# Budget 2012: What does it mean for cities?

**Rachel Smith, March 2012**

## Overview

As the UK economy moves gradually towards economic recovery, this year's Budget was an important opportunity for the Government to demonstrate that it has a clear plan to support economic growth as well as manage the deficit. The Chancellor recognised this, presenting his third Budget as the Government's plan to "reward work and support growth". But to what extent did he succeed?

As in previous years, the Government's commitment to reducing the deficit meant the Budget had to be fiscally neutral, with any additional spending offset by cuts elsewhere.

The big headlines for this Budget were around tax, including:

- Reducing the 50p top rate of tax to 45p
- Raising the personal income tax allowance to £9,205 by April 2013
- Reducing the threshold for higher rate tax
- Removing age-related tax allowances for pensioners from April 2013
- Phasing out Child Benefit for households with incomes of £50,000 or over
- Increasing stamp duty on properties over £2 million.

As well as the headline grabbing tax initiatives, it was good to see that cities, as drivers of the UK economy, were well represented, with announcements on devolution of powers, borrowing and infrastructure all affecting cities. Other measures, such as support for enterprise and access to finance, will also affect city economies. This note reviews what the Budget will mean for the UK's cities. It argues that there are some positive measures, but that there are missed opportunities for more place-responsive policies, in particular on youth unemployment – the claimant count for young people currently stands at 6.6 percent in cities[1] – as well as on, skills, job creation and enterprise.

## The bigger picture – the economy

The Office for Budget Responsibility (OBR) predicts that the UK is likely to avoid a "technical" recession, albeit narrowly, with growth of 0.8 percent forecast in 2012 (up 0.1 percent on the OBR's November forecast). In the medium term, growth is forecast to be 2 percent in 2013, slightly lower than was forecast last November, rising further beyond that.

This growth is, however, set to take place against a backdrop of poorer prospects in the Eurozone. Although immediate concerns have eased, the economic health of the Eurozone remains a significant risk to UK economic growth. This, combined with weak prospects for domestic growth this year, underlines the need for the Government to demonstrate that it has a clear plan to support economic growth.

1. NOMIS 2012 Claimant Count, rate for 16-24 year olds, February 2012 data

On the budget deficit, the Chancellor is in line with his borrowing targets and overall, public sector net borrowing has now fallen by 2.8 percent of GDP since its post-war peak in 2009/10. But, borrowing in February was not included in the OBR's calculations and this was considerably higher than expected,[2] indicating that deficit reduction remains a challenge. As a result, public spending cuts are unlikely to slow down.

This makes support for private sector growth critical, and there were a number of measures in the Budget designed to support growing businesses. These include:

- Additional reduction in the main rate of corporation tax to 24 percent in April 2012
- Tax relief for people investing in qualifying seed companies
- Capital gains tax holiday on the disposal of assets invested in the Seed Enterprise Investment Scheme
- An increase in the level of lenders' Enterprise Finance Guarantee loan portfolios to which the Government guarantee applies to incentivise lending to small businesses.

Policies to support enterprise matter to cities because urban areas host 53 percent of the UK's businesses. Business reactions to these policies have been broadly positive, particularly to reductions in corporation tax, but limited market reaction suggests the measures will not make a substantive difference, and questions remain about whether there is sufficient support for small and medium sized businesses in particular.

## Devolving powers to cities

Centre for Cities' research suggests that giving cities greater powers to respond to their distinctive local circumstances could be beneficial for the local economy, as centrally designed policies often cannot respond effectively to city specific issues.

Given this, the announcement that the second City Deal involves the Greater Manchester Combined Authority piloting an "earn back" model is welcome. The innovative model involves Government investing £30m of revenue each year as part of a £1.2 billion pot to invest in infrastructure projects across the city-region. Manchester will be able to "earn back" additional tax revenues generated by this growth. A commitment to finalising City Deals with the other core cities announced today is also good news, although we would also have welcomed formal confirmation of Greg Clark's announcement at our Cities Outlook 2012 launch that City Deals would be extended to other cities.

## Investing in growth

Greater flexibility to manage city finances could have a significant impact on urban economic growth, so it was good to see the Budget delivering on a range of policies that could support greater investment in local infrastructure, including Tax Increment Financing, the Growing Places Fund, Enterprise Zones, R&D tax credits and reducing the cost of Public Works Loan Board (PWLB) loans.

- ***Tax Increment Financing:*** A welcome announcement on Tax Increment Financing (TIF) was made, with £150 million to be made available from 2013-14 for the core cities. This policy will enable the UK's largest cities to borrow against their future business rate receipts and so take forward major infrastructure projects. It is good to see that the Government is moving beyond "TIF Type 1" as this is prudential borrowing and does not provide the certainty of ringfenced funds that can reassure developers and investors. Our research suggests that TIF has the potential to help boost growth in the

2. ONS *Public sector finances* February 2012. Note data is provisional estimates and excludes the temporary effects of financial interventions.

short and long term.[3] We would like to see the amount of money available increase in the future, and to see more cities able to access the funding providing they can demonstrate their schemes will work.

