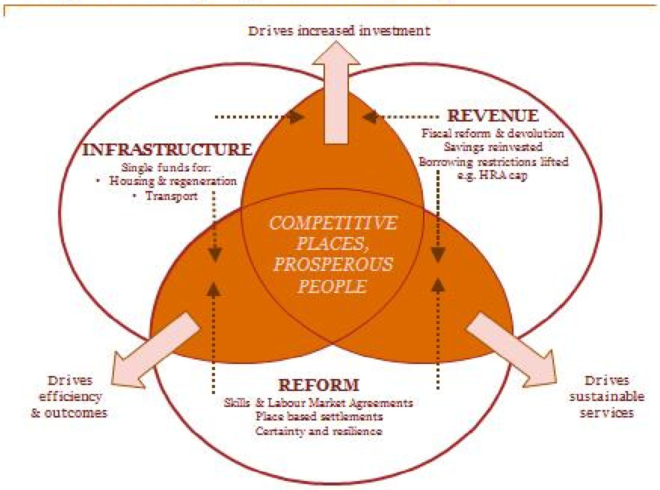
Step 5: Increase Investment

1. What we want to achieve

The Core Cites aspire to be highly competitive places, homes to prosperous people and increasingly financially self-sufficient. Whilst the Core Cities and their surrounding functional economic areas already contribute over 27% of English GVA, as a group they benefit from net funding (being the gap between exchequer benefits generated and the cost of public service delivery across the cities) of circa £40bn.

If the UK is to be economically *and* financially sustainable in the long-term, the Core Cities, as major population and economic centres, need to play a bigger role in the UK's economic productivity and create a sustainable landscape of public services. The diagram (right) demonstrates how local financial control and flexibility underpin the critical elements of a successful, self-sufficient city – supporting investment in infrastructure and reform of public services in order to create the right environment for business growth alongside an efficient use of tax payers money.

The financially self-sustaining city



Core Cities have a clear plan to make their eight cities self-sustaining, which they believe is achievable by 2028, and become net contributors to UKPLC which, alongside the wider package of proposals within their 'Prospectus for Growth', would result in a major and positive economic shift for the UK. Independent forecasts[1] demonstrate that by 2030, Core Cities could then contribute an extra £222 billion GVA and 1.16 million more jobs to the UK economy, which would in turn generate an extra £41.6bn to the national finances through taxation.

2. Why change is needed

The lack of financial independence of England's cities is holding the economy back.

The global financial crisis in 2008 was a wake-up call and Government have responded with policies intended to rebalance the UK economy. This has included policies to encourage export-led growth alongside the beginnings of the devolution of power to cities to give civic and business leadership greater control over the levers of growth. However, to secure long term sustainability for the UK, we need to take more radical steps.

[1] Oxford Economics for Core Cities, 2013

The country needs its cities to perform like never before, and at a moment of constrained public finances. However, the untapped growth potential of Core Cities – demonstrated by the above forecasts - is being threatened by a lack of investment, spending inefficiencies resulting from a fragmented approach to public service delivery and the need for greater flexibility in the way cities can use existing funds to stimulate private investment.

There is a strong relationship between the ability of cities to drive growth, the levels of local financial control and the freedom to make policies match the needs of places. In comparison to our global competitors, UK cities are significantly constrained in their abilities to control, direct and unlock investment. Looking internationally, those cities with more local control over money and policy tend to do better economically, and they can join up public spending and services more easily to get better results.

There is an opportunity to set England's great cities on the path to greater financial independence and self-sustainability, bringing greater economic rewards for the whole of the UK. Achieving this means meeting three key challenges:

Challenge one: Finance for cities is fragmented and short term, creating a lack of confidence for investors on the one hand and undermining public service efficiency and sustainability on the other.

Much of the public spending in England is determined centrally, based on national policies which often take a blanket approach, treating everywhere the same and not playing to the strengths or needs of different places. Cities and the people who live there don't decide what's best for them, which ignores distinct local needs, wastes public money and gets poor results.

Increasingly, evidence indicates that national agencies struggle to join-up with local agencies in England, resulting in duplication and inefficiency. The recent Community Budget pilots suggest that because of the disconnected way in which funding is organised, budget savings made in one part of the public sector (e.g. local government) simply result in an increase in spending elsewhere (e.g. health and welfare). Therefore, public spending isn't reducing in a managed way, but is more likely to be diverted elsewhere as root problems are not being addressed.

