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Public spending priorities in London

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Public Spending Priorities in London
A Report for the Greater London Authority

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Foreword

Public services in London provide essential services for Londoners, London's workers and visitors. Understanding how these are financed and how spending priorities are set is a crucial background to the necessary forthcoming debate on how best to close the deficit gap.

Essential services do not just include help for those in need or spending on healthcare and education. They are also the activities which make it possible for London to be a world city with high productivity and growing output. London generates 18% of the UK's output and a similar proportion of tax revenues for the UK. But it only receives some 14% of government spending. In 2007/8 it is estimated that London contributed between £14bn and £19bn to the rest of the country via a tax export.

The uncertainty in this estimate rests partly on the lack of comprehensive data and partly on difficulty of distributing taxes between London and the rest of the South East. This region too is a net contributor of taxes to the rest of the country and a productive and growing part of the economy. Together the Greater South East provides 43% of all tax revenues in the UK.

It is clear that the robustness of the tax base in London and the South East is crucial to the continued ability to generate future tax revenues and will be essential to bringing down the public deficit through economic growth. In turn we need to understand how growth is supported by public sector spending in London and the rest of the South East.

This report has therefore been commissioned to create a clearer understanding of the spending side of public activity in London and the way in which priorities have been set. The analysis shows that in fact public spending is largely based on a set of needs-based, rather opaque, formulae, which together turn out to produce remarkably stable spending totals over time. London's spending has grown slightly faster than the UK as a whole over the last decade, but has fallen relative to output, with government spending only accounting for 28% of output in the capital compared to 40% for the UK.

Such 'needs based' criteria downplay capital investment needs; government investment represents only 3-4% of London's output, while the private sector invests at least twice this. Infrastructure investment is a key determinant of future economic growth and the ability to exploit London's status as a world city for the benefit of the UK as a whole. Without the continued ability to generate growth, the tax base will slowly degrade. If this is allowed to occur, then the needs based criteria will have a smaller and smaller amount to distribute.

Bridget Rosewell,
Chief Economic Adviser

Contents

Tables

Executive summary

- The objectives of the project were to (i) set out the pattern of public spending in London and how it differs from other regions; (ii) demonstrate how needs differ between London and the rest of the UK; and (iii) give some indication of whether and how priorities might shift to meet strategic needs.

- It is only possible to make consistent detailed comparisons of public expenditure between London, other regions and the UK for the period from 2003-04 to 2008-09, although overall figures are available for earlier years.

- Public spending more than doubled in London during the decade to 2008-09, growing slightly faster than in the rest of the country. Over the last five years however growth rates have hardly differed across the country.

- The picture is quite different if public expenditure is related to economic activity (GVA). On this basis government spending in London accounted for only 28% of GVA in 2008-09 as compared to 40% for the UK overall and 60% plus in Wales and Northern Ireland.

- Expenditure per capita in London is nearly 18% above the UK average as a result of both the concentration of expensive public infrastructure and of concentrations of relative deprivation.

- This differential also reflects the fact that London is part of a much wider economic region made up of the capital, a wholly urban region, surrounded by the Greater South East with its mix of urban, suburban and rural areas where public expenditure is well below the national average.

- Spending on individual services has risen at broadly the same rate across all regions except for health and education. Health expenditure has been more concentrated outside the capital (partly because the figures exclude PFI spending which is higher in London) but education expenditure has risen more rapidly in London.

- There have been changes in spending priorities within London but the proportions of expenditure on the main categories, social protection, health and education, has remained remarkably constant.

- The need for public expenditure is driven by a range of demographic and economic factors, reflecting both the numbers of people requiring services and the relative costs of providing these services. A large proportion of public expenditure is allocated using formulae based on trends in these variables.

- London has seen relatively fast growth in population and therefore increasing needs for public spending. Within this total, London's demographic structure results in relatively high demands for education and relatively low demands for post-65 year old services as compared to the rest of the country.

- While housing needs are projected to grow generally in line with the rest of the country, London faces particularly high and growing requirements for affordable housing

- London has seen relatively fast growth in GVA and in employment, resulting in larger demands for both revenue and capital spending. This puts particular pressure on infrastructure requirements. This need for additional investment is not reflected directly in the formulae for expenditure allocation.

- The growth in GVA also means that London contributes an increasing proportion of national tax revenues which has not been reflected in increased spending.

- Within England the local government grant allocation formulae, which is based on need to spend and tax raising capacity, is immensely complex. Year-on-year changes are also dampened, so those with rising needs lose out. A broadly similar needs-based system operates for the NHS.

- Funding for other services, particularly social security and housing benefit where allocation is based on individual needs, is directly funded by central government.

- Funding for capital requirements is based mainly on Ministerial decisions on a case by case basis. Public sector capital spending in the capital accounts for only 3.5 to 4% of the London economy. This proportion appears unsustainably low.

- The Barnett formula allocates 'block' funding to Scotland, Wales and Northern Ireland and guarantees that any changes in per capita public expenditure in England are reflected in these allocations. Thereafter the national governments have power to allocate in line with their own priorities. There are suggestions for radical reform putting both greater emphasis on specific needs and increasing tax raising powers.

- Key issues raised by the research include

    - how to get the appropriate balance of public funding for London as compared to the rest of the UK;

    - factors driving relative needs;

    - the importance of London's role as the engine of the UK economy;

    - the potential detrimental effects if London's growth significantly outstrips public investment; and

    - might it be possible to give London a funding settlement that both recognizes London's particular role in the UK economy and enables London to determine its own spending and investment

- A fundamental issue is the extent to which public expenditure allocations are based on 'needs' rather than on investment requirements to support further growth. Public capital spending appears relatively low as compared to other world cities. Yet investment in infrastructure is key to increased productivity, output and tax revenue.

1. Introduction

The Objectives

The objectives of the project were stated in the brief as to:

- Set out clearly the pattern of public spending in London and how it differs from other parts of the country
- Demonstrate how London's needs differ from other regions and the UK as a whole;
- Indicate whether and how public spending priorities in London could shift to meet strategic needs better under reasonable scenarios of total public spending.

The Issues

London, in common with all major cities, depends on public services and infrastructure to allow it to function effectively. The density, scale and make-up of population together create a need for railways, roads, schools, hospitals, police services and other provision that, while also required in rural and suburban areas, are of particular importance if so many people and businesses are to be able to co-exist in a relatively small geographical space. Given the economic productivity and environmental benefits of large cities, there are additional reasons for investment in London and other key cities.

A literature has developed about the importance of cities and city regions to wider regional and national economies.[1] Clustering of economic activity in major urban centres produces innovation and relatively high levels of output per head. The GVA of London and the Greater South East (GSE) has been rising (both in absolute and per capita terms) relative to the rest of the country in recent years[2]. London and the GSE have also been shown, over many years, to be 'exporting' tax to the rest of the UK.[3] There are, therefore, a number of powerful reasons why the government might wish to ensure London has sufficient funding to allow its public, regulated and infrastructure services to support the city to continue to be successful.

In considering London's funding needs it is important to address the question of why a rich and successful city should have to make the case for continued investment. On first principles, many of the benefits of agglomeration should go to the activities and population within the region. Why should not London taxpayers fund the services and assets required to deliver the city's growing output?

The answer to this question lies in the United Kingdom's highly centralised public finance arrangements. 95 per cent of all tax and other revenues are collected by the Exchequer[4], with around five per cent available to local authorities such as the Greater London Authority (GLA) and the London boroughs. Even the five per cent collected in council tax is capped. Moreover the government's Formula Grant, paid to local

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[1] See, for example, *Cities Outlook 2010*, Centre for Cities
[2] *Regional, sub-regional and local gross value added 2009*, Office for National Statistics, http://www.statistics.gov.uk/pdfdir/gva1209.pdf
[3] *London's Place in the UK Economy 2009-10*, City of London, 2009, Chapter 7
[4] Budget 2010, Securing the recovery, HC451, HM Treasury, Table C6

authorities, operates in such a way as to 'equalise' away any growth in the local tax base. Thus, the operation of the UK tax system in its entirety makes it impossible for London (or any other part of the country) to capture any part of the tax base.

The GLA and the boroughs therefore have very little capacity to determine their own tax levels. As importantly, they cannot benefit from any growth in tax yield resulting from an increase in the tax base. As a result, London authorities (in common with all others) must rely on a number of grant distribution formulae and on ad hoc allocations of specific grants for purposes such as transport, housing, arts and economic development. Thus, the case for spending and investment is made, on the basis of evidence of past expenditure and likely future demand, not necessarily in relation to potential productivity and social value.

Traditionally, the distribution of public resources in Britain has been, to a significant degree, in relation to 'need'. Need is a largely self-explanatory concept, though it is important to note that in Britain, a very large amount of official time and effort has been spent on the measurement of relative (as opposed to absolute) need. The National Heath Service and local government funding allocations, in particular, have for many years relied on needs-based formulae to distribute resources to health and local authorities.

Needs measurements have included the impact of 'demand', though such measures have generally embraced wider needs than demand alone. Thus, for example, while the number of pupils in an authority will be a key driver of the need to spend, the circumstances of pupils will differ in ways that create different spending needs. Assessments of need within the NHS, local government and in other services have attempted to measure such additional spending requirements taking account factors that research has shown drive (or at least are statistically associated with) existing spending on the service (for instance both relatively low and relatively high densities of population increase unit costs).

