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developing local economies

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INSIGHTS
for public financial management

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Stephen Hughes wrote this paper whilst he held the post of strategic adviser to CIPFA on local government. He acquired this role after leaving his post of Birmingham City Council Chief Executive in February after eight and half years.

At Birmingham he led the ambitious Business Transformation process and drove the Council's commitment to the local economy. Prior to that Stephen's career was in finance, having led the Finance function at Islington and Brent and gone to Birmingham as Director of Resources. He has also been a finance policy officer at two local authority associations and spent a year on secondment managing Council Tax and Business rates policy for the then Department for Environment Transport and the Regions (DETR). Apart from CIPFA, Stephen has a number of other roles including as a Board Member of Housing and Care 21.

\ introduction

There is a growing political consensus that there needs to be increased devolution in England. Partly this is as a response to the Scottish debate and the introduction of 'devo-max' there. It is partly a response to the need to increase public sector agency collaboration driven by austerity. It is also a response to demands from local authorities over many years.

In this context, increased economic growth has been a prime candidate for increased devolution and the part of public policy where some movement has taken place, such as Local Enterprise Partnerships (LEPs), City Deals, Economic Growth Fund and combined authorities.

This piece attempts to look at some of the assumptions behind the consensus, including some differences in what is meant by devolution by different actors. In particular, to ask what is the justification for local authorities to intervene in their local economy? What is the case for centralisation? What is the best way for local authorities to intervene and how do they in practice?

why should local authorities intervene in their local economy?

The current public services climate is dominated by government's priority of reducing its annual funding deficit largely by cutting spending. In this context, all discretionary functions are at significant risk. So, it is both interesting and worth exploring the increased local authority focus on supporting their local economy, even though, with the exception of planning, councils have few statutory duties.

In the context of planning, while there is a clear link between economic activity and physical development, much local concern is about protecting the environment and ensuring that development is not intrusive or likely to overwhelm existing infrastructure, and not necessarily about economic activity. It would be possible for authorities to simply manage 'zoning', ascetics and ensure developers provide sufficient infrastructure support for their application and take a laissez faire approach to the content of development or the lack of it.

In practice, councils are rarely that indifferent to the nature of development. The principal motivation for that could possibly be the democratic context in which councils operate. Councillors are bound to respond to the communities that elect them and in turn residents expect councils to be their voice and to promote the local economy. This is as true of local businesses as the population at large. Local government has pressed for and gained its general power of competence and ability to act for the general wellbeing of its area, largely for economic development reasons.

A second powerful motivation is the relationship between prosperity and social issues that do relate to local authorities duties. Poor economic performance is associated with higher incidence of health/ social issues and many other negative outcomes that directly drive the demand for and cost of local authority services. The evidence that acting on the local economy is an effective way of reducing demand is thin, and there is no definitive estimate of the overall relationship between economic performance and demand for local services. Nevertheless, it is such a powerful correlation that councils believe they must act to improve economic prospects for their area.

This approach has been reinforced by current central government policies. Firstly, 'growth' is the government's second most important priority after cutting the deficit, partly because growth helps grow tax income without increasing tax rates and moderates some spending pressures. It also provides politicians with a positive narrative in contrast to the inevitable negativity of cuts. So, there is a search for ways in which growth can be achieved, which local government responds in order to gain favour, credibility and also resources.

Secondly, the Government abolished Regional Development Agencies (RDAs) and directly encouraged local authorities to fill the gap in regional economic policy by forming Local Enterprise Partnerships (LEPs) and Combined Authorities (CAs), and by seeking to agree bilateral arrangements through, for example, City Deals and latterly the Growth Fund bidding process. Whilst there are no statutory requirements to respond to this, significant resources have been available to bid for and most areas have felt obliged to rise to the challenge.

Thirdly, there has been a sea change in the approach to funding local government more generally. Throughout the post-war period until just after the turn of the century, the orthodoxy had been one of central government providing resources to local authorities to meet need and make good shortfalls in taxable resources through grant. Local authorities became accustomed to arguing that they were more deprived, had higher costs or fewer resources than other areas in order to get more grant. In practical terms that has gone. More highly dependent areas are having greater cuts in grant, business rates localisation comes with a pledge not to readjust resources for several years, and grant is recycled through incentive schemes such as the New Homes Bonus. It is a logical response therefore to switch from a 'begging bowl' approach to central government to one that responds to their incentives.

Finally, is the hypothesis that devolved interventions through local authorities are more effective at delivering economic benefits than through national agencies. This is part of a more general argument about the effectiveness of action at a local level, which has several strands. One is that different policy responses are needed in different areas and therefore priorities are best made at a local level. Another is that ‘stove pipe’ delivery mechanisms are inefficient – they don’t deal with needs holistically, they create duplication and administrative cost, and they cannot co-ordinate the activities of different actors at the point of intervention. These arguments can be persuasively articulated, yet the evidence to demonstrate differential outcomes is sparse, not least because there are few examples of large scale effective devolution. One would expect local government more generally to espouse such arguments because if adopted it leads to a transfer of power, responsibility and resources to local authorities.

