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The Public Sector in the North: Driver or intruder?

Paper 2 from the Northern Economic Agenda project

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Challenging ideas – Changing policy

Contents

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ippr north, the Newcastle-based office of the Institute for Public Policy Research, produces far-reaching policy ideas, stimulating solutions that work nationally as well as locally. These are shaped from our research, which spans the northern economic agenda, public services, Anglo-Scottish relations, food policy and rural issues, as well as a strong democratic engagement strand which involves a wide range of audiences in political debates.

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List of abbreviations

CSR	Comprehensive Spending Review
DCLG	Department for Communities and Local Government
DfES	Department for Education and Skills
DTI	Department of Trade and Industry
DWP	Department for Work and Pensions
GDP	gross domestic product
GVA	Gross Value Added
HMT	Her Majesty's Treasury
HO	Home Office
ICT	information and communication technology
LFS	Labour Force Survey
N8	Network of eight Northern universities (Durham, Lancaster, Leeds, Liverpool, Manchester, Newcastle, Sheffield and York)
NAO	National Audit Office
NWRA	North West Regional Assembly
ODPM	Office of the Deputy Prime Minister
OECD	Organisation for Economic Cooperation and Development
OGC	Office of Government Commerce
ONS	Office for National Statistics
PESA	Public Expenditure Statistical Analysis
PSA	Public Service Agreement
PSE	public sector employment
RA	Regional Assembly
RDA	Regional Development Agency
RES	Regional Economic Strategy
SOA	Super Output Area

Executive summary

This is the second paper produced for ippr north's major Northern Economic Agenda project, which aims to provide a detailed insight into the economic performance of England's three northern regions: the North East, the North West, and Yorkshire and the Humber. The focus of this paper is on the role of the public sector in the North in driving or inhibiting sustainable economic growth.

Dramatic disparities in productivity and welfare across regions undermine the nation's prosperity and reduce the British economy's competitiveness. Among areas of the UK, the North East, North West and Yorkshire and the Humber fit the description of regions suffering from a lack of skills, initiative, capital and suitable infrastructure particularly strongly. Analysing the economic performance of these regions – and in particular, the role of the public sector in their economies – is thus of vital importance both to the regions themselves, and to the UK as a whole.

The scale of the public sector

Both theoretical and empirical analyses in our research suggest that the public and private sectors are not mutually exclusive entities. It is therefore crucial to allow public intervention into the economies of relatively deprived areas that are characterised by high levels of unemployment and low incomes. However, the scale and character of this support should not nurture the regional economy's dependency on public funds. Only well-balanced policies and activities will kick-start positive changes and boost economic growth.

Some parts of the North of England are currently experiencing growth rates above the national average (for example in 2003–05, the North East had a Gross Value Added [GVA] growth rate of 2.5 per cent compared with a UK average of 2.0 per cent). However, it still receives a relatively large proportion of public funds. In 2005–06, the North East, North West and Yorkshire and the Humber received 24.2 per cent of the £448 billion of identifiable expenditures in the UK, which is equal to the region's share of the national population (24 per cent in 2005), but above its contribution to national wealth measured by GVA (20.7 per cent in 2005). The public sector contributes around a quarter of the regional GVA in the North East and around a fifth in the North West and Yorkshire and the Humber, which is above the English average.

Spending or investing?

In assessing flows of public spending, it is important to look equally at current and capital spending. All three regions receive spending per head above the English average level (the North East actually receives £1,000 more than the average). At the same time, the amount of capital expenditure per head is not nearly as high: only the North West receives a substantially higher-than-average amount, while the North East receives slightly more than the national average and Yorkshire and the Humber receives less than the English average per head. The relatively low level of public capital expenditure shows that the investments in public sector reform are failing to address the challenges faced by the most deprived regions.

The *quality* of public funding – its ability to stimulate new economic activity and investment in the private sector – is no less important than the *amount* of funding. High quality public funding should lead to a gradual reduction in the need for state intervention and financial injections; simply spending more, however, may not achieve this. This is especially the case given that the recently published Comprehensive Spending Review 2007 (CSR07) signalled that the years of plenty for the public sector are about to come to an end.

If the Government is to achieve its aim of stimulating the northern regions to gradually catch up with other parts of the country, it will have to make more capital investment in the North. Moreover, core public spending will also have to change to reflect changing needs in different regions. A modern, needs-based approach to distributing funds across the English regions has to be developed. At the regional level, the public sector's *enabling functions* should take precedence over its intrusive, regulatory elements in order to unlock regions' potential and drive higher investment flows.

Costs of providing services and allocation of spending

It is important to note that it costs more than average to provide services to large regions with relatively small populations: the lower the population density, the higher the costs. The North has greater needs because it has income levels that are relatively lower than those of other regions while its costs are higher due to the presence of large rural areas and a relatively small number of big urban centres. Its greater needs are also explained by the relative weakness of the private sector in the region, which is still struggling to find its place in the new, post-industrial, socio-economic environment and cannot provide adequate services to the population.

In the context of the North of England, spending for the region (in the terminology used by the Treasury, spending that directly contributes to the development of the region) could be particularly important in catalysing growth. However, a dramatic advancement in the northern economies relative to the rest of the UK remains unlikely, since the distribution of spending for specific regions remains almost entirely driven from the centre. The current opportunities are available to all English regions equally, but some areas, notably the Greater South East, are more entrepreneurial and successful than others and are thus likely to be better placed to exploit such spending and will remain better off as a result.

The public sector in the North plays an important role in creating an enabling environment for the private sector. However, it is not simply a matter of using conventional economic instruments such as interest rates, fiscal stability, financial support and labour market interventions. Nowadays, the public sector also plays a key role in building and improving *links between* business, innovative science and higher education. Achieving successful economic growth requires a range of supporting mechanisms, from financial incentives to encouraging participation in collaborative projects, through adequate transport and communications infrastructure to an effective regulatory environment. The public sector is also emerging as a leading actor in ensuring that the UK and its regions are following patterns of environmentally-friendly, sustainable economic growth and providing equal opportunities to people regardless of their social class or place of residence.

Leadership and capacity

Public spending in the northern regions should become more developmental in nature. It should stimulate and nurture initiative and growth, challenging, rather than supporting, the status quo. Unfortunately, the traditional instruments of public policy and spending have led to symptoms of clientelism[1] appearing in the North. As a result, a deficit of initiative and regional leadership is undermining these regions' drive towards economic growth and prosperity.

A new approach to public intervention should stem from the idea that regions and sub-regions are self-sufficient and relatively autonomous units capable of formulating their own priorities, unlocking their potential, and delivering services that match the needs of the local population. Regional and local authorities have already been given functions that allow them to identify certain needs and deliver some public services (see, for example, the Sub-national Review of Economic Development and Regeneration), as well as to plan and implement policies in the areas of economic growth and regeneration. However, they should enjoy greater flexibility to use different approaches in their attempts to achieve higher standards of public services. For this, capacity is crucial. Even when formally granting the regions the opportunity to explore their local potential, Whitehall still performs the role of 'backseat driver' through instruments of centralised planning, its passion for uniformity in policy mechanisms and its rigorous control mechanisms. What local and regional authorities do need, however, is more support in building their own capacity to do such things on their own.

Employment and skills

The role of the public sector in providing jobs is equally important. At the moment the most significant task is to improve the skills and qualifications of current and future employees. While the share of public sector employment has been growing over the last ten years, the relative productivity of the northern economy (measured by GVA per head) has been going down. This is because most old and also most new jobs are concentrated in the low-skilled segment of the market. Our research did reveal a positive trend in the relocation of public sector managerial posts to the North West and Yorkshire and the Humber during the latest round of relocation (2004–06). However, it is still not enough in absolute terms, and this trend needs to be sustained and distributed across all northern regions.

To really contribute towards regional decentralisation and to close the productivity gap between the North and the South, the public sector should move more policy and research posts to the North, thus strengthening the expertise and scientific capacity of these regions. Relocating public sector jobs from London and the Greater South East would also make jobs available to young specialists graduating from the region's universities who wished to stay in the area, who might otherwise move south to get those jobs.

There is no clear evidence that the public sector has been 'crowding out' private sector jobs in the North. In these regions, the two sectors have quite different job profiles. Furthermore, the private sector can still offer more attractive remuneration packages, though it is worth remembering that the public sector tends to attract more employees during economic recessions but appears less attractive during periods of strong economic growth.

The existing quality and scope of data limits the rigour and depth of any analysis of the impact and dynamics of the public sector on the labour market. It is thus recommended that the Government makes funding available for the further development and gathering of statistics on public sector employment. Administrative data should be produced for the English regions as it is for Scotland, Wales and Northern Ireland. The Labour Force Survey definition of public sector employment should be used as a basis, since it is the more accurate of the two standard measures available (the other being the National Accounts classification).

Efficiency at the local level

Public sector reform is currently largely driven by an agenda that stresses modernisation, efficiency and value for money. Due to their rigidity, the efficiency targets have caused problems at the local and regional levels. Although efficiency undoubtedly should be a key priority for government, the uniformity of approach and the lack of well-designed 'positive discrimination' have been partly responsible for hindering the North's chances of radically improving its performance. The same results could be better achieved through other means, for example by creating a system of incentives to boost collaborative initiatives, or by setting up a conditionality principle (where benefits are only received if specified obligations are met) for providing financial resources (on top of the minimum required) to spur innovation and create better value for money in the public sector. Greater emphasis on the *spatial efficiency* of public services is also needed to enhance the cluster effects that can be generated from relocated offices and use of local factors and resources more successfully.

While the Government should continue to improve the efficiency of public procurement procedures by introducing higher standards, and solutions based on information and communication technology (ICT), it should do so in a way that increases the chances for regional and local companies to participate in the process. These companies should receive support, advice and training on how to comply with new standards, how to use new tools in public procurement, and how to become more competitive. This could enable them to provide goods and services not only locally, but also to public agents located in other regions of the UK.

Following their own way

The current path of reforms can only lead to 'linear' changes and improvements in the region, for example through transition from an industrial to a service economy. Yet if the ambition is for the North

1. Clientelism is a form of personal two-way exchange, usually characterised by a sense of obligation and unequal balance of powers between involved parties. It is often used as a synonym for the political machine, denoting an unofficial system of political organisation based on hierarchical patron-client relations (Hopkin 2006).

to perform better than – or at least as well as – other parts of the country, it will have to be more creative and 'leapfrog' through several stages quickly (perhaps missing out or amalgamating some stages). It needs to learn from both positive and negative experiences from other parts of the country if it is to create its own unique route of progress, truly rooted in the local environment. The three northern Regional Economic Strategies (soon to become Integrated Regional Strategies) often consider the public sector (and public spending on economic development and regeneration in particular) as one of the key drivers of sustainable economic growth and as a potential catalyst of a multiplier effect for the labour market and businesses. The centrally-driven process of relocation should be planned in such a way that it is fully integrated into the implementation of regional strategies and these processes are mutually reinforcing.

Recommendations

Our research concludes that there are ways for the Government, jointly with the regional and local authorities, to increase the efficiency of the public sector in the North of England. In particular, policymakers should focus on the following:

- The Government should increase the amount of capital investment in the public sector, especially for the North East and for the Yorkshire and the Humber.
- Her Majesty's Treasury should develop a modern, needs-based approach towards allocating current spending across the regions.
- Public spending should challenge the existing status quo in the three regions by playing a more developmental role.
- Regional Development Agencies and local authorities, with support from central government, should invest more in leadership and capacity in order to perform new planning and implementation functions effectively.
- The Government should relocate more managerial and expert jobs to the North of England, coordinating this process with the priorities of Regional Economic Strategies.
- The Cabinet Office, in implementing its efficiency agenda, should go beyond efficiency targets and use more varied means to improve value for money in the public sector.
- The Office of Government Commerce, jointly with local and regional authorities, should support and build the capacities of local businesses in order for them to benefit from modern ICT-based procurement solutions.
- The Government's efficiency agenda should take into account the *spatial* efficiency of the public sector.
- The Office of National Statistics should improve the quality of public sector employment data for the English regions.

Introduction

The importance of the public sector in the economy of Northern England is hard to overestimate. The three northern regions have received a much higher than average proportion of public spending per head for the last 50 years: the North East has consistently been top of public spending tables (after London), followed by Yorkshire and the Humber and the North West. The North's inability to adjust to the new economic situation following the collapse of its traditional industrial economy has prompted the Government to direct money to different instruments aimed at industrial regeneration and social protection. However, questions remain to be answered over how effective this spending has been.