Other public spending (ie where not distributed by formula) has been allocated on the basis of ministerial decisions. Although judgmental allocations of this kind are not as 'objective' as formulae (though formulae are only as objective as the decision-making about their composition), it is reasonable to assume that decisions are made on the basis of information about the demand for services and their potential benefits.

Demand for public services and infrastructure will, therefore, generally be influenced by the following factors:

- the number of people using the service
- the circumstances of individuals and families
- wider societal needs for particular economic or social outcomes
- government policy.

Latterly, the government has moved in a new and different direction in relation to the provision of services. Ministers have become concerned with 'entitlements' to services – that is, in giving individuals the right to demand particular provision. While such an approach could disqualify some individuals from the receipt of a service, it will also have the effect of strengthening the link between demand and the need for a public authority to make provision. That is, councils and other providers may find themselves with

greater pressure to deliver services than hitherto. Such entitlements are not clearly reflected in current formulae.

The section that follows explores the pattern of public expenditure in London, the Greater South East and the UK over the period since 2003-04, analysing total, current and capital spending on services. London and the GSE are compared to the UK as a whole, in absolute and per capita terms. This analysis shows how the capital has been treated in relation to the rest of the country during a period of significant public expenditure expansion. Figures for each UK region and nation have not been included in the tables (though they are available from official sources[5]) in order to make the tables manageable and readable.

There is then a section of the report which looks at demand-drivers for the period starting in 2010 and running ahead to 2020 and beyond. Projections of population (by age group), employment, transport demand, income inequality and other indicators have been assembled to create a basis for assessing the likely growth in demand in the short to medium term. In particular, the analysis considers London's demand in relation to other parts of the country.

Section 4 then turns to an examination of the actual mechanisms for allocation grant while section 5 brings out the most important issues affecting future decision. Finally, we conclude by asking whether the current approach of formulae plus ministerial discretion has generated levels of expenditure which reflect identified needs.

[5] *Public Expenditure Statistical Analyses 2009*, Cm 7630, HM Treasury (and earlier volumes in this series).

2. Recent trends in public expenditure

Overall spending patterns

It is possible to follow recent trends in UK and London public expenditure in a number of official publications, but notably in Public Expenditure Statistical Analyses, an annual report from HM Treasury. This document covers overall UK expenditure and also spending in each nation and region. In this report we have distilled the large volume of data from these tables into a number of summary tables. Here we present public expenditure figures for London, the Greater South East (consisting of London, the South East and East) and for the UK as a whole. Figures are shown in cash and as a proportion of UK spending for the period since 2003-04. This period is used because, for a number of statistics, there is no consistency in the official figures over a longer period before this date.

The years from 2003-4 to 2008-09 cover a period of substantial growth in UK public expenditure. Public spending as a share of GDP rose from 39.4 per cent to 43.1 per cent during these years – at a time when the economy was growing consistently. London shared in this growth, though different services were treated differently. Tables 1 to 8 show totals and service sub-totals, including both current and capital expenditure. While most public expenditure is 'identifiable' as between regions, some cannot be attributed. The tables below concentrate on 'identifiable' spending, which includes over 85 per cent of the total.

Table 1 provides figures for overall 'identifiable' expenditure, showing that over the decade from 1998-99 to 2008-09, government expenditure in London more than doubled from £34.4bn to £73.7bn – a rise of 114 per cent. The equivalent rises for the GSE and the UK as a whole were 108 per cent and 101 per cent respectively. Thus total identifiable expenditure in London has grown slightly faster over the past decade than expenditure in the GSE or the UK as a whole. Over the last five years, however, the picture is rather different. Expenditure in London rose by 36.6 per cent over the period 2003-04 to 2008-09, in the GSE by 36.9 per cent and for the UK as a whole 36.1 per cent. These figures are remarkably similar – there was virtually no difference in the overall increase in public expenditure in London, the GSE and the UK over the last five years.

Table 2 gives total identifiable expenditure on services as a percentage of workplace-based gross value added (GVA). This provides a rough indication of what proportion of economic activity is accounted for by government spending. It also gives a sense of how far public expenditure is changing in relation to the overall size of the economy. That is, it shows how far State spending is expanding (or contracting) in relation to the capacity of the public sector to service the private sector economy. In London, government spending accounted for 23 per cent of GVA in 1998-99; this rose gradually over a decade to 28 per cent in 2008-09. However, this percentage point increase was relatively low as compared to the rise in the UK as a whole, where identifiable expenditure on services made up 33 per cent of GVA in 1998-99 and 40 per cent in 2008-09.

Public spending in relation to GVA is also much lower in London and the GSE than in other nations and regions: while government spending accounted for 28 per cent of GVA in London in 2008-09, the figures for Wales and Northern Ireland were more than twice as high, at 60 per cent and 62 per cent respectively. Across all regions and

nations, government spending as a proportion of GVA rose fairly steadily over the last decade.

Table 3 gives identifiable expenditure in each region as a percentage of overall UK expenditure over the last decade. There is remarkably little variation from one year to another. Government services expenditure in London has accounted for 13 or 14 per cent of total UK expenditure throughout the last decade--slightly more than its share of the population, which is 12.4 per cent. The proportions spent in other regions and nations have been similarly stable. The GSE accounts for fully one-third of UK government expenditure, and London for about one-seventh.

Per capita government expenditure by region is given in Table 4. Per capita expenditure in London is 17.6 per cent above the UK average. It is also significantly higher than for the GSE as a whole. GSE expenditure per capita is almost four per cent below the UK average which, given the relatively high costs of providing services in the area in and around London, reflects 'regional' spend in the GSE (an urban, suburban and rural area with more in common with other UK nations and regions than London alone) well below the national average. In London, per capita government spending in 2008-09 was 96 per cent higher than in 1998-99. Per capita spending in the GSE rose by slightly less over the decade (93 per cent), and for the UK as a whole the rise was lower still (90 per cent).

Table 5 presents per capita expenditure on services by region as an index, with the UK equal to 100. Where the index is over 100, per capita spending in that year and region was above the UK average; where the index is less than 100, per capita spending was below the UK average. Per capita public expenditure in London has exceeded the UK average throughout the period since 1998-99. This is not surprising, because London has a high concentration of expensive public infrastructure as well as significant areas of deprivation. The difference between per capita expenditure in London and the UK as a whole narrowed slightly between 1998-99 and 2001-02, but since then has widened. The index for the GSE, on the other hand, has been under 100 for the last decade, reflecting the fact that per capita expenditure in London itself is above the UK average, while in the rest of the GSE is well below the UK average.

The Greater South East is shown because although official statistics treat London as a UK region it is, in truth, the urban area at the core of a wider economic region. Other UK nations and regions consist of a mixture of cities, towns and rural areas. It is likely that if, for example, Birmingham were looked at in isolation to the West Midlands then its public expenditure would appear relatively high. Major cities not only contain many headquarters and other key activities, but also include areas with high levels of deprivation. Rural areas, by contrast, are generally more affluent. London's region – in a form that would be comparable with others in the UK – is thus bigger than the administrative city. The 'Greater South East', including London, the South East and the East is, for the practical reason that data is collected at the regional level, thus shown to provide a more appropriate comparison.

Expenditure in particular service areas

Turning to individual service areas, Table 6, 7 and 8 provide a breakdown of government expenditure in London, the GSE and the UK as a whole. The services are in order of the total of expenditure in London. Table 6 gives figures for 2008-09 and for the percentage change in expenditure since 2003-04, the most recent year for which consistent data

were available. Table 7 shows per capita expenditure in 2008-09 and percentage change since 2003-04, and Table 8 gives spending on each service as a percentage of total government spending on services in London, in 2003-04 and in 2008-09

Table 6 shows the increase in expenditure (in cash) between 2003-04 and 2008-09 in London, the GSE and the UK. Spending on the biggest individual service, social protection, has risen at broadly the same rate in London, the GSE and the UK over this period. However, there is a somewhat different picture for health and for education. Health spending – particularly on capital – has risen faster outside London than within, while education expenditure has increased significantly more in London than outside. London has had a relatively larger share of major NHS private finance initiative (PFI) projects, which will have reduced the conventional 'capital' expenditure figure for London health spending as compared to other regions where PFI has been relatively less important. Public order and safety spending rose more outside London than within, while 'housing and community affairs' expenditure increased more in London than elsewhere (though it increased far less in the rest of the GSE).

Economic affairs, comprising enterprise and economic development; science and technology; employment policies; agriculture, fisheries and forestry; and transport, saw a fall in current expenditure but a substantial rise in capital spending – notably in London. Much of this additional investment was in transport capital in London. Transport makes up 54 per cent of spending on economic affairs in the country as a whole but 82 per cent in London. 'Recreation, culture and religion' spending rose significantly more rapidly outside London than within the capital. In particular, capital investment appears to have been heavily concentrated outside London.

Per capita spending, shown in Table 7, shows the numbers used for Table 6, but taking account of changing population in each nation and region. For London, the GSE and the UK, rising population has meant that per capita increases are smaller than absolute ones.

Table 8 shows how spending priorities have changed in London between 2003-04 and 2008-09. Social protection (pensions, housing and other benefits etc) is almost one third of all public expenditure in London and, though it fell as a share of the total between 2003-04 and 2008-09 was remarkably static especially given the growth in prosperity for much of this period. Health (21 per cent) and education (17 per cent) were the second and third largest blocks of expenditure. Each grew by one percentage point between 2003-04 and 2008-09. 'Housing and community' expenditure doubled as a share of the total – though from only two to four per cent. 'Economic affairs' and 'public safety' both declined as a share of total spending. Overall, there was a shift of resources towards social programmes and away from economic and protective ones. Capital investment remained a small share of the total from 2003-04 to 2008-09.