The current consensus is clearly in favour of local authorities having a role in economic policy, not least because local people expect it of their council. The evidence that such intervention is effective is thin, and in practice we are entering into a period of experimentation which will test that hypothesis.

what limits on economic devolution?

The argument for devolution of economic interventions has been widely aired and supported. Those that want change argue that the policy hasn't been adopted largely because of issues of politics and power. National Government Departments see their role to develop policy and use 'their' money to shape and control its delivery. Politicians are motivated by improving lives of Britons, and want their chance to try once they achieve Ministerial authority. These arguments are clearly not intended to be serious justifications for inaction, but there are genuine issues that do deserve detailed consideration and debate.

The first of these is about accountability. The nature of devolution is that ultimate accountability still remains at the level devolving, accountability that resides only at a local level has to be associated with autonomy and not receiving power or resources from a greater geographical aggregation. In the UK system this leaves Ministers and Civil Servants directly accountable to Parliament. The Parliamentary Accounts Committee (PAC) and the National Audit Office (NAO) clearly state they want to follow the taxpayers' pound wherever it goes.

There are parallels at a local authority level. In devolving service delivery, councils carefully assess the governance, track record, capacity and capability before they do so, and then place on top of that strict requirements on how to deliver the service, as well as performance measures and reporting requirements, with reserve powers to intervene in various ways if not satisfied with outcomes. Government inevitably does the same when dealing with local agencies, whether that is local authorities, health trusts, academy schools or delivery arms of government departments. This adds to cost and inefficiency at one level, but it is an inevitable additional cost of devolution because it is part of managing the risk of failure.

A consequence of this can be seen, for example, in the allocation of Growth Fund money to LEPs. As the Centre for Cities analysis shows, with few exceptions, almost all of the allocations are for specific projects for which funding is effectively ring-fenced and arises out of a bidding process. In effect, this is still a national programme delivered by local authorities and LEPs. There is the chance of better delivery on the ground because of greater collaboration, but this isn't devolution of responsibility for delivery of economic objectives. The Manchester, Leeds and Sheffield proposals allow some virement between schemes subject to controls, and only Manchester's in relation to skills allows some virement of revenue resources.

A related aspect is the way that central government is always seeking to find solutions that include all areas. The core cities, for example, have argued that clearly the capacity and capability of some areas is greater than others, so policy on devolution should vary to reflect that. Governments are concerned with delivering common standards and if possible common outcomes across the country, and are held to account for it. Local authorities have managed the trick of delivering common policy objectives through varied delivery mechanisms. They will take different approaches to service delivery in different parts of their area to reflect the different capacity of local delivery partners. Where there is a strong community group with good governance, facilities and services may well be devolved, even if this means direct delivery elsewhere.

There is a specific dimension to failure in the economic field. Where a community completely fails economically the tradition and expectation in the UK is that the government will do something about it. Regional economic policy arose in the first place as a central government's response to the demise of major industries that were geographically concentrated, such as ship building, steel manufacture or textiles. If this role is to continue, and many in local government think it should, then a key question is how to reconcile this safety net with the desire of ambitious areas to take control of their own economic destiny.

The most radical argument for local tax raising powers and full responsibility for all public spend in an area, including that for welfare benefits, for example see the ResPublica report on devolution for Greater Manchester. There is a wide spectrum of possibilities here, but the dilemma is the same for them all. If even some areas are allowed to sink or swim on their own – with the safety net removed – then can they be allowed to capture and retain additional resources that might have been used to ease the burden elsewhere.

This dilemma has been resolved in the current circumstances by strictly limiting the degree to which local areas can keep the fiscal benefits of growth which occurs in their place. Famously, Manchester negotiated an 'earn back' provision in their City Deal whereby additional grant was paid if certain transport investments delivered measurable economic growth – although it has taken a long time to turn the principle into an actionable programme. The initial Enterprise Zones (EZs) allowed local areas to keep the uplift in business rates income for 25 years giving a powerful incentive to develop projects that grew the tax base in those places. It's worth noting that the later ones were much smaller scale and strictly limited by grant available rather than taxes raised. Even in these cases, what is really happening is a redistribution of resources – for example the uplift in business rates for EZs is effectively paid for by a small reduction in business rates going to every other area.

Arguably, the partial localisation of business rates can be said to give local authorities an incentive to support growth in their area. It is certainly part of the change away from needs based grants discussed above. However, there are too many uncertainties about the tax yield for marginal changes in it to enable local authorities to invest speculatively in developments that could grow the tax base. Not least, that Treasury can step in to 'redistribute' any gain away and that a general re-basing is likely to happen every seven to ten years. Investments that will make a real difference will be large and take more than seven to ten years to plan implement and 'pay-back'. The incentive effect of the current business rates regime is physiological rather than real. Local authorities find it hard to understand this risk adverse approach to what looks like a slam dunk idea. However, an understanding of Treasury's approach to economic management explains it all.

