives for local government to play their part in boosting economic growth and job creation.

The precise details of such a scheme would need detailed appraisal, not least in identifying the best method to assess where income is earned. In addition, it would have to be reset at regular intervals – perhaps every 10 years – to ensure that certain poorer-performing areas did not fall too far behind. Again, combined authorities would be the most obvious starting place for piloting such reforms: trying to introduce such a change at a lower geographical level may be less effective as these areas would probably be too small to significantly influence economic growth and job creation.

This would mean that an extra £1.2 billion of revenue per year would be raised and retained by the five combined authority areas in total. In effect, approximately 8 per cent more sub-national government expenditure would be raised from sub-national taxation within these areas, helping to bring tax-raising powers closer to the aspiration of a 50:50 split between central and local government. If 10 per cent of income tax raised was retained by local areas, the proportion of sub-national government expenditure raised from sub-national taxation would rise to 20.8 per cent.

Increasing borrowing powers would also provide local government with an additional invaluable tool. The London Finance Commission has recommended that the government should distinguish between borrowing used to promote growth or reduce public expenditure (and which is therefore likely to be repaid) and other kinds of borrowing (London Finance Commission 2013). Sub-national levels of government should also be able to take independent borrowing and investment decisions within the limits of the prudential code and not subject to any further constraints. Combined authorities should also be able to determine which TIF projects to proceed with, again within the prudential borrowing code.

Recommendations:

As part of the 2015 spending review:

- Ten per cent of the income tax take in each of the combined authorities should be assigned to those authorities with a corresponding reduction in the central government grants to their constituent local authorities.
- Combined authorities should be able to take independent decisions on borrowing and investment within the limits of the prudential code and not subject to any further constraints.
- All local authorities should be given the power to set business rates, subject to restricting the amount that business rates can be increased to RPI plus half the size of any council tax increase.
- All local authorities should have full control over setting council tax bills, with the restrictions on raises over 2 per cent a year being lifted and a commitment by government not to interfere in council tax decisions. Local authorities should in addition be allowed to introduce new additional council tax bands as they see fit.
- Government should consider which minor taxes could be devolved to combined authorities. The taxes devolved should include landfill and aggregates taxes.

Ahead of the subsequent spending review, government should:

- Carry out a radical review of all property taxes, including assessing the benefits and risks of decentralising such taxes.
- Consider the feasibility of a wider roll-out of income tax assignment to areas outside of the combined authorities.

E. Business investment incentives

Urban policy in the UK is both patchy and marred by failure; historically, both political and antilocalist ideologies in national government have accentuated a general spatial blindness, which has real consequences for local government. The most notable example of this is enterprise zones policy, implemented since the 1980s in the UK and notably in the US and France; these have been resurrected by the current government despite wide acceptance of their failure (Larkin and Wilcox 2011). The challenges these were designed

to combat – of physical, largely urban decay – are now no longer the major priorities, with human capital taking a much more central place in economic development policy more generally.

However, this sorry history should not be allowed to taint the evidence that has been gleaned from these (very costly) experiments or to deter policymakers from learning from them. Notably, Larkin and Wilcox (ibid) have advocated 'local growth zones', which learn from the failure of enterprise zones, and set out a positive vision for policy in this area. Several recommendations follow from this work:

- Employer national insurance contributions (NICs) are a good candidate for tax incentives, as this would counter the fact that previous policies tended to benefit capital-intensive businesses and therefore had a limited impact on employment growth.
- The focus should be on skills not on urban decay – the challenges our urban areas face today are fundamentally different in nature to those that existed during the industrial decline of the 1980s.
- Inward investment should also be a focus, in order to avoid the displacement that occurred in many natural economic areas when enterprise zones were designated.

It is important to ensure that NIC discounts are not so broad in their scope that they are likely to create high deadweight costs by incentivising actions many firms would have taken anyway or because they simply lead to displacement. Targeting NIC at hires of specific types of worker can overcome this criticism.

Sissons and Brown (2011) also looked at the issue of enterprise zones, pointing out the ineffectiveness of tax breaks to stimulate investment, being expensive and poor at creating sustainable growth that hasn't simply been displaced from somewhere else. However, they recommend:

- making zones bigger, to avoid displacement
- accompanying them with skills and infrastructure interventions
- ensuring they are supported by local communities.

There is also evidence from the experience of enterprise zones in the UK that it is the inward investment element that is strongest (Potter and Moore 2000) as this avoids local displacement and creates a high proportion of resulting jobs.

At root, the evidence shows that the designation of small areas as sites for economic investment means working in direct opposition to the (often short-term) market forces which have driven businesses from such locations, and that this risks being an expensive and inefficient approach. The geography of these policies therefore becomes vital – not just in terms of the areas they cover but the decision-making bodies which oversee them. Insofar as there remains a *small-area* element to economic failure, it is not simply a lack of physical investment within the travel-to-work area of those who are unemployed or in low-paid work. Rather, the problem is two-fold and self-fulfilling: companies won't locate near a low-skilled, poorly connected workforce, and individuals lack the skills and connectivity to either benefit from or drive what economic growth is occurring.

