ITEM 8

AGMA EXECUTIVE BOARD

26 NOVEMBER 2010

ECONOMIC IMPACT OF THE SPENDING REVIEW ON GREATER MANCHESTER

PURPOSE OF REPORT

This report assesses the effects of the Spending Review and the broader current economic climate on GM's growth prospects. It provides a strategic analysis of opportunities to raise productivity, and so create growth and jobs, through maximising investment in GM, ensuring Greater Manchester's residents are supported through the economic transition and increasing the pace of collaboration across AGMA.

RECOMMENDATION

Executive to note the contents of the report.

PRIORITY

Relates to the implementation of the Greater Manchester Strategy.

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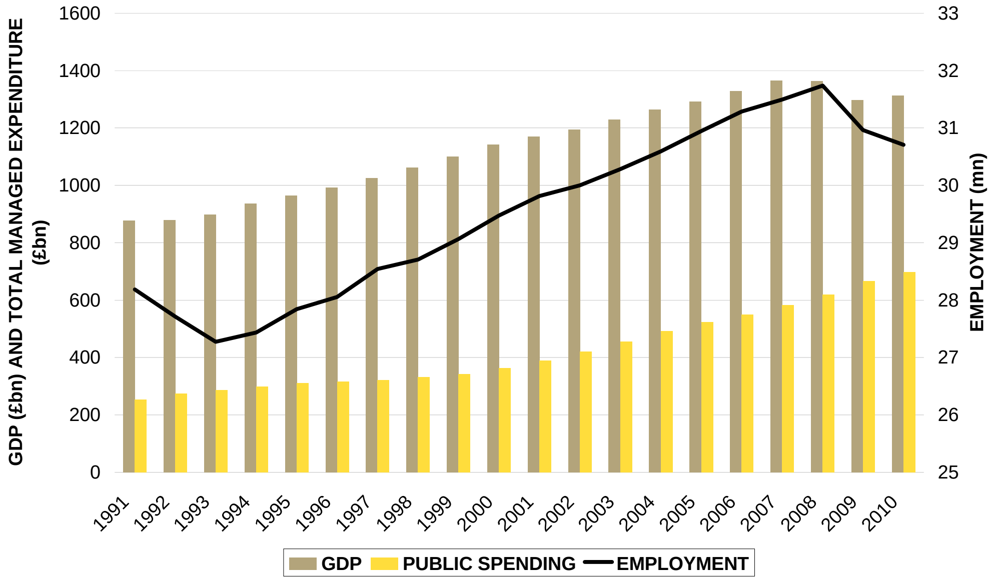
ECONOMIC IMPACT OF THE SPENDING REVIEW ON GREATER MANCHESTER

1. INTRODUCTION

1.1 This report responds to a request by the AGMA Executive Board for an assessment of the effects on Greater Manchester of the Spending Review. More broadly, it assesses the current economic climate and provides a strategic analysis of opportunities to raise productivity, create growth and generate jobs. Separate detailed briefings have been produced by New Economy on the June Budget, the Spending Review and on their impact on employment in GM[1].

1.2 The economic situation, and the Budget and Spending Review that have come in its wake, represent a significant and long-term downsizing in the public sector. The catalyst is the national budget deficit of some £160bn, representing over 11% of GDP (compared to a norm of below 3%). Government have made clear its top priority is to remove that over the lifetime of this Parliament, in part through tax increases, but largely through reducing expenditure. Just as the high rate of spending over the last years has seen a strong positive correlation with both GDP increase and employment (see Fig 1), so this reduction can be expected to create significant job losses (although the negative GDP effects can be expected to be mitigated by rising productivity). A real shift in spending priorities is also discernible, as is the continuing shift in Greater Manchester's basic economic landscape. Larger and more bespoke interventions will be needed to ensure that the skills of residents closely match the needs of the current and future labour market needs to ensure they are able to fully participate in and benefit from future economic growth.

Figure 1: UK GDP, Public Spending and Employment Growth



1.3 GM is well-placed to capitalise on the opportunities for private sector-led growth the current economic outlook is likely to lead to, but this will be neither easy nor

1 See http://neweconomymanchester.com/stories/1108-thinking_new_economy and http://neweconomymanchester.com/stories/1109-thinking_new_economy_briefings

automatic. There is much policy that GM needs to develop and implement to positively affect the level of growth required. This is elaborated in Section 3.

