

A balancing act: spending cuts, private sector growth and a sustainable economic future

Policy Insight

Autumn 2010



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As the public sector steps back, the private sector is expected to step in.

The Government has put deficit reduction at the heart of its agenda: the Emergency Budget in June set out initial cuts of £6bn in the coming year with further cuts to be unveiled in October. Recognising this atmosphere of austerity, the Prime Minister has warned of the challenges ahead. In his own words, the Comprehensive Spending Review would be the "time the rubber hits the road".¹

So far there has been much speculation about the scale and impact of fiscal austerity measures, with the geography of cuts being a particular concern for local areas. Many local economies rely on public sector jobs and fear looming job losses.

Although the impact of spending cuts is most obviously concentrated within the public sector, it will undoubtedly have a knock-on effect on the private sector. There are many firms that supply a large proportion of their goods and services to the public sector, and these could be affected as a result of reduced spending from public sector bodies.

Against this backdrop the Government has emphasised the overriding need to 'rebalance the

economy', with growth in private sector jobs making up for losses in the public sector and becoming the main driver of growth. Implicitly, this suggests the Government believes that the public sector has been 'crowding out' or displacing private sector activity. In other words, as the public sector steps back, the private sector is expected to step in.

Supporting the Government's plans for a sustainable economic future, there have also been many changes to governance arrangements, specifically related to those organisations responsible for delivering local economic development and jobs growth. Radical changes have been put forward in a short space of time. Regional Development Agencies (RDAs) have been scrapped and local areas have been invited to submit proposals to form Local Enterprise Partnerships (LEPs) in their place. In addition, a new fund – the Regional Growth Fund – has been launched to provide financial support to LEPs and others as they work to stimulate private sector jobs, and a consultation on its role has been put forward.

¹ BBC, 07/09/2010, <http://www.bbc.co.uk/news/uk-11211326>

In some areas public sector jobs represent over 30% of total jobs in the economy.

Despite parliamentary recess and the holiday season, councils have been busy responding to these changes, setting out their proposals for LEPs and providing suggestions on the Regional Growth Fund.

So far a hectic start, and a great deal of uncertainty remains over how these changes will play out geographically. Which areas are more vulnerable to spending cuts given their reliance on public sector jobs? Are there specific industries within the private sector that could be affected given their supply chain links with the public sector? What are the likely sources of future employment growth and business investment and how can local areas and LEPs take advantage of these?

The public sector steps back

We still do not know where the axe will fall and how the impact will be felt across the country. However, by identifying those areas more reliant on public sector jobs, we can begin to understand which districts could be more vulnerable to future spending cuts.

There are a large number of local areas that rely heavily on public sector jobs. In some areas, public sector jobs represent over 30% of total jobs in the economy – much higher than the Great Britain average (20%).²

This is the case in Scotland (e.g. Eilean Siar, Argyll & Bute, West Dunbartonshire), Wales (e.g. Merthyr Tydfil, Denbighshire, Swansea, Torfaen), the North East (e.g. Durham, Middlesbrough and Newcastle) and the North West (e.g. Sefton and Blackpool). And it also applies to some districts in the South (e.g. Gloucester, Exeter, Plymouth, West Dorset and Taunton Deane).

Job losses within the public sector constitute the most obvious and direct impact of public spending cuts. However, the public sector plays an important role not only as a direct employer, but also as a buyer of products and services from other parts of the economy. Cuts will undoubtedly impact upon the private sector, undermining its ability to grow.