Their approach is to look at the economy as a whole. In that context investing in proposals that promote growth, grows tax receipts and cuts benefits, just as it would locally. However, it also makes sense to invest in the projects with the greatest return wherever they happen to be. So it is more fiscally efficient to invite bids and fund the best ideas, rather than lose control of part of the income stream in the hope that will produce better overall results. The local desire to do well for their area is irrelevant and illogical if your objective is to maximise production for the whole economy.

This view point is reinforced by a deep suspicion that many locally championed economic projects do not add net value to the overall economy, but merely displace activity from one place to another, at a cost to the public purse as areas compete with each other. Greater Manchester fought hard to create the Media City at Salford Quays with the relocation of BBC investment in the area including attractive deals on property for example. However, it is clear that the BBC would have made that investment somewhere in the UK without additional public subsidy. In perhaps the clearest case I ever came across, the old RDA Advantage West Midlands subsidised the move of Severn Trent HQ from Birmingham to Coventry to prevent a move to Derby, and no doubt counted that as 'jobs protected' in its statistics. Would giving up fiscal control lead to further fruitless competition between different parts of the UK economy?

There are two types of answers to this paradigm. Firstly, one can argue that the increased efficiency of allowing greater choice about what to invest in at a more devolved level, whether through better collaboration and connected commissioning or because of a more differentiated approach that accounts for variations in local circumstances, plus the reduced bureaucracy more than outweighs the potential loss of some investment. This of course requires some detailed investigation and collection of evidence which doesn't currently exist. In the meantime, it is also possible to point to the inevitable consequence of total central control – what in the USA is labelled 'pork barrel politics'. To demonstrate 'fairness' and to address the pressing concerns of different localities resources are not distributed according to strict efficiency of investment returns – instead they are spread all over the country, and there are many examples of poor centrally made investment decisions to make that point. What better way to settle the argument than to give it a try by some effective devolution in places that can manage it and want to do it.

The second argument is that some displaced investment may be a good thing. One of the biggest problems with the UK economy is the enormous productivity gap between London and the South East and most of the rest of the country. It begins to overheat whilst many other parts are still in recession. The capital is a magnet for world investment and is where all the key power and influence of the country is concentrated. In consequence, the region requires a massive public subsidy for housing costs, and to sustain a viable transport system and other infrastructure assets. Empowering other parts of England to more effectively compete can deliver improved fiscal efficiency by reducing total costs to the public purse and raise productivity.

Of interest is the debate on the devolution of powers to Wales, Northern Ireland and, following the referendum and the instant pledge of 'devo-max', particularly Scotland. In these parts of the UK decisions on spending have now largely been devolved, but (with some marginal exceptions and until 'devo-max' is implemented) there is still not much control over tax receipts. It is becoming clear that, in Scotland at least and firstly, that is going to change sooner rather than later. If English localities* can generate the same passion as the Scots for their place, then it will be hard to resist some change in England as well, given that some English localities have a bigger population and economy.

* I use the term 'localities' to avoid using the term 'regions'. I mean some sub-national grouping but not necessarily old standard regions, new LEPs or Combined Authorities.

Leaving politics aside, what is clear is that the argument for devolution of spending decisions and of tax receipts is partly an empirical one about which type of decisions are more efficient, and partly a question about capability and capacity at a local level. The evidence isn't available to answer the empirical question, and capability and capacity is variable. Perhaps the strongest proposition is therefore a partial devolution to places that can demonstrate capability in order to help produce the evidence that answers the wider question.

how should local authorities support growth?

The previous sections considered whether local authorities have a role intervening in their local economy. Accepting that they do, what is the best way for them to act? This is different from looking at what they actually do, but important in considering what are the barriers to effective intervention. This raises the question: what could they do and what is most likely to be effective.

To answer that, one needs some conceptual model of what growth is and how it occurs. Now, that's something economists have been debating since before Adam Smith and are no nearer a conclusion. There are no pretensions that the answer has been found, but instead we rely on common elements for this discussion.

In a local place context, where the interests of residents are considered paramount, there are two different dimensions that matter. Firstly, how to create jobs and increase wage levels, secondly, how to give access to those very jobs to local people. The second part isn't strictly about growth, but is part of economic intervention and general well-being.

Creating jobs

One orthodoxy is that the public sector doesn't and can't create jobs – that's what the wealth-creating private sector does. The sense in which that is true is that the wages that the public sector pays are funded by the tax receipts from the whole economy, and if there was nothing but public sector services there would be no funds to sustain them. In practice, this is too limited a view and it is clear that public sector investment in infrastructure and human capital help maintain high levels of private sector productivity, whilst it is also the case that much private sector activity is in providing goods and services for the public sector.

Instead, use the statistical definition of the economy – the sum of recorded financial transactions in one place, each of which reflects an income to a supplier of goods and services, consumption by the purchaser and a measure of production. One can identify four broad areas which help sustain and expand this sum of financial transactions:

- the existing investment in infrastructure, environmental factors and the political and social context
- direct investment in maintaining and expanding productive capacity, which given the importance of high value added services in the UK economy includes the stock of human capital or the skills of the workforce as well as buildings and factories
- innovation in product design, marketing and production method and
- sustaining and growing demand for the products of the place.

