Daily Themes

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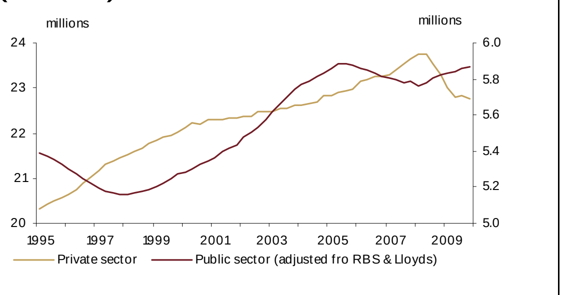
UK spending cuts: impact on regions and cities

We have shown previously that not all sectors will be affected equally by the need for fiscal consolidation after the next election. This applies to regions too – with some regions and cities more vulnerable to government spending cuts than others. The key differentiators are the relative importance of both public sector employment and private sector production that is dependent on government spending. Based on these factors, the three British regions we identify as most vulnerable are Wales, the North East and Scotland. By contrast, the London region is the least exposed, suggesting its housing market could outperform other regions. The five most vulnerable cities are Durham, Liverpool, Canterbury, Preston and Cambridge.

Rapid growth in public employment

Public sector employment grew rapidly over the course of the past decade. By the end of 2009, 5.9 million people were employed in the public sector compared to 5.3 million at the beginning of the decade according to data from the Office for National Statistics (ONS). Some studies suggest the increase has been even larger.

UK Public & Private Sector Employment (millions)



Source: Bloomberg

Indeed, a recent 'Centre for Cities' report estimates that over two thirds of the 1.2 million net additional jobs created in UK cities between 1998 and 2007 were in the public sector.

Public sector still a cushion from downturn?

Traditionally, areas with a large public sector have been viewed as more stable and resilient during economic downturns. Even during this recession this has proved to be the case. Over the period from the beginning of the second quarter of 2008 to the end of the third quarter of 2009, when the economy was contracting, public-sector employment continued to rise. Some 100,000 jobs were added, even as the private sector shed 924,000. Without the additional government jobs, the total unemployment rate would have been a third of a percentage point higher.

However, the resilience of public sector employment is unlikely to continue after the general election. The need for action to reduce the budget deficit, estimated at 11.8% of GDP in 2009/10, is recognized by all main political parties. It is also recognised that this will involve substantial cuts to departmental spending budgets and reductions in total public-sector wages and employment levels. In a recent televised debate none of the prospective Chancellors of the three main political parties ruled out public sector job cuts when asked specifically about them.

Flexible working and wage freezes could provide some of the savings required, but job losses, either voluntary or involuntary, are inevitable. The "Centre for Cities" report estimated that from 2009 to 2014 public sector employment could shrink by between 240,000 and 290,000. The report also highlighted that local government will be hit hard by spending cuts, given that it receives the majority of funding in the form of central-government grants.

As we have also previously highlighted, not all private companies will be affected equally by government spending cuts. Some industries and

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sectors will be affected more than others because of their dependence on government spending as a source of demand for their products. Some of the sectors we identified in a previous Daily as most vulnerable to government spending cuts were IT equipment, weapons & ammunition, shipbuilding & repair, aerospace and rail. This was because of the importance of government demand as a proportion of total demand for their products, combined with dependency on capital spending, which is likely to be cut substantially over the course of the next parliament.

Which regions and cities are most exposed?

We have calculated an 'overall dependency' rate for British regions and cities by combining the proportion of public sector employment to total employment with the proportion of total employment that is dependent on the 10 private sectors that are most exposed to public-spending cuts (the relevant data is not available for Northern Ireland). The most vulnerable region is Wales, followed closely by the North East and then Scotland.

British Regions' Public-Sector Dependence

	% of jobs in public sector	% jobs in 10 most dependent sectors	Overall dependency rate
Wales	32.9	8.5	41.5
North East	32.2	8.5	40.7
Scotland	30.0	9.2	39.2
South West	28.7	9.0	37.7
North West	28.2	9.1	37.3
Yorkshire & Humber	28.6	7.9	36.5
South East	25.6	10.9	36.5
East Midlands	26.7	9.1	35.8
West Midlands	27.0	8.0	35.0
East	25.3	9.7	35.0
London	22.2	7.4	29.6

Source: RBS, ONS ABI survey for Great Britain

Paradoxically, some of this greater vulnerability may reflect the relocation of some central government administrative functions to the regions and away from London in recent years. Devolution and the setting up of the Scottish Parliament and Welsh Assembly together with a number of associated regional administrative functions is also likely to be part of the reason for higher public sector employment levels in these regions.

Interestingly, London is substantially less exposed than other regions to government spending cuts. This may seem counterintuitive given that many central government functions are still located in London. However, it is a reflection of the large private sector in the capital. The lower exposure to government spending cuts could be a factor supporting London's housing market compared to other regions over the next several years.

The regional dependence is evident at a city level as well. We have listed the 20 most vulnerable cities/towns below.

20 Most Vulnerable British Cities/Towns

	% of jobs in public sector	% jobs in 10 most dependent sectors	Overall dependency rate
Durham	36.0	9.5	45.5
Liverpool	38.8	6.3	45.2
Canterbury	36.4	8.8	45.2
Preston	29.8	14.6	44.4
Cambridge	30.7	13.7	44.4
Dundee	35.2	8.8	43.9
Paisley	33.2	10.1	43.3
Swansea	35.6	7.4	43.0
Llandudno	36.0	7.0	42.9
Falkirk	32.5	10.3	42.8
Plymouth	32.3	10.4	42.7
Kilmarnock	32.9	9.5	42.3
Cardiff	33.1	9.0	42.1
Hull	33.2	8.6	41.8
Inverness	33.1	8.6	41.7
Cleveland	32.0	9.7	41.6
Kirkcaldy	32.7	8.9	41.6
Blackpool	34.7	6.7	41.4
Portsmouth	30.3	10.9	41.2
Shrewsbury	33.3	7.9	41.2

Source: RBS, ONS ABI survey for Great Britain (excluding cities with less than 85,000 total employment)

Conclusion

Just as not all sectors will be affected equally, not all regions will be affected equally by the coming fiscal consolidation after the next election. Regions and cities most exposed to government spending cuts are likely to see underperformance in their respective housing markets. In contrast, employment in London stands out as less exposed to government spending cuts, suggesting its housing market may outperform.

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