² Annual Business Inquiry 2008, <http://stats.berr.gov.uk/ppse/index.asp>

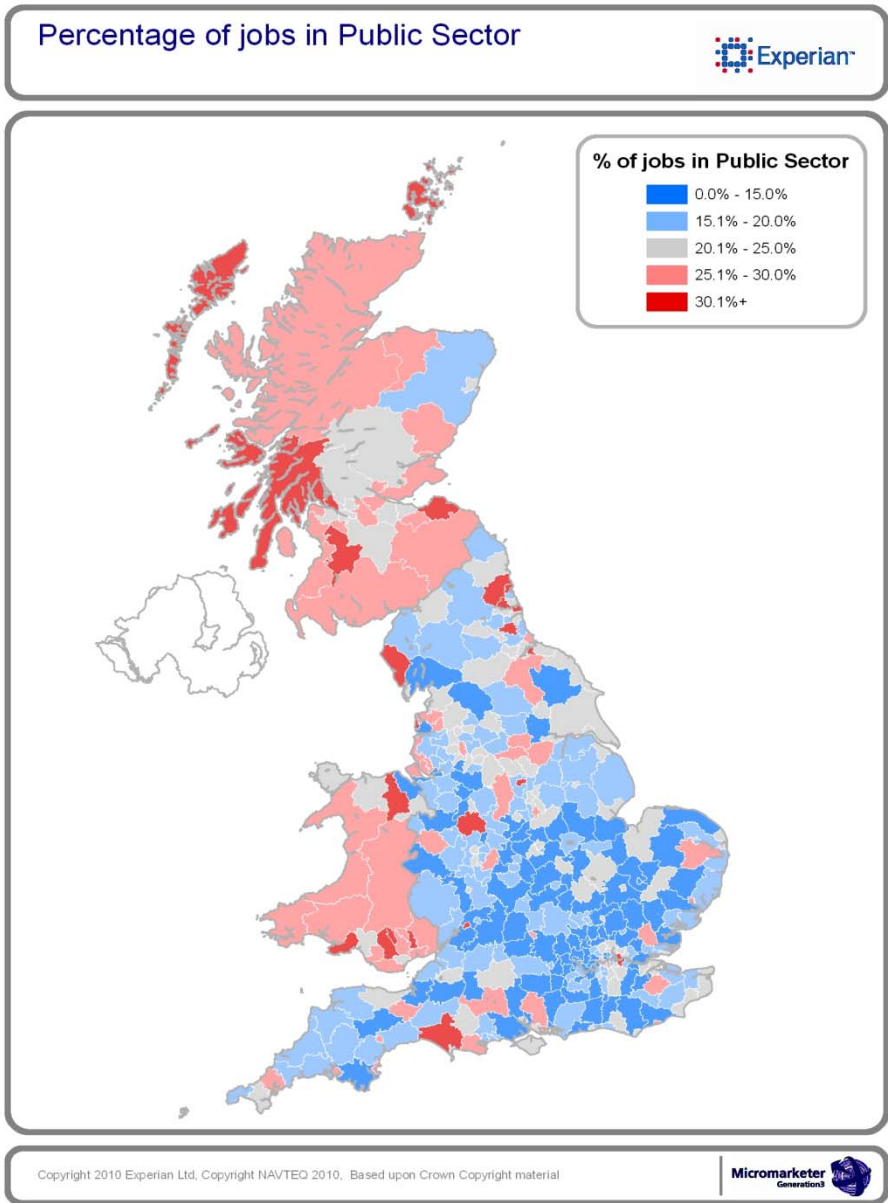


Figure 1: (Above) Jobs in the public sector 2008 (as % of total jobs)

Figure 2: (Right) Districts within highest 10% for public sector jobs (as % of total jobs)

Local authority	% of jobs in public sector
Copeland	50%
Castle Morpeth	49%
Eilean Siar	40%
West Dunbartonshire	39%
Orkney Islands	38%
Merthyr Tydfil	38%
Wansbeck	38%
Argyll & Bute	36%
Shetland Islands	35%
Denbighshire	35%
Durham	35%
East Ayrshire	33%
Middlesbrough	33%
Stafford	33%
West Dorset	32%
Newham	32%
East Lothian	32%
Gloucester	32%
Swansea	32%
Torfaen	32%
Rhondda, Cynon, Taff	31%
South Tyneside	31%
Blackpool	31%
Chesterfield	31%
Greenwich	31%
Newcastle-upon-Tyne	31%
Bridgend	30%
Taunton Deane	30%
Gwynedd	30%
Dundee City	30%
Carrick	30%
Derbyshire Dales	30%
Inverclyde	29%
Carmarthenshire	29%
Exeter	29%
Shrewsbury & Atcham	29%
East Renfrewshire	29%
Blaenau Gwent	29%
Sefton	29%
Plymouth	29%
Great Britain	20%

Source: Annual Business Inquiry, 2008
<http://stats.berr.gov.uk/ppse/index.asp>



There is the risk that businesses that are highly dependent on revenue from the public sector may 'go to the wall' as a consequence of public spending cut-backs.