- ***The Growing Places Fund:*** The Growing Places Fund is to be increased by £270 million, £70 million of which will be for the Greater London Authority. As we've highlighted in the past, this announcement is welcome as it helps cities to take forward infrastructure projects that enable economic growth but also establishes revolving funds which can then be reinvested elsewhere. Involving Local Enterprise Partnerships (LEPs) in the process is also positive. It provides them with a source of funding and allows decisions about investment to be made at a spatial scale which matches cities' economic footprints.

- ***Enterprise Zones:*** Since the last Budget, 24 Enterprise Zones (EZs) have been announced and are intended to create jobs and boost local economies. More specifically, the Zones operate with different rules and incentives – such as 100 percent business rate discounts and simplified planning approaches – to bring in new firms and support business growth.

  The Chancellor announced that additional EZs will be created in Scotland and Wales. Enhanced capital allowances will also be made available for designated sites in five EZs, two of which are in city locations – London's EZ at the Royal Docks and Dundee's EZ.

  While we support place-based policies in general, our analysis of the EZs in the 1980s showed that capital allowances were expensive and the benefits were more often captured by land owners rather than the local businesses. Capital allowances can provide a positive impact if they go to businesses having trouble accessing finance. But, in labour-intensive businesses like those in services and creative industries, costly capital allowances may provide more buck than bang. We would have liked to see the money invested in funding and support for providing skills and training to workers, to help firms add more qualified labour and make them more competitive. Support could also have been provided to firms in EZs around patenting to help them commercialise new innovations, adding value to the economy.

- ***R&D tax credits:*** Innovation is a driver of productivity and important for economic growth.[4] Given this, the introduction of an "above the line" R&D tax credit with a minimum rate of 9.1 percent before tax is a welcome addition to the R&D tax credits for SMEs announced in last years Budget.

- ***Public Works Loan Board:*** It was also good to see that Government is planning to make it cheaper for local authorities to borrow from the PWLB, on the condition that local authorities provide *"improved information and transparency on their locally-determined long-term borrowing and associated capital spending plans"*. This will help enable cities with clear plans about how monies will be invested to access funding at lower interest rates, supporting the delivery of projects that could support local job creation and economic growth.

## Infrastructure

Infrastructure investment can generate jobs in the short term and make a significant contribution to economic growth in the longer term – studies show, for example, that high levels of congestion in urban areas can dampen growth[5] – so it was good to see a range of infrastructure announcements.

3. Wilcox Z & Larkin K (2011) *A Taxing Journey: Progress and challenges on implementing Tax Increment Financing* London: Centre for Cities
4. HM Treasury (2000) *Productivity in the UK: The evidence and the Government's Approach*, London: The Stationery Office
5. Hymel K (2009) "Does Traffic Congestion Reduce Employment Growth?" *Journal of Urban Economics* 65 (2): 127-135

Important infrastructure announcements for cities included a commitment to delivering ultra fast broadband and high speed wireless in the cities of Belfast, Birmingham, Bradford, Bristol, Cardiff, Edinburgh, Leeds, London, Manchester and Newcastle. London could be awarded up to £25 million and Leeds and Bradford almost £15 million as a result of the Chancellor's pledge. An additional £50 million will also be made available to create ten super connected smaller cities in a second wave.

With regards to transport infrastructure, Network Rail will invest £130 million in the Northern Hub improving connections between cities like Manchester, Sheffield, Preston and Blackpool. As we highlighted in *Access all Areas* last year, better transport connections, combined with better skills could support economic growth in the Northern cities.

Elsewhere, London received an agreement in principle for Transport for London to receive funding from a locally retained share of the city's business rates. Reinvesting businesses rates in this way has the potential to support firms to access skilled labour and individuals to access jobs. Other commitments were made to improve London's transport infrastructure through, for instance, exploring ways to streamline planning processes for proposed additional river crossings and a commitment to review airport capacity needs in the South East.

The creation of Transport Systems and Future Cities Catapult Centres was also announced. The centres will seek to commercialise technologies that improve the quality and efficiency of the transport system, one of the factors that supports economic growth.[6] Developing a national roads strategy and exploring new ownership and financing models for the national road network could similarly support the delivery of a fast and effective transport system.

The establishment of a new Pension Infrastructure Platform owned and run by UK pension funds, which will make the first wave of its initial £2 billion investment in UK infrastructure by early 2013, is also positive news. A separate group of pension fund investors has also presented proposals to the Treasury for increasing pension plan investment in infrastructure in the construction phase. These measures could be very useful in kick-starting further infrastructure projects.

## Housing and planning

The Budget also announced a few measures to stimulate the demand for housing and increase the supply of dwellings. For cities, the expansion of the Get Britain Building fund – which was first announced back in November – from £420 to £570 million is a positive. Jobs are created in the short term, while increasing the number of dwellings in cities increases the labour force firms have access to and helps people connect to job opportunities.

But, the number of houses the fund will bring forward will be fairly low, with the original £420 million delivering around 15,000 homes. With experts estimating that in the region of 270,000 net additions per year are likely to be needed to stabilise current affordability levels,[7] more needs to be done to boost the housing supply.