The public sector largely operates with short-term, hand to mouth funding. Local authorities operate under one year budgets which, whilst Councils want to operate in a prudent manner, restricts their ability to act more commercially, innovating and to attract investment and to make public services more sustainable. A lack of certainty over funding in the medium term makes it harder to create the conditions to leverage much needed private sector investment and inspire investor confidence. This issue was acknowledged by the Department for Transport in the Wave 1 City Deals and resulted in the agreement of 10 years major scheme funding, enabling cities to invest in major infrastructure over the longer term rather than having to follow short term budget cycles which reduce the scale of investment and deter private investors. We want to build on this progress.

Challenge Two: Cities in the UK are already huge contributors to the country's finances but lack the local control over resources to invest in growth and public service reform at scale

The Core Cities urban areas contribute some 27% to England's economy and are major contributors to the public finances, with an estimated £94billion a year generated in tax revenue by the cities. Despite this, the cities are still a net receiver of public finance, meaning that the cities currently account for more public spending than they raise in taxes. Our current estimates suggest the gap is about £40 billion a year.

Cities are best placed to decide many of the local service delivery needs, but have limited local control over funding. This also stymies their ability to invest in a way that would lever in more private sector money. The scale of centralised control experienced by cities in the UK is comparatively rare internationally. In England, cities only directly control about **5%** of all the taxes raised from local people and businesses, with **95%** going straight to Government. This figure excludes the amount of business rates which are now retained to fund local authority services, but even adding that in only raises the sum by a fraction. Some of this money is then spent back in cities, for example on health, police or grants to the local authority, but it comes with nationally controlled strings attached. We estimate that about 40% of public money spent in our cities has some local control, with the remaining 60% being under national control. Cities in other countries often control a large share of the taxes raised either at the local or regional level, which they can spend on local services and local investment priorities. For example, in Canada about 10 times the amount of tax raised in a city is controlled at the local / regional level than in England. In the USA, it is 7.5 times more and in Germany it is almost 6 times more. English cities lack the level of local financial control of international competitor cities and are therefore not competing on a level playing field.

The lack of local control over funding raised by a city means not only that opportunities for greater efficiency and better outcomes through local action are missed, but also that when cities are successful, they are not directly rewarded for the risks they have taken. For example, where cities invest to support economic growth, the rewards from a larger tax base return to Government, restricting cities from being able to build momentum by reinvesting in economic success. When cities implement new public service solutions, for example improving health or tackling unemployment, it is often the associated national agencies that reap the rewards either through reduced demand on services or increases in the number of taxpayers. This does not incentivise cities or other agencies to always act in a way which is in the wider interests either of the economy, or that will create the public service efficiency we require.

The centralised approach to tax and resources in England diverts the proceeds of growth and reform away from the places that can make the biggest impact at scale and prevents cities reinvesting those proceeds to accelerate growth and transform public services.

Challenge Three: Cities do not have the flexibility to implement innovative investment and reform mechanisms

The Core Cities have the physical, demographic and economic scale to make a significant contribution to the public purse through economic productivity, job creation and the reform of public services. Internationally, studies have shown that where cities have greater control over local public resources and the flexibility to innovate with finances, those cities are more economically successful.[2] Core Cities want the local flexibility to make sure the UK captures more of the private finance that is available to transform the economy.

However in England, local authorities are unable to take the initiative and use local financial capacity to make long-term, innovative investment decisions at the necessary scale to support economic growth. As part of the City Deals, Government approved three Tax Increment Finance (TIF) schemes for three cities and whilst this was a welcomed and major step forward at relatively low risk, the scale of investment is small by UK and international standards. The fact that Scotland is now able to implement TIF without UK Government approval highlights the extent of financial restriction faced by English cities.

The economic capacity of the Core Cities represents a major opportunity for the UK but Government need to back our cities, back local accountability and trust the strong financial management cities have historically shown. Local authorities are widely recognised as the most efficient part of the public sector, delivering public service reform and efficiency where others can't through strong civic leadership and accountability to the local electorate.

Public investment remains critical to unlocking private investment in cities. To be able to compete internationally, Core Cities should have the flexibility to manage their finances over the medium term, manage financial risk and be able to undertake innovative investment activity to put English cities on a level playing field with their global competitors.

3. Core Cities offer and proposal

Core Cities have three sets of proposals to enable cities to: raise the investment they need to outperform the national economy by 2030; and become self-sustaining and deliver more back to the UK than they receive by 228. Together, these proposals would achieve three things:

- create more certainty and stability over public finances which will allow lasting, positive reform to be delivered;
- achieve the critical scale needed to drive really significant investment in growth by allowing cities to share in the proceeds of success; and
- provide the necessary freedoms to innovate with whatever funds will be available within an area, to create the most attractive environment possible for investors.