There are a number of firms that sell a large proportion of their goods and services to the public sector that could also see a negative impact on their activity and employment as a consequence of reduced spending by public bodies. In other words, there is the risk that businesses that are highly dependent on revenue from the public sector may 'go to the wall' as a consequence of public spending cut-backs.

Using detailed input-output tables sourced from the Office for National Statistics, which show sales and purchases between different sectors, we can identify those industries that supply to the public sector. See the Nottingham City Council case study, right.

Finally, it is important to note that in addition to a potential negative impact on public sector suppliers, changes in policy could also lead to new areas of growth for particular industries. For example, changes in the provision of public services and the drive to encourage more private and voluntary sector involvement could mean some businesses in these particular industries benefit from the new Government's policy. However, the overall net effect remains uncertain.

Case study 1: Nottingham City Council, Public sector supply chains

Experian was commissioned by Nottingham City Council to provide an update of the city's economic resilience – its ability to withstand external shocks. The project included analysis of a number of up-to-date indicators in relevant areas including its business base, the skills and characteristics of its people, community, and its place offer. The updated indicators were used to inform Nottingham's Local Enterprise Partnership (LEP) submission and response to the Regional Growth Fund consultation.

The economic resilience report included a special feature on Nottingham's public sector, particularly on its supply chain. This helped the Council and Nottingham business, finance and academic leaders to understand potential knock-on effects on the private sector from public sector cuts. In Nottingham City, the public sector has a strong presence making up 6.8% of total jobs against 5.2% in England – this takes into account only the public administration and defence sector. Overall, the public sector represents 27% of total jobs, compared to 20% in Britain.³

Using input-output tables sourced from the Office for National Statistics and Experian's own economic model for the East Midlands, we provided estimates of

³ Public administration and defence jobs sourced from Annual Business Inquiry, SIC code L (2003). Overall figures sourced from ONS <http://stats.berr.gov.uk/ppse/index.asp>

the public sector supply chain. We found that the business services, banking and insurance, and construction sectors accounted for over half of the sales made to the public sector in the Nottingham core city area. Thus, spending cuts affecting the public administration and defence sector could have an impact on activity and employment in these specific industries.

Using this information, we estimated that for every £1 million contraction in the public administration and defence sector's output, overall output in the core city area could decrease by £1.2 million because of indirect effects, including the impact on private sector suppliers.⁴

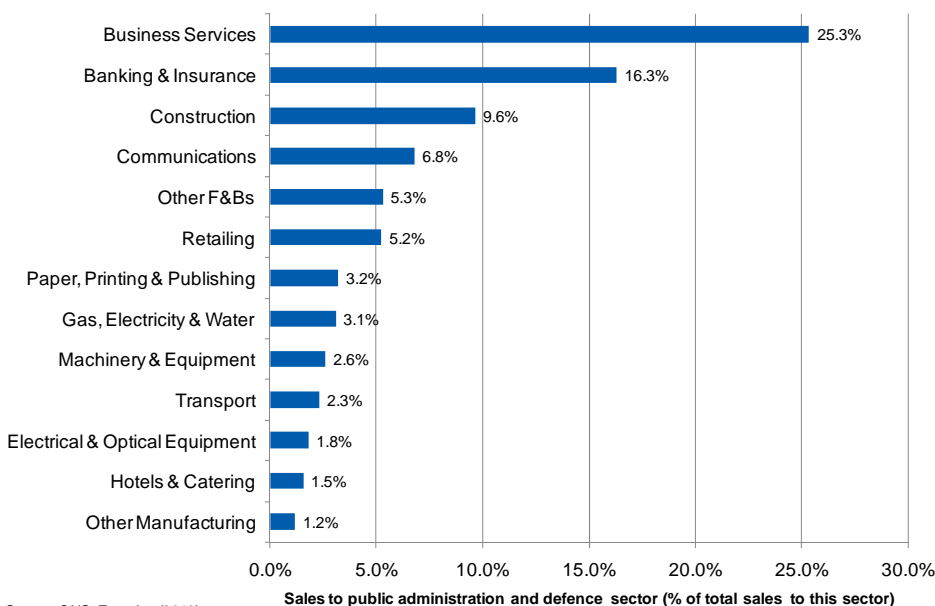
The private sector steps in?