'General public services', shown in many tables, is a catch-all category that encompasses public and common services (including various administrative activities), international services, and public sector debt interest. The last category accounts for the bulk of expenditure under this heading (almost 60 per cent in 2008-09), and this expenditure is not allocated to a specific location. The figures in Table 6 therefore should be read with caution.

What is most remarkable about the expenditure trends analysed in Tables 1 to 8 is their relative stability over time. The pattern of public spending from region to region and

across services in London has not altered significantly over the period. There is evidence of a modest shift of resources towards capital investment after 2003-04, but the overall scale of investment remains low in relation to all expenditure and, indeed, to the economy as a whole. Public spending represents broadly one third of the London economy in the long term. Of this expenditure total about 12 to 13 per cent represents capital spending (though it may be a little higher if PFI-type projects were included. Consequently, public sector capital investment appears to amount to 3½ to 4 per cent of the whole London economy. For a city that depends so much in its infrastructure, this total is surprisingly low. In the longer term, if London's productive capacity is to be maintained the amount of resources devoted to publicly supported infrastructure (whether provided by the public sector or the private sector) will have to be increased. The balance between revenue and capital expenditure suggests under-investment in the infrastructure needed to secure growth and tax yield.

Table 1: Total identifiable expenditure on services, London, GSE and UK, 1998-99 to 2008-09											
											£ million
	1998-99 outturn	**1999-00 outturn**	**2000-01 outturn**	**2001-02 outturn**	**2002-03 outturn**	**2003-04 outturn**	**2004-05 outturn**	**2005-06 outturn**	**2006-07 outturn**	**2007-08 outturn**	**2008-09 outturn**
London	34,414	36,559	38,628	42,542	47,432	53,914	57,024	60,831	63,486	68,050	73,659
Greater South East	82,416	87,422	92,718	101,554	110,949	125,266	134,500	142,970	149,229	158,749	171,495
Scotland	25,349	27,274	28,820	31,944	33,701	36,805	38,427	41,792	43,875	46,409	49,188
Wales	14,327	15,036	16,025	17,170	18,697	20,636	21,626	23,037	24,164	25,309	27,427
Northern Ireland	9,647	10,080	10,801	11,810	12,697	13,414	14,272	15,030	15,618	16,863	17,742
Total identifiable expenditure	**257,865**	**273,492**	**291,296**	**316,268**	**342,115**	**380,233**	**407,998**	**434,363**	**454,043**	**481,866**	**519,139**

Source: PESA 2009, Table 9.1; PESA 2005, Table 8.1; PESA 2004, Table 8.1

Table 2: Total identifiable expenditure on services as percentage of workplace-based GVA, London, GSE and UK, 1998-99 to 2008-09											
	1998-99 as % of 1998 GVA	**1999-00 as % of 1999 GVA**	**2000-01 as % of 2000 GVA**	**2001-02 as % of 200 GVA**	**2002-03 as % of 2002 GVA**	**2003-04 as % of 2003 GVA**	**2004-05 as % of 2004 GVA**	**2005-06 as % of 2005 GVA**	**2006-07 as % of 2006 GVA**	**2007-08 as % of 2007 GVA**	**2008-09 as % of 2008 GVA**
London	23	23	23	24	25	27	27	27	27	27	28
Greater South East	26	25	26	27	27	29	29	30	29	29	31
Scotland	40	41	42	45	45	46	46	48	47	47	47
Wales	48	49	50	51	53	55	55	57	57	57	60
Northern Ireland	55	55	56	59	60	60	59	60	59	60	62
UK Total identifiable expenditure	**33**	**33**	**34**	**35**	**36**	**37**	**38**	**39**	**38**	**39**	**40**

Source: Calculations based on PESA 2009, Table 9.1; PESA 2005, Table 8.1; PESA 2004, Table 8.1; ONS NUTS1 GVA figures

Table 3: Total identifiable expenditure on services, London, GSE and UK, 1998-99 to 2008-09											
						As a percentage of identifiable expenditure					
	1998-99 outturn	**1999-00 outturn**	**2000-01 outturn**	**2001-02 outturn**	**2002-03 outturn**	**2003-04 outturn**	**2004-05 outturn**	**2005-06 outturn**	**2006-07 outturn**	**2007-08 outturn**	**2008-09 plans**
London	13	13	13	13	14	14	14	14	14	14	14
Greater South East	32	31	31	31	32	33	33	33	33	33	33
Scotland	10	10	10	10	10	10	9	10	10	10	9
Wales	6	5	6	5	5	5	5	5	5	5	5
Northern Ireland	4	4	4	4	4	4	3	3	3	3	3
Total identifiable expenditure	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**

Source: PESA 2009, Table 9.1; PESA 2005, Table 8.1; PESA 2004, Table 8.1

Table 4: Per capita total identifiable expenditure on services, London, East, South East and UK, 1998-99 to 2008-09											
						£ per head					
	1998-99	**1999-00**	**2000-01**	**2001-02**	**2002-03**	**2003-04**	**2004-05**	**2005-06**	**2006-07**	**2007-08**	**2008-09**
	outturn	**outturn**	**outturn**	**outturn**	**Outturn**	**outturn**	**outturn**	**outturn**	**outturn**	**outturn**	**plans**
London	4,938	5,110	5,338	5,810	6,435	7,321	7,717	8,159	8,451	9,005	9,666
Greater South East	4,087	4,275	4,500	4,895	5,324	5,986	6,397	6,743	6,987	7,375	7,906
Scotland	4,993	5,377	5,692	6,308	6,667	7,277	7,567	8,203	8,575	9,032	9,538
Wales	4,947	5,184	5,513	5,900	6,396	7,040	7,340	7,800	8,147	8,493	9,162
Northern Ireland	5,750	6,004	6,418	6,991	7,484	7,878	8,345	8,716	8,967	9,577	10,003
Total identifiable expenditure	**4,321**	**4,562**	**4,832**	**5,280**	**5,640**	**6,228**	**6,629**	**7,018**	**7,291**	**7,675**	**8,219**

Source: Calculations based on PESA 2009, Tables 9.1 and 9.2; PESA 2005, Tables 8.1 and 8.2; PESA 2004, Tables 8.1 and 8.2

Table 5: Per capita total identifiable expenditure on services, London, Greater South East and UK 1998-99 to 2008-09											
						Index (UK identifiable expenditure = 100)					
	1998-99 outturn	**1999-00 outturn**	**2000-01 outturn**	**2001-02 outturn**	**2002-03 outturn**	**2003-04 outturn**	**2004-05 outturn**	**2005-06 outturn**	**2006-07 outturn**	**2007-08 outturn**	**2008-09 plans**
London	114	112	110	110	114	118	116	116	116	117	118
Greater South East	95	94	93	93	94	96	97	96	96	96	96
Scotland	116	118	118	119	118	117	114	117	118	118	116
Wales	114	114	114	112	113	113	111	111	112	111	111
Northern Ireland	133	132	133	132	133	126	126	124	123	125	122
UK identifiable expenditure	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**

Source: Calculations based on PESA 2009, Tables 9.1 and 9.2; PESA 2005, Tables 8.1 and 8.2; PESA 2004, Tables 8.1 and 8.2

Table 6: Expenditure on main services, London, GSE and UK: current, capital and total 2008/09 and percentage change since 2003/04

	£ million					
	London		***GSE***		***UK***	
	2008-09	**% change since 2003-04**	**2008-09**	**% change since 2003-04**	**2008-09**	**% change since 2003-04**
Social protection						
Total	24,906	28%	64,882	31%	201,152	29%
Current	24,807	29%	64,653	31%	200,321	29%
Capital	99	-26%	229	-1%	830	71%
Health						
Total	15,475	46%	37,826	48%	111,028	48%
Current	14,730	46%	36,004	48%	105,481	47%
Capital	745	37%	1,821	49%	5,547	67%
Education						
Total	12,451	43%	29,168	39%	82,855	36%
Current	11,060	38%	25,875	35%	74,222	32%
Capital	1,391	94%	3,291	92%	8,633	80%
Public order and safety						
Total	6,391	25%	11,853	26%	33,599	29%
Current	5,937	22%	10,972	22%	30,768	24%

Capital	455	65%	882	97%	2,831	103%
Economic affairs						
Total	7,674	23%	13,953	21%	40,670	23%
Current	3,787	-5%	7,403	0%	25,418	10%
Capital	3,887	73%	6,551	192%	15,252	53%
(of which transport)						
Total	(6,298)	(34%)	(9,791)	(108%)	(22,062)	(35%)
Current	(2,461)	(-7%)	(3,615)	(37%)	(9,920)	(14%)
Capital	(3,836)	(84%)	(6,175)	(196%)	(12,142)	(59%)
Housing and community amenities						
Total	3,144	147%	5,092	34%	15,290	128%
Current	530	9%	1,196	14%	4,324	13%
Capital	2,614	232%	3,896	290%	10,965	280%
General public services						
Total	1279	63%	3034	52%	53722	37%
Current	973	27%	2392	32%	51142	34%
Capital	306	1600%	642	247%	2580	109%
Recreation, culture and religion						
Total	1,168	15%	2,639	24%	13,827	44%
Current	924	20%	1,975	22%	10,046	23%
Capital	243	-1%	664	31%	3,781	152%

