centre for progressive policy

The levelling up outlook

CPP outlook #3

March 2021

About the outlook

The government's levelling up agenda aims to address the place-based inequalities that have held back the country's economic progress for decades. It is at the heart of the promise made by the Conservative Party to former Red Wall seats in the 2019 General Election but fulfilling it has been made harder by the Covid-19 pandemic.

The purpose of the levelling up outlook is to track the country's progress in reducing economic inequalities – particularly as they relate to place – in the context of the ongoing crisis.

This quarter, the outlook focuses on the geographic distribution of pandemic spending before assessing which regions and places stand to benefit the most from the Chancellor's latest policies for recovery. We use official statistics and other reliable data to publish the outlook every quarter.

Key takeaways from the March outlook

The levelling down of London's labour market

London's labour market continues to be worst hit – seeing the highest rise in Universal Credit, highest proportion furloughed and largest fall in total employment of any region during the crisis.

CPP modelling reveals that all regions are likely to experience substantially lower economic output in the summer compared with before the crisis, with the South East and London marginally worse off than other regions.

Pandemic spending has been far higher in London

While levelling up is the government's manifesto goal, preventing the levelling down of London appears to have taken priority during the pandemic. CPP analysis of spending per resident on key emergency economic measures suggests spending has been much higher in the capital.

- **Furlough:** £1,300 per resident spent in London in comparison to £620 per resident in the North East.
- **Self-employment support:** £440 per resident in London in comparison to £190 per resident in the North East.
- **Business loans:** £360 per resident in London in comparison to £150 per resident in Scotland.
- **Universal Credit:** this is more evenly distributed with London, the North East and North West topping the spending at around £80 per resident.

Taken together, this means London has had £7bn more spent on emergency economic measures than the North East and North West combined despite having a population similar in size.

Economic recovery policies are poorly targeted for levelling up

While preventing the levelling down of London is an important short-term aim, the March Budget set out the Chancellor's thinking on long-term economic recovery and levelling up. But CPP analysis finds many of the key policies wanting:

- The super-deduction capital allowance was by far the most expensive policy for economic recovery outlined at the Budget, costing approximately £25bn.
  - Based on pre-crisis rates of business investment in machinery and equipment by sector, London is likely to receive the largest tax breaks per resident of any UK region, £510, in comparison to just £280 in Yorkshire and the Humber and £320 in the North East.
  - London is top because of high levels of investment, reflecting its large economy, and a concentration of investment in sectors like business services where investment tends to be in machinery and equipment.

- More details were announced on the Levelling Up Fund and Community Renewal Fund which together with the Towns Fund are supposed to support left behind local authorities. But the definition of left behind areas leaves much to be desired:
  - CPP calculates that there are 6.5 million people living in deprived local authorities which are not going to be prioritised by any of these funds. It will do little to level up these places.

- The UK Infrastructure Bank (UKIB) was framed as a way of helping to tackle climate change and level up regional and local growth. But this is not new money for investment.
  - As the OBR notes, the government's forecast implies that the UKIB will lend £1.5bn a year, but this is just a third of the financing that was provided by the European Investment Bank prior to the EU referendum.

Has the government given up on levelling up?

Given the continued scale of regional and intra-regional inequality, there has been a general recognition that levelling up will require a generational effort with greater sustained investment directed at the regions and places left behind.

Yet from 2023 onwards, the government will tighten overall spending – principally through large tax rises but also by cutting spending on public services.

The sharp contrast between the huge amount of government spending thrown at the pandemic – which our analysis shows has been dispersed to London more than other regions – and the reversion to austerity by 2023, implies the government has turned its back on any serious effort to level up the country.

So what can the government do to get levelling up back on track?