The private sector is expected to be the key driver of future business investment and employment growth, making up for potential job losses in the public sector. But how has the private sector performed in the past, particularly in those areas with a high proportion of public sector jobs?

Over the past five years, the public sector created over 250,000 jobs in Britain compared to 1.1 million created by the private sector, about 20% of all jobs created between 2003 and 2008. Consequently, the Government is putting a strong emphasis on the need to 'rebalance' the economy, particularly fostering more private sector growth, arguing that over the past years the public sector has to a certain extent displaced private sector activity.⁵

Figure 3: Sales to the public administration and defence sector (% of total sales to the public administration sector)

Please note that this only takes into account sales within the local area, in this instance Nottingham core city area.



Source: ONS, Experian (2010)

⁴ These are known as multiplier effects. This incorporates the effect of public sector purchasing from other industries (Type 1 – supply multipliers) and the spending made by those workers employed as a consequence of this activity, (Type 2 – income multipliers).

The multipliers for the public administration and defence sector in Nottingham core city area were estimated to be around 1.1 for Type 1 and 1.2 for Type 2. It is important to note that although the multipliers make a useful point about these knock-on effects of public sector cuts on the private sector, some of the impact will not be felt locally as a significant proportion of public sector procurement is undertaken centrally. In addition, the information presented in figure 3 and the multipliers do not take into account capital expenditure streams, therefore the impact could be much greater.

⁵ See footnote 2.

In some local areas with a strong public sector presence the private sector did not grow at all, or even contracted over the last decade.

Although the picture varies markedly across the country it is set within the broader context of slow private sector growth at UK level. In some local areas with a strong public sector presence (identified in figures 1 and 2) the private sector grew at a slower pace than average, did not grow at all or even contracted over the last five years.

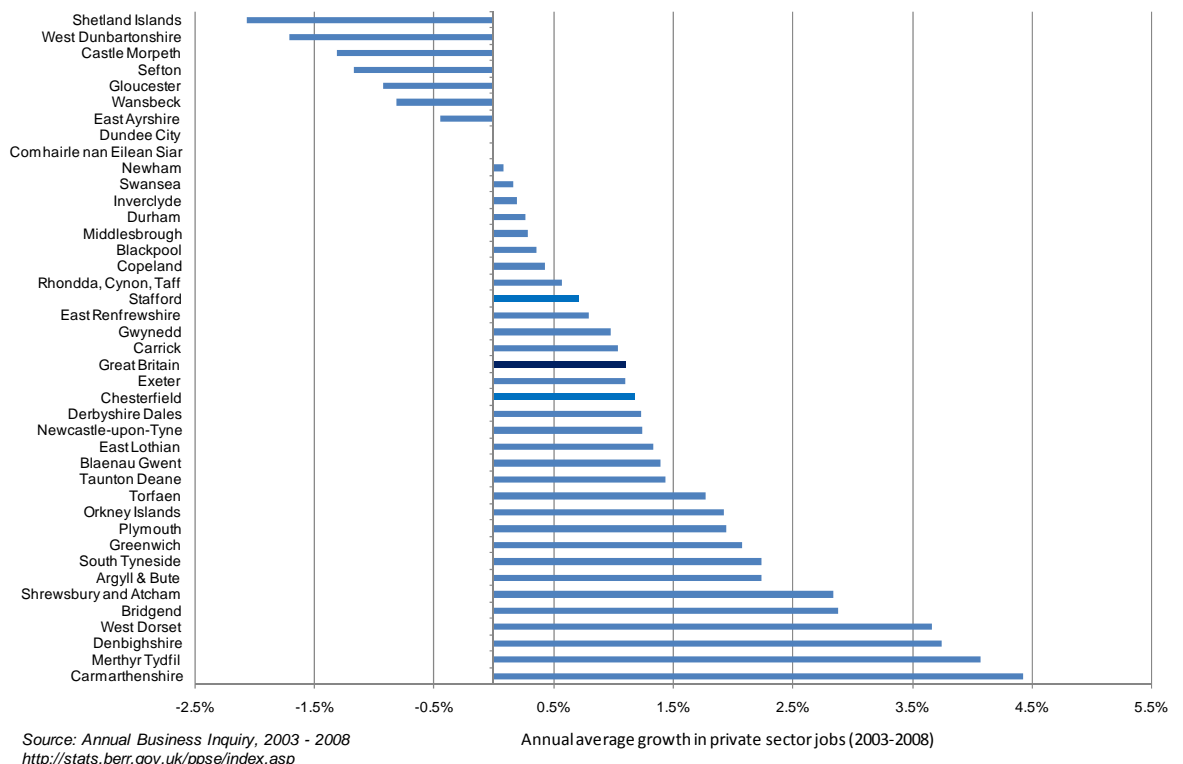
This suggests that in some of the industrial heartlands the public sector propped up the local economies, mitigating the impact of ongoing industrial decline. Arguably, this means growing private sector jobs in some of these areas could be extremely challenging.