Infrastructure and contextual issues

Some of these factors are UK wide. The political stability, broad social cohesion, strong rule of law and tolerant cultural ethos makes the UK an attractive place globally to do business. The massive historic investment in networks – transport, energy and water, data transmission, hospitals and primary care, education and cultural assets – sustain the UK economy and enable private businesses to flourish.

However, there is considerable variability in the state of networks in different parts of the UK, which opens up the potential for local action. The most obvious is around transport. While the national arteries of motorways and intercity rail have to be planned and managed on a national scale, connectivity to these networks and their capacity in different places is of local concern and is a primary restraint on growth.

Similarly, there is considerable variability in modern data transmission networks where the massive potential of fibre optics to the premises is not being met everywhere for market failure or other reasons. While there is a national network it doesn't connect to all who could benefit from it. There is potential for local intervention to create hubs of high technology infrastructure where the private sector has failed to do so.

There are also critical constraints to development in access to energy supplies. Partly this is about legislative controls that need to be managed nationally, but there is growing investment in a variety of different local energy solutions that can make a contribution, whether through combined heat and power, biomass, energy from the ground or from wind amongst others. It is not clear whether local sourced energy solutions could ever operate on a scale sufficient to make a difference to the growth potential of different areas.

Other networks related to health and education do not necessarily need to be physically linked to operate so local capacity can in consequence vary considerably. Local authorities clearly have statutory duties to ensure that sufficient places for school children are provided, but have a lesser role for Further Education (FE) and none directly for Higher Education (HE). Education is discussed more below. Similar considerations apply for health and the productivity of the local workforce is in part determined by the strength of the health system in any place. One can see an economic case, there may well be other arguments around efficiency and accountability that complement the economic argument, for local influence over health priorities in different places instead of a network of largely autonomous units managed nationally.

There is another particular dimension to environmental factors that is particularly important in the context of growth. Certain places have natural advantages and certain places have created, through clusters and the like, relative advantage in some sectors. For example, Aberdeen exploited its vicinity to the North Sea oil fields to take advantage of its development. The City of London has such an agglomeration of banking institutions as to make it one of the globally predominate financial centres, attracting further investment in the field and intimidating other places from entering the market and competing.

Whether advantage is due to natural geographic or geological factors or created by economic action, these clusters of industry are important for creating relative advantage and therefore economic relevance for different places. In consequence a key part of many local economic strategies is to help foster and develop new clusters particularly in vibrant and growing industries. This may be through active inward investment support, setting aside zones for clusters, building on existing local strengths for example. Where there is public investment there is a risk of inefficient and unproductive competition between areas for the same investments. For example, many areas have attempted to gain advantages in digital and cultural sectors with little hope of success as they didn't have the necessary inherent advantages to grow self-sustaining clusters.

Direct Investment

In one sense direct investment in productive capacity is what the private sector is all about, and the role of the public sector may be considered less important. Nevertheless one can think of a number of areas where the public sector can and does make contributions:

- Provision of incubator premises, other property investments for start-ups and SMEs up to and including estates – the provision of infrastructure such as this attracts and retains businesses that can't afford to build or buy themselves;

- Inducements of various kinds to encourage established businesses to invest and expand in the UK, rather than abroad;
- Loans and other financial support to SMEs for investment purposes;
- Development deals whereby Local Authorities provide public sector infrastructure that levers in private investment;
- Investing in human capital to help with the supply of a skilled workforce to the local economy.

Within the European Union there are strict limits as to the extent that public authorities can subsidise private enterprise (state aid rules) that impinge directly on the first three areas above. Where activity is undertaken on a commercial basis (for example investment in property or loans to businesses) there is also a potential conflict with existing private sector providers of the same product, and so public agencies need to be able to demonstrate gaps in market provision to legally act in these spaces.

There is also a very significant risk of public sector activity in these areas being wasteful, as discussed above. Areas may well compete against each other for the same investment and in the process drive up the amount of unnecessary public investment to secure private investment. This is of course hard to measure, and is mitigated by the state aid rules. On the other hand, the marketing of an area and the provision of effective welcoming services is an important element in prompting internal self-confidence and reinforcing a perception that here is a place where business can be done. Some of these services are about meeting locally generated demand and not in competition with other places.

Development deals are different. There are many examples of public private partnerships that are seeking to create value by combination of public and private assets and skills leading to physical regeneration of areas. In some places, especially in London and the South, the partnership captures the added land values that results from regeneration. That can be sufficient to pay for the supporting infrastructure investment and give added social value, for example increased and/or improved social housing provision. In other places the increase in land values isn't enough and then there is need for direct public investment to make physical developments work.

This doesn't mean that the latter type schemes are commercially unviable, but just that insufficient of the economic benefits can be captured locally to make it work without subsidy. This is clear once greater benefits are captured locally as seen in the first phase enterprise zones. For example, the Paradise Circus redevelopment in Birmingham will lever in £400m private sector investment as a result of £60m public investment all more than paid for from the amortised uplift in rates paid. Similarly, Manchester's 'earn back' scheme works because fiscal benefits are created by the public investment in transport.