Ensure local government is properly funded, through making deprivation and need the default criteria for the distribution of any further funds. This includes upcoming schemes such as the UK Shared Prosperity Fund. See CPP's *Why the government needs to pay up before levelling up*. Available at: progressive-policy.net/publications/why-the-government-needs-to-pay-up-before-levelling-up

Reboot locally-led industrial policies which target investment at high value-added growth sectors in left behind places as argued in CPP's *A Gear change for growth*. Available at: progressive-policy.net/publications/a-gear-change-for-growth

Invest heavily in social infrastructure including public health, adult education, childcare and youth services as argued in CPP's *Let's get social*. Available at: progressive-policy.net/publications/lets-get-social

Measure what it cares about – if the government is serious about levelling up it should construct a baseline from which to measure progress and evaluate policy decisions. CPP developed a framework for this in *Back from the brink*. Available at: progressive-policy.net/publications/back-from-the-brink

Latest trends and developments

Regional employment and output

Table 1: Key labour market statistics for January 2021
Source: ONS and HMRC

Region	Year-on-year employee growth (%)	Claimant count year-on-year change (pp)	Furlough: provisional Jan (%)
London	-5.2	5.1	17
Scotland	-2.8	2.7	15
South East	-2.8	3.0	15
South West	-2.1	2.7	16
East of England	-2.1	3.0	15
Wales	-2.0	2.6	14
West Midlands	-1.9	3.3	14
Yorkshire and the Humber	-1.8	3.1	14
North West	-1.7	3.3	15
East Midlands	-1.6	2.7	14
North East	-1.5	2.6	14
Northern Ireland	-0.8	2.2	14

London's labour market has been worst hit by the pandemic

London has experienced the largest year-on-year rise in Universal Credit of any region (5.1 percentage points) and the largest fall in employment rate (-5.2%). London also had the highest proportion of people furloughed at the beginning of the year (17%).

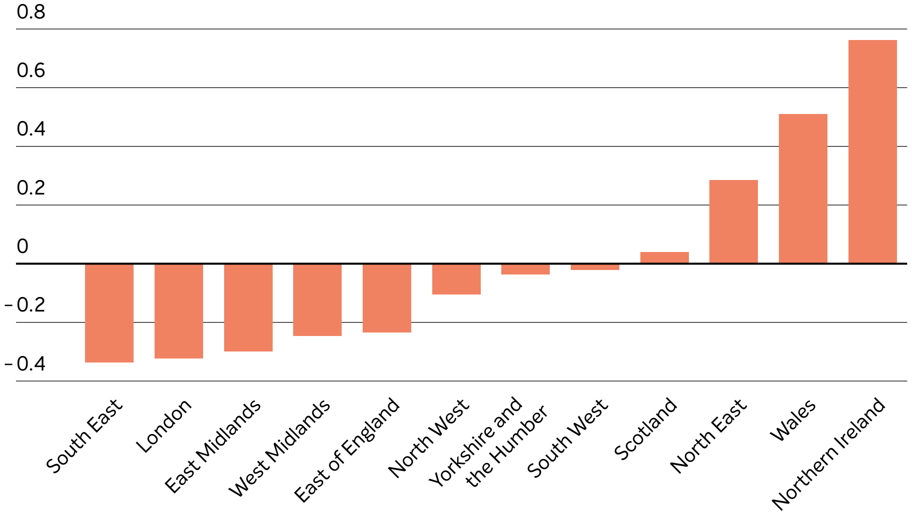
The levelling down of London's labour market has complicated the government's economic strategy and manifesto pledge to level up the regions outside of London and the South East. Instead, its first economic priority has been to shore up those worst affected by the pandemic and lockdowns.

London's crisis has revealed shortcomings in the levelling up concept which typically focuses on the North of England.

> Embedding a commitment to inclusive growth – whereby everyone – regardless of whether they live in London or Yorkshire – can contribute to and benefit from growth could help reset the government's economic strategy

Chart 1: Implied GVA change by region relative to UK average (projected June 2021), percentage points

Source: CPP analysis of OBR and ONS data[1]



Marginally larger falls in output expected for the South East and London

With the vaccine taking hold, it is hoped that economic recovery can start to take root as we move into the summer. The OBR's central forecast is for a 6% decline in output in June 2021 which is smaller than the 11% decline in output during the January lockdown (both relative to January 2020).