2. BROAD ECONOMIC OUTLOOK FOR GREATER MANCHESTER

2.1 After a decade of growth, Greater Manchester was hit hard by the recession. The Greater Manchester Forecasting Model (GMFM) estimates the conurbation will have lost 46,000 jobs (3.5%) and £1.8bn of GVA (3.0%) between 2008 and the end of 2010. Unemployment has risen very significantly over the past two years, although it remains lower than forecast at the start of the recession. This is in part because of a flexible labour market response (pay freezes, reduced hours and so on) and in part the result of significant Government spending undertaken to combat the worst recessionary effects.

2.2 However, although GM's economy may have started to grow again, it remains behind the pace of the southern-based recovery, and is subject to the very strong risk of the economy stalling or experiencing weak growth for a prolonged period. Reduced public spending will exacerbate this in the short-term. Broadly, relative to other centres outside London, Greater Manchester's economy is well-placed to prove resilient to this, as it is less reliant on public sector employment than the national average. However the next 12-18 months are likely to be an extremely challenging period. Most important will be the economy's ability to switch much more rapidly to a well-populated, high-growth, high-innovation base that sucks in mobile capital and talent and so brings growth and prosperity.

2.3 In the short-term, as Government spending falls and the conditions for substantial private sector-led growth take time to emerge, there will be a difficult transition period. The assumptions made by the Office for Budget Responsibility indicate that 21,900 public sector jobs will be lost across GM (in public administration, education, and health) over the next five years. This will be accompanied by consequent private sector job losses too. Estimates of these, such as by PwC and the Chartered Institute of Personnel and Development, vary considerably, but a considered view, controlling for variance based on the accuracy of the 2008 forecasts, would assume around a further 26,760 jobs would be lost. However, this does not necessarily equal a net loss. GMFM forecasts also show potential for significant additional private sector growth to more than offset this, albeit there are significant risks to achieving this. Figure 2 shows how public sector job losses and private sector growth may be spread across GM.

2.4 Broadly, the evidence suggests that employment – i.e. the number of jobs – will return to pre-recession levels by around 2014/15. This will be driven by growth in services, particularly business services, on the back of an export-led recovery. However, the effects on individual residents are mixed. It is clear that many of the unemployed will struggle to return to the labour market. Under the GMFM base scenario, unemployment is not forecast to get back down to the level seen in the early 2000s for the foreseeable future, and is expected to remain above 65,000 (4%) over the medium term, a level similar to the late 1990s. This is due to a combination of fewer jobs, continued population growth, and skills mismatches.

Figure 2: Public and private sector job losses/growth 2010 – 2015

	PUBLIC SECTOR		PRIVATE SECTOR LOSS		PRIVATE SECTOR GAIN		TOTAL	
	Number	**%**	**Number**	**%**	**Number**	**%**	**Number**	**%**
Bolton	–2,600	–8.8	-3,200	-4.4	4,900	6.7	-900	-0.9
Bury	–1,400	–6.2	-1,700	-4.5	2,600	6.8	-500	-0.8
Manchester	–5,100	–5.4	-6,200	-3.0	28,800	14.3	17,500	5.9
Oldham	–1,500	–6.6	-1,800	-3.5	2,800	5.5	-500	-0.7
Rochdale	–1,700	–8.8	-2,100	-4.2	3,500	7.0	-300	-2.6
Salford	–2,500	–7.1	-3,100	-4.0	8,600	11.1	3,000	2.7
Stockport	–2,600	–8.3	-3,200	-3.5	7,800	8.6	2,000	1.7
Tameside	–1,500	–7.7	-1,800	-3.9	1,800	3.9	-1,500	-2.5
Trafford	–1,200	–5.6	-1,500	-1.6	10,800	11.6	8,100	7.0
Wigan	–1,700	–6.7	-2,100	-3.0	4,800	7.0	1,000	1.1
GM	**–21,900**	**–6.8**	**-26, 760**	**-3.4**	**76,600**	**9.7**	**28,500**	**2.6**

Source: OBR, GMFM and New Economy

2.5 The benefits proposals outlined in the Spending Review and the Budget, with further details provided in the Universal Credit White Paper, will also have a significant impact on GM's out of work and in-work resident populations. It is estimated that the reforms outlined in the Spending Review will, by 2014/15, result in benefit payments to GM residents being some £333m lower annually. This is in addition to the savings outlined in the June Budget, of which the GM impact is estimated to be around £520m. These figures are based on the Treasury model and are composed of both reduced benefit payments per person and fewer people claiming benefits. In total the reductions in benefit payments announced in the budget and the Review are equivalent to around 1.5% of GM's economic output. However, these figures do not include the positive economic impact of individuals moving into paid employment, which ought to be significant as people previously on welfare enter the productive economy.