Finally, a skilled workforce is the key to high added value production, high income and the prosperity of an area. The amount and number of schemes, projects and programmes are many and various. At least three Government Departments, The Department for Business, Innovation & Skills (BIS), Department for Education (DfE) and the Department for Work and Pensions (DWP) are actively involved in commissioning or direct provision of investment through schools, FE and HE colleges, apprenticeships, welfare to work programmes to name the most obvious. Local authorities have statutory duties for education, as well as discretionary powers to intervene with young people not in education or a job. Evidently, there is a need for local programmes tailored to local circumstances as well as national provision for more specialised skills. There is less likelihood of unproductive competition between areas as the impact should be a net increase in human capital irrespective of where it is made, and this is a supply side service for local people. Clearly these activities are relevant to getting local people into jobs as well as discussed below.

Innovation

Economic growth can be about making and selling more of the same things. But, a large part of the dynamic of modern economies is about new ideas in production, design and product invention, creating new things and where they connect with business needs or the public imagination stimulating new markets. Products like smart phones, digital tablets and interactive networks on the internet are now ubiquitous but have not been about even for decades but merely years.

While these things can come from anywhere there are two factors that substantially increase the probability of success: universities and venture capital. Universities are set up to find new ideas, not all of which have a commercial use, and even private companies with large research and development functions frequently collaborate with universities. However, that isn't enough, because the translation of an idea into a commercial product capable of mass production requires considerable investment in further research, technical development, plant, machinery and people, marketing and developing distribution networks.

This all takes significant money and involves considerable risk, which is where the venture capitalists come in. They take risks and bet on enough good ideas that a few of them pay back enough to cover all investments and make net returns. The huge success of Silicon Valley in California and Boston in conjunction with Massachusetts Institute of Technology is as much to do with the enormous investments by venture capitalists as with the brilliance of the science coming from the universities.

This is not safe territory for the public sector in the UK. There is such a small tolerance of failure that any investment in new ideas will be expected to pay back. The few occasions when UK Government has put enough money in to make a difference (for example De Lorean in Northern Ireland) when it has gone wrong it has created deep scars that intimidate it from further ventures.

Despite this, there is still a big focus on encouraging innovation in many local strategies. In the main this is about creating an atmosphere to encourage spin outs and other conversion of ideas into practice and frequently with established businesses. Local authorities are not well placed to provide venture capital funds themselves or build investment pots with funds from different sources, because the essence of success relies on spread betting when many investments will fail. There is no appetite for that approach in the UK's current political climate.

Growing demand

Ultimately, growth is about selling more services or products and that is about demand. This is not the place to explore how macro-economics works mainly because it isn't that important for individual places. Of course, the state of the economy as a whole will impact on every place, but in a stable environment the question is how do you grow relative demand – how do we make the businesses in our area prosper by making and selling more.

National economic policy regulates some key parameters, such as interest rates, foreign exchange rates, the level of the fiscal deficit, which all have an impact on the overall level of demand and its component parts. Local authorities don't have a role there, but can they help businesses exploit whatever the current economic climate is?

By observation, it is clear that the principal instinct of local councils is mercantilist. By a series of policies they attempt to bend demand towards local suppliers and in particular against foreign ones. This is particularly in their procurement policies, taking advantage for example of the powers they have to evaluate social value in bids, by exhorting partners to act in a similar way, by packaging contracts to advantage smaller local companies, by use of local procurement portals, and in many other ways. The main thrust of these policies is to buy locally.

Economic theory, by contrast, convincingly argues that such an approach (at least at a functioning economic area level) is counter-productive, as it reduces the extent to which there is specialism and trade, and it is by the exploitation of relative advantage that productivity, income and growth is maximised. It is this theory that first led to the abolition of the corn laws in the nineteenth century and also underpins the philosophy of the free market in the European Union. All those rules against state aid and requiring open and fair tendering processes are there to counter any latent Mercantilism.

There is a kind of game theory exception to this theory. If everyone else espouses free trade whilst I put up trade barriers and promote local goods I am better off compared to everyone else. Of course as soon as I start to discriminate so does everyone else, which leads to worse outcomes for everyone. The questions therefore for Local Authority Protectionists is will they be sufficiently noticed to provoke retaliation, and assuming not will the collective protective action by all local authorities worsen outcomes for all? There simply isn't the data or research to know the answer, but one's instinct is that the scale and impact of such policies is so marginal that it probably doesn't matter. The main benefit is therefore political – enabling local leaders to point to something they are doing to 'help' even if the impact is immeasurable. There is sometimes a real cost to the taxpayer from these policies as the 'bending' of demand will be more expensive, on balance, then, probably not activity that should be carried out.

However, there are things that Local Authorities can consider doing to grow demand that are not protectionist. This is where they are using their purchasing power to stimulate production. The classic example used to be when local authorities built houses on a large scale. Other examples are the development deals discussed above that level in private investment. Investment of this kind directly creates demand which will have a local impact. There are examples other than investment in construction, such as energy savings which have been innovative.

