



THE LONDON SCHOOL
OF ECONOMICS AND
POLITICAL SCIENCE ■

London's Place in the UK Economy, 2008-09



October 2008

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London School of Economics
Houghton Street
London
WC2A 2AE

Tel: +44 (0)20 7405 7686
Web: www.lse.ac.uk

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Foreword
Stuart Fraser
Chairman, Policy and Resources Committee
City of London

This is the seventh annual edition of *London's Place in the UK Economy*, a report which places the London economy in its regional and national context. Examining both long-term trends and recent developments, it demonstrates that the relationship between London and the rest of the UK is a strongly beneficial, two-way process, which enhances the economic performance not just of London and the adjacent southern regions, but the nation as a whole. The authors of this year's report, the London School of Economics, provide further evidence of London's position and pivotal role in driving growth throughout the UK economy.

As in previous editions, the calculation of the net contribution of the London economy to UK public finances is a key part of this report. In 2006/7, London's contribution is estimated to have been in a range of £11.5bn to £18.4bn, with a mid-point net contribution of some £15bn. This is a conservative estimate but shows a sharp increase in the contribution to public revenues over the £12.7bn midpoint calculation for 2005/6. New analysis shows that public capital spending in London is below the national per capita average which is unusual for a fast-growing region. This contrast is a cause for concern with London also expected to fund major infrastructure projects including Crossrail and the 2012 Olympic Games. There is a risk that its long-term economic growth could be seriously compromised and therefore also its revenue-raising capacity. Maintaining London's competitiveness through targeted public investment that benefits London's global businesses remains critical even at this difficult time for the economy.

A special article in this edition features an analysis of differences by borough (or groups of boroughs) with respect to productive activity, prosperity and deprivation. It is interesting to note that while total London employment expanded by 6% between 1998 and 2006, at borough level this masks a considerable diversity, ranging from increases of over 50% to declines of nearly 20%. While London remains successful overall, there are many localities in the capital that are marginalised and among the most deprived, and which feature the highest unemployment rates in the country.

This report acknowledges that the London economy will be strongly affected by the unfortunate combination of a credit crunch and rapid increase in oil and non-oil commodity prices. A sharp downturn in the London economy as well as the national economy is the likely consequence during the next 12-18 months, though London has been relatively resilient to the global slowdown according to most recent data. It is also argued that London's long-term economic performance should be largely unaffected. Though London's reputation as a financial centre has taken some damage, it should be stressed that the origins of the current slowdown lie outside the UK, and this

should mean a return to good underlying long-term growth as we move beyond the current turmoil to recovery. This depends however on the economy responding to the remarkable changes in the balance of economic wealth.

The underlying factors that make London a highly effective competitor in the global economy remain in place. There is no room for complacency here though and the current turmoil makes it even more important that we have active engagement by all policy makers in maintaining and enhancing the factors that boost the global position of London, and the competitive opportunities this provides as the major gateway for all of the UK's global business. There is a need to take far-sighted decisions in an increasingly difficult environment.

Stuart Fraser

London

October 2008

Executive Summary

Context and Long-Term Trends

Since the early 1980s, London has grown more rapidly than the UK as a whole in terms of population, output, earnings and particularly productivity. Many factors have contributed to this success story.

Employment growth has also been rather above the national average because those economic sectors where London specialises are the ones where jobs have been expanding across the UK as a whole. The largest growth has been in business services. Employment in consumer services has yet to return to the high levels of the 1970s, while manufacturing employment has fallen by 80% over a forty year period.

London has benefited from contemporary economic change, and has adapted over the past 25 years in ways that have reinforced its strengths. On the other hand, unemployment and worklessness have risen in comparison with the rest of the country, while housing costs in particular have risen more rapidly.

London's Competitive Position

About 20 per cent of all private sector London employment is currently in businesses that are wholly or partially foreign-owned. London is also successful in attracting foreign direct investment, but typically such investment tends to be small-scale, whether measured in jobs or capital investment.

The scale of international migration has increased enormously in London over the last twenty years and an increasing proportion of these migrants have graduate-level qualifications. The same is true for migrants from other parts of the UK, while the substantial outflow from the city is heavily concentrated among those with lower levels of qualification.

In most service categories, London's share of output has increased over the past 15 years. London performed strongly in financial services compared with other parts of the UK, although growth in this sector did not keep pace with that in the London economy as a whole.

Labour Markets, Housing Markets and Real Incomes

There has been strong employment growth in and around Central London over the past decade, boosting longer-distance inward commuting as well as in-migration. Employment in Outer London has notably failed to match the growth in areas beyond the GLA boundary, significantly increasing shorter-distance outward commuting.

Most of London's highly-skilled workers have migrated to the city from elsewhere. The report estimates that 45 per cent come from other UK regions

and 30 per cent from overseas, with the remaining 25% coming from London. During the last decade the overseas-born share has gone up by a half.

The housing stock in London has grown less rapidly than elsewhere in the country putting additional pressure on house prices. On the other hand the private rented sector has responded to increasing demand, keeping rent rises below the national average.