Rather than ameliorating poverty with the one hand, and stimulating economic growth with the other – expecting the gains from business growth in one part of a natural economic area to benefit those in another without any intervention – local government

should be given the tools it needs to link the unemployed with the skills and jobs they need within a reasonable travel-to-work area. This approach requires working strategically to form policy within the natural economic geography in which businesses and employees already operate and to shape the decisions made by economic actors so that they have a social and long-term economic benefit.

Recommendations: The 2015 spending review should allow LEP areas, particularly those with the highest claimant to vacancy ratios, to 'apply for' the following incentives to encourage business investment (including foreign direct investment) based on presentation of a sufficiently strong business case.

- Employer NIC breaks and priority financing from a British Investment Bank (which would have regional structures)[24] for companies that hire harder-to-reach unemployed individuals (within terms to be defined locally).
- The responsibility for graduate retention within the natural economic area (in some but not all cases the LEP/combined authority area) and the authority to require universities to align their careers services with the local body in which they are based.
- The authority to compulsorily purchase, levy and/or develop the sites of urban decay that do persist for both housing and business use.[25]
- UKTI support (both financial and in terms of dedicated, seconded personnel) to attract inward investment to specific areas within reach of areas of persistent worklessness, when matched by skills and transport infrastructure investment.
- In those areas where this has not been already devolved, discretion over skills funding streams and the authority – whether conventionally existing within the remit of schools, further education providers, JobCentre Plus or Work Programme providers – to plug evidenced skills shortage vacancies and skills gaps via either direct or commissioned delivery, focused specifically on those who are out of employment for a long period, whether sustained or intermittent (low-pay no-pay cycles).

24 For more on this see Cox and Schmuecker 2013
25 See for example Wintour 2013

5. THE SPENDING REVIEW PROCESS

5.1 Current weaknesses and recent innovations in the spending review process

While each spending review is a lengthy process and involves huge amounts of effort, the current setup is a far from perfect. Some of its elements have arisen as much from circumstances as from systematic planning. Spending decisions, both large and small, have lacked a consistent process, transparent analysis and strategic oversight, and have been as much a result of human interactions as of objective consideration. Although there are internal HM Treasury practices that tend to feature in each fiscal event simply because they always have done so, there is in reality no set process for running a spending review.

For the 2010 spending review, however, several new processes were introduced. These were heavily influenced by examples of 'successful' fiscal consolidations overseas, not least the Canadian 'programme review' model. While HM Treasury was well used to taking a sceptical view of spending requests, it was not used to introducing swingeing cuts and so was eager to find a blueprint for doing this effectively.

The new elements of the spending review process included:

- **Distributional analysis:** For the first time, HM Treasury conducted a distributional analysis of the impact of the spending review, which was intended to show that the review had met the Coalition's key principle of fairness. This did have a limited effect on spending review outcomes: a few million were traded here and there to redress imbalances. But, as with impact assessments, this was conducted once policy had been decided. It was not done beforehand to explore which policy would have the best outcome, nor was it reviewed later in light of actual impacts.
- **Public engagement:** A programme of public engagement was launched to achieve buy-in from a range of audiences, including public sector workers and the public. The main components of this were:
  - The Spending Challenge: a website asking first public sector workers and then the wider public for ideas on how to save money. Overall, around 100,000 suggestions were received, the majority from public sector workers.
  - A series of high-level seminars covering major areas of spending to which a range of academics, private sector, charities and thinktanks were invited. Subjects included security, science, early years, local government, health and welfare. The chancellor or chief secretary chaired the seminars, and were given a standard briefing from spending teams, setting out the main issues and a few key questions to ask. They were attended by relevant ministers and Treasury officials but no department officials.
  - Regional engagement events: every minister was expected to submit suggestions for regional engagement events focusing on their departmental area.

  The engagement strategy had little or no impact on the final outcome. This was partly because the quality of responses, particularly to the Spending Challenge, was low. By contrast, the quantity of responses created a bureaucratic nightmare, and was more hindrance than help to departments and HM Treasury in the closing stages. The expert seminars tended to be used as an opportunity for special pleading, and did not uncover new ideas or evidence. The end result was that the legitimacy of the process was undermined even further: if nothing was to be done with the response then it would almost have been better not to ask the question at all.

- **Cross-Whitehall engagement:** The key instrument to engage Whitehall across departmental lines was the Independent Challenge Group (ICG), a group of senior civil servants (director-level or above) drawn from across Whitehall who were split into groups and tasked with delivering a report on how to achieve major savings from each departments. They were provided with background briefing on departmental spend and given confidential access to departments' starting offers. Reports from the group went directly to the chancellor.

