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ECONOMIC FUTURES
COMMISSION

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NORTHERN PROSPERITY IS NATIONAL PROSPERITY

A STRATEGY FOR
REVITALISING THE
UK ECONOMY

REPORT

IPPR North and
the Northern Economic
Futures Commission

November 2012
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Institute for Public Policy Research

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IPPR North
3rd Floor, 20 Collingwood Street
Newcastle Upon Tyne NE1 1JF
T: +44 (0)191 233 9050
E: north@ippr.org
www.ippr.org/north
Registered charity no. 800065

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for CHANGE

NORTHERN PROSPERITY IS NATIONAL PROSPERITY

A STRATEGY FOR REVITALISING THE UK ECONOMY

IPPR North and the Northern Economic Futures Commission
November 2012

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- Geoff Muirhead CBE, former chief executive, Manchester Airports Group (NEFC chair)
- Ed Cox, director, IPPR North (NEFC deputy chair)
- Bill Adams, regional secretary, Yorkshire & Humber TUC
- John Anderson, regional director, BT Yorkshire & Humber
- Rhiannon Bearne, group director for policy, The Cyrenians
- Paul Callaghan, chairman, Leighton Group
- Adeeba Malik, deputy chief executive, QED-UK
- Professor Philip McCann, chair of economic geography, University of Groningen
- David McKeith, chairman, Greater Manchester Chamber of Commerce
- Rodger McMillan, former area head for therapy, AstraZeneca
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- Peter Nears, strategic planning director, Peel Holdings
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This report is a consensus report of the Northern Economic Futures Commission. Analyses and recommendations contained within should be attributed to the commission as a whole rather than to any individual member.

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FOREWORD

When the Northern Economic Futures Commission was formed, we accepted a challenge to develop a medium-term strategy for long-term and sustainable economic development in the north of England, based on a detailed understanding of the northern economy in its national and international context and driven by a clear business focus.

Over 18 months we have met to consider evidence presented from a wide range of sources as well as the findings of new research we have commissioned. Our discussions have been rigorous, but there has been remarkable unanimity about our sense of direction, our proposals and – above all else – about the urgency and importance of our task.

At the outset, we expected that our work would contribute to wider thinking about a steady, if slow, return to economic growth. Instead, it has proceeded against the backdrop of a protracted double-dip recession, which continues to have a disproportionate impact upon the North and poorer households in particular. Much of our initial thinking presumed that, despite the short-term pain that would come with the deficit reduction programme, the promised improvement in public finances would provide scope for modest public investment in the medium to long term to stimulate northern growth. Government itself accepts that this is still long way off, however. And despite recognising the challenge involved in addressing the problems at the heart of the eurozone, we did not expect the sense of ‘crisis’ to persist in quite the way that it has.

With the worsening of each of these situations, the necessity of a proactive approach to northern economic development has only been re-emphasised.

The policy context has moved on too. The Coalition government has continued to apply pressure on the banks to lend more. It has attempted some ‘rebalancing’ with support for key sectors and technologies, such as advanced manufacturing and offshore wind, and with its Regional Growth Fund and enterprise zones. ‘City deals’ have been a step forward in decentralising small elements of economic growth policy to combined authorities and a small number of local enterprise partnerships. And there has been a welcome admission of the need for significant investment in northern transport infrastructure, backed up initially by support for the Northern Hub rail improvements.

In policy terms then, our work has been going with the grain of the stated policy of greater decentralisation to our core cities as the principle drivers of economic growth. In reality, however, many policies have pulled in the opposite direction, repatriating many functions that had been devolved to regional development agencies. To meet the scale of the challenge ahead, we need to see a significant acceleration of decentralisation, with initiatives being spread more widely across government and beyond the core cities.

In London, we have witnessed unprecedented investment and attention as the government – in concert with the mayor – have delivered extremely successful Olympic and Paralympic Games. In Scotland, the debate about independence is gathering steam; in almost any eventuality, the Scottish parliament is likely to be able to build upon its existing ability to act in its own interests. Without any obvious settlement for England outside of London, there is a clear risk that the North will continue to struggle to articulate its strategies and plans and to be heard in Westminster.

Now is the time to act decisively: to prevent our fiscal crisis from deepening, to set our local economies free to drive growth, and to give the North its voice on a national and global stage.

In this, our final report, we have brought together a strategy for growth that we believe can make a significant difference; a strategy for growth that can unlock much of the potential in the north of England which currently lies untapped; a strategy for growth that will ensure that northern prosperity is national prosperity.

While we are writing for a broad audience, we hope that the audience is also prepared to act. Many of our proposals are for national government – decentralisation necessarily requires central departments to let go. Many of our proposals are for regional, subregional and local agencies, not least the local authorities and local enterprise partnerships which play such a critical role in creating the conditions for growth and which already have at their disposal many tools to stimulate innovation, infrastructure improvements and investment. But some of our proposals are unashamedly a call for northern businesses, workers and local residents to act in their own right.

Our proposals should be treated as a unified whole, not in a piecemeal fashion. If some recommendations are ignored, others will be less effective and potential will not be maximised. By addressing each of the main drivers of growth, we are presenting a coherent and a consistent economic case for change. Our proposals are not short-term or quick-fix either. Unlike many policies of recent years, they need time to bed in before their best effects will be seen. In many cases, it is only after a decade or more that they will bear the fruit that we should expect to see – and this slow germination is another reason for the urgency to begin.

Taken together, we believe that our proposals mean that the UK can rebalance its economy towards higher business investment, stronger export performance, and high-quality, high-productivity jobs carried out by a better-skilled workforce, and that the north of England is the place from where this will be driven. Far from being a drag on the national economy, the North can be the place where our fiscal challenges can be consigned to the past and a new type of responsible, resilient capitalism can flourish.

Northern prosperity is national prosperity, and now is the time to prove it.

A handwritten signature in black ink that reads "Geoff Muirhead". The signature is written in a cursive style with a large, looped initial "G".

Geoff Muirhead

Chair of the Northern Economic Futures Commission

EXECUTIVE SUMMARY: NORTHERN PROSPERITY IS NATIONAL PROSPERITY

Our analysis and vision

In our interim report, we set out the argument that northern prosperity is national prosperity (IPPR North and NEFC 2012). Our case was founded upon the central proposition that the economic fortunes of the north of England are too important for the nation to ignore. With a quarter of the population contributing a fifth of economic output, the northern economy is twice the size of Scotland and, if it were a nation, it would rank as the eighth-largest in the EU, ahead of Sweden, Denmark and Belgium. Just halving the output gap between the North and the national average would increase national economic output by £41 billion.

But size alone is only part of the picture. The North holds huge untapped potential. The transformation of cities like Leeds, Manchester, Newcastle and Sheffield has demonstrated that transition from an industrial past is possible and profitable. As many nations look to their mid-sized cities as the engines of future growth, so the potential of these key centres of employment and economic dynamism is yet to be fully exploited (Parkinson et al 2012, Overman and Rice 2008).

New knowledge sectors, advanced manufacturing, biohealth, renewable energy industries, and culture and tourism are just a few of the sectoral specialisms where the North has some clear comparative advantages. It is in such areas that the North has consistently increased its share of UK exports over the past decade (IPPR North and NEFC 2012).

And the North holds the key to a more resilient national economy. While the congested Greater South East region continues to push up against the limits of growth, the North has land, water and energy sources in abundance. Such natural assets can only grow in value as their scarcity in the south of England increases and as businesses are increasingly attracted to invest in areas offering lower input costs and a higher quality of life.

Nevertheless, the prevailing public narrative about the economy of the North is most often a negative one. We regularly contrast the dominance of the prosperous and powerful Greater South East with the lagging regions of the North West, North East and Yorkshire and the Humber. The 'north/south divide' is stock-in-trade; 'it's grim up north' is a familiar refrain in the national media.

Like all clichés, there is more than an element of truth in this characterisation of the North. It clearly falls behind the south of England on the conventional measures of economic performance such as output, productivity and employment, and a greater proportion of its households live in poverty.

This is not a recent phenomenon. Such regional inequalities date back nearly 150 years and, despite some narrowing of the disparities between north and south in the post-war period, since 1985 the UK has had a higher rate of regional divergence than France, Germany, Italy and even the United States (BIS and CLG 2010).

The causes of these disparities are many and complex. In this report we highlight the macroeconomic conditions and long-term trends that have been at the heart of the North's economic challenges: deindustrialisation, outward migration and the over-valuation of sterling. Various waves of 'regional policy' have attempted to turn back this tide, from the Barlow report in 1940 through to New Labour's regional development agencies in the past decade, but none has succeeded in doing more than slowing down an ever-growing divide.

In more recent times, the double-dip recession, a lack of lending and investment and the government's austerity measures all appear to have exacerbated these pre-existing maladies. Policies aimed at 'rebalancing' – the Regional Growth Fund, enterprise zones and city deals for example – appear only to be scratching the surface of much more deeply rooted problems.

It is our strong belief, therefore, that in order to meet these real and present challenges, the north of England needs a new economic agenda – an agenda that allows it to tell a story about its future that is radically different from the tired stereotypes that too often dominate its image today.

This new agenda should clearly identify the North's structural weaknesses but put in place the foundations for a new era of prosperity. It should recognise what has held the North back in the past but articulate a strategy which builds on emerging strengths and new opportunities. It should engage with present challenges but clearly set out the steps needed to bring real and lasting change. In this report, we seek to do just that.

Our agenda starts, unashamedly, with a vision:

We believe that the north of England is capable of taking its place in the ranks of the most successful northern European economies, with competitive companies trading in global markets, a fully employed and well-skilled workforce, and strong civic leadership that supports growth and shared prosperity.

We believe that significant progress can be made towards this vision by 2025. Indeed, we go further: **if the UK is to rebalance its economy towards higher business investment and stronger export performance, it is essential that the North is at the forefront of economic change.**

Since the financial crash in 2008 it has become increasingly apparent that our economic growth model has been too heavily dependent on the fortunes of the financial services sector. A successful City of London represented a central – if not the only – plank of a national economic strategy that redistributed the tax revenues generated by financial services into supporting public sector employment and ameliorating the effects of low wages and economic inactivity elsewhere. Insofar as wider economic strategies have existed, these have largely been market-led and spatially blind, resulting in disproportionate levels of investment in London and the south east at the expense of the North (Cox and Schmuecker 2010).

Despite more recent acknowledgment of the flaws in this growth model and the call for rebalancing, we must not overlook the theoretical orthodoxies that have underpinned policies designed to drive economic dynamism in London and the south east. Even since 2008, crude and over-simplistic interpretations of concepts such as ‘agglomeration’ and ‘new economic geography’ continue to prevail in the corridors of Whitehall and the pages of the *Economist*,¹ when in academic circles there is increasing recognition of their limitations and greater awareness of the importance of more active industrial and regional policies in driving growth in all types of region (Boschma and Martin 2007, OECD 2006, Parkinson et al 2012). Despite the strongest growth occurring in the capital city, 57 per cent of net aggregate growth in the UK was generated by its lagging regions in the decade to 2008 (Garcilazo 2010).²

But to pin all the blame on the politicians, policymakers and academics who have overlooked northern economic potential in favour of a burgeoning Greater South East would be to underestimate the scale of the transition required for the North to move beyond its industrial past. Recent OECD research comparing the growth trajectories of similarly challenged regions elsewhere in Europe has shown that successful transition requires sustained, long-term support for a wide range of drivers of economic growth (OECD 2012). This prospect looks increasingly bleak during a period of long-term fiscal constraint.

1 See for example ‘London’s Precarious Brilliance’ and ‘On a High’, *Economist*, 30 June 2012; ‘Another Country’, *Spectator*, 14 April 2012

2 The important point here is that the northern economy is very large, and to the extent that it has underperformed so the aggregate UK economy underperforms, irrespective of what is happening in London and the Greater South East. If the performance of the northern regions improves, so does that of the overall UK economy.

In the coming years, the north of England can expect more cuts in central government spending, according to current plans, whether to social security benefits or departmental budgets. In these circumstances, it needs to demand much greater control over the levers of economic growth. It needs a bigger share of the nation's investment in infrastructure, and more power to shape its economic destiny.

If the North is to continue its transition away from its industrial past and maximise its potential then the national playing field needs not to be levelled but to be rebalanced in its favour. Investment in transport infrastructure, innovation and other key drivers of economic growth, so long skewed towards London and the south east, need fundamental rebalancing. The North must be able to grow its private sector base and key economic assets to a point of much greater self-reliance. We need a 20-year focus on building the skills and assets that the century ahead will require. We need an active industrial and regional policy.

Alongside this, the North and its constituent economic areas need much greater autonomy over the drivers and the proceeds of growth. City regions and their hinterlands need greater control over the decisions that can drive economic growth. They need to be able to control their own budgets and raise their own revenues in line with their aspirations. Failure on either point will perpetuate the downward spiral of decline and dependency on central government subsidy to prop up economic weakness and the unemployment and poverty that results from it.

Nonetheless, even with a new deal between central government and the North in place, the long-term path to economic recovery lies principally in the hands of northerners, and it is up to us to define the kind of economy that we want to flourish.

Our 12-point plan for northern economic growth

The OECD has recently published the results of a three-year study into patterns of economic growth in different types of region across the advanced economies (OECD 2012). It identified five key drivers of economic growth in so-called 'intermediate regions' like the north of England. The commission has used this work as the basis for its analysis and a framework for its northern economic growth strategy. Within this framework, it has identified 12 key recommendations that will stimulate economic growth.

Good jobs and skills

The principal driver of economic growth in intermediate areas is human capital. Labour market performance and levels of educational attainment are very good indicators of any region's capacity to thrive and its ability to address poverty and disadvantage. And yet making the most of the talent and skills of its people is both one of the biggest challenges facing the North and one of its greatest opportunities.

The recession has hit the North hard: unemployment is currently at 9.6 per cent, nearly two percentage points higher than the UK average; a growing number of people are in long-term unemployment, and a disproportionate number of people are in temporary or part-time roles because they can't find full-time work. In age-group terms, younger people and older people are bearing the brunt of these problems.

Recommendation 1:

Full employment must be the foundation of prosperity in the north of England. In the next decade, we should aim to increase private sector employment by 500,000 in the North, on the way to a long-term goal of an employment rate of 80 per cent (ages 16–64).

Employment growth in the private sector will be led by business services and personal services like childcare and care of the elderly. Our proposals for economic investment and reform would boost investment in key infrastructure and export sectors. We should also aim, over time, to improve the quality of jobs – particularly at lower levels – as this will be the primary way by which to tackle poverty and disadvantage. The commission therefore commends initiatives to **extend the living wage** where it is practical and affordable. Although the onus of this recommendation is on the private sector, local enterprise partnership areas should be given the responsibility and tools to create **an active industrial strategy** for their area.

Perhaps the most effective means of improving job quality and tackling disadvantage, however, is the effective utilisation of human skills. This requires a strong focus. We have identified the following key challenges to skills policy in the north of England:

- a higher proportion of people with no qualifications at all and a lower proportion of people with high-level skills in comparison with the national average
- outward migration of recently qualified graduates
- a mismatch between skills supply and the demands of local employers
- a lack of demand for skills among employers, the poor utilisation of skills that are available, and the lack of clear training budgets and plans for staff
- a lack of information about the current and future shape of the economy and the kinds of skills that will be required.

In order to meet these challenges, our first priority must be to improve the supply of high-quality apprenticeship places and ensure that all young people stay in education and training that will equip them with the skills needed for gainful employment.

Recommendation 2:

The National Apprenticeship Service and its partners should aim to **double the number of young people in advanced (level 3) apprenticeships by 2015 from 30,000 to 60,000**. This implies shifting funding out of intermediate apprenticeship places for the over-25s and a **major expansion of pre-apprenticeship training programmes in northern further education colleges**. Learning from social partnerships elsewhere in northern Europe, the commission also advocates **the development of local apprenticeship hubs or associations that bring together employers, training providers and trade unions to plan and deliver apprenticeship places**.

In order to deliver skills policy to meet local and regional needs in the North – particularly to improve the match between future employer needs with present skills training provision – local authorities and employers should be given greater control over public funding for apprenticeships and training.

Recommendation 3:

Drawing upon evidence from places like Michigan in the US, Brandenburg in Germany and south Netherlands – where more localised approaches to skills policy have delivered excellent results – **we recommend that a significant proportion of skills and welfare-to-work funding is devolved to local authorities and their partners in city-regions such as Greater Manchester and West Yorkshire, as well as other local enterprise partnership areas**.

This would involve city-regions and their local authority partners taking lead responsibility for linking up skills provision, employment and economic growth in their areas by:

- identifying leading vocational centres of excellence focused upon the key growth sectors identified in their emerging local economic strategies
- facilitating local employers' networks, local apprenticeship hubs and skills action plans to address both short- and long-term industry skills needs
- aligning public resources from all levels to deliver more coordinated and effective skills provision, including co-location of, and resource sharing between, local and national services.

To enable this to happen, central government should:

- devolve significant budget responsibility to city-regions, including budgets for adult further education, skills and apprenticeships
- increase the capacity for gathering robust labour market intelligence at the local level to help identify the sectors and clusters where there will be future skills demand
- take further steps to integrate employment and skills policy, for example by giving city-regions greater responsibility for co-commissioning the Work Programme.

Innovation and business growth

Recently there have been growing calls for a modern ‘industrial strategy’ for the UK. This is not meant in the hackneyed sense of picking winning sectors or firms, or propping up failing ones. Rather, it is about seeking to identify and support the elements of comparative advantage within the economy that enable innovation and new technologies to take root and companies to grow.

To this end, the commission has explored what a northern industrial strategy might look like, identifying current sectoral trends, analysing the emerging strengths and opportunities identified in local enterprise partnership strategies, and carrying out some original quantitative analysis of the export potential of key goods and services in which the North already holds some strengths.

The results of this analysis offer encouragement: despite an ongoing decline in traditional sectors such as manufacturing and extraction, new sectoral strengths are emerging in related fields such as advanced manufacturing, pharmaceuticals and biohealth. The low-carbon economy presents opportunities, such as offshore wind and other environmental technologies. And northern natural assets present opportunities in the visitor economy and agriculture. Export opportunities, not least to the emerging BRICs economies, exist in sectors such as telecommunications equipment and road vehicles. And there will be ongoing opportunities in business and financial services associated with all of these sectors.

Local enterprise partnerships and their local authority partners must continue to build and refine their local intelligence on key subsectors that they identify as prospects in their areas, both in high-growth sectors and in sectors that will create high numbers of private sector jobs. But across the North there needs to be a clear northern innovation agenda that is based on a small number of priorities and strategic assets and which addresses some of the North’s cross-cutting innovation challenges.

Recommendation 4:

To support and galvanise business innovation and growth in the North, **we recommend the formation of a Northern Innovation Council**, bringing together leading universities, employers and local authorities. **It should be endowed with £1 billion of the proceeds of the sale of the 4G spectrum for investment in university–business collaboration, applied research and innovation support and particularly in the development of a small number of its own ‘Catapult Plus’ centres.**

New sources of business investment will be critical in supporting northern business strengths. To this end, foreign direct investment will continue to be an important source of business growth. Since the abolition of the regional development agencies, securing inward investment into the north of England has been led by United Kingdom Trade and Investment (UKTI) within a new national system. However, this system is not working well for many parts of the North and this is unlikely to improve as the system beds in. To this end **the commission recommends that there is a significant shift in current UKTI strategy from one that focuses primarily on business sectors to one which provides greater support to key localities and city-regions. UKTI’s national targets should also be revised to prioritise business growth and job creation rather than new projects and leads only.**

We also need to go further to restore the capability to attract inward investment to the North as a whole and to build on clear strengths and opportunities to maximise export potential, not least to emerging markets.

Recommendation 5:

To secure higher levels of inward investment to the north of England and boost its export capacity, we propose the formation of a **Northern Investment and Trade Board** tasked with developing a small number of key trade and investment priorities for the North at a significant scale and improving coordination between local authorities, local enterprise partnerships and UKTI sector specialists.

Historically, the North has had a lower level of small and medium-sized enterprise (SME) activity than the rest of the UK. Yet it is SMEs which create the bulk of opportunities for those individuals who are currently shut out of the labour market (Urwin and Buscha 2012). With the northern economy carrying a higher proportion of workless people, addressing

this mismatch is essential to unlocking northern potential, particularly for the poorest households – and current trends are promising.

There is no single, overarching solution to enhancing the enterprise ecosystem; while entrepreneurship cannot be government-led, there are a number of ways in which local and national government players can enhance the conditions for small and medium-sized business growth. Access to finance is probably the biggest concern facing SMEs – an issue which we address elsewhere in this report. But alongside this **the commission proposes a number of small but important improvements to SME support, particularly targeted at competence gaps in medium-sized businesses, which – taken together – could make a significant difference.**

Natural assets and infrastructure

Northern natural assets and infrastructure form the building blocks of a successful and sustainable northern economic future. While not sufficient, they are entirely necessary to achieving lasting economic growth. Yet for too long they have been undervalued and neglected. This has to change rapidly.

Unlike the Greater South East, the North has abundant land; our agricultural potential is growing as climate change impacts on southern England and national food security; the ready availability of water is an asset which needs to be turned into a much greater advantage for the North than is currently the case.

The Environment Agency has suggested that need for a more strategic approach to the structure of the water industry and its incentives, including by directing housing and development where the environment can cope with the additional demands but also by both valuing and pricing water differently to promote innovation in technologies designed to conserve and distribute water effectively (EA 2009). **The commission notes how water usage patterns differ markedly between north and south, for both metered and unmetered use, and that this needs to be addressed as a matter of some urgency.**

As the nation looks to new sources of low-carbon and renewable energy, the North is well-placed to make a significant contribution to national energy supplies through its offshore wind potential and through new investment in its longstanding capacity and expertise in nuclear power generation.

On infrastructure, our *Northern rail priorities statement* earlier this year was – along with many other calls for investment – successful in prompting government to approve investment in the Northern Hub rail proposals (IPPR North 2012). We now need to go much further to rebalance transport investment towards the North and to shift power and responsibility for the planning, commissioning and funding of key modes of transport out of Whitehall into the regions.

As a first step, we should make important technical changes to the appraisal of major transport investments, so as to place much greater emphasis on long-term economic benefits across the country, rather than short-term user benefits, such as the alleviation of congestion, which continually privilege transport schemes in London and the south east.

Recommendation 6:

We recommend a major **decentralisation of transport powers** to local authorities and passenger transport executives, including powers over regional franchising, concessionary fares and management of local stations. We also propose the creation of a new body – **Transport for the North (TfN)** – to take power over the northern rail franchise, major hub stations, rolling stock and smart ticketing. In due course, we propose extending TfN's powers to some aspects of bus regulation and Highways Agency responsibilities, so that integrated planning of transport across car, bus and train travel is made possible.

The North also offers solutions in respect of nationwide problems with airport capacity. Rather than a narrow preoccupation with south-east airport capacity, the commission believes **we need a truly national aviation policy framework** that identifies the opportunities that exist for the better use of northern airports. We believe that there should be an increase in the number of direct flights from northern airports to existing and emerging markets. There are direct flights from Frankfurt and Munich to Beijing, Shanghai, Moscow, Sao Paulo, Mumbai and Delhi, and direct flights from Dusseldorf to Beijing and Moscow – no northern airports have flights to these cities.

Recommendation 7:

In order to address national airport capacity concerns and expand connections between the North and key export markets, **Manchester Airport should become a second international airport hub for the UK**. Just as in Germany, France, Spain and many other European countries, there is no good reason why the UK cannot support more than one international hub airport outside its capital city. To stimulate demand for flights out of the North, **we propose a reduction in the rate of air passenger duty at northern airports to the lowest levels (band A) for all flights for an initial period of three years**. Such a reduction will quickly be compensated by the tax revenues generated by jobs and business growth.

In relation to maritime infrastructure as well, the case is made for a much **more coherent national approach to ports and logistics development which integrates container freight with access to road, rail and more local distribution centres**. At a global level, the widening of the Panama canal and the new Liverpool 2 deepwater container terminal, which can accommodate much larger container vessels, are both due for completion in 2015. In combination, these new facilities will open up new and significantly more economic shipping routes, linking transatlantic trade with the Asia-Pacific region and the Mediterranean/Middle East. Liverpool in particular will benefit from this as a natural calling point on these new routes, in preference to a diversionary route via ports in the UK's south east or northern Europe. These developments, coupled with logistics park developments along the Manchester Ship Canal, could provide the lowest cost and carbon logistics hub in the UK, while at the same time reducing congestion on the major arterial roads and railways from southern ports. Meanwhile **a clearer commitment by government to offshore wind development** could trigger a further resurgence in the ports along the north-east coast.

Housing is also vital to creating a competitive economy. The North suffers from significant problems with housing quality, affordability and the viability of new housing schemes. Its needs are very different from those of London and the South. So here again we propose a major devolution of power and funding for housing benefit and capital expenditure to northern local authorities.

Recommendation 8:

We recommend the **decentralisation of housing finance – housing benefit and capital funding for building homes – into subregional housing funds**. Local authorities, individually or as combined authorities, would be able to switch spending from rent subsidies into building new homes, strike deals with local landlords over rent levels, and plan more systematically for meeting their local housing needs. We estimate that this would transfer at least £13 billion a year out of Whitehall into the three northern regions, and as with other similar initiatives could go some way to tackling poverty and disadvantage. As a first step, **we propose a small number of subregional housing fund pilots are established as part of further waves of city deal agreements**.

To achieve many – if not all – of these objectives, the commission believes that we need a much greater spatial awareness in both national and local policymaking. This will be achieved not by a single grand plan but by **the adoption of clear place-based principles** to underpin

policy development and a **'Mapping the Future' programme** to set out a long-term vision and provide an investment framework for some of our key assets and infrastructure opportunities. Unlike other successful economies, the UK fails to think spatially in its economic policymaking, and this needs to be addressed if we are to make the most of all our natural assets. We believe that Germany offers an exemplar of a national spatial approach.

Finance and investment

Investment in the economy, both by government and business, is essential to economic growth. Access to finance in the North is broadly in line with the size of its business base, but in recent years it has become clear that banks have reduced their lending to northern businesses, while at the same time there has been a significant reduction in the demand for credit. The North also suffers from weak public investment: government spending per capita on science and technology and transport in the North is almost half that spent in London and the south east. This long-term trend has a cumulative effect, leading to weaker growth and in turn a weakened justification for additional spending.

In order to reverse this downward spiral there is a clear need for a countercyclical approach to investment. Now more than ever, the North needs a growth stimulus to avoid yet more decades of slow growth and government subsidy. Additionally, in order to break free from this dependency on the redistributive effects of public spending, the North needs much greater levels of financial autonomy. This means having greater power to raise private finance to invest in economic development, but also that public spending is carried out within the local economy.

The commission has explored a range of models to achieve this, considering ideas such as tax increment finance, use of the Public Works Loan Board (PWLB) and local authority pension schemes, models of regional investment banks overseas and recent proposals for a British Investment Bank. We believe action is necessary on a number of fronts.

To stimulate higher levels of public investment in the assets and infrastructure of the North, we propose greater use of **municipal bonds on the part of local authorities, with pooled issuances** to enable investment at scale and on-lending for smaller projects. We also support the creation of a **northern investment vehicle capitalised by local authorities and local authority pension schemes** in the North to raise finance to invest in northern infrastructure projects.

The government has recently announced proposals for a new state-backed business investment bank. We believe this initiative should be built upon and expanded in order to generate a major expansion of regional business and infrastructure investment.

Recommendation 9:

We support the creation of a **British Investment Bank, capitalised with £40 billion nationally, but we recommend a regional allocation of funds** made according to a formula that combines population with economic potential. This would ringfence funding for the north of England, creating a **northern investment capacity within the British Investment Bank**. Its objectives would be to reverse underinvestment in infrastructure and long-term SME lending, with scope for northern leaders to add further high-level strategic funding priorities (although bankers will always make the day-to-day decisions on investments).

Despite this, relying exclusively on debt-based finance does not offer a secure base for northern economic prosperity. As such, the commission believes that locally held revenue-raising powers and access to resources that can be deployed flexibly are also essential to increasing fiscal autonomy.

Recommendation 10:

We recommend the formation of a **single funding pot for economic growth in local enterprise partnership areas** comprising significant central government budgets that have been decentralised according to a clear and transparent formula. Government's contribution should include economic growth, skills, infrastructure, housing, employment and business support funding, which would amount to **at least £129,272 million in England for the 2011/12–2014/15 period. There would be a further £84,699 million ringfenced for the subregional housing fund**. This is not additional spending; rather, it is a change to who is responsible for existing public spending. Over time and in conjunction with a tapering equalisation formula, the single pot would be added to by a significant increase in locally raised revenues through a **more simple and radical localisation of business rates**.

Finally, the commission recognises the significance of the forthcoming European Union structural fund negotiations and the new financial framework for 2014–2020 that will result. With funding no longer ringfenced for particular regions, there is clearly a risk that northern regions will receive a smaller proportion of funding than might have been the case under the previous settlement. To this end, **the**

commission has set out a series of principles for a well-functioning and empowering EU funding framework for the UK. It calls upon all players to adopt these principles as a basis for forthcoming negotiations.

Institutions and leadership

The final factor driving economic growth is the institutional and policymaking capacity in the north of England and, in particular, its economic leadership. There has been considerable flux in the way in which the North has been governed in recent decades. Not least in the past three years, which have seen the abolition of regional development agencies and the introduction of local enterprise partnerships (LEPs) and combined authorities at a city-regional scale. Given that much research evidence points to the importance of stability and coherence in enhancing economic development, this regular upheaval has not been good for the North.

In the interests of stability, **the commission believes that all political parties should now accept the LEP geography and seek to build the economic development capacities of those institutions that work within LEP areas.**

Recommendation 11:

The commission advocates **the development of more-transparent governance arrangements based on the combined authority model** pioneered by Greater Manchester and Leeds city-region but with a greater regard for more direct democratic accountability. **We therefore recommend consideration of directly elected ‘metro mayors’** across LEP areas alongside suitably named rural alternatives and that government should legislate to make their adoption possible.

Our report also identifies a significant number of areas where there is a strong case for wider collaboration between LEP areas at the pan-northern level. A variety of mechanisms for more strategic coordination have already been proposed for these purposes: Transport for the North, a northern investment arm of the British Investment Bank and a Northern Innovation Council, for example. But on the national and international stage the north of England needs a clear voice and a strong sense of priority, not dissimilar to that provided by the Scottish first minister and the London mayor. The credibility associated with such roles is not achieved overnight.

Recommendation 12:

As a first step in a process of establishing a more clear and coherent northern voice, the commission proposes **a Northern Leadership Convention to be held on an annual basis and supported by a small secretariat, followed by an N11 Leaders' Summit, comprising one political and one business leader from each of the 11 LEP areas in the North.** The summit would be action-oriented, focused on developing strategies and plans to address the shared priorities identified during the convention. And it would be headed up by a northern chair, elected at the summit to serve for a period of four years, or alternatively a chair and vice-chair to rotate between LEP areas on an annual basis. The convention would also host an annual **Northern Future Leaders Academy.**

What will the North be like in 2022?

The recommendations set out in this report together represent a coherent strategy for growth. While there is a temptation for them to be considered in a piecemeal fashion, OECD research shows that the most successful initiatives to drive growth in intermediate regions involve coordinated and concerted effort across a wide range of drivers and policy initiatives, exploiting horizontal linkages between businesses, local government, universities and other local actors and vertical linkages between government departments, local and subregional structures.

To monitor and evaluate our progress, we have assembled two new baskets of indicators and targets. The first is a set of short-to-medium-term national indicators; the second is a series of longer-term international measures of economic development. These indicators go beyond simplistic notions of GVA or GDP growth and look to measure the sustainability and resilience of the northern economy.

Alongside these indicators we have identified a series of comparator regions elsewhere in Europe. For too long, crude north/south comparisons have failed to serve the north of England well; by identifying a number of similar European regions that currently outperform city-regions in the north of England, we are suggesting a basis upon which more useful learning and development can take place. **We recommend our carefully selected indicator sets and comparator regions as the primary dataset upon which annual monitoring is carried out for the Northern Leadership Convention.**

But aside from indicators, it is worth considering the impact that the different measures set out in this report might have and to picture what the North might look like in 2022. We offer the following as a glimpse of what success could look like:

- If we can create 500,000 new jobs in the North then our employment rate will soar from the present 69.5 per cent to nearly 75 per cent by 2022, with as many as a quarter of these being good-quality jobs in growing sectors such as offshore wind, biohealth and the creative and digital sector.
- If we increase household wealth even to the OECD regional average then every household will be nearly £500 better off each year.
- If we double the number of advanced-level apprenticeships then 60,000 young people will get their foot on the ladder in careers which keep them in the North, working with satisfied local employers, and multiply local prosperity.
- If we engage employers in decisions about skills and training to meet the needs and priorities of their businesses then we could make our excellent northern universities net importers, rather than net exporters, of skilled graduates.
- On current projections, levels of entrepreneurial activity in the North will reach the England average of 970 businesses per 10,000 population in the coming decade, meaning the creation of 259,000 new businesses by 2022.
- If we halved the gap in exports per head compared with London and the south east we would create 63,000 new jobs in the top 20 exporting sectors alone.
- If the proportion of foreign direct investment into the North returned to the levels that existed prior to the abolition of the regional development agencies through a system of foreign direct investment that better understood the northern economy then it would support a further 122,600 jobs in the next decade.
- Through investment in the Northern Hub and transpennine electrification, we will be able to travel between Liverpool and Leeds in just 77 minutes – nearly 35 minutes faster than is the case today.
- With reduced air passenger duty for northern airports and a genuinely national aviation strategy, we could match German airport performance with twice the number of direct flights to China nationally and new direct routes to Beijing, Shanghai, Moscow and Sao Paulo from northern airports, as is the case out of Dusseldorf and Munich.
- If we double the amount we recycle then we can overtake Germany, which recycles 40 per cent of its household waste, creating jobs and wealth in the process and putting the North on the map as the greenest part of the UK.
- If we devolve housing benefits and a fair share of capital expenditure to northern city-regions then places like Greater Manchester and Leeds would control as much as £2.5 billion and £1.8 billion respectively to subsidise rents and address local housing issues.

- If we hold an annual N11 Leaders' Summit, we will create a strong mandate for the same access to Downing Street and Brussels as is currently enjoyed by the Scottish first minister and the mayor of London.

As we look to neighbouring regions – such as the southern Netherlands, North Rhine Westphalia and southern Sweden, which are regions with similar histories to our own – we see the emergence of new models of economic growth, built upon sustainable, resilient and autonomous foundations. These are regions which are playing a critical role in the context of their wider national economies, regions which are not only driving technological innovation but which have labour market and social innovations to match, to expand the skills base and drive up living standards.

Far from lagging behind the rest of the country, if the north of England was to rise to this challenge and emulate its northern European neighbours then it might just lead the UK economy out of its sluggish and poorly balanced recovery and towards a more progressive and sustainable economic future. Then and only then will the national debate move on, and the nation as a whole will accept that northern prosperity is national prosperity.

What is the North?

The commission was established to concentrate its attention on the north of England: the area commonly understood to be comprised of three regions: North West, Yorkshire and the Humber, and the North East.

Different people have different concepts of the North. Social and economic history, cultural and regional identity and administrative and local geographies are each important parts of its story. The commission's focus, however, is firmly economic. We are concerned with economic roles, processes, relationships and outcomes, but we recognise and draw from these wider concepts of the North as we consider its future, as each contributes to our rationale and purpose.

There is an important debate about the appropriate scale for economic development thinking. Different markets – labour markets, investment markets or energy markets, for example – operate over different geographies, which overlap and interconnect. Very often it is the connections and relationships between areas that are more important than any boundaries. In recent times there has been much consensus about the importance of the 'functional economic area', loosely understood

to align with subregional labour markets and travel-to-work areas but overlapping local administrative geographies. This has been the basis upon which city-regions and local enterprise partnerships have been defined.

But many economic issues lend themselves to consideration on a wider scale. Transport infrastructure, energy generation and inward investment can all benefit from thinking and planning which extends beyond subregional areas and requires cooperation between cities and their surrounding areas. As it has taken and interpreted evidence, the commission has concluded that there is a logic to thinking and acting at the scale of 'the North', especially in a global economy. We believe that our report demonstrates that it offers a sensible level of functionality and scale on a number of issues, underpinned by and able to benefit from a distinctive history, culture, geography and identity. This builds on our common industrial heritage and big cities, the social and political identities forged in our towns and villages, and a range of environmental factors too, such as our rural beauty and our coastal places.

This is not to say that other cities and regions don't share many similar characteristics or that the analysis or recommendations set out in this report might not apply elsewhere – indeed we very much hope they might. Simply, we believe that on some vital aspects of economic development there is a compelling case for a pan-northern approach.

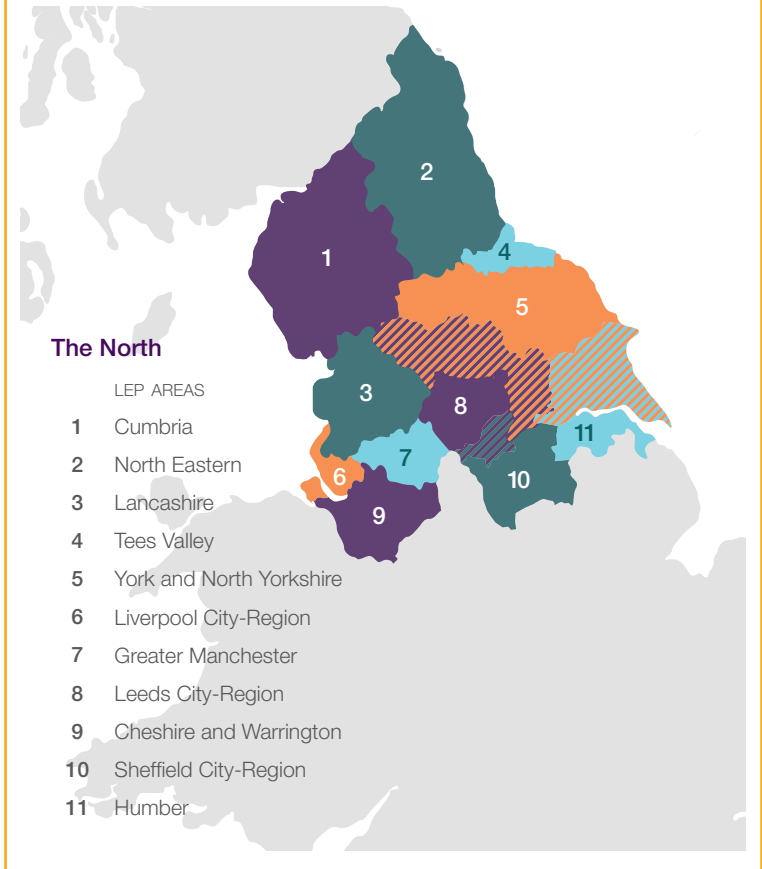
This pan-northern approach must always recognise, however, the great variations that exist within and between different places. Across the North, local economic centres are of different scale and play a variety of roles in a wider 'polycentric' system. Manchester and Leeds exert strong influence across their wider areas and benefit from an increasing density of businesses and skills. Surrounding towns and cities can often benefit from their proximity to the big cities and both places need to recognise these interdependencies.

Sheffield, Newcastle and Liverpool have also made good progress in the past two decades and, while they are less economically powerful, they make distinctive and important contributions to the northern economy, as do a group of dynamic, independent cities, such as York, Preston, Chester and Warrington.

Different parts of the rural economy have experienced different patterns of development. Some have benefited from their

proximity to key cities and towns; others have sustainable land-based economies in forestry and farming, and even in sparser rural areas the tourist offer and other natural assets can bring rapid economic growth.

While the greatest part of growth is likely to come from the core cities, all types of place have an important role to play in maximising northern prosperity. Indeed, some of our smaller places and rural locations have important assets and offer real potential for rapid and successful development. Just as northern prosperity is national prosperity, so the fortunes of Burnley and Blackburn, Hull and Hartlepool, Cumbria and Cheshire need to be interwoven with those of Manchester, Middlesbrough, Morpeth, Leeds and Newcastle.



1. THE NORTHERN ECONOMY AND THE DRIVERS OF FUTURE GROWTH

This chapter provides an initial analysis of the northern economy and in particular its economic composition and productivity challenges. Building on this analysis, it summarises the findings of a three-year study of economic growth in so-called 'intermediate regions'. This study identifies five key drivers – human capital, innovation, infrastructure, investment and institutions – and we present these as the guiding framework for the commission's approach to northern economic prosperity.

1.1 The northern economy in context

In the UK, the prevailing narrative about economic performance contrasts the dominance of the prosperous and powerful Greater South East with the lagging regions of the North East, North West, and Yorkshire and the Humber. Economic underperformance in the North is evident when compared to the South, specifically London and the Greater South East, and also to the UK average (see figure 1.1).



Figure 1.1
GVA change,
1995–2008

Source: BIS and CLG 2010

This is not a recent phenomenon. Over the last 140 years London's GVA has been higher than elsewhere in the UK. Regional imbalances reduced in the post-war period and up until the 1970s, but have increased again since. Between 2000 and 2008, while the annual rate of growth in GVA in the northern regions was a healthy 4.6 per cent, it was below the England and UK averages of 5.2 per cent (Regional Accounts, ONS). International comparisons with France, Germany, Italy and the United States suggest that, since 1985, the UK has had the highest rate of regional divergence; this follows a period between 1950 and 1985 when it had the highest degree of convergence (BIS and CLG 2010).

Throughout this report we explain some of the underlying causes of this divide through analysis of employment trends, skills, innovation and enterprise patterns, infrastructure and investment. But two issues deserve closer attention at the outset: the composition of the economy and its productivity.

1.1.1 The composition of the economy

Underpinning the broad division in the UK economy is the growth of the key service sectors, particularly as a result of the consolidation of London as a key global financial centre in the 1980s, and the deregulation of the City of London (Ward 2011), combined with transition in the North away from its previous industrial economy. Within this overarching picture there is genuine complexity, however. A nuanced examination reveals differences both between and within regions, with certain parts of the economy coming to the fore and others ebbing away. It is useful here to consider employment patterns as a way of revealing some of this variation.

Over the last decade manufacturing has continued to be a significant employer across the North. Central Lancashire and Humber have had the highest share of employment in manufacturing, and Liverpool and Manchester city-regions the lowest. The chemicals industry has been a key employer in the Tees Valley, while high-performance engineering has been a large employer in Central Lancashire, reflecting the importance of the aerospace and other mechanical industries in the area.

The creative industries have been particularly strong in Manchester and Leeds and are growing in many other areas, including Tyne and Wear and Sheffield city-region. Banking and insurance has been concentrated in Manchester, Leeds and Liverpool/Merseyside, though it is a significant employer across the North's city-regions. Food and drink employment has been highest in the Humber, and textiles employment is highest in Central Lancashire, Manchester and Leeds.

Manchester has derived nearly a fifth of its employment from knowledge-driven service jobs, with Leeds and Liverpool city-regions not far behind. Humber, Central Lancashire and Sheffield have been

less strong in these industries. Wholesale and retail employment has been proportionately highest in Humber, Manchester and Leeds. Central Lancashire has had the highest share of employment in hotels and restaurants, reflecting the importance of Blackpool. Construction is a major activity across all the North's city-regions, comprising around 5 per cent of the workforce (Northern Way 2004, 2009).

Some of these historical strengths are complementary. For instance, the Tees Valley looks to both Leeds and Newcastle for business and professional services, while the advanced manufacturing base of Central Lancashire complements Manchester's strengths in financial and professional services (ibid).

But while there are diverse patterns across the North, these patterns are changing. According to present trends, projections made by Oxford Economics (set out later in this report) suggest an ongoing decline in manufacturing jobs accompanied by a reduction in the public sector workforce, with the greatest job growth occurring in distribution and retail, business and professional services, and transport and communications. On current trends, private sector services (along with construction) will be responsible for nearly all of the net job creation over the coming decade.

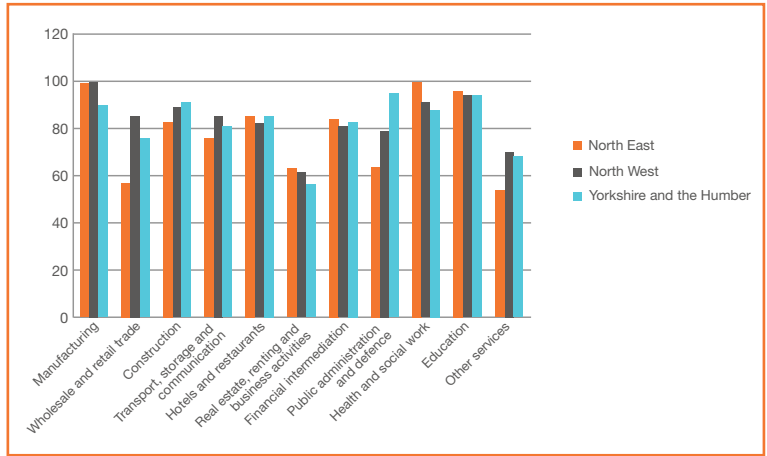
1.1.2 Productivity

One important observation from previous research is that only a sixth of the variation in productivity between the North and the UK average can be explained by differences in industrial composition and the higher prevalence of low-productivity sectors in the North (Johnson et al 2007). Instead, most of the regional imbalance is explained by productivity gaps within sectors.