Source: PESA 2009, Tables 9.5, 9.7, 9.8, 9.10, 9.11, 9.12, 9.13, 9.14; ONS mid-year population estimates for 2003 and 2008

Table 7: Per capita expenditure on main services, London, GSE and UK: current, capital and total 2008/09 and percentage change since 2003/04						
	£					
	London		***GSE***		***UK***	
	2008/09	**% change since 2003/04**	**2008/09**	**% change since 2003/04**	**2008/09**	**% change since 2003/04**
Social protection						
Total	3,269	24%	2,986	26%	3,277	25%
Current	3,256	24%	2,975	26%	3,263	25%
Capital	13	-28%	11	-5%	14	66%
Health						
Total	2,031	41%	1,741	42%	1,809	44%
Current	1,933	42%	1,657	42%	1,718	43%
Capital	98	33%	84	43%	90	62%
Education						
Total	1,634	38%	1,342	34%	1,350	32%
Current	1,451	34%	1,191	30%	1,209	28%
Capital	183	87%	151	85%	141	74%
Public order and safety						
Total	839	21%	546	21%	547	25%
Current	779	18%	505	18%	501	21%
Capital	60	59%	41	90%	46	-1%
Economic affairs						

Total	1,007	19%	642	16%	663	19%
Current	497	-8%	341	-3%	414	7%
Capital	510	68%	301	181%	248	48%
(of which transport)						
Total	827	29%	451	24%	355	32%
Current	323	-10%	166	-10%	158	10%
Capital	503	78%	284	59%	197	58%
Housing and community amenities						
Total	413	138%	234	140%	249	120%
Current	70	5%	55	10%	70	10%
Capital	343	221%	179	276%	179	268%
General public services						
Total	168	57%	140	46%	875	32%
Current	128	22%	110	27%	833	30%
Capital	40	1543%	30	234%	42	103%
Recreation, culture and religion						
Total	153	11%	121	19%	225	39%
Current	121	16%	91	17%	164	20%
Capital	32	-5%	31	26%	62	145%

Source: Calculations based on PESA 2009, Tables 9.5, 9.7, 9.8, 9.10, 9.11, 9.12, 9.13, 9.14; ONS mid-year population estimates for 2003 and 2008

Table 8: Expenditure on main services in London as % of total expenditure: Current, capital and total, 2003/04 and 2008/09				
	2003-04		**2008-09**	
	£	**as % of total expenditure**	**£**	**as % of total expenditure**
Social protection				
Total	19,421	36	24,906	34
Current	19,288	36	24,807	34
Capital	133	0	99	0
Health				
Total	10,598	20	15,475	21
Current	10,055	19	14,730	20
Capital	543	1	745	1
Education				
Total	8,718	16	12,451	17
Current	8,000	15	11,060	15
Capital	718	1	1,391	2
Public order and safety				
Total	5,123	10	6,391	9
Current	4,847	9	5,937	8
Capital	276	1	455	1

Economic affairs				
Total	6,229	12	7,674	10
Current	3,987	7	3,787	5
Capital	2,242	4	3,887	5
Housing and community amenities				
Total	1,275	2	3,144	4
Current	488	1	530	1
Capital	787	1	2,614	4
General public services				
Total	787	1	1,279	2
Current	769	1	973	1
Capital	18	0	306	0
Recreation, culture and religion				
Total	1,015	2	1,168	2
Current	769	1	924	1
Capital	246	0	243	0

Source: Calculations based on PESA 2009, Tables 9.5, 9.7, 9.8, 9.10, 9.11, 9.12, 9.13, 9.14; ONS mid-year population estimates for 2003 and 2008

Note: Percentages may not sum to 100 because some small services were omitted.

3. Public expenditure needs

The demand for public expenditure in London, as in other parts of the UK, is driven by a number of factors. This issue is discussed in more detail in the following section. The key drivers of the need to spend – certainly from region to region – are likely to be the level of economic activity, total population, numbers of children and elderly people, deprivation and employment. The kinds of formulae used to measure need to spend within local government and the NHS tend to use a mixture of population-based 'client groups', deprivation and commuting within their assessments. Although there is no such UK-wide assessment as the basis of the Barnett Formula (as discussed in Section 4, this is based on historic shares of spending in each UK country) there have been reports produced suggesting alternative ways of allocating resources[6]. However, there has been no official interest in an alternative way of allocating public expenditure within the UK. Indeed, the government rejected reform during 2009[7].

In assessing the likely pressures on public expenditure in future years, it is important to provide a broad context for likely need, as well as examining recent trends in indicators that are suggestive of the likely demand for services in the years ahead. Such figures need to be viewed against the background of the consensus public policy to concentrate economic development and residential growth within existing urban areas wherever possible. In the years since the publication of the Urban Task Force report in 1999, the government (and Opposition) have broadly supported policies that minimize the need to build on green land. Consequently, forecasts of growing population, employment and economic activity in southern England are likely to have disproportionate impacts on London. If the countryside and small towns are to be saved from over-development, London will have to continue to grow. Such growth will require public investment and services.

Economic growth

Table 9 shows recent trends in the growth of output in London. Over the period 1996 to 2008, London's share of GVA per head has risen from being 54 per cent above the UK average to 69 per cent. Given that the city's population grew sharply in this period, the per capita rise understates the absolute impact of a rising population on the demand for services. This change suggests that London has seen a relatively fast growth in economic output which is likely to have fed through into a demand for higher services and investment. Against this background, the shift of priority towards capital investment in London has been modest. Moreover, London's economy has grown relatively (as compared with other regions and nations) yet public expenditure per capita has risen, as Table 5 suggests, only slightly faster than the average. Relative growth in economic output has, it would appear, been accompanied by lagging relative growth in public resources. There are no official forecasts for future regional GVA growth, though population projections are available. Given the tentative nature of private forecasts of regional GVA or GDP in the immediate aftermath of the recent recession it is probably best not to use these to assess future spending demands.

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[6] See, for example, Iain McLean and Alistair McMillan "The Distribution of Public Expenditure across the UK Regions" in *Fiscal Studies* (2003) vol. 24, no. 1, pp. 45–71, IFS, 2003.
[7] HM Treasury, *House of Lords Select Committee on the Barnett Formula: the Government's response*, Cm 7772, paragraphs 2.14 to 2.17.

Table 9: Workplace based Gross Value Added (GVA) at current basic prices by region													
													(£million)
	1996	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008[4]**
Total GVA													
London	126 294	136 479	147 548	158 456	166 064	174 952	187 169	199 757	212 094	222 535	237 950	254 621	265 063
Greater South East	278 815	299 740	323 079	344 563	361 314	381 577	405 205	431 852	457 675	477 889	507 486	539 191	558 368
Scotland	58 675	61 439	63 922	66 059	68 185	71 141	75 024	79 622	83 893	87 948	93 465	99 114	103 814
Wales	27 786	28 911	29 946	30 923	32 080	33 665	35 363	37 314	39 022	40 514	42 197	44 263	45 610
Northern Ireland	15 459	16 385	17 493	18 372	19 223	20 180	21 220	22 519	24 037	25 085	26 473	27 890	28 734
United Kingdom	698 410	739 524	781 986	822 774	864 285	907 594	957 094	1015 008	1070 951	1116 648	1181 141	1245 735	1296 332
GVA per head (£)													
London	18 108	19 456	20 883	22 150	22 947	23 893	25 425	27 126	28 704	29 846	31 674	33 694	34 786
Greater South East	13 936	14 887	15 950	16 851	17 538	18 393	19 442	20 637	21 768	22 538	23 762	25 048	25 697
Scotland	11 523	12 086	12 590	13 024	13 468	14 048	14 842	15 744	16 520	17 262	18 266	19 267	20 086
Wales	9 610	9 987	10 328	10 661	11 036	11 568	12 112	12 730	13 244	13 717	14 228	14 853	15 237
Northern Ireland	9 303	9 804	10 426	10 942	11 423	11 946	12 507	13 226	14 054	14 547	15 200	15 854	16 188
United Kingdom	12 008	12 682	13 373	14 020	14 677	15 353	16 133	17 043	17 895	18 537	19 495	20 430	21 147
GVA per head indices													
London	154.4	156.5	158.7	160.7	160.4	159.2	161.0	162.3	163.6	164.7	166.6	168.9	169.5
Greater South East	116.1	117.4	119.3	120.2	119.5	119.8	120.5	121.1	121.6	121.6	121.9	122.6	121.5
England	102.0	102.2	102.4	102.6	102.6	102.7	102.7	102.7	102.7	102.6	102.6	102.5	102.4
Scotland	98.2	97.2	95.7	94.5	94.1	93.6	94.0	94.2	94.2	95.3	96.1	96.6	97.9
Wales	81.9	80.3	78.5	77.4	77.1	77.1	76.7	76.2	75.5	75.7	74.8	74.4	74.3
Northern Ireland	79.3	78.9	79.2	79.4	79.8	79.6	79.2	79.2	80.1	80.3	80.0	79.5	78.9
United Kingdom	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: ONS. Regional Gross Value Added. NUTS1 GVA (1989-2008) Data Table 1.1

Table 10: Workplace based Gross Value Added (GVA) by industry groups, current basic prices by region												(£million)
	1996	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
London	126 294	136 479	147 548	158 456	166 064	174 952	187 169	199 757	212 094	222 535	237 950	254 621
Greater South East	278 815	299 740	323 079	344 563	361 314	381 577	405 205	431 852	457 675	477 889	507 486	539 191
Scotland	58 675	61 439	63 922	66 059	68 185	71 141	75 024	79 622	83 893	87 948	93 465	99 114
Wales	27 786	28 911	29 946	30 923	32 080	33 665	35 363	37 314	39 022	40 514	42 197	44 263
Northern Ireland	15 459	16 385	17 493	18 372	19 223	20 180	21 220	22 519	24 037	25 085	26 473	27 890
UK	682 147	724 906	769 579	808 664	842 540	887 040	937 109	995 133	1049 983	1091 670	1151 810	1216 524

Source: ONS. Regional Gross Value Added. NUTS1 GVA (1989-2008) Data. Table 1.2

Population

The relative growth in London's population over the period since the mid-1990s can be seen in Table 11. London's population grew by 9.2 per cent between 1996 and 2008, compared with 5.5 per cent in the UK as a whole. Projections suggest the population of London will continue to grow ahead of the national trend to 2021 and 2031, albeit with a smaller differential. The pressure for London's services to increase will continue in future, particularly given the far higher population densities in London as compared to all other regions.