Previous spending reviews have typically been subject to three key limitations:

- A siloed approach of settling each department individually means opportunities for greater efficiencies are missed, particularly in tackling issues that fall outside a single department's remit or where earlier intervention in one department could deliver longer-term savings across others.
- The spending review processes are closed and lack transparency, following the traditional HM Treasury approach of bilateral negotiation with departments, with impact assessments and evaluations carried out after the event.
- Even zero-based reviews tend towards grabbing the low-hanging fruit or relying on major efficiencies rather than strategically reorientating spending.

5.2 Improving the spending review process

A. Strategic oversight and governance

Treasury culture is difficult to change. To embed the suggestions we've made already, or to make any other similar moves to increase transparency and open up public spending decisions, strong governance is necessary. The 2010 spending review did introduce some changes, and the Coalition has made significant reforms to departmental governance, strengthening the role of non-executive directors and increasing the power of departmental boards. However, most changes have been made in order to drive through efficiencies and so have had only limited impact on wider strategic objectives, such as rebalancing the economy.

Recommendation: HM Treasury should identify a clear set of strategic outcomes for the 2015 spending review and challenge ministers and government departments to work together rather than compete in order to achieve them. Clear benefits need to be available to departments which come forward with collaborative proposals for change.

Our report has already recommended that HM Treasury should publish a spatial analysis of each spending review, budget and other major fiscal event. But to embed a culture change of this nature, there need to be wider reforms to fiscal governance and strategic oversight.

Establishing the OBR has been possibly the most significant change in terms of fiscal and monetary policy in recent years. Its remit could be extended further, however, with a greater concern for balanced, long-run growth and sustainable employment across the whole of the UK.

Recommendations

- The OBR's remit should be widened to include the assessment of the impact of policies on regional growth, unemployment and rebalancing the economy as part of its assessment of long-term fiscal sustainability.

- In addition, the OBR should publish regional economic forecasts of major economic statistics – unemployment, employment and GVA – as part of its economic and fiscal outlook release.

B. Impact assessment and public engagement

The government already has a range of processes in place to assess policy decisions, the majority of which are reported at some stage in the policy development cycle. These include business cases, which in turn will include the strategic case, appraisals of options and affordability, regulatory impact assessments (which will also include rural-proofing[26] of policies); health impact assessments; environmental appraisals; health and safety impact appraisals and consumer impact assessments.

However, analysis tends to be done after the decision has been made: it is a regular occurrence for the equality or regulatory impact assessment to be done once the policy is designed and ready to 'go live'. This is particularly true of spending reviews.

The next government should look to substantially overhaul this system. At a general level, trials should be carried out to investigate the role of open policymaking in ways that engage external experts, particularly academics, in an open, networked manner. For example, government could frame a problem in open terms, starting with data and hypotheses, and invite experts to validate and refine. As regards the spending review, it is proposed that plans are put in place well ahead of time for a more thorough impact assessment to be undertaken – including distributional and spatial impacts of the spending review – ahead of the 2015 iteration.

Government must also extend its effort to give a more central role to public and expert engagement in the 2015 spending review. The experience of the 2010 Spending Challenge shows that a mass engagement exercise is unlikely to work: even with better governance of the process, this kind of 'free for all' does not tend to drive high-quality responses. Instead, engagement must be done at the local or regional level – led by local government – and feed into the bigger picture. People should be provided with clear and accessible information such that they understand the trade-offs to be made, and have a sense of what is at stake.

This is by no means an easy task, but the temptation for HM Treasury will be to treat the exercise as a publically visible sideshow to a main event that takes place behind closed doors. If the spending review is to be a success not just in economic terms but also in terms of public legitimacy, this temptation must be resisted.

Recommendation: Ahead of the 2015 spending review, the government must support wider engagement in the deliberation process and carry out adequate impact assessment in advance. This should include, at the very minimum, having local government representatives at the negotiating table and engaged in direct and meaningful discussions with the chancellor and Treasury team.

C. Northern voice

It is clear that the current LEP/city 'free for all' is not giving areas of the north a sufficiently clear voice in Whitehall and Westminster. While the Core Cities grouping represents the five largest cities in the north, its influence is nothing compared to the clout of the London mayor or Scottish first minister, and even most core cities find it difficult to speak for

26 Rural-proofing requires policymakers to ensure that the needs and interests of rural people, communities and businesses are properly considered in the development and implementation of policies and programmes.

their entire city-region, let alone their wider hinterlands. Equally, while England's biggest cities have common aspirations in terms of the devolution of more economic investment funding, they have differing priorities in terms of which large infrastructure projects to fund. On transport, innovation and inward investment, LEP areas would all benefit from more strategic planning at a pan-northern level. While some LEP collaboration is already taking place, it is to a large extent ad hoc.

As a first step in a process of establishing a more clear and coherent northern voice, our NEFC proposed a Northern Leadership Convention to be held on an annual basis and supported by a small secretariat, followed by an N11 Leaders' Summit, comprising one political and one business leader from each of the 11 LEP areas in the north (see IPPR North and NEFC 2012).