Figure 1.2 compares productivity per employee across a variety of industries in the northern regions to the UK average. In key sectors where the north is strong – manufacturing, but also education, health and social work – productivity is very close to the national average. However, there are performance gaps in other sectors, such as construction and hospitality, and a much larger gap in knowledge sectors, such as financial intermediation and other services. Again, it is evident that there are significant differences within the North as well.

This analysis of economic composition and the importance of productivity has profound implications for the way we understand the role of industrial and regional policy. These are considered further at the beginning of chapter 3. But one of the most significant implications for our work as a commission is the need to avoid becoming preoccupied with particular sectors or subsectors of the economy and instead to focus on the importance of productivity and the key drivers of growth.

Figure 1.2
GVA per employee
in northern regions
by industry sector,
2007/08 (index 100
= UK average)



Source: GVA statistics, ONS, and Economic and Labour Market Review

1.2 Drivers of growth in the northern economy

In November 2012, the OECD published the results of a three-year study into patterns of economic growth in a range of different economic regions. Using a combination of statistical analysis and 23 case studies of specific regions across the OECD area, its report identified compelling evidence about the complex nature of growth in different types of region. Some of the headline findings are summarised here (all OECD 2012):

- Patterns of regional growth are not uniform and strong growth is possible in all types of region, from core capital cities to less developed peripheral towns to rural areas. Concentration of population or economic activity is neither necessary nor sufficient for economic success; perhaps surprisingly, predominantly rural regions have on average enjoyed faster growth than most other types of region.
- While the concentration of economic activity in particular places (sometimes known as ‘agglomeration’) means that a handful of regions do account for a disproportionate share of aggregate growth, the bulk of aggregate growth occurs outside these big hubs.³ And while urbanisation is associated with higher *levels* of output, it does not necessarily lead to faster *rates* of growth. Indeed, the emerging trends across many OECD countries (ibid) and western European economies suggest exactly the opposite: increasingly, it is second and third-tier centres that are driving the lion’s share of economic growth (see also Parkinson et al 2012). In most rich OECD countries, the share of economic growth accounted for by the ‘big hubs’ has stagnated and so is now largely stable.

3 In the case of the UK, there is only one ‘big hub’, according to OECD criteria: London accounts for 28 per cent of total UK economic growth, 1995–2007.

- For this reason, less developed regions can make a vital contribution to national aggregate growth and to the economic growth rate. Efforts to promote growth in such regions should not be considered as ‘compensatory social policy’ but rather form part of a growth-oriented economic strategy.
- Not only does ‘broad-based growth’ in all types of region make a significant contribution to aggregate national growth, it also reduces vulnerability to economic shocks and reduces the pressures placed upon public finances in regions which suffer from chronic economic underperformance.

These findings challenge conventional theories of agglomeration and economic growth strategies that concentrate exclusively on particular growth hubs or specific growth sectors. The story of growth in recent decades has been about major centres – tomorrow’s growth will be about second-tier cities. But a further question is raised: why do some regions grow faster than others?

In order to answer this question, the OECD study divided all OECD regions into three groups, based upon their GDP per capita in relation to the national average in 1995. ‘Leading’ regions were considered to be those with above-average GDP per capita; ‘intermediate’ regions had GDP between 75 per cent and 100 per cent of the national average; and ‘less developed’ regions had GDP that was less than 75 per cent of the national average. In the English case, all three northern regions – the North East, the North West and Yorkshire and the Humber – all fall into the ‘intermediate’ region category.

Within each group the study then differentiated between those regions that grew rapidly between 1995 and 2007 and those that grew at a rate below the national average. This led to some surprising results, which corroborated some of the headline findings above:

- Over 70 per cent of the regions in the less developed category had experienced above-average growth in the period to 2007; in leading regions, the split was 50:50.
- Only just over one-third of intermediate regions achieved above-average growth, suggesting they experience particular challenges in relation to the big hub regions.

For every region, OECD researchers identified a wide range of comparable indicators concerning educational attainment and skills, labour market performance, transport infrastructure, innovation, agglomeration and a range of other potential drivers of growth. Using statistical analysis, it was then possible to determine – for each type of region – those factors that had led to more or less rapid growth.

This raised some important issues for intermediate regions like the North:

- Human capital (measured in terms of educational attainment) and labour market performance (measured in terms of employment and unemployment rates) have the greatest influence in terms of driving growth rates. Primary attainment and entry-level jobs would appear to have more impact on growth than tertiary-level attainment and high-skilled jobs, although both are important.
- Faster-growing intermediate regions are characterised by better infrastructure and connectivity to global markets. They also tend to be engaged in more innovative activities, such as patenting and research and development (R&D), and in that sense are like faster-growing leading regions, where innovation is the principal driver of growth. (Infrastructure density matters much less in leading regions.)

Alongside this analysis, a review of the case studies highlights a number of additional factors that would appear to be important in enabling declining regions to achieve more rapid growth. Many of these factors are associated with the policies and institutions that are charged with driving growth. The most successful intermediate regions have:

- an integrated approach to economic policy which recognises that different strands can complement or undercut each other. The most common formula for success in intermediate regions appears to be the coordination of policymaking through the horizontal alignment of different economic development institutions, avoiding a predominantly sectoral approach
- coherent and consistent institutions for policy and decision-making, with a focus on the mobilisation of local assets and resources rather than a reliance on external support. The quality of institutions matters particularly in responding to external changes and challenges
- a strong focus on both the infrastructure necessary to enable connectivity both internally and externally and the business environment, including local regulation.

The OECD research is significant not because it identifies any new, previously unrecognised drivers of economic growth but because it highlights the complexity of the inter-relationship between them: simply investing in ‘all drivers all the time’ is not necessarily a recipe for success. Different emphasis needs to be placed on different drivers depending upon a region’s current position and disposition towards growth.

In the case of the northern regions, the research highlights a set of key drivers that would appear to be particularly important in driving economic growth in the medium to long term. These can be listed in priority order:

- **human capital** – not least the need to reduce the proportion of people with low skills and increase the employment rate (this will be addressed in chapter 2 of this report).

- **innovation and the business environment** – including investment in R&D and stimulating entrepreneurship (to be addressed in chapter 3).
- **transport infrastructure** – to facilitate connectivity within and between regions and more widely with the global economy (to be addressed in chapter 4).
- **enhanced institutional capacity** – to enable the horizontal coordination of key policy initiatives, good links between public and private sector players, and a clear emphasis on developing local economic strengths and assets (to be addressed in chapter 6).

The OECD research did not treat investment as a driver in and of itself. Rather, it posits that finance and funding would follow the business growth, innovation, infrastructure and so on that comes as a result of growth. In the current climate, however, investment is a significant issue in its own right. As described already, fiscal constraints have severely constricted public expenditure in driving economic growth, turbulence in the global economy has meant a reduction in inward investment, and many businesses complain that access to finance is a significant problem, as the banking sector seeks to recover from the recent financial crisis. In short, investment is another critical driver in unlocking economic growth in the North which cannot be overlooked (this will be addressed in chapter 5).

Based on the OECD analysis of intermediate regions, it is possible to set out a 'framework' to guide policymaking and drive economic growth in the north of England. This framework is set out in figure 1.3 and provides the basis for our 10-year strategy. In subsequent chapters of this report, we consider each of the five key drivers of growth and the issues and policy developments that will enhance each.

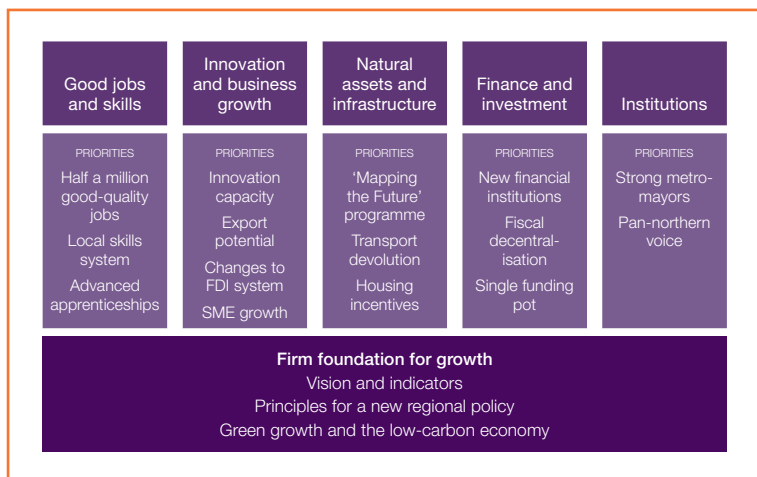


Figure 1.3
NEFC's drivers of economic growth framework

2. GOOD JOBS AND SKILLS

Making the most of the talent and skills of our people is at once one of the biggest challenges and one of the greatest opportunities facing the North. This chapter is in two parts. The first part considers the employment problems of the North and the need for more good-quality jobs. It calls upon businesses to lead the drive to create half a million good-quality private sector jobs in the coming decade. The second part focuses on the question of skills, which are a key driver of economic growth in underperforming regions like the North, and it makes the case for a radical decentralisation of skills funding and powers.

2.1 Sizing up the challenge

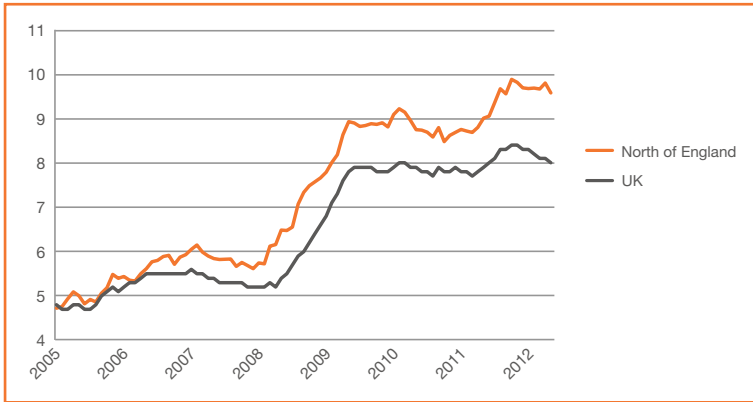
There are three elements to the North's jobs challenge. First, in common with most parts of the UK, the recession has resulted in falling employment levels. Second, this comes on top of a number of long-standing labour market challenges in parts of the North as the economy is restructured. The third issue is the changing demographics of the northern labour market. We address each of these in turn below.

2.1.2 The effects of the double-dip recession

The double-dip recession in the UK has hit the northern economy particularly hard. The increase in unemployment in the North since 2005 (when unemployment in the UK started to rise, well before the economy went into recession) has been relatively large. At the beginning of 2005, unemployment in the North was just under 5 per cent, in line with the UK average. Now, at 9.6 per cent, unemployment in the North is considerably higher than the UK average of 8.0 per cent. It is also higher than in any other part of the country. In the second quarter of 2012, unemployment across the North totalled 719,000.

This suggests that the northern economy is more cyclical than the UK economy as a whole, and that it would benefit disproportionately from measures to promote economic growth. In part, this is because manufacturing remains a larger proportion of the economy in the North and manufacturing tends to be more cyclical than service sector activity. But this is not the whole story. Regions such as the West Midlands, which also have a relatively large manufacturing sector, have not fared as badly as the North over the last five years. This suggests that there must be other factors at play.

Figure 2.1
Unemployment rates, 2005–2012 (%)

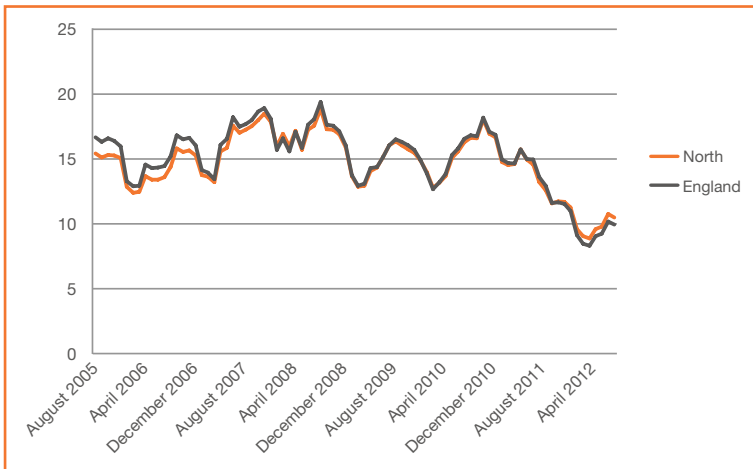


Source: ONS and authors' calculations

In the last year or so, these have included cuts to public sector employment. Recent falls in unemployment nationally have been associated with increases in private sector employment, which have offset falls in public sector employment. The growing gap in recent months between unemployment rates in the North and in the UK as a whole will reflect partly the greater importance of public sector employment in the North, a fact that puts the region at a disadvantage at a time of cuts to public spending.

But the North's jobs challenge extends beyond simply unemployment, with recent data revealing some extremely worrying trends. For example, the proportion of people who are unemployed for six months or longer and then go on to find work is falling, suggesting that large numbers of people are at risk of becoming dislocated from the labour market.

Figure 2.2
Long-term claimant off-flow rates, 2005–2012 (%)



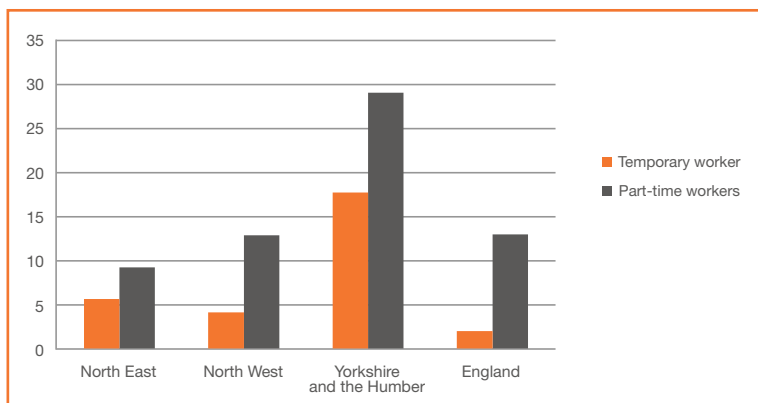
Source: ONS

Note: Claimant off-flow represents the chance of those claiming for six months or more leaving the claimant rolls in the next month.

For those that are in work or finding employment, an increasing number are underemployed – working part-time when they would prefer a full-time job. Increasing numbers are also in temporary rather than permanent posts. This nationwide trend is more marked in the North, especially for temporary work. Yorkshire and the Humber has a particularly high number of part-time workers, as figure 2.3 shows. Already, around 60 per cent of poor children in the UK are living in households where at least one adult works, but these trends towards temporary and insecure work and underemployment increase the risk of people experiencing in-work poverty.

Furthermore, there is evidence of a ‘hollowing out’ of the North’s labour market, with increasing concentrations of people working in either high-paid jobs or low-paid jobs but a reduction in people employed in intermediate occupations (Schmuecker and Viitanen 2011). This trend is less marked in the North compared to the Greater South East, but the risk of a two-tier workforce remains.

Figure 2.3
Underemployment: proportion of workers in temporary or part-time roles because they cannot find permanent and/or full-time roles (%)



Source: ONS

In age-group terms, young and old people have suffered disproportionately during this recession. Table 2.1 provides the unemployment rates for 16 to 24-year-olds between April 2011 and March 2012. After London, unemployment is highest in the North East and Yorkshire and the Humber, with the North West not far behind. Evidence shows that being out of work for a sustained period early in life has a scarring effect on future earning potential that is carried throughout life (Lanning and Lawton 2012).

Unemployment levels are also rising in the 50 to 64-year-old age-group, increasing 53 per cent since 2008. Recent figures from the Resolution Foundation show that 40 per cent of women aged 50–64 and 28 per cent of men in the same age-group could now be classified as NEETs – ‘not in employment, education or training’ (Cory 2012). In the North, the

employment rate among people aged 50–64 is low compared to other parts of the country: just 58 per cent in the North East, 62 per cent in the North West and 63 per cent in Yorkshire and the Humber, compared to 65 per cent nationally. This is a significant challenge, as this is the period in which most pensions savings are made. As a result, a higher unemployment rate among people aged over 50 in the North is likely to result in greater pensioner poverty.

London	25.4
Yorkshire and the Humber	24.9
North East	23.9
Wales	23.9
West Midlands	23.7
North West	23.6
Scotland	21.5
UK	21.2
East Midlands	20.3
Northern Ireland	18.3
East	17.8
South West	16.4
South East	16.3

Table 2.1
Unemployment rate,
ages 16–24 (%)

While the current concern about the long-term position of a generation of school-leavers is both right and understandable, the invisibility of older people not in employment or training is a major concern. In the case of the North, a split focus is required.

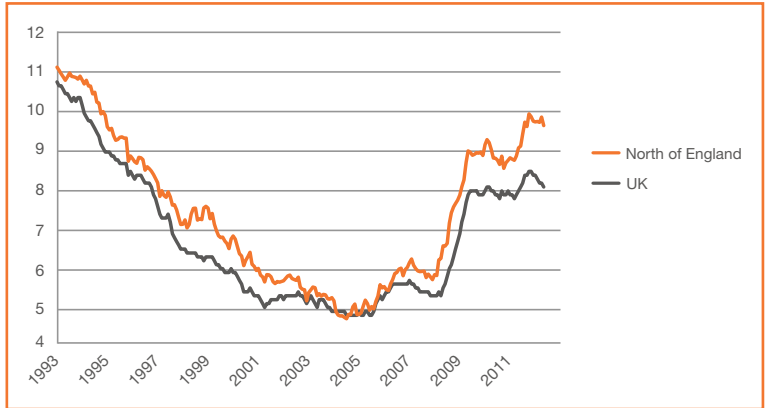
2.1.2 Structural labour market challenges

However, the North’s labour market challenges are not simply the result of recession. While lifting growth in the UK economy over the medium term would help to narrow the unemployment gap between the North and the rest of the country, it would be wrong to see the North’s macroeconomic problem as purely cyclical. The longer-term trends show there is a structural problem too.

Figure 2.4 shows unemployment rates over a longer time period. The only time when the North was able to close its unemployment gap with the rest of the country was when unemployment was at its lowest point in the last economic cycle. In other words, when the labour market was at its tightest and labour was scarce, people in the North found it just as easy to get a job as people elsewhere in the UK. But at all other times over the last two decades, this has not been the case.

This is the result of the longstanding effects of globalisation, which represent a continuing challenge (as well as an opportunity) to the North’s economy.

Figure 2.4
Unemployment
rates, 1993–2012
(%)



Source: ONS and authors' calculations

Globalisation has affected the industrial structure of the economy of the north of England. It has speeded up the process of deindustrialisation in general and, in interaction with historical concentrations of industries, it has devastating effects on particular localities. Market forces struggle to cope with gradual changes, such as the steady loss of the UK's textile and clothing industries to low-cost producers in other countries. Workers need to find alternative uses for their skills in different industries or to be retrained to work in growing industries. Capital needs to be invested to take advantage of the spare resources that have been created. This all takes time (and money) and causes dislocation – in the form of slower growth and higher unemployment – while it is happening.

Even bigger problems occur when there is major change in a particular area. The promotion of industrial clusters – groups of companies that are interdependent and usually located physically close together – is a popular idea right now. But the downside to an established cluster comes when a new competitor from a lower-cost country undercuts one of the cluster's key players. Then the whole cluster is at risk of collapse, and the local economy with it. Unless another, new industry chooses to move into the region, its economic performance is likely to be damaged for a considerable time. Ultimately, the risk is that that decline becomes entrenched, as people retire early or migrate away from the affected area. This is why an active industrial strategy must be flexible and respond to changing circumstances.

This effect has been experienced in some parts of the North as heavy industries have been restructured. There is a risk of history repeating itself as the public sector is restructured and employers use involuntary retirement alongside disinvestment in training and development for older workers by both private employers and government, as they turn their focus to younger people.

Economic restructuring links to (although does not account for entirely) another distinctive northern labour market challenge: economic inactivity (those that are neither in work nor looking for work). In some parts of the North, over a quarter of the working-age population are economically inactive. The government's planned welfare reforms will soon change this, as greater conditionality in the system and a focus on what people can do, rather than what they cannot, is likely to see large numbers of people migrate from economic activity to actively seeking work. As is shown in table 2.2, some estimates have suggested that as many as 700,000 people could join the active job search in the North over the next few years. Clearly the creation of good-quality, well-paying jobs is a major priority.

	Claimant count (Sep 2011)	Labour potential from inactivity	Total available labour
Tees Valley and Durham	42	59	101
Northumberland and Tyne and Wear	47	70	117
North East	88	129	218
Cumbria	9	20	29
Cheshire	22	39	61
Greater Manchester	82	135	218
Lancashire	34	64	98
Merseyside	51	72	123
North West	199	331	529
East Riding and North Lincolnshire	32	37	70
North Yorkshire	13	30	42
South Yorkshire	43	67	110
West Yorkshire	70	108	178
Yorkshire and the Humber	158	242	400
North	445	702	1,147

Table 2.2
Labour 'potential' in the North, 2011 ('000s)

Source: Oxford Economics 2011

Note: Labour potential is based upon 20 per cent of students, 25 per cent of those looking after the home, 50 per cent of sick, 20 per cent of retired and 20 per cent of other inactive people becoming available to work.

2.1.3 The changing nature of the northern workforce

Overall, population growth in the UK has been higher than in other European countries, largely due to migration inflows and people living longer as a result of improved health. In turn, this has impacted on fertility levels, which have decreased; as the 'baby boomer' generation moves towards retirement, the cohort that follows after it is considerably smaller. And while there has been a small recent rise in fertility levels, this generation remains some 15–20 years from entering the labour market. The trend is towards individuals being older for longer, and society being older in general, with significant implications for the labour market.

This presents a number of economic opportunities: changing wealth and consumption patterns among older consumers may, for example, open up new markets for goods and services. Older people remaining active for longer is also likely to increase opportunities for working longer and using their experience to develop new entrepreneurial activities. However, there will also be challenges, such as more people relying for longer on the state pension and increasing social care needs, as people live longer in ill health (both physical and mental), which will put increasing pressure on the welfare and healthcare systems.

While the North faces these challenges in common with the rest of the country, there are some aspects of population change in the region that are distinctive. Much of this is due to the interplay between population trends and economic performance.

A positive story for the North as a whole is that the most recent census data reveals that the trend of declining population levels appears to have halted and reversed over the last decade, as table 2.3 shows. However, population growth still remains at a lower level compared to the rest of the UK.

Table 2.3
Population change
('000s)

	Population			Change		Change (%)	
	1991	2001	2011	1991–01	2001–11	1991–01	2001–11
North East	2,587	2,540	2,597	-47	57	-1.8	2.2
North West	6,843	6,773	7,052	-70	279	-1	4.1
Yorkshire and the Humber	4,936	4,977	5,284	41	307	0.8	6.2
East Midlands	4,011	4,190	4,533	179	344	4.5	8.2
West Midlands	5,230	5,281	5,602	51	321	1	6.1
East of England	5,121	5,401	5,847	279	446	5.5	8.3
London	6,829	7,323	8,174	493	851	7.2	11.6
South East	7,629	8,024	8,635	394	611	5.2	7.6
South West	4,688	4,944	5,289	255	345	5.4	7
Wales	2,873	2,910	3,064	37	153	1.3	5.3
England	47,875	49,451	53,013	1,576	3,561	3.3	7.2
Eng and Wales	50,748	52,361	56,076	1,613	3,715	3.2	7.1

Source: ONS

A more fine-grained analysis shows contrasting patterns of population growth and decline, in particular between rural and urban locations and between north and south. These trends are caused by a combination of ageing in situ in many rural areas, outward migration from urban to rural locations within regions (counter-urbanisation), and wider migration patterns.

A particular opportunity for the North lies in the diversity of its population in many areas and ongoing international migration. Younger minority

ethnic families in particular provide a key resource in a number of northern cities.

However, even with the benefit of the added population capacity offered through migration in-flows and the slight up-tick in birth rates (which is linked in many cases to the different family patterns that exist among these same migrant communities), the North still faces challenging demographic trends that will have implications for the labour market. Long-term modelling (up to 2036) reveals that the size of the northern workforce is expected to continue in decline. This is particularly problematic alongside the rising number of people who are living longer. Table 2.4 lays out these projections, with two different assumptions made about migration, and it is worth noting again that migration is closely interrelated with economic performance. Whichever migration trajectory is nearer to the truth, it is clear that interventions to improve health and to promote active ageing and employment among older people will be essential to the future of the northern labour market.

	TRENDEF			UPTAPER		
	working age population	2036	Time series	working age population	2036	Time series
	2011	2036	2036	2011	2036	2036
Greater Manchester	1,170	1,120	95.7	1,153	1,052	91.2
Liverpool city-region	635	559	88.2	630	545	86.5
Leeds city-region	1,363	1,391	102.1	1,345	1,313	97.6
Sheffield city-region	823	801	97.3	814	768	94.3
Cheshire and Warrington	415	398	96.1	411	381	92.9
Tees Valley	320	299	93.4	316	287	90.7
Cumbria	243	250	102.8	239	233	97.3
Hull city-region	473	458	96.9	468	446	95.2
North Yorkshire	282	298	105.9	277	274	98.9
North East	922	939	101.8	909	877	96.5
Lancashire	712	719	101.0	702	681	96.9
Leeds city-region	1,130	1,157	102.5	1,114	1,090	97.9
Sheffield city-region	591	567	95.9	584	546	93.4
Northern England total	6,891	6,764	95.9	6,804	6,411	93.4

Table 2.4
Projected northern labour force, 2011 and 2036 ('000s)

Source: Rees et al 2011

Note: Time series starts at 2011 = 100.

2.2 The challenge: half a million jobs

The North clearly faces some longstanding labour market challenges, which are being exacerbated by the effects of recession and long-term demographic trends that could see a shrinking workforce and a growing inactive older population. Given the interplay between the economy and migration (both within the UK and internationally), economic growth that creates many jobs is essential.

Projections produced for IPPR North in 2011 (prior to the UK's return to recession) suggest that total employment will not return to 2008 levels until 2018 in the North West, 2019 in Yorkshire and the Humber and sometime after 2020 in the North East (Oxford Economics 2011). Action and investment to create the conditions for economic growth and to boost the confidence of the private sector is needed to ensure that this slow course is not the one the North follows.

Looking at projections produced by Oxford Economics, if the Northern economy continues on its current path then 290,000 net additional jobs will be created in the North in the next 10 years, mostly in financial services and distribution and retail.

Table 2.5
Net job creation,
1998–2022 ('000s)

	1998–2008	2008–2012	2012–2022
Agriculture	-5	9	-17
Extraction	-5	-1	-3
Manufacturing	-396	-44	-131
Utilities	-6	17	-5
Constructuion	99	-78	43
Distribution and retail	27	-66	86
Hotels and catering	38	-31	28
Transport and communications	55	-18	40
Financial services	35	-12	0
Business services	329	-48	240
Public admin and defence	73	-25	-32
Education	112	-20	-31
Health	197	26	15
Other personal services	63	-2	57
Total	586	-300	290

Source: Oxford Economics 2011

This analysis is corroborated by a similar study undertaken by UKCES – in this case, the projections are slightly more pessimistic, on account of the earlier time-period covered.

Table 2.6
Projected
employment
growth by broad
sector, 2010–2020
(change in '000s)

	Yorkshire and the Humber	North West	North East	North	UK
Primary sector and utilities	0	3	-3	0	-22
Manufacturing	-41	-15	-5	-61	-170
Construction	11	17	6	34	237
Trade, accom. and transport	41	6	-13	34	415
Business and other services	93	94	38	225	1,195
Non-market services	-24	-18	-18	-60	-103
All industries	79	87	4	170	1,550

Source: Wilson and Homenidou 2012

Of course projections can only ever be a best-guess, guided by past performance. Nevertheless, in both studies projected employment growth falls significantly short of the projected labour potential we have set out above. To ensure the North exceeds these expectations will require targeted and sustained action to stimulate economic growth.

Looking at measures set out elsewhere in our report, we believe it is possible to exceed projections and create at least another 200,000 net additional jobs beyond projections. Achieving this will require **the development and coordination of an active industrial strategy in each LEP area** (see chapter 3).

How some of the proposals in this report will drive jobs growth

Halving the gap in exports per capita between the North and London and the South East through local enterprise partnerships (LEPs) targeting exports more, the coordinating role of a Northern Investment and Trade Board, and promotion of Manchester Airport as an international hub could create around 63,000 new jobs in the top 20 exporting sectors alone.⁴

If the proportion of foreign direct investment (FDI) into the UK secured by the North returned to where it was prior to the winding down of the regional development agencies (RDAs), through an FDI system that worked for the northern economy, it would support a further 122,600 jobs over the next decade.⁵

Even comparatively modest infrastructure investment in the recently approved Northern Hub is expected create 30,000 to 40,000 jobs. If infrastructure investment, in particular transport spending, was more fairly apportioned throughout England, the potential impact of similar infrastructure projects in the North could be great.

An example from a sectoral perspective:

By 2020, the UK offshore wind sector could employ 97,000 people (CEBR 2012). The North East and Yorkshire and the Humber's position halfway up the North Sea coastline, combined with their supporting infrastructure, puts them in an ideal position to garner a significant share of these new jobs.

⁴ 63,140 is the number of extra 'exporting jobs' which could be created in top 20 exporting sectors if exports per capita in the North were raised from their current level of £3,410 to £3,858, thereby halving the gap between the North and London and the South East. This increase in exports is taken to create a proportionate increase in 'exporting jobs', using the Oxford Economics figures as the baseline. The exports per capita were worked out using the regional export figures for 2010, published by the ONS in May 2012 and, to be consistent, the Annual Mid-year Population estimates 2010, published on the ONS website in June 2011.

⁵ The 122,600 number is based on taking the UKTI figures for FDI successes by LEP area for financial year 2011/12 and the jobs attributed to those successes, and then adding up the figure for the 11 northern LEPs. Half of this figure (12,260) should be a rough estimate of the jobs lost (or not created) due to the one-third fall in FDI since the demise of the RDAs. This figure multiplied by 10 gives the figure for the decade.

For these reasons, the North should focus on creating the conditions for the private sector to create jobs as the economy returns to growth. In order to reach anything like full employment in the North, we have calculated that a million additional jobs would be needed. Achieving this over a 10-year timeframe is unrealistic, but based on the analysis above we do believe that a significant impact can be made, one which will exceed current employment projections. Therefore, **at the very heart of our Northern economic futures strategy is a call to arms: in the next decade, we should aim to increase private sector employment by 500,000 in the North, on the way to a long-term goal of achieving an employment rate of 80 per cent (among 16 to 64-year-olds).**⁶

The vast majority of people work in the private sector, and it is here that the overwhelming majority of new jobs will come from. It is therefore good-quality job creation in the private sector that should be our priority. By ‘good-quality’ we mean those with hours and pay that will lift families out of poverty and those that provide opportunities for training and progression in work.

Job quality is a function of many factors. At a simple level, it requires work to be properly paid. For this reason, **the commission commends initiatives to support a living wage.** This campaign is being taken forward by local authorities in partnership with businesses in a growing number of northern towns and cities, which represents a step in the right direction. But perhaps the most important dimension of job quality is the effective utilisation of skills, to which we now turn.

2.3 Northern skills

Human capital is a critical issue for the North. A more highly skilled workforce is able to respond flexibly to changes in the local labour market and adapt more quickly to technological advances. Skills are also a key driver of productivity in the economy: a better-skilled workforce is more likely to engage in enterprise development and innovation, contributing to a more competitive economy.

Furthermore, higher skills are important for individuals as well as the economy overall. People with fewer skills are less likely to be successful in employment; they have fewer choices in the labour market; they are more likely to be paid less, and are less likely to be able to afford to travel any substantial distance for work. As such, people with low skill levels, as measured by the qualifications they hold, are more likely to experience poverty and disadvantage.

⁶ The use of the age range 16–64 to define the labour force is standard practice within current data collection and policy discussion. We use it in this report because of data availability. However, we recognise the increasing inadequacies of this definition of the labour force because of changing pension ages, changing demographics with increasing opportunities and pressure work into later life, lengthening periods in education and training, and the increasing fragmentation of working lives, including around caring responsibilities. Going forward, a more sophisticated measure will be required to reflect the nature of the modern economy which properly captures these trends.

Recently, however, there has been a significant evolution in the interpretation of the evidence base around skills policy. Until recently, focus was on the supply side: boosting the skills of individuals. But this has been seen to result in poor returns and has been superseded by a new focus: matching the supply of skills with the demand in the economy. In this model, the concern with skills levels remains, but there is an increasing interest in ensuring that the skills produced in the labour market match the demand of employers and the opportunities in the economy. However, while this is common currency among policy thinkers, we are yet to see this shift fully implemented in actual policymaking.

There is also a further strand to this agenda, which is a concern to seek to 'future-proof' the system so that individuals can respond flexibly to changing labour market conditions and are prepared for the opportunities which will become available. This involves linking skills policy to an active industrial strategy and ensuring the contents of training responds to employer needs, especially in priority growth sectors, clusters and supply chains.

This change of emphasis has coincided with an increasing political and economic focus on localism; recent decisions have seen skills included as a key role for LEPs and a focus for city deals (CLG 2011).

In welcoming this reinterpretation of the evidence base, the commission has been keen to explore the place of skills in developing sustainable northern economies where prosperity is shared. OECD research into what holds back regions like the North finds human capital and skills to be the most important factor, making it central to the commission's work. As a result, new research was carried out on the commission's behalf into the nature of the North's skills challenges and the evidence base for what skills policy can deliver, and to consider what a more localised skills system in England might look like.⁷

2.3.1 The nature of the northern skills challenge

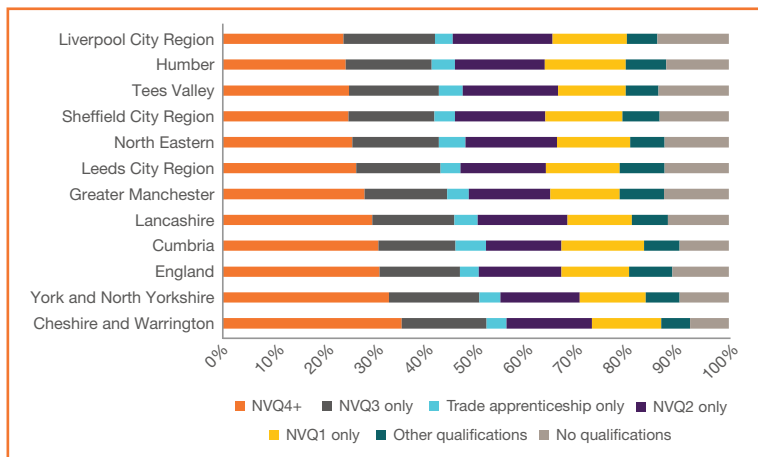
The North faces some distinctive challenges regarding the skills profile of the workforce, demand for skills among local employers and matching the two together.

Looking at the skills profile across the North, a lower proportion of the population is qualified to degree level or above (NVQ level 4) compared to the rest of the UK. The northern city-regions generally have a higher proportion of people with their highest qualification at other levels – level 1, level 2, level 3 and skilled trade apprenticeships (see figure 2.5). This reflects the nature of the northern labour market, where employment in sectors like manufacturing and occupations that require intermediate and lower skills is more prevalent than in other parts of the country (Wilson and Homenidou 2012)

⁷ The commissioners are grateful to the Joseph Rowntree Foundation for supporting this additional research. A full write-up of this research will be published soon after this final commission report.

And while the number of people with no formal qualifications at all has been falling in recent years, the proportion of the population of the North with no formal qualifications remains higher than the English average. This group is at a particular disadvantage in the labour market. This was the only group for which unemployment was *increasing* during the economic boom years, a fact that demonstrates the premium which is placed on skills in the 21st century. As greater emphasis is placed on human capital and innovation to grow regions like the North of England, the labour force will need to be able to upskill in response to demand.

Figure 2.5
Highest level of qualification held, 2011



Source: ONS Annual Population Survey⁸

But employer demand for skills is also an inhibitor. Figures from the National Employer Skills Survey show a worrying proportion of businesses (around one-third) that have no business plan, training plan or budget for training their staff, suggesting a low premium is placed on the skills of the workforce (see table 2.7). This casts a spotlight on the long tail of employers that are taking a low-cost, low-skilled approach to their business, unlike some of our European competitors in places like Germany and Scandinavia (Lanning and Lawton 2012).

But neither is the North's problem simply a lack of demand for skills: the figures from the Employer Skills Survey also give an insight into the mismatch between the supply of and demand for skills in different parts of the North, as set out in the table above. There are areas where employers struggle to recruit the people they need, with employers in the North reporting that between a fifth and a quarter of vacancies cannot be filled due to a lack of applicants with the right skills. At the same time, 10–20 per cent of employees are working in jobs that they are overqualified for. The Heseltine review (2012) argues strongly that

⁸ <http://www.ons.gov.uk/ons/about-ons/who-we-are/services/unpublished-data/social-survey-data/aps/index.html>

the vocational education system is failing here, with colleges not responding adequately to the needs of the labour market.

	England	Cheshire and Warrington	Cumbria	Greater Manchester	Humber	Lancashire	Leeds city-region	Liverpool city-region	North Eastern	Sheffield city-region	Tees Valley	York and North Yorks.
Establishments with at least one vacancy	15	17	10	15	11	14	13	14	12	13	13	11
Skills shortage vacancies as proportion of all vacancies	25	23	27	21	21	24	21	16	20	23	26	20
Establishments with any staff underemployed	47	49	48	46	36	48	40	48	49	42	51	39
Proportion of staff employed who are underemployed	15	13	13	16	11	16	12	19	14	11	16	13
Establishments without business plan, training plan and training budget	27	26	36	27	31	30	27	23	29	29	27	29

Source: UKCES 2012

Table 2.7
Key metrics of skills supply and demand issues (all %)

At the national level, vacancies that cannot be filled due to people not having the right skills are more prevalent in business services, manufacturing, construction, and community, social and personal services.

Looking at the North in more detail, each city-region faces different pressures in terms of the areas where employers are finding it hard to recruit employees with the right skills to fulfil their requirements (see table 2.8). It is important to note that, while between a fifth and a quarter of vacancies are hard to fill due to skills shortages, the total number of vacancies in the economy is relatively small, with only 10–20 per cent of employers in the North (and UK-wide) having any vacancies. Overall, only 2–5 per cent of employers have skills shortage vacancies. It is also important to note that it is possible that what an employer regards as a skills shortage vacancy could actually reflect the fact that they're offering an inadequate wage. Nonetheless, analysing this data enables us to identify key occupations where skills shortages are more likely. The table below sets this out for the North's city-regions.

Professionals and associate professionals occur time and again in this list, suggesting that the smaller proportion of people qualified to degree level is a problem for northern businesses. It may also suggest that the large number of students who study in the North and then leave are either not well enough informed about local job opportunities, have not studied the subjects that local employers are looking for, or simply wish to move to another part of the country for other reasons such as family ties, regardless of job opportunities.

Table 2.8
Top three
occupations facing
skills shortage
vacancies (% of
skills shortage
vacancies)

Cheshire and Warrington	1) Professionals (27%) 2) Elementary staff (23%) 3) Associate professionals (16%)
Cumbria	1) Administration and clerical (32%) 2) Skilled trades (16%) 3) Associate professionals (14%)
Greater Manchester	1) Associate professionals (23%) 2) Skilled trades (23%) 3) Professionals (14%)
Humber	1) Skilled trades (39%) 2) Professionals (37%) 3) Administration and clerical (9%)
Lancashire	1) Skilled trades (21%) 2) Caring, leisure and other services (18%) 3) Professionals, associate professionals and sales and customer services staff (all 17%)
Leeds	1) Associate professionals (23%) 2) Professionals (21%) 3) Skilled trades (18%)
Liverpool	1) Associate professionals (24%) 2) Caring, leisure and other services (20%) 3) Machine operatives (15%)
North Eastern	1) Skilled trades (25%) 2) Associate professionals (16%) 3) Professionals (14%)
Sheffield	1) Skilled trades (26%) 2) Associate professionals (21%) 3) Professionals (16%)
Tees Valley	1) Skilled trades (34%) 2) Associate professionals (33%) 3) Professionals (21%)
York and North Yorkshire	1) Professionals (31%) 2) Machine operatives (30%) 3) Skilled trades (12%)

Source: UKCES 2012

Furthermore, in a large proportion of city-regions, skilled trades emerges as a key area of shortage, suggesting that the focus on apprenticeships and better-quality vocational qualifications is essential for the North to fulfil its potential to increase the number of graduates in the workforce.

2.3.2 Effective northern skills policy

The previous section alongside the evidence heard by commissioners highlights a number of key northern challenges, which we explore in more detail below:

- the outward migration of recently qualified graduates
- ensuring young people – especially the large numbers of young people who are currently unemployed – have the skills employers want, particularly through the provision of apprenticeships

- weak employer demand for skills, and the need to match the supply of skills to the needs of employers and to an active industrial strategy
- the need to overcome a low-skills equilibrium.

Graduate retention

Between 2010 and 2020, the UK is expected to see a rising share of employment claimed by people qualified at degree level or higher, equating to 3,104,000 jobs over this period. On its present trajectory, this proportion as a share of the UK workforce will jump from 34.4 per cent to 42.3 per cent over this 10-year period. However, on current trends, the proportion of the North’s workforce meeting this mark is expected to remain static at 20 per cent (Wilson and Homenidou 2012).

The North’s low level of graduates in the labour market is perhaps surprising given the relatively large number of universities located there. Figures from the Higher Education Statistics Authority show that Yorkshire and the Humber and the North East are particularly large net exporters of graduates. The North West performs relatively better, although it is also a net exporter of graduates.

London	60.9
East	40.2
Northern Ireland	13.0
West Midlands	-1.8
South East	-2.9
Scotland	-6.1
North West	-8.0
South West	-8.5
Wales	-19.7
Yorkshire and the Humber	-23.2
North East	-25.4
East Midlands	-29.2

Table 2.9
Net gain of
graduates, 2006/07
(% change)

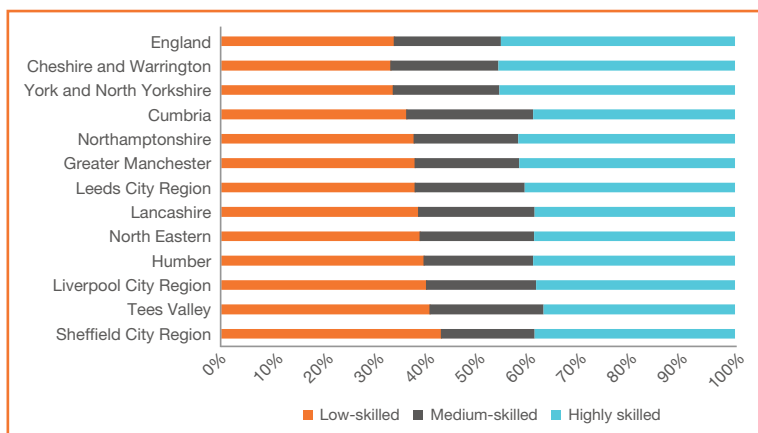
Source: Higher Education Statistics Authority⁹

A key issue here is demand in the labour market. Looking at the types of jobs which are available in the North, a larger proportion of the workforce is employed in lower-skilled occupations, and fewer workers are employed in higher-skilled occupations (see figure 2.6). As availability of skilled graduate employment is the most important factor in graduate retention, this is a critical issue for the North (ERS 2007). However, studies also reveal a number of other factors that influence graduate retention; for example, students who attend a local university and mature students (especially those with family ties) are more likely to

⁹ See http://ww2.prospects.ac.uk/cms/ShowPage/Home_page/Main_menu_Research/Labour_market_information/Graduate_Market_Trends_2008/Graduate_regional_mobility_Winter_08_09_/pleeffbdm#Summary

remain after graduation. Furthermore, courses that have a curriculum that is relevant to local industry needs, sustain good links with local employers and offer work placements in the local area also tend to result in higher retention.

Figure 2.6
Percentage of the population employed in low, medium and highly skilled occupations (April 2010–March 2011)



Source: ONS Annual Population Survey

Note:

Low-skilled: Elementary sales, services and operatives (SOC 6–9)

Medium-skilled: Administrative and skilled associates and trades (SOC 4–5)

Highly skilled: Managerial and professional, and associate professional and technical (SOC 1–3)

In order to improve the North's ability to retain graduates, **the commission recommends that greater focus is brought to bear on building links between universities and local employers and the promotion of increased mature study.** It also requires greater demand from employers for more a more highly skilled workforce (see below).

Apprenticeships

Apprenticeships are a key route to employment for young people who do not pursue higher education. They should be the epitome of employer-led training, allowing young people to combine off-the-job general education and technical training with workplace experience. With the right general educational content in place, apprenticeships should also offer a progression route into higher education.

However, while the number of people undertaking apprenticeships has increased over recent years, the quality of apprenticeships has been eroded in favour of simply boosting quantity. In particular, the number of people starting intermediate (level 2) apprenticeships remains twice as for those starting advanced (level 3) apprenticeships (see table 2.10), despite the fact that the lower-level apprenticeships are often of more questionable value in the labour market (Dolphin and Lanning 2011). Achieving real excellence in vocational education through apprenticeships requires a shift to higher-value qualifications, with a greater focus on advanced (level 3) and higher (level 4) apprenticeships.