Average earnings for those working in London are some 52 per cent above those in the rest of the UK. Once adjustments are made for differences in educational qualifications, occupational attainment and the cost of living, however, like for like standards of living are only a little higher in London than in the rest of the country.

Recent Developments

London's population growth slowed slightly during 2006-7, as net overseas immigration declined. Estimates of changes in regional output, however, showed the London economy growing strongly through 2007. For the year as a whole the reported growth rate was 4.1 per cent against a national average of 3 per cent. Earnings and employment were also continuing to increase right up to March 2008, while unemployment was still declining even relative to the rest of the UK. Indeed, both output and employment were still reflecting real growth to the middle of the year.

Evidence on housing sales and output, on the other hand, shows falls since 2006, well before the credit crunch, across the UK and particularly in London. House prices started to decline later in London than elsewhere but the speed of decline has been more rapid.

Thus the statistics currently available point to a generally healthy economy right into 2008 – except in the residential market, where declines in activity actually preceded the credit crunch. Since the middle of 2008, for which very little statistical evidence is yet available outside the housing market, the position has changed significantly. Large numbers of job losses have been announced especially in financial services and construction, house prices and activity have fallen further, and business and consumer confidence have fallen sharply.

The Boroughs' Place in the London Economy

Borough performance in terms of employment change – the most readily available indicator of relative economic growth over the past decade – is extremely variable. Between 1998 and 2006, when total London employment expanded by 6 per cent, this ranged at borough level from increases of over 50% to declines of nearly 20%.

The pattern of variation between boroughs in the affluence of their residents is quite distinct from that in terms of business performance. This can most clearly be seen in relation to earnings levels among those in work. The most conspicuous examples are within Inner London, where at one extreme,

median earnings among residents of Kensington and Chelsea are 52 per cent above those received by those working in the borough, while at the other extreme median earnings of Tower Hamlets workers are 28 per cent above those of its residents.

London's Position within UK Public Finances

Public expenditure in London accounts for about 14 per cent of that for the UK as a whole. Public expenditure per head is also higher than that of every other country or region except Northern Ireland.

London has above average expenditure on all service groups except 'housing and community amenities'. Expenditure per head on 'public order and safety' and on 'transport' is particularly high, reflecting the costs of security and of running the train and underground networks. But as a proportion of gross value added London has the lowest proportion of public spending.

London provides some 17.5 per cent of public revenues based on residence and 18.5 per cent based on workplace. As in previous years, London contributes far more than it receives. A conservative estimate of London's net contribution to the UK public finances in 2006-07 is in the range £11.5 to £18.4 billion. The actual number could be several billions higher.

Capital spending in London as a proportion of GVA (Gross Value Added) is below the UK national average at 3.4%. London is also expected to contribute more heavily to that total through planning agreements, especially for social housing and specific arrangements for large scale infrastructure projects.

Future Prospects

There are two distinct concerns about the current and future health of the London economy: the credit crunch, the impact of which is still working through the system; and cost inflation notably with respect to oil and food. The potential impact of both of these has only started to emerge during 2008.

The origins of the current slowdown in the London economy lie outside the London region, and the UK as a whole, in the sense that commodity markets are global and that it was lending in the US (rather than UK) housing market which triggered the credit crunch. To this extent, there is no reason why even a sharp downturn in the next year or two should signal a weakening in London's long term economic performance.

It is true that the reputations of both UK-based and US finance houses have been seriously affected by recognition of the processes leading up to the crunch, and inadequacies of the regulatory system in managing both the problems in the wholesale market and more general lending behaviour.

The potential volatility of the 'new' London economy with its international focus and openness as compared to other UK regions is about to be exposed

again. The impact on worklessness is also likely to be heavily concentrated in poorer boroughs.

But this volatility is linked to the same features that continue to make London a highly competitive economy. There is nothing in recent experience which challenges the understanding that scale, diversity, flexibility, international connections and the power to attract talented young workers are crucial assets in the contemporary economy, and ones where London has few rivals internationally; none within the UK.

Chapter 1: Introduction

London is unique within Britain economically, socially, culturally and (now) in its form of governance. It is the only 'global' city in the UK, with a major concentration of advanced service-based business, coupled with the seat of national government and the headquarters of most large British companies. It has strong international links of all kinds, and by far the most cosmopolitan environment of any British city.

For all its distinctiveness and international links, London remains essentially British. Its economy is intrinsically linked to those of all the other UK regions and it is affected by most of the same macroeconomic influences, as well as by the same tax and policy environment – and the same public-sector budgets. London is fundamentally linked to the rest of the British urban system by the functional division of labour that makes its own role so distinctive.

Hence it is crucial to compare London's economic characteristics, performance and challenges with those of the UK economy as a whole, and to look at how the capital relates to some specific groups of regions, notably (on the one hand) its neighbours within the Greater South East and (on the other) regions in the north where manufacturing industry has recently been relatively more important.