The summit would be action-oriented, focused on developing strategies and plans to address the shared priorities identified during the convention. And it would be headed up by a northern chair, elected at the summit to serve for a period of four years, or alternatively a chair and vice-chair to rotate between LEP areas on an annual basis. It would produce a succinct communique to identify priorities for the year ahead.

The convention's discussions would be informed by a small secretariat, which would do preparatory work to ensure conversations are evidence-based and focused on a small number of genuinely pan-northern issues. These issues would then be discussed by public, private and voluntary sector leaders from across the north of England, building on the work of other organisations that already have a predominantly or entirely northern focus, such as Core Cities, SIGOMA and N8.[27] The convention is not intended as a representative body – it would provide an inclusive forum for debate, discussion and the formation of cross-LEP partnerships, and as a high-profile regular fixture in the calendar, would become a milestone for assessing northern progress. **Recommendation:** Political and business leaders from each of the north's 11 LEP areas should meet prior to the 2015 spending review with a view to setting out some clear spending review priorities for the whole of the north of England. This could be through an N11 Summit. They should then work together to lobby all political parties both in the run-up to the general election and in government immediately after.

27 See http://www.corecities.com/, http://www.sigoma.gov.uk/ and http://www.n8research.org.uk/, respectively.

REFERENCES

Adams J, Robinson P and Vigor A (2003) *A New Regional Policy for the UK,* London: IPPR. http://www.ippr.org/publication/55/1292/a-new-regional-policy-for-the-uk

Armitt J (2013) *The Armitt Review. An Independent Review of Long Term Infrastructure Planning Commissioned for Labour's Policy Review*, London: Labour Party. http://www.yourbritain.org.uk/uploads/editor/files/The_Armitt_Review_Final_Report.pdf

Bagaria N, Holland D and Van Reenen J (2012) *Fiscal Consolidation During a Depression,* special paper no 27, London: Centre for Economic Performance, London School of Economics and Political Science. http://cep.lse.ac.uk/pubs/download/special/cepsp27.pdf

BBC News (2008) 'City report 'insane' says Cameron', BBC News website, 27 November 2013. http://news.bbc.co.uk/1/hi/uk_politics/7558742.stm

Beatty C and Fothergill S (2013) *Hitting the Poorest Places Hardest. The Local and Regional Impact of Welfare Reform Data tables,* Sheffield: Centre for Regional Economic and Social Research, Sheffield Hallam University. http://www.shu.ac.uk/research/cresr/sites/shu.ac.uk/files/Welfare_Reform.xls

Bell V, Burriel-Llombart P and Jones J (2005) *A Quality-Adjusted Labour Input Series fort the United Kingdom (1975–2002),* working paper no 280, London: Bank of England. http://ideas.repec.org/p/boe/boeewp/280.html

Bhati N and Heywood J (2013) *Counting the Cost: the impact of spending cuts on the UK voluntary and community sector – 2013 update*, London: National Council for Voluntary Organisations

Brewer M, Gambin L, Joyce, R and Wilson R (2012) *Who Gains from Growth? Living standards in 2020*, London: Resolution Foundation. http://www.resolutionfoundation.org/media/media/downloads/Who_Gains_from_Growth_2.pdf

Butler P (2013) 'Council Spending Cuts: the North Loses Out to the South', *Guardian* Patrick Butler's Cut's Blog, 29 November 2013. http://www.theguardian.com/society/patrick-butler-cuts-blog/2013/jan/11/council-cuts-north-loses-out-to-the-south-newcastle

Cameron D (2009) 'Cutting the Cost of Politics', speech, 8 September 2009. http://centrallobby.politicshome.com/latestnews/article-detail/newsarticle/david-cameron-cutting-the-cost-of-politics/

Cheshire P and Maghrini S (2005) *European Urban Growth: Throwing Some Economic Light into the Black Box,* ERSA conference papers ersa05p13, European Regional Science Association. http://www-sre.wu-wien.ac.at/ersa/ersaconfs/ersa05/papers/13.pdf

Cooke G (2013) *No more NEETs: A plan for all young people to be learning or earning*, London: IPPR. http://www.ippr.org/publication/55/11516/no-more-neets-a-plan-for-all-young-people-to-be-learning-or-earning

Chote R (2013) 'Letter to the Prime Minister', 8 March 2013, London: Office for Budget Responsibility. http://budgetresponsibility.org.uk/wordpress/docs/Letter-from-Robert-Chote-to-Prime-Minister.pdf

Council of European Municipalities and Regions [CEMR] and Dexia (2013) *2010-2011 Edition of Key Figures on Local and Regional Europe*, Paris/Brussels. http://www.dexia.com/EN/news/in_short/Documents/part4-Nuancier2010_en.pdf

Cox E with Harrison M, Davies B and Turley A (2013) *Love thy neighbourhood: People and place in social reform*, Newcastle upon Tyne: IPPR North. http://www.ippr.org/publication/55/11478/love-thy-neighbourhood-people-and-place-in-social-reform