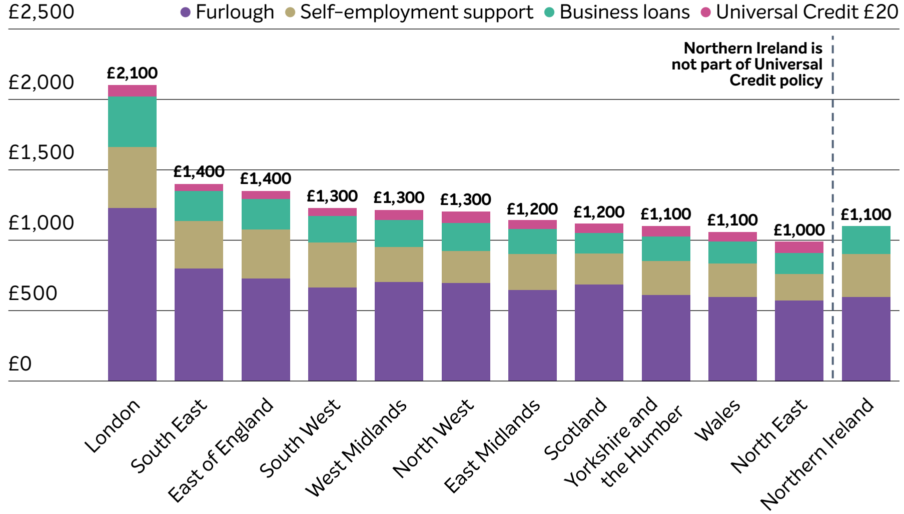
CPP projections based on the OBR's forecast suggest a relatively even decline in GVA by region with the South East and London experiencing marginally larger output falls during early summer.

The pandemic has led to a long protracted economic crisis which is set to extend well into this year. This is likely to cause permanent economic damage of between 1.7% to 6% of UK GDP.[2] The hangover from this crisis will be felt for a long time to come.

Pandemic spending

Chart 2: Major Covid-19 economic policies have resulted in a regionally unbalanced distribution of support

Source: CPP calculations



Pandemic spending has been much higher in London than in other regions

CPP analysis of the four major economic policies that responded to Covid-19 shows spending has overwhelmingly been directed at London.

- **Furlough:** £1,300 per resident spent in London in comparison to £620 per resident in the North East.
- **Self-employment support:** £440 per resident in London in comparison to £190 per resident in the North East.
- **Business loans:** £360 per resident in London in comparison to £150 per resident in Scotland.
- **Universal Credit:** this is more evenly distributed with London, the North East and North West topping the spending at £80 per resident.

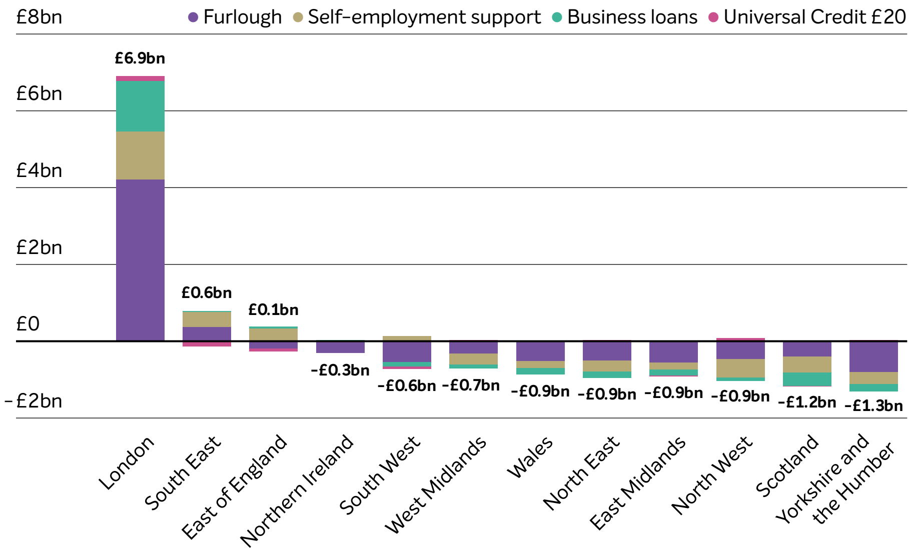
The furlough scheme has been the most costly form of emergency support (£53bn up to 31 January).