As the statistics in our paper *The North in Numbers* (Johnson *et al* 2007) show, there is no doubt that the overall socio-economic situation in the North has improved considerably over the last ten to twenty years. Nonetheless, performance has not been strong enough to catch up with the more productive, more innovative regions in the Greater South East, and so in relative terms, the three northern regions still remain at the bottom of many national rankings. We are interested in the question of what role public spending has played in the rise of certain parts of the North (big cities including Leeds and Manchester), and the relative stability of others (Newcastle upon Tyne), and why public spending has not been able to prevent the continuation of decline in smaller, mono-functional towns such as Rochdale and Redcar.

The aim of this paper is to analyse the role of the public sector in the economy of the North. We start by reviewing theoretical and policy perspectives on the economic impact of the public sector in order to put the empirical evidence in context. We examine different sets of data to illustrate the influence of the public sector on the productivity, performance and structure of the regional economy and its labour market. We then look at the composition and dynamics of spending, the employment opportunities brought about by the public sector, and how the size of the sector is related to local deprivation, total regional output and population size.

The driving question throughout the paper is whether the public sector does indeed play a vital role in the northern economy, and whether a less interventionist policy would bring greater private initiative and investment.

This leads to a number of subsidiary questions:

- One of the most controversial issues when discussing the impact of the public sector on the labour market is the so-called 'crowding-out' effect: whether the strength of the public sector inhibits the creation of private sector jobs. We ask here: does crowding out happen in the North?
- Will current reforms that are aimed at improving the effectiveness of the public sector actually contribute to the North's development?
- Finally, how far is it possible to achieve more equitable social standards across the regions without hampering their potential for growth and improved productivity?

This paper addresses these and related questions.

1. The role of the public sector in economic growth: a review of the theoretical and historical contexts

Theories and concepts

The role of the public sector in the development of national and regional economies has long been debated and researched. From the beginning of the 20th century, when the state started to play a more active role in economic development on the one hand, and took more responsibility for the life of its citizens on the other, theorists approached the analysis of state interventions in several different ways, with correspondingly different results.

Some people have argued that the state's role in securing national prosperity is crucial, since it is only the state that can maintain strict regulations and achieve a more equal distribution of wealth across different social groups and parts of the country. Others have insisted that free market forces should be allowed to execute their unrestricted positive (or negative) effects on the economy, since only in this way will limited resources be used most efficiently, resulting in the highest overall productivity. Two contradictory trends thus exist: one advocating a strong role for the state (which we shall refer to hereafter as the 'Keynesian' model), the other calling for minimal state intrusion in the forces that form the free market (the 'neo-liberal' model). These conflicting trends embody the eternal dilemma of the state's intervention in the economy: efficiency versus equality.

The first fundamental analysis of territorial inequalities and the role of the state was developed in the Keynesian tradition by Myrdal in his theory of cumulative causation. He claimed that regional inequalities are caused by primary differences in local factors and conditions, and that they are aggravated by the fierce competition of a market economy. In such situations, free economic forces alone cannot reverse this divergence and state intervention is crucial (Myrdal 1957). Kaldor, another broadly Keynesian economist, suggested that the disparities in regional development can only in part be accounted for by geographical differences, and that the unequal development of industrial activity is the fundamental explanatory factor. The principle of 'cumulative causation' then exacerbates this disparity, for example in areas where production rates grow faster than average, wages tend to fall at a similarly disproportionate rate, giving the region a further competitive advantage (Kaldor 1970).

History has shown that unlimited top-down interventions applied over a substantial period of time, usually under the influence of theorists in the Keynesian tradition of Myrdal and Kaldor, do not always lead to positive results. The example of Italian regional development until 2000[2] is an informative case. More than 50 years of centrally-driven policies did not reduce the gap between the rich North and the poor South (the 'Mezzogiorno') of the country, and in some cases the disparities actually became more dramatic. The central ministries maintained full day-to-day control of the process using the instruments of 'extraordinary intervention', while local leaders were not given discretion to initiate locally-driven programmes. This prevented the formation of effective, self-sufficient regional institutions.

The Italian government formulated its policies at the end of the 1940s on the basis of Rosenstein-Rodan's 'Big Push' theory. Rosenstein-Rodan argued that the state could promote economic development in backward regions by investing simultaneously in an interrelated set of industries, which would generate strong external economies and migration (Rosenstein-Rodan 1943). Instead, however, these policies led to the politics of 'clientilism'[3] and localism, orientated towards distribution rather than development (Trigilia 1992).

Many analysts argue that there is no strong correlation between the scale of the public sector and the dynamics of economic growth (Ram 1986, Rubinson 1977), while others (Singh and Sahni 1984) claim that government expansion has a positive impact on economic growth. There are also those who believe the opposite: that there is a negative correlation between the expansion of the public sector and the dynamics of economic growth (Gwartney *et al* 1998).

The economies of the Organisation for Economic Cooperation and Development (OECD) are often used to illustrate the success of opposite models and concepts. Several recent analyses of data from OECD countries suggest that the effect of the public sector (in terms of public spending) is neither very positive nor very negative. These studies give examples of developed countries with low public spending, some of which have achieved strong economic growth (Ireland, South Korea), and others of which have not (Switzerland and Japan).

Historically, there are good examples of national economies that have been successful with a strong, paternalistic state (the Scandinavian countries), while other countries have achieved high productivity and competitiveness by applying minimal regulations and having relatively small public sector expenditure (Australia, New Zealand, Canada). Some of the fastest growing economies in the world, such as Taiwan, Malaysia and Cyprus, have a relatively high share of public spending as a proportion of GDP. Contemporary

2. Since 2000 Italy has been going through a major reform process of devolution and regionalisation which seeks to encourage more reliance on 'bottom-up' initiatives.
3. Clientelism is a form of personal two-way exchange, usually characterised by a sense of obligation and unequal balance of powers between involved parties. It is often used as a synonym for the political machine, denoting an unofficial system of political organisation based on hierarchical patron-client relations (Hopkin 2006).

analyses of these issues also suggest there is no evidence that countries with high levels of public spending have poorer economic performance than those with lower spending (Cumbers and Birch 2006). However, higher public spending is important for encouraging more even distribution of wealth across the country.

Some analysts in the neo-liberal tradition argue that public sector growth hinders the growth of private investment and that it generally causes 'crowding out'. There are two key aspects of possible crowding-out effects (Cumbers and Birch 2006): (i) the macroeconomic effect on interest rates and investment, and (ii) the structural effect on employment and firms. Others have expressed reservations, suggesting that crowding out does not always occur, and in fact a 'crowding-in' effect, leading to economic growth, is more plausible. Crowding in happens because the private sector actually benefits from increased public investment and improvements to the legal and institutional framework.

A paper by the Institute of Fiscal Studies suggests that despite the decline in public sector investment and expenditure over the 20 years that followed a peak in the early 1980s, the UK still lags behind countries like Germany, France and the US in terms of private sector investment (Bloom and Bond 2001). Cumbers and Birch also argue that the UK's strong economic performance compared with much of the EU's in the first half of the 2000s was due to increased public sector investment at a time when private sector investment and growth were relatively static (Cumbers and Birch 2006).

Public spending plays an important role in the *regional development* of a country: by redistributing national wealth across the country, the state aims to reduce the inequalities between different regions that have diverse indigenous conditions and diverse factors of development. In the UK persistent widening of regional disparities prompted the Government to introduce the regional performance Public Service Agreement (PSA) target, which is the key indicator to measure the progress of economic convergence. (The target is discussed in a greater detail in Johnson *et al* 2007). It is widely recognised that different regions might have different public spending needs, and also that the costs of delivering the same range and quality of services might differ from region to region.

Another important determinant in the differentiation of public spending is local political choice (Morgan 2001). If local politicians choose greater expenditure on top of national 'equality' measures, there is a strong argument that the difference of spending (the surplus) should be covered from local sources.

The total amount of public spending is thus determined by the three factors of costs, needs and political choice. If the state is to provide equal access to basic public goods regardless of place of residence, it should cover spending for real costs and needs. This means that the state should cover the difference in the underlying costs of providing the services in different types of areas (urban/rural, densely/sparsely populated, remote/island territories and so on) and respond to the diversity of local needs stemming from the varying economic, social or environmental attributes of different regions.

An example of this is that it costs more to provide services to large regions with relatively small populations, such as the North East and Yorkshire and the Humber than vice versa: the lower the population density, the higher the costs. The North of England has relatively large rural areas and a relatively small number of big urban centres (or core cities), and this affects the total cost of providing services (as the data below illustrates). The need for public investment in the North is also greater than elsewhere, since market forces have failed to restructure production facilities in the North away from manufacturing and towards services to the same extent as has occurred in most of the rest of the UK (see Figure 2.4 in Johnson *et al* 2007). All of this raises the threshold for the total amount of public spending required.

The crowding-out effect is often raised as a key concern when the impact of the public sector on the regional economy is analysed. Many argue that a high degree of dependence on public investment and jobs hinders the growth and expansion of the private sector in deprived regions (Bosanquet *et al* 2006). Others insist that the public sector has a positive enabling function for regions that experience difficulties in boosting and sustaining the private sector (Pearce and Paxton 2005).

In practice, it is sometimes difficult to track the 'competition' between two sectors in the labour market since public and private sector jobs tend to have quite different job profiles and diverse remuneration packages, which is especially noticeable at certain stages of the economic cycle such as growth or recession. For example, in the North East there is a strong opinion among key employers and recruitment agencies that the public sector does not cause crowding out in the private sector (especially at high and medium skill levels) because the nature of skilled work in the public sector is quite different from that in the private sector. Moreover, the public sector cannot compete with salaries in the private sector, except in periods of recession when public agencies tend to become more attractive as employers due to the relative security of employment in the public sector compared with the private. However, the relative generosity of public sector pensions compared with private sector pensions (on average) remains a significant factor that attracts workers to the public sector. Also the gap in pension generosity between the sectors has increased over the last decade as more and more private sector firms have shifted away from final salary schemes towards defined contribution schemes, which tend to be less generous.

It is also worth noting that at different stages of economic development and social progress, different views have dominated the academic and policy debate about the significance of the public sector and the degree to which it can impact on the regional economy. It has been observed that the level of interest in collecting and analysing data on the role of the public sector in the UK has traditionally been closely linked to the level of interest in regional development and devolution (McLean 2003). In periods where regional policy was undergoing a renaissance, datasets became more extensive and research became more rigorous. At other times, when disenchantment with regional policy set in (especially during Conservative rule from 1979 to 1997) there was a corresponding drop in data collection and analysis. This means that starting from the 1960s, there are unfortunate gaps in the data and analysis available on the role of the public sector in the economy.

Historical context

It is important to put the role of the public sector in the contemporary economy of the North of England in some sort of historical perspective. Two main initial observations can be made. First, for long periods of time, the economies of the North have been dominated by public sector jobs and investment (compared with other parts of England). Second, it is revealing to consider that at certain times in the past a stronger public sector was advocated as a way to regenerate relatively deprived regions, with little consideration given to private sector initiatives or the implications for economic growth in general, while at other times the strength of the public sector has been treated with suspicion.

The history of the public sector in the North of England has been particularly dramatic and complicated since the 1930s. Following the decline of the traditional coal and textiles economy of the North East, North West and Yorkshire and the Humber, new sources of employment and prosperity needed to be introduced to reverse the deeply negative effects of lost jobs and lack of income. Along with big initiatives aimed at attracting external companies to invest in the region, the role of the public sector was advocated, in Keynesian tradition, as the key consumer of the excess labour force and the provider of sufficient income to the local population. From the 1930s onwards, the northern regions became a ‘policy laboratory’ where many different regional policies were tested, none of which proved to have a sustainable positive effect on the regional economy (Tomaney 2006).

The economic decline in the North had already begun at the start of the 20th century, but it was identified as a ‘problem’ only between the two world wars. The first meaningful policy measures were applied in 1947 when coal production was nationalised, followed by the nationalisation of steel and shipbuilding industries. However, a series of mergers and acquisitions meant that control of these enterprises moved away from the region. Even after this, these industries still did not appear to be economically viable. In the 1970s and 1980s, major contractions in the coal, steel, textile, and shipbuilding industries led to their collapse as major employers with huge job losses. The restructuring of state companies and their consequent privatisation by the Conservative government in the 1980s prompted the final defeat of the region’s traditional industries and its traditional economy, with severe consequences for employment rates in the northern regions.

The scale of state intervention was highly significant throughout the period from the 1940s to the 1980s, leading for example to the North East taking on the appearance of a ‘state-managed region’ to some analysts (Hudson 1989). A fundamental problem with this approach was that it was negative and defensive rather than forward-looking; there was no real plan for industrial renewal via new industries in the regions, which meant that when big job losses did occur in the 1980s, the North suffered very high unemployment.