Cox E and Davies B (2013) *Still on the wrong track: An updated analysis of transport infrastructure spending*, Newcastle upon Tyne: IPPR North. http://www.ippr.org/publication/55/10933/still-on-the-wrong-track-an-updated-analysis-of-transport-infrastructure-spending

Cox E and Schmuecker K (2013) *Beyond big banks and big government: Strategies for local authorities to promote investment*, Newcastle upon Tyne: IPPR North. http://www.ippr.org/publication/55/10545/beyond-big-banks-and-big-government-strategies-for-local-authorities-to-promote-investment

Department for Business, Innovation and Skills [BIS] (2013) *SET Statistics 2013*, London. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/246231/13-499-set-statistics-2013A.pdf

Dobbs R, Smit S, Remes J, Manyika J, Roxburgh C and Restrepo A (2011) *Urban World: Mapping the Economic Power of Cities*, McKinsey. http://www.mckinsey.com/~/media/McKinsey/dotcom/Insights%20and%20pubs/MGI/Research/Urbanization/Urban%20world%20mapping%20economic%20power%20of%20cities/MGI_urban_world_mapping_economic_power_of_cities_full_report.ashx

Eddington R (2006) *The Eddington Transport Study – The Case for Action: Sir Rod Eddington's Advice to Government*, London: HMSO. http://www.thepep.org/ClearingHouse/docfiles/Eddington.Transport.Study%20-%20Rod.pdf

Estevão M and Samake I (2013) *The Economic Effects of Fiscal Consolidation With Debt Feedback*, Washington DC: IMF. http://www.imf.org/external/pubs/ft/wp/2013/wp13136.pdf

Eurostat (2013) *Eurostat Regional Yearbook 2013: Economy,* Luxembourg. http://epp.eurostat.ec.europa.eu/cache/ITY_OFFPUB/KS-HA-13-001-01/EN/KS-HA-13-001-01-EN.PDF

Financial Times (2013) 'Austerity Audit', *Financial Times*, 27 November 2013. http://ig.ft.com/austerity-map/

Greater Manchester Combined Authority [GMCA] and HM Government (2012) *Greater Manchester City Deal*, London. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/221014/Greater-Manchester-City-Deal-final_0.pdf

Hastings A, Bailey N, Besemer K, Bramley G, Gannon M and Watkins D (2013) *Coping with the cuts? Local government and poorer communities*, York: Joseph Rowntree Foundation and the University of Glasgow. http://www.jrf.org.uk/sites/files/jrf/local-government-communities-full.pdf

Heseltine Review (2012) *No Stone Unturned in Pursuit of Growth*, London: Department for Business, Innovation and Skills. http://www.bis.gov.uk/assets/biscore/corporate/docs/n/12-1213-no-stone-unturned-in-pursuit-of-growth.pdf

HM Government (2012) *Unlocking Growth in Cities: City Deals – Wave 1*, London. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/221009/Guide-to-City-Deals-wave-1.pdf

HM Treasury (2012) *Infrastructure Pipeline Data: 2012,* London. https://www.gov.uk/government/publications/infrastructure-investment-pipeline

HM Treasury (2013a) *Public Expenditure Statistical Analyses 2013*, London. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/223600/public_expenditure_statistical_analyses_2013.pdf

HM Treasury (2013b) *PESA 2013 Country and Regional Analyses (CRA) Interactive Tables*, London. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/223615/PESA_2013_Cm_CRA_Interactive_Table.xls

HM Treasury (2013c) *Spending Round 2013*, London. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/209036/spending-round-2013-complete.pdf

HM Treasury and the Wales Office (2013) *Empowerment and Responsibility: Devolving Financial Powers to Wales*, London. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/259359/empowerment_and_responsibility_181113.pdf

Hull A and Cooke G (2012) *Together at Home: a New Strategy for Housing*, London: IPPR. http://www.ippr.org/publication/55/9279/together-at-home-a-new-strategy-for-housing

IPPR Commission on the Future of Higher Education (2013) *A Critical Path. Securing the Future of Higher Education in England*, London: IPPR. http://www.ippr.org/publication/55/10847/a-critical-path-securing-the-future-of-higher-education-in-england

IPPR North (2013) 'Spending Review North: How does the 2013 spending review affect the regions of England?' presentation, 9 July 2013. http://www.slideshare.net/ippr/spending-review-north-final

IPPR North and the Northern Economic Futures Commission [NEFC] (2012) *Northern Prosperity is National Prosperity*, Newcastle upon Tyne: IPPR North. http://www.ippr.org/publication/55/9949/northern-prosperity-is-national-prosperity-a-strategy-for-revitalising-the-uk-economy

Katz B and Bradley J (2013) *The Metropolitan Revolution. How Cities and Metros are fixing our Broken Politics and our Fragile Economy*, Washington: Brookings Institution Press

Kane D and Mohan J (2010) *Mapping Third Sector Organisations in the North East*, Newcastle upon Tyne: Northern Rock Foundation