Table 2.10
Apprenticeship
programme starts
by region, level
and age-group,
2010/11

	Intermediate-level apprenticeship				Advanced-level apprenticeship			
	< 19	19–24	25+	All ages	< 19	19–24	25+	All ages
NE	8,450	5,260	9,140	22,850	2,610	3,240	5,740	11,590
NW	17,900	15,360	18,920	52,180	5,860	8,320	11,820	25,990
Y&H	12,580	10,650	14,200	37,420	4,160	6,030	7,860	18,050
E Mids	8,800	7,760	11,090	27,640	3,020	4,430	5,500	12,950
W Mids	11,720	10,580	13,550	35,850	3,930	6,150	8,100	18,180
E of Eng	8,930	7,880	9,140	25,950	3,230	4,720	5,720	13,660
London	7,720	8,460	11,190	27,370	2,890	4,450	6,590	13,930
SE	11,110	12,790	13,190	37,090	4,610	7,680	8,800	21,090
SW	9,310	10,810	11,970	32,080	3,540	6,190	7,200	16,930
Eng total	96,500	89,500	112,400	298,400	33,800	51,200	67,300	152,400
Other	820	890	1,000	2,710	360	440	700	1,500
Total	97,300	90,400	113,400	301,100	34,200	51,600	68,000	153,900

	Higher apprenticeship				All apprenticeships			
	< 19	19–24	25+	All ages	< 19	19–24	25+	All ages
NE	10	70	30	110	11,070	8,570	14,910	34,550
NW	40	280	160	480	23,800	23,960	30,890	78,660
Y&H	30	200	110	340	16,760	16,880	22,170	55,800
E Mids	30	170	70	270	11,840	12,360	16,660	40,860
W Mids	30	160	70	260	15,690	16,890	21,720	54,290
E of Eng	10	110	30	150	12,160	12,710	14,890	39,760
London	10	60	40	100	10,620	12,970	17,810	41,400
SE	10	120	30	160	15,720	20,600	22,020	58,340
SW	10	170	140	320	12,850	17,170	19,310	49,330
Eng total	200	1,300	700	2,200	130,500	142,100	180,400	453,000
Other	-	-	-	10	1,180	1,330	1,700	4,220
Total	200	1,300	700	2,200	131,700	143,400	182,100	457,200

Source: National Apprenticeship Service 2012

It must be a priority to improve the supply of high-quality apprenticeship places and ensure that all young people are able to stay on in education and training that will equip them with the skills needed for gainful employment. Therefore, **the commission recommends that there should be a move away from intermediate apprenticeships in favour of advanced apprenticeships. The National Apprenticeship Service and its partners should aim to double the number of young people in advanced (level 3) apprenticeships by 2015, from 30,000 to 60,000.**

This must be accompanied by a **major expansion of pre-apprenticeship training programmes in northern further education colleges**, as part of a programme to ensure all unqualified and low-skilled 16 to 19-year-olds achieve a minimum standard of education. This would need to focus particularly on key areas such as numeracy and literacy. At the end of the course, young people should have the skills they need to take up an apprenticeship, should they choose to follow this path (Dolphin and Lanning 2011).

These two recommendations, taken together, imply shifting funding away from intermediate apprenticeships and places for the over-25s in order to expand the provision of advanced apprenticeships for young people and pre-apprenticeship training.

However, experience suggests simply increasing the supply of apprentices in response to a target set by policymakers will be ineffective. The increase in advanced and higher apprenticeships needs to be rooted in employer demand for people with these qualifications. Expanding apprenticeships will be critical for northern city-regions to begin to fill the skills shortages they face in skilled trades and associate professional occupations. But demand for apprenticeships must come from employers, who should be more directly involved in designing the content and delivery of apprenticeships. The North should learn from successful northern European countries here and create a social partnership model for managing apprenticeships. **The commission recommends further development of local apprenticeship hubs or associations which bring together employers, training providers, sector networks and trade unions in order to plan and deliver apprenticeship places.** Through collective purchasing of off-the-job training, this could also be a more cost-effective approach (Fuller and Unwin 2011).

Boosting employer demand and identifying future needs

As already noted, the UK has a problem with a long tail of employers that are content to pursue low-skilled, low-cost business strategies – they have little demand for skills and provide minimal training and development for their staff. As the data from the National Employer Skills Survey demonstrates, these problems are particularly acute in some parts of the North, where up to a third of employers have no business plan, training plan or training budget (see table 2.7). If the policy intention is for skills provision to respond to employer demand for skills, this is a key problem that needs to be addressed.

Another failing in the present system is that while businesses are generally good at identifying their immediate skills needs, their capacity to identify future skills needs is much weaker, especially among smaller firms (Stone 2010). City-regional active industrial strategies have an important role to play here by identifying future growth opportunities, which will help in turn to identify future skills needs in vital sectors, clusters and supply chains. It is essential then that skills provision in the local area is responsive to these needs, with training providers able to adapt courses to deliver what is required. At present, however, funding for further education is routed direct to further education colleges based on the previous year's enrolments, which makes it difficult for the system to respond to an active industrial policy with a focus on the future.

Again, in northern European countries that have markedly higher-performing vocational education systems and much stronger employer demand for skills, the idea of social partnership stands out. Bringing together employers with employee representatives and trade unions across a sector, cluster or supply chain creates opportunities for links to be forged, strengthening business relationships and embedding them in a place. Collectively, these networks can begin to identify the future skills needs of their industry or cluster, filling in informational gaps and sharing costs (Lawton and Lanning 2012). Networks have also been identified as the most effective means of increasing employer demand for skills, recasting the provision of skills as a collective good and reducing the fear of poaching (UKCES 2009).

This whole process needs to be supported by good labour market information, with timely and robust intelligence to inform decisions about where there are skills shortages, which are the key growth sectors that should be the focus of an active industrial strategy, and what skills these sectors will require in the future. Coordinating this process effectively also requires an intermediary that is seen to be neutral, in order to secure trust, and arrangements for data-sharing between otherwise competing firms (see the case studies outlined below).

In addition, individuals need to be provided with better information about what qualifications or training courses will be the most effective for their future job prospects. Currently, their decisions tend to be influenced by what courses happen to be on offer in their local area.

Tackling the low-skills equilibrium

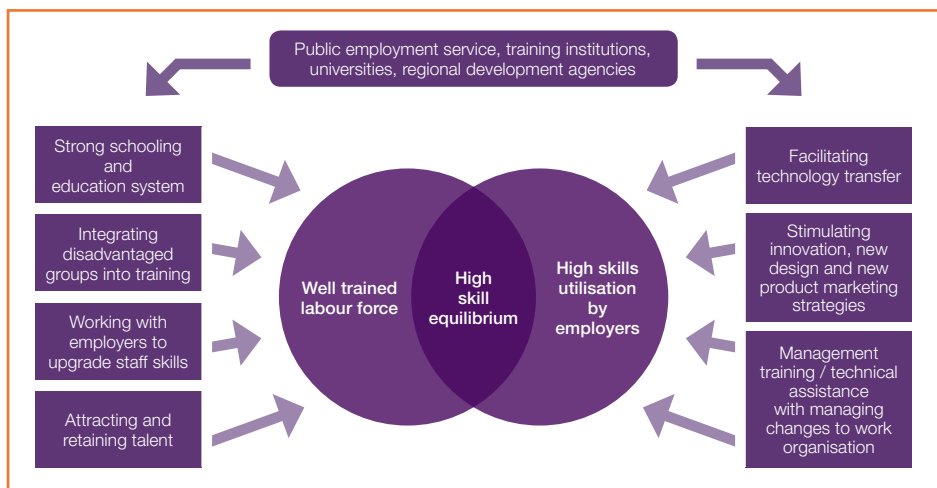
The North faces some distinctive skills challenges on both the supply and demand side. On the demand side, the proportion of employers lacking any sort of strategic approach to the skills of their workforce is higher than the national average in almost all parts of the North. On the supply side, a smaller proportion of the northern workforce has a degree and a larger proportion has no qualifications. In some areas this results in a vicious circle of low skills and low productivity: the low-skills equilibrium.

Furthermore, a large number of people who have been detached from the labour market and claiming an incapacity benefit or employment support allowance will, in time, begin to actively seek work once again, as the government's welfare reforms are implemented. Many of these people are likely to need support to update their skills and increase their confidence in order to find work.

Progress will require carefully coordinated activity: boosting demand without supply will result in employers being unable to fill vacancies; improving supply without demand will result in a brain drain. The OECD LEED programme (OECD 2008) has developed a useful

model summarising the approaches that need to be deployed in local economies in order to achieve this long-term transition, focused on both supply and demand (see figure 2.7). The case studies set out in the next section demonstrate how strategies to tackle the low-skills equilibrium have been implemented in other countries.

Figure 2.7
Supply and demand in skills policy and provision



Source: OECD 2008

2.3.3 Evidence from international case studies¹⁰

The commission's research has reviewed three international case studies exploring varied strategic approaches to skills policy in regions facing similar challenges to many parts of the North.

Michigan, United States

The strategy identified five key sectors where future jobs and wages growth was possible, based on a wider economic strategy and labour market intelligence. This led to the formation of employer-led cluster partnerships, bringing together employers, training providers and state bodies to:

- identify industry skills shortages and long-term skills challenges
- work with training providers and welfare-to-work providers to fill these gaps
- develop career progression pathways so people can improve their earnings, opening up entry-level opportunities for new entrants
- stimulate employer demand for skills.

Noteworthy lessons from this case study include:

- the important role played by dedicated and skilled intermediaries in facilitating and sustaining collaboration

¹⁰ More detail on each of these case studies will be included in a forthcoming report, 'A skills system for northern growth and opportunity' (working title).

- that the start-up funding provided of around \$100,000, which was intended to be self-sustaining, has needed to be supplemented on an ongoing basis from grants and donations from charitable foundations and through influencing mainstream workforce development resources by the state government.

Brandenburg, Germany

The 'Strengthening the Strengths' strategy, which aimed to build on existing economic assets in the region, included as a key action the development of localised skills plans by locally coordinated groups of partners. The goal was to integrate skills supply and demand over the long term alongside the wider economic development programme, including extensive monitoring and intelligence sharing. Over 100 specific measures have been developed across eight fields of activity.

Outcomes have included:

- a change in the direction of the guidelines for funding from EU/national sources, increasingly aligned towards the identified needs and long-term employment and skills goals
- a greater emphasis on supporting lifelong learning and business adaptability, particularly for small and medium-sized businesses (SMEs)
- coordination of the activities of companies within innovation clusters to address shared needs for specific special skills, developing skills courses and attracting workers to the area
- development of wider economic development plans in housing and spatial planning which help to retain these skills workers in the area
- Increased use of and value given to data monitoring and the involvement of local businesses and education institutions in these processes, including regular discussion between business and ministries and the alignment of resources.

Zuid-Nederland, Netherlands

'Brainport' is an integrated approach to innovation and skills led by a public-private partnership. A 'triple-helix' board comprised of local mayors, knowledge leaders from key educational and research institutions and senior business representatives has sustained a long-term commitment to the programme, which is part of wider focus to develop and sustain open innovation in a region of the Netherlands that is seeking to become a European innovation hub.

Key elements have included:

- promotion of craftsmanship through a network of specialised education and research institutes which offer quality vocational and business-oriented education, involving businesses in programme design
- increasing the inflow of technical talent through national and international migration

- a focus on building a flexible labour market: promoting lifelong learning, fostering opportunities for flexible or part-time working and developing a solid skills base out of the education system.

The greatly improved outcomes are attributed to:

- the range of higher educational facilities in the area, including three strong universities and the more specialised higher educational establishments, some of which have been created through the programme
- the fact that all educational levels (from secondary to university) are now working together with industry
- the early adoption and ongoing stability of the triple-helix structures underpinning cooperation
- continuity in the policy goals over several cycles.

2.3.4 Localising the skills system

From the evidence base set out above, it is clear that skills policy has a critical role to play in both growing the northern economy and delivering the ambition for more good-quality, well-paying jobs.

But the North's ability to develop a world-class skills system is currently hampered by fragmentation. Skills policy, education, welfare-to-work, economic growth plans and active industrial strategies all need to be mutually reinforcing, as the case studies in the previous section demonstrate. But a lack of coordination by Whitehall departments and conflicting objectives mean this does not happen at the local level.

These failings make it difficult for northern city regions to effectively realise their economic development ambitions. They also stand in stark contrast to successful northern European models, in which social partnerships between employers within a given sector, employee representatives and the state have responsibility for identifying strategic funding priorities for skills in their sector, developing qualification frameworks for their sector, and setting occupational standards and any licencing arrangements (Lawton and Lanning 2012).

Empowering city-regions

The city-region emerges as the appropriate and correct level for this kind of coordination and orchestration for two reasons. First, because the geography of city-regions (and their rural counterparts) reflects real travel to work and travel to learn areas. We argue in chapter 3 that city-regions should be responsible for developing active industrial strategies for their area; this requires a complementary skills strategy to be developed, focused on servicing the needs of key growth industries and addressing local skills challenges.

Second, there is a pragmatic reason for focusing on city-regions: the city-region is a sensible scale at which to seek to engage with businesses in order to develop local networks of employers and

employee trade union representatives, particularly in key growth industries. It is simply not possible to do this in a meaningful way from central government other than with the largest employers.

LEPs, which operate at this level, have sought to carve a role for themselves here. For most, their main focus to date has been on compiling a clear analysis of the skills position in their area. Interviews with a number of northern LEP skill leads¹¹ reveal that the system is not working effectively.

A number of consistent themes emerged from this review.

- Most interviewees felt that LEPs lacked legitimacy in the skills system, making it difficult for them to influence the decisions of training providers.
- This stemmed in part from a lack of clarity around the envisaged role of LEPs in the wider skills system, whether that's a planning and management function in the short term, or an analytical and coordination function focused on the future.
- Skills were regarded as absolutely critical to LEP economic development work, but a lack of resources means they often rely on goodwill and volunteer support to perform this role. This was seen to be unsustainable, and was particularly an issue in those LEPs yet to negotiate a city deal.
- These capacity challenges limit the scope of work being done to understand skills needs in more than a handful of key sectors.
- A lack of coordination between Whitehall departments results in divergent strategies emanating from the Departments for Business, Innovation and Skills, Work and Pensions and Education, which undermine efforts to develop a coherent approach at the LEP level.
- The reluctance of Whitehall departments to share data inhibits the ability of LEPs to gather good labour market intelligence.

Recent developments through the city deals that have been agreed between the government and the core cities along with their associated LEPs do, however, give some indication of the creativity that could be unleashed if city-regions were able to play a more significant role in skills policy. Skills elements of the five city deals, which are expected to be replicated across the wider LEP area, include:

- a local skills funding model in Sheffield
- a 'mutual' skills bank vehicle in Liverpool, enabling pooled investments in skills from public and private sectors
- sectoral industrial centres for excellence to lead business curriculum content in Bradford and Sheffield

¹¹ In-depth interviews were carried out with skills leads from northern LEPs at different stages of maturity, in order to give a picture of the different levels of development within the LEP network.

- a pilot tax incentive system to encourage business investment in skills in the Manchester and Liverpool enterprise zones
- localised youth contracts (Leeds city-region, Liverpool and Newcastle)
- apprenticeship and skills hubs.

There is also government funding and support for development of 'skills action plans' in some places which, it is expected, will provide the basis for further development at this level.

The commission does not believe that the North should recreate heavy-handed bureaucratic state organisations to plan skills provision. It does, however, emphasise the need for intelligent intermediaries that are empowered to orchestrate the employment and skills system at the city-regional level and to facilitate and host social partnerships between employers, employee representatives and training providers in order to drive the skills system. But while LEPs (or other emerging city-regional models, such as combined authorities) would seem the obvious candidates for performing this role, they currently lack the capacity to do so.

The commission recommends that in the short term LEPs and their local authority partners must take greater responsibility for linking up skills, employment and growth in their areas in a number of ways:

- They should identify **leading vocational centres of excellence** in their areas, focused on the key future growth sectors identified in their emerging local economic strategies.
- They should facilitate and host **social partnership organisations** around key growth sectors, clusters and supply chains. These would bring together employers, training providers, welfare-to-work providers, employee representatives, unions and the state, with a remit to:
 - identify current and future demand for skills in the sector, cluster or supply chain
 - facilitate networking and linkages between partners to improve information flows and coordination
 - shape the content of training courses to ensure skills needs are met now and in the future.
- They should create more local apprenticeship hubs to enable employers to collaborate and develop the content of on- and off-the-job training, working through the social partnerships described above.
- They should use their evidence base to seek to **align public resources from all levels** to deliver better-coordinated results, covering issues such as transport connections needed to improve access for low-paid workers.
- They should continue to experiment and develop **different models**, such as the Liverpool Mutual Skills Fund and the Sheffield City Region local skills funding model.

To do all this, LEPs will need to strengthen their core capacity so that they have the personnel and skills to deliver. The government has provided LEPs with temporary core funding (for two years) – this should be made permanent.

However, creating truly empowered city-regions requires central government to decentralise the tools, powers and funding local bodies need in order to tackle their distinctive labour market challenges. As such, in the medium term, **the commission recommends the devolution of a significant proportion of skills and welfare-to-work funding to local authorities and their partners in city-regions and their rural counterparts.**

These bodies should have the principle role in orchestrating the connections between skills and employment in their area. In particular, this requires central government to:

- **Increase capacity for robust labour market intelligence:** This will enable city-regions to conduct detailed research to identify the sectors and clusters that have potential to deliver economic growth, and the support they need – including their likely skills needs. The recent announcement of a small amount of core funding for LEPs is welcome in this regard, but it is only for the next two years. City-regions need to be put on a more secure footing.
- **Devolve significant budget responsibility:** City-regions should be responsible for administering the budget for adult further education, skills and apprenticeships, which currently stands at £3.8 billion for 2012/13. This would give them much greater traction in the employment and skills system. Most of this funding would still be expected to go to colleges and training providers to deliver high-quality education and skills, as well as off-the-job training elements of apprenticeships in response to local demand. But city-regions should also have control of some of this budget at the margin (say 5–10 per cent) to enable them to deliver their growth plans. So, for example, they might choose to provide seed funding for particular training courses to support the development of a key growth cluster, or to create a funding pot to which social partnerships can apply for match funding for in-work training.

As a consequence, local partners can:

- **Integrate employment and skills:** There needs to be much closer integration between employment and skills policy, which in turn need to be linked into identified city-regional growth priorities. Ultimately, powerful city-regions should have responsibility for co-commissioning the government's work programme, alongside their local industrial strategy and skills responsibilities.

Lifelong learning

Given the evidence cited in sections above about the changing demographics of the North and its older population profile, it is important that we consider lifelong learning too. The commission is acutely aware of the rapid increase in the number of people over the age of 50 facing unemployment as a result of the changing labour market. This is a particular challenge for the north of England given the impact of cuts in public sector employment and it has the potential to lead to significant levels of poverty in older age, especially among older women, who are disproportionately affected by these cuts and changes in pension entitlements. To this end, **within local skills policy there should be a concerted strategy to support older workers to secure work and to establish new enterprises, this should be supported by a national strategy to enhance lifelong learning throughout the labour market.**

2.4 Conclusions

The north of England faces a very significant employment challenge. Not only has the current recession had a disproportionate effect on unemployment in the North – not least among younger and older people – but it has exacerbated longer-term trends. In order to address this and make the most of the North's vital human capital, there is an urgent need to exceed current employment projections and create half a million good-quality private sector jobs. This presents a harsh challenge to every employer in the North, and policymakers need to be tightly focused on creating the conditions for businesses to flourish, as we set out in this report

In order to rise to that challenge we need a strong focus on productivity and skills. We are failing to retain sufficient graduates; our apprenticeship schemes are not delivering for employers or apprentices; there is weak employer demand for skills and poor skills utilisation; and the skills individuals hold and those demanded by employers are mismatched, especially in professional, associate professional and skilled trade occupations.

The solution needs to move beyond simply trying to do a better job of matching supply and demand. Instead, there needs to be much closer integration between employment, economic development and skills in order to tackle the North's low skills equilibrium and drive up demand.

Better integration will also ensure that skills policy can serve the active industrial strategies of the North. At present, the skills system is not fit for this purpose. A significant decentralisation of the skills system is required to collectively give businesses, employees, skills providers, welfare-to-work providers and city-regions (and their rural equivalents) the tools they need to drive local productivity now and in the future. In our next chapter, we will consider what that future demand is likely to look like.

3. INNOVATION AND BUSINESS GROWTH

This chapter asks what a northern industrial strategy might look like. It explores some of the sectoral strengths that exist in the north of England. It presents a 'northern innovation agenda' and makes the case for the formation of a Northern Innovation Council. It explores northern export potential and a number of measures to improve the number and quality of foreign direct investments in the North. And it makes recommendations about how to boost SME growth and SME export potential.

3.1 Laying the ground for a northern industrial strategy

The North has many promising sectors with substantial potential to grow. This makes the need for an active industrial strategy particularly pressing. If justice is to be done to the potential in key sectors and subsectors, so that it might counter the ongoing decline in others, emerging specialisms will need to be nurtured and opportunities for collaboration between sectors will need to be targeted. Crucially, an industrial strategy for the North will not be about championing a couple of sectors, but many.

Traditionally, industrial 'policy' has been conceived of as targeted government support for priority sectors or firms, usually to stimulate productivity, growth or foster economic development. In theory, industrial policy aims at the structural transformation of the economy and, in practice, often consists of activities that 'deliberately favour particular industries over others' (Chang 2009: 2). The term 'industrial strategy' – referred to less frequently in the literature and often synonymously with 'industrial policy' – has a slightly broader meaning and generally refers to 'any attempt by government to apply a coherent and consistent set of policies that are designed to improve the performance of the economy' (Jenkin 2010).

Such approaches have many critics, and few today would advocate unbridled 'command and control' economics or underestimate the risks of 'government failure'. Yet, there is a growing consensus among economists that state intervention in the economy is often necessary, not least for the purpose of correcting market failures and to strengthen the entrepreneurial drive to restructure and diversify low-income economies (Rodrik 2004). The purpose of industrial policy here, it is argued, is to work *with* the market to overcome barriers to growth, rather than for government to dictate its operation. Indeed, industrial

activism today is very much based on the premise that government can support the market without actually owning firms or necessarily making investment decisions (Clifton et al 2009: 26).

Dani Rodrik, in particular, has attempted to reframe industrial policy away from notions of overly-prescriptive government intervention in the economy, in favour of an ongoing strategic public-private sector partnership to identify and understand the barriers and opportunities facing an economy, and to facilitate the performance of high-potential sectors or activities in world markets. Industrial policies are also designed to weed out losers (as opposed to picking winners) to the extent that the ‘point [of industrial policy] is to discover where action is needed and what type of action can bring forth the greatest response’ (Rodrik 2004: 38). They can facilitate the gradual shift from a reliance on a handful of smaller ‘comparative-advantage conforming’ industries to other industries in order to consolidate, diversify and build on economic growth (Chang 2009).

Alongside a change in approach to industrial policy, there has been a similar transition in thinking about its relationship with regional policy. This has been neatly summarised by OECD (2009):

Table 3.1
Traditional and new
forms of regional
policy

	Traditional regional policy	New regional policy
Objectives	Balancing performance through temporary compensation for disparities	Tapping underutilised regional potential to increase competitiveness
Strategies	Sectoral approach	Integrated development projects
Tools	Subsidies and state aid	Soft and hard infrastructures
Actors	Central government	Different levels of government
Unit of analysis	Administrative regions	Functional regions
Impact	Redistribution from leading to lagging regions	Building competitive regions to bring together actors and target key local assets

Source: OECD 2009

New thinking about industrial strategy and regional policy then leads us to question where the current and future sectoral strengths (and weaknesses) lie in the northern economy, and what shape will economic opportunities take in the future.

3.2 Emerging strengths and opportunities

In the previous chapter, we identified the crucial sectoral trends: the ongoing decline in manufacturing jobs and in the public sector contrasted with jobs growth in non-financial business services, retail and distribution. We also identified the need to exceed current employment projections. The commission argues that the principal means by which

this will be achieved is through attention to the conditions for and drivers of growth. At a local level in particular, it is also important to consider sectoral and subsectoral strengths.

Over the past decade, there have been reasonably systematic attempts to identify and exploit emerging strengths and opportunities. The northern RDAs, for example, developed regional economic strategies and subsequently regional spatial strategies that identified key sectors and clusters where it was perceived that future economic strengths might lie.

More recently, every one of the 11 northern LEPs has identified sectors which they see as vital to their subregion’s future growth prospects.

Table 3.2
LEP priorities

Cheshire and Warrington	Cumbria	Greater Manchester
Rural economy Low-carbon Knowledge economy	Nuclear and diversification Specialist manufacturing Low-carbon and renewable energy Visitor economy Food and drink Agriculture, land and sea-based	Health and life sciences Financial and professional services Creative and digital Education Sport Advanced manufacturing
Humber	Lancashire	Leeds city-region
Renewable energy Ports and logistics Chemicals	Advanced manufacturing Aerospace and aviation Automotive manufacturing Creative, digital, ICT and new media Energy and environmental technology Business and professional services	Life sciences Creative industries Low-carbon industries Advanced manufacturing Financial and business services Orthopaedic manufacturing
Liverpool city-region	North Eastern	Sheffield city-region
Knowledge economy SuperPort Visitor economy Low-carbon	Low-carbon vehicles Offshore wind Chemicals and process industries	Advanced manufacturing and materials Digital Orthopaedic manufacturing
Tees Valley	York, North Yorkshire and East Riding	
Digital Advanced manufacturing Health and social care Logistics Chemicals	Agriculture and food businesses Visitor economy	

Some LEPs are targeting very specific subsectors, such as low-carbon vehicles and orthopaedic manufacturing, while others have taken a much more broadly defined sectoral view.

Both how these priority sectors have been decided and what their prioritisation means in practice vary greatly. For Liverpool City Region, for instance, the rationale for selecting each of its four priority sectors differs somewhat. A key consideration, however, was to pick sectors in which the LEP had the expertise and tools to be able to play a useful role, and where that role was necessary to ensure the sector maximised its potential. Identifying the sources of future jobs growth was also of paramount importance.

One striking characteristic of this simple analysis of LEP priorities is the degree of similarity that seems to exist. Nearly half of the LEPs identified advanced manufacturing as a key priority, a third have prioritised the visitor economy, while almost all of them make reference to one or more aspects of the low-carbon economy.

In annex 5 we provide a consolidated table setting out the key subsectors as identified by LEPs, by their RDA predecessors, by national government, by Oxford Economics' analysis on employment trends and by our own analysis of export trends. It summarises their strengths, their potential and threats, and the extent to which these sectors have a specific geographic focus. The following case study concerning offshore wind is offered as a further illustration of northern economic potential.

Case study: Offshore wind in the North East

Offshore wind is often cited as one of the most promising subsectors in terms of creating sustainable growth and quality jobs in the North East. The UK's long coastline and status as the windiest country in Europe put it in a strong position, albeit that it is a comparatively latecomer to the sector behind its main European competitors. The North East's position halfway up the North Sea coastline, combined with its supporting infrastructure put it at the heart of the emerging UK offshore wind cluster. From an investor perspective, the UK is the second-most attractive country in the world for offshore wind development, behind only Germany, with which it had previously held joint-first spot (Ernst & Young 2012).

The new markets for low-carbon goods and services which have been opened up by climate change policies have an estimated global value of over £3.5 trillion and are expanding by 4 per cent each year (HM Government 2009). RenewableUK has estimated that by 2022 the UK offshore wind industry could generate

£60 billion of gross value added, supporting up to 45,000 jobs (RenewableUK 2011). More recently, CEBR (2012) identified that by 2020 the UK offshore wind sector could support 0.4 per cent of UK GDP and employ 97,000 people. The Offshore Valuation Group (2010) attempted to measure the value of the UK's offshore renewable energy resource and established that by utilising less than a third of that resource the UK could, by 2050:

- generate the electricity equivalent of 1 billion barrels of oil a year
- reduce its CO₂ emissions by 1 billion tonnes
- create over 145,000 new jobs.

Building on this analysis, CEBR established that planned investment in offshore wind electricity generation can be expected by 2030 to add 0.6 per cent GDP growth, create 173,000 jobs and provide an increase in net exports of £18.8 billion, which is enough to fill nearly 75 per cent of the UK's current balance of trade deficit (CEBR 2012). Offshore wind is expected to make the single biggest contribution to the UK meeting its target of 15 per cent renewable energy generation by 2020.

The North East has established itself as the centre of the UK's burgeoning offshore wind industry. This is not surprising when we consider its assets:

- Location: Halfway up the North Sea coastline and close to Dogger Bank, the largest of the planned North Sea windfarms
- Workforce: Strong manufacturing heritage and technical expertise in offshore structures inherited from the oil and gas industry
- Infrastructure: Three international ports, a growing local supply chain and a strong research and development base
- Institutions: NAREC (the National Renewable Energy Centre), two CORE centres, Energi Coast, TSB catapult.

Building up the local supply chain is crucial if the North East is to be competitive up against Denmark, Germany and the rest of the Britain's East coast. It will also help to bring down the price of offshore wind as an energy source and reduce the risks associated with heavy reliance on any one supplier. More crucially, it will ensure that the region fully capitalises on its offshore wind expertise. For instance, when the world's largest offshore windfarm (as at 2010) was opened at Thanet, less than 20 per cent of that £900 million investment went to UK firms (Royal Academy of Engineering 2011).

While the UK has managed to attract some turbine manufacturers (RWE in Birkenhead, Gamesa in Dundee and Siemens in Hull), the North East has so far been unsuccessful in this respect. While the importance of turbine manufacturers can be overstated, with half of capital expenditure on offshore wind spent on other parts such as foundations and cabling, this is a weakness (ibid).

There are a number of potential risks to the success of the North East offshore wind cluster. Not least, there is a perception that policy uncertainty is damaging business confidence. The CBI cites the slippage of the review of support for renewable energy generation under the existing renewables obligation mechanism and the uncertainty over the level of wind project subsidies (CBI 2012). Equally, much work remains to be done towards the construction of an offshore grid, essential both for the deployment of offshore wind and for future deployment of wave and tidal energy. Notwithstanding these challenges, however, offshore wind represents an important example of an emerging northern sectoral strength that should be fully exploited.

3.3 Maximising sectoral strengths and export potential in the North

It is important that LEPs and city-regions more generally continue to identify and promote emerging sectoral strengths. However, the commission is concerned that there should be a systematic and coordinated basis upon which these bodies base their analysis.

To this end, the commission recommends:

- **LEPs must continue to build up and refine their intelligence on which subsectors they see as vital to their subregion's future growth prospects.** This analysis needs to be as rigorous and systematic as possible – currently, some LEPs are much further ahead in this respect than others. To fully appreciate the scale of the potential that exists, there is a need for LEPs to look not only at local strengths but also at export opportunities (see section 3.5). Better understanding of both inherent strengths and latent potential can assist with targeting skills policy and infrastructure spending and attracting inward investment.
- **Analysis by LEPs has to be much more aware of the threats that exist,** both in terms of declining subsectors and the risk of not fulfilling the potential of others. In the first instance, action is required to ensure that expertise is transferred to and utilised by growing sectors and, as far as possible, is not simply lost. For the

latter, there are a host of threats standing in the way of maximising growth opportunities, from weaknesses in supply chains to lack of investment and inconsistent public policy measures. The growing opportunities are matched by growing competition both from Europe and converging economies such as China. 'First mover' advantage is crucial in new and rapidly expanding markets.

- LEPs should not focus on too few sectors or subsectors. **A good balance and spread of growing subsectors is crucial**, as is ensuring that opportunities for cross-fertilisation between sectors is spotted and acted upon, deepening supply chains, utilising geographic strengths and ensuring public policy is stable and supportive. Lessons from successful clusters also need to be applied in other subsectors.

3.4 Innovation

Given the evidence elsewhere in this report about the importance of innovation in a successful subnational economic strategy, the commission has given significant attention to how it could be better fostered in the North.

The commission has recognised that much of the focus in current policy thinking is linked to research, science and technology. It has, however, embraced a broader understanding and recognises innovation as a sustained search for competitive advantage not only within individual businesses and organisations but also within wider economic systems and the economic environment. The commission believes that both the economic role of innovation and the processes through which it is fostered and exploited need to be understood in new ways, well beyond the more traditional focus.

3.4.1 Innovation in the wider economy

Nesta suggests that 'a small number of high-growth businesses hold the key to job creation and prosperity'. They show evidence that, between 2002 and 2006, 50 per cent of new jobs were created by just 6 per cent of high-growth firms. The common characteristic of these organisations was that they were disproportionately innovative, compared with other businesses. The impact of these businesses is also likely to spread within an economic system. The research suggests that those cities and regions containing more innovative, high-growth firms are likely to see more employment growth than those without such innovative firms. Nesta estimates that a 5 per cent rate of employment growth on the part of high-growth firms will lead to an extra 1 per cent growth in employment levels in the wider economic system, even taking into account the likely negative impact of competition on slower-growing firms in the same area.

Beyond innovation at the firm level, there is increasing evidence about the importance of wider innovation 'eco-systems' for diffusing new

knowledge and supporting the translation of ideas into commercially viable products, processes and services.

In their comprehensive review of evidence concerning so-called 'regional innovation systems', Asheim, Lawton Smith and Oughton (2011) emphasise the range of horizontal and vertical linkages which characterise them and their location together in clusters or networks with high levels of trust and providing connections and opportunities for learning. They highlight how, for some industries and sectors, this clustering will be highly territorial and contained, achieving a critical mass on a local or city-regional scale. These clusters generate spin-off activity and can attract and develop linked sectors and businesses, which are drawn into this hub of activity. They also highlight how networks of active, non-market organisations often play a key role in the success of these systems. For example, public sector bodies responsible for encouraging, supporting or fostering clustering, though planning, investment or boundary spanning activities, can be crucial to the successful evolution of clusters.

Other evidence also demonstrates how real economic value is delivered through innovation within associated supply and value chains, with these 'agglomeration' benefits being secured in both territorial and more spatially distant networks, provided that key relationships and 'social capital' are present (Humphries et al 2007). These are illustrated very well by considering the following case study of the biohealth sector in the North.

Case study: biomedical and life sciences in the North

The biomedical and life sciences sector takes in companies operating across diverse areas, including pharmaceuticals, biotechnology, analytics, diagnostics, contract research, contract manufacturing, medical devices and healthcare, as well as very specialist support and supplier companies.

At the end of 2011, this sector comprised over 4,500 companies, employing approximately 166,000 people and generating a turnover of over £50 billion nationwide. While the North is home to around 20 per cent of all of the companies, employment and turnover (£10.8 billion), this is a rapidly growing sector. Company numbers in the North West, for example, have increased by 86 per cent over the past 10 years, with growth evident in each of these years and employment increasing by an annual average of 10 per cent.

But the contribution of the North is also vital because of its distinctive strengths in key areas such as industrial biotechnology, biologics (antibodies, therapeutic proteins

and vaccines), small molecule therapeutics, wound care, and orthopaedics – each clustered in different parts of the North – which complement those elsewhere in the country. The North West, for example, is the largest producer of pharmaceutical and biomedical products in the UK, contributing 32 per cent of all classified UK exports in this sector to a value of £5.5 billion.

One area of particular expertise is ‘downstream manufacturing’, which complements other key sector locations, such as the ‘golden triangle’ of Oxford, Cambridge and London. This area has expertise in early stage innovation but depends upon northern facilities to translate innovation into commercial success. For example, the multiple vaccine manufacturing centres located in Speke, South Merseyside, employ 1,500 people and together represent the largest concentration of biomanufacturing capacity in Europe. Biomedical product manufacturing jobs are particularly valuable to the economy as they are often related to products protected by both patents and multiple regulatory authority licences. Once initial approval is achieved there is the prospect of some 10 years of growth and ‘protected’ manufacturing. For particular products, such as vaccines and protein biopharmaceuticals, the process itself is an inherent part of the licenced product safety and quality, which in turn encourages companies to maintain and increase investment in their prime sites.

At present, the Novartis plant at Speke is the only injectable vaccine manufacturing facility on UK soil and one of the largest producers of flu vaccine in the world. It saw a massive influx of workers from around the world and a marked up-tick in output during the swine flu outbreak of 2009. Speke is also the location for the National Biomanufacturing Centre, a unique facility catalysed by Bionow, which enables SMEs to access the extremely specialist facilities needed to manufacture biopharmaceuticals for clinical trials.

SME development has been critical to the success of the biomedical sector in the North. To a large extent this has been due to larger companies seeking to de-risk certain aspects of their work. However, the sector also uniquely combination an engine for developing and growing early-stage businesses (driven to a large extent by the N8 research partnership universities developing and commercialising novel ideas and technologies) that are intrinsically linked to medium and large-sized commercial manufacturing operations – these, in turn, are

increasingly focused on using their skills and knowledge to foster the smaller companies in order to drive their own commercial development. The local connectivity between these companies and, most importantly, the ability to effectively communicate supports the development of new large-molecule (biologic) therapies, for example, where scaling up and manufacturing these new developments would present a significant and possibly insurmountable challenge to the companies in the south conceiving these potentially ground-breaking new treatments.

The sector is also characterised by its significant interaction with and reliance upon the basic and clinical research base (higher education institutions and the NHS) and its relatively high-risk nature, specialist skills requirements and venture capital demands. More recently, larger companies are now typically outsourcing more and relying even more heavily on smaller companies for new technology and innovation, which means that the whole ecosystem and geographical accessibility become critically important to the growth of all businesses.

A number of international companies that produce products such as laboratory supplies and bioanalytical equipment or provide specialist contract services have chosen to locate and invest in the North in preference to other locations and to use the strong local market and skills base to build a European presence. Recent examples include ICON Development Solutions, Fujifilm Diosynth, Gen-Probe, Medimmune, Qiagen, Recipharm and Waters – to name only a few. In August 2012, ICON secured a 40,000-square-foot pre-let at Citylabs, a newly developed biomedical centre of excellence (formerly the Manchester Royal Eye Hospital).

3.4.2 Innovation in the North

The OECD's territorial innovation review, published in 2008, provided a substantive assessment of the North's innovation performance. It focused in particular on the work of the three RDAs and other associated bodies, such as the science and industry councils that had been convened to work on innovation across administrative, sectoral and geographical boundaries.

The OECD reported against the range of measures which is generally used to measure the performance of innovation systems:

- output levels of commercially viable ideas (measured through patents)

- levels of investment into innovation activities (investment into R&D from both business and public sector sources)
- quantum of high-level skills (number of students in higher education institutions and levels of tertiary-level qualifications in a population).

The OECD found that each of the three northern regions rated ‘below average’ against these metrics, but it also highlighted how the three RDA’s had taken positive steps to make progress, taking into account the very different developmental conditions they faced (OECD 2008).

The findings of the OECD study led to a new, collaborative, pan-northern Innovation in industry steering group, which was facilitated by the Northern Way to bring together RDAs, science councils, industry figures and universities, and a report, *Major Innovation Assets in the North of England*, which documented the North’s most significant current innovation assets and prepared information about emerging opportunities.

The report (SQW Consulting 2008) highlighted large-scale concentrations of private or public–private research and development, such as the Wilton complex in the Tees Valley, the Daresbury Science and Innovation Campus and the AstraZeneca laboratories in Cheshire, as well as ‘substantial city/place-based R&D-intensive concentrations’ (primarily public sector-led) at the Advanced Manufacturing Park in South Yorkshire, the Campus for Ageing and Health linked to Newcastle Science City, and NAREC (the National Renewable Energy Centre) in Northumberland. NAREC, which was supported by both One North East and the Northern Way, has subsequently become one of the Coalition government’s ‘Catapult centres’.

Progress has also been made by the N8 partnership of northern research-intensive universities¹² in initiating the Industry Innovation Forum (IIF) with financial support from the Technology Strategy Board and HEFCE (the Higher Education Funding Council for England).¹³ This brings together the N8 universities with key industry to identify opportunities for collaboration around industrial subsectors in which the N8 has strengths, such as advanced materials.

While the N8 IIF is a discrete project built around the capacity and interests of the N8 universities and their partners, the commission concludes that it demonstrates the potential of:

- bringing together key players in particular subsectors and technologies, using the critical mass and research excellence of a group of universities
- building relationships and collaboration at a sensible geographical scale, taking into account the structure and spread of the assets

¹² Durham, Lancaster, Leeds, Liverpool, Manchester, Newcastle, Sheffield and York.

¹³ Worth £1.2 million over three years.

and the benefits to communications and relationship management of proximity and local network knowledge

- the North as the subnational scale for supporting processes of innovation development. While a small number of participants in the projects supported via the N8 IIF have come from outside the North, it is clear that the relative proximity of a critical mass of researchers and businesses, working with enabling institutions, has been vital in identifying and evolving collaborative possibilities.

But in order for the north of England to build on these initiatives much more needs to be done. The commission proposes the development of a northern innovation agenda, overseen and animated by a new Northern Innovation Council.

3.4.3 A northern innovation agenda

The commission believes that **the North is endowed with a number of key strengths on which to build a northern innovation agenda.**

These include:

- A strong network of universities, including but not exclusively the N8, and other educational institutions which foster science, research and education, and which generate critical innovation assets, including technologies, physical facilities, enhanced human capital and specific skills.
- Key private sector capacity in a number of sectors, located in different areas across the North.
- A network of local economic centres and assets, including cities, city-regions and natural and infrastructure resources, which provide the physical context for innovation development.
- Sectoral and subsectoral strengths and specialisms, including a number with established export potential. These include low-carbon energy generation, advanced manufacturing, process industries, life sciences, financial and legal services, and logistics. There are also other assets with the potential to grow.
- Local and city-regional institutions, including local authorities and emerging LEPs with responsibilities for leading different aspects of local economic development and planning, which can enable innovation.

Alongside these strengths, however, the commission also recognises a number of substantive challenges, including:

- The attraction and retention of high-level skills, including the 'leakage' of graduates from northern academic institutions seeking employment opportunities elsewhere.
- Underdeveloped processes for commercialising technological developments, caused by poor connections between science and business, and gaps in available investment resources.

- Underdeveloped processes for linking innovation hubs to wider business networks and supply chains across the North and beyond.
- Inadequate scale and intensity of innovation networking, outside of a small group of established sectors, to provide the framework for high levels of open innovation.
- Fragmentation of and competition between local political and leadership institutions, creating difficulties in joining up infrastructure and investment decision-making. This is limiting the capacity to promote northern innovation potential to leaders and investors at national and international levels and to collaborate effectively with national bodies.
- Inadequate awareness of northern potential within key parts of government and its key agencies, leading to underdeveloped systems of vertical collaboration and coordination with bodies such as the Technology Strategy Board and UKTI.
- Relatively weak SME and social enterprise sectors in terms of density, innovation and growth, hampered by poor access to finance, information and networks and the management culture within many organisations.

Reflecting on these strengths and weaknesses, **the commission has identified a set of principles that should underpin an approach to innovation and business growth in the North:**

- There must be a focus on building upon existing strengths and leveraging existing and emerging networks and clusters as the most likely source of sustainable innovation and comparative advantage. These should be systematically identified and appraised and provide a primary focus for supporting activity.
- Additional opportunities lie in specific sectors or subsectors that demonstrate notional potential but weak current development. Most success is likely to derive from linking existing capacity to these emerging opportunities, supported by strong analysis and collaboration.
- Local institutions, public–private partnerships and infrastructure investments are each critical to maximising cluster and supply chain development through defined support roles. These need to be highly motivated, industry-focused and closely coordinated.
- There should be a focus on how technologies are spread and diversified, and on supporting the commercialisation of opportunities. Technologies need to be aligned with locally embedded economic activities to enable smart specialisation and cluster development and to encourage the inflow and mobilisation of knowledge and learning rather than the outflow of skills and experience.

- Boundary-spanning approaches, crossing both institutional and geographical territories to maximise support for innovation, are vital. Such approaches should respond positively to patterns of development and place a strong emphasis on connectivity in order to maximise opportunities for cluster and supply chain development.
- Enhancing the management culture of individual businesses is crucial in influencing their capacity for innovation and growth. Practical support to foster confidence, ambition and market awareness, particularly within SMEs, can deliver business growth, innovation and skills development.

3.4.4 A Northern Innovation Council

Identifying the principles behind a northern innovation agenda is important, but without the capacity to implement them it is unlikely that they will reap any real economic returns. The commission believes that there is a clear rationale for a structure that works at the scale of the North to perform a group of strategic functions with an innovation focus and which can support a wide network of northern institutions and businesses. Furthermore, it believes that this body should be endowed with a significant fund with which to stimulate and promote innovation in the North and thereby to rebalance national research and development spending.

The commission recommends **the formation of a Northern Innovation Council, bringing together leading universities, employers and local authorities.**

The overall aim of the Northern Innovation Council should be to help to promote higher levels of innovation in the north of England and to translate these into economic benefits, including economic growth, business growth and employment growth.

