The implications of the Spending Review for cities

Kieran Larkin, October 2010

The Spending Review gave us the detail on how the Government intends to reduce its £109 billion structural budget deficit. The impact of the cuts will certainly fall heavily on all cities. However, it was pleasing that the Spending Review focused not only on cuts but also on how Government spending could support long term growth, in which cities – home to 75 percent of the UK’s private sector jobs – will need to play a key role.

The major announcements for cities in the Spending Review included:

• a larger public investment budget;
• an extension to the Regional Growth Fund;
• some protection for the transport budget; and
• greater spending freedoms for local authorities.

The Centre for Cities suggested many of these policies in our Spending Review submission.

Impact on jobs

The Spending Review sets out a demanding package of fiscal consolidation. By 2014-15, £81 billion of spending cuts will be made and result in 490,000 public sector job losses, according to the Office of Budget Responsibility's calculations. While some cities, such as Barnsley, Newcastle and Swansea, are more vulnerable to public sector job losses than others all cities will be affected. Public sector job losses will result in further private sector losses, which could reach half a million over the same period. The public sector workers that remain will face a two-year pay freeze and higher pension contributions, reducing the money that they will spend on the high street in local economies – further affecting the private sector.

The Chancellor has asserted that the private sector will be able to shoulder the burden of public sector job cuts – citing that the economy has created 178,000 jobs in the last three months alone. However, 143,000 of those jobs (80 percent) were in part time employment. In the years ahead, the economic recovery cannot be sustained by a workforce operating on reduced hours.

Capital budget

The Government added up to £2.3 billion per year to the capital budget, compared to its June Budget projections, boosting gross investment from a planned £44.9 billion in 2014-15 to £47.2 billion. Interestingly, this takes the investment budget back to Labour’s planned expenditure in its March budget, with the coalition having taken out £2 billion per year from capital spending as part of the initial cuts announced in May.

Nevertheless, public investment still faces savage reductions. Net investment (i.e. accounting for the money spent on doing up existing infrastructure) will fall by 46 percent in real terms between 2010-11 and 2014-15. In 2014-15, net investment will be just 1.3 percent of GDP.
Education, skills & universities

The spending reductions have favoured the policy areas most likely to boost long term economic growth – a good thing. The education budget, a key driver of growth, got off relatively lightly – with the current spending going to schools seeing a real terms increase of 0.1 percent per year, between 2010-11 and 2014-15.

New money was also found for adult apprenticeships. Spending on adult apprenticeships will be increased by £250 million per year by 2014-15 and there will be a new loans system to fund students, aged 24 and over, studying for an A-level equivalent qualification. Train to Gain will be abolished and student fees introduced as part of a drive to lower the cost of further education.

It seems that many of Lord Browne’s proposals on university funding have been accepted. As a result, there has been a significant cut to government spending on universities, to be offset by the introduction of higher graduate contributions. The cost to Government of higher education will be reduced by 40 percent.

Transport

The transport budget also did better than expected – this is another positive for long term growth. Total spending by the Department for Transport will fall by 15 percent in real terms between 2010-11 and 2014-15. However, as a share of the total capital budget, spending on transport in England will rise from 15 percent in 2010-11 to 19 percent in 2014-15. Increasing the share of the capital budget spent on transport was something that we argued for in our Spending Review submission.

Key projects like Crossrail, which is vital for sustaining London’s economic growth and also impacts on jobs in other cities’ economies, have also been safeguarded, but the call for efficiencies to be found on Crossrail suggests that the final plans for the route could still be altered.

On the other hand transport funding to local authorities is set to be cut by 28 percent, bus subsidies to operators will be reduced by 20 percent, and rail fares are set to rise by three percent above inflation. These changes will put pressure on local transport systems, cut the number of bus routes serving less commercially viable areas (which is likely to have implications for connecting people to employment), and may reduce commuting via rail in big cities outside of London. No reduction will be made to concessionary fares – possibly a missed opportunity.

Regional Growth Fund

The Government has also enlarged the Regional Growth Fund, extending it by one year and adding £420 million to the pot. Again, this is an idea that we suggested in our Spending Review submission.