London has seen a higher spend per resident because it has both a higher number of claims for its population size and the value of those claims is greater (because wages are higher)

(Please read our appendix for data sources and methodology on spending by region).

Chart 3: Regional distribution of emergency support measures

Source: CPP calculations



£7bn more spent in London

CPP estimates that these policies have resulted in the government spending £6.9bn more on London, in just nine months, than if each region had been allocated the same amount of emergency spending per resident.

As discussed above, this is driven by a higher number of claims for the size of population in London and a higher average value for those claims (in the case of furlough).

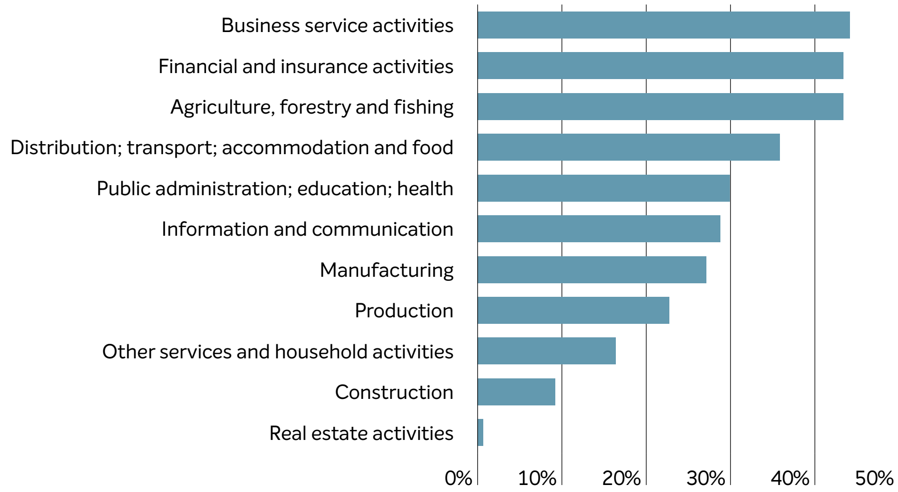
> That London has received such a large amount of pandemic spending relative to other regions at a time when the government would have preferred to be focusing on levelling up other regions is a cruel twist of fate

London has a slightly smaller population than the North East and North West combined but has seen over £7bn more spent on these emergency measures.

Economic recovery policies and long-term spending plans

Chart 4: Investment in fixed assets that is machinery and equipment

Source: CPP calculations



The super-deduction will have unintended consequences

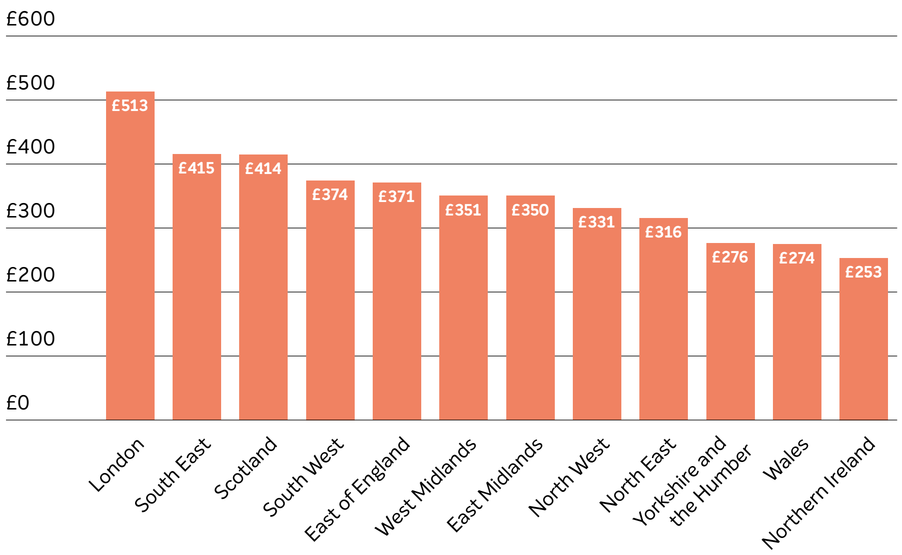
By far the largest economic policy for recovery contained in the March Budget was the super-deduction which the Office for Budget Responsibility (OBR) estimates will cost the Treasury about £25bn over two years. The policy works by providing 25p off company tax bills for every £1 spent on qualifying plant and machinery investment.