The council should bring together key partners to collaborate in the promotion of northern innovation by:

- Building capacity among LEPs and their members and partners to identify subsectors, technologies, themes and practices which hold significant potential for local collaboration and growth and to bring forward a small number of key priorities for development.
- Establish up to three new 'Catapult-Plus' centres, based on these identified priorities, to drive forward northern innovation in new areas such as chemical industries, nuclear energy and electric vehicles.
- Facilitating collaboration and networking at the scale of the North between businesses, LEPs, local authorities and universities to identify and nurture these opportunities, with a particular focus on commercialising emerging opportunities.
- Developing and maintaining active vertical linkages with national and global partners and agencies to provide a clear voice for the

North. The aim should be to maximise investment opportunities, draw upon good practice and offer a strategic voice on innovation issues from a northern perspective, including by promoting a stronger understanding of the North's existing and emerging assets.

To achieve these objectives, the Northern Innovation Council should be endowed with £1 billion¹⁴ of the proceeds of the sale of the 4G spectrum, thereby massively boosting and rebalancing the funding for university–business research.

The council would have a close relationship into the N11 Summit (see chapter 6) and could play a key role in advising government on the proposed Innovation Incentives scheme. It would need to operate as a cross-sectoral, pan-northern body drawing together leaders from the following organisations to work together to deliver the agenda set out in the previous subsection:

- businesses and business leadership organisations
- LEPs and local authorities
- universities, including the N8 partnership, and representatives from other higher and further education structures
- Catapult centres focused on sectors of interest to the North
- the Technology Strategy Board, UKTI and other relevant national bodies and government departments
- experts in the field from academic and international bodies who can offer advice and information and both support and challenge the council.

3.5 Northern export potential

While numerous opportunities are arising from technological change, sectoral strengths and innovation, the increasing size of the global export market is a source of significant and growing potential. Even though the UK economy has shrunk by 4 per cent since the start of the financial crisis in 2008, in the same period the world economy has continued to grow, with an increasing proportion of it attributable to the global export market. In fact, the value of this export market has gone from \$8 trillion in 2000 to almost \$19 trillion in 2010 (close to being two and a half times larger) (UNCTAD 2011: tables 2 and 3).

While this creates enormous opportunities, the market is becoming increasingly competitive – emerging economies represent potential competitors as well as potential customers. While emerging countries' share of world export trade has almost doubled, developed countries have seen their share of world export trade decrease by almost 20 per cent. China's share of world export trade has increased six-fold to more than 10 per cent.

¹⁴ This figure is based on the approximate proportion of the population and economic activity based in the North – equivalent to a 'fair share of the air'.

Table 3.3 shows the UK's top export sectors prior to the financial crisis and the number of exporting jobs¹⁵ they represented. It shows the huge contribution exports already make to the UK economy – these top-20 sectors account for exports worth more than £276 billion.

Table 3.3
Top exporting sectors by value, UK 'exporting jobs' and regional breakdown, 2008

	Total exports of goods and services (£m)	Number of 'exporting jobs' (UK)	Region with highest % of 'exporting jobs'
Banking and finance	33,100	275,400	London
Other business services	27,400	559,700	London
Motor vehicles	26,100	118,300	West Midlands
Auxiliary financial services	21,800	179,000	London
Oil and gas extraction	18,900	30,300	Scotland
Coke ovens, refined petroleum and nuclear fuel	18,700	24,200	North West
Pharmaceuticals	18,100	33,500	South East
Aircraft and spacecraft	14,300	100,400	North West
Medical and precision instruments	10,000	84,700	South East
Water transport	9,600	15,100	South East
Hotels, catering, pubs, etc	9,100	255,500	London
Non-ferrous metals	8,900	12,400	West Midlands
Iron and steel	8,800	35,000	Yorkshire and the Humber
Organic chemicals	8,100	10,300	North East
Office machinery and computers	7,900	15,100	South East
Mechanical power equipment	7,700	55,400	East Midlands
Computer services	7,500	327,800	South East
Recreational services	7,400	183,700	London
Special purpose machinery	6,700	41,900	West Midlands
Insurance and pension funds	6,500	115,700	South East
Total (top 20 sectors)	276,600	2,473,400	London

Source: Oxford Economics analysis of the ABI, Census of Employment, and UK IO tables

The government, rightly, has placed much emphasis on increasing UK exports to driving the economic recovery, and the North in fact accounts for a growing share of UK exports (see figure 3.1).

Currently, the North produces 27 per cent of the UK's manufacturing output and accounts for a quarter of the UK's exports of goods, a half of which are exported to countries outside of the EU (BIS 2011a). In terms of export goods per workforce job, the North East outstrips every other region, and all three northern economy regions compare very favourably

¹⁵ Exporting jobs are calculated from UK IO tables. A ratio of the export / total output is applied to employment at a 26-sector level and the total is calculated as the sum of the sectors divided by total employment.

in terms of exports-to-output ratio when judged against London, the South East and the East (CoL 2004). Indeed, despite popular perceptions, the London economy’s export propensity is actually slightly *below* the national average (CoL 2009). This puts the North in an ideal position to lead the UK’s push for export growth.

To do this – or rather to do this well – it needs to understand where these export opportunities will come from and how they correlate to the North’s current strengths. By analysing current trends we can ensure that decisions on infrastructure and other investment are better informed.

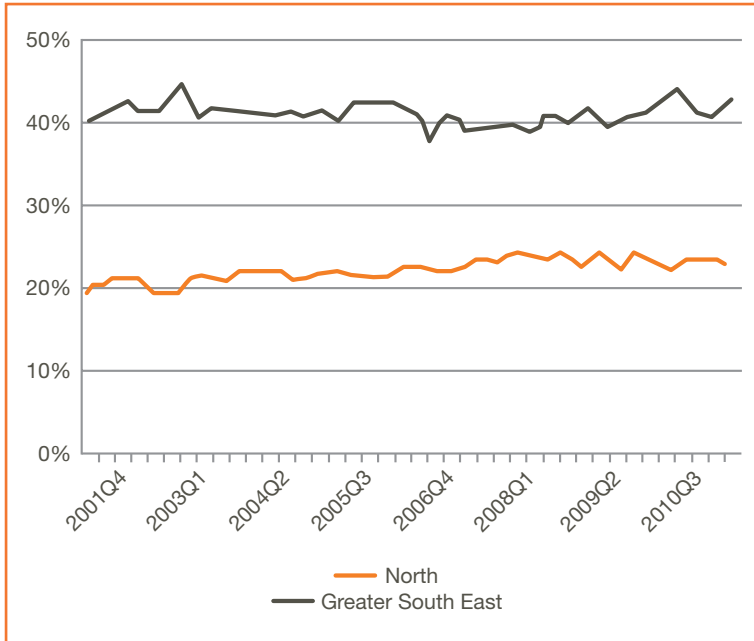


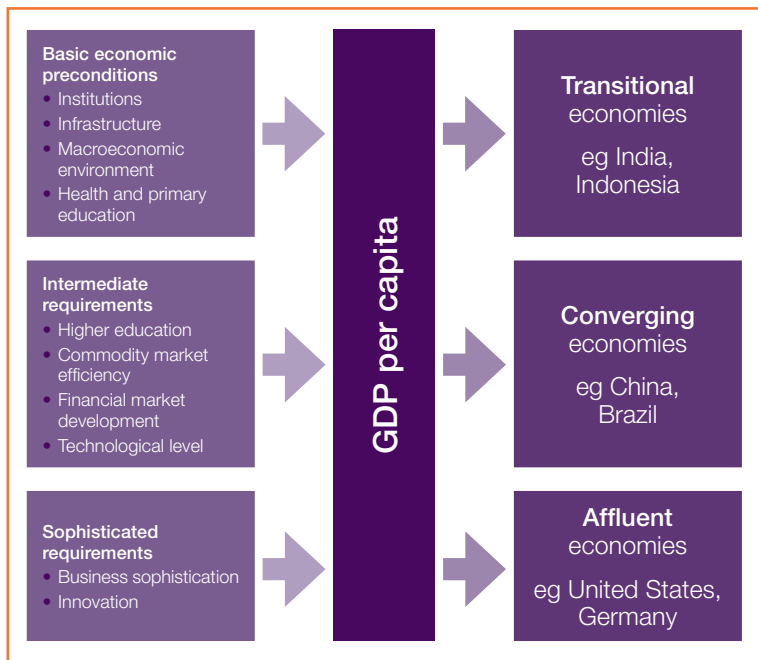
Figure 3.1
The North's growing share of UK exports (% of UK export goods value)

As part of its analysis, the commission has carried out detailed quantitative analysis to learn how increases in population and prosperity overseas are likely to affect future export potential for the northern economy, by estimating income elasticities on a sectoral basis.¹⁶ This information provides an indication of where future increases in northern exports should come from, assuming current trends continue.

¹⁶ In essence, this entails asking by how much should the value of UK exports to a country increase for every pound by which that country gets richer. The analysis uses the imperfect substitutes model, which assumes that foreign and domestic products are imperfect substitutes, and has import demand as a function of income and relative prices (domestic versus foreign prices). We have estimated the income elasticities for each of the major goods and services categories in respect of exports from the northern economy to the rest of the world over the period 1996–2009 by country (from 2000 in respect of services). Due to data limitations, we had to use UK-wide data to calculate the income elasticities for UK service exports but we would not expect income elasticities for service exports to vary greatly from region to region.

While the BRIC economies of Brazil, Russia, India and China, alongside those of other emerging markets, are the fastest growing and offer enormous opportunities, the composition of this increased demand will almost certainly differ from that exhibited by older developed economies. Figure 3.2 classifies the various world economies into three categories depending on their level of development. We looked at our results in respect of both affluent economies and converging economies.

Figure 3.2
Transition,
converging and
affluent economies



Sources: Based on WDI and World Economic Forum classification, *Global Competitiveness Report 2011–2012*, p9

Roughly half of UK exports currently go to the rest of Europe, but this proportion is likely to shrink over time. This is not due to the sovereign debt crisis in the eurozone, although if the crisis deepens and tips the eurozone economy into a severe recession then exports to that region will drop sharply. Rather, it reflects the strong relative growth expected in emerging economies, particularly in Asia and Latin America, over the next decade. As these economies get richer and develop large middle classes, their demand for goods and services from overseas will increase.

Figures 3.3 and 3.4 show the results of this analysis, presenting income elasticities on the vertical axis, growth of global exports by sectors on the horizontal axis, and overall current northern exports by the size of the discs. For example, the exports of telecommunications to affluent countries has an income elasticity of approximately 2.2, has grown by 30 per cent over the past five years, and accounts for approximately £811 million of northern exports.

Figure 3.3
Northern exports to affluent economies: income elasticity, export growth and northern export value

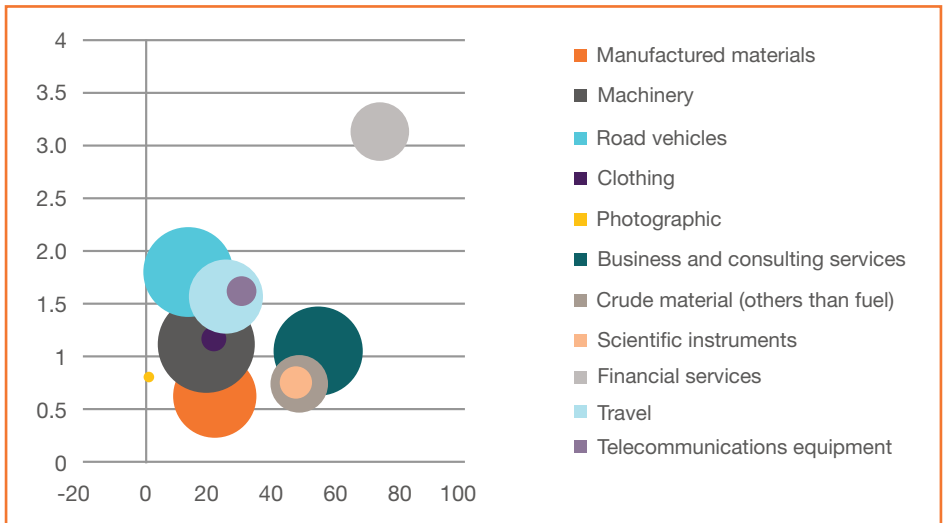
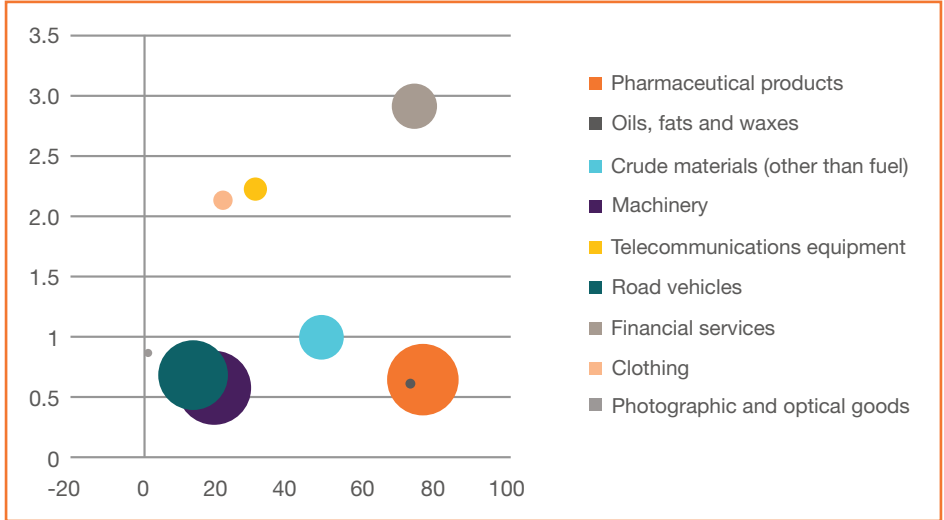


Figure 3.4
Northern exports to converging economies: income elasticity, export growth and northern export value

Our analysis highlights the sheer size of future exporting opportunities. For products with a high income elasticity and for which the North has a significant market share, future increases in export value have the potential to be very large indeed. The charts suggest that as other trading partners become wealthier, exports of financial services and telecommunications equipment to affluent and converging economies will show particular potential, as will exports of travel services and road vehicles to converging economies.

The overall pattern is perhaps even more striking. Many more of the northern export markets to converging economies have high income elasticities and are already large. Moreover, it is these converging economy countries in which the vast majority of growth will occur over the next decade. In short, the North is very well placed to greatly expand its exports over coming years – the fastest growing markets are spending a rising proportion of their increased wealth on the exports in which the North already specialises. The challenge, then, is to ensure that this potential is fully capitalised on.

The impact of exchange rates on northern export potential

Northern export potential is affected significantly by the exchange rate. Over the last 15 years or so, deindustrialisation in the North has been accelerated by the financialisation¹⁷ of the economy. Employment in manufacturing has fallen faster in the UK over the last decade than it has in any other G7 nation, and there is a correlation between the pace of manufacturing's decline and the value of sterling on the foreign exchanges. Employment in manufacturing increased between 1993 and 1998, after sterling fell sharply following its ejection from the European exchange rate mechanism (ERM). Since then, following a sharp appreciation of sterling in 1998, employment in manufacturing has fallen consistently.

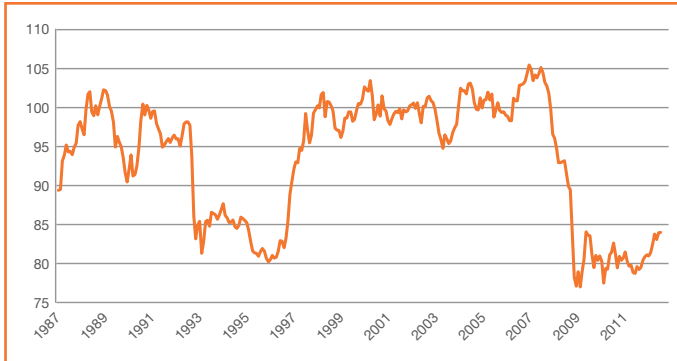
Exchange rates are determined by many factors and the relative importance of these factors varies over time. But one of the main reasons for sterling's high value from 1998 to 2007 was strong capital flows into the UK, much of which flowed into the financial sector in the South East. This led to a form of what economists call 'Dutch disease'¹⁸ – financialisation was accompanied by strong capital inflows into the UK financial sector, these capital inflows helped to push sterling's exchange rate to a higher level than it would otherwise have been, and the overvaluation of

17 The increasing role of finance, the financial sector and financial workers in the economy and in political considerations.

18 'Dutch disease' usually refers to the situation when the discovery of a natural resource (such as the large natural gas field found in the Netherlands in the 1960s) leads to a stronger exchange rate, which is detrimental to manufacturing. Financialisation can be seen as analogous to exploiting a natural resource.

sterling resulted in a significant loss of competitiveness – and global market share – for UK manufacturing. One by-product of this process was stronger growth in London and the South East and weaker growth in the north of England.

Figure 3.5 Sterling's exchange rate index



Source: Bank of England

Ever since sterling was forced out of the ERM, policymakers have adopted a policy of benign neglect towards its value on the foreign exchanges. In particular, monetary policy is now focused on an inflation target, while the exchange rate is merely one of a range of factors the Bank of England's Monetary Policy Committee takes into account when considering the inflation outlook and, thus, determining the appropriate level of interest rates (and more recently the right amount of quantitative easing).

There is nothing to suggest that this approach is about to change, and the fact that sterling's exchange rate index (its value relative to a basket of other currencies) has appreciated by more than 6 per cent in the last 12 months – primarily due to weakness of the euro – has passed largely without comment. But it will be detrimental to the outlook for the northern economy if sterling's exchange rate continues to appreciate significantly from current levels. Exports represent a major opportunity for the northern economy, but this opportunity will be curtailed if sterling continues to strengthen.

3.6 Foreign direct investment in the North

Alongside exploiting northern export potential, it is essential to identify new sources of the business investment that will be crucial in supporting further development of the North's strengths – and foreign

direct investment (FDI) should continue to be one of a number of such sources. However, in the first phase of its work programme, the commission heard significant concerns about the North's long-term capacity to secure inward investment following the demise of the RDAs and the subsequent transition.

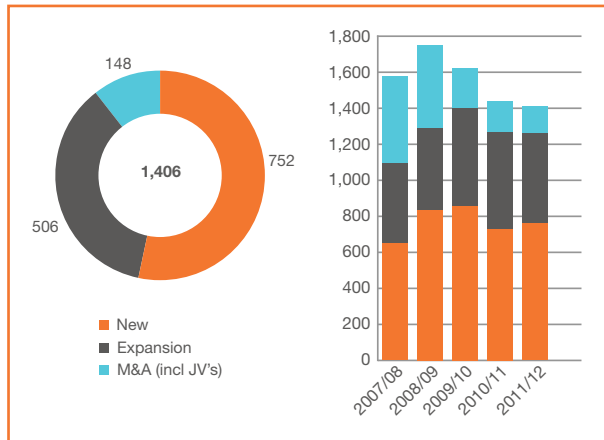
In response, the commission initiated research seeking to understand this issue in detail. This work has provided some clear insights into a number of issues that are likely to affect the performance of the emerging 'UK First' system for securing FDI, particularly with regard to its focus and impact in the North.

3.6.1 Current FDI performance

The general environment for securing inward investment is difficult. Ernst & Young has found that economic conditions and specifically 'the level of domestic demand' is the 'single most important factor driving decisions to locate in the UK' (Ernst & Young 2012). Key markets in Europe have declined significantly, although there are growing opportunities from countries like China, India and the US.

While the UK maintains a good reputation as a place to do business and a good relative position in the FDI league table, the overall trend in terms of projects secured is downwards.

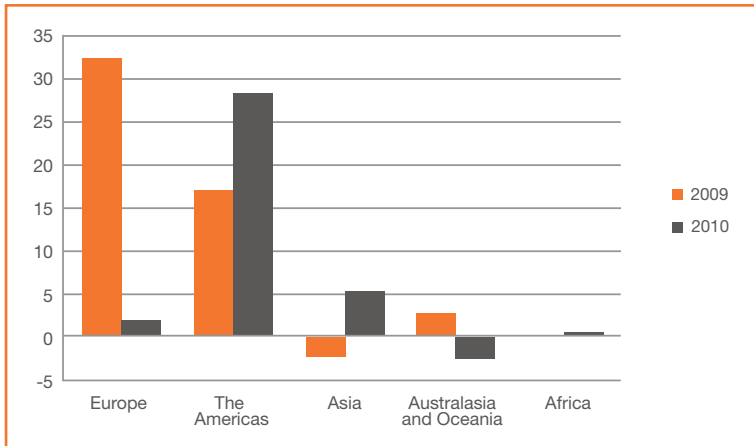
Figure 3.6
UK inward investment, projects by type, 2011/12 (left), 2007/08–2011/12 (right)



Source: UKTI 2012

In 2011, the UK attracted inward investment from a record 54 countries. However, because of a decline in investment from Europe and Australasia, the UK appears to be increasingly heavily reliant on a small number of countries for the bulk of inward investment projects, with a particular dependency on the US. In 2010/11, the US accounted for 27 per cent of all inward investment projects in the UK and almost 40 per cent of created or safeguarded jobs from FDI inflows (UKTI 2011).

Figure 3.7
Net direct
investment in UK
companies by
foreign companies
(£bn)



Source: UKTI 2011

Looking at new and emerging sources, Ernst & Young (2012: 11) reports that inward investment from the BRIC countries has remained relatively flat in recent years and has experienced relative decline from two key countries. So, while the UK continues to be Europe's largest recipient of inward investment from India, its share of Indian projects in Europe fell from 47 per cent in 2010 to 38 per cent in 2011. Similarly, the UK's share of Chinese inward investment projects fell to approximately 22 per cent in 2011, compared to 28 per cent in 2010.

Differential trends can be seen at the regional level (see tables 3.4 and 3.5). Overall project numbers are largely holding up around London and the South East, from a high base, but other parts of the UK have experienced a decline in fortune over the same period, in many cases to a significant degree.

Figures for employment are more variable and potentially tell a different story. In this case, performance overall is holding up nationally and in the North, buttressed by a relatively small number of large investments in projects such as the Olympic Games and the expanded investments in Sunderland by Nissan.¹⁹

Scotland, used as the most appropriate 'control' for the research, because of its decision to retain its strategic inward investment agency, has outperformed the northern regions on both indicators, especially if Nissan's investment is excluded. Wales, on the other hand, which adopted a different approach in the mid-2000s, appears to be seeing difficult outcomes on both measures. There, responsibility for inward investment is overseen by the Welsh assembly government's brand, International Business Wales (IBW), working with UKTI and a plethora of separate local and national agencies.

¹⁹ Note that these figures for employment included jobs to be created within two years of an investment being secured.

Table 3.4
Inward investment – total projects, 2005/06–2011/12

	2005/06 total projects	2006/07 total projects	2007/08 total projects	2008/09 total projects	2009/10 total projects	2010/11 total projects	2011/12 total projects	% difference between 2011/12 and 2012/11
East Midlands	74	84	88	82	83	84	49	-42%
East of England	92	119	108	116	92	76	94	+24%
Greater London	323	388	424	540	527	483	573	+19%
North East	63	64	66	68	68	54	66	+22%
North West	112	138	151	176	179	175	115	-34%
South East	223	235	220	219	145	151	164	+9%
South West	61	57	65	97	79	78	50	-36%
West Midlands	82	104	112	115	84	78	76	-3%
Yorkshire and the Humber	54	54	124	125	147	88	49	-44%
England total	1,084	1,243	1,358	1,538	1,404	1,267	1,236	-2%
Northern Ireland	23	31	56	65	49	44	27	-39%
Scotland	60	89	91	78	96	83	96	+16%
Wales	51	67	68	60	65	38	23	-39%
Devolved nation total	134	187	215	203	210	165	146	-12%
Non-region/nation specific	2	1	0	3	5	2	24	+1,100%
UK total	1,220	1,431	1,573	1,744	1,619	1,434	1,406	-2%

Source: UKTI 2012

Projects figures include both UKTI involved and non-UKTI involved.

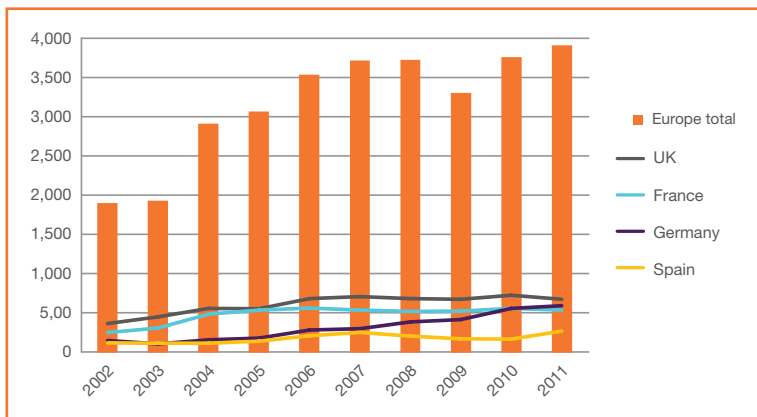
Table 3.5
Inward investment – total jobs, 2005/06–2011/12

	2005/06 total	2006/07 total	2007/08 total	2008/09 total	2009/10 total	2010/11 total	2011/12 total	% difference between 2011/12 and 2012/11
	jobs	jobs	jobs	jobs	jobs	jobs	jobs	
East Midlands	4,525	4,657	5,960	5,595	4,123	6,055	4,375	-28%
East of England	4,546	5,733	6,383	3,164	14,566	4,125	5,663	+37%
Greater London	6,752	8,019	9,525	11,619	10,253	28,291	15,150	-46%
North East	5,775	5,659	3,634	5,466	6,673	4,239	10,679	+152%
North West	6,803	7,520	12,636	11,436	13,486	13,139	15,430	+17%
South East	6,343	6,295	7,533	6,344	9,869	9,672	5,561	-43%
South West	3,925	5,841	5,031	4,813	2,443	8,839	2,948	-67%
West Midlands	10,300	14,611	30,120	6,143	5,866	4,661	14,254	+206%
Yorkshire and the Humber	4,499	2,846	6,311	6,588	5,911	1,538	3,700	+141%
England total	53,468	61,181	87,133	62,706	74,594	80,559	77,760	-3%
Northern Ireland	4,079	4,717	4,765	5,790	2,129	2,136	1,480	-30%
Scotland	2,915	6,242	6,012	2,851	5,471	7,809	12,610	+61%
Wales	5,204	6,167	5,629	2,714	7,362	3,544	2,854	-19%
Devolved nation total	12,198	17,126	16,406	11,355	14,962	13,489	16,944	+26%
Non region/nation specific	24,200	50	0	4,479	4,790	550	17,955	+3,165%
UK total	89,866	78,357	103,539	78,540	94,346	94,598	112,659	+19%

Source: UKTI 2012
Jobs are defined as New and Safeguarded Jobs.
Jobs figures include both UKTI involved and non-UKTI involved.

Benchmarking internationally, over the same period, other countries have been catching up, including Germany in particular. One feature of other countries' performance is long-term strategic relationship-building in key markets outside of Europe.

Figure 3.8
Total inward investment projects in Europe's four largest recipient countries



Source: Ernst & Young 2012

3.6.2 Targets and measurement

Beneath the figures, the commission's research has highlighted an important debate about the tasking framework for the current UKTI-led system. The Treasury's target is to secure 750 'UKTI-involved' projects each year, with a further informal target of 1,000 projects to include those with which UKTI is not involved. The current conversion rate for projects is at 1:3.5 across the system, meaning that each year it needs to identify in the region of 3,500 projects in order to meet its target, with new and expanded projects counting equally. Interviewees at both the national and local level raised concerns with this target.

The annual nature of the target is seen to focus behaviour on securing the easiest projects, rather than those of greatest strategic economic significance, and can also lead to inaccurate reporting, in terms of the number of projects counted as 'UKTI-involved'. Indeed, a strong consensus emerged that the targets needed to be changed in order to refocus behaviours within the system. National-level respondents expressed a preference for indicators focused on employment numbers and contribution to economic growth, and for these to be delivered over a longer timetable than one year to allow for longer-term relationship-building to take root.

It was also seen as a key goal to shift the proportion of FDI projects away from new projects and towards expansions of existing projects. While 70–80 per cent of projects are secured from existing investors in other countries, this figure is only 35 per cent in the UK. Yet expanded

projects are the ones which are more likely to build extended capacity and jobs on to small initial investments and embed an investor in the country. From the commission's perspective, these are also the projects most likely to deliver investment into the sectors that are already present in the North.

In terms of system capabilities, respondents highlighted a number of factors crucial to securing these longer-term returns:

- a strong intelligence capability capable of identifying and delivering opportunities to build and maintain long-term relationships with investors and linking them to places and partners in the UK
- strong specialist capacity to translate these contacts into commercial opportunities and investments
- good 'aftercare support' to embed an investor in place, to secure ongoing investment into the country, and to support the development of a wider value chain connected to a core investment, often at a large scale
- partnership with key local policymakers, such as local authorities and LEPs, to collaborate on issues such as transport, infrastructure and skills.

3.6.3 Supporting spatial economic development

UKTI respondents explained that the current system is 'spatially blind' in its current approach, with the focus being on meeting the requirements of investors. The UKTI system works within a framework of eight key sectors and 40 subsectors identified through a baseline-setting project in 2011. These drive resourcing and targeting decisions for the UKTI system, shape information acquisition through the ongoing 'Surfacing the National Offer' process and associated CRM system, and provide the focus for the team of sector specialists and staff in FCO-led overseas offices.

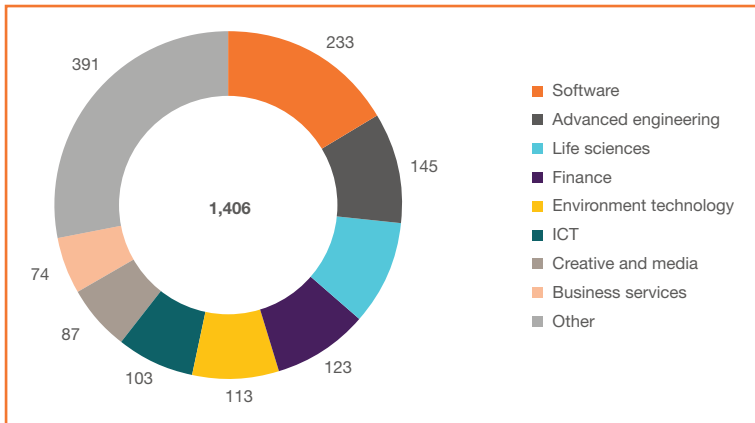


Figure 3.9
UK inward investment, projects by sectors, 2011/12

Source: UKTI 2012

In the past, the RDAs played a key role in keeping the UK's overseas offices informed about the offer from their regions. They worked to link with investors and organise support systems locally. They also promoted regionally based projects that sat outside the national priority framework. Many maintained international offices in their own right and pursued their own regional interests.

However, commentators have reported a number of perverse outcomes of this approach, such as overt competition between regions and a lack of collaboration, illustrated by stories of multiple UK region desks at trade fairs and negative briefing. Within the UK context, RDAs were also reported to have tried to capture all investor resources to their region, and to have been unwilling to collaborate across boundaries to build supply chains reaching outside their regions, even where it might cement relationships with investors.

The research found that the closure of the RDAs addressed these issues of perceived competition. For local participants, it also removed the 'brand confusion' around the core cities, seen as the key investment assets for the system but previously subsumed by regional brands.

On the whole, though, the consensus is that a heavy price has been paid for removing RDAs, in terms of the infrastructure that has been left behind. Respondents reported a difficult and incomplete transition to replace lost capability and a severely reduced capacity. Knowledge and skills were lost and general activity levels on inward investment have declined significantly. Although some local inward investment agencies have been able to absorb some of the capacity and maintain momentum, there is a general decline, as well as what appears to be a particular problem in Yorkshire.

City-regions are now a more important scale for work in this area, and their relationships with local authorities are vital to creating the conditions to secure investments. New business-winning functions are being created at both levels. To some extent, this local role has always been in place, with the needs of investors for infrastructure, skills and support on the ground being addressed by local authorities. In addition, some of the more developed city-regions have maintained strong and successful local infrastructure, such as in Merseyside and Manchester. However, other areas are significantly underdeveloped and continuing investment to support development is required.

A significant amount of work has been done and is continuing through the UKTI contract with PA Consulting to retain knowledge and skills, with the aim of ensuring that the system can access and maintain up-to-date information about the national offer, to support and improve local capacity in LEPs and local agencies, and to link up the various parts of a now badly fragmented and under-resourced system, extending to overseas and specialist capacity as well. Particular concerns reported

from local respondents relate to the extent to which new and emerging subsectoral opportunities identified locally can be introduced into the specialist and overseas parts of the UKTI system if they sit outside UKTI's current priority sector framework and given disruptions in the flow of information.

Respondents from all levels acknowledge that the system is in transition, with the RDAs' demise only confirmed in 2010 and the UKTI-led system just one year old. However, there was also wariness about whether it would be possible to return the system to a 'steady state', with national-level respondents in particular having significant concerns and frustrations about fragmentation, information levels, and capacity and capability gaps. A particular issue is in the area of aftercare, which is especially important if the wider aspiration is to lean towards expansions of existing FDI projects. Making the system work better is seen as a significant challenge, given the number of partners looking to UKTI – 39 LEPs nationwide and a large number of local authority agencies – for a national system reduced by 52 per cent in terms of its fieldwork capacity.²⁰

In the meantime, UKTI has begun to work directly with national trade and sector bodies which are perceived as good partners. These tend to disregard location, although there are examples of such initiatives with a strong northern flavour, including the 'Intelligent Textiles' programme and the Automotive Council, which offered a full supply chain and involved both private sector and LEP partners across the North East, Merseyside and Lancashire.

In the course of the discussions, a number of potential scenarios for were suggested, which could emerge in combination:

- a patchy local system working with the current UKTI, with the main local focus being on core cities and urban LEPs
- a reversal of the centralisation decision, with more resources decentralised to the current LEPs who can then build a wider infrastructure
- a national system delivered through a combination of private sector-led sectoral structures and local spatial partners focused on addressing local infrastructure issues
- an evolution at local scale through mergers of capacity and/or increasing local collaborations between LEPs and local agencies to create a scale that is focused on cities but extends to wider regional areas
- the reintroduction of some kind of 'mezzanine structure' between LEPs/local authorities and the centre, to enable a more strategic

²⁰ BIS (2011) shows current spending on the PA/BCC consortium of £41.5 million (2011–2014) against an equivalent RDA spend for the same period of £42 million on regional capacity and £45 million on local infrastructure. The UKTI central spend has declined much less quickly and averages about £30 million each year.

approach, including working at larger, supply chain-level scales. This could be a deliberate variation on the collaboration theme and was mentioned by a number of national-level respondents.

3.6.4 Recommendations

With the benefit of this work, the commission has concluded that there are a number of key issues which need to be addressed:

- **Shifting capacity into the local system:** There is a lack of capacity in the field – particularly in LEPs and local authority-led inward investment agencies – to deliver enhanced levels of FDI activity and to play their envisaged role within the national system. Reductions in capacity since the demise of the RDAs have been concentrated in this key part of the system, creating particular risk for those areas outside of London and the South East which do not have the same level of global brand awareness. Given the current economic priority to promote a strong local offer which can rebalance the economy and the evident issues with information flow within the system, the commission recommends that a greater share of the national resources available are decentralised in order to support local capacity to build and project the local and spatial offer, both into and through the UKTI system.
- **Changing behaviours through the target and monitoring system:** The current system of measuring the number of projects secured annually is not adequate or suitable. The commission supports a stronger focus on expansion rather than new projects and a shift to assessment in terms of short and long-term employment growth and impacts related to targets such as sustainable economic growth potential. It also recognises that longer-term outcomes will best be driven by longer-term targets. It recommends that a tasking framework is created that can radically shift behaviour in the system towards long-term economic outcomes, including both growth and jobs. In making this recommendation, it has noted that Scotland Development International came to a similar conclusion some time ago and now works to a target for the number of jobs secured with salaries 20 per cent higher than the national average.
- **Building collaboration at a wider scale:** The commission supports the continuing focus on core cities and their surrounding city-regions in this area of work, but is also convinced that a stronger and more embedded relationship is needed between the UKTI's national and international functions and its partners in the North, if the system is to build on current performance.

Finally, **in order to secure inward investment and maximise export potential, the commission believes that a strong rationale exists for a Northern Investment and Trade Board to work close to the economy to:**

- focus on a small number of strategic projects within which the North as a whole has capacity – such as nuclear, water and energy – acting as a point of coordination to build links between assets and project them effectively to UKTI, BIS and other government agencies to help secure investment
- engage actively with UKTI sector specialists and provide an opportunity to draw them more effectively into the North to work with LEP areas and local investment agencies, and to support projection of the key northern assets
- provide a coordinating account management role, working with local authorities and LEPs to provide ongoing contact with key investors and existing trade partners to secure expansions and to build on existing trade links to secure leads
- integrate inward investment activities and trade activities relating to northern export strengths, as set out in section 3.5 above.

3.7 Enterprise in the North

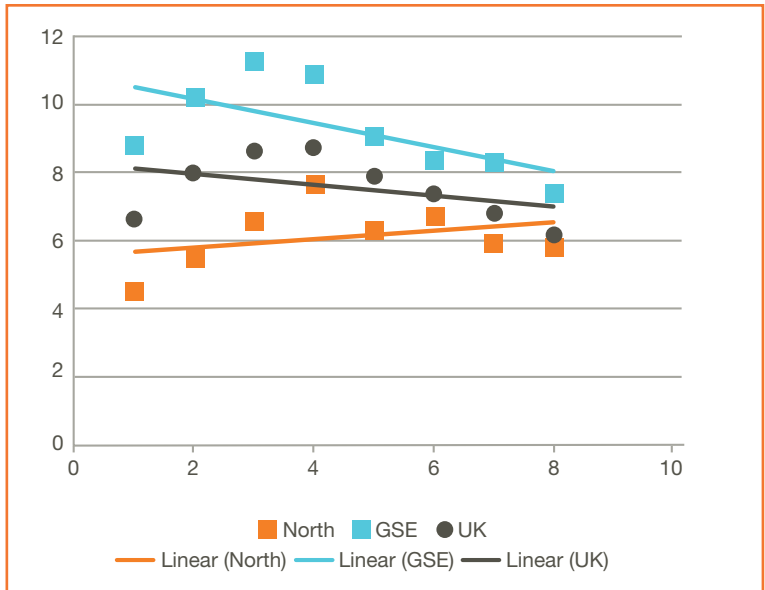
Historically, the North has had a lower level of SME activity compared with the rest of the UK. Yet it is SMEs which create the bulk of the opportunities for those individuals who are currently shut out of the labour market. With the northern economy having a higher proportion of these individuals, this mismatch needs to be addressed.

Lower SME stock and entrepreneurial activity can be attributed in part to the industrial structure of many subregions in the North, which were previously dominated by larger employers – both in the public sector and in heavy industry, where, faced with cyclical patterns of demand, there was a tendency not to subcontract. Over the last 30 years, the increase in smaller enterprises has not kept pace with the jobs lost as a result of the decline of heavy industry, and the contraction of the public sector in the North has exacerbated this.

On the bright side, however, the northern economy does show signs of a growing entrepreneurial culture. On current trends, the North will overtake the Greater South East as the UK's enterprise centre over the coming five years, both in terms of the proportion of adults involved in entrepreneurial activity and the proportion of adults expecting to start up a business in the next three years (BIS 2011a). Total entrepreneurial activity rates for 2010 and 2011 indicate are already slightly higher, at just over 8 per cent for the North compared with the UK rate of 7.5 per cent.

While these trends are encouraging, much more needs to be done to improve the 'entrepreneurship ecosystem of the North and to translate this increased entrepreneurialism into growth in businesses and jobs. Studies all over the world consistently link entrepreneurship, particularly the fast-growth variety, with rapid job creation, GDP growth, and long-term productivity increases (Isenberg 2010).

Figure 3.10
Percentage of adult population expecting to start a business in the next three years (2002–2009)



Source: BIS 2011a

3.7.1 The contributions of SMEs

Providing jobs for the unemployed and non-participants

Research commissioned by the Federation of Small Businesses (Urwin and Buscha 2012) emphasises the critical role SMEs play in getting the unemployed back to work: SMEs account for 88 per cent of all movement from unemployment into private sector employment. Even more strikingly, 95 per cent of the non-economically active (people of working age who are not actively looking for or available to work) who take up a job in the private sector either start their own business or work for an SME. Combining these findings indicates that SMEs account for 92 per cent of all movement from unemployment or non-participation into private sector employment.

Women, young workers aged 16–24, and older workers over retirement age are all more likely to be employed in smaller firms. In addition, the unemployed and non-participants without a degree are significantly less likely to find employment in a large firm than a small one. Overall, the FSB research indicates that small firms hire larger numbers of individuals with characteristics that put them ‘at risk’ in the labour market (ibid).

Small firms’ social contribution

Social enterprises can reduce the cost of social services and plug gaps in provision. In our interim report, we noted that social enterprises represent a growing subsector with relatively strong growth in the North West and Yorkshire and the Humber, and with particular potential in

relation to changes in government policy on public services (IPPR North and NEFC 2012). But they are widely misunderstood by traditional investors. There is also an important opportunity provided by ethnic minority-led businesses, which are playing an increasingly important role in the northern economy. These businesses are often crucial in particular places and subregional areas, but suffer difficulties in accessing mainstream finance and business support. In addition, employment in smaller firms is significantly more important in rural areas compared with urban areas.

Unlocking medium-sized firms' potential

In the UK, new firms create one-third of all new jobs, while small firms create another third. At the same time, there is a high rate of job destruction, and job creation is concentrated in around 6 per cent of innovative, fast-growing SMEs (Nesta 2009). A report by the Confederation of British Industry (CBI) has looked at how the potential of high-growth medium-sized businesses (MSBs) can be maximised (CBI 2011). In Germany and France, the contribution of MSBs to jobs is approximately twice as much as in the UK. The CBI argues that harnessing MSB potential could unlock up to £50 billion of economic output by 2020.

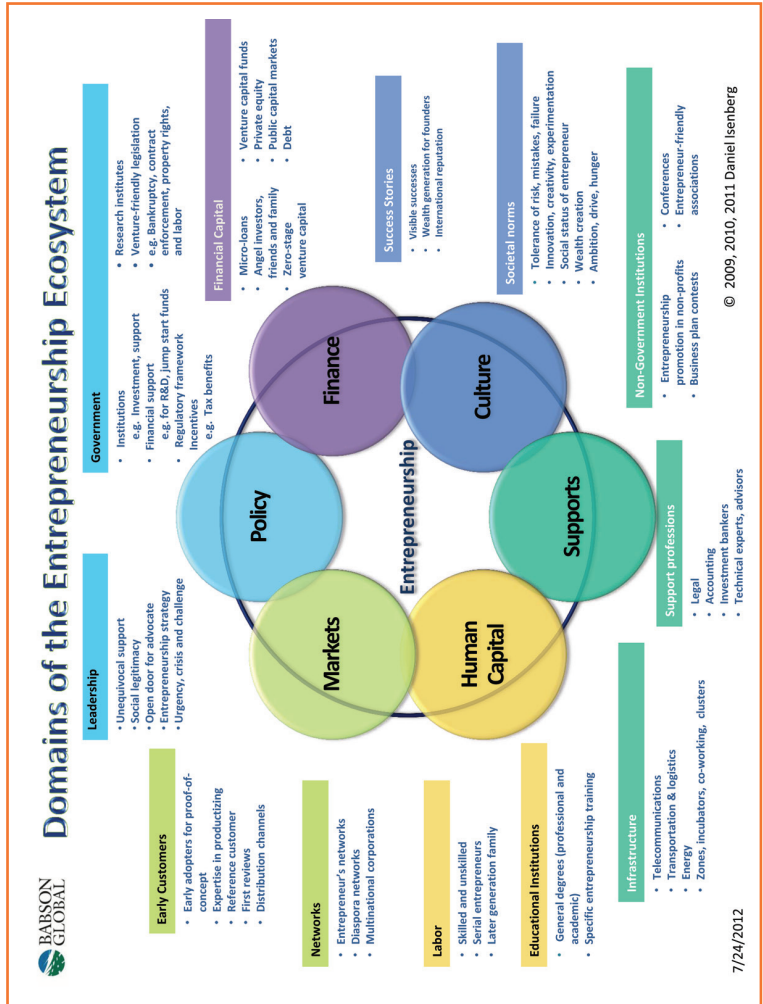
Low levels of confidence and ambition, a lack of relevant skills and competencies, and poor access to finance are all cited as holding back MSB growth (ibid). Low levels of confidence and ambition relate respectively to a reluctance to take on risk and the absence of growth strategies. Skill and competence gaps relate to management capability, recruiting the best talent, seeking advice, exporting, financial strategy and innovation. The finance gap relates to obtaining equity investment and barriers to debt markets, where costs are generally prohibitive.

3.7.2 Unleashing the potential

The most significant constraint in trying to start a new business in the North is obtaining finance, followed by lack of know-how. However, education and training, mentoring and networks, and ensuring that regulation works for SMEs and the self-employed are all important. Indeed, the so-called 'entrepreneurship ecosystem' is complex and comprises many domains including finance, policy, culture, skills, markets and so on (Isenberg 2010). This means a long-term and holistic approach is required to unleash SME potential.

Figure 3.11 gives a flavour of the long-term and holistic approach required, and this needs to be categorised by trial and error and endless experimentation. Entrepreneurship cannot be government-led but it is invariably aided, either directly or indirectly, by government leaders helping to build environments that nurture and sustain it. Key to this is not focusing on one or two elements to the detriment of other crucial parts.

