city leadership

giving city-regions the power to grow

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with chris urwin

ippr

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About centreforcities

The Centre for Cities is an independent urban policy unit, based at the institute for public policy research (ippr). It is taking a fresh look at how cities function, focusing on the economic drivers behind urban growth and change.

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executive summary

City Leadership sets out the economic case for radical financial devolution to England's cities and towns. It argues that more financial powers and autonomy are essential for our urban areas to achieve their economic potential.

But the scale of devolution is critical. *City Leadership* recommends a priority focus on our largest city-regions, plus a set of general flexibilities for all areas:

- The two biggest city-regions outside London – Greater Birmingham and Greater Manchester – are ready for significant new powers over regeneration, transport and skills, including devolved spending and revenue-raising. Other large city-regions could follow.
- All areas need greater financial flexibility, building on existing policy initiatives.

This is 'asymmetric devolution', with different places having different degrees of autonomy, proportionate to their economic importance.

Over the next year, *City Leadership*'s findings will feed into the Lyons Inquiry, the Local Government White Paper and the Comprehensive Spending Review.

Key recommendations

Radical devolution to Birmingham and Manchester city-regions:

1. **City-Region Contracts** that devolve key economic development powers and budgets to city-regions
2. **Supplementary Business Rates**, hypothecated to key city-regional infrastructure priorities
3. **A City-Region Growth Incentive** to promote cross-boundary collaboration and efforts to grow the business base
4. **A clear policy framework** with Whitehall departments, Regional Development Agencies (RDAs) and other agencies sharing a common focus on city-regional growth
5. **New city-regional governance structures**, with directly elected mayors in the lead, supported by existing local authorities

More freedoms for all cities and towns:

6. **Economic Development Contracts within Local Area Agreements**, giving local authorities greater discretion over regeneration spending
7. **Enabling greater take-up of existing powers**, including prudential borrowing, Business Improvement Districts and user charging
8. **Improving capacity and skills in local authorities**, to further public-private co-operation and promote investment

foreword

Tony Travers, London School of Economics

Centralisation and its discontents

Britain is a centralised country. The concentration of resources and decision-making power that exists in Whitehall today cannot be attributed to a single government or political party. Instead, it is a reflection of the way British democracy has evolved.

The Exchequer collects all but a tiny fraction of the United Kingdom's taxation. Local government, which is responsible for 25 per cent of public expenditure, raises only one-quarter of the income needed to fund this expenditure – and relies on tax powers that are subject to central capping.

City Leadership asks how centralised public finance affects Britain's cities. Critically, it concludes that the current level of centralisation is holding cities back – with consequences for the national economy as a whole.

National governments would find it hard to provide effective, successful political and economic management if most of their tax take was determined by an external authority. Yet cities and other local authorities are expected to achieve a huge range of objectives – including service delivery, community leadership and, increasingly, economic management – without the fiscal autonomy that central government enjoys.

Moreover, demands for good local governance have been particularly intense in British towns and cities because of the profound de-industrialisation and economic restructuring they have experienced.

It wasn't always this way

When England's cities originally industrialised in the mid-nineteenth century, they petitioned Parliament to create corporations that had among their powers the ability to set a local tax. This power, supported by municipal enterprise, allowed civic leaders to institute improvements, including the introduction of water supplies, sewers, utilities and tramways. It was not necessary for every policy measure or civic development to be approved and funded by central government. See Asa Briggs's seminal book *Victorian Cities* for an account of the golden age of nineteenth-century municipal power and entrepreneurial leadership.

Then, as now, major cities produced large tax yields. However, since 1945 English local authorities have seen their dependence on central grants increased: the property tax was not able to sustain the wider range of services, particularly welfare provision, demanded of councils during the twentieth century. Grants have been reformed in order to equalise variations in expenditure needs and taxable capacity – thus achieving widely desired social-democratic goals. The increasing sophistication of the grant system, coupled with growing use of specific-purpose grants, has meant that Whitehall departments have assumed ever-greater responsibility for local authority funding, but at a price for local autonomy.

Centralisation versus autonomy

In short, Whitehall is now the origin of most resources for both day-to-day and investment finance in English cities. Authority and policy-making capacity have, inevitably, passed upwards. Local political life and civic leadership have diminished as a result.

City Leadership identifies greater financial autonomy as a top priority, especially for our biggest city-regions. Autonomy is clearly linked to the quality of government in cities and larger towns. The existing literature makes it hard to attribute a clear and direct link between particular governance arrangements and economic outcomes, yet there are good reasons to believe that autonomy and choice produce more effective results. City politicians who must balance the costs and benefits of their expenditures against the tax consequences for their local population will be more likely to use resources wisely and effectively than those who simply beg for funding from the centre.

The academic literature suggests that urban centres are highly productive, thanks to the benefits of agglomeration economies. In England, however, around 40 per cent (on average) of cities' GDP is taxed away and then dribbled back to them in central government spending (Travers, 2004a).

Even if this degree of centralisation could be shown to be the best way of managing the public finances (which it can't), the notoriously fragmented nature of Whitehall means that city governance institutions are required to attempt to 'join up' dozens (if not hundreds) of separate central government funding streams. For every one pound spent by the public sector in Birmingham and other cities today, less than five pence will be funded by local taxpayers. In the nineteenth century, the figure would have been 95 pence.

The impact on leadership

In a country where local political leaders must submit bids to central government for a share of their own residents' tax payments, accountability for urban government has, inevitably, become confused. This problem has been made worse by the extraordinary clutter of institutions created to co-ordinate spending programmes and to promote regeneration initiatives. Independent bodies such as the Audit Commission have been clear that there are now so many partners involved in the redevelopment of some cities that paralysis is inevitable (Audit Commission, 2005a).

Leadership of major urban centres has evolved well away from the traditional 'city boss' role. Complex local partnerships must be chaired, public and private resources must be sought, and time must be spent on trains to and from the capital, since major spending decisions are made at the heart of government rather than city halls. Each time a tram scheme is rejected, the decision is announced from the Department for Transport in London. As a result, cities increasingly look to Brussels, rather than Whitehall, for financial assistance.

Yet, local authorities are judged – notably by the Comprehensive Performance Assessment regime – across a wide range of outputs and outcomes. Urban leaders are expected to produce results by the use of techniques such as 'commissioning', 'enabling', 'empowering', and 'partnership working'. This role is a long way from the traditional one of raising resources from local taxpayers to deliver services and economic success locally.

If the new role of local political leadership were well developed and understood, individuals would be more likely to be attracted to it. But there is a strong perception that English local government is permanently being reformed, and that it is becoming weaker and less capable. Geoff Mulgan, until recently head of policy at 10 Downing Street, has stated that 'local government has been so squeezed, knocked and drained of power that its impotence has become … a problem'. It is implausible to imagine any but the most dedicated political and managerial talent opting for a career in such an institution.

A universal problem?

Perhaps the decline of local political power and leadership is an international phenomenon, with central governments drawing power to themselves in an era of globalisation.

Yet there is no international evidence that power and resources are drifting away from city governments. Indeed, in the United States, France, Spain, Italy and Germany there have been moves to enhance the powers of regional, metropolitan and city governments. France introduced regions in the 1980s, and beefed up city-regional structures in the 1990s. Successive presidents have transferred programmes from federal to state and local government in the United States. Spain's nascent democracy has involved the creation of a series of powerful regional governments.

Italy has also devolved power to regions, while both it and Germany have introduced directly elected mayors in some cities. Even the United Kingdom has devolved powers to Scotland and Wales, while introducing a directly elected mayor for London.

The continued top-down approach to urban local government in England appears to be out of line with experience in a number of other countries. Indeed, a number of recent events suggest that effective city leadership is an essential element in good government. The Giuliani/Bloomberg era in New York City – now stretching to four consecutive terms in office – has shown how powerful leaders can provide cities with effective government during a crisis and during the rebuilding phase that follows serious urban problems. Here, ministers publicly accept that Ken Livingstone's leadership was a key element in London winning the 2012 Olympic Games.

Britain is out of step with much overseas experience. *City Leadership* suggests that in a number of countries it is possible to find thriving urban leadership, with resources derived locally, rather than drip-fed from the national capital.

We are where we are…

Virtually all politicians will admit – both publicly and privately – that England is now over-centralised. The Government has presented a number of ideas to transfer power to local institutions such as schools, hospital trusts, housing bodies, regeneration partnerships and other micro-bodies. This form of 'new localism' is certainly a step towards greater local control, but does not always involve traditional city and local governments.

Thus, in future, cities are likely to see more of their public service provision in the hands of new bodies outside of local government. But this does not mean local leadership, especially in areas like economic development, will be less necessary. Arguably, the very lack of certainty as to how these 'new localist' institutions will operate suggests a new role for city and other urban governments. Institutional machinery and financial support for economic development can, realistically, come only from city and town halls.

City government will have another key role. As urban centres redevelop, the process of continued regeneration and economic expansion will require infrastructure and other public assets. As *City Leadership* suggests, transport facilities, affordable housing and many other community resources cannot be delivered without an effective city-regional entity. This entity also needs the power to raise resources to underpin continued expansion. Here, surely, lies the clue to what urban government will need to do in the years ahead.

...But we can do better

City Leadership outlines a number of pragmatic proposals that will enable city-regions to lead the continued economic revival of their component cities and towns. However, to do this, their leaders will need access to resources, derived from the growing tax base in their area, that enable them to invest in the 'hard' and 'soft' infrastructure that can facilitate economic expansion.

The search for additional resources for cities and other urban authorities cannot be divorced from the Lyons Inquiry's work on the future of local government. But it is worth stating why cities need different – and possibly more immediate – treatment if they are to continue to develop. Rapid de-industrialisation and middle-class flight from many English cities has created a position where emergency action has been required. Successive national and local administrations have just about stabilised the situation: the freefall economic and social decline of the 1970s and 1980s has been stopped, and cities are now experiencing something of an economic recovery. But there is little room for complacency. Much more action – with decision-making and resources at a local, not national, level – will be required if cities are to continue to expand and grow.

Lyons will now report at the end of 2006. It is unlikely there will be any significant reform of local government finance before 2010 at the earliest. This *City Leadership* report makes a strong case for devolving both resources and decision-making to urban areas well before that date.

1 introduction

Why bother?

After years of decline, the past decade has seen an increase in investment, confidence and prosperity in England's largest cities (ODPM, 2004d, 2004e; Labour Party, 2005). Many towns are following suit, with ambitious strategies for recovery.

Policy-makers want to find more ways to strengthen urban economies – and are asking whether cities are run in a way that allows them to achieve their full potential.

The UK is highly centralised, and its cities do not have enough power. English city councils want the sweeping financial powers and political latitude enjoyed by European and American city mayors, while Whitehall has favoured a more cautious approach.

Most policy-makers agree that English cities need more power to make their own decisions, but there is no consensus on how, what or why to devolve. Despite years of debate and three major reforms of local government, our cities still lack the tools they need to fulfil their economic potential.

The *Devolved Decision Making Review* (HMT *et al*, 2004a), *Productivity in the UK* (HMT and ODPM, 2003) and the work of the Core Cities Group (for example, Parkinson *et al*, 2004) put this agenda on the map. But ministerial rhetoric has not been matched by policy action. Local Area Agreements, Local Authority Business Growth Incentives, the Local Enterprise Growth Initiative and other programmes are only a small step in the right direction.

This report examines the case for financial devolution to towns, cities and city-regions. It explores the distribution of resources and decision-making power, and uncovers barriers to success. Using original research in Birmingham, Liverpool and Barnsley, the report asks whether specific policy changes could help cities and towns promote regeneration and economic growth. Finally, it urges the Lyons Inquiry – and government ministers – to support significant financial devolution, beginning with city-regions.

Research questions

City Leadership addresses three sets of questions:

- First, finance. Do cities need additional fiscal powers to facilitate economic development and attract private investment? Is there a case for greater financial devolution from the centre?

- Second, co-ordination. How should powers and funding be distributed between local, regional and central government? How can we co-ordinate functions, finance and skills most effectively? And how can we promote cross-boundary co-operation, strategic decision-making and stronger economic outcomes?
- Third, governance. How do we apply freedoms, flexibilities and growth incentives to different cities and towns? What scale is appropriate? And who should be in charge?

Public- and private-sector stakeholders alike say that English cities are handicapped by a complex, overly centralised public finance system.

Our research set out to examine these claims, and to investigate whether targeted devolution could help cities to do better.

Why this report adds value

For some observers, devolution is an ideological imperative, and the political objective of 'localism' (for example, Stoker, 2005; Jenkins, 2004). Yet, too much of the local governance debate is focused on local-authority structures and boundaries. This approach places too much emphasis on the 'container' – and not enough on content.

City Leadership, by contrast, tackles the issues around city governance from a different perspective. The report:

- Focuses on barriers to economic growth and regeneration
- Develops the case for financial devolution to city-regional level
- Recommends specific changes to the financial tool-kit for city-regions, cities and towns.

The report starts from the premise that we need to consider functions and finance first, before addressing the question of structural change. We need to identify the obstacles to regeneration and economic growth in urban areas – and then develop finance and governance arrangements that can deliver results.

Why is this important now?

There is currently a critical window of opportunity to present arguments for financial devolution.

First, the Lyons Inquiry into Local Government – which is reviewing the functions, role and finance of local government – is set to report in late 2006.

Second, the 2007 Comprehensive Spending Review will have a substantial impact on the flow of funds from central government to local authorities. The review is expected to reduce growth in public expenditure – meaning that all parts of government, including cities and towns, will need to do more with less. Devolution and greater flexibility would help cities to use limited resources more effectively and efficiently (OECD, 2001; Oates, 1999).

Third, there is an increasing awareness that city performance is important to the national economy, and to the achievement of central government's key goals (Strategy Unit, 2002). City economies will largely determine whether the Government is to meet ambitious economic targets, especially its commitment to raise growth rates in lagging regions so they catch up with London and the wider South East (HMT, 2002). This is confirmed by emerging evidence that suggests that large, well-connected urban areas offer the best opportunity to boost regional growth and narrow the productivity gap (SURF, 2004; SURF and CUPS, 2006; HMT, 2004b; Parkinson *et al*, 2005).

Whitehall has recognised that more regional and local flexibility is needed to drive growth over time (HMT *et al*, 2004b). Government has publicly acknowledged that local authorities need to be empowered if they are to help boost national economic performance (HMT and ODPM, 2003).

Speaking in 2003, the Chancellor of the Exchequer, Gordon Brown, stated that Government faces:

> *a challenging agenda for modernisation and reform: more radical devolution of responsibilities from Whitehall as we give the role of Whitehall a sharper focus; greater attention to the conditions favouring a new localism in delivery with greater transparency, proper audit and new incentives.*[1]

So the local financial 'tool-kit' for cities is very much a matter of current debate. This report provides decision-makers in Whitehall, cities and towns with new evidence – and helps them to make a case for greater devolution.

The report

The report is arranged as follows: Chapter 2 details the methodology and structure of the research; Chapter 3 explores evidence linking devolution, governance and city economies, and identifies a case for greater devolution to the city-regional level; Chapter 4 details the findings of our primary research in Birmingham, Liverpool and Barnsley; Chapters 5 and 6 lay out a range of policy recommendations that emerge from these findings; and Chapter 7 sets out conclusions and next steps.

1 Rt Hon Gordon Brown MP, speech to the Social Market Foundation, 3 February 2003.

2 city leadership: who, what and where?

Introduction

This chapter provides a brief outline of our research methodology, and introduces our three case study areas: Birmingham, Liverpool and Barnsley.

Two key concepts that feature throughout the report are city-regions and economic development. Both of these terms have a number of definitions and meanings, and remain contested (SURF and CUPS, 2006).

City-regions are both economic and political entities (SURF, 2004; NLGN City-Regions Commission, 2005).

City-regions already exist as economic areas. They include a core city, as well as surrounding areas that have close economic relationships with that city. These relationships can be measured in a number of different ways, including labour markets, housing markets, retail catchment areas and business-to-business links.

If governance arrangements are imposed at a level that matches specific economic flows, city-regions become political entities, with administrative boundaries that broadly reflect an economic area.

Chapter 5 sets out a methodology to draw up city-regions that match the economic realities of England's largest urban areas. Our definition of city-regions explicitly excludes small urban areas (for example, Stoke-on-Trent), polycentric city networks (for example, the Three Cities), and shire counties (for example, Kent).

Economic development is the nurturing of economic and employment growth. It is a very broad area, including regeneration, housing, planning, skills, labour markets, transport, enterprise and innovation policies.