The intention is that it will help level up the regions outside of London by spurring on investment in the manufacturing and construction sectors.

> But as CPP analysis shows, the sectors with the highest concentrations of machinery and equipment (M&E) investment as a proportion of total fixed investment are business services activities and financial and insurance activities

Chart 5: Implied tax breaks per resident due to super-deduction

Source: CPP calculations



London is likely to benefit most from the super-deduction

London's high levels of investment which reflect its large economy, and the concentration of investment in sectors like business services where investment tends to be in M&E, means that it stands to gain most in tax relief from the super-deduction.

Distributing the £25bn according to past trends in M&E investment would result in tax breaks of over £500 per resident in London and over £400 in the South East in comparison to just £250 per resident in Northern Ireland. The North of England also stands to do relatively badly from this policy.

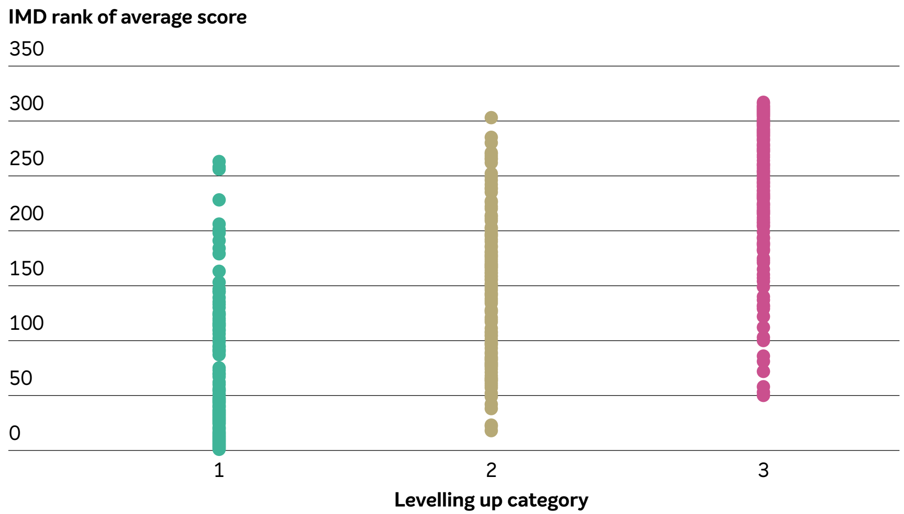
The super-deduction is poorly thought through. Even before considerations about whether this is just bringing forward investment that would have otherwise happened, the policy design will not do anything for levelling up.

> This policy will concentrate tax breaks in London and the South East helping business services and financial services firms

(Please see our appendix for more details on our methodology and data for calculating this).

Chart 6: Distribution of the deprivation and productivity of local authorities by levelling up category

Source: CPP analysis of levelling up places and MHCLG and ONS data



The Levelling Up Fund, Community Renewal Fund and Towns Fund leave many of the poorest places high and dry

The Levelling Up Fund, Towns Fund and Community Renewal Fund have been mooted as new pots of money for supporting 'left behind' places to level up the country. But these funds are being allocated on the basis of criteria which do not match other recognised definitions of left behind.