2.6 Financially, the most significant reform is that all benefits (apart from the state pension and pension credit) will become indexed to a lower method of calculating inflation (the Consumer Price Index rather than the Retail Price Index), saving more than £5bn nationally in total by 2014/15, and taking around £322 million a year out of the GM economy - almost as much as all the measures in the Review combined. Within the Review announcements: time limiting the contributory Employment Support Allowance (ESA) to one year for those on Work Related Activity Group is estimated to reduce payments to GM residents by approximately £120.3m; withdrawing child benefit from higher rate tax payers is estimated to have a £110.9m per year impact; and the net reduction in payments to GM residents of the tax credit announcements is likely to be in the region of £42.6m. The geographical distribution of these changes will be disproportionately concentrated on the most deprived areas, with those areas with the highest levels of worklessness experiencing the most significant reductions.

2.7 The government is also bringing forward changes in other areas that affect GM's ability to reduce worklessness and to tackle dependency, such as in skills funding, apprenticeships, social care and education. As well as the changes to the benefits system, these will also impact on GM's ability to increase its productivity. A more integrated approach between education, skills, health, social care and employment interventions would benefit Greater Manchester residents and have a notable positive effect on ensuring residents are able to participate in and benefit from the expected local economic growth. The CSR and subsequent announcements now give us some of the practical tools we need to translate this into operational delivery. Greater Manchester's Community Budget, which was set out in Local Growth White Paper, offers an opportunity for cross-Agency and cross-border working that can help realise these gains, through integrated commissioning. The potential exists to build on the City Region pilots which sought to focus on place and community, and to develop interventions which integrate various programmes. A robust cost benefit analysis evaluation framework is being developed with Government to help understand the effects of multiple integrated interventions that help residents into work.

2.8 On current trajectories, skills mismatches will continue to be driven by the changing composition of GM's economy. The pace of change can be expected to accelerate. There will be a continued shift away from manufacturing, which will continue to decline, albeit at a slower pace than over the previous decade. The main requirement for residents to develop new skills comes from the continued growth towards services, although within that field there will also be significantly rising skills mismatches as growth in business services accelerates and public services continue to diminish. Employers will increasingly demand intermediate and higher level qualifications and generalist skills. Over half of available jobs over the next decade are forecast to require at least a Level 3 qualification. At present, just 29% of GM's workless population have a Level 3 or above qualification, and a third have no qualifications.

2.9 Closely monitoring the effects of this economic and skills transition, and developing tools and levers that can respond quickly and effectively to the challenges it raises, is a key need. In terms of intelligence, an appraisal framework could be quickly developed to track and measure changes on the ground, reporting to the LEP, the AGMA Executive Board and the Combined Authority. Quarterly reporting is proposed. Co-ordination with commissioners should be designed to ensure that the investments made in GM residents strikes the right balance between short-term amelioration and long-term investment in skills.

Figure 3: Sectoral employment growth in GM

	1998-2008	2008-2010	2010-2020
Manufacturing	-76,600	-15,600	-23,900
Electricity, gas and water	-4,400	0	-300
Construction	17,100	-11,500	9,800
Distribution and hotels	6,900	-9,300	34,200
Transport and communications	14,200	-3,800	11,900
Finance and business services	89,600	-22,900	84,900
Public admin and defence	11,200	1,400	-7,000
Education and health	43,000	16,000	4,700
Other personal services	18,200	-1,200	15,600

Greater Manchester	**120,300**	**-46,300**	**129,000**

Red shading: sectors experiencing the greatest decline in employment
Green shading: fastest growing sectors
Source: GMFM

3. OPPORTUNITIES FOR GM IN THE NEW ECONOMIC ENVIRONMENT

3.1 National policy is clearly trying to focus on generating private sector jobs and growth, and Greater Manchester is relatively well-placed to take advantage of that and to prosper as a result. There are three key areas of focus in terms of how GM policy can positively affect outcomes: supporting residents through the economic transition, accelerating collaboration across the public sector, and most importantly, maximising investment into Greater Manchester.

3.2 The economic changes of the last years, and those still to come, which will be different but no less radical, mean that the drivers of future growth and prosperity are not those of the past that GM is familiar with. The tools at GM's disposal are not familiar either. The property boom will not return in the foreseeable future, nor will credit-rich and free-spending consumers. Simultaneously, there will be a significant reduction in the level of public sector investments in skills, transport and GM's most deprived areas. Public authorities must avoid becoming consumed in their efforts to reduce their costs, and instead seek a strong brand and messages about vitality, innovation, technology and growth.