In the next section we go on to ground our analysis in the available data.

2. The significance of the public sector in Northern England

Any analysis of the effectiveness of public spending in the North of England must be grounded in appropriate data and information. This section illustrates the key trends in the three northern regions regarding the public sector and its impact on the regional economy.

The public sector has traditionally played a significant role in the economy of Northern England. Long and dramatic industrial decline has left the North East, Yorkshire and the Humber, and to a lesser extent the North West, very much reliant on public sector investment to sustain economic growth and raise personal incomes. The breakdown of the composition of regional Gross Value Added (GVA) in Table 2.1 shows clearly just how important the public sector is to the northern economy.

It is important to highlight, however, that in all three regions private services play a much greater role than the public sector, and their strength in the economy is growing. In particular, Manchester and especially Leeds are experiencing a dramatic growth in high value-added service sectors such as finance and banking, and retail and real estate services play a crucial role in all three regions.

Furthermore, this is just a 'headline' sectoral split, which does not show the overall economic impact of different sectors. For example, spending on health and social work might have positive spill-over effects on the regional performance over and above its current monetary value resulting from increased well-being, and research and development (R&D) spending can have a positive impact on many parts of the economy (as discussed in detail in Johnson and Reed 2007). On the other hand, the nature of spending in many sectors may be wasteful, though this is difficult to evaluate since many public sector outputs are not sold on the open market.

The public sector's effect on the regional and local economy could be measured by assessing its impact on regional productivity and performance, as well as on employment dynamics, but the most important factor is probably the structure and quality of jobs offered by the sector. Quality of spending is also crucial: current spending usually reflects the satisfaction of needs based on existing practices and capacities, while capital investments in the public sector show how much is being spent to improve the system, its strategic functions and delivery mechanisms. The dynamics of capital spending in the public sector regionally are thus extremely important, and are analysed in detail later in this paper (see section on spending, below).

Apart from the North West, the northern regions do not contribute much to the total national output (Figure 2.1). For example, the

Table 2.1: Structure of regional Gross Value Added (GVA), 2004, per cent (the public sector contribution is shown in bold)

Sector	North East	North West	Yorks & Humber	UK
Agriculture, hunting, forestry and fishing	0.6	0.7	1.1	1.0
Mining and quarrying of energy-producing materials	0.1	0	0.2	0.1
Other mining and quarrying	0.3	0.1	0.1	0.2
Manufacturing	19	18.4	18.2	14.4
Electricity, gas and water supply	2.8	1.4	1.5	1.7
Construction	7.3	6.4	7.1	6.3
Wholesale and retail (including motor trade)	10.8	13.3	13.3	12.4
Hotels and restaurants	3.0	3.2	2.9	3.2
Transport, storage and communication	6.6	7.9	7.8	7.7
Financial intermediation	4.6	6.2	6.5	8.4
Real estate, renting and business activities	18.4	21.8	19.3	25.2
Public admin., national defence, compulsory social security	**6.5**	**4.8**	**5.6**	**5.3**
Education	**8.1**	**6.5**	**6.7**	**6.0**
Health and social work	**9.5**	**8.0**	**8.8**	**7.4**
Other services	4.7	4.7	4.2	5.5
Financial intermediation services indirectly measured (FISIM)*	-2.3	-3.4	-3.6	-4.8
Total GVA (£m)	34,419	102,336	75,260	1,024,088

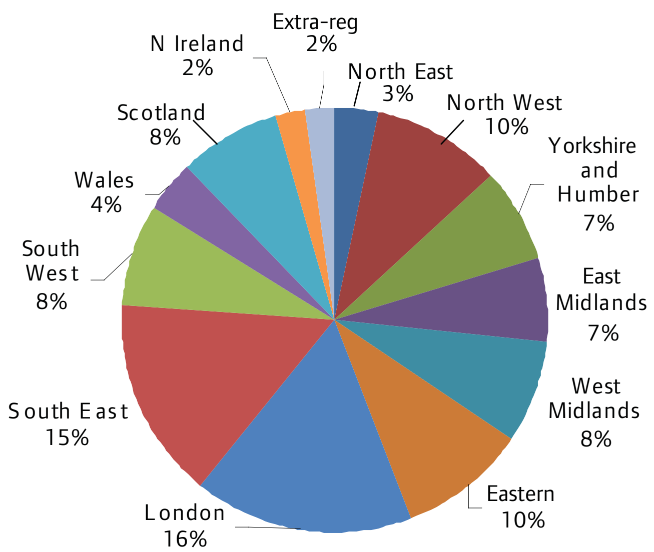
*Note: FISIM is a measure of the indirect charges made for financial services, for example the difference between interest paid by consumers and interest received by lenders, across the whole of the UK economy.
Source: ONS 2006c

North East's share of national GVA is only 3 per cent. This is the second lowest in the UK, higher only than Northern Ireland (2 per cent), and lagging far behind not only the South East (15 per cent) but even neighbouring Yorkshire and the Humber (7 per cent). In total, the three northern regions provide 20 per cent of national GVA; London alone produces 17 per cent. (Caution should be exercised when comparing these figures, however, given the specific functions executed by the capital city as the administrative, political and financial centre of the country and as a global financial centre.)

It is, of course, important to underline that these figures reflect the relative populations of each region. For example, the North East is the least populated English region with only two and a half million people. Moreover, over the last 15 years different regions have experienced quite different dynamics of population growth (as shown in Figure 2.1 in Johnson *et al* 2007). During the period 1991–2004 London, the South West, the East and the East Midlands experienced much higher than average growth (4.2 per cent), the North East and North West were the only regions to experience falls in population (-1.6 per cent and -0.2 per cent respectively).

The main source of population growth in the UK over this period was not natural growth but immigration; the North of England has not experienced any significant migrant inflows and thus it has not had the opportunity to experience the potential economic benefits that migrants can bring (see Pillai 2006). The region also has an ageing population, which reduces the economically active population while increasing the burden on health and social services. It is obvious that the costs of some public services, therefore, will increase over the next ten to 15 years, though this might be offset by a relative cut in education spending (if the absolute number of children in the region continues to fall) and efficiency/ technology savings (which we explain below).

Figure 2.1: Structure of GVA per region, 2005 (in real prices)



Source: ONS 2006c

Table 2.2: Relative labour productivity by regions, UK=100, 1998, 2001 and 2004

Region	1998		2001		2004	
	Per hour worked	Per head	Per hour worked	Per head	Per hour worked	Per head
UK	100	100	100	100	100	100
North East	94.5	79.8	98.2	79.2	93.5	79.9
North West	95.1	88.8	94.2	89.0	92.4	89.9
Yorkshire & Humber	93.3	88.8	94.7	87.8	91.1	88.8
East Midlands	95.0	92.5	96.6	91.4	98.7	91.5
West Midlands	91.0	92.3	94.5	91.6	93.7	91.2
East	100.7	107.6	97.9	109.4	101.6	108.7
London	119.2	133.0	116.1	131.4	118.2	132.1
South East	104.1	115.6	106.0	117.4	105.8	116.1
South West	94.3	93.1	96.6	93.4	95.3	92.9
England	100.9	102.0	101.2	102.0	101.2	102.0

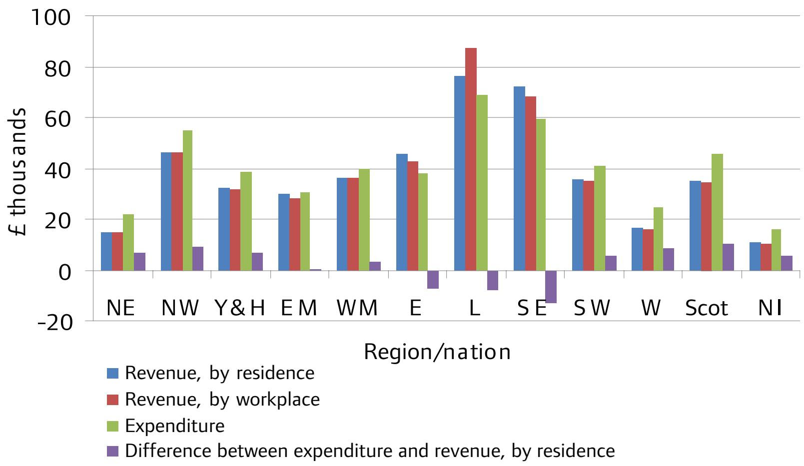
Source: ONS 2006a

In recent years, the economies of the northern regions have under-performed. We analyse their relative performance in detail in Johnson *et al* 2007. Here it need only be recalled that these regions perform much better if productivity is measured using GVA per hour worked rather than GVA per head of the population (Figure 1.2 in Johnson *et al* 2007). A clear trend is evident over the period 1998–2004: in worse-off regions, per-hour productivity is substantially higher than per-head productivity, whereas in better-off regions the opposite is true (Table 2.2). Nonetheless, it should be noted that in all three northern regions productivity measured per hour worked declined against the national average between 1998 and 2004, although the pattern in the North East and Yorkshire was uneven.

Across England, there is a strong correlation between economic performance and *deprivation*. In the North of England, it is notable that although certain localities have shown strong trends of regeneration, in general there are high levels of deprivation in the area. Almost a century of economic decline is reflected in considerably lower than average personal incomes in the northern regions (see Johnson *et al* 2007). In 2005, the North East had the lowest gross weekly income per person in the UK, and the figures for the North West and Yorkshire and the Humber were not much better. At the same time, the North East had the lowest national gross weekly spending. However, these figures do not reflect the differences in the cost of living in different regions of UK (see Table 1.5 in Johnson *et al* 2007).

The North is also lagging behind (relative to England and often to the whole of the UK) on various other indicators, including life expectancy, level of educational attainment, quality of housing, health conditions, joblessness and so on. This is well reflected in the Index of Multiple Deprivation designed by what was the Office of the Deputy Prime Minister (ODPM) in 2004. As the data in Johnson *et al* 2007 shows (Table 1.4), all three of the northern regions are affected: together, the three have the highest proportion of localities that lie in 20 per cent most deprived super output areas (SOAs) in England.

Figure 2.2. Revenue and expenditure per region and nation, 2004–05



Source: Oxford Economics 2007

Table 2.3: Total identifiable expenditure on services per country and region, per head in real terms[1], 2001–02 to 2005–06, accruals[2], £ per head

Region	2001–02	2002–03	2003–04	2004–05	2005–06
North East	6,815	6,984	7,398	7,572	7,814
North West	6,360	6,567	6,954	7,228	7,481
Yorkshire & Humber	5,948	6,121	6,431	6,708	6,949
East Midlands	5,359	5,423	5,747	6,057	6,205
West Midlands	5,687	5,838	6,223	6,512	6,757
Eastern	4,926	5,145	5,504	5,716	5,928
London	6,611	6,932	7,608	7,781	8,164
South East	4,951	5,126	5,495	5,825	5,960
South West	5,519	5,536	5,931	6,200	6,398
England	5,753	5,930	6,342	6,603	6,835
Scotland	6,980	7,152	7,630	7,729	8,179
Wales	6,675	7,019	7,318	7,514	7,784
Northern Ireland	7,792	8,016	8,240	8,451	8,713
UK identifiable expenditure	5,962	6,148	6,554	6,796	7,049

Notes: 1. 2005–06 prices 2. Accruals are where income is due or a cost is incurred during an accounting period, but for which no invoice has been received.
Source: PESA 2007: Table 9.4

Spending

There are two main types of public expenditure: (i) *identifiable* expenditure, incurred for the benefit of individuals, enterprises or communities within particular regions; and (ii) *non-identifiable* expenditure (namely for overseas activities and defence), incurred on behalf of the whole country (ONS and HMT 2007).

There is also a differentiation between public spending 'in' and 'for' the region. Public expenditure is defined as 'in' the region if it physically takes place there, while it is 'for' the region if it directly benefits that region, no matter where it is spent (McLean 2003). In some sectors, such as defence and security, the regional allocation of public bodies and goods depends on the needs of the state as a whole, not on local needs. Such public spending is referred to as spending 'in' the region, and the Office for National Stastics (ONS) provides regular accounts of how it is distributed across the country. On the other hand, HM Treasury also provides accounts of spending 'for' the region that goes directly to the regional population and is aimed at facilitating and building on regional potential, contributing to improved economic performance and social justice. It is thus important to treat total public spending across the regions carefully, bearing in mind that not all spending is directly targeted at a region itself: some goes to supporting the basic functions of the state, especially in a situation where national-level public sector jobs are gradually being relocated to the regions. (We return to this issue below in the section 'Relocation to the regions').

