Centre for Cities' reaction to the
Emergency Budget

Kieran Larkin, June 2010

The Emergency Budget has set out a tough new package of spending cuts and tax increases. In its 'unavoidable' Budget, the Coalition provided the headline details on how it will reduce the deficit. It also began to outline its vision for how it intends to rebalance the economy.

We have identified three major themes relevant to cities: tough spending cuts, rebalancing the economy, and the abolition of RDAs.

Tough spending cuts

The Emergency Budget set out just how difficult the spending climate is going to be over the course of this Parliament. The discretionary fiscal consolidation of £128 billion by 2015-16 is eye-watering. Spending cuts will account for 77 percent of this. So, by 2015-16 the public sector will be spending £99 billion less per year than it is now. That's more than the Government currently spend per year on the entire education system (£89 billion).

Cuts to departmental budgets (excluding health) of up to 25 percent will inevitably result in significant public sector job losses. We have previously said that 290,000 jobs could be lost[1], but other analysis puts this figure closer to 500,000.

Some cities are looking more vulnerable to public sector job losses than others, including places like Hastings, Newcastle and Barnsley. In these cities it's unlikely that the private sector will grow quickly enough to offset losses from the public sector.

It's positive that the Government has recognised the importance of capital investment and hasn't made further cuts to this budget, but the cuts pencilled in by Labour were already substantial and could still be very damaging. Net investment is scheduled to fall from £49 billion in 2009-10 to £20.9 billion (or 1.1 percent of GDP) in 2015-16. There's clearly a risk that this will impact on economic performance because it means we'll be spending much less on the transport investments that can be so crucial in unlocking growth.

Given the tight fiscal settlement, it will be important that the Government's appraisal process identifies those projects that generate the biggest economic return. In this context, the Government should probably think twice before giving light rail schemes extra weight in transport appraisals. These kind of schemes tend to be hugely expensive and they often aren't the most useful transport upgrades for a city's economy. Research has shown that smaller scale projects can be much more cost effective and these should probably remain the key focus for transport investment.

Rebalancing the economy

The Chancellor reiterated the Government's desire to rebalance the economy by promoting private sector growth outside London and the South. Unfortunately, as our recent *Private Sector Cities*[2] report showed, a fundamental rebalancing of private sector activity will be very difficult to achieve.

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1. *Larkin K (2009) Public Sector Cities: Trouble ahead London: Centre for Cities*
2. *Webber C & Swinney P (2010) Private Sector Cities: a new geography of opportunity London: Centre for Cities*

Indeed, the Chancellor acknowledged the scale of the challenge when he quoted one of the key statistics we used in that paper: for every new private sector job created in the North and Midlands between 1998 and 2008, ten were created in London and the South.

It's more complicated than a straightforward North-South divide. But as we argued in the report, major long term trends like globalisation and technological change have made some areas of the country much better placed to generate private sector jobs. Labour spent billions trying to counteract this shift, but the results were disappointing.

With much less money to spend, the Coalition will find the task of rebalancing even more difficult. For example, while the National Insurance employer contribution intervention may help to increase enterprise rates in the North, we would expect that its overall impact will be marginal – partly because this kind of tax break will suffer from a large amount of 'deadweight loss'. A lot of the businesses who end up benefiting from the incentive would probably have started up anyway so the money could be wasted.

Overall, the NICs incentive is probably best viewed as a policy that the Coalition can use to claim that they are taking action, rather than a policy that will radically impact on business growth.

As we argued in *Private Sector Cities,* what the Government really needs to do to support private sector jobs growth, and help people access the opportunities being generated, is to physically expand buoyant economies that are creating private sector jobs. It is vital that the Government's White Paper on sub-national growth, to be released later this summer, recognises this and puts forward a set of policies that allow the housing supply to be expanded in places like Cambridge, Bristol and Oxford.

The abolition of Regional Development Agencies

Finally, it's good to see the Government announce more detail on the future of Regional Development Agencies (RDAs) and its plans for Local Enterprise Partnerships (LEPs). RDAs will definitely be abolished, and it's helpful for cities that after months of confusion this has finally been cleared up. We think LEPs are a positive development as they will move decision making into line with real economic areas.

The Budget indicated that the creation of LEPs will be particularly supported 'around England's major cities'. We think this is a good idea – cities are the drivers of the UK economy and our big cities tend to be the ones with the most complex governance arrangements. The Budget also suggested that LEPs will be led by locally-elected leaders, which seems sensible as they will be democratically accountable.