Larkin K and Wilcox Z (2011) *What would Maggie do? Why the Government's Policy on Enterprise Zones needs to be radically different to the failed policy of the 1980s*, London: Centre for Cities. http://www.centreforcities.org/assets/files/2011%20Research/11-02-25%20Enterprise%20Zones.pdf

Lessman C (2011) *Regional inequality and decentralization—an empirical analysis*, working paper no 3568, Munich: CESifo. http://ideas.repec.org/p/ces/ceswps/_3568.html

LGIU and the Municipal Journal (2013) 'Councils Demand Tax Freedom', press release, 28 February 2013. http://www.lgiu.org.uk/news/councils-demand-tax-freedom/

Little G (2013) 'Update on Community Budgets and Troubled Families', proceedings of the Manchester City Council Economy Scrutiny Committee, 16 October 2013. http://www.manchester.gov.uk/download/meetings/id/15709/5_update_on_community_budgets_and_troubled_families

London Finance Commission (2013) *Raising the Capital: The Report of the London Finance Commission,* London. http://www.london.gov.uk/sites/default/files/Raising%20the%20capital.pdf

Moretti E (2010) 'Local Multipliers', *American Economic Review: Papers & Proceedings*, 100: 1–7. http://emlab.berkeley.edu/~moretti/multipliers.pdf

Mulhern I with Davies G, Lambert R, Davis E, Corry D and Holtham G (2012) *Osborne's Choice: Combining Fiscal Credibility and Growth*, London: Social Market Foundation. http://www.smf.co.uk/files/2413/2968/6130/20120219_Osbornes_choice_final_final.pdf

National Council for Voluntary Organisations [NCVO] (2013) *UK Civil Society Almanac 2013*, London

Newcastle City Council (2013) 'Cuts by Local Authority, England', *Guardian* Patrick Butler's Cut's Blog, 29 November 2013. *http://www.theguardian.com/society/patrick-butler-cuts-blog/2013/jan/11/council-cuts-north-loses-out-to-the-south-newcastle#data*

ODPM: Housing, Planning, Local Government and the Regions Committee [ODPM Select Committee] (2004) *Local Government Revenue, Ninth Report of Session 2003–04*, volume I, HC402–1. London: House of Commons. http://www.publications.parliament.uk/pa/cm200304/cmselect/cmodpm/402/402.pdf

Office for National Statistics [ONS] (2012a) 'Regional Economic Indicators'. http://www.ons.gov.uk/ons/publications/re-reference-tables.html?edition=tcm%3A77-300556

Office for National Statistics [ONS] (2012b) 'Regional Gross Value Added (Income Approach), reference tables'. http://www.ons.gov.uk/ons/publications/re-reference-tables.html?edition=tcm%3A77-265236

Office for National Statistics [ONS] (2012c) 'Regional Gross Value Added (Income Approach)'. http://www.ons.gov.uk/ons/dcp171778_291684.pdf

Office for National Statistics [ONS] (2013a) 'Annual Population Survey, Jan 2012-Dec 2012', accessed 11 November 2013. http://www.nomisweb.co.uk/

Office for National Statistics [ONS] (2013b) 'Regional Economic Analysis, Subregional Productivity, April 2013'. http://www.ons.gov.uk/ons/publications/re-reference-tables.html?edition=tcm%3A77-303281

Office for National Statistics [ONS] (2013c) 'Mid-Year Population Estimates', accessed 29 November 2013. http://www.nomisweb.co.uk/

Office for National Statistics [ONS] (2013d) 'Labour Market Statistics November 2013, Workforce Jobs by Region and Industry'. http://www.ons.gov.uk/ons/publications/re-reference-tables.html?newquery=*&newoffset=&pageSize=50&edition=tcm%3A77-283783

Office for National Statistics [ONS] (2013e) 'Quarterly National Accounts Q2 2013'. http://www.ons.gov.uk/ons/publications/re-reference-tables.html?edition=tcm%3A77-302051

Office for National Statistics [ONS] (2013f) 'UK Gross Domestic Expenditure on Research and Development, 2011, reference tables'. http://www.ons.gov.uk/ons/rel/rdit1/gross-domestic-expenditure-on-research-and-development/2011/stb-gerd-2011.html

Office for National Statistics [ONS] (2013g) 'Public Sector Finances, April 2013'. http://www.ons.gov.uk/ons/dcp171778_309625.pdf

Organisation for Economic Cooperation and Development [OECD] (2012) *Promoting Growth in All Regions: Lessons from across the OECD,* Paris. http://www.oecd.org/site/govrdpc/49995986.pdf

Organisation for Economic Cooperation and Development [OECD] (2013a) 'Stat Extracts: Labour Statistics'. http://stats.oecd.org/Index.aspx?DataSetCode=REG_LAB_TL2

Organisation for Economic Cooperation and Development [OECD] (2013b) 'Stat Extracts: Regional Accounts', Paris. http://stats.oecd.org/Index.aspx?DataSetCode=REG_LAB_TL2