This report focuses on three specific strands of economic development: regeneration (including elements of housing), transport and skills. Our initial research found that the inability to initiate and deliver large projects in these areas was a fundamental constraint on city-regional economies.

This report does not address area-based or neighbourhood interventions, which are undertaken at or below the local authority level.

Project methodology

The research programme was designed to address the questions around financial devolution, co-ordination, governance and leadership introduced in Chapter 1. It is based on a range of qualitative, quantitative and comparative evidence collected from:

- Desk-based research
- Consultation with national stakeholders (for example, HMT, ODPM, CBI, LGA)
- 'Action research' with city stakeholders in Liverpool, Birmingham, Barnsley and Manchester.

Desk-based research and primary research were conducted between April and October 2005 by members of the Centre for Cities team, with assistance from our city partners.

Desk-based research
A wide-ranging literature review examined:

- The links between city governance and city performance, including the relationship between devolution and effective governance
- The existing financial powers of English cities, and how they compare to the financial levers held by regional and central government
- Fiscal powers and governance structures at city and city-regional level in other countries, with specific emphasis on France, Spain, Germany and the US.

This research resulted in a number of literature review papers, which are available at www.ippr.org/centreforcities.[2]

National stakeholder consultations
Consultation with a wide variety of national stakeholders from the public and private sectors helped to uncover key policy and evidence gaps.

Additionally, the Centre for Cities held a number of events that yielded further evidence on financial devolution and barriers to investment in cities and towns. These included a seminar on City Mayors,[3] two *Working Cities* events,[4] which focused on city governance, and an international seminar on financial devolution held jointly with the *Diputacíon* of Bizkaia, Spain.[5]

Reports summarising these events are also available as web-based annexes.

City stakeholder consultations
Primary research was conducted during summer and autumn 2005 in Birmingham, Liverpool and Barnsley. This included:

- *Case studies* of specific regeneration projects, and the financial arrangements required to achieve them;
- *Semi-structured interviews* with key city stakeholders, focused specifically on economic development powers and barriers to investment.
- *Business stakeholder groups*, organised jointly with local business organisations

2 Web annexes 1, 2 and 3.
3 Centre for Cities City Mayors seminar, London, 19 May 2005. See web annex 4.
4 Held jointly with the Smith Institute and Inclusion at 11 Downing Street, 8 June 2005, and the Labour Party Conference, Brighton, 27 September 2005. See web annex 5.
5 Held in London with a delegation from Bizkaia and our three partner cities on 17 November 2005. See web annex 6.

in all three cities, which tested business views on governance and financial devolution.[6]

The report also draws on stakeholder interviews conducted in Manchester as part of the field research for our *City People* project (Nathan and Urwin, 2005).

Emerging conclusions were presented and refined during November and December 2005. This process involved our three case study cities, the Office of the Deputy Prime Minister, HM Treasury, the Local Government Association's Urban Commission and the Confederation of British Industry.[7]

We have deliberately focused on local authorities and businesses to investigate barriers to economic development. Other research, including work commissioned by the Lyons Inquiry, is examining broader public attitudes toward the functions and funding of local government (GfK NOP Social Research, 2005).

This extensive evidence base is summarised in Chapter 4.

Selecting case study areas

Detailed research was carried out in three urban areas, selected deliberately for their differences:

- Birmingham – a large city-region with multiple urban centres
- Liverpool – a large city-region focused on a single centre
- Barnsley – a town on the edge of two city-regions (Sheffield and Leeds).

This range of case studies enabled *City Leadership* to look at how barriers to growth and investment vary from place to place. The case studies revealed a number of common themes – such as an acute desire for control over local transport investment – as well as substantial differences.

Birmingham

Birmingham is the largest local authority in Britain (and Europe), with 992,000 inhabitants.[8] It sits at the heart of the West Midlands conurbation (2.5 million people)[9], and a wider city-region that takes in additional areas to the north and south.

The city-region is polycentric, with a number of different employment and retail centres. Birmingham city centre is the largest employment and economic driver, but it is supplemented by a range of smaller centres with distinct economic profiles. The city-region includes four travel-to-work areas (TTWAs), including two focused on the Black Country to the west and one around Coventry in the east (ONS, 1998).

The Birmingham area performed well in the immediate post-war era, but experienced

6 The Centre for Cities would particularly like to thank Birmingham Chamber of Commerce and Industry, Birmingham Forward, Liverpool City Growth, Liverpool Chamber and Barnsley Chamber of Commerce for their assistance in convening and hosting Business Stakeholder Groups.

7 The Centre for Cities would like to thank the LGA and the CBI for their assistance in organising respective sessions.

8 Census mid-year estimates, 2004, from www.nomisweb.co.uk

9 Census mid-year estimates, 2004, from www.nomisweb.co.uk

Map 2.1 Birmingham and the West Midlands

massive economic decline in the 1970s and 1980s with the collapse of the manufacturing base.

During the 1980s and 1990s, the city responded to economic crisis by starting a comprehensive redevelopment of its city centre, fostering professional/business services jobs, and expanding the business tourism sector. There has been a substantial improvement in economic growth across the city-region in recent years, with gross value added (GVA) growth outpacing that of the West Midlands region as a whole (SURF, 2004). This has largely been led by the growth in high-value-added employment in Birmingham city centre.

The city-region still faces substantial socio-economic challenges. Birmingham is ranked as the fifteenth most deprived local authority in the country, and both Sandwell (sixteenth) and Wolverhampton (thirty-fifth) also feature in the top fifty (ODPM, 2004b).

Poor transport links and skills have been consistently identified in strategy documents as the key barriers presently facing the city-region and the West Midlands as a whole (West Midlands Joint Committee, 2005; AWM, 2004). For example, Birmingham is the largest European city without a metro system, and faces capacity bottlenecks at its airport and its principal railway station. The existing transport network fails to effectively connect people to jobs and employment centres.

Liverpool

The city of Liverpool is substantially smaller than Birmingham, with an estimated population of 444,500.[10] It is the hub of the Merseyside conurbation, which has approximately 1.5 million residents, as well as a wider city-region that extends into West Lancashire, Cheshire and North Wales (Mersey Partnership, 2005a).

In economic terms, Liverpool city centre is the principal driver and employment centre of the city-region, supplying some 230,000 of the area's 900,000 jobs (ibid).

The decline of traditional manufacturing and port-related activity in Liverpool left the city searching for a new economic role in the

10 Census mid-year estimates, 2004, from www.nomisweb.co.uk

Map 2.2 Liverpool and Merseyside

Map 2.3 Barnsley and South Yorkshire

1970s and 1980s. Consistent population decline was a hallmark not just of the city but of Merseyside as a whole. Recent efforts to revive the area's economic fortunes have centred on tourism, the city's designation as European Capital of Culture for 2008, development of the city centre as a location for business and services, and 'strategic investment areas' across Merseyside. New public-sector jobs have been the top driver of employment growth.

Despite impressive strides in regeneration, Liverpool remains England's most deprived area, and four other local authorities on Merseyside also rank in the top fifty.[11] This has made it difficult to build up the city-region's economic base, and has left the area dependent on regional, central and European Union Objective 1 funds for the lion's share of regeneration and economic development projects.

Barnsley

Barnsley is a metropolitan borough in South Yorkshire with an urban core and a rural hinterland. Its population is approximately 221,000.[12] Uniquely, Barnsley is considered part of both the Leeds and Sheffield city-

11 This includes Knowsley (third), Halton (twenty-first), St Helens (thirty-sixth) and the Wirral (forty-eighth).

12 Census mid-year estimates, 2004, from www.nomisweb.co.uk

regions as defined by the *Northern Way* (NWSG, 2004).

Barnsley's economy was severely damaged in the 1970s and 1980s by the collapse of the coal industry and the subsequent loss of thousands of jobs. It is the twenty-eighth most deprived local authority in England (ODPM, 2004b), and has struggled to find a new economic role in the shadow of its more successful neighbours, Sheffield and Leeds. However, Barnsley is now attempting to deliver a much-publicised reinvention – and its political and business leaders are implementing an ambitious vision for regeneration focused on the town's central area (Simpson and Lewis, 2003).

Barnsley was chosen for this study for the opportunity to examine the investment needs of large towns and small cities, as well as their relationships with larger conurbations.

Understanding the evidence base

The next two chapters address the quantitative, qualitative and comparative evidence collected over the course of our research. Chapter 3 reviews the evidence on the economic merits of devolution, while Chapter 4 presents the key messages of our primary research in Birmingham, Liverpool and Barnsley.

3 the case for devolution

Introduction

Drawing on international comparisons, existing analysis and our own primary research, this chapter sets out the case for devolution of economic development responsibilities to cities and city-regions. It is argued that cities would make a stronger contribution to the national economy with more revenue-raising powers and spending flexibilities. But devolution must be done at the appropriate scale – and the evidence suggests this means empowered city-regions.

Policy context

When Labour came to power in 1997, it found regeneration and economic development functions were controlled by a 'patchwork quilt' of agencies, zones and quangos (Audit Commission, 1989). Reforms of local government during the 1980s and 1990s had left cities more fragmented and financially dependent than ever before.

ODPM-commissioned studies (Parkinson, 2003; Parkinson *et al*, 2004) have argued that the UK cities are underperforming compared to their EU counterparts. They claim European cities' greater control over revenue-raising and expenditure are linked to stronger economic performance. Indeed, the lack of city-level autonomy in Britain – the most centralised nation in the developed world – contrasts greatly with experiences in France, Germany, Spain and the US. Researchers and government therefore started to ask if devolution could help boost city performance in the UK (for example, Boddy and Parkinson, 2004).

Devolution became an important part of the Government's public service reform agenda when, in July 2003, the Chancellor of the Exchequer announced the *Devolved Decision Making Review* to explore how best to achieve devolved delivery and responsive local and regional services in a way consistent with equity and efficiency (HMT, 2004a, 2004b).

But Labour's urban initiatives, starting with the 2000 White Paper (DTLR, 2000) have complicated economic development policy-making. It remains the case that 'Complex funding arrangements from a bewildering variety of sources result in excessive administrative costs and uncertainty about the sustainability of projects' (Audit Commission, 2004).

A change appears overdue. This chapter examines the case for devolution of economic development responsibilities to cities and city-regions.

Why cities? England's largest urban areas contain the highest concentrations of economic activity in the country (Simmie, 2001; Rice and Venables, 2004; Clark and Hildreth, 2005). A growing base of research evidence suggests that strong city-regions are key to improving wider regional performance and driving national economic growth (SURF, 2004; SURF and CUPS, 2006; HMT, 2004b; Parkinson, 2003; Parkinson *et al,* 2004; Simmie, 2005; OECD, 2001).

Why economic development? Our research has shown that it is lack of autonomy in the areas of physical regeneration, transport infrastructure and skills development that most constrains cities in their pursuit of growth. There would also be much value in assessing the case for devolution for other policy areas such as active labour market policies.

Cities are drivers of the national economy. Better economic development policies are what they need to fulfil their potential. So it is critical that they have the right level of fiscal freedom to achieve their goals.

This chapter first reviews the level of devolution in other countries. Second, it assesses arguments in favour of devolution and their applicability to economic development responsibilities.[13] Third, it reviews cities' existing powers to deliver large-scale economic development projects. Finally, it analyses the scale at which devolution should take place.

International comparisons[14]

Cities in continental Europe and North America have a far wider degree of local autonomy than their counterparts in the UK. These cities can access a range of innovative mechanisms to fund economic development initiatives. They also have a greater degree of freedom when it comes to setting spending priorities.

The evidence from France, for example, shows that financial instruments can be deployed at the city-regional level to achieve both service delivery and economic development goals. *Grand Lyon* is a good example of how much an empowered city-region can achieve. An equivalent in Spain would be Bilbao. With an exceptional level of autonomy, the city and its surrounding province have successfully re-invented themselves, following de-industrialisation.[15] In Germany, too, sub-national governments have far more spending freedom. In the US, city mayors have significant autonomy and financial powers, which are conducive to policy innovation and strategic thinking (Travers, 2004b).

International evidence suggests that both over-centralisation and too much devolution are bad for economic performance (Thiessen, 2003). A balance is required. Intuitively, the

13 Many of these arguments are developed more fully in web annex 1.
14 See web annex 3 for a longer appraisal of city spending and revenue-raising powers in France, Germany, Spain and the US.
15 See web annex 6.

state of affairs in continental Europe and the US suggests England needs to move towards greater power at the sub-national level to promote economic development.

To devolve or not to devolve?

There are a number of pro-devolution arguments, each countered by pro-centralist points. The evidence is imperfect, but strongly suggests a need for devolution.

1) Local expertise

Devolutionist view: Devolution would allow local expertise to be applied to local issues (Cheshire and Magrini, 2002). With central control, the distance between the design and delivery of economic development policies means that decision-makers lack relevant local knowledge. City-level decisions should be taken by those who know and understand the city best, rather than remote central government civil servants. Each city has unique assets; a thorough understanding of those assets will allow them to be put to best use.

Furthermore, local decision-making can be more effective in other ways, too. For example, proximity to agents can make local fiscal authorities more efficient tax collectors. Our work with the highly autonomous provincial government of Bilbao, the *Diputacíon* of Bizkaia, stressed that this was a key advantage of local revenue-raising.[16]

Centralist view: Tax collecting and policy-making at a national level deliver clear economies of scale. Central government can develop expertise and apply lessons from one city to another effectively.

In some policy areas, the costs of devolution (less efficient policymaking due to reduced economies of scale) may outweigh the benefits (the application of local expertise) (Martinez-Vazquez and McNab, 2001). But in the field of economic development, where a strong understanding of local issues is fundamental, this is rarely the case.

2) Internalising costs and benefits of policy measures

Devolutionist view: A key benefit of devolution is that it allows the costs and benefits of public services to be kept within the same area (Oates, 1999; Fujita and Thiesse, 2002).

Devolution can improve accountability. Who is responsible for what is more apparent. This allows voters at the ballot box to effectively reward politicians for strong performance and punish them for poor performance. Over time, this alone could improve outcomes.

Secondly, devolution can ensure resources are allocated to best reflect people's tastes and

16 See web annex 6 for more details.

preferences. Desired levels of economic development activity vary from city to city. Levels of expenditure should depend on how highly residents value economic development policies compared to other types of public expenditure, and the potential effectiveness of such policies to make a difference to people's lives.

Both of these are likely to vary from city to city. With appropriate devolution, cities would have the freedom to select a level of economic development expenditure best suited to their needs and their inhabitants' preferences.

Centralist view: As few public goods are purely local by nature, local provision may fail to internalise territorial spillover effects. Policies can have impact beyond the political boundaries they are designed for (Joumard and Kongsrud, 2003). So a policy measure introduced using devolved powers in one area could impact on another area, resulting in a democratic deficit.

But this is why scale matters (Cheshire and Gordon, 1998; Cheshire and Magrini, 2002). In the fields of regeneration and economic development, devolving power to the city-region level would minimise spillover effects. We return to this below.

3) An impetus to strategic thinking

Devolutionist view: Devolution gives cities the freedom to be innovative and experimental. It allows them to devise and implement strategic plans in a way that centralised public expenditure and decision-making make impossible (OECD, 2001).

Centralist view: Within central government, there are concerns about the low level of ability and capacity among decision-makers at a local level. There are doubts that local leaders have the ability to think strategically, or to manage income and expenditure prudently.

Such capacity concerns are linked to fears over increased public sector spending. It is argued that the existing system allows Whitehall to maintain a hard budget constraint and a careful watch over local expenditure (Walker, 2002), and that devolution can have a negative effect on macroeconomic management objectives (see Ter-Minassian, 1997; Tanzi, 1996).

But a lack of capacity should be seen more as the result of the lack of power at the local government level, rather than the cause of it. Local government careers are unattractive to very capable people, as proscribed powers limit their ability to change outcomes. Strategic thinkers are unlikely to take up a job where no strategic thinking is involved. Through empowering local government, devolution will make it a more attractive career path for talented individuals.