3.3 To ensure residents are effectively support to participate in and benefit from economic growth, it is vital that we continue to work closely with Jobcentre Plus, and with Work Programme providers, to monitor and ensure that residents are being well supported and appropriately advised. A more integrated approach to this across GM, as well as to a broader range of connected policy matters, such as stimulating and supporting "Big Society" initiatives, would enable better quality advice and activity and help reduce duplication.

3.4 The forecasts that GM will return to pre-recession levels of employment by 2014/15 depend on very significant growth in the private sector. To be sustainable, this requires a transformation in GM's business profile towards highly-productive, high-value, high-innovation firms, with the whole business stock being much more internationally connected, and many more start-ups being "born global".

3.5 Though not a solution in itself, establishing a "Technology and Innovation Centre" and a "Growth Hub" may be important catalysts for this shift to knowledge intensive business. The "Manchester" brand needs to be seen as a location to which talented people and capital in all its forms is attracted to commercialise ideas and success. This requires a strong range of profile-building activities, support systems (such as greater investor-readiness) and partnerships that quickly come to define the GM offer. Large domestic companies are a key part of this, as are the Universities, and especially the University of Manchester, given its track record of attracting the world's most talented, including the recent Nobel-winning inventors of Graphene.

3.6 The clear and present challenge for Greater Manchester is to develop a creative environment which will result in commercial exploitation getting done here rather than on foreign shores such as Silicon Valley. The rewards for this, in terms of employment, supply-chain, business base, and fundamental economic sustainability and resilience are enormous, with positive repercussions across the whole North, and indeed the UK.

3.7 Greater Manchester has significant assets of national importance, which have the potential to be more productive in the future to drive this growth. These include: a critical mass of research and development expertise, especially in technology and science, including world-leading biotech and healthcare sectors, particularly around the Corridor; large employment sites such as Kingsway, Trafford Park, Hollinwood Junction and Ashton Moss; town centres such as Bury, Bolton and Stockport that research shows have strong comparative advantages and the ability to grow; a large cluster of creative & digital industries, based around MediaCity:UK and the Sharp Project; and the largest financial & professional services sector outside London.

3.8 GM has a strong track record for delivering major projects and policy initiatives, and has potential to capitalise on this, for example in showing the productive benefits to investment from public-based vehicles such as the Green Investment Bank and Regional Growth Fund. GM's greatest need and opportunity, and policy focus going forward, is in attracting more significant private inward investment, especially from global growth zones such as the Middle East, India, Brazil and China.

3.9 For residents to benefit from private sector growth, for example through job opportunities or supply chains, they must have the relevant skills and support. This highlights the need for a much better alignment of skills provision with business needs, linking business support and providers into a common approach to business engagement, and aligning these services to support growth in the local economy. Functional economies like GM will be the ones driving growth in the UK, and driving the best outcomes will result from a better alignment of these services. Government and local policy needs to be sharpened to meet the needs of both GM businesses and residents, and the emerging LEP has an important role within "GM plc" in this respect.

3.10 How public sector partners respond to these challenges is also important. For example how quickly innovation and best practice are spread to realise change. Skills development is also crucially important, and could become a priority for the Improvement and Efficiency Commission. There may be benefits to a broader look at retraining public sector workers to be better able to respond to, and take advantage of, the coming organisational changes. GM would benefit from its public authorities rapidly shaping up for a likely new role which is less about providing services and more about management, oversight, and policy opportunism. This would take the form of a clear strategy that builds a strong brand and messages, which for GM are about vitality, innovation, technology and growth. Part of this change may come from supporting, challenging and galvanising parts of each authority that in the past have had little to do with economic growth. Tameside's decision to expose their services to an external "IMF Article IV" style challenge may set an innovative precedent. This will support and challenge each function of the council to understand the impact of what it does or doesn't do on broader economic growth.

3.11 There are many potential opportunities in the restructuring of public service organisations necessary in order to drastically reduce spending over the next years.

Driving real change and efficiencies in the back-office through cross-border and agency collaboration will maximise the protection that can be given to front line services. The history of working across Greater Manchester presents a very solid foundation for much greater collaboration that could redefine how whole fields of activity are conducted. Essentially non-statutory services, such as economic development, are at a higher risk, making identifying new ways of working a high priority. The logic of solutions that involve less than ten teams generating and considering evidence, developing policy and interventions and implementing, commissioning and managing activity has never been stronger.

