Invest to save: applying the concept to cities

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Introduction

1. Many people recognise that cities are in need of investment in infrastructure of all kinds - housing, social, physical and green infrastructure. Having this infrastructure would bring about benefits to the city, its economy and its population down the line, even monetisable benefits, but to achieve this, investment has to take place now. How can this be done in cash-strapped circumstances?

City competition depends on public goods

2. It is now widely accepted that economic success (and to an extent wider wellbeing) is determined less by competition between nation states and more by competition between city regions. This could be due to a variety of factors, including the creation of trading blocs wider than single nation states, and the growing importance of the largest single-state economies such as the United States and China. Another key factor is the importance of talent, skills and people-to-people contact to growing industries in the 21st Century, as opposed to more place-tied matters such as raw materials and access to markets.

3. Following pioneering work by Richard Florida[1], it is also becoming increasingly argued by experts (but not always by politicians) that it is factors which attract international mobile talent that count. So what does attract this fortunate group of people? I might hazard a shopping list which looks something like this:

   - Excellent public transport
   - Very good cycling facilities
   - High standard of culture
   - Bars and restaurants
   - Beautiful public realm: streets, squares and parks
   - Clean air
   - Affordable housing*

   (*important to migrants because they are moving by definition. Non migrants are typically better housed due to a skew to incumbents in both private and public housing policy.)

   The environmentally-minded may also seek places where green energy policies are pursued. Depending on what their field is, people with talent may also cluster where there are high levels of investment in higher education and research.

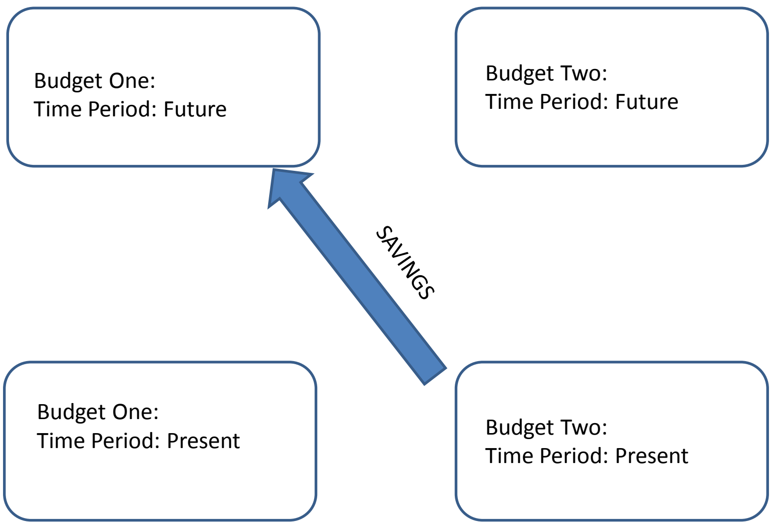
4. It is an interesting list because it represents a turn around. Previous trends after the Second World War tended to exhibit increasing atomisation: television instead of live entertainment; meals in the home and not at the factory; private not public transport. However the challenge with this shopping list is that a lot of it is public goods. This runs against the increasing trend for opening markets and greater reliance on the private sector within national economies. It is as if the lesson learned is “you must have a large and competitive private sector but also an effective public sector which takes the initiative and practises innovation”. And this is a lesson of apparently

[1] Eg Cities and the Creative Class, Routledge, New York, 2005

increasing importance, which is certainly not what Reaganomics would have led us to expect. Perhaps it is depressing to hear “I’m from the [national] government and I’m here to help”. But perhaps we do need to hear “I’m from the [city] government and I’ve just completed a new tram line”. Anywhere which can bring this off is heading for pole position in the competition between cities.

5. Investments made by one organisation or part of an organisation at one time may well yield advantages to a different department at a different time (see figure 1). So there is both a time barrier and a sector barrier to progress. But, increasingly, the kinds of things which distinguish successful cities from others in a world where it is the competition between cities which counts are investments of precisely this kind. This is what makes it very difficult to make progress in cities. It is also impeded by an issue highlighted by the international cities expert Greg Clark, who points out that across the globe, many policies of huge importance to cities are actually governed by national bodies with single-sector priorities and one-size-fits-the-whole-country standards[2].