Figure 3.11
Domains of the
entrepreneurship
ecosystem



Source: Isenberg 2010

For instance, inspiring young people to consider starting their own business but not creating the right conditions to pursue it can lead to brain drain. Creating the right conditions requires ‘engaging the private sector, modifying cultural norms, removing regulatory barriers, encouraging and celebrating successes, passing conducive legislation, being judicious in emphasizing clusters and incubators, subjecting financing programs to market rigors, and, above all, approaching the entrepreneurship ecosystem as a whole’ (ibid).

Pockets of the North with diverse economies are already showing robust levels of entrepreneurial culture, including Calderdale, York and

Manchester. Here, we discuss how to address four specific policy issues which are particularly pertinent for the North in any bid to create an entrepreneurship ecosystem and thriving SMEs.

The provision of finance

Access to finance is the single biggest constraint on SMEs. Elsewhere in this report (see chapter 5), we note the persistence of an 'equity gap' relating to the shortage of funds available to SMEs, which has been a problem since the 19th century. In 2007, businesses in the Greater South East attracted 41 per cent of all investment, despite making up only 32 per cent of the total number of businesses in the country. By contrast, the North received 23 per cent of all investment, equating to 10 per cent of investment value. Evidence presented to the commission suggests that SMEs' access to finance in the northern economy has become even more difficult since the 2008 financial crisis.

Our proposals on how to address the finance constraint are set out in chapter 5 of this report. In the context of our SME recommendations, however, **we stress the importance of a clear regional allocation of funds within the British Investment Bank.** Under these proposals, lending that is partly underwritten by this bank could be channelled through commercial banks. We note also that EU structural funds for the period 2014–2020 will have an entrepreneurship component. Countries and regions can choose entrepreneurship as a funding theme. **We recommend that entrepreneurship is identified as a key theme in the current negotiations concerning future use of EU structural funds.**

Plugging the competence gap

Lack of know-how has been identified as a significant constraint on new business start-ups. In principle, LEPs, local business networks and GOV.UK (the online home to the new, slimmed-down version of Business Link), should provide the bulk of advice to nascent and young businesses. However, certain types of business still encounter difficulties in accessing the business support they need, notably social enterprises and ethnic minority-led businesses, where the majority of support needs are similar to other SMEs but entry points in particular may differ. For rural businesses, distance and travel as well as a lack of awareness of what help is available can provide barriers to accessing support. Female entrepreneurship is considerably lower in the UK than in comparator countries, and women are half as likely as men to start a new business. This is a waste of significant potential in terms of both economic and social contribution. **We recommend that LEPs review business support in respect of social enterprises, ethnic minority-led businesses, rural businesses and female entrepreneurs in particular to ensure any deficiencies in service provision are addressed.**

A striking feature of new business formation in the UK is a high level of destruction, with as many as one in three enterprises failing in the first three years. Northern businesses actually had higher survival rates of new businesses during the recession than the UK average (IPPR North and NEFC 2012). Nonetheless, this is still a concern. The main reasons identified are poor marketing, poor cashflow management, weak business planning and management, lack of finance, failure to adopt new technologies, wrong location, and poor employee management. With the possible exception of finance, all of these factors could be mitigated to some extent by good business advice. **We recommend that LEPs give increased attention to maintaining relationships with firms after start-up and to reaching out to enterprises that have not received start-up assistance, with the aim of reducing business failure. We recommend that local business failure rates are included as a metric in LEPs' management reporting.**

We have noted the potential contribution of MSBs to regional output and employment (see subsection 3.7.1). **We recommend that LEPs take the lead in developing targeted services to address five key competence gaps in MSBs: developing management capability, harnessing talent (recruitment and specialised external advice), designing and implementing the right financial strategy, innovating, and exporting.**

Exporting should be an early priority for business support, reflecting the low levels of overseas sales typically achieved by UK MSBs and the large prize it represents in terms of potential output. **We endorse the CBI's proposals that UKTI should take more MSBs on trade delegations**, showing other countries that the UK has a strong and internationally competitive mid-sized sector, and also proactively target mid-sized enterprises with export potential.

A pervasive inhibitor of MSB growth is owners' low levels of confidence and the perception of risk. This is common throughout the UK, but in certain areas of the North it may be exacerbated by an industrial structure and history characterised by frequent economic shocks coupled with the long-term decline of traditional industry. Not surprisingly, this historical experience may have inculcated attitudes of uncertainty, caution and risk-aversion. In response, we recommend that all business services aimed at MSBs should incorporate a management confidence dimension. Linked to this issue is the historical lack of entrepreneur and SME-owner role-models in the North, with an entrepreneur's family and acquaintances usually more likely to work in large-scale enterprises or the public sector. The best predictor of someone starting their own business is a social or family background of entrepreneurship. To compensate, networks and mentoring are vital, as are celebrations of local success by government and LEPs.

Once SMEs have reached a certain level of business maturity, the support needs of fast-growing enterprises (commonly known as ‘gazelles’) are likely to demand professional business advice. At the same time, we recognise that there is a general reluctance among SMEs to seek professional business advice or consultancy. This may be due to lack of confidence discussed above, cost considerations, or simply lack of knowledge. In these circumstances, we recommend that consideration should be given to working with professional business advisory firms in the North to provide services aimed at potentially high-growth SMEs. **The commission recommends that a scheme should be explored whereby professional services firms discount their fee rates in return for introductions to ‘gazelles’ – after all, these businesses might be their high-growth clients of the future. Consideration could also be given to the possibility of further reducing the cost to SMEs by government match-funding this discount.** LEPs should take the lead in identifying SMEs that could benefit from the scheme.

Proposed action	Responsibility
Plug gaps in business support to social, ethnic minority-led, and rural enterprises	LEPs in concert with all SME support agencies
Promote business advisory services to female entrepreneurs	LEPs in concert with all support agencies
Maintain SME contact after start-up to improve survival rates	LEPs in concert with all support agencies
Include SME survival rate as a metric in LEP reporting	LEPs
Develop MSE targeted services covering management capability, harnessing talent, financial strategy, innovating and exporting – with early priority given to exporting	LEP-led
Involve MSEs on trade delegations	UKTI
Include management confidence building in all above services	LEP-led
Celebrate success stories	LEPs and BIS
Develop professional consultancy scheme for ‘gazelles’ and identify suitable MSE candidates	LEPs and BIS

Table 3.6
Summary of recommendations for plugging the competence gap

Regulation that works for SMEs and the self-employed

Small businesses are understandably concerned about the administrative burden of regulation. More than the amount of such regulation or the number and breadth of exemptions applicable to small businesses, the more pressing concern is that regulation is too often one-size-fits-all – or, rather, one type fits all sizes. Regulation invariably is developed with larger businesses in mind and does not adequately address the differing requirements of small business.

A case in point is the universal credit proposals, which will introduce onerous additional reporting requirements for the self-employed who, as a result, may even be encouraged to enter or remain in the informal economy (Urwin and Buscha 2012). Moreover, with the minimum income floor being set at the national minimum wage for reported hours of work, universal credit assumes that self-employed individuals are earning at least the minimum wage. This is not realistic, especially for nascent businesses, and means that self-employed individuals who are reinvesting in their business and so taking a below-minimum wage would be eligible for a lower amount of universal credits. **We recommend that government revisits the reporting requirement associated with universal credit and look at how to make it better work for the self-employed. This could include providing the self-employed with greater flexibility as to when within the financial year they make use of universal credits.**

Equally, small business is not well resourced to introduce pension schemes under the new auto-enrolment proposals, nor to fully play their part in creating more apprenticeships. Government and the LEPs need to provide the necessary support and ensure that it is accessible, if small businesses and entrepreneurship are to flourish.

Education and training

Incorporating entrepreneurial education in schools can prompt young people to consider becoming an entrepreneur and provide them with the knowledge and tools to pursue that option. Evidence is starting to emerge in Wales and more recently in Scotland of the benefits of entrepreneurial education in schools.

Young people in Wales are the most entrepreneurial in the UK, with early-stage entrepreneurial activity for 18 to 24-year-olds in Wales at 10 per cent in 2011, against a UK average of around 6 per cent (Hart and Levie 2012). This is a remarkable increase from a Welsh figure of 3.5 per cent in 2002, and seems at least in part to be connected to the increase in enterprise training. During this period, the Welsh government implemented an *Entrepreneurship Action Plan for Wales*, which covered all levels of the education system. For instance, in the 2008 GEM survey, 58 per cent of 18 to 29-year-olds in Wales said they had received training in starting a business provided by a college or university that was not part of their formal education, compared with only 35 per cent in Scotland, 39 per cent in England and 29 per cent in Northern Ireland (ibid). **We recommend that LEPs should support schools in the North to follow Wales' lead and instil, in a more formal and comprehensive way, an entrepreneurial culture within our future workforce.**

In the North, a key element of converting entrepreneur education into actual entrepreneurs is to get better at retaining graduates. It is telling

that Manchester and York are areas which both do well at retaining students after they graduate and have substantial entrepreneurial activity. If an area has good graduate entry jobs and is seen as a place people want to live then graduates will stay, or even be attracted in from elsewhere. Becoming an entrepreneur is often not feasible, or at least not desirable, for new graduates but something they may look into after a few years in the labour market. It is these highly skilled young workers who can create the high-growth companies of the future. A mixed economy with an emphasis on high human capital can foster the conditions to encourage this career arc.

The New Enterprise Allowance (NEA) scheme provides support to those who are unemployed and would like to start their own business. The scheme provides access to a volunteer business mentor, a weekly allowance, and the facility to access a loan. The scheme's impact, however, is greatly restricted by a low profile and the fact that it is only available to those who have been unemployed for at least six months. If this scheme is to make a real difference we feel that it should be open to appropriate individuals irrespective of how long they have been out of work. **We recommend that LEPs consider ways of promoting the NEA scheme through appropriate local channels.**

Social enterprise in the North

Social enterprises – broadly defined as third sector organisations actively trading as a means to deliver their social aims – are something of a Cinderella sector in the North economy. Work by the Northern Rock Foundation, looking only at the size of the civil sector in the North East and Cumbria, highlighted an income of £1.54 billion against assets of £2.7 billion, representing nearly 5 per cent of the North East's combined GVA. This included 23,000 employees, or 4 per cent of the regional workforce (Northern Rock Foundation 2012). So the economic weight of a sector more traditionally thought as akin to volunteerism is easy to overlook.

And much like the overall northern economy, there is significant potential for social enterprise to do more. The GEM data for northern social enterprise start-ups compares favourably to mainstream start-up figures, and the RBS SE100 index posted median growth in the sector in 2011 of 81 per cent, tentatively suggesting the sector might be faring better in the recession than mainstream equivalents (Hart and Levie 2012). However, social enterprise can also be considered as an emerging market, with similar opportunities and challenges to that of its mainstream business counterparts.

Social enterprises, or enterprising third sector organisations in the North, are ideally placed to address some of the comparative disadvantages and exploit some of the new markets that have been identified by the commission's work. These include primary growth sectors such as health and social care, as well as secondary sectors such as criminal justice, employment and skills. The City Health Care Partnership CIC in Hull, for example, has developed a strong relationship with its local health trust and now employs 1,400 staff delivering integrated social care services worth £52 million.

Social enterprises are also leading the way in relation to many aspects of the low-carbon economy. Co-wheels is an innovative social enterprise that offers a 'pay by the hour' car club. The organisation has grown to over 200 vehicles in 24 locations and has approximately 3,500 drivers signed up. It also offers a modern alternative to pool vehicle management for public sector and NHS organisations, which contributes towards the environmental and social aims of reducing unnecessary car use and changing the way that organisations use grey fleet and operate pool cars. It employs 11 full-time equivalent staff and has doubled its turnover in the past 18 months to over £800,000.

Access to sufficient capital at the right time is a common difficulty experienced by the sector, compounded by a degree of risk-aversion, inflexible operating structures or inefficient use of balance sheets which can often result in poor overall demand for social investment. Evolving mechanisms – such as the wholesale Big Society Bank, which aims to provide £400 million to the sector through a wide variety of intermediaries – go some way towards addressing these needs, but intermediaries need a very good local knowledge and there is a case to be made for a more regional approach to this fund.

3.8 Conclusion

It is easy to highlight the structural weaknesses of the northern economy; its industrial legacy and heavy manufacturing base have continued to shape the recent fortunes of its workforce and its economic outlook. But its industrial past also provides something of a launchpad for a more sustainable future: its strengths in advanced manufacturing, the automotive sector and engineering give it certain comparative advantages in a national economy which is seeking to rebalance away from dependency on the financial services sector. Its export orientation clearly demonstrates the vital contribution it has to make in restoring a more sustainable balance of trade and – as our pioneering new analysis

demonstrates – there are a number of critical export markets in affluent and converging nations which offer the North some clear opportunities to exploit: financial services, telecommunications, the automotive sector and tourism in particular.

But if the North is to continue its transition to a new type of economy, then it must also improve its technological and innovative capacities. Its biohealth sector is leading the way in this regard and the opportunities for the further development of the offshore wind sector demonstrate that the northern economy can lead the way in addressing the challenges of environmental sustainability. In each case, comparative advantage has been derived both by spatial location and public-private collaboration. The development of further innovation systems and clusters will be critical to future success. To this end, we have set out a northern innovation agenda and proposed the formation of a Northern Innovation Council to build and foster innovation capacity in the north of England.

Some of these sectoral strengths and innovation clusters will be nurtured through foreign direct investment, but our timely new research shows that the newly introduced UK First approach poses significant risks for northern investment opportunities. It requires a shift in capacity into the local system; much smarter targets; and a Northern Investment and Trade Board to coordinate and promote a set of investment priorities.

The North also needs to become more entrepreneurial. Access to finance and better business support are vital not only in starting up a new business but also in unlocking the potential of existing family businesses and mid-sized businesses which may demonstrate relatively high levels of risk-aversion and which have yet to realise their latent export potential.

Identifying and capitalising on sectoral strengths, promoting and building the capacity to innovate, building overseas trade and inward investment, and stimulating enterprise and business growth will each enhance Northern prosperity, but in order for any of these to take root, the north of England needs a to build on its natural assets and enhance its underinvested infrastructure. These are the subjects of the following chapter.

4. NATURAL ASSETS AND INFRASTRUCTURE

This chapter assesses the potential of the wide range of natural assets – land, energy and water – that exist in the north of England. It considers the North’s urgent need for increased transport infrastructure investment and proposes the decentralisation of transport funding to local bodies and to a pan-northern body ‘Transport for the North’. It argues for a truly national aviation policy framework to maximise northern airport capacity and a regional rate of air passenger duty. It considers northern housing challenges and opportunities, and calls on government to decentralise housing finance through subregional housing fund pilots.

The chapter concludes by calling for the kind of national spatial vision that lies behind Germany’s successful approach to regional policy. It presents a series of place-based principles that need to be adopted across government, and it makes the case for a ‘Mapping the Future’ programme designed to frame a national approach to natural assets and infrastructure and to mobilise private investment.

In our interim report, the commission argued that northern prosperity is national prosperity. Nowhere is this more true than in the case of natural assets. Given global challenges, the North’s land and coastal assets provide new opportunities in areas such as energy generation, food security and water, and the quality of its environment offers ongoing potential in sectors like tourism. Moreover, the North presents an attractive living environment arranged around core urban economies.

However, as the OECD study on promoting growth in intermediate regions shows, maximising the potential of natural assets involves investing in the necessary infrastructure. Indeed, strengthening infrastructure assets – roads, railways, airports and ports in particular – is identified as one of the most critical factors in driving faster growth in regions like the North (OECD 2012).

This chapter looks at each of these issues in turn and makes the case that much more needs to be done to make the most of our valuable natural assets. It argues that we need a radical change in our approach to infrastructure investment and transport spending. Both of these changes will derive long-term benefits for the entire nation, but in order for this to be the case we need a national spatial vision, which is currently lacking.

4.1 Natural assets

There is a need for new and sustainable sources of economic prosperity, and growing international concern about environmental and demographic pressures, energy and food security. Within this context, then, the commission's goal has been to identify opportunities to develop and foster sources of sustainable economic prosperity, and to understand what's required to realise their potential. Given the external factors, we believe that getting this right can work as a strong magnet for business growth, investment and employment.

4.1.1 Land

The North's land assets lie in rural and urban areas alike. The economic importance of land means that debates about land use are highly contested, with debate often presented as a choice between development and the natural environment. However, reality and perception are strikingly different – for example, a survey conducted for the Barker review suggested that over half the population believed that 50 per cent of land in England was developed, where the reality is closer to 10 per cent (Barker 2004). And the Foresight land use study highlighted that macro patterns of land use in the UK have remained fairly stable over the last 50 years, with agriculture, farming and forestry amounting to about 80 per cent of current use and urban development just 10 per cent (Foresight Land Use Futures 2010).

With the vast majority of England's land therefore being put to some form of economic purpose, the underlying trend is towards intensification of land use in both developed and semi-natural economic settings, rather than change in the usage pattern.

For industrial purposes, the proportion of previously developed land that is vacant or derelict is 4.6 per cent for the North – this compares to just 1.7 per cent in the South East, where the pressures on land use are greater. By area, there is twice as much vacant, previously developed, land available in the North than in the Greater South East (BIS 2011a). This offers potential sites for both existing industries and new developments.

This is also true in relation to land for residential development. Like other parts of the country, the North has gaps in its residential offer and wider built environment, but it has a network of successful and increasingly attractive cities and city-regions which can be the basis for stronger regional growth. The Foresight land use study attributes evolving patterns of residential development, in large part, to the planning process. It highlights how planning for growth in demand tends to be derived from trend-based population projections which 'build upon' the current population distribution. They suggest that this approach reinforces existing patterns of concentration, focusing growth in those parts of the country which are already built-up and creating overspill

areas in increasingly distant neighbouring areas. We need to think more strategically about how to manage economic and housing development (an issue we return to later in this chapter).

4.1.2 Agriculture

Land use is very closely related to agricultural activity. Although there has been a small decline in land that is put to agricultural use, this is a result of set-aside policies designed to address over-use and a growth in woodland reforestation to address climate change concerns. Reforestation has, in its own right, created an increasingly valuable economic sector.

Beyond land use trends, the commission is also interested in the work within the National Ecosystem Assessment (NEA) to understand possible scenarios for the impact of climate change on national food security. Given the importance of water supply in food production and wider agriculture, future levels of rainfall are important influences on land use. Mapping shows the impact of climate change on rainfall during the growing season and on temperatures, with precipitation projected to decline and temperatures to rise, particularly across the south and east where current performance suggests we are facing a high-emissions scenario.

Even in a low-emissions scenario, the NEA concludes that:

‘Forecast increases in temperature and shifts in rainfall patterns may well improve the agricultural potential of currently challenging upland areas, resulting in increases in incomes in much of upland England, Northern Ireland, Scotland and Wales. Impacts upon lowland areas, including most of southern England, depend crucially upon changes in technology such that under current forecasts, incomes are liable to decline in these areas.’

Bateman et al 2011

There is, therefore, potential that the North could provide a significant alternative source of agricultural production and employment for the UK at a time when food security will become an increasing pressure and use of existing land becomes increasingly problematic. However, agriculture is also an expensive industry in terms of carbon production and land use and there are choices to be made in how to balance its potential against other challenges, such as demand for energy and housing, and to increase quality employment in low-carbon industries. Our proposals for increasingly strategic spatial thinking about the structure and role of our economy at the end of this chapter would provide a context for balancing these priorities.

Figure 4.1

Precipitation in the growing season (April–September) in 2004 and UKCIP projections for 2040, in an IPCC high-emissions scenario

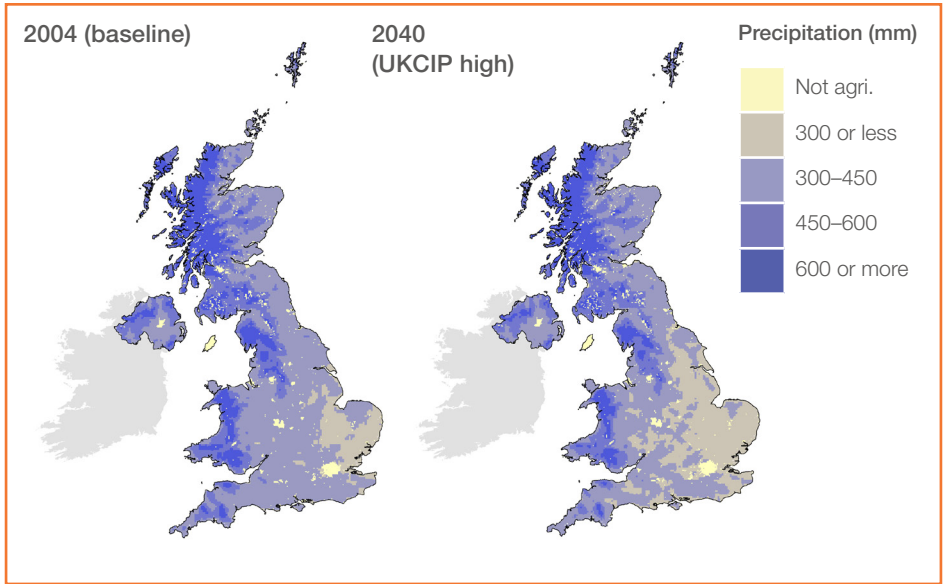
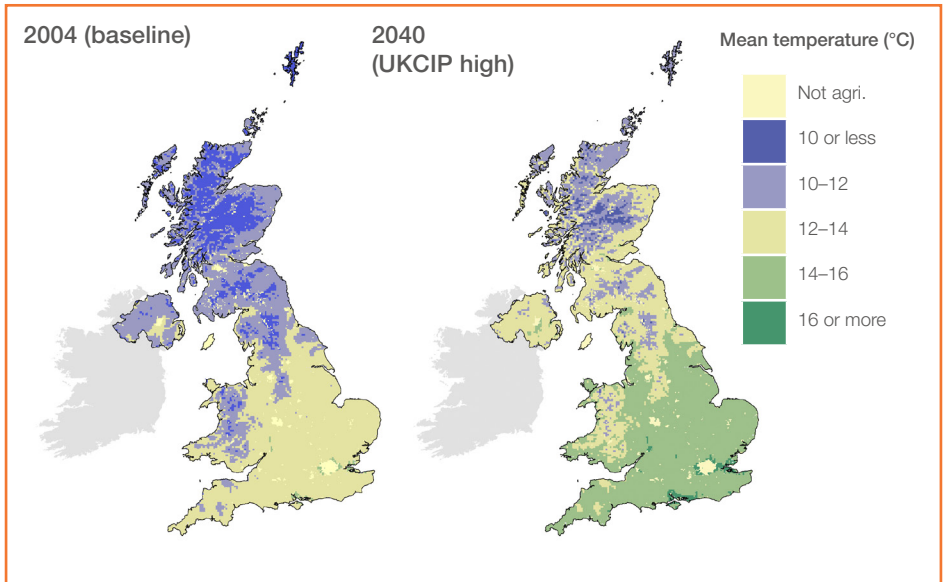


Figure 4.2

Mean temperature in the growing season (April–September) in 2004 and UKCIP projections for 2040, in an IPCC high-emissions scenario



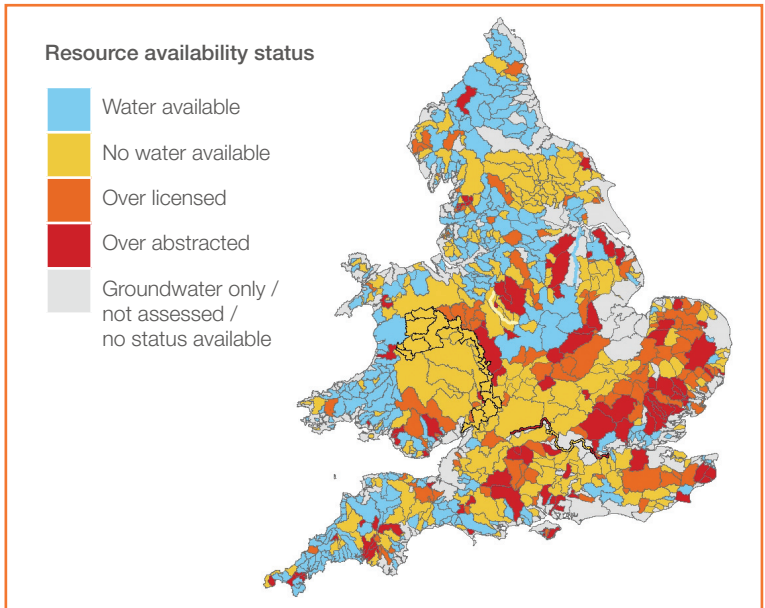
Source: Defra, UK Climate Projections UKCP09: <http://ukclimateprojections.defra.gov.uk/>

4.1.3 Water

At a national level, the Environment Agency (2009) has highlighted conflicting pressures of short-term demand for water from businesses and consumers and longer-term requirements to manage supply as a result of climate change, which implies both reduced rainfall and more turbulent weather patterns and events. As the UK population increases, the Environment Agency (EA) envisages demand for water increasing by up to 6 per cent by 2020 from household use alone, before taking business and agricultural demand into consideration. Demand for water for irrigation purposes is expected to rise by 25 per cent over the same period.

Meanwhile, climate change creates additional risks including flooding and drought, even simultaneously. The EA points out that areas of immediate water shortage in the south and east of the country are also those with the highest development pressure. Figure 4.3 indicates the available water sources in 2008, based on a comprehensive mapping of both surface and groundwater sources. This shows that the available water is concentrated in the north and west of the country, with most of London and the south east already using more water than is sustainable given current levels of availability and demand, with environmental damage, rationing and shortages an increasing likelihood. The EA highlights how, because of the concentrated nature of development in England, especially in the south-east corner, many parts of the country have less water availability than much hotter countries such as Greece and Spain.

Figure 4.3
Water availability
by combined
groundwater and
surface water, 2008



Source: Environment Agency 2009

The commissioners have noted the recent government-sponsored ‘water summit’, which began to explore how the impact of these changes on the economy and consumers can be addressed. One of the proposals is to create a ‘water grid’ for the UK to enable the movement of water around the country,²¹ however this solution appears to be practically very difficult and would require significant investment which aims to manage demand more intensively.

The EA proposes a number of more practical steps to manage these pressures downwards, and highlights the need for a more strategic approach to the structure of the industry and its incentives, by:

- directing housing and development where the environment can cope with the additional demands
- targeting approaches to management where the stress on water resources is greatest
- ensuring more efficient water use in homes and buildings and by industry and agriculture
- providing greater incentives to water companies and individuals to manage demand, including through pricing
- ensuring that reliable options for resource development are considered.

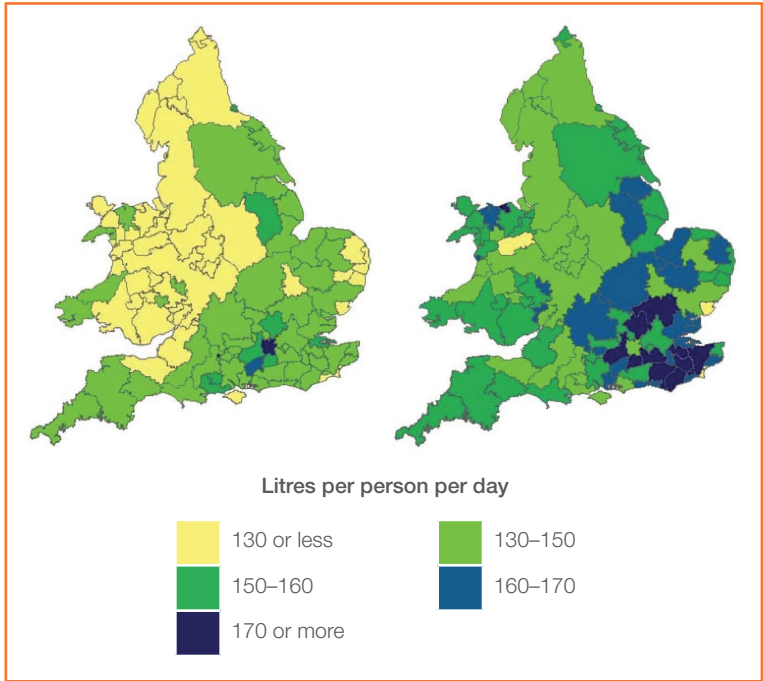
The EA has suggested that both valuing and pricing water differently could promote innovation in technologies designed to conserve and distribute water effectively (EA 2009). **The commission notes how usage patterns differ markedly between north and south, for both metered and unmetered use, and believes that this needs to be addressed with some urgency.** (See figure 4.4.)

Without these changes, the EA’s scenario modelling – taking into account climate change and population pressures – suggests that uncontrolled demand would be 35 per cent higher than currently by 2050, and at a time when climate change is expected to reduce supply significantly. It has called for an increasingly spatial approach to water and environmental risk management, involving local authorities and others to plan use and development of land to maximise the efficiency of water use.

All of these issues call for systemic innovation, and the commission notes the EA’s concern at the decline in R&D investment by water and sewerage companies, which fell by 60 per cent between 2000 and 2005 to a level of 0.3 per cent of total turnover. It has highlighted the need to invest more in technologies relevant both to water management specifically and to the wider risks identified.

21 See for example Water Briefing 2012

Figure 4.4
Consumption of water (litres per capita per day) metered (left) and unmetered (right)



Source: OfWat cited in EA 2009

4.1.4 Energy

As the North’s contribution to the UK’s energy supply through coal has declined, its natural assets have offered opportunities to exploit new sources of energy, with a particular focus on low-carbon and renewable sources, including nuclear, wind and water, as well the recently explored potential of shale gas. In this its location – situated along an extensive coastline in the windiest country in Europe²² – is advantageous.

Wind

The government’s Renewable Energy Strategy has set a target of 15 per cent of all energy being generated by renewables by 2020; given the continuing importance of gas, this implies that 35–40 per cent of all electricity generation will need to derive from renewables during this period. This in turn implies an investment of £60 billion and the creation of 160,000 jobs. The Committee on Climate Change places the focus of this effort on wind energy, suggesting that it could contribute 30 per cent of supply by 2020 (Committee for Climate Change 2011).

The Foresight land use study highlighted difficulties in siting wind turbines onshore and in achieving the necessary scale. Replacing the capacity of the Drax power station alone through onshore turbines

22 See <http://www.renewableuk.com/en/renewable-energy/wind-energy/index.cfm>

would require a land area of 1,750km². Achieving half of current targets through onshore wind generation would require 1.5–4 per cent of the UK landmass (Tewder-Jones 2010).

Offshore wind, therefore, offers the more likely prospect. The North has the land, the coastal sites and the offshore allocations from the Crown Estate to make a significant contribution in a sector which could build on the region’s industrial history and tradition of technological orientation and skills.

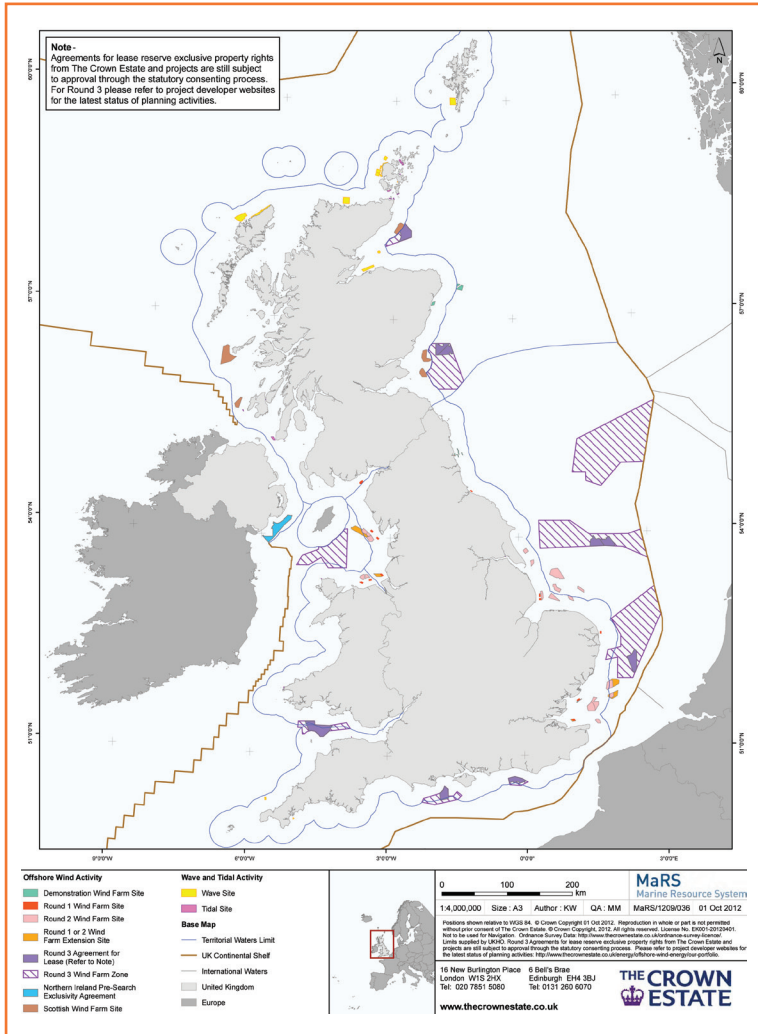


Figure 4.5
 Offshore renewable energy activity, UK waters

Source: Crown Estate²³

23 <http://www.thecrownestate.co.uk/energy/downloads/maps-and-gis-data/>

The UK has the world's largest offshore wind installed capacity, with over 1.85 GW installed by June 2012, across 15 full operational wind farms. A further six wind farms were under construction, totalling over 2.35 GW (DECC 2012). Beyond the immediate pipeline, there is close to 40GW of projects with leases and at various stages of pre-planning development, including extensions to current offshore windfarms, Scottish territorial waters projects, and the 'Round 3' developments.

The number of people working in the UK's offshore sector has grown from 700 in 2007 to around 3,200 in 2011. Work completed this year by Cambridge Econometrics for RenewableUK gives three scenarios for employment growth in the offshore sector by 2020:

- a projection of 13GW creates 1,800 direct full-time employees (FTEs), and 6,400 indirect FTEs
- 23GW creates 29,700 direct FTEs and 17,500 indirect FTEs
- 31GW creates 42,400 direct FTEs and 25,300 indirect FTEs.

Nuclear

The North has key nuclear assets, including existing generation capacity and the potential both to provide key sites for new nuclear development and to develop a significant supply chain for the industry, which could support development in the UK and also play a key role internationally.

The accident in Fukushima, Japan, in March 2011 has significantly dented confidence in the sector. While this has led to some changes in direction in a number of countries, nuclear energy is still a key part of the strategy for many others who continue to believe that it provides a realistic low-carbon energy solution, energy independence, security of supply and protection against the price volatility of fossil fuels. As existing energy sources decline, supplies are exhausted or pricing and carbon regulation makes them uneconomic, it has been demonstrated that new nuclear power generation should play an increasingly important part in the energy mix and towards the shift to low-carbon energy supply.

In January 2008, the Labour government published its nuclear white paper (DECC 2008) which set out that:

- new nuclear power stations should have a role to play in the UK's future energy mix, alongside other low-carbon sources
- it would be in the public interest to allow energy companies the option to invest in new nuclear power stations
- the government should take active steps to facilitate this.

The Coalition government followed this lead and published its own programme in June 2010, which set out a similar vision: that nuclear should play an important role – alongside renewable energy and carbon capture and storage – in the UK's future energy mix and that energy companies could build new nuclear power stations provided they were subject to the normal planning process for major projects. It confirmed,

however, that they would receive no public subsidy, a controversial decision which continues to be a key issue in the development process.²⁴ However, in October 2010, the energy secretary reconfirmed this decision.

For the north of England, the nuclear power generation industry represents a significant current activity and future opportunity. While current capacity in Cumbria, Lancashire and Hartlepool is scheduled to be decommissioned by 2025, each of the sites has been selected as a potential site for New Nuclear development on the same timetable (DECC 2011: part 4). There will be opportunities for northern businesses in both the decommissioning and build projects, the latter of which is estimated to be worth £40 billion nationwide (Dalton Nuclear Institute et al 2011).

This supply chain study has estimated the global market for new nuclear build to be worth in excess of £800 billion over the next 20–30 years, and that the northern nuclear supply chain is well positioned both to play an active role in the local nuclear new build programme and to scale up to take a share of the international market. The North is home to more than half of the UK nuclear workforce and extensive nuclear skills capability, encompassing heavy component manufacturing, consultancy and maintenance services, operations, and world-class R&D, and this is within a market lacking in resilience with supply in key areas, being concentrated across two main players in France and Japan (ibid).

However, the report also sets down a challenge to the UK as a whole, which will impact in particular on this northern capacity. With no new reactors built in the last two decades, the existing supply chain needs to be actively mobilised to ensure that companies are able to take advantage of the global opportunities – the report estimates a window of 18 months in which to claim a market-leading position. The authors suggest that the UK government and nuclear industry must develop a national policy to coordinate the development of a UK nuclear supply chain and to position UK-based businesses for growth in both local and overseas markets.

4.1.5 Maximising the potential of northern natural assets

A focus on our natural assets can open up opportunities both for direct economic gain and to play a crucial role in supporting the wider national and international economy.

As the examples above demonstrate, not only do northern natural assets present vital opportunities for future economic growth, they also address a range of emerging pressures and problems facing the southern parts of England and our overheating capital city. Land availability, house price inflation, water shortages and congestion all

²⁴ See for example Gosden 2012

suggest that, as the population of Greater London pushes nearly 8 million, it has reached a tipping point. It is becoming increasingly clear that the benefits of agglomeration are outweighed by congestion and its associated costs. This is characterised by the fact that London residents' quality of life satisfaction is significantly and consistently lower than anywhere else in the country (Smart 2011).

The commission's work comes as government also steps up its own work in this area, seeking to identify opportunities in a low-carbon economy and manage the pressures of environmental change and resource insecurity. We believe that **the potential of the North should secure strong recognition in the programmes that flow from the natural environment white paper** (Defra 2011), including the ongoing UK National Ecosystem Assessment exercise,²⁵ the Natural Capital Committee²⁶ and Ecosystem Markets Task Force.²⁷

We are also committed to ensuring that future policy realises the benefit of these assets to the North. Three particular concerns stand out:

- The new market relationships and payment regimes being introduced by the government, in areas such as water and energy, to promote investment in supply and transform payment mechanisms from consumers (Turner 2012) must not disadvantage consumers in the North through short-term subsidies for other parts of the country. The conditions must be created whereby these resources can sustain local economies and environments, in both urban and rural areas.
- Stronger evaluation of the value and potential of ecosystem supplies and investment into key technologies is required. Sustaining the quality of the North's natural assets and exploiting the potential of so-called 'ecosystem services' to the UK and international economy will require innovation and investment. More thinking is required around technological investment in areas of strength in order to both address issues in the UK and open up new markets. Two illustrative examples are provided by the proposals within the Liverpool city deal to develop a centre for water purification technologies and the work at Newcastle University to build expertise in irrigation and flood management technology – in both cases, these technologies could have positive outcomes both economically and environmentally. There will be many others.
- Data presented at the scale of the North is limited. Instead, much analysis is produced at scales which cross over or are enclosed within administrative geographies. Catchment areas, landmasses and watercourses each provide their own different economic, social and cultural geographies which need to be understood

25 See <http://uknea.unep-wcmc.org/Home/tabid/38/Default.aspx>

26 See <http://www.defra.gov.uk/naturalcapitalcommittee/>

27 See <http://www.defra.gov.uk/ecosystem-markets/>

and managed. As with wider economic patterns, we believe that an increasingly functional and spatial approach should be taken to analysis of and policy concerning natural assets, an approach which takes account of the issues within, and flows and linkages between, rural and urban territories.

However, perhaps the predominant concern emerging from this analysis – and in-keeping with many other commentators in this field – is that **the UK is insufficiently strategic in the way it thinks about issues of land use and must adopt a more holistic and cross-cutting approach** if we are to address those key market failures which impact upon both urban and rural locations. We will return to this issue in the final section of this chapter.

4.2 Transport

The importance of connectivity in enabling growth is clear: cities derive a significant proportion of their prosperity from their accessibility and connectedness. Research carried out by IPEG and CUPS (2008) shows a consistent correlation between areas that have experienced the strongest productivity growth during the past decade and their degree of connectivity.

However, while transport and connectivity are necessary for growth, they are not sufficient. Research by the Work Foundation (Work Foundation 2009) shows that the relationship between connectivity and skills, in particular, is crucial: labour connections are the strongest indicator of complementary links between places, and these links depend not only on good transport, broadband and so on but also on high concentrations of productive firms, higher skills and good housing stock.

In many respects, the north of England does operate as a dense and highly interconnected ‘polycentric’ urban area. However, connections are patchy and many locations are not as well connected as their geographical proximity would suggest they should be. For example, there are numerous towns, such as Burnley and Blackburn, lying within reach of urban centres that have relatively isolated local economies. In another illustration, one significant study has shown that commuter travel between Manchester and Leeds is around 40 per cent lower than expected, given the relative characteristics and proximity of these two centres (Overman et al 2009).

On top of this, there are very wide disparities between connectivity and transport infrastructure in the North compared to that in the Greater South East. For example, analysis of ONS data shows that of the 50 best-connected local authority areas in England, 35 lie in London and the South East, compared to just four in the North West and none in either the North East or Yorkshire and the Humber (ATOC 2010).

A number of factors can account for these issues.

4.2.1 Transport infrastructure investment

The commission has identified the rules of the HM Treasury Green Book and the New Approach to Appraisal (NATA) framework for major transport projects is a key factor behind underinvestment in northern transport infrastructure. The NATA methodology does not take sufficient account of wider economic benefits or the social and distributional effects of transport investments. To this end, benefit–cost ratios (BCR) are heavily skewed towards projects taking place in areas of high population density, resulting in over 80 per cent of major transport infrastructure spending in the current national infrastructure plan being earmarked for London and the South East, compared to just 6 per cent for the North (HM Treasury 2011b, Cox and Schmuecker 2011).

This is despite the fact that demand for transport has been growing fastest in the regions: passenger growth across the regional passenger transport executives (PTEs), for example, has grown by over 150 per cent over the last decade – a far faster rate than in London (PTEG 2011). Over the Control Period 4 (2009–2014), Network Rail's investment in new infrastructure exceeded £8 billion, but less than 15 per cent of this will directly benefit regional railways (Network Rail 2011). Yet regional operators contribute more than 30 per cent of the total fixed track access charges received by Network Rail (PTEG 2011).

Government accepts there is a problem: the transport secretary recently told the transport select committee that if decisions were taken on the BCR alone then almost all funds would go to strategic highway schemes and schemes in London. He explained that various 'non-monetised adjustments' were made, including 'regional equity' and 'modal equity' consideration (Transport Select Committee 2011). But this process appears insufficient and far from systematic.

Beyond this, the Coalition agreement itself included a commitment to reform the decision-making process, while the Department for Transport's business plan says that it will:

'Reform the way that transport projects are assessed and funding prioritisation decisions are made so that the benefits of low carbon proposals are fully recognised. [It will] Review and revise DfT guidance on appraising projects; [and] Review and revise DfT processes for assessing schemes and supporting Ministerial decisions.'

DfT 2012

There are suitable alternatives, and the north of England is leading the way in this regard. The Greater Manchester Transport Fund (GMTF) is a programme of transport investment worth £1.5 billion which uses different criteria for assessing investments. Potential transport projects have been modelled to account for their potential impact on GVA, employment and productivity, as well as reductions in carbon emissions.

This new approach produces very different outcomes from traditional methods. Indeed, the scheme which ranked first under this ‘real economy’ approach came only ninth using traditional models.

Similarly, the appraisal approach taken in relation to the ‘Northern Hub’ was somewhat different to traditional methods, as it incorporated the wider economic benefits of interventions. Of £900 million in economic benefits identified using this methodology, only around £170 million – those increases in productivity from cost-savings and agglomeration – would have been captured in a standard transport appraisal.

Overseas, countries such as Ireland, Spain, Finland, Canada and Japan employ multi-criteria analysis systems, whereby a form of weighting is used to balance the impact of individual criteria within an overall assessment.

The commission advocates the introduction of a new system for transport appraisal within the current parliament to place much greater emphasis on long-term economic benefits across the country rather than shorter-term benefits to users. The new system, drawing upon tried-and-tested processes developed elsewhere, should include an assessment of the extent to which proposed investments will:

- enable reductions in direct costs due to, for example, fuel and staff time
- improve access to labour and product markets to increase competitiveness, productivity and efficiency
- support ‘clustering and specialisation of business activity, feeding through job creation and economic growth’ (Network Rail 2011)
- facilitate better access to job opportunities, taking account of fares and prices, with a view to reducing worklessness and the costs of unemployment.

The system should be monitored and evaluated against the extent which it facilitates the real increases in the long-term economic performance of different regions that accrue as a result. The new system should also provide a much greater level of transparency, and genuine attempts should be made to communicate effectively concerning those aspects of its operation which are necessarily complex.