Concerns about public borrowing and budget constraints should not be seen as a

Table 3.1 Spending flexibilities and limitations

Current spending flexibilities	Limitations
General power of well-being	
• Powers effective across the UK since 2001 • Gives local authorities the ability to promote social, economic and environmental well-being of their areas	• New powers, but no new resources to fund them • Freedom limited by Secretary of State's reserve power to prevent specific actions • Little evidence as yet 'of any major effect of the changed powers on local economic development' (ODPM, 2005a)
Local Area Agreements (LAAs)	
• Funding frameworks negotiated between central government and local stakeholders • Aim to simplify funding streams and increase flexibility to invest in local priorities	• As yet unproven • Primarily for service delivery expenditure, rather than economic development expenditure • Limited coverage – not to be rolled out nationwide until 2007 • Exclude many capital streams • Freedom in expenditure constrained by resources
Local Enterprise Growth Initiative (LEGI)	
• First funding stream to flow through the economic development 'fourth block' of LAAs • Fund of £300 million over three years • First successful bidders to expect funding from early 2006 • Local authorities will get significant discretion over the use of the fund (HMT, 2005)	• Complexity of negotiations can outweigh positive impacts (see Chapter 4) • Extremely limited coverage • Yet to be seen working in practice • Requires huge effort for small financial gain • Revenues of £2 million to £10 million per year per city highly unlikely to aid the funding of large-scale economic development projects

barrier to devolution. They simply mean that devolution has to be well executed – not ruled out.

The tools of economic development in English cities[17]

When it comes to economic development, English cities have their hands tied. They have some of the smallest local revenue-raising powers in the developed world, and also face severe spending constraints (Owens, 2003). Council tax – the only truly local tax – raises only four per cent of the tax collected in the UK, and this sum represents only 22 per cent of English local government spending (Joumard and Kongsrud, 2003). American cities, by contrast, raise 41 per cent of their spending through local taxes and charges (Katz, 2005), and French cities and regions around 45 per cent (DGCL, 2005).

The imbalance in central-local fiscal relations has been highlighted recently by the ODPM's Balance of Funding Review (ODPM, 2004a) and the Lyons Inquiry (Lyons, 2005). And there is a significant gap between local powers of provision and powers of taxation (Turok, 2005). Cities have been granted some policy latitude – but lack the resources to make it work.

Current spending freedoms

English local authorities face a high level of budgetary uncertainty; this is a critical barrier for cities seeking to finance major economic development projects. Whitehall has recognised that spending limitations are hampering cities' ability to promote growth. Currently, funding settlements are transitioning from a one-year to a three-year cycle, which is intended to help local authorities plan strategic expenditure better (ODPM, 2005d).

In recent years, local authorities have gained new powers, intended to increase spending freedoms. These include a general power of 'well-being' and Local Area Agreements (LAAs). However, as Table 3.1 indicates, these freedoms are very limited. England's towns and cities are unable to use spending flexibilities to drive economic development in the way Whitehall ministers claim.

Current local revenue-raising powers

Local spending powers are clearly limited. Table 3.2 indicates that English cities have a wide range of fundraising tools, but their significance is generally small.

With such limited revenue-raising tools, cities lack the freedom to fund large-scale economic development projects. This contrasts with the situation in continental Europe and North America, where powers and resources are more evenly distributed across government scales.

17 See web annex 2 for a detailed overview of spending, borrowing and revenue-raising powers held by cities, regions and central government in Britain.

Table 3.2 Revenue-raising tools and limitations

Current revenue-raising tool	Limitations
Council tax	
• Local authorities have discretion to vary council tax levels	• Revenues are under immense pressure • Increases subject to capping by ODPM
Prudential borrowing	
• Since 2004, local authorities can use the Public Works Loan Board or borrow on the capital markets	• Borrowing is restricted by the Prudential Code, which sets guidelines for 'reasonable and prudent' borrowing levels (CIPFA, 2003b) • Local authorities' relatively small revenue streams limit the amount they can borrow and interest charges could lead to capping
User charges/trading powers	
• Significant income source: charging – for example, rent for council properties, charges on goods and services – accounted for 12 per cent of local authority income in 2001 (Travers and Esposito, 2004) • Local Government Act 2003 gave local authorities power to trade in activities related to their core functions, and to use surpluses as seen fit locally	• No discernible impact as yet • Unclear whether new trading power will add significantly to local authority revenues (ODPM 2003, 2005c)
Capital disposals	
• Local authorities can sell land or capital assets to raise economic development finance	• Many places, including some big cities, have few assets to sell

cont. overleaf

table 3.2 cont.

Current revenue-raising tool	Limitations
Section 106 agreements	
• S106 agreements give local authorities the chance to capture some of the increase in land values created by the granting of planning permissions • An important financial lever • Used to fund a wide array of development-related costs including transport infrastructure, environment remediation, community needs and affordable housing	• Inefficient levy; involves costly negotiation • Considered unjust – equivalent outcomes for different developers or from different authorities are far from guaranteed • Can become a barrier to private sector development – the British Property Foundation argues for the use of standardised local development tariffs and a drastic reduction in the use of S106 (BPF, 2005) • Likely to be constrained by the proposed Planning Gain Supplement (HMT et al, 2005a; Maxwell and Vigor, 2005)
Local Area Business Growth Incentive (LABGI)	
• Allows local authorities to keep 70p in the pound from relative growth in business rate income • Local authorities free to decide how to spend the money • Reintroduces revenue link between local authorities and local businesses	• Unpredictable revenue source • Revenue to be treated as a windfall gain by local authorities, and is therefore unsuitable for strategic investments • Complicated rules and regulations mean LABGI is difficult to use
Business Improvement Districts (BIDs)	
• Introduced in 2003 to allow local authorities, with the assent of businesses in targeted areas, to levy a supplement on business tenants for an initial period of five years • Potential revenue stream to market or provide public realm improvements in city centres and key business concentrations	• Financial resources generated by BIDs are usually extremely small • Success dependent on the size and engagement of local business communities

Where are the more important economic development tools held?

The Labour Government has taken steps to redeploy economic development tools – but has concentrated them at the regional level. First, Regional Development Agencies (RDAs) were created and given responsibility for regional economic and innovation strategies. They are unelected bodies, accountable primarily to central government. And second, Regional Funding Allocations for transport, housing and regeneration have been established.

Total regional budgets outside London are expected to reach £4.34 billion by 2007/08 (HMT *et al*, 2005b). RDAs have direct control of the economic development and regeneration pot, while Government Offices for the Regions (with partnership boards) run housing and transport allocations. These resources enable RDAs and Government Offices to control substantial economic development funding, much of which is deployed in cities.

Other unelected bodies with responsibilities for economic development include Learning and Skills Councils, which spent over £8 billion in 2003/04 (LSC, 2005), and English Partnerships, the national regeneration agency, whose 2003/04 expenditure topped £485 million (English Partnerships, 2004).

These budgets are clearly significant – but they are all held by unelected bodies. This means that England lacks an elected and accountable layer of sub-national government with significant powers to drive forward economic development. England needs greater devolution if its cities are to fulfil their economic potential.

How to devolve: scale matters

But we are not simply making a case for devolution – it has to be the right type of devolution. As has been mentioned above, scale matters. Urban areas perform better when administrative and economic areas match up (Cheshire and Gordon, 1998; Cheshire and Magrini, 2002; Marshall, 2005).

Aligning economic and political boundaries suggests that devolution will require different models for different places. Where local authority boundaries cover a functioning economic area, devolution should be to the local authority level. But in Britain's biggest urban areas, local authority boundaries have little relation to economic flows. Here, city-regional governance arrangements are required to maximise the effectiveness of devolution.

City-regions and metropolitan governance have been the focus of a lot of attention in recent years (OECD, 2001; Heinelt and Kuebler, 2005). Many observers argue that city governance needs to be widened to cover larger geographical areas in order to be more effective. Their conclusions have been bolstered by a recent comparative OECD study, which argues that 'the absence of a close match between local benefits and costs may result in a sub-optimal provision of public services and goods' (Joumard and Kongsrud, 2003).

Generous boundaries that capture a large proportion of an area's economic activity would allow cities to implement economic development initiatives, plan effectively, and, above all, to develop the capacity to enable growth (see, for example, Cheshire and Magrini, 2002). Since city governments deliver public goods that are crucial to success, 'when there are several public goods, the relevant decision-making entities should be consolidated and incorporated into areas sufficiently large to allow them to internalise the effects of local public policies as much as possible' (Fujita and Thisse, 2002).

It is a city-regional approach that allows local public goods (such as economic development) to be provided at a scale that allows their impact to be contained (Oates, 1999). Wide-ranging powers at the *Diputacíon* (provincial) level – which neatly matches a functioning city-regional economy – have been crucial to Bilbao's successful regeneration.[18] City-regions with high levels of spending flexibility are a feature of French governance arrangements. Places such as Lyons are clear examples of how effective city-regional entities can generate economic success by determining and investing in local priorities.

18 See web annex 6.

Conclusion

The case for the devolution of economic development responsibilities to a lower tier of government is strong. And it is clear that city-regions are the most appropriate scale for radical financial devolution.

Britain is one of the most centralised nations in the developed world. Cities in particular are relatively powerless – they do not have at their disposal the spending or revenue-raising powers necessary for them to drive their economies forward. And it is cities and city-regions that power should be devolved to.

Devolution of economic development responsibilities offers opportunities to boost city performance (and therefore national performance). But it has to be done in the right way. Scale matters, and efficient and accountable governance structures have to be put in place. These requirements will be different in different places but will involve city-regions in Britain's largest urban areas. Devolution to cities should be from both central government and regional bodies. Placing powers at the most appropriate level will not only correct the over-centralisation of fiscal powers: it will also rationalise the fragmented, disjointed and dysfunctional landscape of urban governance we now see in England.

4 money, power, freedom: the barriers to success

Introduction

There is a strong case for financial devolution, especially to the city-regional level. But what form should devolution take?

Our primary research set out to answer this question. We found that cities have distinctive concerns and needs, reflecting variations in size, political history, financial position and administrative capacity. This corroborates recent research (Simmie, 2005) conducted for the *State of the Cities Report* (forthcoming). A one-size-fits-all programme of devolution will simply not work.

Four key messages emerged from our fieldwork:

- Control over existing public spending is the biggest problem facing English cities and towns
- There is strong interest in new revenue-raising powers in a few of the largest cities – but not all of them
- City-regional working has wide rhetorical support, but requires political and financial incentives in order to proceed
- Capacity and skills are still below par in urban local authorities.

This chapter summarises stakeholder opinions from Birmingham, Liverpool and Barnsley; extensive national consultation; and case studies of selected regeneration projects, which highlight barriers to investment.

National consultation

Interviews with ministers, Whitehall civil servants and business interests yielded a variety of messages – many of them surprisingly favourable towards greater financial devolution.[19]

Interviews with central government officials

Under-utilisation of existing powers

- Cities are not doing enough to take up existing powers, such as well-being and prudential borrowing
- Poor take-up prevents further devolution – although it may be due to poor policy design in Whitehall
- Cities need to do more to 'bend' mainstream funding to their benefit
- Large cities are too conservative and dependent on the centre.

Cities need to make a case for control

- Cities need to explain why they want greater financial flexibility

19 This phase of consultation included approximately 40 interviews.

- Pragmatic moves towards greater local control can be accomplished now – using vehicles such as Local Area Agreements
- However, radical change to the financial tool-kit is unlikely before 2010
- Cities need good leaders who can be trusted with more powers
- Strong interest in financial incentives in return for good performance
- England's cities should see London as a 'trailblazer' for devolution
- Relationship between cities and RDAs needs to be rethought and reformed.

Interviews with national business interests

Cities need leaders that can overcome fragmentation

- Cities need strategic focus and stronger political leadership
- Engaging with cities is currently too time-consuming, problematic and slow
- High level of 'partnership fatigue' among businesses
- Cities should have one leader with discretion and power
- Fragmented institutions and agencies at local and regional level are a key barrier to business participation and investment.

Investment and finance priorities

- Transport infrastructure and skills are the top investment priorities in cities
- Mixed views on whether businesses should pay more tax in order to achieve these priorities
- Strong interest in hypothecation of revenue to strategic priorities
- Interest in further expansion of Business Improvement Districts and other mechanisms that increase business input for key spending decisions.

Interviews with major property developers

Cities need financial flexibility…

- Stronger tax-and-spend powers would help cities to pump-prime investment, spread risk, and maintain the public realm
- There are too many different urban-policy initiatives, and there is too much bureaucracy surrounding them
- Complexity enhances investment risk and uncertainty.

…And better local governance

- Elected mayors would improve decision-making, plan strategically, and catalyse action
- Local politicians and officers need greater capacity and sharper skills to deliver large-scale regeneration
- Investment could be increased by reducing delays – and by bringing more people with private-sector experience into city government.

Messages from case study cities

Primary research in Birmingham, Liverpool and Barnsley was conducted during the second half of 2005. Council leaders (one Conservative, one Liberal Democrat, one Labour) were interviewed in each of the three local authorities, alongside public officials and private-sector players from across each city-region. The findings strongly confirmed the need for variable devolution, with some areas better prepared for change than others.

Birmingham

Public-sector stakeholders

Funding streams and institutions are poorly aligned

Local authority officers across the Birmingham city-region expressed strong concerns about the lack of integration between local, regional and national objectives – and the funding streams that support them.

Local authorities cited a poor relationship with RDA Advantage West Midlands (AWM). AWM was accused of being 'extremely risk-averse'[20] and bureaucratic, and its investment decisions were described as slow, disjointed and poorly aligned with local priorities. As a result, local authorities tended to look to 'easier' funding sources before approaching AWM.

AWM interviewees were critical of Birmingham City Council and of city-regions. There was substantial tension between the Regional Economic Strategy and Midlands Way (led by AWM) and the city-region proposals negotiated by the seven local authorities of the former West Midlands County.

Strategic investment priorities identified by city-regional actors included:

- Transport infrastructure (New Street Station, Birmingham International Airport, expansion of the Midland Metro, road improvements)
- Overcoming the 'skills gap' and promoting employment
- Development of employment areas, for example, Eastside (see Case Study 1)
- Business tourism: renewal/expansion of the National Exhibition Centre in Solihull.

Stakeholders underlined that nearly all of these strategic priorities – save the NEC refurbishment – were out of reach without financial assistance from Whitehall. They argued that existing financial tools were being exploited, and that more flexibility was needed to achieve results.

Strong interest in new financial powers

Birmingham has used prudential borrowing extensively to improve key assets, such as the National Exhibition Centre

20 Stakeholder interview, senior local authority officer, Birmingham, 4 May 2005.

Case study 1: Birmingham Eastside

Eastside is one of Birmingham City Council's top regeneration initiatives. It expands the city centre, beginning with the demolition of the Inner Ring Road at Masshouse Circus. Projections suggest that the area could support up to £6 billion of investment, including new employment areas and public amenities.

The initiative to redevelop Eastside was launched as an informal public-private partnership, led by Birmingham City Council, in 1999. The demolition and replacement of Masshouse Circus was completed in 2003, using £23 million from local resources, the West Midlands Local Transport Plan, and EU Objective 2.

Despite 'breaking the concrete collar' around the city centre, Eastside has not yet taken off. Birmingham City Council lacks the revenue streams needed to pump-prime high levels of additional development. AWM participation has been hampered by Treasury 'write-down' rules as well as the RDA's own performance constraints, causing delays and even more complex financial arrangements.

Key lessons

- *Spending constraints*: with greater spending flexibility, the public sector could 'do more' to lever in/accelerate private investment in Eastside.
- *Fragmentation*: problems securing EU, RDA, DfT and local financing illustrate incompatible funding pots, objectives, accounting rules, and floor targets.
- *Leadership*: political instability and shifts in party control have led to concerns that investment in Eastside has slowed.

Potential solutions

- *Greater spending flexibility,* and control of regeneration funding at city-regional level, would help focus public investment in Eastside.
- *Stronger revenue-raising powers* could help to generate a pool of revenue to pump-prime greater private investment.

These solutions will be explored further in Chapter 5, which proposes the devolution of economic development powers to the city-regional level.

(BCC, 2005a, 2005b). However, the design of the prudential framework has inhibited large-scale use in other parts of the city-region – where small revenue streams have stopped local authorities from borrowing to invest.

Interest in additional local revenue-raising powers was pronounced within the local public sector. Partial control over business rates, additional Business Improvement Districts (BIDs), and new value-capture mechanisms were mentioned as possible ways to boost revenue streams. Financial skills need to be developed alongside new revenue-raising tools, to ensure take-up and use.

City-region: progress, but tensions remain
Interviewees other than AWM were positive about the emerging city-regional agenda. However, Birmingham is seen as overly dominant by other local authorities, some of whom would not recognise the 'Greater Birmingham' name for the wider city-region. Many felt that a sustainable and dynamic city-region required Whitehall guidance to complement existing bottom-up efforts.