1. **Reform through certainty: aligning public budgets across places with longer term budget agreements**

- **Implement place based budgets** (see Step 8). Core Cities have the capacity to transform public services and reduce the cost of the state in the UK's most populous urban centres. Increased local control over public spending through 'place-based budgets' – effectively a single budget approach for public services across an agreed geography - will overcome the inefficiencies and duplication between services, breaking down a currently siloed approach, built on segregated departmental budgets linked to nationally defined rather than locally agreed outcomes. This should include

[2] Parkinson, M. et al (2012) Second Tier Cities

funds for Health and Social Care Integration, Skills and the Work Programme through Skills and Labour Market Agreements (see Step 1.)

- **Longer budgeting periods aligned to length of parliaments**. Single year budgeting cycles do not provide the certainty needed to support strategic investment decisions nor the flexibility to "buffer" local market risks. A longer term budgeting window would provide much greater ability to plan and provide consistent messages to private investors. A number of Government agencies operate in a similar way. If its good enough for Government agencies, Core Cities believe it's good enough for them too.

2. **Investing and reinvesting in growth at scale: retaining a greater share in the proceeds of growth and reform**

- **Support city growth and success through specific immediate changes.** Some specific flexibilities could make a big immediate difference, ahead of more comprehensive decentralisation:

    - **Business Rates Retention** – improving how business rate localisation operates to incentivise growth (e.g. introducing incentives for high growth sector development) as part of implementing the London Finance Commission findings (see below).

    - **Licensing Taxes** - relaxation of rigid restrictions over the use of licensing revenues e.g. to allow to pay for night time policing.

    - **Council Tax** – support a more flexible, mature relationship with council tax payers in setting the Council tax, discounts and taking a different approach to referendums (including on Transport Levies). This would more closely reflect the complex decisions that face cities trying to achieve economic, social and environmental wellbeing

    - **TIF** – extend the ability of cities to enact TIF.

    - **Urban Growth Zones** - to promote growth in cities that builds and capitalises on distinctive local competitive advantage. For example, an innovation UGZ could support a city to link innovation, technology transfer and commercial exploitation to support sector growth in emerging sectors, skills retention, FDI and trade growth and enhance a city's competitive advantage

- **Deliver the recommendations of the London Finance Commission for Core Cities and London.** Support economic growth, rebalancing and decentralisation by implementing the London Finance Commission recommendations, devolving property taxes to Core Cities, within a framework that has a neutral effect on the rest of local government finance (allowing for 'equalisation').This will help UK cities compete on a level playing field with international competitor cities.

- **Ability to retain a greater share of other local taxes**. Core Cities should have the ability to set smaller local taxes e.g. hotel room tax, and explore other taxes having a local element, e.g. VAT and income tax.

- **Local Investment / Business Bank**. Review financial institutional arrangements and whether a 'Local Investment / Business Bank', perhaps across all Core Cities, building on proposals from BIS, would help increase the business investment focus across Core Cities, particularly for SMEs.

3. Local financial flexibility: using all available funds in the best way possible to create an attractive investor environment

- **Greater financial flexibility to innovate with all funds that are available.** Core Cities require greater flexibility and control over available funds to: capture a greater share of reward; innovate to drive reform; and stimulate private investment by creating the right conditions for investment and growth. This means that national spending, for example on infrastructure, should play to the strengths and needs of cities, giving them a seat at the table from the start. Greater access to revenue will enable cities to innovate more financially using instruments like TIF to create growth and jobs, and attract institutional and private sector investment.

- **Extend the Single Pot approach** Core Cities welcomed Lord Heseltine's recommendations to help cities grow, and supported the principle of the Single Local Growth Fund built upon this, whilst feeling that the Government could go further. Core Cities would ultimately like to see an extended 'Single Pot Plus' which combines a wider range of cross-departmental capital funds that are spent within a place (complimenting the 'Place Based Budget' approach which focuses more on revenue) with maximum local flexibility. This will give Core Cities the financial capacity to unlock growth through locally defined investment priorities, boosting economic productivity, creating jobs and speeding up economic rebalancing.

- **Lift the HRA debt ceiling**. Cities require greater power to manage their Housing Revenue Account finances to support the delivery of housing supply in cities. A stronger focus on housing in the Core Cities will create better life choices for more of the UK population, construction jobs, apprenticeships and ultimately stronger local economies and national rebalancing