However, changing the transport appraisal formula in relation to large schemes of regional and national importance should only be the first step. Perhaps the more important step in relation to transport infrastructure funding would be to decentralise a significant proportion of the funding to a more strategic body operating at a pan-northern scale. While it is conceivable, perhaps necessary, that such a body might ultimately take on powers in relation to all forms of transport infrastructure – not least some of the powers that currently sit with the Highways Agency – the commission proposes that the most significant

steps in the coming decade concern the decentralisation of railway funding and powers.

4.2.2 Transport devolution

Rail

It is widely perceived that the web of legal, commercial and regulatory arrangements that overlay decision-making on the privatised railway is too tightly controlled from the centre. In recent years, this has made it 'harder, more costly and more time consuming to get things done' (PTEG 2010). Moreover, we know from direct evidence over the past decade that devolution of transport policy can bring significant benefits.²⁸

The best example is probably provided by London Overground. Since Transport for London became the franchise holder for a series of heavy rail lines in Greater London, an investment programme of £1.44 billion has utterly transformed what is now known as London 'Overground'. This arrangement has involved careful partnership working with the Department for Transport (DfT) and with Network Rail.

Improvements include:

- faster, more frequent and more reliable services, following improvements to signals, tracks and points and extended hours of operation
- new direct services and new stations between Dalston Junction, West Croydon, Crystal Palace and New Cross
- validity of the 'Oyster' pay-as-you-go system across the Overground network²⁹
- a brand new fleet of longer trains
- all stations deep-cleaned and refitted, providing a more comfortable travel environment for passengers.

Passenger numbers have since risen dramatically on London Overground since 2007, from 600,000 a week to 1.9 million. This stands in stark contrast to the remainder of London's suburban rail network, where around 10 different train operating companies (TOCs) provide the myriad of services across the suburban and inter-urban network. Satisfaction has also increased dramatically, with London Overground one of the top-performing TOCs in the country, alongside Merseyrail.

Since the Merseyrail Electrics franchise became the responsibility of Merseytravel there has been a transformation in investment in the network and its performance. Merseyrail Electrics is now one of the most punctual and reliable railway networks in the UK and also tops the passenger satisfaction league table. The Merseyrail network is one of

28 Except as noted otherwise, this subsection is substantively based on PTEG 2010a.

29 For more on the Oyster card system, see <http://www.tfl.gov.uk/tickets/14836.aspx>

the most intensively used in the UK, with over 780 trains on weekdays and 30 million passenger journeys a year. The partnership between Merseytravel and the operator, Serco-NedRailways, has meant that all of its trains have been refurbished and there has also been substantial investment in stations, with all now meeting 'secure station' standards. There is common branding, passenger information and level of service across the network, with nearly every station staffed before the first train arrives until after the last leaves, and there is a clockface timetable operating throughout the week. For the duration of the recession, fare rises have been capped to the retail price index (RPI).

Scotland is another example of the benefits of devolution. The Scottish government now holds all of the powers which in England and Wales belong to the DfT, including responsibility for securing future franchises as well as powers to manage and monitor the performance of ScotRail services. The government takes long-term, strategic decisions about future investment and specifies where resources are targeted by Network Rail through a process of periodic review.

Since devolution:

- 15 miles of track have been reinstated to provide a new link between Edinburgh and Glasgow
- the 21-kilometre Stirling–Alloa–Kincardine line has been reopened
- 130 new carriages have been ordered, at a cost of £200 million
- performance has been improved: delays have been cut by 50 per cent and passenger numbers are up by 20 per cent
- a plan has been devised and is ready for implementation which will see 35 miles of the Waverley route reopened, creating a link from Edinburgh to the Borders.

Changes in London, Merseyside and Scotland fit a pattern that is increasingly common in continental Europe, whereby responsibility, planning and development of local and regional rail networks have been devolved to the regional or city-region level, generally resulting in greater investment, passenger numbers and satisfaction.

In Germany, for example, in the 10 years since public transport powers were devolved to the state level, passenger traffic has risen by some 30 per cent. In France, rail funding and powers have been devolved; in places like Lille, for example, the central government allowed the city to make the most of its resources by integrating rail with other modes, resulting in significant surge in use across the system – up 47 per cent since 2001. In most European countries, the local and regional tiers have much more extensive powers than England's PTEs. In particular, European regional authorities tend to franchise directly for all modes of public transport, as well as setting out specifications and funding arrangements and determining the precise terms of capital investment.

These effects of devolution are unsurprising. As the Commission for Integrated Transport (2006) has noted, there is a 'direct relationship between the degree of functional integration of local authority, governance, the delivery of key strategic transport powers and the achievement of results around the country'. At present, the role of PTEs is largely restricted to overseeing local transport plans, with few powers extending beyond their local areas or directly over local transport providers. But where they do have greater control, such as on Merseyside, the effects are extremely positive.

To reverse this trend and inject new life and investment into our regional infrastructure, **the commission recommends that PTEs in England should be given similar powers to those held in Scotland, Wales and London, including over regional franchising.** PTEs should work with neighbouring local transport authorities and LEPs at the local level and with the Office of the Rail Regulator at the national level to ensure that service quality, frequency and capacity is responsive to local needs.

Individual PTEs, LEPs and local transport authorities should consider the range of powers they wish to pursue. However, as a minimum guide, the powers for individual PTEs should include:

- the ability to develop regional rail strategies, ideally in conjunction with LEPs and local authorities
- greater power and control over regional franchising with, at the very least, joint weight to that of the DfT
- branding of networks and services (like that of 'London Overground')
- investment in and management of local stations.

Also, PTEs should work in conjunction with Transport for the North (see below) in relation to:

- control of concessionary fares and ticketing
- responsibility concerning the provision of rolling stock unique to its geographic purview, either individually as PTEs or through the creation of a Transport for the North-sponsored rolling stock operating company.

PTEs should also have a clear role in determining infrastructure spending and in ensuring that there is complementarity between Network Rail's route strategy and their own plans.

Local transport and Transport for the North

PTEs and other local transport authorities, such as the shire counties and unitary authorities, also need greater powers and freedom to plan and manage local transport more effectively. A useful starting point would be to devolve local transport major capital funding to transport authorities, but further devolution could take the form of enhanced powers to regulate buses and other local transport, including introducing London-style franchising.

However, as important as these new powers might be, the North also needs a body that would be able to take a more strategic view across the whole of the three northern regions. **The commission recommends the formation of a new ‘supra-PTE’, Transport for the North (TfN).** While services which are provided within any given PTE area would be managed by the relevant individual authority and funded by their own resources, Transport for the North would bear responsibility for longer and intra-regional services.

TfN would wield the following powers:

- letting and management of what are currently the Northern Rail and Transpennine franchises
- serving as the key strategic client for Network Rail in the North
- investment in and management of major hub stations
- management of a pan-regional Oyster card smart ticketing system
- management of inter-regional fares
- a greater voice concerning freight management, and control where appropriate
- acting as a rolling stock operator for the North, with the ability to lease rolling stock at a specified and reasonable price to franchisees.

TfN could also take on the package of strategic planning, funding, delivery and monitoring right across the North. Over time, TfN would gather powers over other transport modes, mirroring, for example, Transport for London’s strategic role.

This new body would be most useful around issues such as franchising. For example, it could build on proposals by authorities in Greater Manchester, South and West Yorkshire suggesting that decisions about rail services in the north of England should be devolved to the North:

‘It might be like a Strategic Rail Authority (and potentially a strategic transport authority) for the North. The PTEs could come together and form a united body which would run the franchise.’

TFGM 2012

There are risks, and the costs may be considerable. For TfN to work an appropriate cost-sharing and risk-sharing arrangement would need to be established between central government and the new body nationally and with PTEs and other local transport bodies locally.

Nonetheless, as the case studies in London, Merseyside, Scotland and further afield demonstrate, with the detailed negotiation of a carefully designed package of powers and responsibilities, the potential gains are enormous. The government must reverse a now firmly established trend and work to re-empower PTEs and the regions to spur new growth.

4.2.3 The rail subsidy

The commission is concerned about subsidies relating to rail service provision. This is currently governed by the farebox recovery ratio, a mechanism which calculates the fraction of operating expenses that are met by the fares paid by passengers.

When it comes to rail fares, TOCs operate under a heavily regulated system. All revenues are earned within a regulated 'farebox', bound on either side by a 'cap and collar': if fare revenue goes above the cap then the excess is taken from the TOC and used by the DfT, but if regulated fares fall below the collar then the DfT must increase the subsidy.

So the emphasis of the regulated fare regime is not on fares per se but on revenue. If revenue is threatening to fall below the collar, then TOCs are permitted by the DfT to increase fares (subject to no individual fare being increased by more than an additional 5 percentage points) to restore regulated revenue to annual growth target of 'RPI plus 3 percentage points' for the regulated farebox. In this way, the farebox calculation is not linked to the actual level of passenger journeys and, furthermore, if TOCs increase their fares to the point where the price acts as a disincentive to passengers then they would be able to charge the taxpayer for any loss of revenue. Thus, in effect, these private companies have their earnings permanently underwritten.

The effect of this mechanism is that rail services in the north of England, with the exception of some inner-city routes, are heavily subsidised, a fact which is regularly used to explain why the North receives poorer rolling stock and lower levels of capital investment. However, the mechanism also provides very little incentive to TOCs to improve services, which in turn locks the North into a negative cycle of poor services, weak revenues and rising subsidies.

Specifically, the farebox recovery ratio in the North is lower than the British average, reflecting the North's lower wages and cost of living. However, the Coalition has expressed its desire for more of the train network's operating costs to be met via fares (that is, to increase the level of the farebox). This is a significant challenge to the North, where fares are lower – here, any proportional increase in fares will simply not go as far as the same proportional increase applied in an area with higher existing fares. There is a risk this will merely further entrench the 'catch-22'.

The commission recommends a fundamental overhaul of the rail subsidy system in order that farebox regulations place a much greater emphasis on the level of passenger journeys and the quality of service rather than revenue alone. Instead of simply competing to run the most profitable routes, there should be incentives in place to encourage TOCs – working closely with government, LEPs and other economic development institutions – to increase passenger journeys on key

strategic routes. This should be captured within the wider processes of rail decentralisation described above and at the heart of the letting of new franchises in the coming period.

4.2.4 Airports

Northern airports make a contribution to the regional economy that is substantial and which has gone largely unrecognised and underappreciated by politicians and policymakers. Manchester airport – the only northern airport classified as a ‘category A’ international gateway airport – contributes £3.5 billion to the UK economy and is the 18th-largest airport in Europe, providing direct employment of 26,000 and a further 50,000 indirectly. The jobs created via the airport, both directly and indirectly, constitute nearly 6.5 per cent of the total number in Greater Manchester (Butcher 2012). At a different scale, a study by York Aviation found that even Newcastle airport supports 3,200 jobs on site and a further 4,600 jobs indirectly, contributes an estimated £243.2 million to the North East economy and handles exports valued at £173.6 million.³⁰

Despite this, figures show that there is significant spare capacity in a number of northern airports. Liverpool airport, for example, currently operates at 45,000 air transport movements (ATMs) per year but is able to accommodate up to 177,000. Even Manchester airport currently has traffic of only 150,000 ATMs compared to a maximum capacity of 330,000 (AEF 2011).

Table 4.1
Airport traffic and capacity, actual and projected ('000s)

Airport	2010 ATMS	Projected ATMS 2030	Maximum ATMs	ATM Availability by 2030	Projected ATMS 2040	ATM Availability by 2040
Heathrow	450	480	480	0	480	0
Gatwick	230	260	282	22	260	22
Stansted	140	260	264	4	260	4
Newcastle	50	55	165	110	65	100
Liverpool John Lennon	45	55	177	122	95	82
Birmingham	85	210	169	-41	200	-31
Leeds Bradford	35	45	167	122	65	102
Durham Tees Valley	5	<5	156	151	< 5	151
Manchester	150	280	330	50	400	-70

Source: DfT 2011b/AEF 2011 and author’s calculations

At a basic level, there is scope to boost local demand for northern airports, principally by addressing business and consumer demand for direct flights to key destinations from their local airport. A simple comparison with Germany illustrates how far behind northern airports are in this regard. There are direct flights from Frankfurt and Munich to Beijing, Shanghai, Moscow, Sao Paulo, Mumbai and Delhi, and direct flights

³⁰ <http://www.newcastlegateshead.com/corporate/member-e-news/newcastle-international-airport>

from Dusseldorf to Beijing and Moscow. No northern airport offers flights to these cities. This is crucial, as there is a very clear link between the number of direct connections and the amount of business trade between two places (Frontier Economics 2011).³¹ As a nation, Germany offered 4,600 flights to China in 2011, while the UK had only 1,500.³² Today, the UK remains without any direct connections to 11 cities in mainland China that are expected to be among the 25 largest in the world by 2025.

It is routes like these where there could be significant new demand over time. However, in order to boost this demand the commission believes some short to medium-term incentives are required.

Perhaps the most obvious incentive is air passenger duty (APD). APD is a tax charged on all flights from UK airports which anyone operating an aircraft that departs from the UK is required to pay. Since November 2009 APD, has been demarcated into four distinct bands pertaining to the length and class of journey – longer distances attract a higher charge, as do higher classes of travel.

Table 4.2
Air passenger duty
bands

Band (distance of destination from London)	Reduced rate (for travel in the lowest class available on the aircraft)		Standard rate (for travel in any other class)	
	1 Nov '10 to 31 March '12	From 1 April 2012	1 Nov '10 to 31 March '12	From 1 April 2012
Band A (0–2,000 miles)	£12	£13	£24	£26
Band B (2,001–4,000 miles)	£60	£65	£120	£130
Band C (4,001–6,000 miles)	£75	£81	£150	£162
Band D (6,000+ miles)	£85	£92	£170	£184

Source: HMRC 2012

The importance of APD is twofold: first, because of the costs it imposes on the aviation industry, and second, because it is a key factor considered by airlines when making investment decisions. Northern Ireland has already been granted the freedom to reduce APD and passenger traffic has nearly doubled on key flights as a result. There is also evidence that regional airports – unlike big national hubs – are particularly sensitive to small variations in APD (CAA 2012). In these cases, the costs of a reduced tax take are significantly outweighed by the economic benefits of increased passenger numbers.

31 In more general terms, UK businesses trade 20 times more with emerging market countries that have a direct daily flight to the UK than they do with those countries that do not. The same report estimates that the UK is missing out as trade goes to France, Germany and Holland, and quantifies the cost to the UK economy at £1.2 billion a year.

32 Jeremy Hunt quoted in Warrell and Thompson 2012

In order to stimulate the economic opportunities presented by northern airports – and, at the same time, as one means of reducing national capacity problems – **the commission proposes that northern airports should be allowed to reduce their APD rate to the ‘Band A Reduced Rate’ levels for all flights for an initial period of five years.**³³ Should this recommendation fail on legal grounds then an alternative would be to impose a ‘congestion charge’ on particular airports or routes in the south east.

Beyond driving local demand for direct flights, there is also a strong case for northern airports to strengthen their role in providing services in and out of other European hubs in order to increase the number of passengers making connections through the North. There is a significant barrier to this, however: a lack of capacity at the south-eastern airports means that northern airports struggle to secure and maintain flights into Heathrow and Gatwick. Airlines running local services from northern airports to the big hubs like Heathrow have ceased to fly in and out of the North, preferring instead to keep their Heathrow slots for more lucrative international destinations. Between 2004 and 2006, the number of flights from Newcastle to London declined by 7 per cent; over the same period, Manchester airport saw a decrease of 10 per cent (Civil Aviation Authority 2011). As a result, northern airports have resorted to making connections into continental European hubs, which is not good for the UK economy as a whole.

Given the current debate about airport capacity in the south east, northern airports would seem to present an obvious solution to the problem, obviating the need for either a third runway at Heathrow or an entirely new London airport. There can be little doubt that overall UK aviation would support a second major hub airport besides Heathrow. Countries like Germany and Spain benefit from such an arrangement; indeed, it is a central plank of their policies to drive national economic output and enhance regional economic prosperity.

The commission recommends that government ends its preoccupation with south-east airport capacity and brings forward a truly *national* aviation policy framework which identifies the opportunities that exist for better use of northern airports.

Additionally, **the commission proposes that Manchester airport represents the most viable option for a second international hub airport for the UK.** Based on its existing infrastructure and capacity and its potential for further development, developing Manchester airport will have clear benefits for the whole of the North. Moreover, in concert with planned high-speed rail links from the south east, this development would provide efficient access to international services from many

³³ Given that the majority of short-haul flights made by holidaymakers are already charged at this level then the principal beneficiaries of the change will be business travellers to long-haul destinations.

regions of the country and also facilitate the integration of air and high-speed rail ticketing, as occurs in Germany and France. As such, the benefits of maximising the potential of Manchester airport would be extended to the whole economy and alleviate significant pressure from south-east airports, not least Heathrow. A truly national aviation policy with Manchester as the nation's second hub would go a long way to solving the national capacity squeeze.

4.2.5 Ports and logistics

There are about 120 commercial ports in the UK. These include major all-purpose ports, such as London and Liverpool; ferry ports, such as Dover; specialised container ports, such as Felixstowe; and ports catering for specialised bulk traffic, such as coal or oil. Although ports do not often feature prominently in the national media, they are significant drivers of, and a key component in, the national economy. Of UK international trade, 95 per cent is handled through seaports. In terms of total tonnage handled, the UK ports industry is the largest in Europe: total tonnage is about 560 million tonnes a year, and annual international passenger throughput is about 30 million. Over the last 10 years, however, total UK traffic has been roughly static.³⁴

It is estimated that some 130,000 people are directly employed in the UK ports industry. In addition to being important modal hubs in the country's transport system, many ports represent centres of local economic activity. Much industry is located in or near ports, such as oil refineries and power stations. Ports themselves are increasingly diversifying their activity into logistics and other value-added services, including aspects of landward distribution. And ports also represent a key opportunity for enhancing environmental sustainability, having significantly lower carbon emissions levels than their land or airborne equivalents.

However, despite the large number of ports, much of the tonnage is concentrated among a comparatively small number of ports – the top 16 ports account for 80 per cent of the total. Of these, the top two in terms of total traffic are Grimsby and Immingham and Tees and Hartlepool – both are based in the north of England. These, along with the third-ranked port – London – are of similar sizes and account for more than 150 million tonnes of traffic per annum (MDS Transmodal 2006).

However, narrower analysis of containerised traffic – an increasingly important slice of the industry – paints a very different picture, with over 70 per cent of all such traffic passing through ports in London, the south east and the east of England, compared to just 15 per cent through northern ports (ibid). Indeed, the ports at Felixstowe and Southampton rank sixth and 15th in the list of the busiest container ports in Europe, a long way ahead of any northern ports.

34 <http://www.ukmajorports.org.uk/pages/industry-profile>

Over the past two decades, governments have tended to be laissez-faire in their approach to port development, allowing ports to compete with one another and the market to dictate their relative strengths. This has led to what can be described as a ‘national distribution centre’ model, whereby container freight arriving into British ports is carried to the Midlands for warehousing and distribution, as shown in figure 4.6 below.



Figure 4.6
The national distribution centre model of freight transport

This represents a relatively efficient model of operation so long as there are two-way flows of full containers on different routes. However, this is no longer the case. Due to changes in trade patterns, loaded containers are carried full from the increasingly dominant Felixstowe and Southampton ports but return empty, with little two-way loading to and from other locations (as shown in figure 4.7 over). This is costly both in financial and environmental terms and inhibits the development of other ports and shipping companies. However, there are few incentives for distributors to move towards a more efficient model.

Figure 4.7
All one way:
inefficiencies in the
distribution model



The commission recommends that a more coherent national approach to ports and logistics development be taken, which integrates container freight with access to road, rail and more local distribution centres. This ‘multi-modal’ approach would enable enhanced linkages between ports, rail and road services, reduce the inefficiencies of unloaded journeys, reduce the costs to suppliers and distributors, and allow more effective supply chains and clusters to develop at the subregional level. This is shown in figure 4.8.

This approach has been instrumental in the decisions of both Asda and Tesco to set up distribution centres at Teesport, but more could be done to support similar developments at other northern ports. At the local level, investor confidence is essential to enable public and private investment in local infrastructure improvements.

At a global level, the widening of the Panama canal and development of the new Liverpool 2 deepwater container terminal, which can accommodate much larger container vessels, are both due for completion in 2015. In combination, these changes will open up new and significantly more shipping routes, linking transatlantic trade with the Asia-Pacific and Mediterranean/Middle East regions.

Figure 4.8
An example of
a multi-modal
approach to freight
transport focused
on Liverpool



Liverpool in particular will benefit from this, as a natural calling point on these new routes, in preference to a diversionary route via ports in the UK's south east or northern Europe. These developments, coupled with logistics park developments along the Manchester Ship Canal, could provide the lowest cost and carbon logistics hub in the UK, while at the same time reducing congestion on the major arterial roads and railways from southern ports.

Moreover, **a clearer commitment by government to offshore wind development could trigger a further resurgence of the ports along the North East coast** (see chapter 6).

4.3 Housing in the North

4.3.1 Housing and the local economy

The construction sector is often considered a barometer of local economic health, and housing and the wider 'residential offer' are key to creating a competitive economy. Housing markets are also critical to patterns of household wealth and consumption which have significant effects on local and regional economies.

Housing can underpin many of the recognised growth drivers, such as labour mobility, competitiveness and even innovation, and a high-quality residential offer can help a place to be more attractive as a business destination. Research carried out in partnership between Tribal, Arup and CURS (Birmingham University) concluded that many places across the North are missing opportunities to raise the overall attractiveness of the region as a place to live and work (Tribal et al 2009). The relationship between the economy and residential offer is idiosyncratic to each functional economic area, but many would benefit from an integrated approach to economic strategy and residential planning, prioritising local investment and developing new approaches to integrated delivery. The commission concurs with previous research which recommended that ‘the debate about planning for housing needs to move beyond a focus on gross numbers and new development locations, to a more holistic understanding which includes the contribution of existing neighbourhoods – where the great majority of change and economic potential will actually occur’ (ibid).

The commission recommends that new approaches to analysis and policymaking are developed and adopted which – as with transport infrastructure appraisal – are better able to understand the wider and longer-term economic benefits of housing investment and account for them in scheme appraisal.

4.3.2 Housing as a strategic opportunity for the North

In housing, as with other aspects of this report, it is too easy to allow the immediate challenges to overshadow the long-term opportunity.

The North suffers significant problems with housing quality and affordability. In the past decade, Pathfinder schemes have attempted to address this through demolition and large-scale transformation. But too often these have not served local communities well and regeneration schemes have not brought lasting changes to the underlying housing market – and many have now stalled altogether.

With the squeeze on supply and many prospective homeowners unable to afford mortgages, there is growing demand within the privately rented sector (PRS). The number of housing benefit recipients in the PRS has increased in terms of both caseload and overall spend between the early 2000s and the present day. Parts of the PRS are notoriously poor quality and poorly regulated, with some 40 per cent of privately rented homes considered to be ‘non-decent’ and – given so much is pre-1919 stock – with particular problems concerning energy efficiency (Pendleton and Viitanen 2011).

Alongside this, a further challenge facing the UK as a whole but the North in particular is a lack of housing supply. Although housing supply issues are most acute in London and the south east, they appear particularly intractable in the North, as the economic viability of housing

development is weak and government initiatives to stimulate house-building, such as the New Homes Bonus, are not sufficient to lever private investment into northern schemes.

While each of these challenges is great, the situation is exacerbated by a centralised approach to housing policy with a focus on solutions that pertain primarily to London and the south east. In the case of each challenge, greater local control of housing policy and funding could radically transform problems and weaknesses into opportunities and strengths.

4.3.3 The decentralisation of housing funding

Attempts to advance a clear national strategy for housing have been consistently undermined by huge local and regional variation in housing markets and the separation of policy and funding for housing in Whitehall. This has left northern councils with legal responsibilities but little power to deliver meaningful change for people in their area.

At root, the solution requires rebalancing public expenditure away from subsidising rents and towards building more homes. In the late 1970s, four-fifths of housing spending went on supply-side grants to support house-building, with just 20 per cent channelled through rent allowances (the precursor to housing benefit). Since then, this balance has been entirely reversed. This has been partly the result of trends in income inequality and the labour market, but also of housing market factors and explicit government policy. The result is that during the current spending round £4.5 billion will be spent on grants to support the building of new affordable homes while £94 billion will go on housing benefit (and a significant proportion of that amount goes to private landlords) (Cooke and Hull 2012).

The housing benefit bill is now so high in part because of the impact of the recession, which has driven unemployment up and increased the number of people needing help with housing costs, but also because of substantial structural factors relating to the housing market. In particular, the balance of tenures, the pressure on rents and the demographic composition of claimants have played important roles. Looked at over the longer term, the shift from capital to current expenditure in housing has contributed to a constrained housing supply and weak work incentives, and has probably driven rents up. The result is that the UK is an outlier internationally, with the highest share of the population in receipt of a housing cash allowance in the OECD. Within the UK, the North lies at the heart of this problem.

Reversing this shift is not straightforward, not least because so much public expenditure is locked in current benefit spending to support rents. The current distribution and structures of power make it even harder, with different Whitehall departments in charge of housing policy and funding. Similarly, the scope for innovation is constrained by the

straitjacket of a national system incapable of bending to northern needs and circumstances.

To achieve change we need national reforms which give local areas the power and responsibility to meet housing needs. The commission recommends that this should be done by **decentralising housing finance – housing benefit and capital funding for building homes – into subregional housing funds** – an idea adapted from recent IPPR proposals (Cooke and Hull 2012). These would be single pots of funding channelled to individual or groups of local authorities and which would include housing benefit spending and the share of capital expenditure for that area.

Under this reform, northern councils would have the power to use those resources to spread access to affordable housing in the local area, balancing spending on building new homes against providing cash support to those on low incomes, in the service of improved affordability. It would take time to enact the shift from subsidising rents to building homes, and so such subregional housing funds would stretch over a minimum of three years and be based on a national formula that took account of local population, housing costs and relative deprivation. If councils were effective at reducing deprivation (not population) they would split savings with the Treasury. The aim would be to achieve a national redistribution of resources to areas of high cost and high need, but with full freedom for local authorities to decide how best to use that money in light of local circumstances. A multi-year approach would also enable councils to plan for the medium term and cope with (minor) fluctuations in need. They would also be able to borrow against and securitise future funding streams to help drive additional economic development projects.

There are a number of ways that local authorities could use their subregional housing funds, depending on local circumstances such as:

- doing long-term deals with private developers and housing associations to build new affordable homes for letting and sale
- establishing a local scheme to provide support for people on low incomes with their housing costs (as an alternative to national housing benefit)
- entering into agreements with private landlords to secure a better deal for tenants and taxpayers
- purchasing existing properties not currently in residential use and bringing empty properties into the market
- providing support to get people into employment and reduce worklessness, so that people are better able to meet their own housing costs
- taking initiatives to address the local residential offer including small interventions to address wider neighbourhood improvements.

A series of protections would also need to be introduced. Significant rises in local unemployment should lead to adjustments in grant allocations to protect individuals and ensure that the automatic stabiliser effect of housing benefit is not lost.

There should be a broad legal duty for councils to improve access to decent, secure and affordable housing in their area, and they should be required to spend their affordable housing fund solely for this purpose. Councils should be required to establish an affordable housing panel, representing a balance of interests including the state, landlords and tenants. This panel would be responsible for agreeing overall expenditure and strategy for the local area, including how the fund would be used to secure affordability. The government would establish an 'affordability index' to assess housing affordability across local areas, rather than for individual households. This would be used to judge the progress and performance of local authorities against their core housing goal.

To begin to enact a shift from benefits to building, councils could start by agreeing deals with private landlords to prevent excessive rent rises, taking advantage of multi-year fund allocations to 'invest to save' and leveraging their own greatly enhanced revenues (alongside their assets and wider borrowing powers). Underpinning this new regime would be a reserve power for the government to renationalise affordable housing grants where local councils were not using resources for their core purpose (or displayed gross financial mismanagement).

In-keeping with other sections of our report, this more radical, long-term thinking would enact a rebalancing of decision-making and resources to enable local authorities, LEPs and wider housing agencies in the north of England to carve out their own northern residential offer. **The commission recommends that a small number of subregional housing fund pilots are established as part of imminent waves of city deal agreements.**

4.3.4 Housing and innovation

Housing supply also represents an opportunity for the North. In the most simple terms – and as described elsewhere in this report – the North suffers from low demand and poor scheme viability, as opposed to the south east, where land supply is the problem. The challenge then is to drive up demand and viability. Fundamentally, this will be done through the job creation and wider economic improvements that will flow from other recommendations in this report, but it can also be stimulated by a particular focus on housing innovation.

The focus of housing innovation needs to be on the North's transition to a low-carbon economy and adjustment for an ageing population.

This already forms a key part of the Scottish government's economic development plans. They see their ambition for new homes to meet

the highest sustainability standards as representing a huge opportunity for innovation in the housing sector. This extends to trying to obtain a ‘first mover’ advantage in the export market in Europe and beyond and its supply chain. The European commission will be investing over €2 billion in the Energy Efficient Buildings European Initiative over the next 10 years. In the UK, a technology innovation needs assessment for domestic buildings is under development by the Low Carbon Innovation Coordination Group and will be used to inform the process of prioritising public sector investment in low-carbon innovation.

Smaller scale projects are already underway in many parts of the North. Doncaster council, for example, has recognised that most older people would prefer to stay in their current home and want to be supported to do so. Even where older people have health and care needs, they have a strong desire to retain their independence and maintain their well-established social contracts and support networks. New technologies and minor adaptations can make this happen. In response, Doncaster has introduced the ‘Standards for Housing in an Ageing Population’ and is working in collaboration with adult services to develop collaborative strategies for independence, including strategies focused on dementia, extra care and ‘Telecare’ as well as the council’s review of sheltered housing.

Wakefield council recognises the importance of ‘innovation in urban realm design, developments to encourage social interaction, new housing supply to provide attractive alternatives to the under-occupation of family housing, housing options for the growing number of older homeowners, and role of extra care housing and assistive technology’ (Wakefield Council 2012). Their Lifetime Communities Programme is intended to establish an innovative new ‘lifetime community’, using residential urban design best-practice to promote a positive experience of ageing, and aims to ensure that all new homes on council-owned land are delivered to a ‘Lifetime Homes’ standard.

Sheffield Housing Company, a partnership between Sheffield City Council and two private developers, aims to provide the council with a stronger influence on housing development, creating the right mix of housing and tenure types to meet local needs, such as affordable family homes and homes suitable for older people. The partnership also seeks to increase standards of design and sustainability in new housing developments and takes a 10 to 15-year view, allowing investment in infrastructure to ‘unlock’ larger development sites and support the regeneration of Sheffield’s communities.

The commission recommends that the north of England builds on these initiatives and seeks to become a global leader in house-building and renovation technologies. To support this aim, the commission proposes the designation of ‘housing innovation

zones³⁵. With a window of 7 to 10 years, these would provide an incentive framework to encourage investment by homeowners, landlords and developers in areas which, despite high demand, have severe and entrenched viability problems. The most efficient way to do so is through enhanced capital allowances for housing development and renovation, extending the provision already available (such as the existing allowances aimed at rented housing and business premises). This could be coupled with an enhanced New Homes Bonus, encouraging local authorities and LEPs to facilitate investment and promote sustainable economic development within each zone.

4.4 Mapping the Future

This report makes clear that the economic development of the UK as a whole has seen different regions developing different roles, sometimes in competition but also complementary to the development of other parts of the national economic system.

The role of market processes in shaping economic geographies is widely recognised, with the role of economic concentration a particular focus, as businesses seek to benefit from economies of scale in labour markets and business networks. As such, urban centres provide increased opportunities in a range of other economic, social and cultural functions. These processes – agglomeration economics – can lead to very different roles and outcomes for different places, sorting assets and performance spatially.³⁵

It is also recognised that policy interventions can significantly influence the outcomes and impacts of these market processes. Influencing the composition of the economic assets of an area – such as its clusters of innovation, natural assets and transport infrastructure – can have significant long-term implications. Place-neutral approaches, which rely solely on market processes to determine the economic role and fortunes of places, will fail to shape the economy to secure balanced economic, social and environmental development.

In some respects, spatial and economic thinking does come together in national policymaking. The current government's localism approach, through initiatives including city deals, LEPs, enterprise zones and rural growth networks all implicitly acknowledge the spatial dimensions of economic development. But these tend to be the exception rather than the rule: innovation policy, inward investment and schemes such as the Regional Growth Fund all purport to be 'spatially blind'. While successive governments have recognised this and variations on the current 'rebalancing' rhetoric have been advanced before, the alternative approach – to promote the economic development of the regions outside of London in the national interest – has yet to be addressed effectively.

³⁵ See Krugman 1991 and Work Foundation et al 2009

The commission believes that in the UK, we have failed to adequately shape the spatial dynamics of economic development and this has led to a concentration of economic activity in London and the south east. Our consideration of the nation's natural assets – land, water and energy, for example – and our analysis of northern transport infrastructure needs both point to the importance of a more strategic approach to national spatial planning to maximise economic growth potential. By this, we are not arguing for another reconfiguration of the planning system but much for a more radical rethinking of the way in which we perceive our nation in spatial terms.

In their report, *The Condition of England*, the Town and Country Planning Association (TCPA, forthcoming) argues strongly that we need to learn how to think and act spatially again, to help the UK to manage its way successfully through the pressures caused by these economic realities, especially at a time when associated environmental and demographic trends will serve to further exacerbate these issues for our capital city and its hinterland.

But there are models of successful economies – in Germany (see boxed text) and the Netherlands³⁶ for example – where economic success has been achieved alongside economic balance through a more visionary approach to the spatial economy. In both of these economies, the kinds of strategies which have been promoted by the previous and the current governments – investing in institutions at a subnational scale to support and enable economic growth – have been accompanied by a national spatial framework or process which has explicitly recognised the economic assets, strengths and roles of different places and, over an extended timescale, arranged governance, made investments and decisions which have supported their growth, shaping markets to promote economic diversity and secure other national goals across the national economy. The TCPA has identified this approach as having fostered a 'culture' of spatial thinking, which is largely absent from our own national economic thinking.

The commission believes that to achieve a genuine spatial rebalancing to a level which is sustainable, given the nature of the market processes described earlier, will demand a sustained period of investment into the medium term. This commitment is required to enable the northern economy to complete its transition from the heavy industrial economy of the past to a modern industrial economy of the future, taking advantage of both key growth sectors such as renewable energy, advanced engineering and creative industries and the potential of city-regions across the North such as Manchester, Leeds and Newcastle.

36 The sixth revision of the Dutch spatial strategy since 1960, *Structural Vision on Infrastructure and Space (Structuurvisie Infrastructuur en Ruimte (SVIR))* was published in June 2011 and provides mid-term objectives through to 2028.

This will need to be accompanied by a continuing deepening of the decentralisation processes that the current government has initiated.

However, the commission also believes that the UK needs to firmly embed this culture of spatial thinking across government and the wider economy and to ensure that the rebalancing objective is firmly embedded in decision-making and analysis.

The commission proposes the development and adoption of a set of ‘place-based principles’ to be adopted into the UK’s national economic approach and which should inform and guide evidence-based policymaking and investment decisions across central and local government.

These principles should be developed to recognise that:

- Different places perform **different economic roles** in the national economy, based on their history, strengths and assets. Cities and city-regions have assets which provide the potential for strong knowledge-based and service sector economies, while other places have assets with the potential to supply a range of industrial, infrastructure and natural resources. These capabilities and roles should be recognised and built on through policy to provide a clearer understanding of development priorities, more certainty for investors and a framework for ensuring resource efficiency.
- Economic activity functions at different scales and levels, enabled by economic and infrastructure linkages. Optimising economic outcomes and enhancing integration requires **co-operation between different economic partners at different spatial scales** to develop the physical infrastructure, such as transport and digital connectivity, and the softer networks and connections, such as supply chains and clusters, which can promote economic activity at these different scales.
- Processes of economic, social and cultural development interact with policy decisions to define the roles of different places in the national economy. **Public policy and investments** have the potential to help to manage these processes and should therefore be aligned to support more balanced economic growth and development in the long-term national interest, both sectorally and spatially.
- The economy is not divorced from the interests of individuals and individual businesses. Economic decision-making should be **accountable** through processes which can engage elected and accountable leaders, businesses and business organisations, and local people at the appropriate spatial scale.
- **Measures of economic success** should be gathered at a variety of spatial scales. They should recognise and balance economic, social, cultural and environmental objectives and be future-proofed.

- **Sustainability and equality of opportunity** should be a priority across each of these areas and embedded into the spatial economic thinking over both the shorter and longer terms to provide confidence for businesses and citizens alike.

Alongside these place-based principles, **the government should develop a ‘Mapping the Future’ programme setting out its broad approach in key areas such as population, water, land use and the role of places, energy production and transport.** These should not be command-and-control style plans, but statements of vision and direction which can guide and shape public and private policymaking and investment.

Case study: spatial planning in Germany

German spatial planning has undergone a major shift in perspective, with the new strategic approach built around metropolitan regions as alliances for growth in ‘communities of responsibility’.

The central objective of German spatial planning has traditionally been to ensure equivalent living conditions across all regions by transferring financial resources and improving infrastructure in less well developed regions. This objective became even more important after reunification when East Germany had to be integrated economically and socially with the rest of the country.

To finance this policy, regions with the potential for growth and innovation needed to become more competitive, especially given the long-term demographic implications of lower birth rates and an ageing population and analysis which foresaw the impact of increasing economic integration, urban concentration and competition in Europe.

The Ministerial Conference on Spatial Planning, in which state and federal ministers discuss the future of spatial development in Germany, developed and approved a new ‘Concepts and Approaches for Spatial Development in Germany’.³⁷ In this joint development strategy the ministers agreed on three key ‘visions’ to guide their approach to spatial development (*Leitbilder*):

- growth and innovation by strengthening the competitiveness of regions
- an obligation to provide the services necessary for public welfare, especially in regions with a declining population
- preservation of natural resources, including the shaping of cultural landscapes.

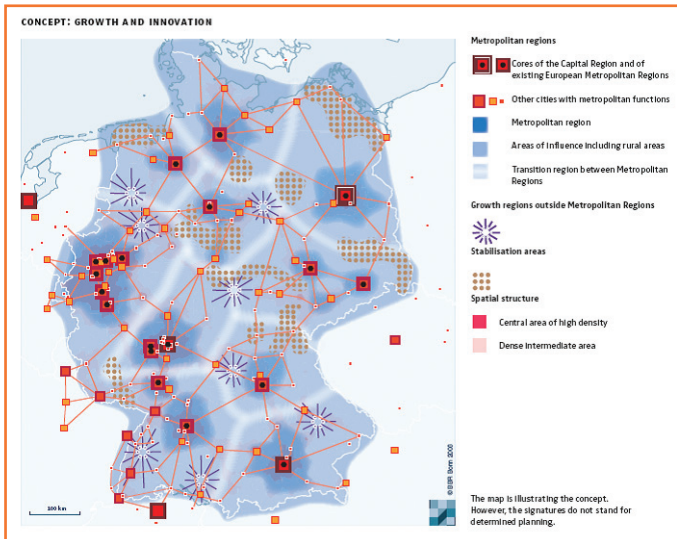
³⁷ *Leitbilder und Handlungsstrategien für die Raumentwicklung in Deutschland*, June 2006.

The first *Leitbild*, which provides the framework for promoting economic growth and development, was a deliberate commitment to realigning the norms of spatial planning policy in Germany. It focuses on the functions of metropolitan regions but also emphasises the importance of regional governance, interconnections within and between metropolitan regions, and the significance of cooperation between centres, surrounding areas and peripheral areas. The other two *Leitbilder* are no less important but reflect more traditional elements of spatial planning policy. The concept of growth and innovation has been the most important change and attracted intense political debate.

The 'Concepts and Approaches' policy develops the concept of the 'European Metropolitan Region' into a strategy for competition and growth, recognising urbanisation as a global trend and focusing regional development strategy on its consequences. Through 'growth alliances' between the metropolitan centres and their hinterlands, it reinforced specific strengths and aimed explicitly to allow weaker regions to benefit from growth generated in the urban centres.

Figure 4.6 illustrates the links between the core centres and other towns and cities with important metropolitan functions. Germany's polycentric regional structure results in centres of international importance distributed across the entire federal territory.

Figure 4.6 German spatial planning



Source: Sinz 2009; for more, see <http://bit.ly/QaEd66>

4.5 Conclusions

Northern natural assets and infrastructure form the building blocks of a successful and sustainable northern economic future. While not being sufficient in their own right, they are entirely necessary to achieve lasting economic growth, and yet for too long they have been undervalued and neglected. This has to change rapidly.

This chapter has highlighted the extent of the natural assets present in the North. It has shown how – in the face of future challenges from climate change and population trends, and pressures on other parts of UK from congestion – more strategic planning and investment can realise both the North's existing capacity and growing potential to host new industrial and residential development and to address concerns about the security of our food, energy and water supply. We have made the case for a radical transformation in the way in which major transport investment are appraised and for the decentralisation of many transport powers to local authorities, PTEs and a new body, Transport for the North. We have also argued for changes to break the North's dependence on the rail subsidy and to give rail companies more incentives to invest. And we have demonstrated the North's potential to address our national airport capacity problems and how container freight might move to a more multi-modal approach.

We have demonstrated that our housing challenges could be turned to opportunities through the decentralisation of housing benefits and capital spending into locally controlled subregional housing funds and through a concerted effort to make housing innovation an area of global expertise and competitive advantage for the North.

But to achieve many – if not all – of these objectives, national and local policymaking needs to be much more spatially aware. This will be achieved not through a single grand plan but by the adoption of clear place-based principles to underpin policy development and a Mapping the Future programme in relation to some of our key assets and infrastructure opportunities.

5. FINANCE AND FUNDING

This chapter considers the historical lack of business and infrastructure investment in the North and highlights challenges around both supply and demand. It calls for a number of new investment vehicles, including pooled issuances of municipal bonds, a northern infrastructure investment vehicle capitalised by local authority pension schemes, and a regional dimension to proposals for a British Investment Bank. In order to enhance northern financial autonomy, it argues for a 'single pot' for economic development devolved to LEP areas. Finally, it presents a series of principles to underpin the investment framework for 2014–2020 European structural funds.

5.1 Investment patterns in the North

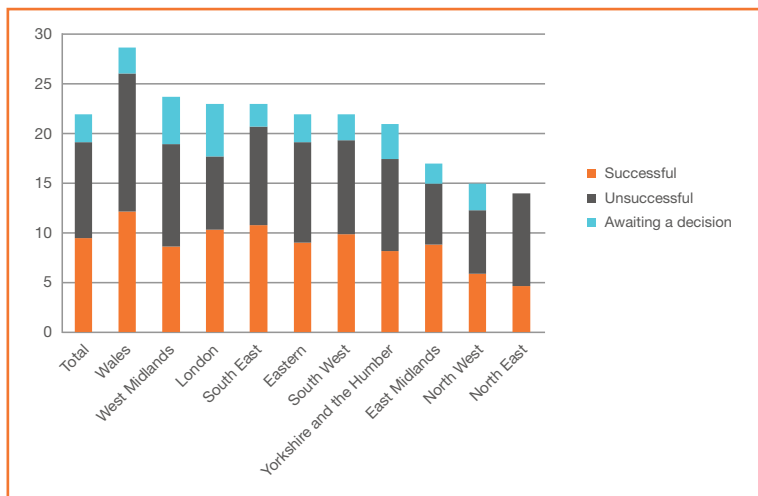
Investment in the economy, by both business and government, is a key driver of productivity and economic growth. Insufficient investment holds areas back. The UK has a longstanding problem of underinvestment, comprised of two major elements: a lack of long-term investment in business, especially small and medium-sized businesses, and a lack of investment in infrastructure.

The lack of access to investment funds for SMEs was noted as long ago as 1931, when the MacMillan Committee on Finance and Industry gave birth to the term 'MacMillan gap'. They noted that finance and industry in the UK lacked the symbiotic relationship that they did in Germany and the United States at the time (and to a large extent still do). Banks clearly have a pivotal role to play here. For them, a key difficulty is the transaction costs of carrying out due diligence on individual SMEs, leading them to rely on formulaic criteria – such as firm track record and level of collateral – which makes securing finance particularly difficult for new entrants.

As in other parts of the country, SMEs in the North report finding it particularly difficult to access lending from banks in the current climate. Figures published by the British Bankers' Association show that lending is broadly proportionate to the number of businesses – in other words, northern SMEs are no more disadvantaged than others across the UK (BBA 2011). However, figures also show that growth in lending over the last three years has been negative – in other words, there is far

less credit available to business overall (BoE 2012). The government has recognised this problem, but their appeals to banks to lend more have fallen on deaf ears, as they seek to shore up their balance sheets. Furthermore, figures from the FSB show that northern businesses are less likely to have sought credit from their bank in the first place, and where they have, their success rate has been lower. It seems there is a problem of both supply and demand.

Figure 5.1
Status of applications for credit (loan or overdraft) by small businesses to banks (%)



Source: Data provided by FSB, author's own calculations

Businesses particularly find it difficult to access funding of £500,000–£2,000,000, as this is too much to raise informally but too little to be of interest to institutional investors. This general problem of access to venture capital and equity needed by businesses to start up and grow is acute in the North. Figures published by the Association of British Venture Capitalists demonstrate the deep concentration of private equity and venture capital in London and the south east. This is perhaps not surprising given the heavy concentration of venture capital businesses in London and the south east (Martin et al 2003).