The Regional Growth Fund is clearly not going to transform the country’s economic fortunes – in its entirety it’s still only the same size as the RDA budget for this year (£1.4 billion). But, if spent on the right things and in the right places, it could unlock investment in projects that boost private sector jobs growth. Unfortunately, the balance of spending is actually more on the resource side than the capital side – with 59 percent of the Regional Growth Fund allocated to resource expenditure. Ideally it would be capital projects, such as the infrastructure needed to allow buoyant cities to expand, that the Regional Growth Fund would be spent on.

1. Using the RPI measure - which was dropped as the measurement for almost all other benefits in the June Budget.
Table 1: Profile of Regional Growth Fund expenditure (2011-14)

<table>
<thead>
<tr>
<th></th>
<th>2011-12</th>
<th>2012-13</th>
<th>2013-14</th>
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<tbody>
<tr>
<td>Resource (£m)</td>
<td>215</td>
<td>205</td>
<td>420</td>
</tr>
<tr>
<td>Capital (£m)</td>
<td>280</td>
<td>300</td>
<td>-</td>
</tr>
<tr>
<td>Total (£m)</td>
<td>495</td>
<td>505</td>
<td>420</td>
</tr>
</tbody>
</table>

Source: HM Treasury

Housing

The housing budget has come under severe pressure in the Spending Review. To a certain extent we would recognise that this has been necessary in order to protect other area of spend. The Communities and Local Government’s departmental budget will be cut by 68 percent in real terms between 2010-11 and 2014-15.

The department’s capital budget, the major source of housing expenditure, will be cut by 74 percent in real terms – from 6.8 billion in 2010-11 to 2.0 billion in 2014-15. As a result, just £6.5 billion will be spent on housing during the spending review period, with £4.5 billion spent on affordable homes. To offset these cuts social landlords will be able to charge new tenants intermediate rental contracts, priced between current market and social rents. These are expected to be around 80 percent of market rents.

As a result of the change to social landlord rents and the housing expenditure that will continue (albeit reduced), the Government expects to be able to deliver 150,000 new affordable homes over the Spending Review period. By comparison, 207,000 affordable houses were completed between 2006 and 2010.

Business support

Little detail was given on future business support polices in the Spending Review. The Government has earmarked £200 million per year by 2014-15 to be spent on supporting manufacturing and business development, with a focus on potential high growth firms. The money will also be used to fund a network of technology and innovation centres.

We welcome the recognition of the importance of high growth firms, but would question the prioritisation of manufacturing. While the sector is an important and large part of the economy – accounting for 12 percent of Gross Value Added – we do not believe that there is a strong economic case for manufacturing to warrant special government support relative to other sectors in the economy. We also think that manufacturing is highly unlikely to be a significant net generator of jobs.

The Government has also ringfenced £4.6 billion per year to be spent on science and research to support innovation. This will maintain spending on this area in cash terms. Government support will include expenditure on projects like the Diamond Synchrotron facility in Oxfordshire.

Tightening welfare

A defining feature of the Spending Review was the decision to extract bigger savings from welfare expenditure, to limit the pain to public services. The Spending Review added £7 billion worth of welfare savings to the £11 billion originally set out in June’s emergency Budget. Crunching down on the welfare bill will have big implications for all cities but particularly those with high shares of residents claiming benefits.

2. However, £1.6 billion (18 percent) of the total reduction is a devolution of resources to local government
The Spending Review made new cuts to Employment and Support Allowance (ESA), Housing Benefit, Council Tax Benefit and the Working Tax Credit. **One of the biggest savings will come from a decision to limit the ability of individuals to claim the contributory element of ESA linked to work to one year.** This change is expected to bring in £2 billion in 2014-15. ESA is the long-term out of work benefit that replaced Incapacity Benefit in 2008. The change to ESA will hit cities like Blackburn, Burnley and Liverpool where at least two percent of the working age population are in receipt of this benefit. Many of these places are cities that have already been hit hard by job losses during the recession (see our City Tracker website).