Business views[21]
Centralisation is undermining the city's growth
There was a near-unanimous feeling that centralised policy and funding structures were holding back economic growth in greater Birmingham. Frustration centred on the fact that local strategic priorities – the replacement of New Street Station, improved transport links, and upgrades to key business-tourism infrastructure – were undermined by central government departments, RDAs and other agencies. The city-region needed more local discretion over spending in order to invest in its key priorities, as well as the ability to use the uplift generated to invest further.

City-regional working requires incentives
Business stakeholders strongly supported the concept of devolution to the city-regional level. They argued that local authorities in the area were not acting strategically to promote economic development, but felt that strong cross-boundary working would depend on 'fiscal blackmail' by central government. Two splits were identified: one between Birmingham and the other metropolitan councils, and another between the seven metropolitan councils and their hinterland.

Conditional support for new local revenue-raising powers
Business interviewees in Birmingham were receptive to the concept of stronger local revenue-raising powers. Changes to business taxation were regarded as a possibility, provided that funds were clearly hypothecated to strategic economic priorities such as transport, and that business had a clear role in

21 Collected from private-sector interviewees and a Business Stakeholder Group, Birmingham, 18 August 2005.

prioritising and deploying these funds. Frustrations over the lack of local control of existing funding streams, coupled with the positive experience of the Broad Street BID to date, were the principal motivations for this.

The city and city-region need stronger political leadership
Many business stakeholders expressed interest in the concept of a directly elected mayor with the power to develop strategic vision and clarity, negotiate with central government, and produce results on key infrastructure and skills priorities.

Council leaders in the city-region were thought to be parochial, and lacking the strategic perspective needed to drive forward the metropolitan economy. For this reason, interviewees expressed a clear desire for stronger political leadership. However, they questioned whether there were candidates with the right skills to lead the city-region if a mayoral model were selected.

The Birmingham city-region

- One of England's two largest city-regions, with Manchester
- Strong business interest in financial devolution (spending, revenue-raising)
- Locally-driven proposals to establish city-regional body and pool funds

We will recommend Birmingham as a pilot area for city-regional devolution – see Chapter 5 for more.

Liverpool

Public-sector stakeholders

Lack of co-ordinated funding
The lack of co-ordinated funding streams for regeneration, infrastructure and economic development was also the chief concern in Liverpool. The area had done well out of European, national and regional funding pots, but there was a great deal of concern that Liverpool and Merseyside had developed an unsustainable 'grant mentality'.[22] The end of EU Objective 1 and Single Regeneration Budget funding programmes in 2006 was a significant worry.

Tight local finances
Shifting grant regimes were seen as a threat to the area's relatively weak financial resource base. Tight revenue constraints across Merseyside limited local authorities' ability to use fiscal flexibilities to best advantage:

> *Liverpool's capacity to raise capital funding is constrained by a relatively weak asset base. The city has to be very good at marshalling and attracting funds from outside…*[23]

Liverpool City Council had one large prudential borrowing scheme on its books,

22 One Liverpool official noted that 'people only want [regeneration projects] if they are free,' given the city's slim resource base. Stakeholder interview, senior official, Liverpool City Council, 21 September 2005.

23 Stakeholder interview, Urban Regeneration Company project manager, Liverpool, 19 August 2005.

Case study 2: Liverpool Kings Waterfront

Kings Waterfront is a large-scale mixed-use development scheme, now moving ahead on a site that has been under-utilised for over two decades. A public-sector vehicle was deemed necessary to begin regeneration, after proposals for commercial and retail-led development failed to materialise during the 1990s. The current development programme is based on the Strategic Regeneration Framework for the city centre, which was produced by urban regeneration company Liverpool Vision (2000).

The £145 million core scheme will provide Liverpool with a new arena and convention centre of international quality, plus waterside public-realm improvements. It will have city-regional economic impact: 2,700 new jobs are expected, plus £21 million in additional visitor-spend over the first three years (Liverpool Vision, 2004).

The scheme is being led by Liverpool Vision, in partnership with English Partnerships (who are contributing the land and £68 million), the Northwest Development Agency (NWDA, £15 million), Liverpool City Council (£12 million) and the Merseyside EU Objective 1 programme (£50 million). Early phases of private investment include nearly 500 residential units and a hotel development.

Lessons

- *Complex funding mix, with too little local control*: Funding from the EU and central government lies at the heart of the mix.
- *Complex spending constraints*: Whitehall approvals, conflicting objectives and 'write down' issues have threatened project viability.
- *Take-up of powers*: Liverpool was unable to use existing powers to provide more finance for the project.
- *Capacity*: Interviewees stated that Liverpool City Council would have a hard time tackling a project of this size without the involvement of the other key partners.

Potential solutions

- *Greater spending flexibility* at the local-authority level would facilitate wider use of Liverpool City Council's existing economic development powers.
- *Better capacity-building initiatives* that deliver skill-sets specific to urban economic development. Liverpool City Council has driven forward a number of major city-centre regeneration schemes in recent years, including the massive £920 million Paradise Street development, but some interviewees felt that the skills base could be further improved.

These solutions will be developed in further detail in Chapter 6.

contracted to pay for its share of the Kings Waterfront development (see Case Study 2). However, the city was unable to undertake much further borrowing because it lacked the revenue streams needed to service the resulting debt. The take-up of prudential borrowing in other parts of Merseyside was hampered by similar constraints.

Little appetite for new revenue-raising powers
Given Liverpool's narrow financial base, public-sector stakeholders did not express enthusiasm for new revenue-raising powers. There was a strong sense that the local tax base was too fragile (and too small) to support substantial new taxation or borrowing, although there was interest in small discretionary taxes, such as hotel taxes.

Capacity concerns
Public-sector stakeholders outside Liverpool City Council were concerned that the council was trying to do too many projects at once, and that it had created too many partnerships and organisations to manage them. Additionally, there was concern that local and regional resources were being concentrated on city-centre priorities (Kings Waterfront, Paradise Street) at the expense of other parts of the city and city-region. The stalled Merseytram scheme and the slow-moving redevelopment of Edge Lane were cited as examples. Liverpool City Council responded that investment emphasis on the city-centre was needed to create an economic driver with 'critical mass' for the wider city-region.

There was substantial concern over the capacity of councillors and officers, both in Liverpool and across the city-region. Some stakeholders feared that capacity issues, coupled with well-publicised political feuds, could undermine investor confidence. Despite this, there was praise for (then) Liverpool City Council leader Mike Storey and chief executive David Henshaw for their work on city-centre regeneration and the Capital of Culture bid.

City-region: voluntary co-operation but political tension
City-regional co-operation was felt to be developing steadily, through existing joint authorities, networks, and the business-led Mersey Partnership. However, we detected political and competitive tensions between Liverpool and other local authorities, and a sense that deeper co-operation would be difficult at this stage.

There was also concern that the boundaries of Merseyside did not accurately reflect local transport and labour markets, which spilled beyond Merseyside into Cheshire, North Wales and the fringes of Greater Manchester. Local authorities were working to address this problem, notably in the area of skills and employment. However, there was no appetite for local government reorganisation or broad-based structural changes among interviewees in the city-region.

The uncertain relationship between the Northern Way Growth Strategy, the NWDA Regional Economic Strategy, sub-regional partnerships, the City-Regional Development Plan (Mersey Partnership, 2005b) and local authority economic development and capital strategies was brought up repeatedly. Many argued there were too many public-sector strategies, at too many levels, with too little real focus.

***Business views*[24]**

Opposition to new local revenue-raising powers

Trust is a central issue for businesses in Liverpool. The legacy of the militant era of the 1980s makes businesses highly sceptical of Liverpool City Council and its ability to deliver.

Accordingly, there was no support for significant new revenue-raising powers. Given the city's narrow economic base, business taxation already raises more than the council tax in Liverpool. Congestion charging was opposed on the premise that it would hurt Merseyside's fragile economic recovery.

However, there was support for more local control of existing tax revenues, as well as a small hotel tax. The failure to approve a city-centre BID at the first ballot was thought to show the ambivalence of local businesses toward additional taxation at this stage of Liverpool's recovery, though the BID was endorsed in a second vote in September 2005.

The fragmented governance of economic development in the city-region was a key source of confusion. Business interviewees disliked current levels of fiscal centralisation, and were interested in devolving spending to Merseyside's local authorities. The existence of 'too many initiatives with separate funding pots and audit trails', with little relevance to local priorities, was roundly criticised. Merseyside had too many partnerships, too much bureaucracy, and too many arms'-length regeneration organisations.

Lack of clarity over the city-regional agenda

There was also uncertainty over the city-regional agenda for Merseyside, and the roles played by local authorities, the NWDA and central government. The voluntary Mersey Partnership approach to cross-boundary working was cited as a positive factor. However, there was no agreement on how that partnership might be deepened, and antipathy to formal structural change.

Infighting within Liverpool City Council was seen as a threat to the economic progress of the city-region. Stakeholders felt that Liverpool had to play a leadership role for the area, and that the poor tone of politics in the city over the past year was preventing this from happening.

24 Collected through private-sector stakeholder interviews and a Business Stakeholder Group, Liverpool, 19 August 2005.

Liverpool and Merseyside

- Economic recovery moving ahead, but still fragile
- Political uncertainty within the city and the wider city-region
- Mixed feelings within the business community on devolution

For these reasons, we do not believe the Liverpool city-region is currently ready for radical devolution – but it does need more freedoms and flexibilities. Chapter 6 proposes an interim route forward.

Barnsley

Public sector stakeholders

Strong leadership has been key

Barnsley's key objective was to develop a new economic role, following the complete shutdown of the mining industry in the town during the 1980s and 1990s. Leadership was seen by most interviewees as the lynchpin of the town's efforts to accomplish this goal. Council leader Steve Houghton and key officers were widely praised for their work in developing and driving the 'Remaking Barnsley' strategy.

However, there was concern that council politics could prevent delivery by undermining the confidence of the town's investment partners. There was a sense that council leaders needed more time and more stability to deliver on regeneration priorities.

Barnsley's economic development agenda was described as 'transformational' and 'ambitious', but interviewees were very concerned about the resources needed to deliver projects on such a large scale. Delivery was the principal focus of ongoing development efforts, with 'cranes in the sky by 2006' an overwhelming imperative.

LAA frustrations

Barnsley is a pilot Local Area Agreement (LAA) authority, with £44.5 million of non-mainstream expenditure aligned and pooled over three blocks (ONE Barnsley, 2005). While stakeholders expressed support for the principles behind LAAs, they were frustrated by progress to date. One noted that 'the reporting regimes that the LAA was supposed to replace are either still there or are more invasive than before',[25] while a second called the LAA 'another set of rules to shackle us with'.[26] Additionally, the funding streams included in the LAA were seen as a relatively small portion of the overall borough budget. The flexibilities offered by the LAA were being outweighed by the complexity of the negotiations.

Interviewees underlined the fact that discussion around the Fourth Block remained in its infancy in both the council and the Local Strategic Partnership. Stakeholders were still trying to define what the block meant for Barnsley, and how LEGI would fit in. In general terms, LEGI was not prominent in local thinking or decision-making, beyond an awareness that an application would need to be made to ODPM in due course.

25 Stakeholder interview, director, Barnsley MBC, 13 September 2005.

26 Stakeholder interview, director, Barnsley MBC, 13 September 2005.

New flexibilities helpful – but not enough to drive change
Interviewees described Barnsley as a 'historically low-spending authority', but expressed frustration with the gap between the new power of well-being and the lack of financial resources to put that power into practice.

Barnsley MBC had used prudential borrowing powers more than similar-sized councils. Stakeholders welcomed the new flexibility afforded by the borrowing powers, but stated that revenue constraints prevented their use for large-scale regeneration or infrastructure projects. Since the town lacked the revenue streams necessary to pump-prime large developments, the borough was still dependent on regional, national and EU funding streams for the vast majority of regeneration and infrastructure investment.

Little interest in additional revenue-raising powers
Despite the clear funding gap, there was little interest in additional revenue-raising powers because of the fragile state of the local tax base. One interviewee noted that 'you need something to tax to introduce new levers', and that more power over existing funding streams and programmes was more important to tackling the town's two top priorities: joblessness and town-centre regeneration.[27]

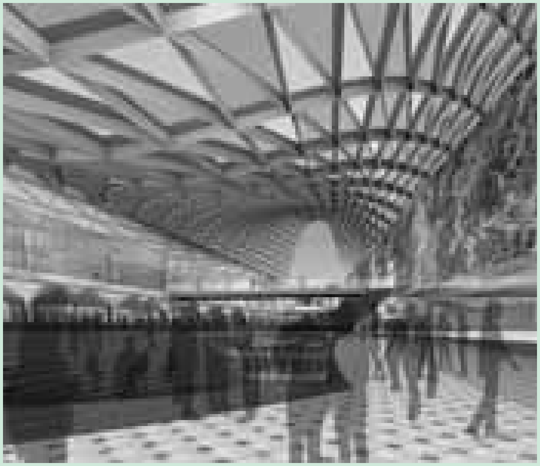
Strong council–RDA relationship seen as a model
The council's close working relationship with RDA Yorkshire Forward on the Barnsley Markets project (see Case Study 3, opposite) was cited as critical to the town's drive to develop a new economic role.

Relating to larger cities
Barnsley interviewees argued that they were working hard to relate economic development projects to emerging city-regional strategies based around Leeds and Sheffield. Both public- and private-sector stakeholders argued that Barnsley's short-term economic role was as a housing and commuter town for the two larger cities. In the medium to long term, they believed that Barnsley could develop a new economic base around services and office/manufacturing overspill from elsewhere in Yorkshire.

However, there was a strong feeling that Leeds and Sheffield were not doing enough to engage the towns around them. This was echoed by public-sector interviewees from outside the borough, who stated that there were serious divisions between the core cities and surrounding areas, especially around areas like transport.

Business views[28]
Need for a stronger policy focus on towns
There was a strong feeling that public policy did not adequately address the issues faced by ex-industrial towns, and confusion over the way that funding is distributed between various

27 Stakeholder interview, politician, Barnsley MBC, 24 May 2005.
28 Collected from private-sector stakeholder interviews and a Business Stakeholder Group, Barnsley, 14 September 2005.



Case study 3: Barnsley Markets

The Markets project is the town-centre flagship of the Remaking Barnsley initiative. A shopping centre, market hall, apartments and parking facilities are planned.

The total cost of the Markets project will exceed £222 million, of which £54 million is public-sector pump-priming. Barnsley MBC, like most councils of its size, lacks the financial resources to pump-prime a project of this size using local resources. Yorkshire Forward committed £34 million towards site assembly, plus skills and expertise through its Urban Renaissance programme. Yorkshire Forward's willingness to take a significant financial risk was critical to unlocking large private commitments to Barnsley's economy.

Detailed financing and planning negotiations are now being undertaken by the 1249 Regeneration Partnership, including Ashcroft Estates, Wilson Bowden, Barnsley MBC and Yorkshire Forward. A start on-site is expected in 2007.

Lessons

- *Joint working between towns and RDAs can pay off*. Joined-up public sector intervention can help to reduce risk, market regeneration opportunities, and get private investors interested in marginal areas.
- *Fiscal constraints limit public-sector investment.* Treasury 'write-down' rules constrain the RDA investment needed to bring private-sector players to the table (only overcome here by Barnsley's ability to convince Yorkshire Forward to shoulder a high level of risk).
- *Leadership*. Consistent political and managerial leadership is critical to keeping a project of this scale on track. Private-sector partners said the level of commitment in the town won them over.

Potential solutions

- *More financial flexibility*, using the Local Area Agreement as a vehicle to devolve control of more regeneration and capital funding.
- *Mechanisms to help RDAs and towns work together* to draw in transformative private investment, as this best-practice example shows.

These ideas will be discussed further in Chapter 6.

levels of government. Businesses also stated that bigger cities were not doing enough to engage with Barnsley and similar towns.

No additional local revenue-raising powers
Though there was a strong desire for more devolved and accountable public spending, business representatives felt that there was no scope for additional revenue-raising powers in a town with a small and fragile business base. Adequate public money was already present – but there was not enough local control or discretion to make it work well.

Strong leadership, but more communication needed
The 'Remaking Barnsley' plan for town centre regeneration was lauded, but there was concern that the council needed to communicate more with businesses to see the plans through.

Barnsley

- Making Local Area Agreement work is a key priority
- Being on the periphery of two city-regions is an opportunity and a challenge
- How can it use this position to develop a new economic role?

Barnsley, like many big towns/small cities, needs incremental devolution, and a stronger LAA, to build a new economic base (see Chapter 6).