It also seems likely that 'strong' LEPs will have a range of powers – with the Budget listing transport, housing, skills, regeneration and other areas of economic development. LEPs will not be limited to overseeing the remaining RDA programmes. This is important as the nominal 'RDA budget' will be fairly small during the next Spending Review period and cities need to be able to coordinate a range of other levers to ensure that they can support economic growth.

Given that LEPs have now been given the go ahead, local authorities are going to need to start planning which other local authorities they want to be in an LEP with, which business leaders might be suitable to join and what powers they want their LEP to exercise. The Government needs to think about the transition to LEPs, with some areas – such as Greater Manchester and Leeds, which were developing plans as statutory city regions – ready to move more swiftly than others.

Emergency Budget detail

Headline announcements

In addition to the £73 billion of fiscal tightening announced by Labour, the Coalition has announced an additional £32 billion worth of spending reductions and £8 billion worth of net tax increases, by 2014-15.

This will bring the current structural budget into surplus in 2014-15 – a year ahead of the timescale required by the new fiscal mandate (the new name for the fiscal rules). Under the current plans, net debt is also due to be falling by 2014-15 – that's the other part of the fiscal mandate.

As a result of the lower levels of public spending, growth forecasts have been revised down by the Office for Budget Responsibility.[3] The new growth forecasts are: 1.2 percent growth in 2010, 2.3 percent in 2011 – almost a full percentage point below the March Budget forecast of 3.25 percent – and with growth hovering between 2.7 percent and 2.9 percent, thereafter.

Spending cuts

In terms of spend on frontline services, in addition to the £44 billion worth of cuts to the current departmental spend that the previous Government had outlined, the Coalition is planning an additional £17 billion worth of cuts.

The Coalition has announced that, as health spending will continue to increase in real terms and spending on overseas development will also be increased, other departments could face a cumulative fall in their budgets of 25 percent, by 2014-15. We will find out what the individual departments will receive in the Spending Review, which will take place on 20 October 2010.

An extensive package of welfare reforms has been put forward, including reforms to the working tax credit and housing benefit. All benefits, except the state pension, will now be linked to the Consumer Price Index rather than the Retail Price Index. In combination these changes will generate £11 billion worth of savings.

Capital spending will see no further reductions beyond the cuts announced by Labour, except for the £2 billion savings made as part of the £6.2 billion worth of cut outlined for 2010-11, in May. This lower profile of capital spending will be repeated in subsequent years.

Policy implications for cities

The Budget made a number of policy announcements that are very important to cities. It included a whole section on '*Growth in all parts of the UK*'. This is part of the Coalition's attempt to 'rebalance the economy'. To help support regional growth the Government will:

- Allow new businesses, set up outside of the Greater South East, to gain a reduction on their **National Insurance (NI) employer contributions**. In its first year, a new business will not have to pay the first £5,000 of NI contributions, for each of its first 10 employees. This could result in a potential £50,000 saving for firms. The scheme is due to start running in September 2010, will run for three years and is projected to cost £940 million. Qualifying businesses can benefit immediately.
- Create a **Regional Growth Fund** for 2011-12 and 2012-13 to fund capital projects that support business and employment growth. In part, this fund will be part of the RDA transition process.
- **Publish a White Paper** later in the summer to set out the new Government's plans for a new approach to sub-national growth.

3. A straight comparison is not entirely fair due to the way the growth forecasts are calculated

The Government also finally confirmed that **RDAs will be abolished** through a Public Bodies Bill, to be replaced by strong Local Enterprise Partnerships. These will improve coordination over transport, housing, skills, regeneration and economic development. Further detail is expected in the White Paper this summer.

A simplified planning consent regime will also be looked at in areas where there is the potential or a need for business growth. This will be achieved through the use of Local Development Orders.

Finally, subject to the agreement of local authorities, Council Tax will be frozen for one year, in 2011-12, with local authorities being compensated in return for keeping their costs down.

Other major policy implications

Other policy announcements that will directly impact on cities, in the Budget were:

- VAT will be increased to 20 percent from 4 January 2011.
- The main rate of corporation tax will be reduced by 1 percent per year for four years, from 28 percent to 24 percent. Capital Allowances will be reduced a bit to offset this cut.
- There will be a two year pay freeze for all public sector workers earning more than £21,000. This will save £3.3 billion a year by 2014-15.
- The Government will establish the body Infrastructure UK (IUK) which will plan and deliver for the long term infrastructure needs of the UK. IUK will publish a national infrastructure plan in the autumn.

Private Sector Cities: A new geography of opportunity is available to download from **www.centreforcities.org/privatesectorcities**

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