> This will have real life consequences with our analysis suggesting that 6.5 million people live in local authorities with high levels of deprivation who are unlikely to be prioritised by any of these funds

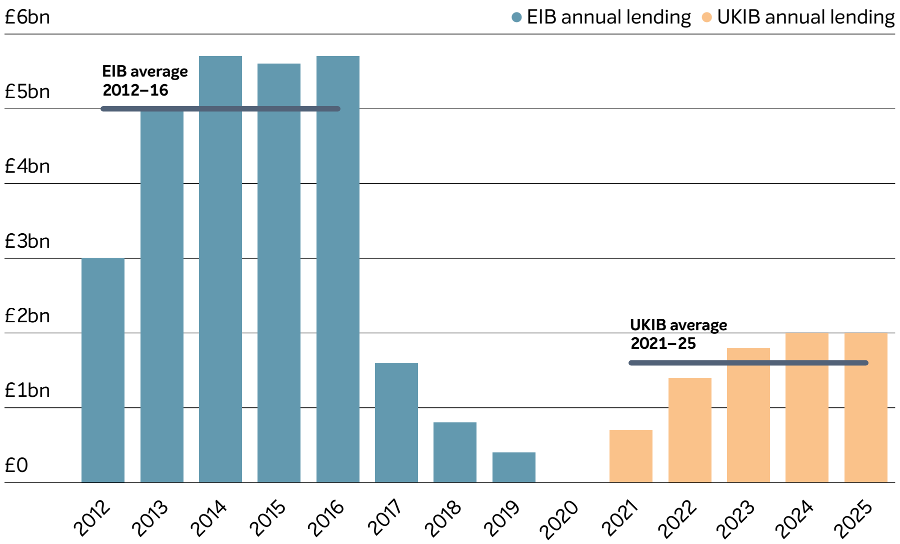
There is an added complication that so far only 45 of the 100 Towns Fund places have had their funding confirmed as well as suspicions that the Levelling Up Fund will be part funded by the Towns Fund.[3] The Community Renewal Fund is worth less than the others – £220m – but it will be a precursor to the distribution of the larger Shared Prosperity Fund (of which there are few details).

Levelling up is about addressing inequalities within as well as between places. Clearly these funds cannot do everything, but ensuring they are real new pots of money that are at least partly allocated on the basis of deprivation could help.[4]

(Please see our appendix for details on calculations and list of places).

Chart 7: UKIB lending relative to historic EIB lending

Source: CPP analysis of OBR data



The UK Infrastructure Bank will not deliver significant new investment

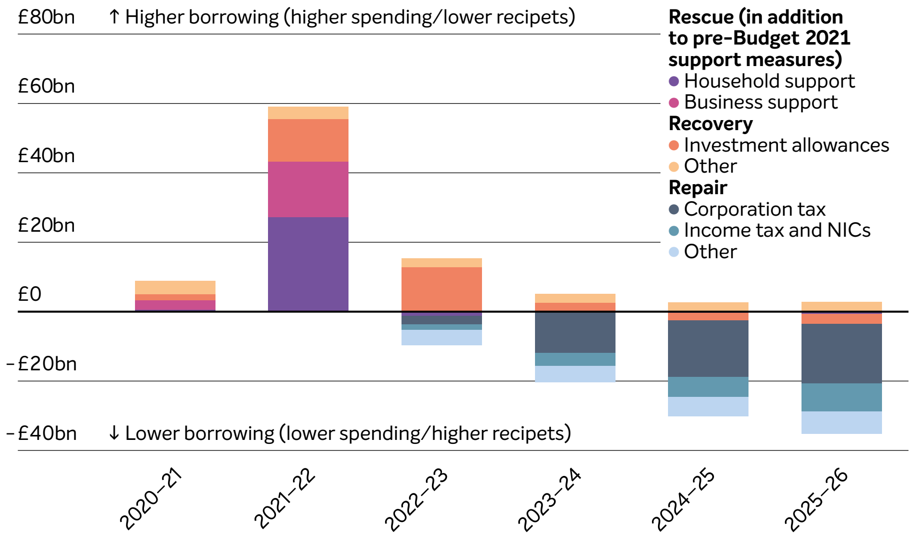
The new UK Infrastructure Bank (UKIB) which will be headquartered in Leeds, has been branded as an essential element of the government's infrastructure strategy and will help underpin the government's mission to level up every part of the UK by strengthening local economies.[5]