Table 11: Mid-year sub-national population estimates and projections (000s)

	United Kingdom	London	Greater South East
Estimates			
1996	58,164	6,974	20,007
1997	58,314	7,015	20,135
1998	58,475	7,065	20,256
1999	58,684	7,154	20,448
2000	58,886	7,237	20,603
2001	59,113	7,322	20,745
2002	59,323	7,362	20,842
2003	59,557	7,364	20,926
2004	59,846	7,389	21,025
2005	60,238	7,456	21,204
2006	60,587	7,512	21,357
2007	60,975	7,557	21,527
2008	61,383	7,620	21,729
Projections			
2011	62,649	7,817	22,257
2016	64,773	8,114	23,164
2021	66,958	8,390	24,063
2031	70,933	8,858	25,669

Source: Table 1.3. ONS Population Trends No. 138. Winter 2009

The young and the old

Table 12 shows the change in the number of young and older people in the years from 2008 to 2031. Unsurprisingly, given London's relatively young population, the projected figures for the capital's school age population show an increase of 16.2 per cent by 2021 and also in 2031. These percentages are slightly bigger than those for England as a whole. But the reverse is true for the over-65s. London's over-65 population is projected to rise by 15.2 per cent by 2021 and 41.8 per cent by 2031. The equivalent figures for England are 41.8 per cent and 58.7 per cent – a substantially faster rate of growth in the population of those over the current retirement age. Thus, the relative pressure on London's public services will be greater for schools and children's services, while although growing sharply in London, number of the elderly will rise relatively faster in the rest of the country.

Table 12: 2006-based sub-national population projections												
AGE GROUP		**London**	**GSE**	**England**		**London**	**GSE**	**England**		**London**	**GSE**	**England**
		2008				**2011**				**2016**		
0-14		1386.7	3874.0	9029.0		1446.2	3982.0	9208.1		1547.5	4213.8	9701.9
65-85+		881.3	3248.8	8279.8		893.5	3426.2	8754.8		957.9	3597.4	9887.0
All Ages		7620.7	21690.5	51487.5		7816.8	22256.6	52706.4		8114.3	23164.4	54724.2
AGE GROUP		**London**	**GSE**	**England**		**London**	**GSE**	**England**				
		2021				**2031**						
0-14		1611.7	4417.8	10186.8		1611.9	4470.8	10289.2				
65-85+		1015.5	4176.8	10740.9		1250.1	5149.8	13140.5				
All Ages		8390.1	24062.8	56757.0		8857.9	25669.1	60431.5				

Source: Office for National Statistics

Households and housing need

The projected number of households in future years is shown in Table 13. On this basis London will experience average growth in household numbers of 34,000 per annum between 2006 and 2031, a percentage rate slightly slower than for England as a whole, though the difference is relatively small. The fact that household numbers are shown rising at a faster percentage rate than the population implies that average household size will continue to fall in the capital, as elsewhere. But the important difference between London and the rest of the country comes in terms of the increase in those likely to need for social housing which is proportionately far in excess of any other region and the largest total in the country. The backlog of housing need is also concentrated in London, with more than double the proportion of households in London in need as compared to England as a whole. Within this total London accounts for a very large share of those in temporary accommodation in the private rented sector, of those in bed and breakfast accommodation, of concealed households and of those in shared accommodation. Thus, London's investment requirement to meet the backlog of unmet need is heavily concentrated in additional affordable housing. More detail is provided in Annex A.

Table 13: Household projections by region, England (000s)

	Number of households				Change 2006 - 2031	
	2006	**2016**	**2026**	**2031**	**Per year**	**Percent**
London	3,178	3,516	3,867	4,016	34	26%
Greater South East	8,996	10,069	11,167	11,652	106	30%
England	21,515	24,107	26,674	27,818	252	29%

Source: Table 4, CLG, Housing Statistical Release, 11 March 2009

Deprivation

Deprivation measures are not projected into the future. London, it is accepted, is a city of enormous contrasts of wealth and poverty. Table 14 shows the number of 'lower level super output areas' in the most deprived decile of the economic deprivation index in London and the GSE, showing these totals as a proportion of the national total. London is seen to have experienced a growth in its share of the most deprived neighbourhoods between 2001 and 2005, rising to 11.6 per cent by 2005. This share is slightly below London's share of the population of England, suggesting that despite the concentrations of poorer areas in London, this particular measure does not show the city having a disproportionate share of the total. But the number is still significant, especially within a relatively small geographical area.

Table 14: Number of lower level super Output areas in the most deprived decile (% of national total)				
		Raw Numbers		*Percentages*
	London	**Greater South East**	**London**	**Greater South East**
2001	433	603	9.1	18.6
2002	449	625	9.4	19.2
2003	486	668	10.2	20.6
2004	453	744	11.4	23
2005	555	757	11.6	23.3

Source: Table 5.1 Communities and Local Government, 'Tracking Neighbourhoods: the Economic Deprivation Index', 2008

Employment

Table 15 provides figures for the projected increase in employment in London, the GSE and UK for the period to 2020. London is shown as having a 5.2 per cent increase in employment over this period, slightly ahead of the GSE and UK figures of 4.6 per cent and 4.8 per cent respectively. These numbers do not suggest a radically different pattern of employment growth affecting London during the next decade, though there is a marginal relative increase in the London numbers.

Table 15: Employment in London, GSE and UK			
	London	**Greater South East**	**UK**
Employees (million)			
1989	3.731	9.001	23.726
2007	4.074	10.153	27.155
2009	3.977	9.920	26.367
2020 projection	4.286	10.624	28.457

Source: NOMIS and Professor Ian Gordon, LSE

The above tables suggest that recent relative growth in the London economy has been significant. Such an increase, particularly in such a densely-populated area, will inevitably have generated additional demands for services and infrastructure. Looking ahead, London's population, employment and school age population are expected to grow rather faster than the national average, though the numbers of elderly people will rise relatively faster outside the capital. The overall picture is one of continuing relative growth for London, though perhaps at a slower relative rate than in the past decade. However, given the reliance of the city on services and infrastructure to service such a large population within such a small area, even marginal further rises in population, employment and other indicators are likely to generate either a need for new provision or for radical changes to other policies.

Economic growth in London has, in recent years, tended to be relatively more rapid than in other regions within the UK. This growth in GVA and the consequent tax yield has been achieved during a period when public sector capital investment has increased,

though it has remained at a level equivalent to less than four per cent of the city's GVA. Looking ahead, the present government's plans for public spending in the years from 2011-12 to 2014-15 suggest a sharp reduction in government capital spending[8]. These plans will reduce capital spending by over 50 per cent by 2013-14. There is no evidence to suggest London (or any other part of the UK) will be protected from this scale of reduction. As a consequence, it is likely that capital spending as a share of the London economy will decline from about 3½ per cent to no more than 2 per cent of GVA. If this occurs, it is almost inevitable that growth in the population and employment will occur against a backdrop of relatively little new public sector infrastructure investment.

Government current expenditure is to be constrained, with real spending projected to rise by 0.8 per cent per year from 2011-12 to 2014-15. The NHS, schools and international development will be protected, suggesting major reductions in other services[9] - possibly of as much as 25 per cent. It is impossible to be sure which reductions will fall on which services, but those such as economic development, the environment, arts & culture, transport and housing appear most exposed. London, in common with other major urban areas, is particularly dependent on basic street services, environmental provision, transport and housing. The impact of significant spending reductions affecting such services on a city as large of London will be different than in less densely-populated areas.

[8] HM Treasury *Budget 2010 Securing the recovery* HC 451, March 2010, TSO, London, paragraph 6.12.

[9] Institute for Fiscal Studies*, Public services: the axe comes soon* by Carl Emmerson, IFS, March 2010.

4. The process of allocating public expenditure

There is no 'right' or objectively 'fair' distribution of public expenditure between different regions, authorities or, indeed, individuals. The Treasury's recent development of its analyses to allocate spending between the nations and regions of the UK inevitably creates the opportunity for comparisons of total and per capita spending, and also of trends over time.

Virtually all taxation and other revenues collected in the UK are attributable to the Exchequer. Over 95 per cent of taxes, including income tax, VAT, customs & excise duties, National Insurance contributions and corporation tax are attributable to central government. Only council tax, which is capped by the centre, is the sole local tax revenue. The current method of allocating resources from central government to different parts of the country and from service to service varies significantly from one part of the UK and service to another.