Innovative approaches to local procurement and tendering were needed to provide a short-term economic boost to small businesses.

Business interviewees supported the personal leadership of council leader Stephen Houghton. However, there was a great deal of concern that short-term political considerations within the council sometimes trumped strategic decision-making. 'Entrepreneurial' leadership in local government at both officer and political level was thought to be lacking, and was needed for the town to communicate a distinct offer.

Control over regeneration spending: a key barrier to success

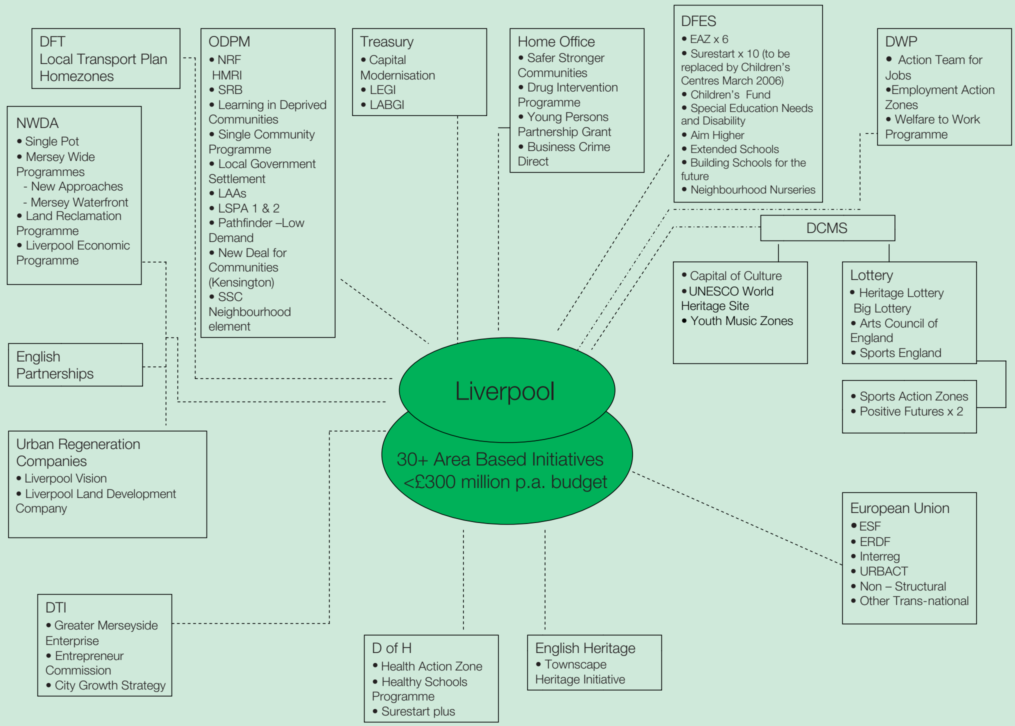
> *It never ceases to amaze me that projects do happen, given the cocktail of funds and systems involved. [However] you can't cut the cloth according to the money that you have – because you don't know whether you have it!*[29]

> *We have to beg, borrow and steal from wherever we can to get the necessary regeneration funding.*[30]

The key finding of our primary research in Birmingham, Liverpool and Barnsley was that lack of local control over existing regeneration spending is the biggest problem facing cities and towns.

29 Stakeholder interview, politician, Liverpool City Council, 2 September 2005.
30 Stakeholder interview, politician, Barnsley MBC, 24 May 2005.

Figure 4.1 Regeneration funding in Liverpool



Source: Liverpool City Council

Resources are divided into too many pots, and lack of direct control prevents cities and towns from regenerating town centres, promoting business growth and improving transport networks. As one interviewee noted: 'Cities would feel more confident about planning, and developing approaches to economic development, if funding were more localised…'[31]

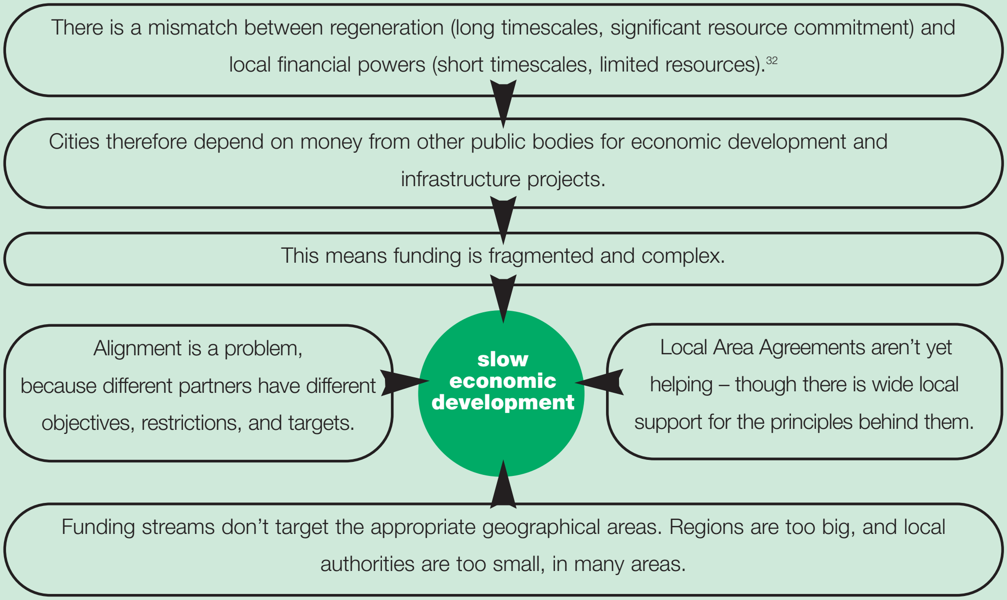
Fragmented funding pots, poor alignment between public-sector bodies, and low investor confidence are the symptoms of this problem. And the uncertainty this generates leads private investors to walk away from some major economic development projects.

Take Liverpool as an example. The complexity of economic development funding in the city is immense.

As Figure 4.1 shows, dozens of departments and agencies are involved in decisions that

31 Stakeholder interview, senior local authority officer, Birmingham, 7 October 2005.

Figure 4.2 The 'catch-22' of economic development in cities



could be taken more efficiently and effectively if funding were rationalised and devolved.

These problems are not new. Government has recognised the problem of 'funding silos' and the difficulty cities and towns face when seeking to assemble resources for economic development (LGA, 2005b; ODPM, 2005b, 2005d, 2004a; HMT, 2004a, 2004b; HMT and ODPM, 2003). Despite moves to co-ordinate and align central and regional funding in recent years, our city research found that control over economic development resources is still perceived as a critical barrier to growth.

For England's cities to perform better, public resources supporting economic development projects need to be rationalised, pooled and devolved wherever possible. If control is the problem, and fragmentation the symptom – then devolution is the cure.

The next two chapters develop this idea more fully – proposing mechanisms for devolution to selected city-regions (Chapter 5) and to all urban areas (Chapter 6).

32 The Government has committed to stretching funding settlements over three years, rather than one (ODPM, 2005d) - but regeneration timescales are usually far longer. City governments in Spain and France have five- and six-year settlements respectively, with far less central government oversight of spending decisions. This permits more strategic regeneration investment (Green and Marshall, 2005). There is a precedent for longer financial settlements in the UK, such as Transport for London's exceptional five-year settlement (DfT, 2004). But most local settlements remain annual and align poorly with economic development needs.

5 devolving to city-regions: a new approach

Introduction

The next two chapters outline policy recommendations designed to tackle the barriers and obstacles identified in our primary research.

Chapter 5 lays out proposals for devolution to the Birmingham and Manchester city-regions, including:

- *City-Region Contracts*: financial frameworks for economic development that devolve over £600 million in annual regeneration, transport and skills spending to each city-region
- *A city-regional revenue-raising power*: the power to levy a small Supplementary Business Rate, delivering £35 million per year toward strategic infrastructure (for example, trams, rail services and airports)
- *Fiscal incentives from Whitehall*, creating a City-Region Growth Incentive that promotes cross-boundary working and business growth
- *An agreed Whitehall framework* that gives city-regions the financial and political support they need to succeed.

We argue that *directly elected city-region mayors* offer the best option to deliver the type of radical financial devolution proposed here.

Chapter 6 sets out policy recommendations for all urban areas outside the pilot city-regions.

City-regions: from theory to reality

Our primary research uncovered a great deal of uncertainty about city-regions at the local, regional and national levels. Stakeholders still have a hazy understanding of what they are, leading to disagreement about what they should actually do.

> *City-regions are interesting – but we have no idea how the Government wants them to fit in with RDAs.*[33]

> *The city-regional agenda still lacks credibility. It's unclear what it's going to result in – influence? Policy instruments?*[34]

A number of obstacles stand in the way of meaningful devolution to city-regions.

- *First, a clear definition of a political city-region is needed.* This chapter outlines a definition that takes in political realities, economic flows and the need for a flexible, dynamic model.
- *Second, we need clear consensus on what*

33 Stakeholder interview, senior RDA official, West Midlands, 4 August 2005.
34 Stakeholder interview, senior officer, Liverpool City Council, 11 May 2005.

city-regions are meant to do. City-regions can be used to promote democratic devolution, improve service delivery and enhance economic performance (SURF and CUPS, 2006). All of these are important – but we argue for an economic performance focus.

- *Third, we need a formal framework for city-regional devolution*. City-regions need more than rhetorical recognition to tackle economic development priorities.
- *Fourth, central government and RDAs must embrace city-regions.* Devolution could help Whitehall departments and RDAs deliver critical economic floor targets.

The next section defines city-regions, and explores how a contractual approach could devolve a range of spending and revenue-raising powers.

Recommendation 1: City-Region Contracts

We propose the creation of City-Region Contracts to co-ordinate and devolve funding for regeneration, transport and skills.

This approach builds on existing research as well as international experience. A recent ODPM-commissioned study noted that:

> *National government needs to develop a new framework for incentivising the development of city-regional partnership and governance structures, through interdepartmental single pot mechanisms that can only be drawn on if there is clear consensus on priorities across districts… (SURF, 2004).*

The Lyons Inquiry's Interim Report, published in December 2005, also expressed interest in using a 'contractual approach' to central-local relations to give local authorities greater flexibility over decision-making and funding (Lyons, 2005).

Contractual approaches have helped to co-ordinate and devolve control of public investment in other countries. In France, for example, *contrats de ville* (at city level) and *contrats d'agglomération* (at city-regional level) have marshalled central, regional and local resources for the achievement of economic development priorities.[35]

City-Region Contracts must be selective; they are meant for England's biggest conurbations. However, only two areas – Manchester and Birmingham – are ready to try them out.

Why these two city-regions?

- *Size and geography*. Manchester and Birmingham are England's two largest provincial city-regions. They drive regional economies in the North and the Midlands.

35 See web annex 3.

- *Tax base:* Birmingham and Manchester have tax bases that are robust enough to support additional revenue-raising powers.
- *Maturity of joint working*: local governments in both areas have developed strong city-regional agendas, and have put forward proposals for closer co-operation and resource pooling.[36]
- *Business buy-in*: Business communities in both areas agree that greater devolution from Whitehall is critical to local economic success. They also buy in to a cross-boundary approach.

Five other city-regions – Liverpool, Newcastle, Leeds, Sheffield and Bristol – could follow as they develop similar levels of political consensus, business buy-in, and economic stability.

How City-Region Contracts could work

Six steps to a City-Region Contract

1. Defining city-regions – getting the scale right
2. Developing priorities for action at a city-regional level
3. Devolution and co-ordination of relevant funding streams
4. Setting targets and evaluating progress
5. New powers and incentives – unlocked by the Contract approach
6. Three-year implementation period, with renewal linked to delivery

1) Defining city-regions – getting the scale right
As Chapter 2 notes, city-regions already exist as economic entities (SURF and CUPS, 2006), but need political boundaries in order for City-Region Contracts to work. Boundaries will always be imperfect, as administrative areas are not coterminous with economic spaces. A pragmatic approach would be to use existing local authority districts as building blocks, and create an area that broadly reflects economic flows.

ODPM should be involved in this process to ensure that city-regions offer the best possible fit to economic realities, and to prevent the emergence of 'cliff-edges' between urban areas on either side of a city-region boundary.

We propose the adoption of pragmatic city-regional boundaries that reflect both economic and political realities:

- *Begin with the existing metropolitan scale.* Cross-boundary proposals have already been put forward for the former metropolitan counties around Birmingham (seven districts) and Manchester (ten districts). There is also well-established functional co-operation across these areas, for example for passenger transport.
- *Add areas with strong economic links.* City-regions should reflect labour market flows for the core city in question. Using

36 The West Midlands metropolitan districts have taken the lead on this with proposals for a 'Metropolitan Area Agreement' (LGC, 13 October 2005).

Map 5.1 West Midlands Conurbation

5.2 Birmingham travel-to-work area

5.3 'Best-fit' travel-to-work area

5.4 Birmingham City-Region

5.5 Greater Manchester Conurbation

5.6 Manchester travel-to-work area

5.7 'Best-fit' travel-to-work area

5.8 Manchester City-Region

travel-to-work areas (ONS, 1998), it is possible to identify additional areas that form part of the city-region economy. These are then 'best fit' to existing local authority boundaries.

2) Developing priorities for action at city-regional level
Once geographies are set, public- and private-sector leaders must set a succinct City-Region Economic Development Strategy. This blueprint would set out a small number of strategic projects – such as public transport infrastructure – and would identify how devolved funding streams and financial powers would be used to pay for them.

These priorities need to be tightly focused, with demonstrable economic impacts. The local business community should play a clear role in selecting projects and in monitoring their implementation.

3) Devolution and co-ordination of funding streams
Once a clear strategy is agreed, funding streams need to be identified and pooled so that city-regions can deliver their priority projects. The Core Cities Group has suggested the concept of a city-regional single pot, backed up with a statutory duty of pooling and collaboration (Core Cities Group, 2005). City-Region Contracts would achieve both of these goals, and devolve substantial funding from central[37] and regional government. This could include:

Regeneration:

- *City-regional share of RDA single-pot funding.* RDAs should see City-Region Contracts as vehicles that can help to deliver Regional Economic Strategies. The devolution of single-pot funding would allow RDAs to concentrate limited staff and revenue resources on other priority areas.
- *City-regional share of Regional Funding Allocation for Housing.* Devolution of the Regional Housing Strategy and strategic funding allocations is currently being considered for London (ODPM, 2005f). It should also be devolved to areas where City-Region Contracts exist.
- *English Partnerships funding.* Where City-Region Contracts exist, EP could devolve resources and delivery to local hands.
- *EU Structural Funding* should be devolved from Government Office to city-regional level, allowing city-regions to match EU funds with their own regeneration money. Many cities will continue to qualify for some form of EU assistance after 2006, under the 'Competitiveness and Employment' stream (CEC, 2005).
- *Elements of local authority regeneration*

37 ODPM Minister David Miliband has argued that mainstream funds need to be 'bent' to promote local economic objectives (Miliband, 2005). Ambitious city-regions could try to include additional funding streams when negotiating their contracts – especially if they can show they will deliver better results.

budgets. Although individual local authorities must retain funding for micro-level regeneration and small capital infrastructure works, they must also be ready to commit revenue and capital resources to the achievement of city-regional priorities as part of the Contract approach.

- *City-regions are about strategic regeneration funding, not local area-based initiatives.* Local authorities should continue to lead neighbourhood-level regeneration programmes, as they sit at the most appropriate scale to do so.

Transport:

- *City-regions need to control transport provision and mechanisms for investment.* City-regional transport agencies need powers similar to those of Transport for London (TfL) (control over rail, metro/trams, strategic roads, funding of local transport plans and, critically, bus regulation) as well as financial flexibility (including control over fare-box income). Devolved funding streams, integrated with existing Passenger Transport Executive (PTE) levies, will boost transport investment – and allow city-regions to prioritise major capital projects such as tram systems.
- *City-regional share of Regional Funding Allocation for Transport.* This is presently overseen by Government Office-led Regional Transport Boards – but would be delivered more effectively through city-regions.
- *Passenger Transport Authority (PTA)/ PTE Local Transport Plan (LTP) funding*, which is allocated to metropolitan PTAs for rail and bus services.
- *Transport Innovation Fund bids.* This fund will offer substantial support for schemes that can demonstrate benefits across functional economic areas (DfT, 2005). This is ideal for city-regional implementation.