But as the OBR points out in its Economic and Fiscal Outlook, the new infrastructure bank is expected to lend just a third of the financing that was provided by the European Investment Bank (EIB) prior to the EU referendum.[6] It amounts to less than 0.1% of GDP which compared with, for instance, Germany's equivalent – which has total assets worth 14.7% of GDP – is tiny.[7]

> The UKIB does not represent new money since it will fall far short of the amount of lending that occurred via the European Investment Bank before the UK left the EU

Chart 8: The impact of Budget measures on public sector net borrowing

Source: OBR



Reversion to austerity by 2023–24

The March Budget showed the government will throw everything at supporting households and businesses during the pandemic with £43.2bn more 'rescue' spending announced for this year. By contrast, when it comes to recovery, the government is banking on the super-deduction (marked under investment allowances above).

As the chart shows, it really is the only game in town when it comes to spending big on recovery. By 2023–24 the government will revert to austerity – with corporation tax doing the heavy lifting but also cuts to public services of around £4bn per annum.

Given the long run and deep-rooted inequalities in the UK, levelling up has been called the work of a generation by IFS Director Paul Johnson, requiring a reallocation of capital spending for investment in skills, health, early years and industrial strategy.[8] The pandemic and the long-term economic scarring that it threatens to inflict, makes it even more imperative to bring new resources into these policy areas.

Yet after the end of the super-deduction – which our analysis shows will benefit London and the South East – the government will opt for tax rises and spending cuts. This strongly implies government has turned its back on any serious generational effort to level up the country.

Data sources for charts and tables

Table 1

Numbers claiming out of work benefits
https://www.ons.gov.uk/employmentandlabourmarket/peoplenotinwork/outofworkbenefits/timeseries/bcjd/unem

Official furlough data (HMRC)
https://www.gov.uk/government/statistics/coronavirus-job-retention-scheme-statistics-february-2021

Employment growth
https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/earningsandworkinghours/bulletins/earningsandemploymentfrompayasyouearnrealtimeinformationuk/february2021

Chart 1

GVA by region and local authority
https://www.ons.gov.uk/economy/grossvalueaddedgva/datasets/regionalgrossvalueaddedbalancedlocalauthoritiesbynuts1region

OBR sector level forecast (see Table 2.4)
https://obr.uk/download/economic-and-fiscal-outlook-march-2021/

Charts 2–5: please see our appendix for methods and data sources

Chart 6

Indices of Multiple Deprivation 2019
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/833995/File_10_-_IoD2019_Local_Authority_District_Summaries__lower-tier__.xlsx

Levelling Up Fund places
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/966137/Levelling_Up_Fund_list_of_local_authorities_by_priority_category.xlsx

Charts 7–8

OBR Economic and Fiscal Outlook – March 2021
https://obr.uk/download/economic-and-fiscal-outlook-march-2021/

Endnotes

1 Calculations are based on sector shares of regional output using ONS data. We then apply the OBR's national level sector forecast to derive regional projections for June 2021.
2 This is based on a range of institutional forecasts noted with the OBR's Fiscal and Economic Outlook March 2021.
3 See: https://www.lgcplus.com/finance/new-levelling-up-fund-using-money-diverted-from-towns-fund-25-02-2021/
4 For more on this see: https://www.progressive-policy.net/publications/priority-places-for-levelling-up-fund-fail-to-match-those-that-need-it-most
5 See: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/966131/UKIB_Policy_Design.pdf
6 See: https://obr.uk/download/economic-and-fiscal-outlook-march-2021/
7 Ibid.
8 See: https://www.ifs.org.uk/publications/14757

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About the Centre for Progressive Policy

The Centre for Progressive Policy is a think tank committed to making inclusive economic growth a reality. By working with national, local and international partners, our aim is to devise effective, pragmatic policy solutions to drive productivity and shared prosperity in the UK.

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