It is well known that the North of England receives a proportionally greater share of public spending than other parts of the country, and that the northern regions contribute much less to the national coffers than they consume (Figure 2.2). There is an emerging tension within the UK between 'donor' and 'recipient' regions, which is largely prompted by the way money is distributed between the UK's four constituent nations. This is starting to fuel discontent in the South of England, which is no longer happy to support lucrative public spending not only in Scotland, Wales and Northern Ireland, but also in the poorer North. This tension may lead to more serious social and political consequences in the future if it is not addressed now.

The mechanism used to distribute money to Scotland, Wales and Northern Ireland, known as the Barnett Formula, was introduced in 1978 and has proved its worth by helping to reduce some of the widest disparities between public spending on the UK's four nations. However, it is now in need of a major revision in order to reflect the real needs of each nation, and also the English regions, if we are to avoid further accusations that there is uneven treatment of different parts of the country (McLean *et al* 2007, forthcoming).

Recent figures from the Public Expenditure Statistical Analyses 2007 (ONS and HMT 2007) illustrate that, in absolute figures, London receives the highest amount of public funds. The North West is in second place with 11.7 per cent of all identifiable spending. It is important to underline that this is one of the most densely populated regions (containing 11 per cent of total UK population) while the North East has one of the smallest shares of population (4.2 per cent). The South East receives the third greatest amount of public funds. A regional breakdown of total expenditure measured against population gives a different picture (Table 2.3).

Table 2.4: Total government expenditure per region per head, 2004–05

Region	Identifiable (£)	Total min (£)	Total max (£)
North East	7,167	8,200	8,700
North West	6,930	7,600	8,500
Yorkshire and Humber	6,363	7,500	7,800
East Midlands	5,865	6,800	7,300
West Midlands	6,291	7,100	7,800
Eastern	5,605	6,900	7,100
London	7,530	9,000	9,500
South East	5,624	6,900	7,800
South West	5,962	7,300	9,000
Scotland	7,597	8,700	9,300
Wales	7,248	8,000	8,900
Northern Ireland	8,216	9,700	10,100
UK	6,563	7,600	8,500

Source: PESA 2006, Oxford Economics 2007

In 2005–06, the regions of the North of England received 24.2 per cent of the £448 billion of identifiable expenditures in the UK (slightly less than the 25 per cent in 2004–05) – equal to the region's share of national population (24 per cent in 2005), but above its contribution to national wealth measured by GVA (20.7 per cent in 2005). In all UK regions apart from London public spending is dominated by central government agencies, and local government spending is equal to only around 30 per cent of total spending (in London the figure is higher, at 38 per cent).

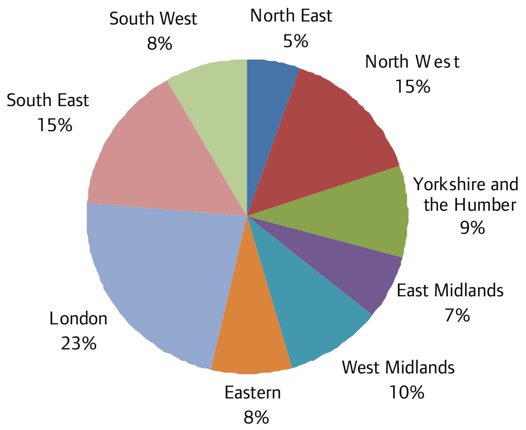
It is more difficult to account for regional distribution of unidentifiable expenditures, which are mainly spent on defence, security, and some financial services. Oxford Economics recently made some estimates of these expenditures and allocated non-identifiable expenditures that benefit UK residents across the regions (Table 2.4).

It is argued that even unidentifiable spending in areas such as defence might indirectly contribute to regional development through patterns of employment and taxation (Oxford Economics 2007). For example, innovations brought to the region by high-tech defence companies might be a small but important stimulus for the regional economy. Due to the difficulty of identifying the exact amount that goes to each region, the authors of the Oxford Economics study allow for a range providing minimum and maximum amounts.

It is also important to distinguish illustrations of current spending on public services from illustrations of capital investment. The former shows only the current dynamics of spending on routine tasks in a situation where things remain the same, while the latter might show trends in terms of what is spent on improving the infrastructure and practices used to provide public services and public sector activities – which in the end should lead to greater productivity and a substantial improvement in quality.

Looking at identifiable capital expenditure on public services, the North West is in a much better position than the other two northern regions (see Figure 2.3). Out of a total of £31 billion capital

Figure 2.3: Identifiable capital expenditure on services per region, 2006–2007

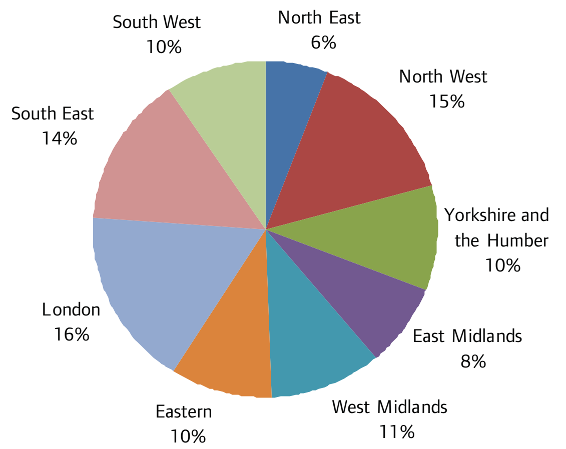


Source: PESA 2007, Table 9.10b

expenditure on public services in England in 2006–07, the North West's share is equal to 15 per cent, while Yorkshire and the Humber has 9 per cent, and the North East only 5 per cent. Even if the amount of capital expenditure is measured against the population size, the North West still receives a higher-than-average amount at £664 per head, compared with the North East receiving £632, and Yorkshire and the Humber just £572 per head. Average capital expenditure per head in England is £619.

Despite complaints within the North West region (see, for example, North West Regional Assembly 2003) that it is not receiving sufficient benefits from the Government relocation strategy, at £4.53 billion the North West actually receives the third largest amount of capital investment after London. The South East receives £4.5 billion and London absorbs almost a quarter of all investments – £7.04 billion. The North West also receives more than the East and West Midlands, where more public sector jobs were created in 2006–07 as they were in the North. Furthermore, this trend of capital investment distribution across the regions has been steady over the last five years.

Figure 2.4: Identifiable current expenditure on services per region, 2006–2007

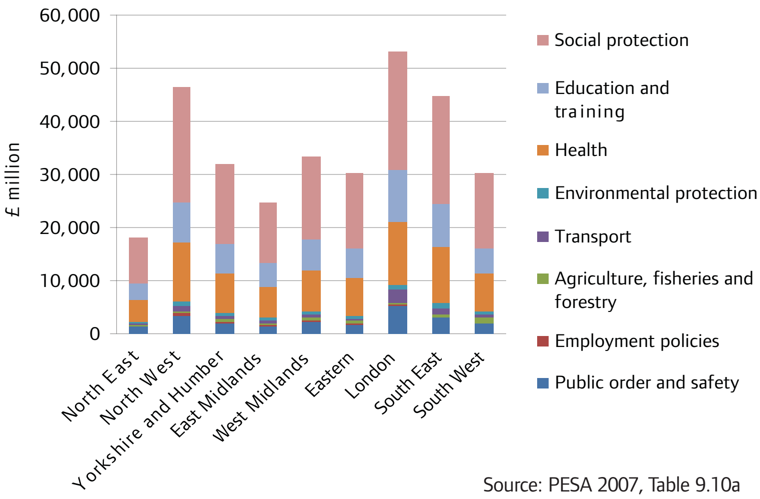


Source: PESA 2007, Table 9.10a

It is interesting to compare this picture with the regional structure of current expenditure (Figure 2.4). London's share of capital investment is much greater than its share of current spending (23 per cent versus 17 per cent), while in relative terms other regions are receiving capital investment that is less than current spending. In the North West, however, both capital and current spending are at the same ratio – 15 per cent. London also receives much greater capital investment measured relative to population size, and thus has more opportunity to modernise services and increase the effectiveness of service delivery.

The data in Appendices 1 and 2 also illustrate the sectoral breakdown of current and capital spending. This clearly shows that current spending in all regions is dominated by expenditure on social protection, health and education; no particular region has a much greater share spent on these services than another (Figure 2.5). In fact, in all regions but London the share of expenditure on social protection is between 43 and 44 per cent of total current expenditure (in London it is 39.5 per cent).

Figure 2.5: Identifiable current expenditure on services, per region and per function, 2006–2007

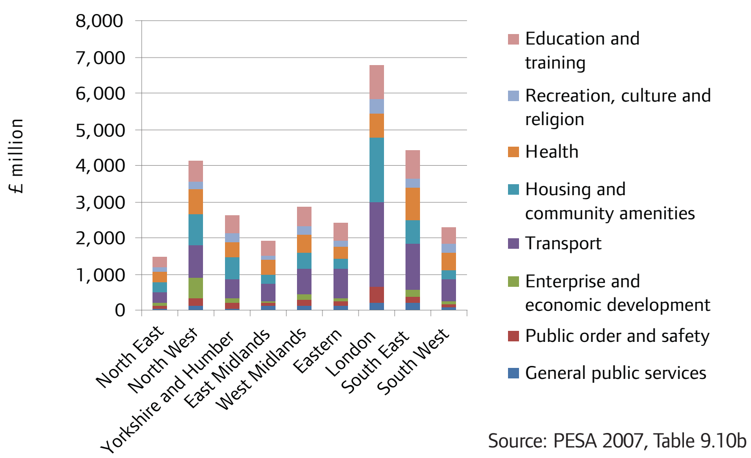


Source: PESA 2007, Table 9.10a

However, the picture changes when expenditure is mapped against local population size. Along with London, all three northern regions have above the English average per capita spending on social protection. This amounts to £3,390 in the North East; £3,161 in the North West; £2,939 in Yorkshire and the Humber; £3,018 in London and £2,842 in England on average. This trend does reflect the greater cost and greater needs of northern regions for this type of service: in order to be in a position to provide a minimum level of public services, less populated but territorially large regions with ageing populations and generally negative demographic trends require more expenditure than regions that do not have these features.

When it comes to capital expenditure on particular services by region (Figure 2.6), the situation changes again but in the opposite direction. For example, in both the North East and Yorkshire and the Humber, investment in transport per head is substantially lower than the English average: £115 and £107 respectively, compared with an average of £157 for England. In the North West, the situation is a little better (£134). Of course, this figure is 'distorted' by London, where £308 per head is spent on transport; by comparison, the figure in the South East is very close to the national average.

Figure 2.6: Identifiable capital expenditure on services per region and per function, 2006–2007



Source: PESA 2007, Table 9.10b

Employment

According to statistics on public sector employment from the ONS, in the fourth quarter of 2006 the total number of public sector employees in the UK (seasonally adjusted – that

Table 2.5: Total civil service employment in the northern regions, 1997–2002

	Civil service employees (1997)	Civil service employees (2002)	Actual change	Percentage change
North West	55,138	57,378	2,240	4.06
Yorkshire and the Humber	24,717	29,915	5,198	21.03
North East	32,323	34,819	2,496	7.72

Source: Cabinet Office 2002

Table 2.6: Dynamics of public sector employment in the UK, 1991–2006

Year	Central government ('000s)	Local government ('000s)	Public corporations ('000s)
1991*	2,336	3,078	569
1994*	2,241	2,760	434
1997*	2,107	2,734	338
2000	2,154	2,776	359
2003	2,434	2,838	373
2006	2,560	2,942	348

*not seasonally adjusted
Source: ONS 2007a

is, modified to account for seasonal fluctuations) was equal to 5.83 million, which is 25,000 fewer than in the same period of 2005 (ONS 2007a). This figure includes employment in central and local government agencies and public corporations.

Despite the very high level of attention paid to the importance of civil service jobs for regional prosperity, only about 10 per cent of total public service jobs are in the civil service itself (550,000). It is interesting to look at the dynamics of civil service job creation. Over the period 1997–2002 (Table 2.5) Yorkshire and the Humber saw large growth in civil service employment (21 per cent), admittedly from a lower base, while the relative growth of the civil service in the North East and North West was much more modest (7.7 per cent and 4 per cent respectively). These trends have sustained and by 2005 the number of permanent full-time staff in Yorkshire and the Humber had grown to 38,670, while growth had been much lower in the North West (59,720). There had been none at all in the North East, which still had only 34,460 permanent civil service employees (Cabinet Office 2005a).