Skills:

- *Learning and Skills Council (LSC) funding.* Through the Contract approach, city-regions could gain an element of control over LSC funding for adult learning. This could help to tailor LSC programmes to the city-regional level, and achieve key social and economic regeneration goals without undermining national entitlements or floor targets. One way forward would be to create 'dual key' arrangements that give city-region authorities and the national LSC joint control over the post-19 skills budget for the city-region (see also DeLorenzi and Robinson, 2005).
- *This is the first step in devolving control over skills and employment policies.* Other

areas could follow.

- *Devolving skills and employment budgets to city-regions will be difficult*. Government is presently considering radical devolution of skills budgets to the Greater London Authority (ODPM, 2005f), so there should be room for debate in other city-regions too.

Devolving spending to the city-regional level[38]

If the funding streams above were devolved in full during the 2005/06 financial year, we estimate the following city-regional budgets:

Birmingham city-region: £675 million

Manchester city-region: £600 million

This would represent a radical shift in control and accountability – and the concentration of economic development resources at a logical scale for delivery.

4) Setting targets and evaluating progress
A small set of strategic targets would need to be agreed between the city-region, regional agencies and central government.

These should be based on three general principles:

- City-regions need maximum discretion over devolved funding streams in order to deliver their Contracts.
- Targets should be built around outcomes – not processes.
- Assessment should be on a multi-annual basis, giving local leaders a more realistic timeframe to deliver progress on objectives.

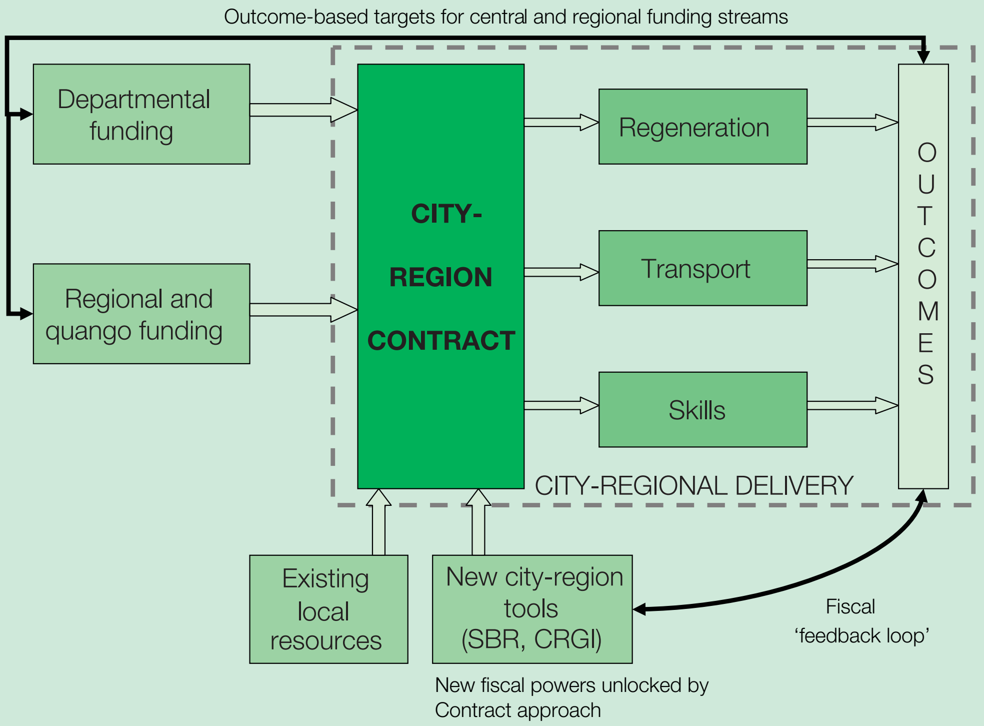
Government departments need to accept that a light-touch targeting framework, with minimal negotiation, will give city-regions the time and the space they need to tackle obstacles to regeneration and growth.

5) New powers and incentives
City-Region Contracts should include new revenue-raising powers alongside spending freedoms. Forthcoming sections model a new revenue-raising power (City-Regional Supplementary Business Rates) and a fiscal incentive (City-Region Growth Incentive), which are designed to give city-regions additional tools to pump-prime investment and key infrastructure.

6) Longer timeframes for delivery
City-regions need spending stability over a period of time to deliver a step-change in economic growth. Evidence from other countries, such as France and Spain, shows that local governments have been able to develop more innovative policies, and take investment risks, because they have five-to-

38 See Annex 1 for a more detailed analysis.

Figure 5.1 City-Region Contracts



six-year spending rounds (Borraz and Le Galès, 2005; Farber, 2002).

City-Region Contracts should build on recent shifts towards three-year funding settlements for English local government, and should include options for extension and renewal. Sanctions – such as the loss of powers and flexibilities – could be applied in the event of non-delivery.

Recommendation 2: City-Regional Supplementary Business Rates

Alongside the devolution of existing funding streams, we believe that city-regions should have some revenue-raising options.

We propose a modest revenue-raising power for city-regions, based on a Supplementary Business Rate (SBR). City-regions should be given discretion to raise business rates by up to five per cent, with additional revenues hypothecated directly to strategic transport priorities.

Why five per cent? First, this minimises the potential for cliff-edges and therefore distortions between city-regions and neighbouring areas. Second, it limits the financial impact on business – with small businesses paying less than £150 per year. Although small next to devolved spending, an SBR of this size is not insignificant. It is a step toward greater revenue-raising at the appropriate economic scale.

The business rate debate

As Chapter 3 notes, the existing balance of funding leaves cities with few revenue-raising tools. The re-localisation or part-localisation of business rates has been widely debated as a way to provide cities with additional revenue streams.[39]

Council tax, for example, is overstretched, politically sensitive, and subject to capping. What's more:

- Council tax grew 37.5 per cent in real terms between 1993 and 2003, whereas business rates grew only 5.4 per cent (Travers and Esposito, 2004).
- Business rates have declined from 29 per cent of local-authority expenditure in 1990/91 to only 19 per cent in 2004/05 (Lyons, 2005).

The Lyons Inquiry Interim Report noted that there was interest in mechanisms that devolve 'some local discretion over [business] rates in order to fund investment in transport and road improvements and regeneration activity' (2005). Our evidence suggests this would be most effective at a city-regional – rather than a local-authority – level.[40]

A city-regional SBR would be:

- at the correct economic scale
- hypothecated to specific priorities (for example, transport)
- collected at minimal extra cost
- buoyant (revenues grow alongside the city-regional economy)
- highly predictable (useful for securing and servicing debt financing)
- an incentive to improve joint working across local authority boundaries.

What would a city-regional SBR raise?[41]

A City-Region SBR in Birmingham (2000/01–2004/05)
A two-pence (4.7 per cent) SBR would have raised £36 million per year, or £180 million over five years.[42]

A City-Region SBR in Manchester (2000/01–2004/05)
A two-pence (4.7 per cent) SBR would have raised £35 million per year, or £174 million over five years.

39 Research and policy papers have identified a number of fiscal tools that could be devolved downward from central government (ODPM, 2004a; McLean and Macmillan, 2003; London Assembly, 2004; Falk, 2004; Glaister, 2004; Stoker, 2005).

40 The example of Walsall illustrates this point. A two-pence SBR in Walsall alone would raise approximately £1.1 million per annum between 2000/01 and 2004/05 – far too little to address major economic-development needs.

41 These calculations use the city-regions defined above, with 13 local authorities in the Birmingham City-Region and 11 in the Manchester City-Region.

42 The figures for additional revenue do not take account of potential revenue loss from other sources of taxation, e.g. Corporation Tax. New companies could reduce SBR-take by locating outside the city-region. However, the city-regional scale minimises spillover, cliff-edges and opportunistic moves between areas.

Figure 5.2 How would an SBR affect local businesses?

Business property	SBR cost to business in 2005/06
Virgin Megastore, Walsall	
16-18 Park Street, Walsall, West Midlands WS1 1NG	£3,320
The Sony Shop, Birmingham	
60-162 Corporation Street, Birmingham B4 6TB	£485
Ben's Cookies, Coventry	
Unit 2, Cathedral Lanes Shopping Centre, Broadgate, Coventry CV1 1LL	£138[44]

The impact on local business

City-regional supplementary business rates would have a marginal impact on the overall business tax burden. We randomly selected three businesses around the Birmingham city-region to test the impact of an SBR. To safeguard smaller businesses, reliefs and exemptions are applied as in the existing system.

According to figures from the Treasury and the CBI, the overall business tax burden in 2004 was £109.6 billion, of which business rates represent £19 billion, or 17.4 per cent. Using this ratio, it is possible to calculate the impact of a two-pence SBR on overall business taxation: 0.82 per cent.[43]

As the above case studies show, a 2p city-regional SBR would have a minimal impact on local businesses – many of whom would see a direct benefit from infrastructure investment brought about by the SBR.

Since the business rate is relatively stable and predictable, city-regional SBR revenue could be used to underpin prudential borrowing and other forms of capital financing.

Recommendation 3: City-Region Growth Incentive (CRGI)

In addition to new revenue-raising powers, a clear fiscal incentive is needed to promote business growth across city-regions.

Our research found that the existing Local Authority Business Growth Incentive (LABGI):

- is complex and poorly understood
- sits at the wrong scale to provide substantial fiscal benefit
- contains too many floors, ceilings and equalisation mechanisms to provide a real incentive for business growth.

43 Based on CBI (2005) and HMT figures (www.hm-treasury.gov.uk). For the sake of providing examples of the effect of the SBR on specific businesses in 2005/6, the ratio of business rates to overall tax burden has been assumed constant between 2004/05 and 2005/06.

44 Ben's Cookies would enjoy 17 per cent relief on the SBR, reflecting the fact that its rateable value is below £10,000.

Thanks to the scheme's complexity, we found that local authorities preferred to use staff resources to pursue grant funding rather than to grow the business base, undermining LABGI's incentive value and impact.

Yet the principle behind LABGI is a sound one. We recommend that LABGI be refocused at city-regional level in Birmingham and Manchester, which would enable the Incentive to promote cross-boundary working and encourage business growth at a scale that matches up to market realities.

How would it work?

A City-Region Growth Incentive (CRGI) would not create a new tax. Instead, it would allow city-regions to retain increases in business rate revenue resulting from growth.

Under CRGI, each city-region would be allowed to keep all growth in the local business rate take, up to £200 million, over a period of five years.[45] This money would be pooled and delivered through the City-Region Contract. Individual local authorities within the city-region would no longer participate in LABGI.

With a potential value of £200 million in each city-region, CRGI would create:

- a simple, properly scaled incentive for business growth
- a clear payoff for cross-boundary co-operation
- a sizeable resource to focus on economic development.

In the short term, CRGI receipts would vary along with the regional economic cycle, as business growth rates mirror overall performance. However, concerted city-regional business growth efforts would result in clearer, more stable revenue streams over time. City-regional economic development activities could be judged by how much of the incentive pot they unlock for further investment.

City-regions could smooth the spending of CRGI receipts over a number of years, using economic forecasts to build up an even spending profile. This could help to reduce the uncertainty problem that has stopped many areas from aggressively pursuing LABGI.

Paying for CRGI

Under CRGI, the Manchester and Birmingham city-regions would retain funds that would otherwise be put into the National Non-Domestic Rates (NNDR) pot – leaving less money for resource and needs equalisation. By setting aside £400 million to compensate the NNDR pot over five years, the Treasury could create an incentive without affecting the highly-contentious equalisation system. A portion of this cost could be offset by moving a proportion of the £1 billion pot presently earmarked for LABGI.[46]

45 All growth over an inflation-indexed baseline, kept at city-regional level. The baseline could be set at the time of business property revaluation, and revised at the following revaluation.

46 This could be set at £100 million, using the relative weight of the two city-regions, which together account for 9.8 per cent of rateable property in England according to 2005 Valuation Office Agency data (www.voa.gov.uk).

If the two city-regions are allowed to retain increases in business rate take without compensation to the NNDR pot, there would be a marginal effect on the equalisation of business rates, estimated at 0.42 per cent of the overall NNDR pot in 2005/06.[47]

Whether the Treasury chooses to pay for CRGI, or whether it tweaks the equalisation system at the margin, CRGI would offers city-regions an important fiscal incentive to promote business growth.

Recommendation 4: City-regional governance to deliver growth

The devolution of economic development budgets to city-regions requires a step-change in accountability. City-Region Contracts offer a high level of financial freedom, including devolved budgets and new tax levers. Given the size and scope of the resources concerned – over £600 million per annum in greater Birmingham alone – governance structures must be adequate for the functions and financial tools being devolved.

If the Birmingham and Manchester city-regions want the level of financial freedom proposed here, they will need a step-change in accountability and leadership. We believe that means a directly-elected city-region mayor, but recognise that there is huge opposition to this.

City-regional governance arrangements should be judged against the tests in the box:

47 If the two city-regions retained £80 million per annum (the maximum available under the scheme), based on a national business rate pot of £19 billion.

City-regional governance: four key tests

1) Democratic legitimacy

People making decisions that impact on a particular area should be directly elected by the people of that area. Leaders will be taking on financial risks and responsibilities on behalf of local residents. The use of powers and funding must reflect the values and opinions of the electorate.

2) Clarity and visibility

In order for voters to influence the use of funding and powers, they need a clear understanding of who is responsible for what. Simple arrangements with well-defined lines of responsibility are essential to enable good leadership to be rewarded, and for poor performance to be punished at the ballot box.

3) Strategic vision

To take advantage of the city-regional approach and increased powers and financial tools, a governance format that facilitates strategic thinking is essential. City-regional governance arrangements must prioritise investment, make difficult decisions, and avoid spreading limited financial resources too thinly.

4) Delivery

City-Region Contracts are focused on delivery as well as strategy. As a result, they require governance arrangements that can shepherd major projects from the planning stage through to completion.

Executive Boards

Several areas, including Greater Manchester and the West Midlands, have developed proposals for 'Executive Boards' at conurbation level, composed of the leaders of existing local councils. The New Local Government Network (NLGN) City-Regions Commission recently argued that city-regions should involve voluntary association and 'an executive committee of leaders drawn from local authorities' (2005). But are voluntary partnerships and Executive Boards the right structure to deliver functions and funding across a city-region? Or are there better alternatives?

The most advanced proposal, by the seven metropolitan councils of greater Birmingham (West Midlands Joint Committee, 2005), calls for devolution of regeneration/housing, transport and skills powers through a Metropolitan Area Agreement, alongside a City-Regional Development Fund. They have argued that the existing Joint Committee, or a voluntary authority, could be responsible for budgets at a city-regional level, with decisions taken by the seven local authority leaders. Manchester and Sheffield have also set out plans for executive boards, but have not yet made financial structures public.

Executive Boards would be an improvement on existing cross-boundary collaboration, which tends to be ad hoc and single-issue in nature (for example, police, fire, waste). They would provide major city-regions with a forum for co-ordination, and could help to sharpen up economic development policies. Additionally, Executive Boards could be put in place in selected city-regions with relative speed, and could serve as transitional vehicles between the status quo and directly elected mayors.

But Executive Boards are not robust enough to take on the full range of spending and revenue-raising powers proposed in this report. They perform poorly on all four of the tests opposite, as described below:

Executive Boards

Democratic legitimacy: Executive Board members would have only indirect and partial democratic legitimacy. Council leaders lack a direct mandate at the city-regional scale. ✗

Clarity/visibility: Executive Boards only slightly increase clarity of leadership. They make it difficult for local people to hold city-regional decision-making to account. ✗

Strategic vision: Council leaders have different political needs and priorities, and may spread resources thinly across objectives rather than target strategic goals.[48] ✗

Delivery: Council leaders are elected to deliver resources and results within the boundaries of their local authorities. Executive Board members would be driven by their own local considerations, and could 'pass the buck' on responsibility and financial risk. ✗

48 Businesses in Birmingham, for example, are concerned that 'the political sensitivities between the metropolitan districts could be a barrier to effective voluntary co-operation…' (Birmingham Chamber, 2005). One stakeholder group expressed a fear that Executive Boards were creatures of local authorities – and that central government would need to resort to 'fiscal blackmail' and 'bang heads together' to make them work (Business Stakeholder Group, Birmingham, 18 August 2005).

City-regional 'commissioners'
Another governance proposal, examined recently in the Newcastle city-region, is the commissioner approach – whereby individuals would be directly elected to deliver specific portfolios at a city-regional level (Newcastle City Council, 2005). This would involve separate commissioners for regeneration, transport, and skills, for example.