3.12 The Improvement and Efficiency Commission has identified several areas as having the potential to deliver hundreds of millions of savings to the Authorities and their populations, along with increased collaboration in high-cost areas such as adult services, children's services, ICT, vehicles and & social transport, corporate and back office shared services, workforce development, property and asset management and procurement, with a combined spend of £2.4bn on goods and services across the AGMA Authorities. Generating the savings required, whilst maintaining service levels, will not arise from information-sharing type collaboration, but requires full-scale service re-design. The work of the Commission and the Community Budget provide a good framework for this to take place where there is willingness. Another immediate opportunity may be for an integrated approach to the current cycle of public sector redundancies. Those who have certain skill sets and work habits may, with appropriate support and (re)training, help Greater Manchester boost its self-employment rate, and the nature, quality and scale of business start-ups.

3.13 In terms of maximising investment, the Evergreen Fund has the potential to grow significantly and to become a magnet for private sector investment, not least through providing the certainty of a robust GM investment framework, which could also underpin RGF, ERDF and other European funding. Evergreen's real significance is that it responds to the lack of 'gap financing' capacity in the marketplace. The Fund is not designed to replace gap financing, but responds to a need for a smarter way to access this finance. This is not only about investment in capital projects, but also about investment in Greater Manchester's people.

3.14 Given the direct correlation between levels of certainty, confidence and private sector equity, the robust investment framework that underpins Evergreen also enhances the chances of, and opportunities to benefit from, an Accelerated Development Zone, which the Government is committed to introducing in England. This may sharply increase the possibility for more investment in Greater Manchester's infrastructure (real and digital) and generally for leveraging different investment streams, as well as providing a much better framework for driving economic value from spending. All this is highly consistent with MIER and the GMS, particularly in terms of widening and growing the economic base, attracting talent, helping more residents move quickly to higher employment-focused skills, facilitated by transport investment and a strong will to ensure that building a low carbon sector is an economic driver.

4. CONCLUSION

4.1 The recession, and the Budget and Spending Review that have come in its wake, represent both a significant and long-term downsizing in the public sector, and also a potential shift in spending priorities. Economic growth, as it returns, will require skilled people, infrastructure, investment, talent, accessible capital and a vibrant and attractive business ecosystem to make it sustainable. GM's ability to engineer or positively influence these factors is maximised by working together at the level of GM's functional economic geography, with the LEP and Combined Authority representing opportunities to strengthen the positive economic outcomes of this governance effect.

4.2 The likelihood of significant job losses increases the need for interventions designed to ensure that residents have the necessary skills to return to employment as quickly as possible, to remain in work, and to be incentivised to move up the skills ladder. There is also a significant need for skills to be aligned to real and future labour market needs, to ensure GM residents' long-term employability. The economy may benefit, for example, from innovative activity aimed at newly out of work public sector workers, who would benefit from support and encouragement to update their skills. More broadly, more residents will need support and advice to manage the transition to the new economic realities.

4.3 The new welfare regime, alongside changes in skills funding and health increase the necessity for GM and its core partners to work together across a range of issues, including social care, education and transport. This is both to reduce costs and also enhance people's ability to obtain work and remain in employment. Increasing the connectivity of people and jobs, not just in terms of transport, is a key determinant in helping tackle worklessness in the most deprived communities - reducing demand on healthcare, social care and the benefit system.

4.4 As succinctly evidenced in the MIER, GM needs to remain focused on productivity. With reduced public spending, this will require a focus on supporting business in more innovative ways, to enhance profitability and productivity, better incentivising and enabling them to compete in global markets, and aiming for bigger opportunities. This reinforces that the GMS priorities of widening our economic base, increasing international connectivity and attracting, retaining and nurturing talent are the right ones. The achievement of those goals requires a transformation in GM's business profile towards highly-productive, high-value, high-innovation firms, with the whole business stock being much more international. "Manchester" needs to become synonymous as a location to which talented people and capital in all forms is attracted.

4.5 With the reduction of the public sector, the private sector needs to be the driver of growth around the country, and especially in GM. Broadly, GM is well-placed to capitalise on the opportunities for private sector-led growth that the current economic outlook is leading to, but this will be neither easy nor automatic. There is much policy that GM needs to develop and deploy to positively affect the level of growth required. It is important not to be too downbeat, as there is significant private sector money in the national and global economy looking for a return. The Evergreen Fund, and the associated investment assessment framework being built up around it, represents a serious attempt to send the message that Greater Manchester is open for business and will continue to invest and do more to drive economic value from that investment. It also signals that the public authorities are highly supportive of private investment and are actively seeking to attract it.