Thus, allocations of much of the public money spent in Scotland, Wales and Northern Ireland is determined by the Barnett Formula. This mechanism (not really a formula) has operated since the late 1970s and guarantees the three nations that any changes in per capita public expenditure within England are reflected in equivalent per capita changes for Scotland, Wales and Northern Ireland. Each country receives a 'block' of funding to be used by the relevant devolved government.

An examination of the Barnett formula was undertaken recently by a Parliamentary committee which concluded that at some point in the future a more sophisticated distribution mechanism would have to be introduced[10]. The Committee stated: "The Barnett Formula is overdue for reform and lacks any basis in equity or logic. It creates controversy in all of the constituent parts of the UK. There is controversy in England that the Barnett Formula allows for higher levels of public spending in Scotland from the UK Exchequer and does not deal with different needs in different parts of England. There is concern in Wales that allocation of funds through the Barnett Formula does not adequately meet the higher structural costs of the delivery of some public services. We are concerned that the lack of adequate understanding of the Formula and how it operates has the potential to create tension and fuel disputes". A House of Lords committee also reviewed the Barnett Formula and was similarly critical[11], suggesting the current distribution of resources between the four parts of the UK was "arbitrary and unfair". The Lords committee proposed the creation of an advisory commission to make proposals for allocating resources across the UK, as between the devolved administrations and England.

The possibility of radical reform has been explicitly raised by the Holtham Committee, which has been set up by the Welsh Assembly Government to review Wales's position within the UK funding and taxation systems[12]. Indeed, Holtham argued that Wales had suffered a 'squeeze' in its funding over the years. An analogous study (set up by the UK government) was undertaken for Scotland in 2009 by Sir Kenneth Calman, to review the

[10] House of Commons Justice Committee, Fifth Report 2008-09, *Devolution – A Decade on*, TSO, 2009.
[11] House of Lords Barnett Formula Select Committee, *First Report*, Session 2008-09.
[12] The Holtham Report, *Independent Commission on Funding and Finance for Wales*, July 2009.

Scottish government's funding and income[13], though it did not review the Barnett Formula. Subsequently, the UK government has decided to give Scotland new tax-raising powers[14].

The Holtham report included an instructive discussion of the use of different kinds of criteria to determine the need to spend. Paragraph 4.3 of the Holtham report stated: "needs-based funding formulae that are currently in use generally attempt to take account of the impact of demographics, deprivation and the cost of delivering a service" and then went on to see how Wales compared to English regions using a number of plausible needs factors. Paragraph 4.11 explicitly argued that Wales's falling GVA per head (relative to the UK as a whole) was likely to lead to greater levels of deprivation. The report went on to provide data about Wales's high levels of limiting long-term illness and benefit claimants.

The Holtham Committee's interim report stated: "the fundamental flaw in the current system is that it makes no attempt to align the funding allocated to Wales with the country's relative needs" in effect that Wales should receive additional funding – that is, a larger share of the UK public expenditure total. Such a proposal, in effect, challenges the existing Barnett Formula with a view to securing extra public expenditure in Wales. The Welsh Secretary, Peter Hain, did not rule out the possibility that Wales might indeed be given a larger share of UK public spending[15].

Calman, reporting about Scotland, proposed that the Scottish government should be given a new power to set income tax, with a corresponding £-for-£ reduction in the funding block from the UK government. That is, the overall impact of the reform would be financially neutral as between Scotland and the rest of the UK. However, Calman did consider the question of the Barnett Formula and the relationship between Scotland's funding settlement and the UK as a whole[16]. The Calman report stated: "it is not for us to judge whether the present level of public spending in Scotland is appropriate or not. Until such time as a needs assessment is conducted, the Barnett formula, proportionately reduced to take account of devolved taxes, can continue to be used to determine the grant element in the Scottish Budget".

Holtham's report accepted the long-held view within British government that 'need' should be the key determinant of resource allocation within different territorial units. Of course, the Barnett Formula did not start off with any kind of need calculation. Nor has it been adjusted subsequently to take account of difference in need between England, Wales, Scotland and Northern Ireland. This fact (that is, the lack of needs equalization between the four UK nations) implies that it is not impossible to run resource allocation systems that do not embrace sophisticated needs assessments. But Holtham's desire to extend needs equalization to the distribution of money from the UK government to Wales and other parts of the UK begs an important question of whether such needs alone should be the basis for allocation. London, with its high productivity and tax yield, might

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[13] The Calman Report, *Serving Scotland Better: Scotland and the United Kingdom in the 21st Century Final Report* – June 2009.
[14] http://www.timesonline.co.uk/tol/news/uk/scotland/article6932051.ece
[15] http://news.bbc.co.uk/1/hi/wales/wales_politics/8154392.stm
[16] The Calman Report, *Serving Scotland Better: Scotland and the United Kingdom in the 21st Century Final Report* – June 2009.

argue that the propensity to stimulate economic growth and tax payments should also be included in any revision to the resource allocation process.

Within England, there has been no such detailed examination of the finances of particular regions, though the Greater London Authority has from time to time published reports that challenge the relatively under-powered nature of London's funding compared, say, with comparative cities overseas.[17] It would be possible to undertake a fundamental inquiry into London's longer-term and/or relative spending needs and, doubtless, come up with a cogent argument for a bigger share of national resources. This, to some extent is what the Holtham Committee has suggested for Wales. The Greater London Authority, could certainly, as a devolved administration, argue for inclusion within the Barnett Formula, even though its service responsibilities are significantly smaller than those of the Scottish or Welsh governments. Presumably the whole of the GLA and boroughs' funding could be treated as a block. If significantly more public expenditure and political power were devolved to London, then the argument for a Barnett-style ring-fencing of London's resources would be greater still. London could be treated in a similar way to the devolved governments, with its resources at the starting point of any new arrangement being maintained – in per capita terms – thereafter in relation to the rest of England, Wales, Scotland and Northern Ireland. Of course, if a new method of allocating resources to the nations and regions were to be introduced, this would affect all parts of the UK.

Within England (and separately within Scotland, Wales and Northern Ireland) resources are allocated to local government, the health service, schools, housing and other provision. Such allocations rely in part on ad hoc grants from the centre to councils and arms-length bodies and in part on formulae. Local government and the NHS have long-established formulae to allocate resources from central government to local institutions. These two distribution systems share a number of features:

The local government 'formula grant' is immensely complex. It has evolved authority-by-authority 'need to spend' indicators for all council services, though these are aggregated into a single number for the purposes of assessing relative need. Since 2006, these service-based and total need numbers have been implicit (ie not published, though still embedded in the system), making it virtually impossible for authorities to know what their spending need total is. Need to spend takes into account the numbers of people or 'clients' expected to use a service, any additional needs factors and an allowance for labour costs. Against this need-based assessment, an off-set is made to take account of each council's capacity to raise resources from the council tax. A grant figure is thus calculated that takes into account both spending need and tax capacity. Year-on-year changes in grant are smoothed out by 'damping'. A broadly similar system operates in the National Health Service to allocate resources to authorities, though without the local tax off-set.

Housing uses a rather more interactive approach with the region calculating needs but the government allocating grant on the basis that takes account of need, efficiency and opportunity (see Annex A for details).

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[17] Mayor of London and London Councils, *Investing for Recovery*, December 2009, Greater London Authority.

Other, specific-purpose, grants are also paid. Much funding to other services is either determined by ministerial decision or by the social security system (whose rules are determined by the government, though its distribution will depend on circumstances). The numbers used in this report for expenditure within London and across the UK are the sum-total of the money allocated by different means. The total given to England then drives the amounts fed through the Barnett Formula into Scotland, Wales and Northern Ireland.

It would be possible to move the allocation of resources to each nation and region within the UK, as discussed earlier in this report. But ministers have thus far resisted all efforts to reform the Barnett Formula. It is likely that ministers of different parties have, over the years, decided that not reforming the system would produce no more than grumbles from a small number of elite commentators. On the other hand, a move to a formula-based allocation of resources would risk turning the issue of distributing resources to the nations and regions of the UK into a massive political controversy. Sleeping dogs have been left to lie.

5. Key issues raised

The tables and analysis above have reviewed public expenditure in London over the past decade within the context of past and projected demand-drivers. In Britain, which has a highly centralised system of public finance, any report of this kind has, as one of its objectives, an attempt to test whether or not a particular level of expenditure is appropriate for an area. Because 95 per cent of all government revenue is allocated from the centre, each part of the country is under pressure to make a case for itself and its particular patterns of spending need. 'Need' has been the most important criterion for determining the distribution of public money, either by formula, by one-off grants or by the social security system. Yet it is clear from developments in the economy in recent years that the economic potential of a region or authority is also an important determinant of the need to spend. Parts of the country that produce tax 'surpluses' that can be used elsewhere need to be nurtured if the overall UK tax take is to be sustained. Indeed, following the collapse of the government's revenues during the 2008-09 recession, the need to re-build tax revenues is arguably more important than ever. This study therefore raises a number of issues, which are discussed below.