This model has not been developed in great detail to date. However, as the box below shows, elected city-regional commissioners would fulfil two of the four governance tests set out on page 50.

Elected city-region commissioners

Democratic legitimacy: Elected commissioners would satisfy this test, although the model lacks a single clear leader.	✓
Clarity/visibility: This model links responsibilities to portfolios clearly, but again lacks a single leadership figure.	✓
Strategic vision: Separation of powers could prevent the emergence of a strategic vision for the city-region. Rivalries between commissioners possible.	✗
Delivery: Clear lines of policy accountability and financial responsibility, but there is the potential for confusion because of overlapping competencies (for example, between regeneration and transport).	?

This model would be harder to implement than Executive Boards – but would offer a higher degree of accountability and transparency.

City-regional elected mayors
The third model of city-regional governance centres on a directly elected city-regional mayor (Stoker, 2005; NLGN City-Regions Commission, 2005; Core Cities Group, 2005). This is an ambitious and contested idea. However, we believe it offers city-regions the best chance to deliver financial devolution successfully.

Greater London has had an elected mayor for five years now – and the GLA model has been evaluated positively by academic observers (for example, Travers, 2004a), statutory evaluators (Audit Commission, 2005b), and ministers, who are now consulting on expanded powers for the Mayor of London (ODPM, 2005f). While London's governance arrangements are substantially different from our City-Region Contract model, London's experience does suggest mayors could work in other conurbations.

But could directly elected city-regional mayors deliver economic development policy effectively in places like Manchester and Birmingham? Would mayors make City-

Region Contracts, new tax-raising powers, and devolved funding streams work? They would meet all four of our governance tests, as shown in the box below.

Directly elected city-regional mayors

Democratic legitimacy: Mayors would be directly elected across a city-region – providing a clear democratic mandate for spending and revenue-raising decisions. ✓

Clarity/visibility: Mayors who cover a large economic area can be highly visible, and provide clear lines of accountability, as Ken Livingstone has shown in London. ✓

Strategic vision: A mayor would be well placed to develop consensus around a strategic vision, negotiate a City-Region Contract, and oversee implementation. ✓

Delivery: City-regional mayors would be responsible for delivering economic development and regeneration projects. They could also hold city-regional budgets and be accountable for delivery and financial risk. ✓

City-region mayors would be responsible for the delivery of substantial budgets. We are recommending that they take over substantial responsibilities from RDAs and other quangos, and that existing bodies (such as Passenger Transport Executives) be transferred to mayoral control. This package of powers could help to attract higher-calibre individuals to city politics, and deliver a step-change in leadership.

The Executive Boards proposed by Birmingham and Manchester could play a critical scrutiny role under this model – with local authority, business and community representatives working to ensure transparent and accountable mayoral decision-making.

With their democratic legitimacy and broad strategic responsibilities, mayors could work with stakeholders to marshal economic development resources, deliver key infrastructure priorities and promote growth.

We understand that this will not be popular with existing council leaders, and that voters do not yet identify with the concept of the city-region in the same way that they feel loyalty and belonging to the city. But given the strength of the case for directly elected mayors, we believe the option should be pursued.

Recommendation 5: A clear Whitehall framework to support city-regions

City-regions remain a ‘hard sell’, both locally and in Whitehall. If government wants to use the city-regional scale to deliver economic regeneration and growth, it must first promote a shared vision of what city-regions are, and what they are for.

Building on the case for devolution presented in Chapter 3, we believe that a shared vision for city-regions should include the following key principles:

Key principles for city-regions

- **Purpose:** enhancing economic performance (SURF & CUPS, 2005)
- **Policy areas:** regeneration/housing, transport, skills (to start with)
- **Boundaries:** to be based on existing local authority districts and travel-to-work areas, agreed by ODPM and local stakeholders
- **Funding streams:** negotiated through City-Region Contracts
- **Selectivity:** restricted to the biggest urban areas, starting with Manchester and Birmingham.

Building commitment to city-regions

Some departments buy in to the city-region concept – but others are sceptical. ODPM and the Treasury have expressed an active interest in city-regions as a means of boosting economic performance and delivering regeneration (Clark and Hildreth, 2005). But we found scepticism in the Department of Trade and Industry, and low levels of awareness and interest in the Department for Transport, the Department for Education and Skills, and the Department for Work and Pensions.

The best way for the Treasury and ODPM to promote city-regional working is to set out what city-regions are for, how they can promote economic performance, and how they will help other departments to deliver their objectives. A clear policy statement, with the backing of the Treasury, would boost the case for city-regional devolution across Whitehall.

City-regions can help to address regional disparities and boost growth. The existing Regional Economic Performance PSA target – currently shared by HMT, ODPM, and DTI – should be strengthened. Extending the target to cover the DfES, DfT and DWP would bring all the major 'economic development' departments within the target's ambit.

New tasking frameworks for RDAs and quangos

These adjustments need to go hand-in-hand with a radical change in the relationship between RDAs, Government Offices and city-regions. Our research identified existing regional grant and oversight regimes as a key obstacle to regeneration, investment and growth.

> *A shift in the RDA's sense of accountability is needed. They are here to help the region, not to tell us what to do…*[49]

49 Stakeholder interview, politician, West Midlands, 7 October 2005.

> *The RDA approach is not yet coherent. We still have a lack of understanding of city-regions and what they need.*[50]

National and regional quangos will need to let go of certain functions, starting with regeneration, transport and skills in our two largest city-regions. This will be complex and difficult – and will require sponsoring departments to set new tasking frameworks for RDAs (DTI), English Partnerships (ODPM), and the Learning and Skills Council (DfES).

The legislative framework

Radical financial devolution along these lines will require legislation that enables ministers to set up city-regional entities. This will take some time. We urge Birmingham, Manchester and other major urban areas to press ahead with bottom-up initiatives for cross-boundary collaboration until the legislative framework for city-regions is fit for purpose.

Main points for decision-makers

- City-regions need to be carefully defined – with clear objectives and agreed geographies
- HM Treasury must ensure that other Whitehall spending departments buy in to the city-regional agenda
- Devolution to city-regions should be selective – Birmingham and Manchester for now
- City-Region Contracts can be used as flexible vehicles to devolve spending, create revenue-raising tools, and incentivise growth
- Devolution at city-regional level requires stronger accountability – and elected city-region mayors are best suited to the job.

50 Stakeholder interview, RDA officer, North West, 20 September 2005.

6 more freedoms and flexibilities for all urban areas

Introduction

We are recommending asymmetric devolution, with the Birmingham and Manchester city-regions leading the way. A small number of other big city-regions could follow.

However, other cities and towns also need greater financial flexibility to unlock their economic potential. The Government has made important commitments to devolved decision-making and Local Area Agreements (HMT *et al*, 2004a, 2004b; ODPM, 2005b). However, more needs to be done to enhance local autonomy and simplify funding streams.

In places like Barnsley and Liverpool, greater local control over regeneration spending would promote more creative and effective use of existing resources. It would also incentivise risk-taking, improve accountability and responsibility, and enable greater take-up of existing local authority powers.

This chapter suggests three pragmatic ways to devolve additional freedoms and flexibilities to cities and towns across England:

- Expand the Economic Development and Enterprise component of LAAs (the 'Fourth Block')
- Promote the use of existing financial powers and flexibilities
- Develop stronger capacity and skills at the urban level.

Recommendation 6: Economic Development Contracts

LAAs are designed to bring together funding pots and boost local flexibility. However, they do not presently provide a strong enough framework to join up and devolve funding for local economic development.

The Fourth Block for Economic Development and Enterprise was tacked on to LAAs late, as a home for the new Local Enterprise Growth Initiative (HMT, 2005).

ODPM's guidance for Local Area Agreements states that:

> *The Economic Development and Enterprise Block gives areas the opportunity to improve the economic growth and productivity of a locality, addressing market failures that prevent sustainable economic development, regeneration and business growth… (ODPM, 2005b)*

However, this gives little sense of how the block could operate – leaving many local authorities wondering what to do next.

Our consultation found that there was a great deal of confusion around the Fourth Block. LAA pilot authorities – including Barnsley and Derby – told us that they were not really sure what it meant for them. One senior official in Barnsley noted that 'there have been many fine words – but evidence of true flexibility has yet to be established.'[51]

Why the Fourth Block is a major opportunity
A strong Fourth Block would help towns and cities to join up regeneration and economic development funding, and result in greater local prioritisation and decision-making. At the same time, it could promote capacity improvements within local authorities, by linking greater freedoms and flexibilities to visible economic outcomes.

The Government has failed to communicate the potential of the Fourth Block as a vehicle for strategic economic development to local authorities and other stakeholders. Ministerial speeches (for example, Miliband, 2005) and guidance (ODPM, 2005b) have so far placed the wrong emphasis on the Fourth Block, describing it as a vehicle for area-based initiatives focused on deprived areas. The block needs to be recast with a wider, more strategic remit – and as a vehicle for greater local flexibility.

Cities and towns also need to develop more aggressive Fourth Block proposals – and argue for the freedoms and flexibilities they need to address key economic priorities.

Economic Development Contracts
We recommend:

- Rebranding the Fourth Block as a clear, wide-ranging Economic Development Contract (EDC)
- The rollout of EDCs in towns and cities across England.[52]

EDCs would be clear statements of economic development goals – prepared locally – which businesses, community groups and citizens could also use to scrutinise local government and build pressure for delivery. They should be used in single-pot areas[53] as well as conventional LAAs to focus and devolve economic development funding streams. EDCs would thus help local authorities further develop their economic role.

Every EDC should articulate a limited number of strategic priorities – forcing local stakeholders to take tough decisions on what to fund using limited public resources. This will help to counter the 'shopping lists' that have often characterised local authority resource bids in the past (Glaister, 2004).

The development of EDCs should be led by local authorities, not Local Strategic

51 Stakeholder interview, director, Barnsley MBC, 13 September 2005.
52 Except for those areas that have taken up the City-Region Contract approach.
53 Despite the fact that they have greater flexibility, local authorities with 'single pot' LAA arrangements need to organise funding around economic development and enterprise much in the same way as conventional LAA areas. The alignment and pooling of funding around a small group of strategic objectives – in areas like regeneration, transport and skills – is critical to unlocking economic growth.

Partnerships (LSPs). LSPs are relatively new organisations, and their progress to date has been variable (ODPM and DfT, 2005).

Economic Development Contracts

Why?
To join up existing economic development funding streams, and devolve greater control over spending decisions and outcomes to the local level.

What?
An agreed set of clear objectives for economic development, allowing funding streams from central, regional and local government bodies to be pooled. RDA funding, the Local Transport Plan, Single Regeneration Budget (and successors), European Union, LEGI (for those areas that get it), LABGI, and local authority capital and revenue funding should be included. A 'duty to collaborate' placed on all public sector organisations operating at the local level (ODPM, 2005e). In bigger urban areas, this duty could include a cross-boundary element.

Who?
Led and delivered by local authorities, with regard to LSP-led Community Strategies.

How long?
Updated as part of LAAs every three years – but with a longer-term delivery focus.

Key strengths of EDCs

1) *Reduce the number of external funding streams.* EDCs would greatly reduce the number of external funding streams involved in many economic development projects – and streamline the onerous, burdensome reporting requirements that often drive away private investors. Local discretion over existing public funding would be greatly enhanced as Contracts were implemented.

2) *Allow local authorities' performance to be judged locally*. EDCs would set clear, simple targets – around outputs and outcomes, not processes – so that performance in achieving key economic development priorities can be judged.

3) *Allow towns to develop roles in relation to larger economic hotspots*. Contracts should emphasise local and regional connectivity, which would unlock new synergies between towns and more dynamic markets nearby. The EDC process could help town authorities to select economic development priorities that play to their geographical and physical strengths, as well as their future aspirations.

4) *Could transform the Fourth Block into a more effective framework for economic*

development in a relatively short period of time. EDCs would not require primary legislation. Local authorities already have the legal capacity (as accountable bodies) and powers (for example, the power of well-being) needed to deliver resources. EDCs could be introduced in 2007, alongside the third and final round of Local Area Agreements. ODPM and DTI could promote delivery by directing RDAs to respond positively to the strategic economic priorities of cities and towns, as expressed in their Contracts. This would help to overcome the confidence and trust barriers that presently affect regional-local funding relationships.

Recommendation 7: Making existing powers work better

Alongside simpler, more devolved funding streams, many cities have expressed interest in a range of smaller taxes to boost their revenue-raising potential (ODPM, 2004a; LGA 2004b, 2005a; Travers and Esposito, 2004; ODPM Select Committee, 2004).

How useful are small revenue-raising levers?
Many of the proposed tax levers – especially 'green' taxes and congestion charging – can play an important role in influencing behaviour and promoting more sustainable outcomes. However, the financial argument for the introduction of 'marginal' taxes is weak.

Taxes/charges and revenue impacts

Hotel taxes
Minimal revenue impacts
A flat-rate, £1 levy across Merseyside would raise £3.3 million per annum.[54] This is marginal compared to other funding streams – and could have high collection costs.

Plastic-bag charges
Minimal revenue impacts
In Ireland, a 15c national bag charge resulted in a 95 per cent decrease in use within one year of introduction. A 10p tax applied in England would raise £800m nationally if consumption remained unchanged, but would decrease to a mere £40 million annually if consumption declined as it did in Ireland (LGA, 2004d).

England's cities and towns should have the right to experiment with marginal taxes if they wish. However, we recommend that they focus their efforts on making better use of existing charging and borrowing powers.

Existing powers
Charging and trading
Local authorities have gained a number of additional powers in the last five years –

54 Figures based on 2004 UK Tourism Survey (UKTS) statistics. See www.staruk.org.uk//default.asp?ID=738&parentid=469.

including expanded powers to charge for discretionary services, and to set up profit-making trading companies.[55]

These powers are both new and unclear. For example, the guidance on charging (ODPM, 2003) does not set out whether local authorities can profit from the charging regime (ODPM, 2005a). With respect to trading, local authorities are explicitly allowed to profit, though there is little evidence that the power has been taken up to date.

Cities and towns could generate significant new revenue streams for economic development by making better use of charging and trading powers. Michael Lyons recognised this in his interim report, and is actively exploring new ways to use charging in local finance (Lyons, 2005). Central government should promote greater take-up of local charging and trading powers by making them clearer and easier to use.

Workplace parking charges

The 2000 Transport Act gave local authorities the power to introduce a variety of transport-related charges, including workplace parking levies and congestion charging (DfT, 2002). While the primary aim of such schemes is to change behaviour, and to shift motorists toward public transport, they have the potential to generate revenue streams for transport improvements. For example, a scheme devised for Nottingham's city centre would generate £100 million over ten years if put into action (CfIT, 2005). The revenue generated by workplace parking charges would be hypothecated directly to the expansion of the city's tram network.

Local congestion charging (road pricing) could also generate significant revenue for transport projects. London's charge brought approximately £100 million in net revenue into the Transport for London budget in 2004/05 (TfL, 2005). A number of areas, including the Birmingham city-region, are currently debating the potential merits of local schemes.

Business Improvement Districts

Business Improvement Districts (BIDs) also offer towns and cities a way to generate new revenue streams for economic development in co-operation with local businesses. Yet only 20 BIDs have been approved through business ballots since their introduction in England. This is a surprisingly small number, given experience in other countries.[56]

There is a strong correlation between the level of public-private co-operation in a city and a BID proposal's chances of success. England's cities and towns need to work harder to promote the take-up of BIDs in areas where they could improve the investment environment. Though they provide only small revenue streams, these are directly targeted on promotion of investment and visitor spend – making a big difference to local outcomes.

55 In the Local Government Act 2003.

56 By way of contrast, there are 51 BIDs in New York City alone. www.nyc.gov/html/sbs/html/bid.html (last accessed December 2005).

Prudential borrowing

As noted in Chapter 3, cities and towns have gained new flexibilities on capital finance with the introduction of the prudential framework (CIPFA, 2003b). While prudential borrowing is being used to support projects in all three of our case-study cities (see Chapter 4), the finance officers we interviewed argued that more flexible revenue streams were needed in order to use the borrowing powers at a more substantial scale.

Yet there is evidence that prudential borrowing can provide cities with substantial leverage if local authorities are able to find innovative ways to make it work. Birmingham City Council, for example, is using the power to borrow £215 million in 2005/06 to refinance the National Exhibition Centre (BCC, 2005b).

Under the EDC approach, the importance of prudential borrowing would grow, as greater spending flexibility would allow local authorities to commit to more ambitious prudential schemes for major economic development and infrastructure projects.