As for the dynamics of public sector jobs in UK it is interesting to note that the number decreased from 5.983 million in 1991 to 5.168 million in 1998, but then started to grow again, reaching 5.850 million in 2006 (Table 2.6).

Until recently, no robust data existed on public sector employment at the regional level. In 2004 Christopher Allsopp's Review of Statistics for Economic Policymaking (Allsopp 2004) highlighted the importance of such data and since then the ONS has started to develop a methodology for producing regional estimates of public sector employment. While in Scotland, Northern Ireland and Wales this data is available in a coherent form from administrative sources, in the English regions there is no such data available. The ONS has to construct datasets using a combination of data from the Labour Force Survey (LFS) and the public sector employment estimates based on multiple returns from public sector organisations that use the National Accounts classification[4].

However, the combined use of LFS and National Accounts data has some limitations due to problems with the inconsistency of their classifications. Even though LFS estimates have been adjusted to match the National Accounts definitions more closely, the difference between estimates from the two sources grew over the period 1995–2005 (Millard 2007). The greatest difference between the two series is in the sphere of local government, in particular education and public administration. One possible reason for the increasing overestimation of the numbers of public sector workers within the LFS might be the large-scale outsourcing of some services within the public sector to private sector businesses (such as cleaning, catering and transportation). However, when responding to the LFS, workers in such contracted-out jobs might still refer to their activity according to the activity of the organisation on whose premises they work, rather than the organisation with whom they are employed.

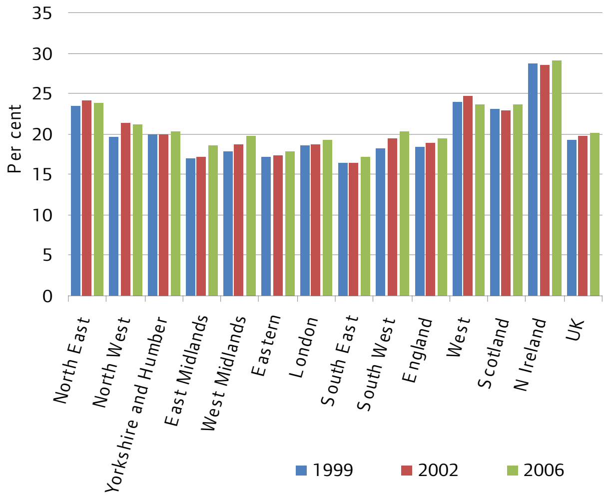
The number of public sector jobs across the regions of England increased over the period 2000–2005. The largest increases were observed in the South West (15.7 per cent) and the East of England (14.7 per cent). Yorkshire and the Humber experienced the smallest growth (only 6.2 per cent), while the North East (with 12.3 per cent) and the North West (with 11.4 per cent) had growth above the English average (11 per cent).

The more deprived regions and nations have a higher share of public sector employment. For example, in the North East public sector employment was 23.8 per cent of total employment, compared with 17.2 per cent in the better-off South East and 17.9 per cent in the East (2006) (Figure 2.7). In 2000–2005 the highest growth for public sector employment as a share of all employment was in the South West (1.9 percentage points) and the East (1.6 percentage points). Over the same period, Yorkshire and the Humber saw only a marginal increase of 0.1 percentage points, while growth rates in the North East (1.5 percentage points) and North West (1.4 percentage points) were above the English average (1.2 percentage points).

The picture is different if we take the share of public sector employment relative to the number of residents in each region. This shows the correlation between the public sector and the customer

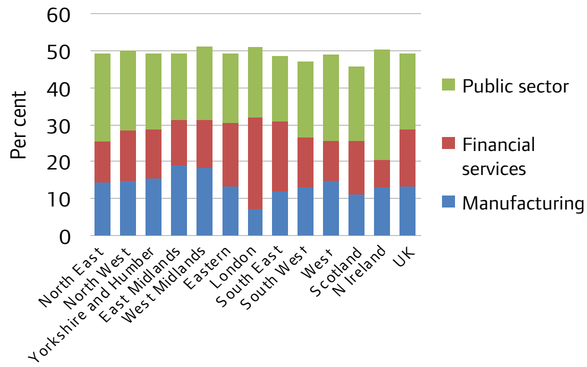
4. These two data sources take different approaches to defining public and private sector jobs. For example, in the National Accounts definition, university staff and GPs are classified as private sector employees, while the LFS defines them as being in the public sector. As a consequence, original LFS estimates of public sector employment are around one million higher than those from the final PSE numbers.

Figure 2.7: Public sector employment as a percentage of all employment, per region



Source: Labour Force Survey in Millard 2007

Figure 2.8: Employment in manufacturing, financial services and the public sector, 2005



Source: ONS 2005

base it is serving. The top positions still belong to Northern Ireland, Scotland and Wales, while the North East is the top region in England, followed by London and the South East. In all of these countries and regions, the percentage of public sector jobs as a share of the total resident population exceeds 10 per cent, while in other English regions it is between 8 and 9 per cent.

Comparing the amount of public sector jobs with those in key sectors such as manufacturing and financial services shows that the North of England has quite a particular employment structure (Figure 2.8). In all three northern regions, employment in manufacturing is higher than the national average, but not as high as in the West and East Midlands.

The three northern regions lag behind the UK average for employment in financial services, however (the sector in which productivity and average salaries are among the highest): the North East has only 11.4 per cent employed in this sector, and the North West and Yorkshire and the Humber both 13.4 per cent, compared with a national average of 15.6 per cent. Meanwhile, the North East has the highest overall public sector employment as a proportion of its workforce, while the North West and Yorkshire and the Humber are close to the national average.

3. A review of the Government's public sector reform

The Labour Governments since 1997 have supported an 'enabling state' approach in which public sector spending is used to address market failures and invigorate spending by other parties. The ultimate ambition of current policy reforms is to evolve the British welfare state into what we call an 'Anglo-social' model, guaranteeing social justice via high but flexible employment and service-based labour markets combined with a strong public sector (Pearce and Paxton 2005). This model attempts to combine the dynamism of the American economy with Scandinavian-style social democracy. It is believed that this will lead to lower levels of inequality and poverty than alternative approaches would, without putting the UK's strong economic performance in danger.

The Government's current approach to the UK public sector stresses three key drivers of change:

1) The modernisation agenda

2) The move towards efficiency

3) Decentralisation and deconcentration of public functions.

The Labour government has a long-standing commitment to the modernisation of public services, confirmed in the 1999 White Paper Modernising Government (Prime Minister and Cabinet Office 1999). This established the central objective of public services as being meeting the needs of customers, largely through the use of information technology and the introduction of an 'e-'government agenda (although the implementation of the latter is lagging behind schedule in many areas).

The deficiencies in the public sector and its inability to respond to modern technological, economic and cultural challenges have prompted a range of independent reviews commissioned by the Treasury. Two key reviews that had big implications for the 'spatial' functioning of the public sector and its regional dispersal were the Gershon Efficiency Review (2004) and the Lyons Relocation Review (2004). Some of the key recommendations from these reviews were integrated into the Cabinet Office's Transformational Government Strategy (Cabinet Office 2005b). Gradually, the public sector is gaining more relative flexibility and becoming more modern by employing some of the techniques and approaches that are common in the business environment. This has also been facilitated by the Government's strategy of employing more business and voluntary sector leaders in government institutions.

Streamlining procurement, outsourcing, and collaboration in order to save on administrative functions are the key features designed to change the public sector landscape over the next five to ten years. Efficiency is at the core of these reforms, which aim to achieve a high level of performance by employing fewer resources to deliver maximum quality services.

The rationale for the UK's policy of decentralisation and 'deconcentration' is informed by global economic trends. Regions and cities are challenging the predominance of nations in the international arena, becoming more independent, important players in their own right. If a nation as a whole wants to achieve strong results, it must allow its cities and regions more authority to execute the functions that would allow them to position themselves effectively not only at the national, but also at the international level. The centralised approach hitherto employed in the delivery of public services has not so far produced effective, efficient or equitable outcomes in the UK. Central governments thus need to delegate more powers to sub-national governments (and it has already started doing this; see, for example, the Review of Sub-National Economic Development and Regeneration), which have greater understanding of the local situation and could thus devise more effective strategies to use local factors and conditions for the ultimate prosperity and welfare of the population.

Since 1997, the Labour Government has recognised the vast inequalities between UK regions, notably between the North East and Northern Ireland and the rest of the country (HM Treasury and DTI 2001). However, the Government has failed to design individually tailored instruments to address the problems of particular regions. Thus, even such policies as 'Enterprise for All' (2000) or the introduction of Regional Development Agencies (RDAs) in 1999 failed to address inequalities because an 'equal approach' was applied to all regions, giving each the same opportunities to benefit from each initiative. More advanced regions such as the South East and London were thus able to take much better advantage of these initiatives than regions such as the North East or Yorkshire and the Humber.

Recently, the Government identified five key aspects that need to be (and are being) addressed in order to bridge the productivity gap between North and South: skills, investment, innovation, enterprise and competition. More recently still, the Government has aimed to improve the performance of lagging UK regions, which is of key importance for achieving narrower regional disparities (which remain the biggest among EU countries [Eurostat 2007]). In 2005, the ODPM outlined five key factors that should be addressed in order to improve the regions' economic performance. These were: employment, education (and skills and training), business growth, regional investment and structure. The emphasis, however, was on employment, with a target for an 80 per cent employment rate across the whole country (ODPM 2005).

Some commentators argue that the current public spending approach still favours quantity rather than quality. While the next period of the Comprehensive Spending Review will see a small drop in spending as a share of GDP, this is because extra resources have dried up after a decade of increased spending rather than because of a change of approach. Bosanquet *et al* (2007), in a report for the think tank Reform, claim that 'reform' is discussed in the language of 'efficiency' (administrative savings) rather than choice, competition and prices – which in their view, should be the real drivers of change. They believe that should more money become available in future, total spending would soon increase again, at the cost of higher taxes and disincentives.

Bosanquet and colleagues propose to cut back public expenditure in struggling regions in order to encourage private investment and business start-ups. In their opinion, this will also address the problem of a declining and ageing population in the North, as younger people will no longer automatically be drawn to London and the Greater South East for employment. The vast inequalities in economic output between London and the South East and other regions are largely explained by the inefficient distribution of public expenditure, whereby London pays 18 per cent of total UK personal taxation, but receives only 14 per cent of identifiable public spending. Meanwhile, the South East pays 18 per cent but receives only 11 per cent (Bosanquet *et al* 2006).

However, this approach looks very unlikely to be feasible in the context of the Anglo-social model pursued by the Labour government. Others, like Kevin Morgan, propose solutions that are more in line with this model. They argue that in order to tackle regional inequalities there is a need to progress from purely administrative devolution to democratic devolution. It is thought that this might have three major benefits:

1. It would empower local knowledge, without which localised learning has little practical use
2. It would allow UK regions to design and deliver policies that better correspond to their real needs, rather than Whitehall requirements
3. It would help to create conditions for a more democratic and locally accountable system of governance. (Morgan 2001)

There is, however, a need to fully and rigorously estimate the economic costs and benefits of a deeper devolution, both regionally and nationally. It is argued that devolution could bring not only big gains, but also significant burdens. Rodrigues-Pose and Gill suggested three core areas in which the drawbacks of devolution might have the most significant negative impact: efficiency of spending, equity in service provision and institutional burdens as a result of increased bureaucracy and the need for more interaction between the tiers of government (Rodrigues-Pose and Gill 2005).

Both theory and practical observation testify that public sector intervention is necessary to revive the economy of relatively deprived areas that have high levels of unemployment. The public sector can catalyse positive developments in the labour market by combating unemployment and increasing personal incomes and public spending, which in turn should stimulate growth in the private (mainly service) sector. However, opponents of this approach argue that such intrusions distort the market and unsettle the equilibrium that would otherwise be reached if market forces were free to determine the size and structure of the labour market. Inflows of public sector jobs, they argue, might lead to the crowding out of the regional labour market.

4. How should public sector change be managed in the North?

Over the last ten years the Labour Government has promoted greater decentralisation of powers to the regions and localities. However, the overarching central institutional and legal framework has remained inadequate for these aspirations. The overwhelming focus on delivering targets designed and passed down by Whitehall means that at the local level, formal targets are delivered mechanically without much initiative or creativity over how things could be done differently to take the local situation into account.