Oxford Economics (2012) *London's Finances and Revenues*, London: City of London Economic Development. http://www.cityoflondon.gov.uk/business/economic-research-and-information/research-publications/Documents/research-2012/Londons_finances_and_revenues_OnlineVersion.pdf

Parkinson M, Meegan R, Karecha J, Evans R, Jones G, Tosics I, Gertheis A, Tönko A, Hegedüs J, Illés I, Sotarauta M, Ruokolainen O, Lefèvre C and Hall P (2012) *Second Tier Cities in Europe: In An Age of Austerity Why Invest Beyond the Capitals?* Liverpool: ESPON & European Institute of Urban Affairs and Liverpool John Moores University. http://www.ljmu.ac.uk/EIUA/second-tier-cities/index.htm

Pissarides C (2010) 'George Osborne has exaggerated and it could cost us 1 million jobs', *Daily Mirror*, 27 November 2013. http://www.mirror.co.uk/news/uk-news/george-osborne-has-exaggerated-and-it-could-cost-256103

Potter J and Moore B (2000) 'UK Enterprise Zones and the Attraction of Inward Investment', *Urban Studies,* 37(8): 1279–1312, 2000. http://www.ied.co.uk/images/uploads/Enterprise_Zones__inward_investment.pdf

Schmuecker K (2011) *Can the Big Society be a Fair Society? A North East perspective*, Newcastle upon Tyne: IPPR North. http://www.ippr.org/publications/55/1840/can-the-big-society-be-a-fair-society-a-north-east-perspective

Simmie J and Carpenter J (2008) 'Towards an Evolutionary and Endogenous Growth Theory Explanation of Why Regional and Urban Economies in England are Diverging', *Planning, Practice & Research*, 23(1): 101–124

Sissons A with Brown C (2011) *Do Enterprise Zones Work?* London: The Work Foundation. http://www.theworkfoundation.com/assets/docs/publications/283_enterprise%20zones_24%20feb_final.pdf

Slack E (2013) *International Comparison of Global City Financing,* London: London Finance Commission. http://www.london.gov.uk/sites/default/files/LFC%20International%20comparisons.pdf

Steeples P (2010) *City-Region Governance, Policy Variation and Economic Performance*, SERC policy paper no 5, London: Spatial Economics Research Centre, London School of Economics and Political Science. http://www.spatialeconomics.ac.uk/textonly/SERC/publications/download/sercpp005.pdf

Travers T (2012) *Local Government's Role in Promoting Economic Growth: Removing Unnecessary Barriers to Success,* London: Local Government Association. http://www.lgcplus.com/Journals/2012/11/30/v/f/d/Local--governments--role--in---promoting--economic--growth.pdf

UK Commission for Employment and Skills [UKCES] (2011) 'Table A2.5 GVA growth, actual and forecast as %pa', *Almanac Online*. http://almanac.ukces.org.uk/context/A2/A2.5_GVA_Growth_Forecast.xls

University of Oxford Research Support (2011) 'Frascati Definition of Research', Oxford University website, 27 November 2013. http://www.admin.ox.ac.uk/researchsupport/applying/frascati/

Wintour P (2013) 'Ed Miliband issues warning to developers over 'hoarding' of land', *Guardian*, 27 November 2013. http://www.theguardian.com/society/2013/jun/21/ed-miliband-developers-hoarding-land

Wren-Lewis S (2013) 'The 'Official' Cost of Austerity', Mainly Macro website, 2 December 2013. http://mainlymacro.blogspot.co.uk/2013/10/the-official-cost-of-austerity.html

ANNEX
THE 2015 SPENDING REVIEW AND THE VOLUNTARY SECTOR

The impact of spending cuts on the voluntary sector

As part of our spending review analysis, IPPR North agreed to consider the implications of any future spending reviews on the voluntary and community sector. This analysis was based on four assumptions about the impact of public sector spending cuts:

1. Cuts will have a direct effect on those voluntary organisations that receive statutory funding to provide their services.
2. There will also be an indirect effect on these organisations, as people turn to voluntary providers for services that had previously been delivered by statutory providers.
3. This will lead to a greater demand on non-statutory voluntary sector funders, including trusts and foundations.
4. Each of these impacts will vary from place to place, just as public spending is not distributed evenly.

It has proven incredibly difficult to find categorical evidence to support any of these assumptions. This is not to say that they are not true, but rather that there is a real lack of timely data about the state of the voluntary sector with which to carry out a proper analysis.