Maximising strategic use of assets

Cities and towns could also leverage substantial investment by using their land and property assets more strategically, for example by pooling public-sector property resources and aggregating buying power (Carter, 2005). One way to do this is through the formation of regeneration-focused public-private partnerships (PPPs).[57]

Two variants – King Sturge Property Regeneration Partnerships (King Sturge, 2005) and PricewaterhouseCoopers' Local Regeneration Partnerships (Mills and Atherton, 2005) – offer a route to lever development finance and private-sector skills into major infrastructure projects.

However, regeneration PPPs are relatively rare; few cities and towns have used them to date. The model should be encouraged more strongly.

Recommendation 8: Boosting capacity and skills

Our research found that central government doesn't want to devolve until the capacity of local government improves, but local government won't improve without devolution. Geoff Mulgan of the Young Foundation has recently referred to this as local government's 'catch-22' (*Guardian*, 16 December 2005). We need to find a way through this impasse.

Our primary research in Birmingham, Barnsley and Liverpool confirmed many of the findings of the Egan Review (Egan, 2004). When it comes to attracting investment and promoting regeneration initiatives, English cities and towns face a number of 'skills gaps' that need to be addressed.

Businesses told us that public-sector bodies are unresponsive to their needs – and local authorities say that the private sector doesn't

57 This was first recommended by the Urban Task Force (1999), and remains of interest to the Treasury (HMT, 2003).

understand the constraints and centralised reporting requirements they face. At times, business and local government speak different languages. For this reason, more public-private exchange, job-sharing, and secondments should be encouraged.

As one interviewee remarked:

> *There's a lack of experience and knowledge of the business environment. Skilled regeneration personnel aren't around. The local public sector often has an insufficient understanding of how to deliver regeneration projects.*[58]

Existing skills initiatives need to be refocused to bridge the public-private divide, by:

- boosting local authority capacity in areas such as planning, site assembly and compulsory purchase
- improving understanding of the risk issues faced by public- and private-sector partners
- tackling information and data issues that hamper inward investment and business growth.

Big cities like Liverpool need highly-skilled personnel in-house. In towns, however, RDAs and Regional Centres of Excellence can help plug regeneration skills gaps – as evidenced by the close working relationship between Barnsley MBC and Yorkshire Forward.

Capacity-building needs to occur alongside devolution, not before it. The two processes, in tandem, will help cities and towns to do better. Currently, local government fails to attract strong politicians and officers because it lacks power. Our recommendations for greater financial freedoms and flexibilities would help cities to attract more motivated, talented economic development staff.

58 Stakeholder interview, chief executive, regeneration company, Liverpool, 14 June 2005.

Main points for decision-makers

- The LAA Fourth Block is a major opportunity to devolve power and funding to cities and towns – but it isn't working.
- The Fourth Block should be rebranded and up-scaled – as an Economic Development Contract between Whitehall, RDAs and local stakeholders.
- A contractual approach will provide a clearer, stronger framework for the devolution of existing funding to cities and towns.
- It will also help local authorities to take up existing powers better.
- Cities and towns need specialised economic development and regeneration skills training.
- More public-private exchange and secondments will help.
- Improved local skills will help cities and towns to attract investment and regenerate.
- Urban authorities need to work with the private and third sectors to identify and plug skills shortages that slow down or stop local regeneration priorities.

7 conclusions: making financial devolution work

> *While all governments have proved to be cautious in devolving power … this Government has done more to devolve power than any other. But we must now look to further devolution of power away from Westminster, particularly to a reinvigoration of local government.*
> Rt Hon Gordon Brown MP, Chancellor of the Exchequer, 14 January 2006

Leadership and power go hand in hand. But our major cities – the drivers of regional and national growth – do not have enough power. Greater financial powers and autonomy would improve their economic performance and their leadership. London's mayor is already proving this to voters, businesses and Whitehall. Our other big cities should watch and learn.

This report calls for radical new financial devolution, with a priority focus on city-regions. We propose new City-Region Contracts for Greater Manchester and Birmingham, with devolved control over economic development funding and revenue-raising powers to promote business growth.

This step-change in fiscal powers requires a similar step-change in accountability. So we identify directly elected city-regional mayors as the best governance model for economic development purposes.

City-regions make good economic sense. There is strong evidence to support the devolution of funding for regeneration, transport and skills to the city-regional level. Scale matters to the performance of urban economies, and it is all too clear that the boundaries of England's cities do not match up to functional economic areas. Our biggest cities should be incentivised to work across boundaries with surrounding areas to promote economic development.

But city-regions are a 'hard sell' – a difficult economic concept, and a political minefield. Financial devolution to city-regions is a huge economic challenge, with downside risks as well as positive potential. Directly elected city-regional mayors are bound to provoke a political outcry, and voters do not readily identify with city-regions.

So how do we get there?

First, we need to build a consensus around city-regions, starting with the biggest. Central government must focus on city-regions, and set out the case for them more proactively. Following the 'no' vote in the

“City-regions make good economic sense. There is strong evidence to support the devolution of funding for regeneration, transport and skills to the city-regional level”

> **“** We believe in selective city-regions, starting with the biggest first. We say very clearly that, as a first step, city-regional devolution should focus on Greater Manchester and Greater Birmingham **”**

North East in 2004, there is now no prospect of meaningful, accountable regional government in England. Whitehall needs to accept that and move on.

Our proposals spell out the implications of ‘variable geometry’, where different places will have different degrees of autonomy. We believe in selective city-regions, starting with the biggest first. We say very clearly that, as a first step, city-regional devolution should focus on Greater Manchester and Greater Birmingham. What will this mean for RDAs, local authorities, towns and voters?

RDAs and other unelected quangos need to understand that city-regions are the drivers of regional and national growth. They will each need to respond to their own economic geographies. In the North West, the NWDA should ultimately cede control over economic development to Greater Manchester, and later Merseyside, but retain that control over the rest of the North West. Advantage West Midlands will face a similar transition with Greater Birmingham.

Local authorities must accept that certain functions – such as transport and skills – are best delivered across boundaries, not in isolation. Within city-regions, local authorities should pool resources and revenues, and work with city-regional entities on strategic investment decisions.

Towns and smaller cities have a lot to gain from city-regions. But this will require the core cities at the centre to work with surrounding towns and cities. For example, Walsall and Coventry would benefit from better cross-boundary connections and strategic city-regional investments. For towns and smaller cities outside the largest city-regions, we are proposing a range of fiscal flexibilities that would allow them to carve out a clearer economic role for themselves.

Voters do not currently identify with city-regions. That is a problem. Voter apathy presents a serious barrier to the development of accountable city-regions. The benefits of city-regional governance need to be promoted: more investment, more jobs, transport improvements, and better service delivery.

Second, we need to give city-regions the powers they need to succeed. London’s mayor has more powers than any English city council. And the current GLA Review will give him even more. If our biggest city-regions outside London had a similar set of powers, they would be able to perform better.

Central government should initiate a fresh round of devolution by giving Greater Manchester and Greater Birmingham the lead over key economic development functions such as transport, regeneration and skills – where the case is strongest for devolution. These city-regions (and London) should also be equipped with new revenue-raising powers to promote business growth and encourage cross-boundary working.

Central government has taken some tentative first steps on the road to financial devolution: the RDA single-pot and regional funding allocations; Local Area Agreements, LEGI and LABGI; Business Improvement Districts and prudential borrowing. These are all useful, but they lack ambition and their implementation is proving problematic.

Our proposed new fiscal incentives build on these existing schemes, but offer much greater autonomy and flexibility. Financial devolution is of course risky, and would present new fiscal challenges for the Treasury, not least on the public sector borrowing requirement (PSBR). But the potential rewards – better-informed investment, more efficient delivery and improved economic performance – are great too.

Third, we need to make city-regions accountable to their residents and businesses. If we are to empower city-regions, they need to be made accountable and transparent. Currently, there are too many unelected quangos making decisions in and around our cities. This is becoming increasingly untenable.

We need to draw together decision-making powers and budgets at the city-regional scale to cut through the confusion. Executive Boards could be a step in the right direction, and might usefully serve as transitional vehicles on the way towards directly accountable city-regional entities. Directly elected commissioners for regeneration, skills and transport are another possible route forward.

Ultimately, though, directly elected mayors would provide the best governance framework for city-regions. We fully realise that existing city leaders dislike the idea, and that voters are sceptical. But meaningful devolution demands clear and visible accountability, as London's example clearly shows. Whitehall is unlikely to devolve substantial powers and budgets without an elected mayor in place.

We believe the case for mayors can be made, if they are given the power to make a real difference – to fund major infrastructure projects, grow the business base and foster job creation. Our cities deserve no less.

“We believe the case for mayors can be made, if they are given the power to make a real difference – to fund major infrastructure projects, grow the business base and attract jobs. Our cities deserve no less”

annex 1: devolving spending to city-regions

This annex estimates the size of regeneration, transport and skills spending pots which could be devolved using the City-Region Contract mechanism introduced in Chapter 5. It uses the financial year 2005/06 as a hypothetical case, and concludes that the Birmingham and Manchester City-Regions would have budgets of £675 million and £600 million respectively.

1. Defining city-regions

We use the model put forward in Chapter 5, which marries existing political realities with travel-to-work areas. 2003 mid-year population estimates (MYEs) are used to ensure data consistency.

Birmingham city-region:
Birmingham, Solihull, Sandwell, Walsall, Wolverhampton, Dudley, Coventry, Bromsgrove, Redditch, North Warwickshire, Tamworth, Lichfield, Cannock Chase

Total city-region population:
3,070,300 (2003 MYE)
Total West Midlands population:
5,319,900 (2003 MYE)

Map A.1 Birmingham city-region

City region as a percentage of total West Midlands population: 57.71% (2003 MYE)

Manchester city-region:
Manchester, Salford, Trafford, Stockport, Tameside, Oldham, Rochdale, Bury, Bolton, Wigan, Salford, Trafford, Macclesfield

Map A.2 Manchester city-region

Total city-region population:
2,893,000 (2003 MYE)
Total North West population:
6,700,000 (2003 MYE)
City region as a percentage of total North West population: 43.18% (2003 MYE)

2. Regional funding allocations

This report focuses on the use of the city-regional scale to promote economic development – especially regeneration, transport and skills. In Chapter 5, we propose the devolution of a share of Regional Funding Allocations from RDAs and Government Offices (which control funding for Regional Housing Boards and Regional Transport Partnerships) to the city-region level.

Using the ratio of city-region population to total regional population, we arrived at the following shares of the 2005/06 Regional Funding Allocations:

Birmingham city-region

Funding block	Regional total (£m)	City-region share (£m)
Economic development	272	157
Housing	182	105
Transport	88	51
Total city-region share		313

Manchester city-region

Funding block	Regional total (£m)	City-region share (£m)
Economic development	382	165
Housing	250	108
Transport	113	49
Total city-region share		322

Source: HMT *et al* (2005b)

3. Learning and Skills Council funding

To derive an approximate city-regional share of LSC funding, we applied the city-region to region population ratio to regional LSC funding allocations. We then estimated the share of adult (post-19) spending for each city-region – the portion of current LSC expenditure recommended for partial or full devolution in Chapter 5.

Birmingham city-region	
West Midlands LSC total	**£978m**
Gross estimated city-region share	£564.4m
Minus pre-19 spend	£355.6m
Birmingham city-region skills share	**£208.8m**
Manchester city-region	
North West LSC total	**£1,180m**
Gross estimated city-region share	£509.5m
Minus pre-19 spend	£321m
Manchester city-region skills share	**£188.5m**

Source: HMT *et al* (2005b); LSC (2005)

4. EU Structural Funding

Objective 2 programmes – which cover much of the Birmingham and Manchester city-regions during the 2000-2006 programming period – are presently administered by the Government Offices for the Regions.

We propose that city-regional shares of this funding be administered and implemented at city-regional level. This would enable city-regions to match EU resources with devolved domestic regeneration spending (a key obstacle which has affected EU Structural Funds in the UK over the past two decades).

In 2005/06, this would mean approximately £85m in the Birmingham city-region[59], and £68.3m in the Manchester city-region.[60]

From 2007, EU Structural Fund grants to the UK will tail off dramatically, as resources are shifted to new member-states. However, city-regions could serve as accountable bodies for transitional resources, which are expected between 2007 and 2013. This is in line with the European Commission's interest in subsidiarity and devolved implementation (CEC, 2005).

5. Spending from the Department for Transport

In Chapter 5, we propose that city-regions gain control of Passenger Transport Authorities/Executives and strategic transport functions. This would require the DfT to devolve:

- PTA shares of Local Transport Plan (LTP) funding
- Funding for major schemes[61]

The bulk of PTE operating budgets derive from annual levies placed on the council tax in metropolitan districts. This report does not

59 Estimate supplied by Birmingham City Council Regional, European and International Division.
60 Given a total spend of £409.5 million in Greater Manchester 2000-2006. Source: GONW.
61 Funding for major schemes is included under the Regional Funding Allocation for transport, calculated in section 2 above.

propose changes to the council tax – but argues that the budget for the regional transport authority should be controlled at city-regional level, alongside budgets for regeneration and skills. The adoption of a Transport for London-type model, with mayoral control and the right to fare-box incomes, could result in city-regional transport authorities with far more resources to underpin capital investment.

We have not included LTP allocations to individual local authorities – but believe that some of these allocations should be pooled within the City-Region Contract as well.

Birmingham city-region

PTA/PTE LTP grant 2005/06: £69.1m

Manchester city-region

PTA/PTE LTP grant 2005/06: £18m

6. Other potential devolved funding

This annex is indicative rather than exhaustive. It does not include all of the funding streams that would be best devolved, allocated and implemented at city-regional level. For example, English Partnerships funding should also be devolved to this level wherever possible – and grants from the forthcoming Transport Innovation Fund should be vired to city-regions for strategic projects.

Local authorities within city-regions should also give strong consideration to pooling some of their own economic development resources within City-Region Contracts. Our research suggests that this would help to progress or unlock infrastructure projects of key strategic interest.

7. Approximate city-regional budgets

Taking the basic figures in sections 2-5 together, the approximate level of spend devolved from Whitehall departments and agencies to our proposed city-regions would be as follows for the financial year 2005/06:

Approximate city-region budgets

Birmingham city-region	£675m
Manchester city-region	£600m

List of web annexes

All available at www.ippr.org/centreforcities

WEB ANNEX 1:
Linking governance and performance: a review of the evidence base

WEB ANNEX 2:
Economic development in Britain: policy, powers, funding

WEB ANNEX 3:
Economic development tools: international comparisons

WEB ANNEX 4:
'City Mayors' event report, 19 May 2005

WEB ANNEX 5:
'Working Cities' events report, September/October 2005

WEB ANNEX 6:
'*City Leadership* and Financial Devolution' event report, 17 November 2005

List of abbreviations

AWM	Advantage West Midlands
BCC	Birmingham City Council
BID	Business Improvement District
BPF	British Property Federation
CBI	Confederation of British Industry
CEC	Commission of the European Communities
CIPFA	Chartered Institute of Public Finance and Accountancy
CRGI	City-Region Growth Incentive
CUPS	Centre for Urban and Community Studies
DCMS	Department of Culture, Media and Sport
DfES	Department for Education and Skills
DfT	Department for Transport
DTLR	Department for Transport, Local Government and the Regions
DGCL	Direction Générale des Collectivités Locales
DTI	Department of Trade and Industry
DWP	Department for Work and Pensions
EDC	Economic Development Contract
GDP	Gross domestic product
GLA	Greater London Authority
GVA	Gross value added
HMT	HM Treasury
LAA	Local Area Agreement
LABGI	Local Authority Business Growth Incentive
LCC	Liverpool City Council
LEGI	Local Enterprise Growth Initiative
LGA	Local Government Association
LSC	Learning and Skills Council
LSP	Local Strategy Partnership
LTP	Local Transport Plan
MBC	Metropolitan Borough Council
MYE	Mid-year estimate
NLGN	New Local Government Network
NNDR	National non-domestic rates
NWDA	North West Development Agency
NWSG	Northern Way Steering Group
ODPM	Office of the Deputy Prime Minister
OECD	Organisation for Economic Co-operation and Development
ONS	Office of National Statistics
PPP	Public-private partnership
PSA	Public Service Agreement
PTA	Passenger Transport Authority
PTE	Passenger Transport Executive
RDA	Regional Development Agency
SBR	Supplementary Business Rate
SURF	Centre for Sustainable Urban and Regional Futures
TfL	Transport for London
TTWA	Travel-to-work area

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