People into jobs

The pattern of relative unemployment or wider worklessness over the past 30 years has remained stubbornly unchanged. Despite enormous investment to tackle issues in deprived communities largely the same areas have similar problems now as then. All around there might have been prosperity. The story of our cities shows them to be remarkably good at creating jobs, raising productivity and growth, yet they still see a higher than average proportion of their residents' unemployed or economically inactive.

Despite this, a large part of economic interventions by both national and local government is concentrated on the job creation part of the task. It has become increasingly obvious, and politically more important, that getting local people into jobs created is something the public sector must try and influence.

Local authority experience over the past decade or so has highlighted that there are a range of complex factors that contribute to long term absence from employment. There is still a continuing wave of migration and there are parts of some of UK Cities that have and are likely to continue to be 'reception' areas for this.

Migration though is a tiny part of the problem. More frequently people born in this country have been failed by the education and social support system, such that they find gaining and keeping work very difficult. There are a range of health and social care factors, which conspire to make it difficult for some people to get jobs and then to hold them down. In addition the difference in income between in-work and not is not that great for people on the minimum wage with effective marginal tax rates higher than faced by any other group in the UK.

While we have a national tax and benefits system it will fall to national government to ensure appropriate fiscal incentives are in place, and the Universal Credit system is designed to address that issue, but in itself that is never going to be enough. DWP is also running the national commissioned 'Work Programme' that attempts to transfer some of the risk of failing to tackle this problem by including an element of payment by results. Again that is only a very partial approach to a multi-faceted problem. Other agencies have responsibilities here schools, FE Colleges and businesses are commissioned to provide education and skills including apprenticeships by DfE and BIS. The local authority still has responsibility for reducing NEETs as well as tackling many of the wider social problems that contribute to failure to get and keep a job. Police, probation and health all have roles as well.

The best examples of success with this issue are where there is a holistic approach to the individual and family and close co-operation between agencies. Work has to be done to raise the aspirations of individuals, work with employers to get less qualified and less able people get access to the jobs, some skills training but in particular ‘on the job support’ to get people used to getting back into a disciplined routine, and other social support to help tackle some of the other social issues that have been barriers. And given the work done by LEPs and local authorities to help create jobs in the first place, there’s a clear role for connecting new jobs created with the people that need work, which is something that many authorities have achieved.

It seems clear that what is needed is something like the other local statutory partnerships that have proved successful in tackling multi-dimensional problems – such as crime reduction partnerships and now the Health and Well-Being Boards. The current fragmented approach is characterised by persistent failure, and something new is needed.

Having looked at how local authorities can support growth, the next chapter will then study what local authorities do to support their economy.

what do local authorities do to support their economies?

The passion that local authorities show for their area is clearly shown by the number and variety of initiatives that they promote to support their local economy. A lot of this is related to the physical development and regeneration of their areas. They can combine their role as planning authority with their powers to assemble land if necessary to support key developments and their leverage as, frequently, significant land owners. The urban landscape in particular has been transformed over the past 25 years as towns and cities have reinvented themselves by bringing in new industries and services on the back of urban renewal, reversing the long term trend of city population decline.

Closely linked to construction and renewal has been a strong focus on transportation, in particular, considerable investment outside London in rapid transit systems. The Metro in the Newcastle conurbation was an early example, but since funding for transport outside London has become scare much more innovative approaches have been needed. Nottingham has controversially introduced a workplace parking levy to help fund further tram lines. Greater Manchester has created an effective combined authority and brought together several funding streams, including the 'earn back' scheme, to continue develop its network. Leeds and Sheffield City regions are also advanced with their own combined authorities. A large part of the Growth Fund allocations are for specific transport investments across LEPs. The key constraint is the paucity of revenue streams to fund the ambitious proposals that many areas have produced.

Investment in other 'networks' has been less coherent and consistent. Education is considered below, and closer working with Health through Health and Well-Being Boards is of increasing importance everywhere. But it is still a struggle in both areas to translate agreement about strategic goals into solid achievement. The transformational change needed to produce results requires shared sovereignty between different public agencies and fundamental changes in how professions work with each other.

There are some interesting developments in energy networks. For example, Birmingham has a growing network of combined heat and power in its city centre, Southampton has invested in ground heat technology, Bristol has secured European Investment Bank funding to develop an energy services company for the city, and there are many other examples. Institute for Public Policy Research argued in its report 'City energy: a new powerhouse for Britain' that local authorities could provide an alternative to the 'big six' energy companies, but there is still a way to go to emulate what has happened in some places abroad.

Perhaps the most disappointing area is with data networks. There have been some interesting partnerships between local authorities and the private sector. In particular there has been some investment in free WiFi networks in cities with BT and collaboration with mobile phone providers around 4G to gain access to council street furniture. However, the UK is still lamentably behind cutting edge countries. In policy terms 'super-fast Broadband' is defined in terms of the fastest that BT and Virgin can get copper wire to carry data from their street cabinets to premises and they charge a high premium for actual optical fibre connections. Attempts by local authorities to tackle this market failure (for example Birmingham's digital district) have been blocked by 'State Aid' claims by the monopoly suppliers. This remains as much a national as local authority issue.