Figure 1: “Diagonal savings”



Potential for cities to adopt innovative financial mechanisms

6. So how do we break out of this impasse? One option given a lot of airtime in England as a consequence of the Scottish referendum is devolving decisions on budgets (at least, if not also taxes) to cities[3]. This does at least begin to address the problem that investment made in one budget – e.g. transport – can yield benefits in another budget e.g. public health. At least it would do if city authorities operated in a less compartmentalised manner than national governments (which is possible, but by no means guaranteed)[4].

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[2] http://centreforlondon.org/wp-content/uploads/2014/03/CFLGCI_Nations_and_the_Wealth_of_Cities.pdf
[3] See for example Ed Cox, Luke Raikes & Graeme Henderson: Decentralisation Decade , IPPR, September 2014
[4] Devolution to cities is probably a necessary, but certainly not a sufficient condition for this

7. However there is still a problem of time delay: returns to budget number 2 accrue a long time in the future but costs in budget number 1 are faced now. At a time of constraints on public spending this is a particular challenge. One model which might address the time delay is the use of bonds. The UK Government has not baulked at a private finance initiative which took in private capital in return for long standing public commitments to payments back to, say, health providers over many years in the future. But arguably this was a less pressing need for such a financial instrument because at least costs and benefits are all in one sector in this case. A financial instrument which could handle "diagonal" trade offs would be a much more imaginative use. So could we see investments in sustainable transport financed by the private financial markets in return for payments from future public health budgets? Or is this far-fetched?

8. The invest-to-save concept has been widely promoted as a solution to the extraordinary state of housing finance today. The government subsidises the rents of people unable to pay their own rents rather than using tax payers' money to build an asset base of property to rent out to people in need. With increasing use of the private sector to house benefit claimants this has the effect of using taxpayers' money to subsidise the capital gains of private landlords –an extraordinary state of affairs and one which seems to do almost nothing to increase housing supply. The IPPR and others have stressed that cities' housing would be better supplied through borrowing to increase housing construction funded from the future rental stream of property[5].

9. Others have come to a similar conclusion for example the New Economics Foundation has promoted the "Social Return on Investment" with reference to calculations like;

   - £1 invested in high-quality residential care for children generates a social return of between £4 and £6.10.

   - £1 invested in alternative, non-prison based sentencing for women offenders generates a social return of £14[6].

   Could investing-to-save be used to deal with "diagonal" future benefits?

10. In all of these discussions and sectors, a factor is the financial context. Attempts were made, for example, in Milton Keynes before the financial crash to overcome the infrastructure investment gap by trying to get private finance interested. The offer was the future revenues from the "Milton Keynes Tariff" which was a charge on each house completed in the City collected through developer contributions legally attached to planning permissions[7]. At the time no interest was forthcoming. Perhaps the opportunity to get involved in credit-default swaps or subprime mortgages was much more exciting. However now we have the combination of a lot of money swirling round the world looking for good, and predominantly safe, long-term investments. These opportunities seem to be scarce and yields are low. So could this be the time to try again?

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[5] Graeme Cook & Bill Davies : Benefits to Bricks IPPR June 2014
[6] www.neweconomics.org/issues/entry/social-return-on-investment accessed 21/09/14
[7] Under Section 106 of the Town & Country Planning Act 1990

Time to act

11. However we go about it the issue will not go away. The UK Treasury might argue that if there are to be any savings from investment now in the NHS budget in the future, then we will simply have lower taxes in the future. The problem is that benefit can't be realised in the future because it is in no-one's interest to make the necessary investment now. This applies across sectors but it has special application in cities: to make individual cities and their surrounding regions attractive and efficient, investments are needed now. To raise the UK's core cities to perform at even the UK average would generate £1.3 billion of additional gross value added[8]. This would seem a goal worth pursuing today.

[8] *Competitive Cities, Prosperous People: A Core Cities Prospectus for Growth* The Core Cities Group, Manchester 2013