1. How to assess an appropriate and fair balance of public funding as between London and the rest of the UK?

The current level of public service and investment is the unpredictable outcome of many different ministerial decisions within a centralised system of public finance. While for local government and the NHS there are broadly objective bases for resource allocation, yet for the bulk of public spending there is no such transparency or objectivity. London's economic importance to the GSE and the UK economy would imply that there would be significant benefit nationally to an acceptance that the economic productivity and potential of an area should be a key criterion in determining the allocation of resources. Of course, social programmes and the protection of vulnerable areas/individuals remains an important element of public policy. But unless economic and tax-generating capacity is recognised in the UK public expenditure allocation, there will be a risk to the tax revenues of the UK as a whole.

2. What do demand indicators suggest are the relative needs of London in the future?

The key drivers of demand for public spending and investment are indicators such as population, employment and economic growth within a nation, region or local authority. Recent trends and projections analysed in this report suggest London has seen and will continue to see growth in relative demand for services and infrastructure. The density of development in the capital creates an added imperative for sufficient investment (on both 'social' and 'economic' services) because of the downside risks of breakdown are so much greater in a large, crowded, city than elsewhere.

3 What is London's place in the UK economy?

A number of studies have been undertaken in recent years that show London and the GSE making a substantial net tax contribution to the rest of the UK. Such figures are generally in the range of £10 to £20 billion per year for London. They have never been challenged by official or other research. Although the recession may have changed this tax contribution (because of the large budget deficit, all UK regions will currently have more public spending than they pay in tax) there is no evidence in the longer term that

London and the GSE will cease to make a major tax contribution to the rest of the country in future. If this is a settled pattern, the distribution of public expenditure will probably need to reflect the country's wider need for tax revenues. Put the other way round, unless London and the GSE economy continue to generate a large tax contribution there is a risk the UK's depleted tax take will not fully recover.

4. Would it be possible to give London a funding settlement that recognised its relative importance to the UK?

Scotland (population 5 million) has been promised that a proportion of the income tax paid there will be transferred to the control of the Scottish government, with a corresponding reduction in the block grant paid under the terms of the Barnett Formula. Wales (population 3 million) is being given substantially greater powers over its own legislation. London (population 7.7 million) which was also an element in the government's constitutional reforms in the late 1990s, is, however, treated very similarly to the rest of England. The existence of the Greater London Authority – and its particular powers – makes London significantly different from the rest of England. Given the economic importance of London and its power as a political entity, it would be logical to consider a move in the direction of ring-fenced, Barnett Formula-protected, funding for the city. Scotland, Wales and Northern Ireland already have such blocks of grant. If ring-fenced funding were extended to London, more radical tax reforms could then be considered.

5. What might the consequences be if London were to see growth that significantly outstripped public investment?

London's population and employment has grown sharply since 1985 – the city now has almost a million more residents than it did 25 years ago. There have been periods (in the early 1990s; between 2001 and 2008) when there have been sharp increases in public expenditure, but also other times when investment has fallen sharply. Looking ahead, it is easy to see a decade in which UK public sector capital spending falls by over 50 per cent. Yet at the same time, as this study suggests, demand and the government's need for tax yield will increase. Even a broadly proportionate cut (ie no more or less than other parts of the country) in London's investment would be likely to have a disproportionate effect in the city because of its capital-intensive urban economy.

6. Would it be possible to give London greater freedom to determine its own spending and investment?

The answer to this question is certainly 'yes', although it would have to be recognised that a large proportion of current funding goes to individuals as of right. Because London has relatively high GVA per head and a very large population, its output is greater than a number of EU countries. It could be a high expenditure/low tax city state if it were cut free from the rest of the UK. But this is an unlikely and undesirable possibility. However, there has been a debate about giving local government in England more autonomy for many years. Official reports from the 1976 Layfield Committee to the 2007 Lyons Review have proposed a stronger local tax base, but to no effect. London is trapped within the 'England' system of public finance which has itself proved impossible to reform. Capital spending controls have been reduced since 2004, though authorities remain unwilling to use the so-called 'prudential rules' freedom to spend over-much because of the revenue spending consequences it produces. The GLA has rapidly used its borrowing capacity to fund new transport and other infrastructure. Such additions to

debt cannot continue within a system where the authority's income is so circumscribed. It is likely that London, given greater autonomy, would invest more in infrastructure than is currently allowed within national control of public expenditure.

In the longer term, London could be moved towards a more devolved model of government and finance, akin to those in Wales and Scotland. But to achieve this, it would require the agreement of the GLA and the boroughs whose expectations would each need to be met. London Councils has itself been active in proposing radical transfers of power and funding over public services to local government in the capital[18]. There is no reason why other changes could not be envisaged.

[18] London Councils, *A Manifesto for Londoner*s, February 2010.

6. Conclusions

This report has explored recent trends in public expenditure within the UK. It suggests that London's share of UK spending has been relatively stable over time, although as the capital's economy has grown relative to other nations and regions, spending has continued to remain a relatively lower proportion of the overall economy than elsewhere. Evidence from gross domestic household income (GDHI) figures published by the Office for National Statistics suggests that a significant part of London's relatively high GVA growth in recent years has been transferred to other parts of the country.[19] London and the rest of the Greater South East has been fulfilling an important role in providing the economic output that has generated the tax yield which has allowed lagging regions to be provided with public services and economic protection.

Public expenditure, as the earlier sections of this report have argued, has been allocated in a relatively stable way by formula and by discretionary grants. London's share of public spending has been preserved while per capita spending has risen at broadly the rate of the rest of the country. But as the discussion of the Holtham and Calman reports above suggests, 'need' is seen as the key criterion for allocation. This raises important issues of the trade-off between support and growth. Far more detailed analysis would need to be undertaken to unpack these different elements in overall public expenditure allocation (e.g. London's poor have become relatively poorer as compared to the rest of the country and has therefore received more help). However the growth in the London economy has benefitted both Londoners but also particularly the rest of the economy.

London and the English regions have not collectively made representations to the government about the 'fair' level of resource for England. However, the increasing economic importance of London and the GSE to the wider UK economy and tax capacity probably now suggests the Treasury should reconsider the use of expenditure need alone as overwhelmingly the most important basis for allocation of public money.

If London and its wider region are to be able to continue to perform their role of producing the economic output and taxation that is, in part, transferred to the rest of the UK, then resource allocation mechanisms ought properly to take account of the potential for public expenditure allocations to deliver higher output and tax income. Any reform of the Barnett Formula (or indeed, local government grants within England) ought to embrace both traditional 'expenditure needs' factors and also the 'propensity for economic growth'.

The economy of London and the rest of the GSE is remarkable not for the size of its public sector but for the scale of the private sector agglomeration within the super-region. It is comparable only with places such as the New York-New Jersey region, the Ile de France or Tokyo-Yokohama. Public expenditure policy, particularly in the years ahead when the UK will be attempting to rebuild its tax base, will need to take more account of the economic growth potential than in the recent past when, to some extent, it was simply assumed growth would continue. Investment in infrastructure is key to increased productivity, output and tax yield within London and the GSE. Unless this factor is recognised within public resource allocation, there is a real and major risk to the longer term economic progress of the UK as a whole.

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[19] Office for National Statistics, Regional *Gross Disposable Household Income*, March 2010, http://www.statistics.gov.uk/pdfdir/gdhi0310.pdf

Annex A

The Relationship between Needs Allocation and Funding: The Example of Housing

This annex sets out in more detail how one set of indicators impacts on the allocation of central government funding. It also clarifies how a range of indicators show the extent of the relative pressure that London faces in meeting its objective of adequate affordable housing for the growing population.

The Allocation Principles for Housing Subsidy

Housing subsidies are of two main types: income related support for tenants and capital grants for investment in housing. These are allocated in relation to two groups of needs indicator.

Housing benefit is a nationally based, as of right, subsidy. Access to subsidy depends on three indicators: household composition; household income; and rent. It pays the full rent from those in social housing and a deemed maximum amount based on local rents for private tenants who have only the minimum level of income determined by Social Security for their household circumstances. Regional and local government act as agents for central government. London receives a disproportionate proportion of housing benefit because they have a larger rented sector; poorer households; and higher rents.

Assessment of need for capital allocations. Housing is atypical in that the needs assessment is undertaken by the regional authority in line with government guidelines, rather than by the government and/or its agencies using national data.

The main indicators of housing need include:

(i) net household formation – i.e. the numbers of additional households that require accommodation;

(ii) the backlog of housing need particular that part of the backlog which to address requires additional housing but also that which involves significant upgrading or rebalancing the mix of the affordable housing stock; and

(iii) affordability – measured either by price to household income or residual income after costs.

The most important indicators of the backlog include:

Concealed households and sharing households where both groups require additional accommodation if their housing situation is not of their own choice;

Homeless households where the majority require an additional home although in some cases there may be a dwelling unit vacated and available for others;

Other measures of inadequate housing including in particular overcrowding – which may be able to be addressed by reallocating households within the existing stock.

On all these needs measures London's position is disproportionately bad. Indeed in many ways it is reasonable to regard housing problems in terms of London as compared to the rest of the country.

Capital grants: are allocated by the Homes and Communities Agency. The HCA works closely with the GLA within the framework of the Mayor's Housing Strategy. That strategy clearly takes direct account of both the needs of additional households and the backlog. The Strategy suggests that London requires 32,600 homes per year to 2017 which is at the lower end of the NHPAU's estimates of between 33 and 35,000 p.a. The draft London Plan commits to 33,400 p.a. within which 13,200 should be affordable (and 60% of these social renting) well below the SHMA estimate of 18,200. Thus the Plan(s) framework is itself likely to be an underestimate of requirements especially in the context of affordable homes.