Today LEPs and local authorities have put considerable emphasis in their strategies to supporting 'clusters' of enterprises in particular industries or sectors. Some of these clearly build on existing capacities and strategic advantage such as petrochemicals in the North East or advanced engineering in the Midlands. However, not as well publicised is what public agencies have done to support such ‘clusters’, nor whether that action has been effective. Authorities using planning powers have declared particular areas as the zone for say digital, or food or some other sector, but I am unaware of any systematic attempt to evaluate the effectiveness of such policies.

Such is the economic power of ‘clusters’ that some areas have attempted to create them. This is particularly true of sectors that have high added value or significant growth potential such as health industries, digital and media. There are two sets of risks with a devolved uncoordinated approach to ‘cluster’ strategy. Firstly, the obvious risk is the inefficient competition between areas for the same investment. More seriously though, the attempt to artificially build clusters where there is no natural advantage or insufficient starting density is unlikely to succeed and will be seen as a wasted public resource.

Attracting direct investment into a local area, as seen above, covers a wide range of different activities some of which have formed core parts of local economic development over many years. There are many examples of investment in incubator units and other industrial premises as an enabler of private investment and growth. Councils have provided loans to private companies in different forms, and with different levels of success, for decades.

Many councils have set up arrangements to help support new companies invest in their area. This shades over into providing inducements for footloose investment to choose one area over another, which is potentially wasteful. It might not be if there was a more general consensus about where particular types of investment should go, and perhaps therefore this is an area where BIS should take the lead. The difficulty is that the devolved authorities, Scotland, Wales and Northern Ireland, are actively competing whilst English authorities outside London and perhaps the wider South East consider BIS is really acting for London as our global city rather than the rest of the country.

Local authority intervention in stimulating innovation is focused mostly on developing a supportive environment. Whilst some loan finance is provided to very risky business, this is far too small to make any difference and the main contribution is through incubator units and the like. There are examples of successful tie ups between universities and venture capitalists for example exciting developments around Cambridge. Local authorities are playing an enabling role in this space.

Finally, on the demand side, there are plenty of examples of authorities attempting to bend spend to local areas, some of these are very product specific. Birmingham tried very hard, within the procurement rules, to buy LDV vehicles before the company went into liquidation to support local jobs. Many authorities have put in place social charters that they are asking their contractors to support. Blackburn placed a job creation objective when they entered into their partnership with Capita and others have done similar things. Local authorities have been particularly hostile to ‘off-shoring’ contracting out arrangements despite the additional cost to their taxpayers, by contrast more recently though authorities in London and the South have sought to save costs by allowing contractors to ‘move’ jobs to the north. Despite the superficial logic of these initiatives, the likely effect is probably counter-productive as argued above.

Councils have attempted to stimulate local markets through more direct actions. Probably the highest profile is building housing. Council built housing is on the increase and the desire to do more is greater than the capacity. One constraint is the cap on borrowing by the Housing Revenue Account, which if lifted could, by Local Government Association (LGA) estimates, lift spend by over £4 billion. Even without that, local authorities are very active as they face significant pressures if housing demand cannot be met. Where land values are high, there is considerable activity raising the density of residential housing to secure the funds for significant regeneration and expansion of social homes in mixed developments. Elsewhere this is more difficult, but deals are being done with pension funds, sovereign wealth funds and others to invest in assets that have long term guaranteed income streams that are currently providing attractive yields. Again, Greater Manchester has some good examples of major investments.

There are examples of innovative initiatives by councils as well. One such was the Birmingham Energy Savers framework agreement that Birmingham signed up with Carillion for the whole of the West Midlands that aimed to take advantage of the Green New Deal legislation and stimulate up to £1.4bn investment in energy conservation and generation. Late changes to the parameters of the legislation in the end made this very difficult to implement at scale, but the scale of the ambition was laudable.

Last, but not least, remains investment in Human Capital and initiatives to get local workless people into the jobs that the economy is still creating. Some of the issues have been discussed at length above, and the problems are well documented. A multitude of initiatives unconnected with each other, a mismatch between the training courses being provided and jobs potential available, many different accountabilities, and the lack of any focused connection in service delivery between access to jobs and the wider support some people need to be able to successfully work. There are many examples of good work by councils, but the major resource is held by national agencies and their suppliers. Decades of investment has not significantly changed the pattern of unemployment. It is clear that there is need for radical reform if this problem is going to be solved.

the local economic model and conclusions

The last two sections set out a complex set of contributors to growth and increasing employment, and sketched out the ways in which local authorities have responded to their opportunities. From it one can create a matrix showing for each area of activity what the public sector can do, the role of local government, some examples and barriers and challenges. The appendix to this paper sets out this matrix with an initial attempt at populating it. Hopefully one of the outcomes of this paper will be to stimulate further debate and create refinements in the framework. In particular there is a need to capture more comprehensively the breath of what local authorities currently do, partly so they can learn from each other, but also to more effectively evaluate the policy options.