Recently Experian carried out work on economic resilience for the BBC. Resilience is a concept used to describe the ability of an area to withstand and respond to shocks in the external environment. We have looked at data for local authority areas across four broad areas – business, people, place and community. The evidence suggests that there is a North/South divide when it comes to overall economic resilience.

However, the picture is not as clear cut, with some economies in the South, such as Plymouth, also likely to face difficulties to respond to rapidly changing macro-economic circumstances.

Figure 4: Private sector growth selected areas (those included in figure 2), 2003-2008.

Annual Business Inquiry, 2003 and 2008 <http://stats.berr.gov.uk/ppse/index.asp>.



The ability to create private sector jobs is influenced by resilience. Analysis of Experian's own *Business Resilience Index* provides similar evidence. Drawing on official and proprietary data sources, this index brings together information on business start-ups, their adaptive and export capacity, among others.⁶

Results from the business index for England show that some areas with a high proportion of public sector jobs, and slow historical private sector growth, are among the bottom 25% when it comes to business resilience. In these areas, the private sector may be less able to step in. In other words, it suggests the presence of long-standing market failures⁷ in some areas that may need addressing if private investment growth is to be fostered.

Figure 5: Business resilience (England districts), 2008

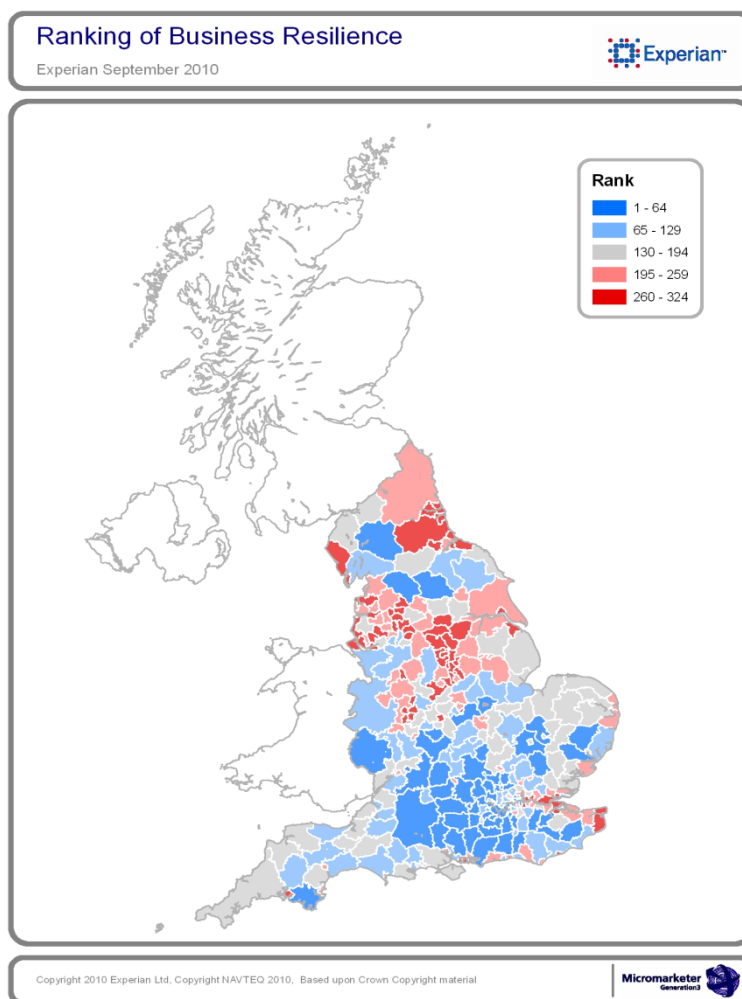


Figure 6: Business resilience rankings, Top and Bottom 10, 2008

Local authority	Rank (out of 324 English districts)	Local authority	Rank (out of 324 English districts)
Top 10		Bottom 10	
St Albans	1	Barrow-in-Furness	315
Cotswold	2	Cannock Chase	316
Islington	3	Stoke-on-Trent	317
Elmbridge	4	Mansfield	318
Waverley	5	Ashfield	319
Surrey Heath	6	Plymouth	320
Mid Sussex	7	South Tyneside	321
West Berkshire	8	Redcar and Cleveland	322
Mole Valley	9	Hartlepool	323
Hertsmere	10	Middlesbrough	324
Source: Experian 2010		Source: Experian 2010	