This uniformity is in part hindering the North's chances of radically improving its performance and its position relative to the rest of the country. The current arrangements can lead only to 'linear' changes and improvements, where the North is following all stages of economic and social development in the same sequence and over the same duration as other more successful regions of the South. But if the North is to outperform other parts of the country, it will need to 'leapfrog' quickly through several stages: it should condense the implementation of necessary reforms into a shorter period of time and develop a more ambitious and specifically tailored agenda, which would then put it in a more competitive position. Merely trying to 'catch up' will not close the £30 billion productivity gap, as identified in the Northern Way strategy, in the foreseeable future. However, the ambitions should not be over-inflated and should reflect the realistic potential of the regions (see, for example, OECD 2006).

More flexibility should be given to regional and local governments to use different approaches to achieve acceptable standards of public services. A substantial decrease in the number of performance indicators and Public Service Agreement (PSA) targets in the Comprehensive Spending Review 2007 have paved the way towards greater freedom for the localities and regions to identify their own policy and monitoring framework. It is, however, essential for the state to maintain a due level of supervision and control over regional and local governments in order to secure a fair approach and to guarantee minimum social standards.

The Regional Development Agencies and other regional economic institutions of the North tend to have a positive outlook on the public sector, which they see as one of the drivers for boosting regional productivity and performance (NWRA 2003). They also sometimes rely on the relocation of public sector jobs as an impulse for the growth of jobs in related sectors (secondary effects). It is still debatable, however, how much these new jobs are 'for' the regions and how much they are 'in' the region.

Relocation to the regions

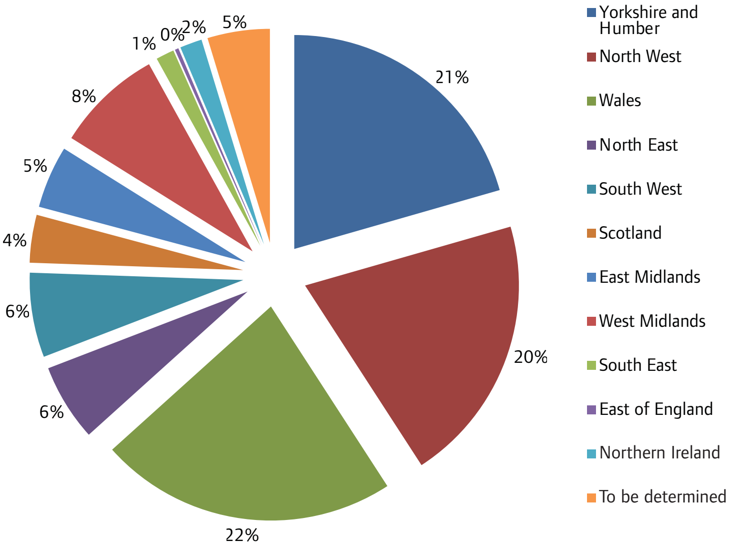
Since the 1970s, the relocation of public sector jobs from London and the Greater South East to other regions has been a key strategy to reduce the congestion of these heavily populated areas and to enjoy savings from the lower costs of running a business in the Midlands or the North of England.

However, previous rounds of job relocation and dispersion in the 1970s and 1980s were largely based on estimates of the consequences for regional labour and capital markets, along with the desire to cut operational costs in the public sector. The Hardman Review in 1973 came to the conclusion that public sector relocation would have only limited positive impacts on the receiving area (Hardman 1973). However, an ex-post evaluation in 2003–2004 during the Lyons Relocation Review discovered that some localities, like Leeds and Newport, greatly benefited from these relocations (Experian 2003).

The Lyons relocation review in 2004 argued strongly that regions and locations will only benefit from the relocation of public sector functions if they are 'regionally responsible' and embedded into the local market situation (in terms of pay, property and skills). The review also suggested that 'clustering' relocated offices in a small number of places is better than dispersing them across the country, since it creates savings from joined-up back-office functions and creates a more competitive atmosphere for public sector employees (rather than trapping them in one location executing the same type of job for a long time) (Lyons 2004).

As a result of the Lyons Relocation Review (Lyons 2004), the 2004 Comprehensive Spending Review confirmed the relocation of 20,000 posts from London and the South East by 2010 (which according to the Review will save £2 billion over 15 years). Data

Figure 4.1: Posts relocated to Government Office Areas, December 2006



Source: Office of Government Commerce 2007 from the Office of Government Commerce (OGC) from December 2006 demonstrates that around 11,000 jobs have so far been relocated (OGC 2007). Two thirds of those jobs went to four regions (see Figure 4.1).

The regions that have gained the most from this process are Wales (2,487 jobs), Yorkshire and the Humber (2,287 jobs), and the North West (2,225 jobs). It is important to highlight that the latter two regions have also gained the most relocated *managerial posts* (24 per cent in Yorkshire and the Humber and 20 per cent in the North West). Meanwhile, the North East has seen an increase of just 654 managerial posts over this period.

Six northern cities and towns are among the top local authorities to benefit from relocation: Liverpool, Catterick, Sheffield, Newcastle, Manchester and Leeds (OGC 2007). Table 4.1 illustrates the location of department offices in the three northern regions as of December 2006.

It is interesting to note the changing nature of the factors used to explain the necessity for more public service jobs (including civil service jobs) being relocated to regions outside London and the South. The gap in economic and social development between these two regions and the rest of the country is dramatic and was still growing until recently. Neither the fiscal restraint of much – though not all – of the period of Conservative Government, nor the financially more generous measures undertaken by the Labour Government, have been able to close this gap. Moreover, even when there was relatively low inter-regional divergence, intra-regional disparities were still growing, not only in the North, but also in the South of England.

Some suggest that the relocation of public bodies from London and the South East to other regions will help to close the productivity gap between the North and South of the country by reducing unemployment, increasing demand and improving the use of inputs such as human resources, financial capital, infrastructure and natural resources, as well as contributing towards improving the capacity and skills base of less developed regions (Marshall *et al* 2005).

Looking at the current approach to relocation and evaluating its impact on regional economies, there are a set of potential benefits of relocation to the northern regions, in particular:

- *New skills and knowledge*, especially if not only administrative and 'mechanical' jobs (like call centre operators) are relocated, but also expert and policy departments
- *A knock-on effect for 'consumption' sectors*, including retail, education, travel, and private health, due to the higher disposable

Table 4.1: Departmental offices located in Northern England

North East	North West	Yorkshire and the Humber
Education and Skills (Darlington)	Crown Prosecution Service (Liverpool)	Health (Leeds)
Work and Pensions (Benton, Newcastle)	HM Customs and Excise (Liverpool)	Emergency Planning College (Cabinet Office) (Easingwold)
Land Registry (Durham)	Ministry of Defence	Education and Skills (Sheffield)
UK Passport Office (Durham)	Education and Skills	Environment, Food and Rural Affairs (Leeds, York)
Child Support Agency (Benton, Newcastle)	Environment, Food and Rural Affairs (Workington)	Work and Pensions (Sheffield, Leeds)
Pension Service (Benton, Newcastle)	Department of Health (Manchester)	Home Office (Sheffield, Leeds)
Commission for Social Care Inspectorate (Newcastle)	Health and Safety Executive (Bootle, Merseyside)	Revenue and Customs (Shipley, Bradford, Leeds)
Prescription Pricing Authority (Newcastle)	Land Registry (Birkenhead, Merseyside)	Trade and Industry (Leeds, Sheffield)
Revenue and Customs – National Insurance Contributions Office (Benton, Newcastle)	Home Office (Manchester)	HM Court Service (Leeds)
Environment, Food and Rural Affairs (Longbenton, Alnwick, Newcastle)	Prison Service	Transport (Leeds)
Trade and Industry (Billingham)	Revenue and Customs (Liverpool, Manchester)	Constitutional Affairs (Leeds)
	Lord Chancellor's Department	Crown Prosecution Service (Leeds)
	Trade and Industry (Manchester)	Culture, Media and Sport (Leeds)
	Communities and Local Government (Manchester)	Ministry of Defence (Leeds)
	Work and Pensions (Salford)	Communities and Local Government (Leeds)
		Central Science Laboratory - Environment, Food and Rural Affairs (York)

Source: Office for Government Commerce 2007 incomes of those moving to the region or being employed by the relocated department offices

- *Improvements to quality of life* as it is believed that on the one hand, people moving from the South will enjoy a much calmer lifestyle and a better work-life balance, and on the other hand that they will bring demands and expectations that would push local service providers and manufacturers to higher standards
- *Secondary effects of improved public service*s in the region (above all education and health)
- *A 'clustering' effect* of relocated offices for local service providers and other private companies. (Some positive examples already exist, for example the Sheffield cluster of the Department of Work and Pensions, Home Office and former Department for Education and Skills.) However, the recommendations of the Gershon Effectiveness Review (2004) might pose problems for the concept of regionalisation through outsourcing, as it proposes higher requirements and uniform standards for potential procurement partners of government agencies, and these are more achievable for big, diversified companies than smaller, regionally-based companies which have only just started to engage in the public sector
- *Tackling the crowding-out effect* for the private sector through regionally-adjustable pay rates that will not distort the regional labour market. (However, as discussed in Section 1 above, there is a strong opinion among key regional employers and recruitments agencies in the North that the public sector does not cause crowding out in the private sector because the nature of the positions is quite different between the two sectors)
- *Synergy effects* for the key government policies aimed at decentralisation and empowerment of regional and local governments.

According to the Lyons Review, relocation also provides a perfect opportunity to modernise, since the geographical move and the 'separation' of offices (with relatively small decision-making/policy hubs remaining in London while the rest moves elsewhere) requires a complete review of operational and technological procedures. Relocation allows the introduction of new information technologies and a shift towards more flexible work patterns to respond to changing lifestyles. If relocation is actually targeted at the North, this could contribute significantly towards growth in the financial, IT, HR sectors and so on. For example, Leeds already has the second biggest financial services sector (in terms of number of jobs), and has extensive expertise in the area of accounting and financial management. Advantage of this factor could be taken when relocating relevant jobs from London and the South East.

The dispersion of public sector jobs will also provide a contribution towards state security: even if London and the South East came under serious threat from terrorism, the threat of disruption to the work of key government agencies would be much smaller if offices were scattered across the country.

The emergence of new regional quasi-governmental agencies in recent years (for example RDAs and Regional Assemblies) also adds value to the relocation: they can bring more local knowledge and comprehensive planning to this complicated process. Quite often, changing an office's location will also prompt wider changes to an organisation's structure in terms of the conduct of operations, technical capability and skills pool. The RDAs, along with the Whitehall departments, were active contributors to the Lyons Review, 'advertising' the advantages of their regions as targets for relocation. For example, One NorthEast created a dedicated website called 'Moving North East' to promote the region as a site for relocated department offices.

Active engagement in this process also gives RDAs the opportunities to link relocation initiatives with their responsibilities for designing and steering the implementation of the Regional Economic Strategies (and in the future, the single Integrated Regional Strategies). The three northern regions' strategies rely to a substantial extent on the public sector (and in particular on public spending on economic development and regeneration) as the driver of sustainable economic growth and the potential carrier of a multiplication effect for the business sector. There are thus opportunities to plan relocation in such a way that it is fully integrated into the implementation of Regional Economic Strategies and these processes are mutually reinforcing. With the institutional changes outlined in the recent Sub-national Review (see Johnson *et al* 2007) it is very important that regional agencies speak with one voice when articulating their views on the future role of the public sector and its expansion/development in the given region.

A well-thought-through, considered approach to relocation might guarantee higher benefits to the region than simply distributing departments equally across the country. Different departments should therefore synchronise their relocation plans and try to pursue a 'reasonable clustering' approach, aiming for concentrations in a relatively small area in order to boost local service and product providers alongside the increase in employment and the enhancement of skills.

Skills levels

The quality of public sector jobs located in the region is very important. The North of England is well known for the contact centres (in both the private and public sectors) that were located in the region over the last 10 years as an element of job creation plans. And though this strategy brought a substantial amount of low- and medium-skilled posts to the region, it has proved to be volatile. These are highly mobile functions, which – like the industrial branch plants of the 1960s, '70s and '80s – are easy to relocate, and are therefore often top of the list of options when it is time to cut costs.

As each of the three northern Regional Economic Strategies states, in order to perform better than others the regions should attract and create more high-value jobs, which would contribute towards more dynamic economic growth and improved welfare (for example see One NorthEast 2006). Until now, the majority of public sector jobs have been created in low- and medium-qualified sectors as simple substitutions for lost manufacturing jobs. The impact of new jobs created has thus not been as dramatic as it would be with high-skilled jobs.

However, the availability of skills in the North is still a major issue. As experience has shown, even the best designed and implemented relocation plan will tend to result in substantial numbers of jobs being vacated in the original location by those who do not wish to move, meaning the onus is on the new location to provide a sufficient amount of skilled labour to fill the positions. Does the North of England have a sufficiently adequate skills and knowledge base to fill a greater number of higher skilled vacancies?