Looking at how the different regions of the North perform, the North West receives investment in line with the size of its business base in terms of the amount invested, as does the North East, although this is spread across a larger number of firms. Yorkshire and the Humber, however, performs relatively poorly. Moreover, the picture looks a little different when the figures are considered as a proportion of VAT-registered businesses. Again, it seems the North suffers not only from a problem of supply but also demand as a result of its relatively smaller private business base.

Table 5.1
Regional share of
investment

	Regional share of total VAT registered companies in UK	Regional share of number of businesses invested in by BVCA members	Regional share of amount of investment made by BVCA members	Companies invested in per 1,000 total VAT registered businesses
London and South East	31	41	62	0.42
North West	10	8	11	0.24
North East	3	9	2	1
Yorkshire and the Humber	7	5	4	0.21

Source: BVCA 2011 plus author's own calculations

In the past, the public sector has stepped into this investment supply gap. Prior to the recession, around 75 per cent of early-stage investment activity in the North was supported by the public sector, compared to around 30 per cent of the same in London (Mason and Pierrakis 2009). This has changed dramatically following the government's austerity drive.

The UK's investment problems are not confined to business investment. Levels of infrastructure investment are also low compared to competitors, with the UK ranking last in the G7 for investment as a percentage of GDP. As a result, the World Economic Forum ranks the UK 24th out of 139 countries for overall infrastructure quality, behind most other EU countries. The UK was ranked 24th for the quality of its roads and 16th for its railways (WEF 2012).

This UK-wide problem is especially acute in the north of England. Looking at the distribution of public spending overall across the UK, the north of England is among the regions receiving the highest spend per head – however, that spend is concentrated on benefits payments, pensions and spending on services like health and education. If we look at spending to grow the economy – what we might call investment spending, in areas like science, technology and infrastructure – the North fares considerably worse, as seen in tables 5.2–5.4. Identifiable public spending per capita on both science and technology and on transport is nearly twice in London what it is in any of the northern regions, and this disparity appears to be growing. Aggregated spending on economic affairs has climbed to over £1,000 per person in London in 2010/11 and fallen to less than £600 per person in all of the northern regions (HMT PESA 2012).

Again, the effects of austerity will be felt here, with deep cuts made to the housing and transport capital budgets. This has a knock-on effect for local government budgets, which have also seen deep cuts (Cox and Schmuecker 2010).

Figure 5.2
Identifiable public spending on science and technology, 2010/11 (£ per head)

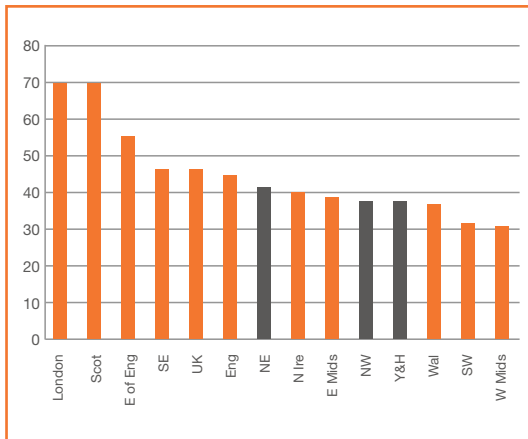


Figure 5.3
Identifiable public spending on transport, 2010/11 (£ per head)

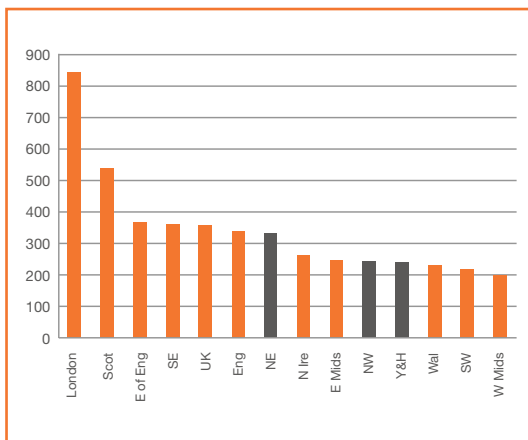
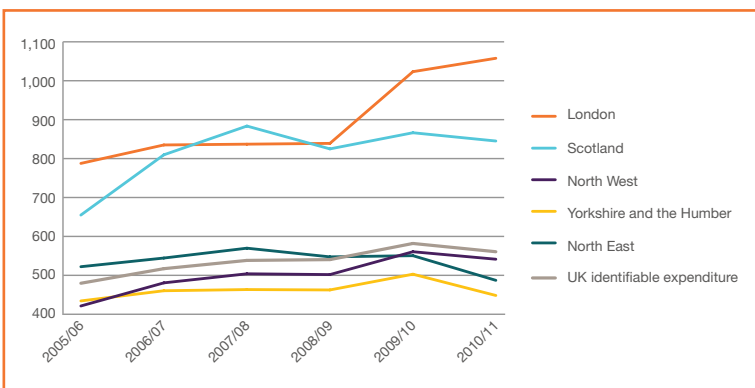


Figure 5.4
Spending on economic affairs: enterprise, development, science, technology, employment policies and transport (£ per head)



Source: HM Treasury 2011a (PESA)

Underinvestment in business and infrastructure is a long-term trend, exacerbated in recent times by recession and austerity. The reality of these market failures is demonstrated by the number of measures that have been tried (and which, by and large, have failed) in various attempts to overcome them over many years. Under the current government, even with its austerity drive, we have seen successive schemes put in place, from the Regional Growth Fund to the loan guarantee scheme, from the Bank of England's 'Funding for Lending' to Vince Cable's British Investment Bank.

Yet now, despite this policy hyperactivity, northern businesses and northern local authorities find themselves in the worst of all worlds. At a time when local government, particularly in hardest-hit areas, ought to be striving to stimulate local demand and invest for the future, its budgets are being cut deeply. Likewise, at a time when businesses need credit to consolidate their position or invest in their future, they struggle to find lenders and investors. This lack of investment finance curtails countercyclical spending to stimulate demand in the economy.

This is not the end of the story. Not only does the North suffer from a lack of investment, it also lacks the autonomy to do anything about it.

5.2 The need for greater financial autonomy

A key reason why local areas are helpless in the face of the deep spending cuts is England's high level of fiscal centralisation. Figure 5.5 shows that subnational agencies control barely 12 per cent of their revenues – only marginally better than in Romania, Bulgaria and Greece, and very poor by comparison with similar bodies in countries like Sweden and Germany, which raise more than half of their own revenues.

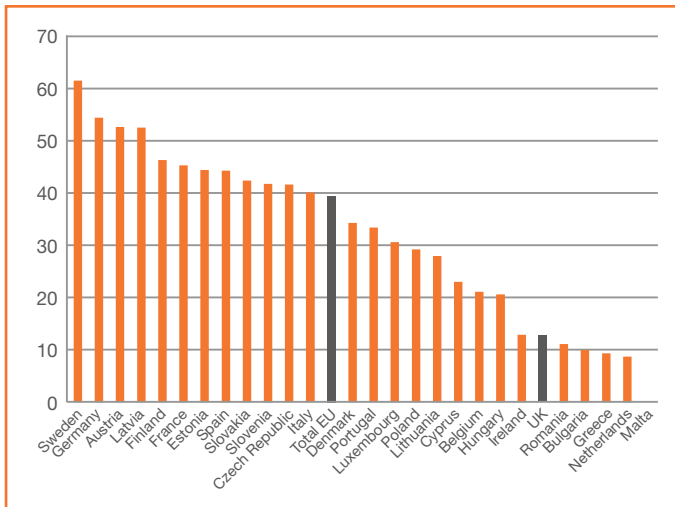


Figure 5.5
Subnational revenue generated by subnational tax, 2010 (%)

Source: CCMR 2012 plus author's own calculations

Most public agencies – not least local authorities – are heavily dependent upon central government for investment and revenue funding. When cuts fall, they are left with little room for manoeuvre. Furthermore, dependency has undermined their ability to shape their local economies, as they have few options for raising revenue with which they might stimulate growth through countercyclical spending.

But there is a more compelling reason for looking at fiscal decentralisation: evidence suggests that aligning spending decisions about economic development with the economic footprint of an area results in more effective and efficient interventions (Cheshire and Magrini 2005). Aligning such decision-making powers with revenue-raising powers more closely maximises the sense of fiscal responsibility, creating stronger incentives to boost economic performance to increase revenue.

Throughout this report, the commission makes the case for decentralisation of powers to enable the North and its constituent parts to exercise greater autonomy in and influence over the future direction of their economy. To fulfil this vision, it is imperative that we look not only at powers and functions but also at funding and finance. To have the power to act without the resources to enable action is to have no real autonomy at all. And there is historical precedent: in the 19th century, the industrialisation of the North was largely funded through local resources and the strong regional and municipal northern banking systems.

In order to develop a sustainable platform for long-term economic growth, the North needs to reclaim and rediscover a much higher level of financial and fiscal autonomy. This means having greater capacity to raise finance to invest in economic growth as well as greater control over public spending carried out in the area and the ability to raise more revenue locally. In the next subsection, we set out how this can happen.

5.3 New financial instruments and institutions

5.3.1 Short-term measures to boost infrastructure investment

Given the slow and faltering nature of the current economic recovery, there is a strong case for quick action to stimulate investment in the North. Municipal bonds are a key mechanism already available to local authorities to access finance for investment in infrastructure and capital projects. In the short term, northern authorities need to make far greater use of this tool to boost investment. Now is a particularly good time to do this, as the current level of yields is extremely low.

Seen internationally, England is unusual in the extent to which its local governments are reliant on a central government source of finance to fund capital expenditure: the Public Works Loans Board (PWLB). It is far more common in developed economies for local or

municipal authorities to use bonds as a way of promoting economic development, particularly for one-off schemes. Major projects have used municipal bonds in Romania, Russia and Slovakia over the last decade; German regional governments issued 770 bonds between 2000 and 2007, representing 82 per cent of the European total for that period (Platz 2009). Schemes allowing different local authorities to issue bonds collectively exist in the low countries, Scandinavia and France; in the US, municipal lending has been done via municipal bonds since 1812 and now amounts to 70 per cent of such activity (Carr 2012).

Even in the UK, local authority bonds were relatively common before the 1980s. They were popular both with local authorities, as they provided a measure of financial independence from central government, and with local residents, who enjoyed a stable investment (a sort of 'micro-gilt') virtually guaranteeing a modest but worthwhile return. In the 1980s, however, the practice rather fell out of favour as capital controls were imposed by central government to limit local authority spending. Until 2003, central government had to approve any attempt by a local authority to try to access money from the money markets. As a result, between Leicester and Salford seeking money for housing and infrastructure in 1994 and the Greater London Authority (GLA) for Crossrail in 2011, not one English local authority made a bond issue (ibid).

Local authorities have since regained the power to issue bonds but few have done so, and this is because they have been able to access cheap long-term borrowing from the PWLB. This changed with the 2010 spending review, when the cost of borrowing from the PWLB was increased significantly, although the 2012 budget partially reversed this by offering a discounted rate to authorities that lay out their spending plans in advance and are deemed most efficient by the Treasury.

So, over the last few years, local authorities have begun to return to bonds, partly because the cost of borrowing from the PWLB has risen. For example, the GLA's 2011 bond issue is 17 basis points below the PWLB rate. This has prompted other authorities – including Wandsworth, Birmingham and Guildford – to apply for and receive credit ratings.

However, this is an expensive process costing up to £50,000 per issuance. A further challenge for some local authorities is they lack the necessary scale to enter into public offerings or private placements. Club placements (or pooled issuance) are an important option here. This involves the use of a vehicle which issues a bond on behalf of a number of organisations and then on-lends to them. This enables local authorities to access the debt capital markets for smaller sums, which can benefit smaller authorities who wish to invest in smaller projects.

Pooled issuances will also enable borrowing at the scale required to fund large projects of city-regional significance, thereby bringing benefits to multiple local authority areas. Some of the institutional framework to facilitate this pooling is already in place, such as the combined authority in Greater Manchester.

In addition to benefits of scale, pooled issuance shares the administrative cost across a number of authorities. The LGA undertook a study which modeled the impact of a pooled issuance type scheme in England. They proposed that local authorities could borrow up to £7 billion and in the process save up to £500 million in costs over 25 years. Such a scheme (covering tens if not hundreds of authorities) would be able to borrow at a rate of 70–80 basis points over gilts or 20–30 below the standard PWLB rate (LGA 2012).

In an era of economic instability and austerity, when investors and lenders are looking for stable and secure places for their money, British local government could offer an opportunity. **The commission challenges local authorities in the North to club together to create a northern investment vehicle which will enable the joint issuance of bonds.** Such pooled issuances will achieve scale, creating opportunities for on-lending for smaller projects as well as significant capital for large, regionally significant projects. What this vehicle may look like is explored below.

5.3.2 Developing a northern infrastructure investment vehicle

In order for northern local authorities to come together to create a northern investment vehicle of the kind through which the pooled issuance of bonds might take place, start-up capital will be required. A survey by the New Local Government Network (NLGN 2009) of local authority finance directors suggested there may be appetite for this, with over 80 per cent saying they would support a local authority mutual bank. On this basis, it was calculated that a fund of between £389 million and £2.8 billion might be viable.

This could be topped up by inviting local pension funds – particularly public sector ones – to invest in the fund. This would build on the idea of the pension infrastructure platform (PIP), the not-for-profit mutual owned by pension funds that is currently being developed by the Treasury, along with the National Association of Pension Funds and the Pension Protection Fund. It is hoped that such a vehicle will raise £2 billion from pension funds (leveraged up to £4 billion) and enable an otherwise disparate industry to pool expertise and resources to invest in infrastructure. The vehicle will primarily consist of debt-based finance but will also include an infrastructure equity option, which will allow schemes to actually own physical assets.

Northern local authority pension schemes hold considerable sums, as table 5.2 sets out.

Greater Manchester:	£10.4bn
West Yorkshire:	£7.9bn
Merseyside:	£4.3bn
Tyne and Wear:	£4.3bn
South Yorkshire:	£4.1bn
Lancashire County Council:	£4bn

Table 5.2
Value of selected
northern local
authority pension
schemes

Source: Localis 2012

There are indications that pension funds are interested in increasing their investment in infrastructure. As Greater Manchester said in its submission to the commission: ‘We need to promote new ways of public funds (both central and local) being harnessed more effectively with private funding and the investment funding available in public sector Pension Funds.’

While pension fund investments need to be safe (in terms of securing a reasonable yield for pension holders), they can also afford to be patient, making them perfect for long-term finance projects. Already, the Greater Manchester pension fund (which brings together the pension funds of all 10 local authorities in Greater Manchester, plus those of over 200 other employers in the area) invests in commercial property, and is currently exploring the possibility of building residential property for letting or sale (Cooke and Hull 2012).

Diversifying portfolios will also be of benefit to pension schemes as they struggle to manage changing demographics and weak returns on investments in recent years. It is anticipated that increasing investment in infrastructure, especially projects that can generate income, will be increasingly attractive (Carr 2012).

But local authority pension schemes are held back by central regulation. Currently, the Department for Communities and Local Government (CLG) places a 15 per cent cap on investments in partnerships, which are often used as vehicles for investment in infrastructure, private equity and real estate. This is in stark contrast to the Treasury, which is actively encouraging the pension sector to invest in infrastructure, something the pension industry has been interested in for some years. The consequence of this 15 per cent cap is that where pension schemes are already committed to investments elsewhere, their capacity to invest in more infrastructure projects will be limited (Smith Institute 2012). CLG is currently consulting on whether to increase the cap to 30 per cent (CLG 2012).

A further barrier to some local authority pension funds investing in infrastructure locally has been concern about conflicts of interest. Making the investment fund pan-northern would help to overcome this concern, while still enabling fund managers to promote investment in the fund as a way of developing economic growth and prosperity in the

area. As with pooled issuances, operating North-wide would also allow the benefits of scale to be realised.

Internationally public sector pension funds in other countries are ahead of the curve in terms of investing in infrastructure. Pension schemes such as the Ontario Municipal Employees' Retirement System in Canada and that of the state of Queensland in Australia have established vehicles to invest in infrastructure both at home and abroad (ibid). These examples would be worth investigating further as the northern investment vehicle is devised.

5.3.3 A regional investment bank

One option for a more autonomous, long-termist northern financial institution considered by the commission is a 'Northern Investment Bank'. There has been considerable political debate in recent years regarding the formation of a state investment bank (see for example Dolphin 2012, Skidelsky et al 2011 and Tott 2012). The purpose of such a bank would be to overcome the twin market failures of a lack of long-term lending to SMEs and underinvestment in infrastructure.

The government has taken a pigeon step in this direction with Vince Cable announcing the establishment of a British Business Bank to provide long-term loans to small businesses. However, the initial capital injection for this bank is a mere £1 billion, which is insufficient for the scale of the challenge faced. Furthermore, the bank is only certain to be up and running between 2013 and 2015, so it is hardly the right model to correct longstanding market failures. It also fails to address the question of underinvestment in infrastructure.

Recent IPPR research has set out a blueprint for a far more ambitious investment bank, as outlined in the boxed text below.

IPPR's proposal for a British Investment Bank

This would be a state-owned bank that acts commercially. Its objectives would be to overcome the twin market failures identified above: a lack of long-term lending to SMEs and underinvestment in infrastructure. Each of these objectives would be dealt with by a different part of the bank, with SME lending taking place through a number of intermediaries, either high street banks or by appointing local agents through a competitive tendering process.

An initial one-off injection of start-up capital would be required. IPPR proposes this would come from the public sector, with £10 billion per year for the first four years raised through a combination of asset sales and borrowing. A one-off levy on the commercial banks could also provide some of the capital, although not the full amount needed.

Another – more radical – option would be to initiate a further round of quantitative easing (QE) to provide the bank with start-up capital. Some question whether it is sensible to mix monetary policy and measures to address long-term structural problems in this way, not least because as the economy returns to balance the Bank of England (BoE) will scale back QE but wouldn't be able to get back money that has been used to capitalise a bank.

The alternative would be for the BoE to capitalise the investment bank outside of the QE programme, which would be a substantial extension of its remit.

Either way, the initial capital would most likely only need to be earmarked for the bank and not actually spent, as this should be sufficient to enable the bank to leverage funds in the capital markets. This should be capped at a ratio of 2.5:1.

The bank would be subject to a rigorous scrutiny arrangement. As politicians must be accountable for the public funds spent by the bank, they will play a role; however, there must be absolute clarity about where the remit of the politician ends and that of the banker begins. A small board of governors, comprising relevant ministers and a small number of others, will set the strategic objectives of the bank and receive the annual report and accounts. They will play no role in day-to-day decision-making, which will be overseen by bankers.

Source: Dolphin 2012

The prospects for the establishment of a British Investment Bank are aided by similar initiatives in other areas – such as the establishment of the Green Investment Bank and Big Society Capital. However, it would require approval from the European commission to ensure it did not breach state aid rules, which would require the net benefit (or 'additionality') of the bank to be clearly demonstrated. However, given the clear market failures that exist in the areas the bank would operate in, this should be possible. Furthermore, as the European commission tends to favour measures that bring economic benefit to areas eligible for regional aid, building a regional element into the bank could assist with this process. The next section addresses how a British Investment Bank could be shaped to ensure it meets the needs of the North.

A regional dimension to the British Investment Bank

The danger for the North and the regions is that they are left out of the debate about a British Investment Bank, especially if it operates under the same tired economic modeling and investment methodologies and centralised ways of working that have so damaged the North over

recent decades. The North must be ready with its own proposals to show how a British Investment Bank can be made to address the twin market failures in the regions. One promising solution is for a British Investment Bank to have a regional structure.

There are a number of international examples that we can look to for inspiration here. The Nordic Investment Bank, established in 1975 by five Scandinavian countries, has a mandate of 'promoting the competitiveness of the member state economies' and promoting a better natural environment. It funds its activities via the international money markets, is triple-A rated, and in 2011 was able to raise over €3 billion on the capital markets. To give a flavor of its activities, in 2010 its investments included new rolling rail stock in Sweden, improvements to Finland's housing stock, and the design, building and opening of hospitals in Sweden. Such institutions are not only confined to broadly social democratic countries: in 2011, US president Barack Obama announced the establishment of an American national investment bank. But perhaps the best example to consider is the KfW in Germany.

Case study: SME lending and the KfW banking group

The KfW banking group is a German government-owned development bank, based in Frankfurt. Its name originally comes from *Kreditanstalt für Wiederaufbau*, meaning Reconstruction Credit Institute. It was formed in 1948 after the second world war as one aspect of the Marshall plan. The bank is owned by the federal republic of Germany (80 per cent) and the states of Germany (20 per cent), and is led by a five-member managing board which in turn reports to 37-member supervisory board chaired by the federal economy and technology minister. It receives funds from the federal budget as well as its own investments in the domestic and international capital markets.

KfW lends to SMEs (via intermediaries), although it also provides up to 50 per cent of investment in major projects including housing, infrastructure and environmental protection. Additionally, it finances telecommunications, transportation, energy infrastructure and other industrial projects around the world.

The KfW does not lend directly to enterprises or individuals – instead, it provides commercial banks with liquidity at low rates and long maturities. These banks then on-lend to SMEs. KfW loans are an extremely well established part of the German commercial and small-business landscape, and so are instinctively called upon by SMEs.

Nevertheless, the system is intricate, balancing risk and reward for the banks that partner with KfW and act as crucial intermediaries:

- the commercial banks levy the KfW with a modest charge for transactional costs
- the KfW underwrites most but not all of the risk: 70 per cent of a loan is financed by KfW and 30 per cent by the commercial bank
- the commercial bank has a commercial reason to offer the loan (a slice of the return on the loan)
- the commercial bank cannot lend irresponsibly merely as a way of levying charges.

The banks are part of the solution while also doing what they are designed to do: assessing risk and making a profit. The KfW benefits from banks' expertise in assessing risk and the banks benefit from a sustainable return.

During 2010, the KfW lent to 100,000 German families looking to purchase homes, made €6 billion available for infrastructure investment and helped create or secure 124,000 jobs (Carr 2012). Global Finance has rated the institution as the safest in the world.

It is worth noting that the KfW, the Nordic Investment Bank and the European Investment Bank, which operate on a similar basis, have never defaulted and have nearly always turned a profit. There would seem to be no intrinsic reason why a northern investment bank would not be able to do the same.

How would a British Investment Bank serve the North?

An investment bank must be able to respond to differences in the economic context in different parts of the UK, including the North. To ensure this happens, the bank must have clearly defined ways of working regionally.

As such, with regard to infrastructure investment, the British Investment Bank's start-up capital should be allocated to regions using a simple formula – perhaps combining population measures with a measure of economic potential. Exactly what this formula looks like should be established by an independent commission comprising representatives from different parts of the country. Essentially, the British Investment Bank should have a regional lending mandate.

However, this is not to say that it should work within the old geography of 10 English regions plus Scotland, Wales and Northern

Ireland. Indeed, to ensure lending can take place at scale and the that bank is able to have the impact intended, larger groupings make sense. This is why we argue for a *northern* investment capacity within a British Investment Bank, rather than one on any smaller geographic scale. It is for other parts of the UK to identify what scale is appropriate for their area.

There would be scope for this regional investment capacity and the northern investment vehicle (as set out above) to collaborate and jointly invest in major schemes where it is mutually beneficial to do so.

With regard to long-term lending to SMEs, the solution is relatively straightforward, as it is proposed that the bank would work through intermediaries – either existing banks or appointed regional agents. This element of the bank’s activity, then, will naturally be more local in its orientation.

The bank’s regional structure must also be reflected in how it is governed. Clearly, a governance structure needs to be put in place that draws a firm line between the work of politicians and that of bankers, who will make day-to-day investment decisions. The overall objectives of the bank will be the same across the UK – to overcome the twin market failures concerning investment in infrastructure and SMEs – and these will be set by the board of governors. However, there should also be space for high-level regional objectives to be added which are specific to different areas, for example to prioritise infrastructure and supply chain development to support the a key growth sector, such as offshore wind.

Assessing and recommending more nuanced, locally relevant objectives would be the job of an advisory council comprising local leaders, representatives of the devolved administrations, UK ministers and civil servants. They would be helped in this task by hearing evidence from technical advisory groups, one from each of the bank’s regions, with membership reflecting local economic development expertise. These groupings would together set the strategic direction for the bank’s investment priorities, and a separate supervisory board would scrutinise activity to ensure the bank’s objectives were being met.

5.3.4 Summary

With respect to new instruments and institutions, the commission recommends:

- **Greater use of municipal bonds by local authorities**, with added capacity to contribute to pooled issuances to enable investment at scale and on-lending for smaller projects.
- **The creation of a northern investment vehicle** capitalised by local authorities and local authority pension schemes in the North to raise finance to invest in northern infrastructure projects.

- **The creation of a British Investment Bank that is based upon a regional allocation of funds** made according to a formula that combines population with economic potential. This would earmark funding for the north of England, creating a northern investment capacity within the national investment bank. Its objectives would be to reverse underinvestment in infrastructure and long-term SME lending, with scope for northern leaders to add further high-level strategic funding priorities (although bankers will always make the day-to-day decisions on particular investment activities).

5.4 Fiscal decentralisation and a single pot for economic development

Relying exclusively on debt-based finance does not offer a secure foundation for northern growth. As such, the commission believes locally held revenue-raising powers and access to resources that can be deployed flexibly are both important.

Many regions and localities elsewhere in the developed world hold direct tax-raising powers. As explained above, in England this is much less the case. The challenge is that while LEP areas are the right geographical scale for decisions related to economic development (with most individual local authorities being too small), they lack the legitimacy to wield direct taxation powers. Indeed, local authorities are the only part of the subnational architecture with the legitimacy to be given taxation powers and the accountability to be responsible for significant public spending. Their involvement in LEP-level decisions about economic development is therefore essential.

The commission believes that local and central government needs to take shared responsibility for ensuring that LEP areas have the autonomy and resources to deliver on their plans by co-creating and co-contributing to a single pot for economic growth. This single pot could be formed from the bottom up, or from the top down.

5.4.1 Bottom-up

The ability of local authorities to contribute to a single pot is constrained by the deep budget cuts that have been passed to them and the lack of room for manoeuvre that stems from their dependence on the central government grant.

Local authorities that were more fiscally autonomous and held greater tax-raising powers could act as a conduit for funding to the single pot intended to support agreed LEP area strategic priorities. In such straitened times, any change would have to be fiscally neutral for the taxpayer (at least initially) with any subsequent decisions made about tax increases or decreases for negotiation between local elected leaders and their electorate. Research shows that local government can be

responsible for raising up to 50 per cent of its own revenue before equity concerns arise (ODPM Select Committee 2004). Currently, we are a long way from seeing this level of local revenue-raising powers in England.

The commission recommends that a 50:50 split should be our goal. This will provide local authorities with options for raising revenue besides debt-based finance.

The government has already set out reforms to business rates so that a proportion is retained locally and the proceeds of business rates growth are kept by local authorities. But these reforms alone do not create significant additional revenue-raising powers. To move towards achieving 50 per cent locally raised revenue, local authorities should have the power to set business rates to enable them to raise funds specifically for economic development. In recognition that this is a debate that makes businesses nervous, checks should be built into the system to ensure any increases are not excessive. This can be managed by restricting the amount business rates can be changed: any change that does not exceed RPI³⁸ plus half the size of the council tax increase would seem reasonable. The logic here is that it will prevent local authorities from imposing tax increases on businesses that citizens are not willing to bear (Sorabji 2006).

Furthermore, such a scheme needs to be balanced, with a tapering formula for equalisation. The taper should be designed in such a way as to ensure that no local authority loses out at the outset but that, as its business base grows, it depends increasingly on its own revenues.

5.4.2 Top-down

There is already tacit recognition that for LEPs to be effective they need funding. Already, the government has moved from saying LEPs should be self-financing to offering funding for capacity-building and research, giving them responsibility for Kick Start funding and making them pivotal to enterprise zones, and most recently providing them each with a small core budget of £250,000 for the next two years. But rather than ad hoc arrangements and scraps of Whitehall funding, northern sub regions need reliable and predictable funding arrangements.

The recent Heseltine review set out proposals for core funding for LEPs plus the creation of a single central pot comprising budgets currently held by Whitehall departments, which is then devolved to subregions (Heseltine Review 2012). The commission agrees with the thrust of these recommendations.

However, there is one key area where we part company. The Heseltine review recommends LEPs bid to the central single pot to secure five-year funding for their economic plan. The commission does not believe this approach will provide the stability and certainty needed to begin to

38 Which is currently used to calculate the regular uplift in business rates.

build truly powerful economic development institutions. Just as we do not expect the Scottish parliament or the mayor of London to bid for funding periodically, we should not make LEPs do this either.

Rather, while a central single pot for economic development should be created similar to the one recommended by the Heseltine review, subregions should be able to draw down from it an ‘economic growth settlement’. The only requirement should be for subregions to demonstrate that they have governance arrangements in place that will deliver accountability back to citizens, such as a combined authority. The amount of funding available to each area should be determined by a formula based on population and economic indicators. The allocation would be central government’s contribution to the subregion’s single pot for the spending review period.

As with the Barnett formula (which is used to determine the block grant made available to the Scottish parliament, Welsh assembly and Northern Ireland assembly), while the funding streams would emerge from particular Whitehall departments, subregions would have flexibility over how to spend their economic growth settlement. This arrangement will also provide places with greater certainty, enabling them to leverage further funding from other sources. A number of the city deals have seen cities take steps toward single pot funding, but greater certainty should be given to this process and more significant resources should be made available. As with Greater Manchester’s ‘earn back’ model, the proceeds of growth could be shared between the subnational and national levels. **This should be a key area for negotiation in the next spending review.**

The single pot should include both capital and revenue spending. We broadly endorse the single pot set out by the Heseltine review:

Function	Contribution
Skills	17,435
Local infrastructure	14,821
Employment support	5,466
Housing	6,800
Business support services	2,939
Innovation and commercialisation	1,611
Total	49,073

Table 5.3
Proposed division of single pot by functional spending area over four-year spending review period (£m)

Source: Heseltine Review 2012

However, there are two areas where we would diverge: transport and housing spending. As we argue in chapter 4, we propose the devolution of major capital funding for local transport infrastructure to PTEs. In 2011/12–2014/15, this amounts to £1.7 billion. However, there would be merit in this funding being included in the subregional single pot, subject to consultation with the PTE. In addition, we also argue that, at

the very least, PTEs should be co-signatories to regional rail franchises. Should they become full franchising authorities in future then the budget they are responsible for would grow further.

Chapter 4 also sets out a far-reaching reform of housing funding, with housing benefit and housing capital decentralised to create subregional housing funds. Given the radical nature of this recommendation, the commission argues that the funding should be ringfenced, at least initially. This means we would remove £4.5 billion in housing capital spend from Heseltine's single pot in order to merge it with the £80.2 billion projected housing benefit budget for England³⁹ for the same period in order to create the housing funds.

The commission believes that the amount of funding that should be the responsibility of subregions is significantly higher than the Heseltine review sets out. **For the 2011/12–2014/15 spending review period, we calculate central government's contribution to the subregional spending pot should be at least £129,272 million in England. There would be a further £84,699 million ringfenced for the subregional housing fund.** This should be further bolstered by the inclusion of EU structural funds, which amounted to €10.6 billion for the UK in the period 2007–2013, with the subregional single pot offering a source of match funding. It is important to note that we are not proposing additional public spending here – rather we are proposing to change who is responsible for existing public spending.

5.5 European structural funds

The next EU multiyear financial framework for 2014–2020 will have far-reaching consequences for regional development policy. It is important that the framework furthers the EU's move towards a more place-based approach to economic development and governance, with public interventions relying on local knowledge.

Following the Barca report (2009), the European commission is committed to increasing the involvement of local and regional authorities in operational programmes and bringing the priorities of the EU closer to citizens. For the 2014–2020 funding round, a common strategic framework has been developed within which each member state is bringing forward its own proposals.

As part of the Northern Economic Futures Commission's evidence-gathering process, we collated views from a wide range of stakeholders on the future of EU structural funds. We are keen to feed these into the government's decisions on what funding arrangements would be best for the country as a whole and, more specifically, for the northern economy. Most UK regions – including the North – will be categorised

39 According to Cooke and Hull (2012) projected housing benefit spend for Great Britain for 2011/12–2014/15 is £93.9 billion. As 85 per cent of housing benefit recipients live in England, we take this proportion of the projected total to arrive at this figure.

as ‘more developed’ regions, for which funding is not ringfenced geographically. There are, as a consequence, significant dangers that a national ‘business plan’ might reduce the emphasis currently given to pan-northern regional development in favour of investment in the south or in England generally. Such ‘spatially neutral’ national infrastructure policies have not typically been good for the North.

The commission argues that the following seven principles should be embedded in arrangements for EU funding for 2014–2020. We have refrained from suggesting a particular funding model, as we believe that the principles which underpin and guide the funding structure are more important than the structure itself.

- 1. Local areas or regions need to be involved at all stages of the funding process,** including in the development of the programmes, identifying priorities, deciding which projects and activities are to be funded, and determining how to deliver them. Localism must be real – if not, rather than galvanising communities, it can highlight and further disempowerment.
- 2. A place-based approach should be followed,** taking into account wider linkages and delivering public interventions that rely on local knowledge. Use of the structural funds is a key element in driving growth and rebalancing the economy. A place-based approach is essential for ensuring that economic growth is inclusive and that we are able to move beyond the myth that spatially blind policymaking is spatially neutral. The UK government needs to be kept to its commitment ‘to promote strong, sustainable and balanced growth that is more evenly shared across the country and between industries’ (HM Government 2011).
- 3. The EU structural funds must be seen as part of an integrated and holistic economic development strategy.** There has to be integration across all EU funds and between EU and domestic funds. While such an approach is sensible full stop, its importance is amplified in the current testing economic conditions.
- 4. Connectivity is a cornerstone of sustainable growth:** the north of England in particular needs to be viewed as an interconnected economic area of metro-regions. While it is diverse, the North has a shared history. Its recovery from devastating deindustrialisation has been held back by entrenched and longstanding structural problems which impact the whole of the northern economy. Connectivity is essential to the North fulfilling its economic potential.
- 5. Joint decision-making is critical.** The local evidence-base can help to guarantee that funding goes where it will be most efficient and effective, while national input is necessary to make sure that local priorities are maximising their contribution to national growth. Design, decision-making and delivery greatly benefit from increased

local input, but audit and risk management processes are better facilitated at a national level. Joint decision-making must be kept as simple as possible and be outcome-oriented.

6. **The range of European Investment Bank-approved financial instruments should be increased**, providing localities with the ability to pick and choose the suite of instruments which best suit their circumstances. The use of financial instruments can help to recycle funds and make the pot of available money go further.
7. **Funds should enable capacity-building and support research to deal with new challenges.** In an increasingly fast-changing world and inherently unstable economic times, the funds should help local areas to increase their knowledge base so that public interventions can better rely on local knowledge and thus be more successful.

Embedding these principles in the EU funding arrangements would help drive to regional economic development and to rebalance the economy.

6. INSTITUTIONS AND LEADERSHIP

This chapter addresses the recent disruption of economic development institutions caused by the abolition of regional development agencies (RDAs) and the introduction of local enterprise partnerships (LEPs). It calls for the improved governance and accountability of combined authorities and LEPs with a view to the growing decentralisation of powers, and makes a case for the importance of metro-mayors.

The chapter also considers the need for pan-northern collaboration and for the articulation of key northern priorities by a more coherent and consistent northern voice. As a first step in achieving this, it proposes an annual Northern Leadership Convention and an N11 Leaders' Summit.

The commission's work has focused on how to grow the economy of the north of England, to the benefit of the whole of the UK. In part, this is concerned with things the North can do for itself, based on the powers, resources and assets already held there. However, it also requires an analysis of the powers and resources central government currently wields, and how some of these should be decentralised. And any argument about the decentralisation of power and decision-making – especially around taxation – inevitably leads into a conversation about how the North is governed.

6.1 How is the North governed?

Instability and fragmentation

There has been considerable flux in how the North is governed. The Labour government's network of RDAs and unelected regional assemblies was responsible for managing considerable amounts of economic development and regeneration spending, and these local bodies were tasked with compiling economic development, planning, housing, transport and skills strategies for their areas. They were supported in this task by the Government Offices for the Regions – Whitehall outposts.

In the latter part of Labour's time in office, a city regional agenda – which had always run alongside the regional agenda – became more prominent. The publication of the *Review of sub-national economic development and regeneration* in 2007 highlighted the role of 'functional

economic areas' as the right scale for most economic development activity. Because it reflects the fact that the real economy has no respect for administrative boundaries, with travel to work areas, housing markets and markets for goods and services all stretching beyond and across the boundaries of individual local authorities, there is a general consensus that the city-region or subregion offers a reasonable approximation of the functional economic area in an English context (HM Treasury et al 2007, LGA 2007). As a result, most regions have developed subregional structures for economic development.

One of the first acts of the Coalition government was to abolish the existing regional architecture.⁴⁰ A number of RDA functions – such as inward investment, innovation and business support – were recentralised to Whitehall and new, voluntary partnerships in the form of LEPs were invited to form at the subregional level. These collaborations between local government and business are tasked with working with others to stimulate private sector growth in their area.

LEPs are very different beasts to the RDAs: while they are far less bureaucratic in form, and so potentially fleetier of foot, they are also drastically under-resourced and expected to operate, until recently, with virtually no central government funding (Schmuecker 2012). Furthermore, the current capacity of LEPs varies considerably from one area to the next, with the depth and extent of pre-existing relationships and partnership-working being a key factor.

A key challenge for these new organisations is how to navigate within a highly fragmented policymaking environment to develop a coherent economic development strategy. Table 6.1 sets out how major functions of Whitehall departments are delivered at the subnational level, the geography they adhere to, and whether or not local authorities are involved. This last point is of interest because their consistent involvement across activities might help to improve coordination.

Such instability and fragmentation is bad for economic development. And this is exacerbated by frequent changes in the ministers of state with responsibilities for these different departments. Research by the OECD has highlighted the importance of continuity and stability in building capacity, knowledge and relationships at the subnational level, thereby enabling improved coordination (OECD 2009, 2012). Detailed research into the factors important for economic growth in 23 'underperforming regions' (like those of the north of England) identifies 'institutional' and 'policy' factors as critical.

40 See <http://www.bbc.co.uk/news/10391326>

Table 6.1
How different
Whitehall
departments
deliver economic
development
functions

Whitehall department	Function	Works through...	Geography	Councils involved?
Business, Innovation and Skills	Economic development	LEPs	Subregional	Yes
	Skills	Skills Funding Agency	National / frontline	No
	Universities	Individual institutions	National / frontline	No
	Supporting policy delivery	BIS Local	Regional*	Yes
Communities and Local Government	Housing	Homes and Communities Agency	Regional	No
	Planning	Local authority collaboration	Local	Yes
	Regeneration	European Regional Development Funding Local Management Committee	Regional	Yes
Education	Education	Increasingly autonomous via growth in academies and free schools	Local / frontline	Increasingly no
Health	NHS	Foundation trusts	National / frontline	No
Home Office	Police	Police and crime commissioners (replacing Police Authority)	Subregional	Increasingly no
Transport	Metropolitan public transport	Independent transport authorities	Subregional	Yes
	Roading (other than local roads)	Highways Agency	National	No
Work and Pensions	Welfare-to-work (mainstream)	Jobcentre Plus	Local / Subregional	No
	Welfare-to-work (longstanding claimants and those with complex needs)	Work programme prime contractors	Regional	No

* BIS Local works across six regions in England, rather than the nine standard administrative regions.

Institutional and policy factors critical for economic growth

Institutional factors:

- The ability to mobilise key actors from across sectors – public, private and civil society – to play an active role in economic development.
- The existence of a clear vision for growth, and the ability of different actors to articulate a consistent and common voice and concern for the region.
- The continuity of economic institutions, programmes and decision-making processes.
- The existence of clear governance structures at different spatial scales and their ability to inter-relate vertically.

Policy factors:

- A changed mentality away from notions of subsidy and external intervention and towards growth potential and existence of endogenous factors.
- A focus on inter- and intra-regional linkages rather than simply the relationship between the central government and the region.
- A concern to ensure there are spillover benefits from economic development interventions.

Source: OECD 2012

Similar findings have also emerged from studies of regions within the same country (see for example Rodriguez-Pose 2000). Clearly, how areas are governed, along with the focus and attitude of policymakers, matters for economic development.

A clear and urgent message emerges: rather than repeatedly reorganising how the subnational level is governed, it is imperative that different parts of the north of England are allowed to develop and build upon the foundations of the partnerships that already exist – now at the subregional (LEP) level.

This is not to argue that there should be no change. The commission has set out powerful arguments for how continuing to devolve further powers to decision-makers in the North will support the northern economy to grow and to prosper. However, as further and increasingly significant decision-making powers are devolved, ensuring accountability back to citizens becomes increasingly important. The next section considers how the governance model for LEP areas could evolve over time to enable them to become truly powerful decision-making bodies.

6.2 Building on the foundations of city-regions

In short, it is time to stop fiddling around with boundaries. In the interests of sustainable institutions, the commission believes we should accept the LEP geography and build on these foundations. While the LEPs are not a perfect geographic match for the economic footprint of different places (see Tomaney et al 2012) they are not far off. And administrative boundaries are not prisons – where it is appropriate, different areas can, should and do work together.

It is right that different places are able to develop different, locally appropriate governance arrangements. However, this places significant responsibility on LEP areas to think about what their specific objectives, the powers they require, and the level of democratic accountability that goes along with it.

The North is already rising to this challenge, with several city-regions developing models for combined authorities. A combined authority is effectively a new authority for the city-regional area; it is a statutory authority in its own right, with decisions taken by its member authorities by majority vote (sometimes by two-thirds majority). These new institutions are able to receive instructions from their member authorities, on the one hand, and substantial economic development and investment powers from Whitehall on the other. In many cases, being part of a combined authority seems to have been reflected in the greater strength of the city deals that have been negotiated with Whitehall.

Over time, other models may emerge. For now, however, the combined authority is the model that best brings together the ability to take strategic decisions with a degree of democratic accountability, which in turn enables it to receive significant powers. Nonetheless, combined authorities must be mindful not to do away with the partnership element of the LEP model, which has implications for how they engage with business and other stakeholders.

Furthermore, there are two questions that need to be answered if combined authorities are to become the foundation for significant additional powers in areas like regional industrial strategy, directing skills spending to support economic development priorities, major investment decisions, and transport infrastructure investment and franchising – one is more practical, the other more of principle.

The practical issue is that combined authorities are currently run on a shoestring budget. They are staffed by officers who are seconded from local authorities or working part-time for both local and combined authorities, and overseen by politicians who still have to deliver all their other local commitments. As these bodies gain more substantial powers, the sustainability of this way of working will be called into question. On a purely administrative level, they need to be properly resourced.

The question of principle, however, is more challenging: what is the upper limit for combined authority powers, when these are bodies that are not directly, democratically accountable? Could a combined authority be in receipt of direct tax-raising powers, for example? The North must begin to map out how the combined authority model can evolve to assume a more directly democratic character. **The commission believes that a metro-mayor – or suitably titled rural alternative – who is elected by the people of an LEP area and who leads and is scrutinised by a combined authority would bring greater direct accountability and visibility to that body.** It recommends that local authority partners consider such options and that central government should legislate to make their adoption possible.

This level of clarity about ‘who to blame’ is also likely to give Whitehall greater confidence to decentralise. Moreover, a metro-mayor could be a significant figure on the national stage, wielding ‘soft power’ and able to give voice to the interests of their city-region in public debate and in Whitehall.

However, the recent history of referendums – from the elected regional assembly in the North East to the city mayor referendums of 2012 – must be heeded: if new democratic arrangements are not accompanied by a genuine offer of new powers, they will fail. If the government is serious about wanting local areas to be able to shape their economic futures, they must stand ready to decentralise significant additional powers to any area that proposes to establish a metro-mayor.

6.3 Northern voice

While individual LEP areas need to be given the tools to drive economic growth in their area, there are times when the individual component parts of the North find they have shared interests. There are a number of issues around which this might occur, such as:

- arguing for investment in inter-city connectivity to boost business links
- injecting a northern perspective into the debate about airports
- pushing the government to deliver a genuinely rebalanced economy
- constructing major investment packages for international investors
- marketing the north of England as a destination for tourism and business location.

On all of these issues, finding a common voice will deliver an impact that is greater than the sum of its parts.

This is important on both the national and international stage. On the national stage, the North is competing for resources with a range of more powerful actors – whether the mayor of London or the first minister of Scotland. Where common cause can be made, a more coherent northern voice that can represent the interests of its component

subregions will help to deliver impact. Internationally, acting in concert as ‘the north of England’ will provide scale in a way that acting as 11 individual places cannot.

It is crucial that the North is able to find a way of developing a more coherent voice.

6.4 Beyond ad hoc collaboration: the Northern Leadership Convention and N11 Leaders’ Summit

At present, action on pan-northern issues relies on collaboration between LEP areas and depends upon committed partners being prepared to look beyond their immediate self-interest. While such collaboration does take place, this occurs on an ad hoc basis: it is the exception rather than the rule. By relying solely on ad hoc arrangements, there is a greater risk that such collaboration simply fails to happen.