⁶ Business resilience includes the proportion of firms in resilient and vulnerable sectors, information on the number of firms in high-value added sectors, data on self-employment, adaptive capacity, exports, foreign investment, insolvency rates and payment data. Data was sourced from a combination of Experian and publicly available sources. For more details on the work commissioned by the BBC, see www.bbc.co.uk/spendingreview; <http://publicsector.experian.co.uk/Products/Economic%20Resilience.aspx>

⁷ There are specific instances where the mechanisms by which markets operate may not deliver the most efficient outcomes. Common causes include public goods, the presence of externalities, imperfect information, market power, and coordination problems. For a full description of each of these see, GLA (2006) *The rationale for public sector intervention in the economy*, London: GLA Economics.

The exciting high-value sectors may not create jobs in some areas, or indeed, may not create the right type of jobs for those left out of work due to public sector cuts.

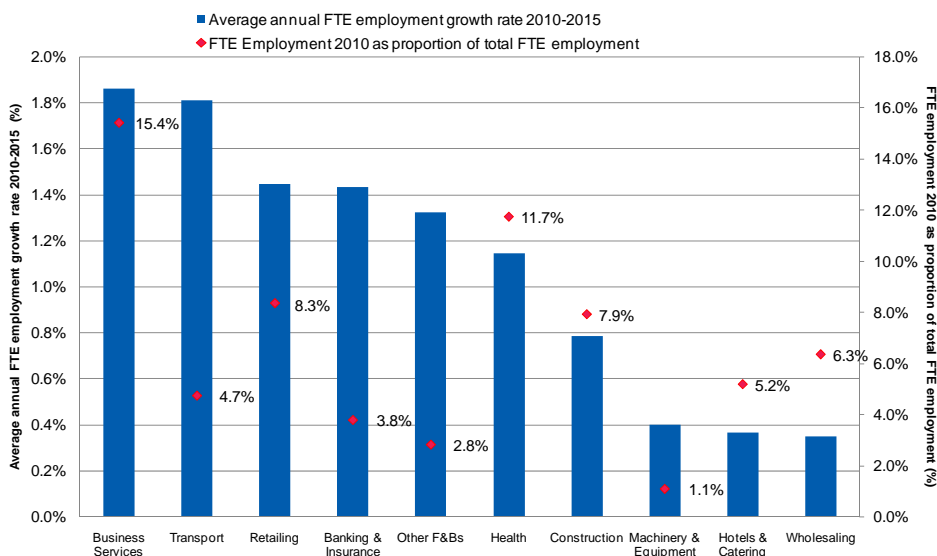
So far we have discussed historical performance related to private sector growth, but what about future performance? Which sectors are likely to experience jobs growth in the coming years? Experian forecasts suggest that one of the sectors where the UK has the greatest strengths, namely business services, is expected to experience significant employment growth over the next five years. In the near term business services growth will be more robust compared to banking and insurance given there is still a degree of consolidation occurring in the latter.

Other sectors, such as retailing, health and construction will also provide future sources of jobs. Manufacturing of machinery and equipment – the higher end of manufacturing⁸ – will also grow, albeit to a lesser extent.

The BIS growth strategy⁹ emphasises that future investment and employment growth needs to be based on those key sectors where the UK has its strengths. It mentions the financial and business services, creative and low carbon industries and advanced manufacturing. But it is important to emphasise that this growth may not always be accompanied by large numbers of jobs, or jobs accessible to all segments of society.