All three northern regions have strong academic and educational bases. A number of the country's top universities are located in the North, with internationally recognised centres of excellence. A substantial number of highly-qualified young specialists graduate from these universities annually who might remain in the region if there were jobs available. Unfortunately for the North, in the majority of cases graduates prefer to move south to advance their career and to take advantage of substantial differences in remuneration. Relocating public sector jobs from London and the South East – where graduates might otherwise move precisely to get these jobs – would make more vacancies available to young specialists who wished to stay in the region.

Northern universities are already thinking about how to maximise their research and academic potential, uniting their efforts to attract more talented people and more investment. In 2004 they created a network of eight big universities, the 'N8' (Durham, Lancaster, Leeds, Liverpool, Manchester, Newcastle, Sheffield and York). The aim was to raise the status of education and academic work (establishing an 'Ivy League' of the North of England), making the universities' research and teaching more relevant to local business, and linking science with practice via innovative venture projects based in the universities. This initiative is also supported by the Northern Way (see Johnson and Reed 2007), which gives backing to activities in the spheres of higher education, science and employment that promote collaboration across the three northern regions.

However, to really match the needs of the public sector, more links are needed between the universities (especially in the social sciences and humanities) and policymakers. There are already some examples of such behaviour, such as the creation of the Academy for Sustainable Communities in Leeds, and the establishment of the Public Sector Academy, a knowledge transfer centre for the social sciences based at the University of Sheffield that works with different local and regional government institutions of Yorkshire and the Humber to bridge the gap between science and practice.

Efficiency in the public sector

The Gershon Review in 2004 had a number of recommendations on how to increase the efficiency of the public sector in six key areas: procurement; back-office services; transactional services; policy, funding and regulation for the public sector; policy, funding and regulation for the private sector; and productivity (Gershon 2004).

The Government accepted these recommendations, and the Chancellor announced its Efficiency Programme in April 2005, the key targets of which are:

(1) To achieve £21.5 billion in efficiency savings by 2007̃08

(2) To reduce the workforce within the civil service and military administrative and support posts in the same period of time by 84,150 (13,500 of these jobs will be relocated to front-line activities).

The recently published Second Review of Progress of the Efficiency Programme by the National Audit Office (NAO) confirmed that the Efficiency Programme is on track (NAO 2007). The Programme has made crucial contributions to the reform of the public sector, especially by putting value for money at the centre of the reform process. According to the data available for September 2006, government departments achieved £13.3 billion out of a total £21.5 billion targeted annual efficiency gains (a 62 per cent 'success rate'). They also cut the total employment headcount by 45,550 and relocated a further 9,400 posts to the 'front line' of public services (ibid). However, there is some evidence to suggest that these figures do not always adequately reflect the real situation. This is mostly due to problems with measurement, particularly the lack of adequate data collection systems in some departments. There are many cases where the reported achievements were not based on actual reductions or cuts, or where the impact of certain initiatives was underestimated. A key issue is thus to improve the quality and availability of data, which would allow departments to establish realistic targets and then measure progress against them.

However, there are also serious examples of inadequately formulated efficiency programmes within particular departments. For example, the Commons Treasury Committee recently criticised the efficiency programme for the Office of National Statistics (ONS), which aimed to save £25 million and cut 700 jobs, with a further 850 posts to be relocated from London to Newport, South Wales. The Committee was concerned that the majority of the ONS's highly qualified staff was against the proposed move to Wales and that this could lead to a large loss of institutional memory and to major problems recruiting new specialists following the relocation. This would go against the main goal of the ONS's organisational reform, which is supposedly to improve public trust in state statistics by ensuring that the ONS is an independent body that produces high quality data. The current efficiency drive thus seems more likely to undermine this objective than to support it.

The Efficiency Programme has important implications not only for central government, but also for regional and local authorities, since all of them are committed to annual targets for efficiency savings of 2.5 per cent (and 3 per cent for the next three years as per CSR07's new efficiency commitments). Regional and local authorities are already struggling to achieve these targets, however, due to the specifics of contracting (often long-term contracts have been agreed and it is then impossible to renegotiate terms and conditions to match the new requirements) and to the relatively small scale of operations.

The most important elements of the efficiency agenda for regions and localities are procurement, back-office functions and transactional costs. The procurement reform in progress envisages making a substantial increase in savings by improving the skills of procurement specialists and creating streamlined IT-based procedures on a one-stop-shop basis for all central departments and regional/local governments.

The Office of Government Commerce (OGC) is leading in the area of more effective mechanisms and procedures of procurement, primarily through the extensive use of ICT. Among recent changes is the establishment of the OGC's Executive Agency, 'OGCbuying.solutions'. This is designed to deliver professional procurement services to public sector organisations: by providing professional advice and technical support, enabling organisations to deliver against their corporate targets of 'value for money' and meet new requirements for sustainability and technical progress.

In order to meet its efficiency targets, the Government is investing heavily in restructuring back-office functions – combining them for several agencies in regional centres close to their locations across the country. On the other hand, efficiency targets mean that a substantial amount of operations need to be outsourced to consultants in order to save on administrative costs and headcounts. However, some outsourced projects have failed (for example, Inland Revenue and NHS IT contracts that led to data corruption or disclosure), or were too expensive because consultants were able to bid for inflated resources and departments did not have the necessary checking procedures to cut costs.

The effect of the public sector in the North of England

From the above analysis and policy review it is clear that the public sector is contributing a lot to the North of England – in terms of both spending and employment. However, the quality of this contribution should be questioned. Current spending levels mainly illustrate the costs associated with the regions' day-to-day needs in terms of running bureaucracies and providing basic services to the population. Spending 'for the region' is playing a significant role, but while its distribution is almost entirely centrally-driven there is unlikely to be a visible advancement in the northern economies relative to the rest of the UK. The opportunities provided by heavily centralised budgets are more or less equal to all English regions, and thus more successful areas in the Greater South East, where there is higher intellectual potential and more private investment available to match expenditure, are likely to benefit more from these opportunities than will the North of England.

The North's relatively high per-capita public expenditure can in part be explained by need: historically, the three northern regions have been characterised by long-term deprivation and structural unemployment, which were reflected in low personal incomes and high levels of economic inactivity among the local population. The policy direction chosen by the Labour Government promotes equality and social justice, although only to a certain extent. For example the Public Service Agreement on regional disparities, as discussed in Johnson *et al* 2007, only commits the Government to reducing the gap in growth rates of Gross Value Added (GVA) between the different regions – not to reducing the absolute disparities in GVA between the regions. Even given this limited objective, substantial amounts of money are required to bridge the gap in capacities and chances between regions. On the other hand, the costs of public service delivery in sparsely populated regions are higher than in the densely populated regions of the South and Midlands. Rural areas, which constitute a considerable proportion of the territory of the North East, Yorkshire and the Humber, and the North West, also require higher per capita costs for basic public functions.

While the share of public sector employment has been growing over the last ten years (particularly in the North East), the relative productivity of the regional economy (measured by GVA per head) has been going down. The share of public spending in these regions has remained more or less steady over this period of time with public capital expenditure being relatively low (except in the North West), thus signalling that government investment in public sector reform is going elsewhere. The public sector has not played a 'developmental' role in the regions for the most part. It has difficulties in catalysing a significant multiplier effect for the private sector and it does not appear to have greatly boosted the private initiative of the local population. Few administrative efficiencies and innovations have been spurred in the region by the commissioning or outsourcing of public services and works.

Like Southern Italy, the North of England is suffering from a deficit of the initiative and regional leadership needed to drive the region towards steady economic growth and prosperity. This was identified in the context of the North East by the OECD's territorial review of the region (OECD 2006) but the lessons go much wider. The habit of getting money from the centre to satisfy the needs of declining regions has played a negative role, nurturing a clientilistic approach among regional and local government leaders. These leaders have failed, jointly with regional and local stakeholders, to formulate a vision for the region. If such a vision were identified, it could be implemented, at least partially, using a joint pool of money from the national budget, EU structural funds (some parts of the North of England still qualify for this support), regional/local budgets and private investment.

Moreover, Whitehall's centralised planning, implementation and control mechanisms have kept it in the role of 'backseat driver', even when formally granting the regions the opportunity to explore their local potential and relative advantages. Very often, local knowledge is ignored or overruled by the expert view from London, for example in decisions about major infrastructure, transport projects or the allocation of European structural funds. Nonetheless, there have been cases in which some English regions (for example, the West Midlands) have managed to present and defend their position clearly in negotiations with central government, and the northern regions should learn lessons from such examples.

There is no clear evidence that the public sector has been crowding out private sector jobs. This is partly because the two sectors have quite different job profiles, and partly because of the differences in remuneration packages between the two. The public sector is more attractive for employees in periods of economic recession and stagnation than in boom periods (at least in the mid- and high-skilled segments of the labour market). Otherwise, for high-skilled positions the salary and other benefits offered by the private sector are more attractive than what is on offer at the same level in the public sector (though public sector employment tends to be more stable).

Demographic trends suggest there will be a growing need for some types of services and a decreasing need for others. An ageing population will put more strain on healthcare and social services. Moreover, the older section of the population is less able or less inclined to use new technologies (such as computers, the Internet, mobile phones, and land telephone lines), and thus it may be harder to cut costs for them through the introduction of new information and communication technologies. On the other hand, new technologies may bring significant benefits to the education sector, as young people adapt to using them much more quickly.

The relocation of public sector jobs outside London and the South East offers significant potential gains to the North, though for these gains to be sustainable, these jobs should be in high value-added sectors. To match this trend, the region's higher education institutions should collaborate more actively with public sector institutions, in order to offer jobs to young, highly-qualified graduates that will keep them living in the region. Relocation also has the potential to have a positive impact on the growth of regionally-based service providers (both for the public sector and private consumption) and on incomes. This needs to be balanced, however, against the fact that an inflow of highly paid specialists could lead to a growth in property and commodity prices, which could have negative consequences for low-income residents.

The public sector efficiency agenda provides some opportunities for cutting costs and rationalising the way public organisations are operating. However, the efficiency drive is proving to be a major problem at the local level, where the relatively small scale of operations and contracting issues make it difficult to reach the 2.5 per cent efficiency target (or the 3 per cent target for the next period, 2008–11). Northern-based companies with no previous experience in public procurement might have little chance of accessing this lucrative sector, as standards are becoming much tighter and more formalised, requiring a great deal of technical expertise which could only be gained from practical experience. (According to the consulting company Kable, outsourcing in the public sector reached £49.4 billion in 2005–06 and has the potential to grow to £64.3 billion in 2008–09 [Kable 2006].) Hence even if government offices are relocated to the North, this might not help if procurement is still largely run from the centre and relies heavily on ICT instruments.

5. Conclusions and recommendations

The analysis undertaken in this paper confirms the idea that the public and private sectors are not mutually exclusive entities. Both theory and practical observation testify that public intervention is necessary to revive the economy of relatively deprived areas that have high levels of unemployment. The public sector can catalyse positive developments in the labour market by combating unemployment and increasing personal incomes and spending, which in turn should stimulate growth in the private sector.

The new role of the public sector

The core purpose of the public sector is to deliver public goods that are not suitable for provision by the private sector (such as defence, justice and aspects of fundamental scientific research), as well as a substantial proportion of education and health services. At the same time the public sector has a vital role to play in creating an enabling environment for the private sector and extending the collaboration and involvement of the voluntary sector in the provision of public services. This role needs to be performed not only through conventional economic instruments such as interest rates, fiscal stability, financial support and labour market regulations, but also by creating the necessary tools to improve the links between business, innovative science and higher education institutions, and by providing an adequate transport and communications infrastructure, and a good regulatory environment.

At the regional level, the public sector's enabling functions should take precedence over its interventionist, regulatory elements. The sector needs to become a real factor of development for the regions and for businesses, enabling them to unlock their potential and to increase their investments.

Costs and benefits

Demographic trends in the UK necessitate a review of current public spending allocations and priorities. The ONS (2007b) reports that apart from negative natural population growth – which could be compensated for by higher levels of immigration – British society has more 'dispersed' families, with a substantial increase in the number of people living alone (from three million in 1971 to seven million in 2005). If this trend continues, it will have serious implications for community and transport infrastructure, landuse planning and housing policy. The health and social services will experience revolutionary changes resulting from increased life expectancy and the greater proportion of older people in the population, who have specialised needs and requirements. An adjustment in education and employment policies will also be required to secure more labour in the over-50s age group, which is currently under-represented in the active labour force. We analyse this theme in detail in Johnson *et al* 2007.