We do not detect support for a Council for the North, as others have suggested (Ward 2011). Instead, **the commission proposes a light-touch approach that can provide structure for and intelligence to northern collaboration: a Northern Leadership Convention and N11 Leaders’ Summit.**

Northern Leadership Convention and N11 Leaders’ Summit

In order to identify, prioritise and build a support around solutions to shared northern challenges and opportunities, we propose an annual Northern Leadership Convention. The convention’s discussions would be informed by a small secretariat, which would provide preparatory work to ensure conversations are evidence-based and focused on a small number of genuinely pan-northern issues. These issues would then be discussed by public, private and voluntary sector leaders from across the north of England, building on the work of other organisations that already have a predominantly or entirely northern focus, such as Core Cities, SIGOMA and N8.⁴¹ The convention would provide an inclusive forum for debate, discussion and the formation of cross-LEP partnerships – it is not intended as a representative body. As a high-profile regular fixture in the calendar, it would become a focal point for assessing northern progress.

To ensure the leaders convention is not simply a talking shop it would be followed by an N11 Leaders’ Summit, bringing together the LEP chairs with those political leaders chairing local authority groupings across each of the North’s 11 LEP areas. The summit would be action-oriented, focused on developing strategies,

⁴¹ See <http://www.corecities.com/>, <http://www.sigoma.gov.uk/sigoma/> and <http://www.n8research.org.uk/> respectively.

action plans and milestones to address the shared priorities identified during the convention. It would produce a succinct communique to identify priorities for the year ahead.

This would be a light-touch but structured way for northern leaders to act in concert. However, it would require local authorities, LEPs and other partners to be willing to fund the costs of the events and a small secretariat. It is proposed that the convention and summit are led by a 'northern chair', elected for a four-year period as a figurehead for northern interests and priorities and to offer the continuity and leadership that is so important. Should there be no consensus in favour of an elected role of this nature, then a rotating chair and vice-chair is proposed, similar to the EU presidency, to host the subsequent convention and summit.

We do not seek to outline or create a set of organisations and institutions that governs the North from one central place. Rather, these bodies would act as a clearing-house through which consensus on northern issues can be sought and joint actions planned. To provide a more tangible example, an obvious early candidate for promotion through the convention and summit would be the importance of renewable energy industries. This platform would allow for a shared northern position to be enunciated in the national debate – but this isn't simply about sending messages to policymakers in London. For instance, a practical action plan would be developed through the N11 summit to ensure the Northern Hub remains on track, to argue where appropriate for expanding the ambition of the Northern Hub plans (for example, to include electrification of the Middlesbrough, Scarborough and Hull spurs) and to identify northern resources and investment monies that can be leveraged in order to catalyse activity.

6.5 Northern Future Leaders Academy

Finally, **in order to support the development of future northern leaders, equipped with the broad range of skills required, we propose the introduction of a Northern Future Leaders Academy.**

The academy would take place on an annual basis for two weeks on either side of the Northern Leadership Convention. Hosted by a local university, it would bring together a small cohort of emerging leaders from across different sectors to engage in study and debate with experts in different fields of economic development.

7. CONCLUSIONS

In our introduction, we set out a vision that:

We believe that the north of England is capable of taking its place in the ranks of the most successful northern European economies, with competitive companies trading in global markets, a fully employed and well-skilled workforce, and strong civic leadership that supports growth and shared prosperity.

In our conclusion, we want to spell out in some more detail what this might look like.

What will the North look like in 2022?

The recommendations set out in this report together represent a coherent strategy for growth. Should such an approach be adopted, it is worthwhile to consider the impact these measures might have and to picture what the North might look like in 2022. We offer the following as a glimpse of what success could look like:

- If we can create 500,000 new jobs in the North then our employment rate will soar from the present 69.5 per cent to nearly 75 per cent by 2022, with as many as a quarter of these being good-quality jobs in growing sectors such as offshore wind, biohealth and the creative and digital sector.
- If we increase household wealth even to the OECD regional average then every household will be nearly £500 better off each year.
- If we double the number of advanced-level apprenticeships then 60,000 young people will get their foot on the ladder in careers which keep them in the North, working with satisfied local employers, and multiply local prosperity.
- If we engage employers in decisions about skills and training to meet the needs and priorities of their businesses then we could make our excellent northern universities net importers, rather than net exporters, of skilled graduates.

- On current projections, levels of entrepreneurial activity in the North will reach the England average of 970 businesses per 10,000 population in the coming decade, meaning the creation of 259,000 new businesses by 2022.
- If we halved the gap in exports per head compared with London and the south east we would create 63,000 new jobs in the top 20 exporting sectors alone.
- If the proportion of foreign direct investment into the North returned to the levels that existed prior to the abolition of the regional development agencies through a system of foreign direct investment that better understood the northern economy then it would support a further 122,600 jobs in the next decade.
- Through investment in the Northern Hub and transpennine electrification, we will be able to travel between Liverpool and Leeds in just 77 minutes – nearly 35 minutes faster than is the case today.
- With reduced air passenger duty for northern airports and a genuinely national aviation strategy, we could match German airport performance with twice the number of direct flights to China nationally and new direct routes to Beijing, Shanghai, Moscow and Sao Paulo from northern airports, as is the case out of Dusseldorf and Munich.
- If we double the amount we recycle then we can overtake Germany, which recycles 40 per cent of its household waste, creating jobs and wealth in the process and putting the North on the map as the greenest part of the UK.
- If we devolve housing benefits and a fair share of capital expenditure to northern city-regions then places like Greater Manchester and Leeds would control as much as £2.5 billion and £1.8 billion respectively to subsidise rents and address local housing issues.
- If we hold an annual N11 Leaders’ Summit, we will create a strong mandate for the same access to Downing Street and Brussels as is currently enjoyed by the Scottish first minister and the mayor of London.

7.1 Monitoring northern progress

To assist this process into the future, we have identified a variety of indicators against which the north of England can monitor its overall economic performance. These indicators include but go beyond simplistic notions of GVA or GDP growth and include both short-term and longer-term measures.

At a national level these indicators are arranged into categories:

- **economic performance:** competitiveness, investment, productivity, innovation, employment
- **environmental performance:** carbon emissions, protection of landscapes and biodiversity
- **quality of life and wellbeing:** economic equality, skills and education, community cohesion and health
- **resilience:** economic diversity, dynamism, connectivity and demographics
- **role:** distinctiveness, linkages and accessibility

In each of these categories, we have identified targets for the coming decade. (See annex 3 for details.)

Central to our vision is the idea that we look to other successful northern European economies for our benchmarks and not – as has historically been the case – to London and the south east. Comparisons between the North and the South in the UK continue to hold sway in the national imagination but in economic terms are not particularly meaningful. London operates a centre of global finance that is comparable with very few other regions in the world. It makes far more sense to compare the North with other European regions that have forged greater success out of similar histories.

To this end, we have identified a series of international indicators – arranged in similar categories to the national indicators – against which we can compare northern progress (see annex 3). But more importantly, we have used available data to identify a set of comparator regions, which are on similar trajectories to the North and against which some very rigorous comparisons can be made over time. These fall into two categories.

First, a series of NUTS1-level regions (larger regions, at the scale of the former northern regions) which, through a detailed quantitative cluster analysis, have been identified as sharing many similar characteristics with the North and as outperforming the North in terms of GDP per capita. (See table 7.1).

Second, a series of NUTS2-level city-regions which, through a more qualitative analysis, have been chosen for their particularly impressive and successful approaches to driving regional growth. (See table 7.2; further details of each are included in annex 4.)

The commission recommends that its two indicators sets and the NUTS1 comparator regions are adopted as pan-northern benchmarks for reporting and discussion at the annual Northern Leadership Convention.

The commission advocates that northern LEP areas consider the NUTS2 comparators in their development of local economic strategies.

Table 7.1
NUTS1 comparator regions

Region	Country
Bassin Parisien	France
Este	Spain
Nord-Pas de Calais	France
Région Wallonne	Belgium
East of England	United Kingdom
South West	United Kingdom
Sachsen	Germany
East Midlands	United Kingdom
Brandenburg	Germany
Mecklenburg-Vorpommern	Germany
Sachsen-Anhalt	Germany
Thüringen	Germany
Noroeste	Spain
Região Autónoma da Madeira	Portugal
West Midlands	United Kingdom

Table 7.2
NUTS2 comparator city-regions

Region	Country	Chosen for...
Asturias	Spain	OECD's focus of comparison with the North/Manchester
Brandenburg	Germany	Determined national strategy and motivated subnational strategies
Lille (Nord-Pas de Calais)	France	Decentralisation from a dominant core city (with Paris as a unique comparator for London)
Nordrhein-Westfalen	Germany	A polycentric industrial region
Øresund (Malmö-Copenhagen)	Denmark	Importance of connectivity between cities in driving economic restructuring after deindustrialisation
Zuid Netherlands	Netherlands	Recovery from a difficult economic shock in key industries

7.2 Tackling poverty and disadvantage

Throughout our report we have identified that both absolute and relative poverty pose significant risks to the general prosperity of the North. There is a danger that a pan-northern strategy glosses over so-called 'pockets of deprivation' and areas of peripherality and disadvantage in its thrust for growth in the core cities.

Many commentators point to a trade-off between raising productivity through an emphasis on high-growth business and innovation and the jobs-rich growth that is traditionally associated with manufacturing and many service-based sectors.

While these are very difficult challenges, we believe a number of the recommendations in our report seek to reconcile the tensions involved in pursuing growth.

- We have emphasised the importance of full employment as our very first recommendation and we have repeatedly highlighted the potential that exists not only within key high-growth sectors – important as they are – but in a number of service-based sectors and through the construction and engineering activities associated with our proposals for investment in transport infrastructure and housing. We have also emphasised the importance of job quality, skills utilisation and the living wage.
- Our recommendations on skills policy highlight the importance of apprenticeships for younger people, skills plans that will enable city-regions to target particular groups and link them to emerging job opportunities, and the co-commissioning of welfare-to-work programmes to enable joined-up approaches to addressing worklessness.
- We have highlighted the importance of SME growth in giving unemployed people their first step onto the employment ladder.
- We have proposed radical changes to housing funding to enable city-regions to find fresh approaches to rent subsidy, tied very closely to building more affordable homes.

While our approach has emphasised the primary importance of economic growth of all kinds, we believe that these particular measures will go a long way to ensuring that our proposals reverse rather than exacerbate levels of inequality and disadvantage.

7.3 Cross-cutting themes

There are a number of cross-cutting themes that run through this report which deserve to be drawn out as guiding principles for our strategy and through which we can usefully summarise many of our recommendations. These are **vision**, **autonomy**, **collaboration** and **investment**.

7.3.1 Vision

There is much in our strategy that is about creating a vision for economic growth in the North. This is far from an abstract exercise or an ephemeral concern: it is about clarifying the direction and purpose of the northern economy in order to inspire business confidence and drive public and private investment.

Significant parts of that vision must be driven by the North itself. Our recommendations for the adoption of a clear set of indicators and comparator regions to chart our progress towards achieving a more productive, innovative and resilient economy represent an important step in that regard – other aspects include:

- our call to private sector businesses to create half a million good-quality jobs in the next decade
- the drive for a northern innovation agenda
- our focus on the North as a future global leader in house-building and renovation technologies.

Central government as well needs a much clearer vision for regional economic development – to this end we have called for:

- the development and adoption of a series of place-based principles to underpin all aspects of economic policymaking alongside a Mapping the Future programme
- clearer recognition of the value of the North's natural assets
- a truly national aviation policy framework, with Manchester airport as the nation's second international hub
- a more proactive stance on enabling a multi-modal approach to UK ports and logistics
- more sophisticated targets and monitoring in relation to foreign direct investment.

7.3.2 Autonomy

If the North is to realise this vision, it also requires the autonomy and capacity to do so. Despite the rhetoric of localisation and decentralisation – and a few tentative steps in this direction – the closure of the RDAs and a lack of finances to match decentralised powers have limited the ability of all but a few areas to harness the benefits of this agenda. In order to make rapid progress we have proposed a range of measures.

Within LEP areas:

- much greater responsibility for LEPs to link up skills, employment and growth
- a well-skilled population that is able to adapt to changing labour market conditions and respond to the demands of businesses, and where businesses take the 'high road' to growth by valuing, investing in and using the skills of their workforce
- the development by LEPs of a more intelligence-led and diverse approach to identifying and developing their sectoral strengths, with specific consideration given to export opportunities
- the handing of additional powers to LEPs, combined authorities and PTEs over regional rail franchising and the collective formation of a new strategic body, Transport for the North

- directly elected metro-mayors – and appropriately named rural equivalents – to offer economic leadership for LEP areas, scrutinised by more powerful combined authorities.

Equally, central government must be prepared to let go still further, by:

- giving LEP areas much greater control over skills funding and decision-making
- giving PTEs similar powers to those of Scotland, Wales and London in relation to rail franchising
- giving local and combined authorities greater autonomy and revenue-raising powers through the creation of a ‘single pot’ for economic development and proper localisation of business rates
- creating a British Investment Bank with regional structures to invest in infrastructure projects and provide SMEs with access to finance.

7.3.3 Collaboration

One clear message from the evidence that the commission received was that further changes to the architecture of economic development must be avoided. For this reason, the commission has identified LEP areas – along with their various partners in LEP boards, combined authorities, local authorities and other public agencies – as the principle focus for local economic development. The commission is not keen to create new structures and bodies except where absolutely necessary.

In places, however, it is clear that the abolition of regional structures has left gaps in this architecture. In these gaps, the distance between national and local institutions is too wide and so strategic coordination and collaboration needs to take place at a mezzanine or ‘pan-northern’ level. To this end, the commission proposes three pan-northern bodies:

- Northern Innovation Council
- Northern Investment and Trade Board
- Transport for the North

These agencies would come together – along with LEPs, combined authorities and other business and third sector leaders – at a proposed Northern Leadership Convention and N11 Leaders’ Summit on an annual basis. They would also work closely with each other in relation to the proposed northern investment vehicle and the northern aspect within the British Investment Bank.

7.3.4 Investment

Recognising the austere times in which we live and the environment of fiscal constraint that lies ahead, the commission has avoided making recommendations that rely on massive public investment.

Instead, it has proposed ways in which public funding can be used to promote northern economic growth and identified new sources of private investment which could be more effectively mobilised.

Some of the highlights in this respect include:

Table 7.3
Investment
proposals and
costs to the public
purse

Proposal	Cost to taxpayer
£1 billion innovation endowment for the Northern Innovation Council	Paid for out of receipts from the sale of the 4G spectrum and sustained through returns on investment
Shifting FDI capacity into the local system	No additional cost
Payments and transfer mechanisms in relation to northern natural assets	No overall additional cost; potential to rebalance costs between south and north
New system of transport appraisal	No overall additional cost; potential to rebalance costs between south and north
Overhaul of railway subsidy	No overall additional cost; potential to rebalance costs between south and north
Reduced air passenger duty at northern airports	Will pay for itself over a five-year period through increased demand and wider economic impacts
New approaches to housing analysis and appraisal	Minimal costs
Subregional housing fund pilot scheme	No additional cost
Housing innovation zones	Will pay for itself over a five-year period through increased demand and wider economic impacts
Pooled municipal bonds	No additional cost
Northern investment vehicle	Capitalised through local authority pension schemes and local authority reserves
Northern capacity within British Investment Bank	Funded through existing British Investment Bank proposal
Principles for EU structural funding, 2014–2020	No additional cost

Vision, autonomy and capacity, collaboration and coordination, and investment will be the four cornerstones of northern success. Without each of these operating effectively we can expect little change from the status quo: a north of England that is ever-more needy, relying upon the redistributive effects of central government grants and the welfare system, and an ever-more congested London, where growth and dynamism fall away as investors turn to mid-sized cities overseas with less inflated land and labour values, more sustainable investment returns and a better quality of life.

Yet if these four themes are embraced and applied then the benefits can be great: a north of England that drives forward a new, modern economy which is rich in jobs and skills and once again at the cutting-edge of technological, economic and social change, a North that plays its full role in driving national economic resilience and prosperity, pays its way in the nation and takes its place at the forefront of global economic transformation.

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ANNEX 1

SUMMARY OF RECOMMENDATIONS

Our 12-point plan

Jobs and skills

- 1: Full employment must be the foundation of prosperity in the north of England. In the next decade, we should aim to increase private sector employment by 500,000 in the North, on the way to a long-term goal of an employment rate of 80 per cent (ages 16–64).
- 2: The National Apprenticeship Service and its partners should aim to double the number of young people in advanced (level 3) apprenticeships by 2015 from 30,000 to 60,000. This implies shifting funding out of intermediate apprenticeship places for the over-25s and a major expansion of pre-apprenticeship training programmes in northern FE colleges. Learning from social partnerships elsewhere in northern Europe, the commission also advocates the development of local apprenticeship hubs or associations that bring together employers, training providers and trade unions to plan and deliver apprenticeship places.
- 3: Drawing upon evidence from places like Michigan in the United States, Brandenburg in Germany and the south Netherlands – where more localised approaches to skills policy have delivered excellent results – we recommend the devolution of a significant proportion of skills and welfare-to-work funding to local authorities and their partners in city-regions such as Greater Manchester and West Yorkshire, as well as other LEP areas.

Innovation

- 4: To support and galvanise business innovation and growth in the North, we recommend the formation of a Northern Innovation Council, bringing together leading universities, employers and local authorities. It should be endowed with £1 billion of the proceeds of the sale of the 4G spectrum for investment in university-business collaboration, applied research and innovation support, and particularly in the development of a small number of its own ‘Catapult Plus’ centres.
- 5: To secure higher levels of inward investment to the north of England and boost its export capacity, we propose the formation of a Northern Investment and Trade Board tasked with developing a small number of key trade and investment priorities for the North at a significant scale and improving coordination between local authorities, LEPs and UKTI sector specialists.

Other recommendations

- i. The commission commends initiatives to support the living wage.
- ii. In order to improve the North’s ability to retain graduates, the commission recommends a greater focus on building links between universities and local employers and the promotion of more mature and part-time study.
- iii. LEPs must continue to build up and refine their intelligence on which subsectors they see key to their subregion’s future growth prospects, to be more aware of the threats that exist in particular sectors from overseas competition, and to develop a good balance and spread of growing subsectors.
- iv. The commission believes that the North is currently endowed with a number of key strengths on which to build a northern innovation agenda and recommends a group of key principles that should guide an approach to innovation and business growth in the North.
- v. The commission has concluded that there are a number of key issues which need to be addressed in relation to foreign direct investment, including shifting capacity into the local system, changing behaviours through the target and monitoring system, and building collaboration at a wider scale.

Small and medium-sized enterprises

- vi. The commission recommends that entrepreneurship is identified as a key theme in the current negotiations concerning future use of EU structural funds.
- vii. We recommend that LEPs review business support in respect of social enterprises, ethnic minority-led businesses, rural businesses and female entrepreneurs in particular to ensure any deficiencies in service provision are addressed.
- viii. We therefore recommend that LEPs give increased attention to maintaining a relationship with firms after start-up and also reach out to enterprises that have not received start-up assistance, with the aim of reducing business failure. We recommend that local business failure rates are included as a metric in LEPs' management reporting.
- ix. We recommend that LEPs take the lead in developing targeted services to address five key competence gaps in medium-sized businesses: developing management capability, harnessing talent (recruitment and specialised external advice), designing and implementing the right financial strategy, innovating, and exporting.
- x. We endorse the CBI proposals that UKTI take more medium-sized businesses on trade delegations.
- xi. The commission recommends that a scheme should be explored whereby professional services firms discount their fee rates in return for introductions to 'gazelles', which could be their high-growth clients in the future. Consideration could also be given to the possibility of further reducing the cost to SMEs by government match-funding this discount.
- xii. We recommend that government should revisit the reporting requirement associated with universal credit and look at how to make it work better for the self-employed. This could include providing the self-employed with more flexibility as to when they make use of universal credits throughout the financial year.
- xiii. We recommend that LEPs should support schools in the North to follow Wales' lead and better instil, in a more formal and comprehensive way, an entrepreneurial culture within our future workforce.
- xiv. We recommend that LEPs consider ways of promoting the NEA scheme through locally appropriate channels.

Natural assets

- xx. We believe that the potential of the North should secure strong recognition in the programmes flowing from the natural environment white paper and ensure that future policy realises the benefit of these assets to the North.
- xvi. The new market relationships and payment regimes being introduced by the government in areas such as water and energy to promote investment in supply and transform payment mechanisms from consumers must not disadvantage consumers in the North through short-term subsidies for users elsewhere.
- xvii. We also need stronger evaluation of the value and potential of ecosystem supplies and investment into key technologies.
- xviii. We believe that an increasingly functional approach should be taken to policy and analysis of natural assets that understands the issues within, and flows and linkages between, rural and urban territories.

Transport

6: We recommend a major decentralisation of transport powers to local authorities and PTEs, including powers over regional franchising, concessionary fares and management of local stations. We also propose the creation of a new body – Transport for the North – to take power over the northern rail franchise, major hub stations, rolling stock and smart ticketing. In due course, we propose extending TfN's powers to bus regulation and highways Agency responsibilities, so that integrated planning of transport across car, bus and train travel is made possible.

7: In order to address national airport capacity concerns and expand connections between the north of England and key export markets, Manchester Airport should become a second international airport hub for the UK. Just as in Germany, France, Spain and many other European countries, there is no good reason why the UK cannot support more than one international hub airport outside its capital city. To stimulate demand for flights out of the North, we propose a reduction in the rate of air passenger duty at northern airports to the lowest levels (band A) for all flights for an initial period of three years. Such a reduction will quickly be compensated for by the tax revenues generated by jobs and business growth.

ix. The commission advocates the introduction of a new system for transport appraisal within the current parliament to place much greater emphasis on long-term economic benefits across the country rather than shorter-term user benefits.

xx. The commission recommends a fundamental overhaul of the rail subsidy system.

xxi. The commission recommends that government ends its preoccupation with south east airport capacity and brings forward a truly national aviation policy framework that identifies the opportunities that exist for the better use of northern airports.

xxii. The commission recommends a more coherent national approach to ports and logistics development which integrates container freight with access to road, rail and more local distribution centres.

xxiii. The commission recommends a clearer commitment by government to offshore wind development, which could trigger a further resurgence of the ports along the North East coast.

Housing

8: We recommend the decentralisation of housing finance – housing benefit and capital funding for building homes – into subregional housing funds. Local authorities, individually or as combined authorities, would be able to switch spending from rent subsidies into building new homes, strike deals with local landlords over rent levels, and plan more systematically to meet their local housing needs. We estimate that this would transfer at least £13 billion a year out of Whitehall into the three northern regions and as with other similar initiatives could go some way to tackling poverty and disadvantage. As a first step, we propose a small number of subregional housing fund pilots are established as part of further waves of city deal agreements.

xxiv. The commission recommends that new approaches to housing analysis and policymaking are developed and adopted which – as with transport infrastructure appraisal – are better able to understand the wider and longer-term economic benefits of housing investment and account for them in scheme appraisal.

xxv. The commission recommends that the north of England builds on these initiatives and seeks to become a global leader in house-building and renovation technologies. To support this aim, the commission proposes the designation of housing innovation zones.

Spatial planning

xxvi. The commission is therefore proposing the development and adoption of place-based principles into the UK's national economic approach, which should inform and guide evidence-based policymaking and investment decisions across central and local government.

xxvii. Alongside these principles, the government should develop a 'Mapping the Future' programme setting out its broad approach in key areas such as population, water, land use and the role of places, energy production and transport. These should not be command-and-control plans but statements of vision and direction which can guide and shape public and private policymaking and investment.

Finance and investment

9: We support the creation of a British Investment Bank, capitalised with £40 billion nationally, but we recommend a regional allocation of funds made according to a formula that combines population with economic potential. This would ringfence funding for the north of England, creating a northern investment capacity within the British Investment Bank. Its objectives would be to reverse underinvestment in infrastructure and long-term SME lending, with scope for northern leaders to add further high-level strategic funding priorities (although bankers will always make the day-to-day decisions on investments).

10: We recommend the formation of a single funding pot for economic growth in LEP areas comprising significant central government budgets that have been decentralised according to a clear and transparent formula. Government's contribution should include economic growth, skills, infrastructure, housing, employment and business funding, which would amount to at least £129,272 million in England for the 2011/12–2014/15 period. There would be a further £84,699 million ringfenced for the regional housing fund. This is not additional spending; rather, it is a change to who is responsible for existing public spending. Over time and in conjunction with a tapering equalisation formula, the single pot would be added to by a significant increase in locally raised revenues, through a more simple and radical localisation of business rates.

Institutions, indicators and monitoring

11: The commission advocates the development of more-transparent governance arrangements, based on the combined authority model pioneered by Greater Manchester and Leeds city-region but with a greater regard for more direct democratic accountability. We therefore recommend consideration of directly elected 'metro mayors' across LEP areas alongside suitably named rural alternatives and that government should legislate to make their adoption possible.

12: As a first step in a process of establishing a more clear and coherent northern voice, the commission proposes a Northern Leadership Convention to be held on an annual basis and supported by a small secretariat, followed by an N11 Leaders' Summit, comprising one political and one business leader from each of the 11 LEP areas in the North. The summit would be action-oriented, developing strategies and plans to address the shared priorities identified during the convention. And it would be headed up by a northern chair, elected at the summit to serve for a period of four years, or alternatively a chair and vice-chair to rotate between LEP areas on an annual basis. The convention would also host an annual Northern Future Leaders Academy.

xxviii: The commission challenges local authorities in the North to club together to create a northern investment vehicle which will enable the joint issuance of bonds.

xxix: We propose the creation of a Northern Investment Fund capitalised by local authorities and local authority pension schemes in the North to raise finance to invest in northern infrastructure projects.

xxx: The commission argues that the arrangements for EU funding for 2014–20 should follow seven key principles as set out in this report.

xxxi: The commission recommends that its two indicators sets and the NUTS1 comparator regions are adopted as pan-northern benchmarks which can be reported on and discussed at the annual Northern Leadership Convention. And the commission advocates that northern LEP areas consider the NUTS2 comparators as worthy of further consideration as they develop local economic strategies.

ANNEX 2

EVIDENCE TO THE NORTHERN ECONOMIC FUTURES COMMISSION

Written evidence was received from:

- Arts Council
- Blackburn with Darwin Council
- Bradford City Council
- Campaign for National Parks
- Campaign to Protect Rural England
- Centre for Enterprise and Economic Development Research, Middlesex University
- City of York Council
- Commission for the New Economy, Greater Manchester
- Cumbria County Council
- CURDS, University of Newcastle
- Doncaster Council/Doncaster Chamber of Commerce
- Federation of Small Businesses
- Future Shaping Ltd
- Gateshead City Council
- Gradcore
- Involve, Yorkshire and Humber
- John Brown (individual)
- Leeds Business School
- Leeds LEP/City Council
- Liberalato Engines
- Manchester Commission for the New Economy
- Michael Knowles (individual)
- Middlesbrough Council
- N8 Research Partnership
- North East Chamber of Commerce
- North East Combined Transport Activists Roundtable (NECTAR)
- North East Councils
- North East Farmers Market
- North Eastern Third Sector Focus Group on Skills and Performance
- North Yorkshire Council
- Northern Rock Foundation
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- North East Councils
- North East Farmers Market
- North Eastern Third Sector Focus Group on Skills and Performance
- North Yorkshire Council
- Northern Rock Foundation
- Northumberland Council

- January 2012, York
 - No witnesses; discussion of interim report
- February 2012, Sheffield
 - Jim Steer, Steer Davis Gleave
 - Matt Brunt, Passenger Transport Executive Group
 - Ann Pittard, NEFC commissioner
 - Jo Boaden, Northern Housing Consortium
 - John Tomaney, CURDS, Newcastle University
 - John Mothersole, NEFC commissioner

Further commission meetings have taken place as follows:

- May 2012 – Manchester
- June 2012 – Liverpool
- July 2012 – Preston
- September 2012 – Newcastle

ANNEX 3

INDICATORS AND TARGETS

A3.1 National indicators

1A. Economic performance: agglomeration, competitiveness, investment, productivity, innovation, employment

Indicator	Measure	Source	Publication lag	Comparability	North*	UK*	Target
Unemployment	ILO unemployment rate	Labour Force Survey	6 weeks	All EU regions	9.7	8.3	Convergence with UK (currently -1.4 % points)
Earnings distribution	Median wage	ASHE	6 months	UK regions	£460.51/wk	£500.70/wk	Convergence with UK (currently -£40 per week)
Competitiveness / innovation	Annual growth in number of enterprises	Business Demography	1 year	UK regions	-3%	-2%	2%

* Most recent data

1B. Environmental performance: carbon emissions, protection of landscapes and biodiversity

Indicator	Measure	Source	Publication lag	Comparability	North*	UK*	Target
Waste**	Municipal waste	ONS	1 year	UK regions	0.57	0.47	Maintain annual decrease of 3%
CO ₂ emissions	kgCO ₂ emitted	DECC	1 year**	UK regions	8.29	7.36	Maintain annual decrease of 5%

* Most recent data

** England

*** Not currently published

1C. Quality of life and wellbeing: economic equality, skills and education, community cohesion and health

Indicator	Measure	Source	Publication lag	Comparability	North*	UK*	Target
Subjective wellbeing	ONS measure	ONS	1 year	UK regions	7.38	7.39	Score above UK average (currently -0.01)
Crime rate**	BCS crime rate	ONS	3 months	UK regions	74	75	Below 70
High skills	Percentage of workforce NVQ4 qualified	Labour Force Survey	6 months	UK regions	31.8%	35.8%	Close gap with UK average (currently -4 % points)

* Most recent data; ** England

1D. Resilience: economic diversity, dynamism, connectivity and demographics

Indicator	Measure	Source	Publication lag	Comparability	North*	UK*	Target
Demographic balance	Support ratio (number of working people per retired person)	ONS	1 year (?)	UK regions	3.96	3.99	4.00

* Most recent data; ** England

1E. Role: distinctiveness, linkages and accessibility

Indicator	Measure	Source	Publication lag	Comparability	North*	UK*	Target
Geographical connectedness	Number of inter-city rail/air journeys to and from the North	DfT	1 year	UK regions	58,635	393,335	Annual growth rate over 5%
Online connectedness	Percentage of households with internet access	ONS	3 months	UK regions	80%	80%	100%

* Most recent data; ** England

A3.2 International indicators

2A. Economic performance: agglomeration, competitiveness, investment, productivity, innovation, employment

Indicator	Measure	Source	Publication lag	Comparability	North*	International comparator	Source*	Target
Unemployment	ILO unemployment rate	LFS	6 weeks	OECD regions	8.67	8.08	OECD median (2010)	Below OECD median
Unemployment	ILO unemployment rate	LFS	6 weeks	OECD regions	8.67	8.08	OECD median (2010)	Below OECD median
Household income	Household income per capita	OECD	>4 years	OECD regions	15,918	16,436	OECD median (2005)	Above OECD median

* Indicators refer to NUTS1 regions; calculated on available data so average/median figures may not take into account all OECD or EU regions

2B. Environmental performance: carbon emissions, protection of landscapes and biodiversity

Indicator	Measure	Source	Publication lag	Comparability	North*	International comparator	Source*	Target
Green space	Percentage of land covered by woodland	Eurostat	>2 years	EU regions	10%	33%	EU median (2009)	Maintain at 10%
Waste	Percentage of waste recycled	Eurostat	>2 years	EU regions	24%	21%	EU average (2008-2009)	Increase to 30% (Ger avg = 40%)

* Indicators refer to NUTS1 regions; calculated on available data so average/median figures may not take into account all OECD or EU regions

2C. Quality of life and wellbeing: economic equality, skills and education, community cohesion and health

Indicator	Measure	Source	Publication lag	Comparability	North*	International comparator	Source*	Target
Low skills	Percentage of workforce with only basic education	OECD	>2 years	OECD regions	23.17%	21.39%	OECD median (2008)	Below OECD median
Life expectancy	Life expectancy	Eurostat	>3 years	EU regions	79.5	80.3	EU median (2009)	Above EU median

* Indicators refer to NUTS1 regions; calculated on available data so average/median figures may not take into account all OECD or EU regions

2D. Resilience: economic diversity, dynamism, connectivity and demographics

Indicator	Measure	Source	Publication lag	Comparability	North*	International comparator	Source*	Target
Innovation	Patent applications per million inhabitants	European Patent Office	>2 years	All EU regions	49	53	EU median (2008)	Above 75 (EU 60th percentile)
Ageing population	Working age population as percentage of the total population	Eurostat	>2 years	OECD regions	65.95%	67.46%	OECD average (2008)	Above OECD average
R&D intensity	R&D expenditure as percentage of GDP	Eurostat	>3 years	EU regions	1.08%	0.76%	EU median (2009)	Above 1.28 (EU 75th percentile)
Economic dynamism	Employment in high-tech sectors	Eurostat	>2 years	EU regions	3.72%	3.90%	EU median (2008)	Above 5 (EU 75th percentile)

* Indicators refer to NUTS1 regions; calculated on available data so average/median figures may not take into account all OECD or EU regions

2E. Role: distinctiveness, linkages and accessibility

Indicator	Measure	Source	Publication lag	Comparability	North*	International comparator	Source*	Target
Online connectivity	Percentage of households with access to broadband	Eurostat	>1 year	EU regions	78%	74%	EU median (2011)	100%

* Indicators refer to NUTS1 regions; calculated on available data so average/median figures may not take into account all OECD or EU regions

ANNEX 4

FURTHER DETAILS OF INTERNATIONAL COMPARATOR REGIONS

Asturias

Densely populated, and characterised by three strongly linked cities surrounded by natural hinterland, the region of Asturias is located in northern Spain, with a population of 1.1 million.

Asturias has experienced ongoing economic restructuring since the 1980s, with the decline of its mining and manufacturing sectors and the opening up of its markets following Spain's integration into the European Union. Both of these changes have led to significant economic, social and cultural challenges.

As well as modernisation of its more traditional industries, Asturias has experienced strong growth in both business services and agriculture in recent years. It has seen particular improvement in the quality of its labour market performance and skills and in investment in its infrastructure. It continues to face challenges in its innovation performance and levels of enterprise.

Brandenburg

Reunification of Germany in 1990 led to significant structural change across the former East German regions over two decades. The merger of the currencies and the demise of government enterprises had significant impacts on Brandenburg with production falling by 30 per cent in one month alone, and the loss of almost 1 million jobs in industry and 0.3 million jobs in mining and agriculture. Wider impacts included a loss of training opportunities, population decline and outward migration.

Brandenburg, which includes five smaller areas, is home to about 2.5 million inhabitants, or 3 per cent of the German population, and borders Poland to the east and four other German regions. A key economic relationship is with Berlin, located at the heart of the regions. Berlin is home to 3.4 million inhabitants itself and the two are strongly linked. Brandenburg is a polycentric region in its own right, but can be understood as part of the wider hinterland for the core of Berlin.

Since 2005, under the theme 'strengthening strengths', Brandenburg has been following an integrated approach to supporting innovation, SME development and sustainable economic development, which has focused on 15 'growth poles' covering 26 cities and municipalities. A particular focus has been on its labour force by supporting low-skilled workers into jobs and investing in a range of institutions promoting higher level skills.

Lille (Nord Pas de Calais)

The region has a population of around 4 million, representing 6.5 per cent of the national population of France. It is located in the north of France adjoining Belgium to its north and the region of Picardie to its south. At the heart of the region is Lille, a city of 1.5 million people and one of the main hubs for the channel tunnel and ferries. Smaller towns and cities and a small rural community are arranged around it.

The region has been undergoing a difficult shift towards a services based economy following the decline of traditional textile, coal, iron and steel industries which has been encouraged by the opening of the channel tunnel in 1994, with high-speed links to Paris and Brussels. These factors have seen the modernisation and expansion of the Lille city-region, which is expected to continue as further investment both internally and to connecting centres is likely. Recent decentralisation trends in France, transferring economic and planning powers to the subnational level, have helped to reinforce this development.

Nordrhein-Westfalen

Nordrhein-Westfalen (North Rhine-Westphalia) is the largest state of Germany with a population of 18 million. It includes four of the country's 10 largest cities: Köln, Düsseldorf, Dortmund and Essen. Formed in 1946 as a merger of the northern Rhineland and Westphalia, it is centred around the polycentric Rhine-Ruhr metropolitan region, which includes the industrial Ruhr region

In the 1950s and 1960s, Westfalen was known as Land von Kohle und Stahl (the land of coal and steel) and the Ruhr was one of the most important industrial regions in Europe. The region faced repeated crises from the 1960s, which led to contractions of these primary industries. However, producing sectors, particularly in mechanical engineering and metals, experienced substantial growth. Despite this structural change and an economic growth which was under national average, the region's GDP of €529.4 billion in 2007 (21.8 percent of total German GDP) made it the economically most important in Germany, as well as one of the most important economic areas in the world.

Of Germany's top 100 corporations, 37 are based in Nordrhein-Westfalen. The region attracts investment from both Germany and abroad. In 2009, the state had the most foreign direct investment (FDI) anywhere in Germany. Around 13,100 foreign companies from the most important investment countries control their German or European operations from bases in NordRhein-Westfalen.

There have been many changes in the economic structure in recent years: employment in the creative industries and professional and financial services has increased and traditional industrial sites have been converted as workplaces for designers, artists and the advertising industry. Many of the smaller and rural parts in the eastern part of the state have built more niche industries, or have maintained a thriving agricultural and farming sectors.

On a per capita base, however, Nordrhein-Westfalen remains one of the weaker among the western German states, with continuing high levels of unemployment.

Øresund (Malmö-Copenhagen)

The Øresund region is centred on the Danish capital city of Copenhagen and the Swedish city of Malmö, located on each side of the Øresund strait and connected by the Øresund bridge. The region has a population of 3.8 million.

Traditionally a hub of shipbuilding and manufacturing, Malmö experienced a difficult industrial restructuring between the mid-1970s and 1990s. The closure of key shipbuilding assets led to a significant loss of economic confidence, a decline in employment and significant population losses. Some 35,000 inhabitants left the city in the decade to 1985, and the Swedish financial crises of the early 1990s exacerbated the decline, with 27,000 industrial jobs being lost between 1990 and 1995.

As the Danish capital, Copenhagen has held a more diversified role combining administrative, commercial and cultural functions and its influence has traditionally spanned a Greater Copenhagen area.

Collaboration between the two cities began in 1993, and from 1994 Malmö started to reposition itself towards cultural and knowledge-based industries. 1995 saw the beginning of the Øresund bridge project. A new university college was opened in 1998 on Kockums' former dockside, followed by further redevelopment of disused harbour and waterfront locations.

On the face of it, the transformation of the economy of Malmö from that of a manufacturing centre to being one of two cultural poles in a wider Øresund agglomeration has been achieved. In the year following the opening of the bridge, commuting between the two centres increased by 43 per cent and there has been increased collaboration, for example by the universities and in restructuring of economic capacity of the two airports. However, the transformation is far from complete for many of the city's original residents, as growth there has benefited a part of the local Swedish population as well as many inward migrants to the area – Malmö has the highest proportion of individuals of non-Scandinavian extraction of any Swedish city. There remain significant parts of the city which have yet to benefit and it is a city of wide social divides and high unemployment.

Zuid Nederland

Zuid Nederland has experienced recent economic challenges. The restructuring of electronics manufacturer Philips in response to global changes in the sector was the largest reorganisation in Dutch history. The workforce declined from 40,000 employees in the 1960s to 25,000 in the early 1990s, with other employers facing financial difficulties resulting from these losses of employment and productive capacity during the 1990s.

Its provinces, including Noord-Brabant and Limburg, are home to 3.5 million inhabitants, or about 21 per cent of the national population. The region benefits from both a central position in Europe, bordering both Belgium and Germany, and a number of medium-sized cities, including Eindhoven and Tilburg and the prominent administrative centre of Maastricht.

Zuid Nederland has moved away from its reliance on old industries towards a new focus on developing and sustaining open innovation to create international competitiveness. This direction was based around significant cooperation between leading businesses, public sector institutions and universities and research organisations. The restructured Philips has invested in a new knowledge campus to stimulate development of new products and processes, with a focus on commercialisation and improvement of their own operations. Other new higher educational institutions have been established. Good signs include an improved level of growth, with rates now above the national average for the Netherlands.

ANNEX 5


AN ANALYSIS OF SECTORAL STRENGTHS IN THE NORTH OF ENGLAND

The following table sets out in consolidated form the key subsectors as identified by LEPs and their RDA predecessors, by Oxford Economics' analysis on employment trends, and by our own analysis of export trends. It summarises their strengths, their potential and threats, and the extent to which these sectors have a specific geographic focus. This is meant to be illustrative of a more integrated, cluster-based approach to regional and industrial policy.

Subsector	Indigenous strength	Potential and threats	Geographical focus
Advanced manufacturing	Strong manufacturing history and centres of innovation such as Advanced Manufacturing Research Centre at Sheffield University and N8 universities	Growing demand from emerging economies Unlikely to create much jobs-rich growth; must be seen in context of overall manufacturing decline	Widely spread
Aerospace	World-leading technology and innovation	Global market worth \$600bn – UK generates £22bn (NW: £7bn)	NW – 40% UK employment share
Agriculture, food and drink	North produces 25% of UK output; sector worth £30bn	UK growth of 4% pa but little likelihood of growing global demand	Clear natural strengths, especially in NW and Y&H, plus location of Heinz, Nestle and others
Biohealth	North home to 981 companies in sector generating turnover of £10.8bn. Strong basic and clinical research base (HEIs and NHS)	Opportunity to strengthen links with complementary expertise in the 'golden triangle' of London, Oxford and Cambridge Challenges created by patent cliffs, outsourcing of supply chains and skills shortages	NW, particularly Liverpool and Manchester

Biotechnology	UK is a world-leader	Massive global growth potential but main focus on 'golden triangle' in the UK	Small clusters linked to Manchester (Biotech Incubator Fund) and Newcastle University
Business services	Huge and diverse sector which has flourished over last 20 years	Predicted to create 240,000 jobs over next decade Is a very mobile sector and thus hard to embed in a particular area	Widely spread, with particular presence in Manchester and Leeds
Construction	Strong prior to recession but forecasts predict weaker than average recovery in NW and NE	Limited in short term unless housing market picks up	Widely spread
Digital and creative	UK major player but North relatively weak in terms of size / agglomeration	Strong emerging markets in BRICs mean high level of competition	NW – MediaCity cluster key
Education	Strong university / HE sector in the North contributing 20% to national output in education and £7bn to local economy	Huge potential in relation to research, innovation business; huge 'export' potential Loss of jobs anticipated in the sector and overseas student falling within immigration cap, constraining export potential	N8 universities plus other key players including Teesside University, Sheffield Hallam, UCLAN
Financial services	North provides only 15% of UK output but Manchester and Leeds are strong regional hubs	Strong growth forecasts especially from BRICS demand but could benefit from specialisation? Unclear whether growth will be jobs-rich	Manchester and Leeds
Healthcare	Huge player already – especially hospitals, employment	Will continue to experience significant growth with ageing population and global demand for healthcare products	NE – biotech / ageing / stem cells NW – pharma links Y&H – teaching hospital & uni links

Motor vehicles	Nissan in Sunderland has the most productive car plant in Europe	Recent expansion by Nissan; huge export potential to converging economies	NE – Sunderland
Petrochemicals	Major strength in NE but tiny part of global market dominated by Middle East and Asia and only 9% of EU market	Could aim for bigger share of EU market but global competition will probably limit wider potential	Strong NE base (58% of UK market) around Tees Valley
Renewable energy	Excellent physical assets as well as emerging expertise	Massive task for UK to reach 20% EU target by 2020 and growing global market National government policy has been inconsistent and much work needs to be done to build up supply chain	NE – offshore wind and hydrogen fuel cells NW – offshore wind and tidal, good research base, CHP opportunities Y&H – wind, carbon capture, CHP opportunities
Retail	10% of northern workforce; benefits low-skilled	Limited signs of recovery due to high unemployment and falling disposable incomes	Significant out-of-town shopping centres in major cities
Telecommunications equipment	Strong R&D but North currently has only a small share of export market	Growing demand for northern exports	[Manchester and Leeds]
Tourism	Clear natural assets and offers wide opportunities from skills / jobs perspective	UK tourist economy worth £110bn and growing rapidly with BRICs visitors; huge export potential to converging economies	Manchester, Liverpool and Lake District



The Northern Economic Futures Commission was established in July 2011 to develop a 10-year strategy for economic growth in the north of England. Its 16 commissioners have taken evidence from a wide range of sources and carried out their own research into drivers of future prosperity.

In this, its final report, the commission sets out a bold vision: that the north of England is capable of taking its place in the ranks of the most successful northern European economies, with competitive companies trading in global markets, a fully employed and well-skilled workforce, and strong civic leadership that supports growth and shared prosperity.

Indeed, the commission goes further: if the UK is to rebalance its economy towards higher business investment and stronger export performance, it is essential that the North is at the forefront of economic change.

Alongside its vision for growth, the commission sets out a 12-point plan focusing on skills, innovation, infrastructure, investment and the institutions that are needed in the North to drive forward change.

BOLD IDEAS
for CHANGE

IPPR North
3rd Floor, 20 Collingwood Street
Newcastle Upon Tyne NE1 1JF
T: +44 (0)191 233 9050
E: north@ipppr.org
www.ipppr.org/north