Moreover only some local areas currently have strengths in these sectors or the combination of assets required to attract this type of investment. This is evidenced by data on high-value added sectors¹⁰ included in Experian’s Business Resilience Index, with many districts in the south having a high concentration of firms within these sectors. In other areas it may well not be these exciting, high-value sectors that create the jobs, or indeed the right type of jobs for those left out of work as a consequence of the downturn and public sector job cuts.

Figure 7: Short-term future FTE employment growth in the UK, 2010-2015



Source: Experian Economics, July 2010

⁸ According to the OECD definition of knowledge intensive industries, this sector is part of the “medium-high technology industry”, http://stats.oecd.org/oe.cd/stat_metadata/ShowMetadata.ashx?Dataset=CSP6&Coords=%5BSUB%5D.%5BHTEXPORT%5D&Lang=en.

⁹ BIS (2010), A model for sustainable and balanced growth, <http://interactive.bis.gov.uk/comment/growth/>

¹⁰ This includes Knowledge Intensive Business Services and High-tech manufacturing.

In reality it may be those sectors that often go unappreciated and overlooked – retail, tourism and hospitality, for example – that will create jobs and help mitigate concentrations of worklessness within local areas.

It is therefore critical that local areas and the new LEPs have an in-depth knowledge of their business base, the sectors that could drive growth and create jobs within their local economies, and the steps that need to be taken in order to capitalise upon these opportunities and foster future investment.

Case study 2: Nottinghamshire City & County Employment and Skills Board, Sector prioritisation

In light of the recession, the Nottinghamshire City & County Employment and Skills Board (NCCESB) wanted to know where future jobs are likely to be created, the sectors that are likely to drive growth, and the support they require to do so.

By critically assessing different sectors, Experian presented NCCESB with recommendations on which sectors to prioritise and the evidence base to support this.

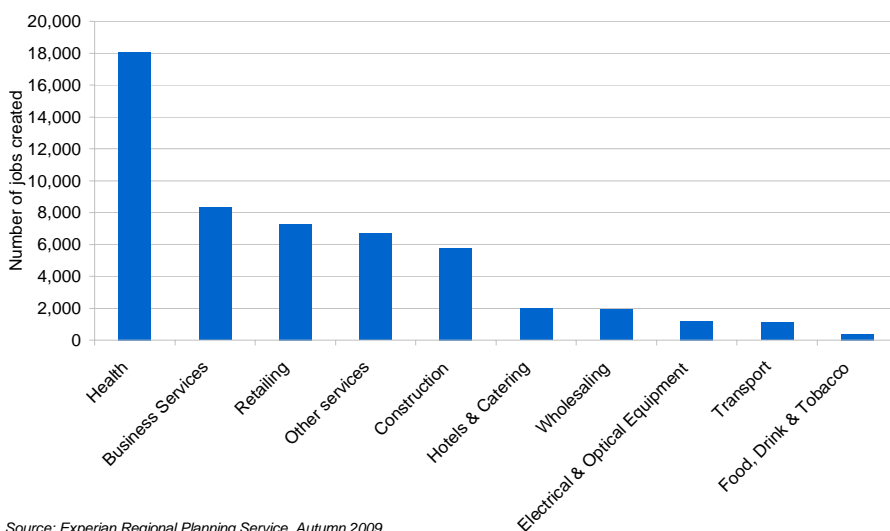
Experian’s approach to this study was to look in detail at the full breadth of the Nottinghamshire economy to provide the evidence for sector prioritisation. This was achieved through four stages:

- Establishing a sound conceptual framework for identifying priority sectors
- Critically assessing different sectors of the economy against these criteria
- Facilitating discussion among the Employment & Skills Board on those sectors that will play a central role in Nottinghamshire’s future
- Presenting evidence-based recommendations on which sectors to prioritise

Our sector prioritisation framework interrogated how sectors impact upon a local area, namely whether supporting the sector would contribute to the local economy; would offer substantial opportunity for growth; and would promote social inclusion.