The lower the population density, the higher the costs of providing services. The North of England has a low population density overall and therefore the total cost of providing services is high. The need for public investment is also greater, since the private sector has continually failed to restructure production facilities and change the specialisation of the regional economy in order to satisfy the growing demand for particular products and services. All of this raises the threshold for the total amount of public spending required.

While analysing the (extensive) role of the public sector in the North of England it is important to look not only at the total amount of public funding, but also at its 'quality': its ability to stimulate new economic activity and investment in the private sector, which will ideally then enable a gradual reduction of state intervention and financial injections. The successful examples of countries such as Sweden or Finland prove that increased public investment in education, R&D, science and technology and crucial business and community infrastructure can keep states and regions at the top of the 21st century global economy.

Current high levels of spending in northern England mainly illustrate the high costs associated with the day-to-day needs of its three regions. Public capital expenditure has been relatively low there (except in the North West), thus signalling that government investment in public sector reform is spread unequally and is inadequate to respond to the challenges of the most deprived regions. They have less money to spend on modernisation and thus have less chance to improve their outcomes to higher-than-average rates (which are needed in order to catch up with the national average). The public sector has not catalysed a multiplier effect for the private sector and has not boosted the private initiative of the local population. The Government's spatial allocation of investments should change in order to allow more capital to unlock the potential of the northern regions.

The core public spending (that contributes directly to the regions) will also have to change to reflect changing needs in spending in different sectors. While the distribution of spending is wholly driven from the centre, there is unlikely to be a dramatic advancement in the northern economies relative to the rest of the UK. Currently, the opportunities provided are more or less equal to those in all English regions, and thus more successful areas in the Greater South East are likely to remain better off. There is a need for Government to develop a modern needs-based approach to distributing funds across the English regions.

Relocation of jobs and skills

While the share of public sector employment has been growing over the last ten years and the share of public spending has remained relatively stable, the relative productivity of the northern regional economies (measured by GVA per head) has been going down. One of the key drivers behind this phenomenon is that the public sector jobs in the three regions are still largely concentrated in the lower segment of labour market, thus hindering the growth of regional output.

Our research revealed the positive results from the relocation of managerial posts to the North West and Yorkshire and the Humber from 2004–06. We argue that this trend should be sustained and distributed across all northern regions. To really contribute to regional decentralisation and close the productivity gap between the

North and the South, the public sector should organise and streamline the relocation process in a way that strengthens the expertise and scientific capacity of these less advantaged regions. This could be done by moving more policy and research posts to the North. Relocating public sector jobs from London and the South East would also make vacancies available to young specialists graduating from the region's universities who wished to stay in the area, and who might otherwise move south precisely to get these jobs.

The centrally-driven process of relocation should be planned in such a way that it is fully integrated into the implementation of Regional Economic Strategies (soon to become single Integrated Regional Strategies) and that these processes are mutually reinforcing. All three northern Regional Economic Strategies often rely on the public sector (and public spending on economic development and regeneration in particular) as one of the key drivers of sustainable economic growth and as a potential catalyst of a multiplier effect for the labour market and businesses.

Efficiency and spatial effects in the public sector

At the moment, the Government in its modernisation of the public sector overwhelmingly focuses on delivering its efficiency agenda. Despite the importance of this mission it is often done in quite a mechanical, non-inventive way. The current efficiency targets have caused problems at the local and regional levels due to the rigidity of the targets and the limits of the regions' bargaining power. The uniformity is partly responsible for hindering the North's chances of radically improving its performance and its position relative to the rest of the country.

Our research concludes that current arrangements can only lead to 'linear' changes and improvements, following the pattern of gradual and successive stages and phases, which require a certain amount of time and resources. We believe that the same efficiency results could be better achieved by adding other means, for example creating a system of incentives to boost collaborative initiatives, or setting up conditionality principles for providing financial resources (on top of the minimum required) to spur innovation and create better value for money in the public sector. For the North to perform better than other parts of the country, it will need to be more creative and to 'leapfrog' quickly through several stages. It needs to absorb positive and negative experiences from other parts of the country, to have clear objectives for the future and to use all this to develop its own unique path for progress, rooted in the local situation and taking full account of local factors.

Also, greater emphasis on spatial efficiency of public services is needed, which stems from enhancing the positive cluster effects from relocated offices and using locally available factors and resources more successfully.

Procurement

We recommend that the Government continues to improve the efficiency of public procurement procedures (via the Office of Government Commerce), introducing higher standards and ICT-based solutions. However, this should be done in a way that increases the chances for regional and local companies to participate in the process. They should receive support, advice and training on how to comply with these new standards, how to use new tools in public procurement (which are often internet-based), and how to become more competitive. This new technology should enable them to provide goods and services not only locally, but also to public agents located in other regions of the UK.

The quality of data

The rigour and depth of our and others' research suffers due to the deficiencies in public sector employment statistics. We recommend that the Government make funding available for the gathering and production of administrative data for the English regions (as is done in Scotland, Wales and Northern Ireland) instead of relying on ONS regional estimates based on Labour Force Survey data. These estimates are inconsistent with the National Accounts classification. The LFS definition of public sector employment should be used as a basis, since it is more accurate than the National Accounts definition (classifying GPs and university staff as public, rather than private, sector employees).

Decentralisation and leadership

The North of England shows some of the symptoms of clientelism – a deficit of initiative and joint-up regional leadership that could drive the region towards steady economic growth and prosperity. To reverse this situation there is a need in additional capacity. Whitehall's centralised planning, implementation and control mechanisms have kept it in the role of 'backseat driver', even when formally granting the regions the opportunity to explore their local potential and relative advantages. Now it is time to provide support to the regional and local authorities to strengthen their capacity in order that they can perform these and other functions on their own.

This means that developmental public spending in the regions will require a different, less centralistic, approach, informed by the idea that regions and sub-regions are relatively autonomous units seeking greater productivity and intra-regional territorial equality. Regional and local leaders should unite their efforts and resources to improve the processes of strategic planning and implementation in the ever-extending areas of their responsibility. Leadership, strengthened capacity and initiative at the regional level should be encouraged and supported, reducing the power of central government to dictate in areas that might benefit more from regional and local knowledge and territorially-adaptable policies. It is, however, essential for the state to maintain a certain level of supervision and control over regional and local government in order to secure a fair approach and to guarantee minimum social standards, which would be imposed by law or targets.

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Appendix 1. Identifiable current expenditure on services, by function, country and region, 2006-07

£ million

	GPS	EUT	IS	DI	D	POS	EED	ST	EP	AFF	T	EP	HCA	H	RCR	ET	SP	UP	Total
North East	295	-	10	-	5	1,300	415	61	219	209	280	265	197	4,184	291	2,932	8,611	-	19,272
North West	683	-	26	-	9	3,366	623	151	437	418	985	961	538	10,997	598	7,676	21,582	-	49,051
Yorkshire & Humber	422	-	20	-	6	2,034	569	131	321	437	557	449	302	7,729	468	5,551	14,811	-	33,805
East Midlands	364	-	16	-	6	1,525	381	105	154	391	548	351	167	5,895	357	4,451	11,357	-	26,069
West Midlands	499	-	20	-	9	2,113	363	97	397	415	724	456	212	7,799	437	5,943	15,469	-	34,954
Eastern	497	-	21	-	11	1,792	169	255	187	411	514	502	111	7,262	410	5,449	14,063	-	31,653
London	926	-	29	-	13	5,253	478	298	409	217	2,371	809	894	12,080	953	9,603	22,422	-	56,754
South East	721	-	31	-	21	2,932	279	252	193	496	1,028	1,131	293	10,714	659	8,058	20,169	-	46,976
South West	482	-	19	-	10	1,876	212	91	159	894	600	743	188	7,066	405	4,899	13,919	-	31,563
England	4,889	-	192	-	91	22,190	3,489	1,440	2,476	3,888	7,607	5,668	2,901	73,725	4,577	54,563	142,402	-	330,097
Scotland	783	-	19	-	8	1,955	567	252	614	672	1,267	1,174	361	8,644	816	6,186	16,021	-	39,339
Wales	614	-	11	-	4	1,359	574	55	112	371	475	397	134	4,659	499	3,431	9,549	-	22,246
Northern Ireland	382	-	7	-	1	1,243	220	52	163	446	250	194	518	2,691	308	2,156	6,097	-	14,729
UK current identifable expend.	6,668	-	229	-	104	26,746	4,850	1,799	3,365	5,377	9,598	7,433	3,914	89,719	6,201	66,337	174,070	-	406,411
Outside the UK	5	4,378	5,289	-	48	0	40	145	9	-	37	34	0	605	160	5	2,308	-	13,062
Total current identifiable expend.	6,673	4,378	5,519	-	152	26,746	4,890	1,943	3,375	5,377	9,635	7,467	3,915	90,323	6,361	66,342	176,378	-	419,473
Non-identifiable spending	4,975	-7,090	1,131	27,166	30,836	1,494	118	327	-	67	137	249	-	167	2,742	-	1	2,081	64,402
Total current expend. on services	11,648	-2,712	6,650	27,166	30,988	28,240	5,008	2,271	3,375	5,444	9,772	7,716	3,915	90,491	9,103	66,342	176,379	2,081	483,875

Source: HMT, PESA 2007, Table 9.10a

KEY GPS=General public services EUT=EU transactions IS=International services DI=Debt interest D=Defence POS=Public order and safety EED=Enterprise and economic development ST=Science and technology EP=Environmental policies AFF= Agriculture, fisheries and forestry T=Transport EP=Environment protection HCA=Housing and community amenities H=Health RCR=Recreation, culture and religion ET=Education and training SP=Social protection UP= Unallocated provision

Appendix 2. Identifiable capital expenditure on services, by function, country and region, 2006-07

£ million

	GPS	EUT	IS	DI	D	POS	7	8	9	10	11	12	13	14	15	16	17	18	Total
North East	40	-	1	-	1	63	96	16	1	2	293	47	287	282	143	281	55	-	1,609
North West	118	-	3	-	1	190	590	29	2	11	915	289	837	714	201	547	87	-	4,533
Yorkshire & Humber	52	-	2	-	1	154	105	33	1	12	539	117	633	414	208	526	83	-	2,882
East Midlands	110	-	1	-	1	98	47	22	1	7	460	51	283	378	139	423	50	-	2,073
West Midlands	125	-	1	-	1	152	169	25	1	9	688	74	458	489	236	522	62	-	3,010
Eastern	126	-	1	-	1	111	87	45	1	4	800	73	295	353	165	454	40	-	2,554
London	199	-	1	-	2	439	31	92	2	39	2,292	61	1,798	660	434	910	80	-	7,040
South East	187	-	1	-	2	179	209	60	1	15	1,266	208	635	925	229	762	69	-	4,746
South West	70	-	0	-	1	104	77	21	1	53	613	185	245	498	218	441	48	-	2,575
England	1,027	-	9	-	11	1,490	1,413	344	12	153	7,864	1,105	5,470	4,713	1,972	4,866	574	-	31,022
Scotland	78	-	0	-	0	209	111	75	49	90	1,232	264	1,188	491	266	550	107	-	4,711
Wales	123	-	0	-	0	118	221	16	1	13	445	67	350	220	158	219	36	-	1,987
Northern Ireland	41	-	0	-	0	95	72	18	0	44	142	77	413	189	116	276	53	-	1,534
UK capital identifiable expenditure	1,268	-	10	-	11	1,912	1,816	452	62	301	9,683	1,513	7,421	5,613	2,513	5,911	769	-	39,254
Outside the UK	1	-	31	-	5	-	72	36	-	-	1	8	-	0	44	-	-	-	197
Total capital identifiable expenditure	1,269	-	41	-	16	1,912	1,888	489	62	301	9,683	1,521	7,421	5,613	2,557	5,911	769	-	39,451
Non-identifiable spending	374	-	159	-	1,218	156	48	81	-	-	9	24	-	80	84	-	-	3,696	5,931
Total capital expenditure on services	1,643	-	200	-	1,234	2,068	1,936	570	62	301	9,693	1,545	7,421	5,693	2,641	5,911	769	3,696	45,382

Source: HMT, PESA 2007, Table 9.10b

KEY GPS=General public services EUT=EU transactions IS=International services DI=Debt interest D=Defence POS=Public order and safety EED=Enterprise and economic development ST=Science and technology EP=Environmental policies AFF= Agriculture, fisheries and forestry T=Transport EP=Environment protection HCA=Housing and community amenities H=Health RCR=Recreation, culture and religion ET=Education and training SP=Social protection UP= Unallocated provision