The HCA budget for London is around £5bn for the period 2008-11 accounts for some 29% of HCAs available resources. This reflects both the disproportionate level of identified needs in the region and the higher costs per unit.

Even so there is no direct link between measured the needs (and the costs of meeting these needs) and allocation as the regional allocation is fundamentally a negotiation process based on but not directly related to relevant indicators. As can be seen above the needs assessment itself includes nothing on costs – these are only taken into account when the site specific grants are determined.

Allocations take account of the capacity to raise developer funding through S106 with the intention of aligning investment with planning obligations for both affordable housing and infrastructure requirements. HCA allocations are intended to fill any gap, so acting as residual funding for successful schemes put forward by potential providers. London is relatively efficient at negotiating S106 contributions which reduces its allocation – but higher costs more than offset this reduction.

Other priorities are also taken into account in HCA allocations including: rural housing; BME provision; supported housing; environmental innovation; potential transfer to Community Land Trusts; and the London temporary to settled scheme. All of these requirements together more general priorities such as design, the Decent Homes Programme and delivery of the Thames Gateway and the 2012 Olympics affect both the scale of the allocation to London and the allocation within the regions.

The HCA Regional Investment Statement 2008-11 (the latest version is January 2010) sets out the details of the allocations to the region and to sub-regions. It also sets out the relationship to particular targets on specific types of dwellings and value for grant measures which will impact on future allocation.

Thus overall housing capital allocations are informed by regional housing strategies which take account of different types of need. However the outcomes are the result of a range of national priorities as well as of negotiation within the HCA and between the HCA and other bodies – including central government and the GLA.

London has done relatively well on capital allocations even though the amounts are nowhere near enough to compensate for relatively high housing needs. London has benefitted from the recession stimulus package because a large proportion of schemes

ready to go have been in London and in some cases viability has been greater than elsewhere.

Evidence on the main sources of need

Looking first at additional households[20]: the projected increase in the number of households for the twenty year period is of the order of 660,000 (table A1). This accounts for some 15% of the projected increase in households in England as a whole. This is only a little above the national rate of increase. But the real difference comes in terms of the increase in those likely to need social housing – 23% – proportionately far in excess of any other region and the largest total in the country.

Table A1: Projected net increase in households by tenure in 2006-26 and proportions of households in the market sector

	Net increase in households			Proportions in market sector	
	(thousands)			(per cent)	
	Market sector	Social sector	Total	2006	2026
North East	113	9	122	62.1	65.2
North West	386	127	513	70.6	71.4
Yorkshire and Humber	395	72	467	71.3	73.7
East Midlands	371	71	442	74.7	76.5
West Midlands	289	75	364	68.1	69.7
East of England	505	90	595	74.7	76.8
London	446	214	660	65.7	66.0
South East	516	202	718	78.3	77.2
South West	486	89	575	78.5	79.7
England	3,507	949	4,456	72.1	73.2

Source: Holmans et al at:
http://www.cchpr.landecon.cam.ac.uk/outputs/detail.asp?OutputID=189

London's position is far worse with respect to the backlog of housing need. Indeed London accounts for some 32% of measured need (table A2) – i.e. more than double the proportion of households in London as compared to England as a whole. Within this total London accounts for 80% of those in temporary accommodation in the private rented sector; 46% of those in bed and breakfast; 20% of concealed households (and this is currently through to be a significant underestimate) and 40% of those in shared accommodation. Thus not only is London's backlog much greater than elsewhere in the country it is also disproportionately concentrated in those needs that require additional affordable housing – as compared to needs that can be addressed by more effective use of the existing stock.

The indicators listed so far are those that are used most directly to assess the need for capital expenditure. However a particular issue for London which is formally only

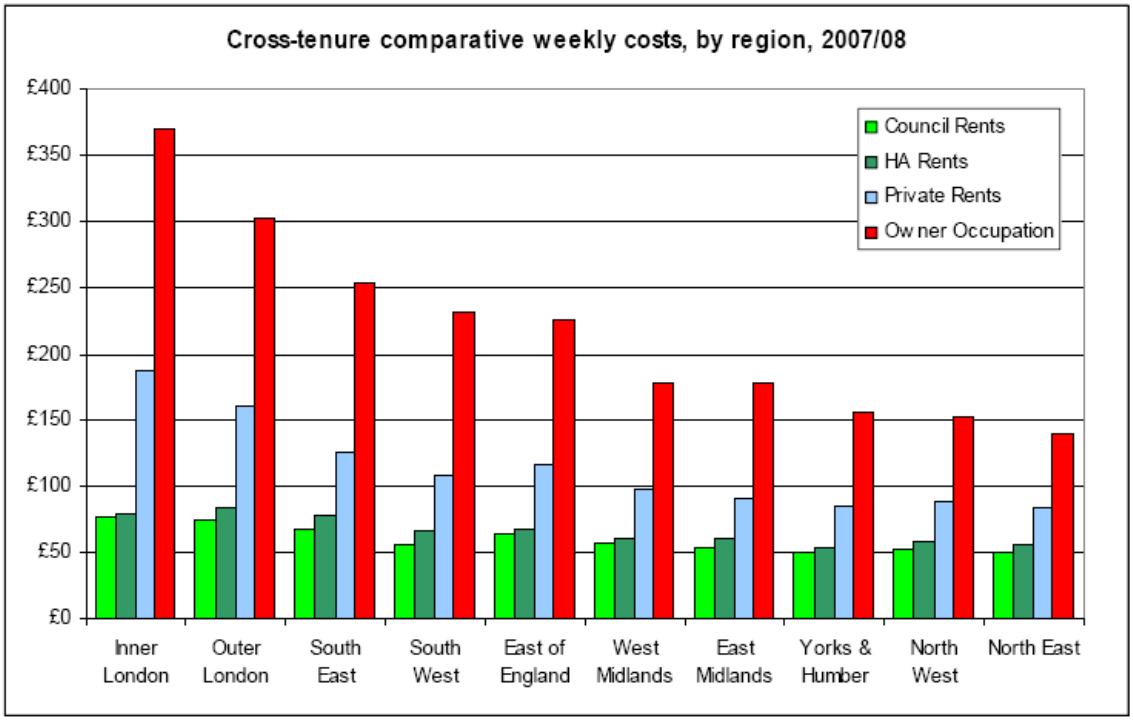
[20] Here we use figures as estimated by A. Holmans, S. Monk and C. Whitehead (2009) as these provide the breakdowns required for evaluating the need for subsidy and consistency with the backlog.

included in government advice is the issue of affordability. Figure A1 shows how rents and user costs for lower income households in the private sector have risen across England but particularly in London. Figure A2 shows how this is reflected in worsening affordability ratios – again across England but particularly in London.

Table A2: Backlog of current un-met need for social sector housing around 2006 by region					
	North	Midlands	London	South excl. London	England
(i) Homeless households in bed and breakfast hotels, hostels, refuges	2,000	1,000	6,000	4,000	13,000
(ii) Concealed families	14,000	11,000	11,000	18,000	54,000
(iii) Private sector tenants in shared accommodation	12,000	6,000	26,000	21,000	65,000
(iv) Singles in hostels	4,000	3,000	6,000	7,000	20,000
(v) Private sector tenants in crowded accommodation	28,000	21,000	48,000	33,000	130,000
(vi) (a) Owner-occupiers and private sector tenants with disabilities who are on social sector housing lists	42,000	24,000	16,000	38,000	120,000
(vi) (b) Other owner-occupiers and private sector tenants on housing lists	24,000	14,000	17,000	30,000	85,000
(vii) Households accepted as homeless and temporarily accommodated in private sector	1,000	1,000	47,000	10,000	59,000
Total of above	127,000	81,000	177,000	161,000	546,000
Less overlaps	10,000	6,000	13,000	12,000	41,000
Net total	117,000	75,000	164,000	149,000	505,000

Source: Holmans et al at: http://www.cchpr.landecon.cam.ac.uk/outputs/detail.asp?OutputID=189

Figure A1: Cross-tenure comparative weekly costs, by region, 2007/08



Source: Banks and Whitehead (2009) at:
http://www.dataspring.org.uk/outputs/detail.asp?OutputID=217

Table A3: Affordability ratios across tenures, 2002/03 and 2007/08

	CORE HA rent/ LQ earning		Private rent/ LQ earning		OO cost/ LQ earning	
Region	**2002/03**	**2007/08**	**2002/03**	**2007/08**	**2002/03**	**2007/08**
East Midlands	0.30	0.31	0.40	0.45	0.45	0.91
Eastern	0.31	0.32	0.47	0.55	0.61	1.12
London	0.28	0.31	0.58	0.64	0.70	1.21
North East	0.30	0.29	0.43	0.41	0.30	0.72
North West	0.29	0.29	0.41	0.43	0.32	0.77
South East	0.31	0.34	0.49	0.55	0.67	1.18
South West	0.34	0.34	0.53	0.54	0.68	1.21
West Midlands	0.30	0.31	0.43	0.47	0.46	0.90
Yorkshire and the Humber	0.31	0.29	0.45	0.41	0.34	0.82
ENGLAND	0.30	0.31	0.49	0.54	0.49	0.96

Source: Banks and Whitehead (2009) at:
http://www.dataspring.org.uk/outputs/detail.asp?OutputID=217

Notes: HA rent was taken from the CORE. Private rents are rents determined by the Rent Officer in HB cases. LQ earnings from the Annual Survey of Hours and Earnings were earnings for all workers in full-time employment.

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