What this paper has identified are a number of questions that are capable of empirical answer. These are the 'precursor' issues requiring resolution before we consider the barriers to action set out in the appendix. The first of these is contextual:

Question 1: To what extent will increasing the employment rate, particularly through employing more people who have had long absences from the job market, reduce other social problems and costs that fall to public agencies to resolve?

It is considered almost axiomatic that this relationship does exist, but its strength and effectiveness is important to understand if action on the local economy is the best use of discretionary resources at a time of fiscal constraint. It may be that other preventative measures are more effective, or that only some economic interventions are useful in achieving social objectives. If, however, the relationship proves to be weak and ineffective then other justifications are needed for local authority leadership on the economy. Those were also explored above.

There is a growing consensus that increased devolution is the way to improve the effectiveness of public sector interventions in the economy. However, there are two types of devolution being discussed and debated: devolution of delivery within a bid based system arbitrated by central government to deliver projects; and devolution of decisions where spending and possibly tax receipts are managed entirely locally to deliver outcomes. The question arises then:

Question 2: Does the devolution of decisions deliver sufficient additional benefits (in terms of additional growth or less cost) and reduced bureaucracy for the UK that outweighs the efficiency of funding those projects that deliver the best economic yields? Do central decisions ensure that projects with the greatest yields get funded?

If true, that devolution of decisions is better, then the central objection to actually doing it will fall away. Equally, if shown that central decisions do not fund the best projects devolution of decisions becomes more attractive.

Within the preamble to the last question devolution of decisions included local management of spend and possibly tax receipts. From a local authority perspective the latter is important if speculative developments that can make a real difference to growth can be funded. This leads to a question that isn't empirical:

Question 3: If an area has been granted devolution of decisions including some impact from variation in local tax yields and yet fails to deliver expected standards of service because of economic failure (or other reasons) can it be left to resolve those issues itself?

If the answer is no, then Treasury and central government will never give away the variation in local tax yields to any great extent. If they did in those circumstances, then they would always stand to pick up the downside risk in any area, but without access to the upside gains in other areas that otherwise would be available to fund them.

Even in the more limited circumstances where only some areas have been given devolution of decisions, central government will see the risk that the more prosperous areas will want to ‘opt out’ of the safety net leaving them to manage and protect the weaker areas with fewer funds. So widespread devolution of decisions requires a system put in place that allows the answer ‘yes’ to the question.

The consideration of these questions leads to the conclusion that we need to try out the ideas in order to gather the evidence and test the tolerance for local failure to be managed locally. Therefore:

***Recommendation 1:** Radical devolution of decisions about spend and resources should be implemented in some places to gather evidence on questions 1 and 2 and to devise solutions to question 3 that would allow an affirmative answer.*

Then we come to the specific challenges thrown up by the detailed analysis, some of which are very specific.

The first is the question of effective investment in Human Capital and the related issues of getting people with long term absences from the labour market back into sustained employment. The latter has been an area of continuous failure over many decades. The approach to the issues is characterised by many different mandates to several Government Departments as well as statutory responsibilities to local authorities. This leads to:

***Recommendation 2:** Statutory partnerships with powers over spending should be established to commission education, skills and employment training with accountability for raising employment rates, preferably across the country but perhaps to test the concept in some places, to include all relevant spend by local authorities, DWP, BIS and DfE.*

The other obvious issue of market failure encountered above was in relation to fibre optic networks. This is not just an issue facing local authorities but of national concern and if not solved will constrain the UK’s productivity growth. So

***Recommendation 3:** Government should review its policy on super-fast broadband to aim to achieve the highest international standards in speed and seek to reduce the high cost of connection to the premises through regulation or by enabling local authorities to create ‘digital districts’ to combat market failure.*

The other specific area where there is perhaps untapped potential relates to energy networks. This is where the key constraint is the ambition and vision of authorities, although practical constraints may arise once the scale of activity is raised. What is probably needed at present is encouragement, so:

***Recommendation 4:** Given the potential to grow local energy markets and provide additional services to reduce energy costs, government should work with local government to encourage further activity by local authorities, to disseminate best practice from the UK and abroad and actively address any barriers to progress identified.*

There are other specific issues set out in the appendix, but these are well known and subject to considerable examination already. There is nothing new or unique to add by way of recommendations. There is one issue that hasn’t been properly considered or managed to date that was revealed above. That is the extent to which the active promotion of one’s own place leads to wasteful competition and unnecessary cost for the public sector as a whole. This potentially arises in pursuit of location decisions by both UK and foreign enterprises (inward investment), attempts to bend public spending towards local producers, and the promotion of specific sector clusters. Whilst every LEP has produced its own economic strategy no one has compared them to identify where they are complementary and where they are contradictory. There is something for the sector to do to attempt to eliminate wasteful competition, to acknowledge places with relative advantage and to modify activity to maximise overall effectiveness of strategies. Therefore:

***Recommendation 5:** Local Authorities and LEPs should work together to seek to ensure that all economic strategies are complementary and additive as far as is possible, recognising the strengths and weaknesses of different places and acting co-operatively.*

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