Perhaps the most rigorous assessment of the impact of the cuts on the voluntary sector is the NCVO's *UK Civil Society Almanac 2013* (NCVO 2013) and their subsequent analysis in *Counting the Cuts* (Bhati and Heywood 2013). However, both depend upon survey data from 2010/11 (the last year for which this data is available) from which it makes calculated projections. Some of the key findings and projections include:

- Voluntary sector income from government in 2010/11 stood at just over £14 billion, representing around one third of all voluntary sector income. Over £11 billion of this sum took the form of contracts and fees, primarily to large and major voluntary-sector bodies. Small and micro community organisations account for just over £360 million (2.5 per cent) of statutory spending on the voluntary sector.
- The change in the voluntary sector's income from government between 2009/10 and 2010/11 largely mirrored the pattern of total government spending – a small decrease in real terms. If the same pattern held into the future, one would expect the sector's income from government to be £1.7 billion lower by 2017/18 than in 2010/11 (using 2010/11 prices).
- There is a great deal of evidence to suggest that the voluntary sector is actually being hit disproportionately relative to other public service providers by public spending cuts – particularly in relation to local government spending – and that many organisations are struggling to capitalise on opportunities around the commissioning, social finance and public sector reform agendas.
- Smaller community organisations that receive funding from local authorities are more likely to receive disproportionate cuts than larger charities which have more opportunities to exploit new contracts and commissioning processes.

Beyond the NCVO's publications, the only more recent data available is charity returns for the year 2011/12. Preliminary analysis by the Third Sector Research Centre at the University of Southampton suggests that there was a sharp increase in the proportion of voluntary organisations experiencing declining incomes after 2008/09, and that this proportion though it has plateaued after 2009/10, remains high.[28]

28 This research is as yet unverified and unpublished.

One particularly interesting point to emerge from the Third Sector Research Centre's research is the fact that there appears to be some interesting regional patterns emerging, particularly among larger voluntary organisations (those with a turnover of more than £500,000 per annum). In London, the south east and the east of England it would appear that there was something of a recovery in 2011/12, while in other regions the proportion of voluntary organisations reporting a fall in income of 25 per cent or more continued to grow. A similar pattern emerges for voluntary organisations reporting *any* fall in income – it would seem, for instance, that by 2011/12 nearly 70 per cent of all voluntary groups in the North of England were reporting falls in their income.

Although this data has yet to be thoroughly verified and published, it does not come as a surprise. In earlier work carried out as part of the Northern Rock Foundation's Third Sector Trends Study, nearly half of all charities in the North East and Cumbria, for example, were found to depend on statutory funding, compared with a UK average of 38 per cent (Kane and Mohan 2010). In IPPR North's previous work we have demonstrated that Northern regions have significantly fewer large voluntary organisations with the capacity to compete for public service contracts, and that philanthropy is disproportionately distributed towards London and the South East (Schmuecker 2011).

In summary, although there is a distinct lack of data, it is unsurprising that the voluntary and community sector is feeling the direct and indirect impact of public spending cuts, and that – in line with the wider patterns – some parts of the country appear to be faring worse than others.

Recommendation: Government and ONS should work with the Charities Commission, the NCVO and the Third Sector Research Unit to ensure that more accurate and timely information is made available about the state of the voluntary and community sector.

Implications for the 2015 spending review

Given the close relationship between the voluntary and community sector and the public sector, the prospect of further cuts to public spending might suggest a counsel of despair – particularly among smaller organisations in more deprived areas and Northern regions. This need not be the case.

In a special workshop organised to complement this research, IPPR North brought together some of the most progressive thinkers from the sector to discuss its future prospects. While there was plenty of anecdotal evidence about reduced services and increased demand, there was also a good deal of optimism about the voluntary sector's involvement in the task of public sector reform. Some of the ideas that were shared included:

- The voluntary sector plays a crucial role in identifying and challenging areas of 'failure demand', where public funding is being used to mop-up service failure in other parts of the system. It can then become a 'catalyst of systems change' to support public sector reform and cost savings rather than cuts.
- Rather than adopt a 'scarcity paradigm' in relation to public funding, the voluntary sector can lead the way in developing 'asset-based approaches' that focus on a wider range of resources – public, private and social. This could create a foundation for a more relational and user-led approach to service provision.
- There is significant scope for developing more effective long-term relationships between statutory and voluntary agencies that work at the neighbourhood level, which could deliver real savings. At present, both public and non-statutory funding can be wasted through duplicated effort and disconnected approaches to funding.

- Statutory agencies could make major improvements to commissioning and procurement practices, particularly by recognising and accounting for the social value and innovative practice derived from voluntary-sector service delivery.
- Much more could be done to support philanthropy and social finance as potential means of mitigating public sector funding cuts, and grant providers could be more co-ordinated in supporting voluntary and community organisations that are facing rising demand for their services.
- It is easy to overlook the importance of small-scale funding – not least grants and core funding for smaller organisations. However, this can often be the lifeblood of vibrant and cohesive local communities, and can save the exchequer millions by preventing neighbourhoods from slipping into spirals of decline.

Each of these points suggests that the voluntary and community sector, if represented in an appropriate manner, could bring a transformative voice to spending review negotiations.

Recommendation: Alongside proposals for wider public and local authority engagement in the 2015 spending review, government should identify and involve voluntary sector representatives from across the spectrum to share ideas and concerns about the possible impacts of the spending round and the opportunities if offers for public sector reform.