**Table 2: Cities with largest share of ESA claimants (February 2010)**

<table>
<thead>
<tr>
<th>Rank</th>
<th>PUA</th>
<th>Total ESA claimants</th>
<th>ESA claimants as % of WA population</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Blackburn</td>
<td>2,000</td>
<td>2.3%</td>
</tr>
<tr>
<td>2</td>
<td>Burnley</td>
<td>2,400</td>
<td>2.2%</td>
</tr>
<tr>
<td>3</td>
<td>Liverpool</td>
<td>10,400</td>
<td>2.0%</td>
</tr>
<tr>
<td>4</td>
<td>Sunderland</td>
<td>3,700</td>
<td>2.0%</td>
</tr>
<tr>
<td>5</td>
<td>Glasgow</td>
<td>13,700</td>
<td>1.9%</td>
</tr>
<tr>
<td>6</td>
<td>Rochdale</td>
<td>2,500</td>
<td>1.9%</td>
</tr>
<tr>
<td>7</td>
<td>Hastings</td>
<td>1,000</td>
<td>1.9%</td>
</tr>
<tr>
<td>8</td>
<td>Swansea</td>
<td>2,800</td>
<td>1.9%</td>
</tr>
<tr>
<td>9</td>
<td>Dundee</td>
<td>1,700</td>
<td>1.9%</td>
</tr>
<tr>
<td>10</td>
<td>Barnsley</td>
<td>2,600</td>
<td>1.8%</td>
</tr>
</tbody>
</table>

Source: Department for Work & Pensions

If people are able to work then having to claim out of work benefits is bad both for the individual concerned and the public finances. However, the reality is that in many of these cities private sector jobs were not being created during the economic boom of the ‘nice’ (non-inflationary consistently expansionary) decade, so there is only a limited degree to which taking away benefits from these people will enable them to find employment in these ‘sober’ times (savings, orderly budgets, and equitable rebalancing – for those not keeping track of Mervyn King’s acronyms). The Centre for Cities has identified a **jobs deficit** in many of the cities likely to be hit hardest by the changes to welfare spending.

More extensive reforms will be required to ensure that people in these cities have the right skills and are able to access the private sector jobs that are being created, wherever they may be in the country.

**Devolving the axe**

Local government received a very tough settlement in the Spending Review. Town halls will get the freedoms that they’ve been calling for, but will be forced to make controversial choices about what to fund, and what to cut. This will not make city leaders very popular.

**The grants to local authorities from central government will fall by 26 percent in real terms over the next four years. That means council budgets will decrease by about 14 percent once council tax revenues are taken into account.** Local authorities that receive less of their revenue from council tax than the average – such as many metropolitan districts and inner London boroughs – will see bigger declines.
To offset this, almost all grant ringfencing has been removed, except for the schools grant and a new public health grant. **Local authorities will gain greater control over £7 billion worth of funding from 2011-12.** They will also have to comply with fewer targets, which the Local Government Association has predicted will save £300 million. And 16 areas will take part in a Community Budgets pilot – including Greater Manchester, Leicestershire and Croydon. There’s little detail on this at the moment, but it seems to be a progression of the Place Based budgets/Total Place agenda, focused on those families with complex needs.

These are first steps towards the devolution of powers and flexibilities and are to be welcomed – but it seems a bit less ambitious than many local authorities were hoping for. For example, currently it’s difficult to see how this would amount to a ‘single budget for Birmingham’

One less widely covered change is that the **interest rate charged to local authorities for accessing capital funding from the Public Works Loan Board, has been increased to 1 percent above UK government gilts**, up from 0.13 percent. As a result local authority financed capital expenditure is expected to fall by 17 percent over four years, saving the Government £1.3 billion between 2011-12 and 2014-15. Such a reduction could put new homes and development at risk.

The devolution of power is obviously good news for cities – which we welcome. But they are now faced with having to take very tough decisions. While they will be able to make the reductions most suitable to their local area, much of the blame for where cuts land will fall on them. Strong leadership will be vital not only to make difficult decisions, but to communicate these to the electorate and to the public sector workforce that remains.

**A plan for local growth?**

The Government has tried to put a positive spin on what is going to be a difficult period. The need to support long term economic growth has been recognised, with spending in areas like transport and education, seeing some level of protection. However, ultimately even spending in these areas is being severely curtailed. The welfare cuts found to ease the burden on public services also seem likely to fall harder on those struggling city economies already dealing with severe economic problems.

At a local level, strategic choices will be necessary to try to ‘do more with less’. Councils need to fulfil statutory obligations and to support private sector growth, as jobs will be one of the most effective ways to reduce dependence on benefits and demands on the state in the medium to long term. In some places this will be easier than others.

Finally, the Government needs to ensure that its forthcoming White Paper supports growth were it is most likely to occur and has a plan for cities hit hardest by the spending cuts and changing economic fortunes.

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