The publication date of the National Planning Policy Framework (NPPF) was announced but the details will remain unknown until next Tuesday. Although the Chancellor was clear that the presumption in favour of sustainable development would remain, until we know what that means, it is unclear how the NPPF will change policy in practice.

6. Hymel K (2009) "Does Traffic Congestion Reduce Employment Growth?" *Journal of Urban Economics* 65 (2): 127-135
7. Nickell S (2011) "*Too Many People in Britain? Immigration and the Housing Problem*", speech delivered at LSE, 21 June 2011

## Conclusions

Despite the big news of the Budget being about tax, its good news that cities, as drivers of the UK economy, were well represented.

The announcement of the devolution of tax powers to The Greater Manchester Combined Authority through a City Deal, commitment to finalising city deals with the other core cities and moves to reduce borrowing costs from the Public Works Load Board are all important steps in the right direction.

Elsewhere, additional incentives to encourage cities to be pro-growth through the expansion of the Growing Places Fund together with broadband and transport infrastructure investments – the Northern Hub, for instance – as well as tentative moves to increase the housing supply through the expansion of the Get Britain Building Fund are welcome.

But there were some missed opportunities. The Budget was noticeably light on measures to support private sector job creation. And, because different cities need different types of policy to support economic growth, the Centre for Cities would have liked to see more place-responsive policies, in particular on youth unemployment (more than 1 million young people are unemployed), as well as on skills and enterprise in the Budget.

It is also worth noting that most of the policies announced today are focused on our largest cities. That's good news, as they are important to the growth of the UK economy overall, but the Government also needs to think about how to support small fast-growing cities such as Milton Keynes, as well as providing the different support required by former industrial cities such as Hull.

The Budget also raises questions. Industrial policy seems to be starting to reappear, with announcements of support for life sciences and the digital sector, as well as Lord Heseltine's review of how the public sector can interact more effectively with the private sector. The question of what industrial policy should look like in a 21st century economy will keep recurring – as will questions about what role Local Enterprise Partnerships can play.

Although we don't have long to wait, the detail of the National Planning Policy Framework will also remain uncertain until next week, when it should become clear what impact the NPPF will have on future development.

Overall it's good to see cities at the heart of the Budget, but questions remain about whether the policies announced today – many of them with impacts that will be felt only in the medium to longer term – will make a substantial difference to economic growth.

## Contact

**Rachel Smith** is an Analyst at Centre for Cities.
r.smith@centreforcities.org / 020 7803 4308



Enterprise House
59 - 65 Upper Ground
London SE1 9PQ

**www.centreforcities.org**

## Summary of city relevant announcements

### Devolution

- The Greater Manchester Combined Authority will pilot an "earn back" model.
- Commitment to finalising City Deals with the Core Cities.
- Intentions to make it cheaper for local authorities with long term plans to borrow from the Public Works Loan Board.

### Incentives for growth

- New Enterprise Zones announced in Scotland and Wales and enhanced capital allowances to be made available for designated sites in five Enterprise Zones.
- £150 million to be made available for Tax Increment Financing (Type 2) from 2013/14 for larger scale projects in the core cities.
- The Growing Places fund to be increased by £270 million, £70 million of which will be for the Greater London Authority.
- Introduction of an "above the line" R&D tax credit from April 2013 with a minimum rate of 9.1 percent before tax.
- Pilot enterprise loans for young people to help them start a business.

### Infrastructure

- Ultra fast broadband and high speed wireless broadband for Belfast, Birmingham, Bradford, Bristol, Cardiff, Edinburgh, Leeds, London, Manchester and Newcastle. £50 million to be made available to fund ten smaller super-connected cities.
- £130 million investment in the Northern Hub to improve links between cities like Manchester, Preston, Blackpool and Sheffield.
- Development of a national roads strategy.
- Consideration of the feasibility of new ownership and financing models for the national road network.
- Creation of Transport Systems and Future Cities Catapult Centres by 2013.
- Agreement in principle that Transport for London should receive funding from a locally retained share of London's business rates.
- Establishment of a new Pension Infrastructure Platform owned and run by UK pension funds, which will make the first wave of its initial £2 billion investment in UK infrastructure by early 2013.

### Housing and planning

- Expansion of the Get Britain Building fund to support the delivery of up to 12,000 homes on stalled sites.
- New Buy scheme and a reinvigorated Right to Buy scheme to help people access home ownership.
- NPPF to be published on Tuesday 27 March including a presumption in favour of sustainable development.
- Consider further simplification of the planning system such as reducing information requirements and amending the Use Class Order.
- Removal of duplication in the consenting regime for major infrastructure development.
- Aim to have two land auction pilots on public sector land ready for market by the end of the year.

### City specific announcements

- £56 million to be spent on Bexhill to Hastings link road.
- A shortlist of options to increase capacity and improve performance on A14 between Huntingdon and Cambridge has been identified.

### Other announcements

- Review of how the public sector can interact more effectively with the private sector conducted by Lord Heseltine.