The research identified four priority sectors for Nottinghamshire: retail, construction, business services and health. These sectors are those that will drive a strong future for Nottinghamshire’s economy, as well as meeting NCCESB’s wider strategic and social priorities. The results and evidence base have directly informed the Employment and Skills Board as it works to understand in more detail the growth potential of the priority

Figure 8: Job creation in Nottinghamshire 2009-19



Source: Experian Regional Planning Service, Autumn 2009

sectors, the roles and skills that will be required to support this expansion, and how to best tailor provision to ensure it is truly employer-led, meeting the needs of Nottinghamshire's businesses now and in the future. To read the full report, visit:
<http://www.nccesb.org.uk/wp-content/uploads/2010/02/GNP-Sectorprioritisation-Final-Report-v2.pdf>.

efficiency and flexibility of the UK labour markets".¹¹

But a great deal of uncertainty remains. Localism was at the heart of both the Conservatives and Liberal-Democrat manifestos. Whether more radical measures to devolve fund-raising powers to a local level is on the cards still remains to be seen. The White Paper on sub-regional growth due in September, the Comprehensive Spending Review, the results from the LEP submissions and the Regional Growth Fund consultation will provide more clarity on the Government's agenda and its impact on local areas.

Genuine business engagement and a recognition of natural economic areas is critical for LEPs governance structures

Despite this remaining uncertainty, LEPs provide an opportunity for local partners to agree on a clear vision and priorities and drive change if they are given the powers and responsibility needed. Given the nature of their task genuine involvement from the business community to help foster future business investment and jobs growth is critical to the success of the LEPs. Indeed, this is why the Government has emphasised the need for business engagement in LEPs as a pre-requisite. However, some submissions have already been criticised for having insufficient buy-in from the business community.

¹¹ BIS (2010), A model for sustainable and balanced growth,
<http://interactive.bis.gov.uk/comment/growth/>

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Delivery challenge: the new LEPs

Having been tasked with delivering business investment and jobs growth, it is ultimately the new Local Enterprise Partnerships (LEPs) that will have to face the challenge of achieving more balanced and sustainable growth in the future. In total 56 bids have been submitted, and the Government will now have to confirm which ones get the go-ahead.

So far, the Government's policy on local economic development has been sceptical of the role of public policy in driving regeneration, encouraging a more active role from the private and voluntary sectors – the latter being a key tenet of the 'Big Society' agenda. In other words, the value for money rhetoric has returned. This translates into spending money only to fix specific market failures, and then leave it to the market. As the BIS growth strategy puts it "government has a key role to play in removing specific barriers to growth for all regions and sectors of the economy, building on the

Furthermore, LEP submissions were also required to reflect their natural economic areas, that is, the way the economy actually works. Economic interactions including commuter patterns, business supply chains, and housing markets often involve different administrative areas. It is important that decisions and policies affecting those interactions are taken at the right spatial level, involving all relevant parties. It is now becoming apparent that a number of submissions cover areas of smaller scale than initially anticipated, following County boundaries rather than larger natural economic areas.

A solid understanding of the characteristics of the business base should underpin realistic economic strategies that play to an area's strengths

As discussed, a clear and detailed understanding of the business base and the key sectors in the economy that have the potential to drive future investment and create jobs is also needed to make sure strategies are realistic and build on existing assets. These may not be exciting high-value added sectors but could for example include retail, tourism and hospitality. These are sectors that could create the right type of jobs for those left out of work as a consequence of the downturn and public sector job cuts. In other words, a robust understanding of an area's business base and business needs should underpin decision-making and priority-setting.

With less money to work with, prioritising policies that will deliver maximum impact will be critical

In fact, in a climate of limited resources, agreeing where there is a real need for public sector intervention and concentrating on those issues that will deliver the greatest impact will be more important than ever. This is not business as usual: LEPs will have less money to work with, therefore prioritising issues, pooling resources, and resorting to innovative finance mechanisms will be critical to creating growth.

Given the limited resources available and prospects of future public sector cuts, there are real challenges ahead. For some areas it will be difficult to attract further business investment and rebalance their economies without addressing key long-standing market failures, for example the quality of their infrastructure or the skills of their workforce. And it is exactly in those places where the Regional Growth Fund could be used to ease the transition towards private sector growth.

Times have undoubtedly changed for local economies. Over the next few years achieving sustainable economic growth will be the number one priority. The spending cuts will impact the public sector directly, and the private sector indirectly; understanding the extent to which this will affect your local area and mitigating the consequences is vital – a unique balancing act.

How Experian can help you shape local economic development and support your LEP

Experian can support the work of your Local Enterprise Partnership. For more details contact:

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