This report, like earlier ones in the London's Place series, sets out to provide *both* an overview of the character of the London economy as it has developed over the long run *and* a perspective on trends and issues of immediate importance. The long-run view now takes in primarily the period since the early 1980s, during which the city has been through great change and some times of substantial instability. The last decade or so, however, has seen steadier growth, which has fuelled confidence not only that London can sustain its position in an increasingly competitive global economy, but achieve substantial growth in population and employment as well.

The confidence engendered by this decade has, however, been somewhat shaken by the international economic events of the last twelve months: the financial crisis triggered by developments in the US housing market, and the subsequent rise in energy, food and commodity prices. These events raise questions about future macro-trends, and about how much reliance can be placed on the recent past as a guide to long-term trends. These issues have a particular salience for London, not simply because of its role in national and international financial systems, but also because experience in the 1980s and 90s suggests the capital may have become particularly sensitive to macro-fluctuations.

The ramifications of the credit crunch are only slowly emerging. It is too soon to know how London will be affected, or to judge how big the shocks may be. In its 'short-term' sections the report looks for early signs of any longer-term impacts. At this stage, however, it is more important to re-examine, in light of the evidence now available, the strength of the growth trends and competitive performance that London enjoyed over the past decade.

Another important aim of this report is to understand the reasons for the persistence of major inequalities in economic outcomes, notably the relatively high level of worklessness in contemporary London. This is particularly important given that any general slowing of growth in jobs and housing provision will most affect those in the weakest economic position.

The report starts with a series of chapters focusing in turn on the major economic characteristics and trends of the London economy as they have developed from the 1980s to the 2000s (Chapter 2); the underlying competitive performance, strengths and weaknesses of the city (Chapter 3); and how its housing and labour markets translate the effects of this performance into economic outcomes for various groups of residents (Chapter 4). The next chapter looks more closely at the evidence on change over the last 18 months or so, the period which should have most relevance to gauging shorter-term economic prospects, but where there are major gaps in the evidence available from the more authoritative sources (Chapter 5).

The second group of chapters begins with the annual 'special topic', which this year relates to the local pattern of variation in economic performance *within* London, and specifically to the place of the boroughs. It deals in turn with contrasts in their productive economies, the economic welfare of residents, and the role of local government (Chapter 6). The next chapter returns to the core question of London's place within the UK, with specific reference to the regional division of public spending and taxation, and the related question of the city's capacity to fund economically necessary capital investment projects (Chapter 7).

The final chapter looks forward to prospects for the region over the short and long term, discussing forecasts for the regional economy in its national context. It also considers key issues that are likely to affect how well the London economy can perform, and what the implications of this performance might be for various groups of Londoners (Chapter 8).

Chapter 2: Context and Long-Term Trends

2.1. Introduction

London's historic position as the economic, political and cultural capital of a centralised but outward-looking nation is the key to its current role within a post-industrial UK facing a highly competitive global economy. As in the past, it remains the seat of governance (private as well as public), the city with the strongest international linkages, and the place to which the most ambitious young people come to launch their careers. Crucially, it is not only by far the largest of the British regions (with three times the population of those in the next rank) but also the most diverse in terms of trades, skills and cultures. Size and success have, however, made London the most expensive city in which to live and operate, requiring both an emphasis on quality-based competition, and a continual process of concentration on those functions in which it has the greatest advantage.

The city's association with the most dynamic sectors of the national economy was broken by the Industrial Revolution, whose new technologies initially favoured those locations closer to coal and mineral resources. From early in the last century it regained the advantage, as the proximity to major markets became more crucial for mass-production industries. By mid-century it was the largest industrial region in the country, and a preferred location for the new generation of light-manufacturing activities. But it only fully regained its economic pre-eminence around the early 1980s, as a result of three linked developments: the acceleration of international economic integration; the tipping of the balance of British comparative advantage from manufacturing to advanced service-activities; and an increased emphasis on the value of flexibility, deregulation and market-based co-ordination.

Each of these shifts played to London's traditional economic strengths, but they involved substantial change in the balance of the economy, and brought some qualitative changes in terms of greater inequalities and potential economic volatility. The structural change from factory- to office-based economy has been going on at least since the early 1960s, with the majority of manufacturing jobs being lost before 1980 – and the process is not yet complete. But the 1980s saw the fruits of this restructuring, as post-industrial activities came to the fore and flexibility, knowledge and international connections became more valuable competitive assets.

This chapter takes a long view of developments in the city's position in relation to the national economy during the last quarter-century. Its main concern is to identify long-term trends and structural characteristics that still affect London's economic performance – and to assess the city's strengths and weaknesses. The period covered is that between the benchmark provided by the 1981 Census and the most recent dates for which relevant statistics are available. In practice, we are looking at changes up to the period *before* the effective onset of the credit crunch.

The geographic focus of this chapter, as of the report as a whole, is Greater London, the territory covered by the (central) 'government office region' for London, by the Greater London Authority (since 2000), and before that (up to

the mid-1980s) by the Greater London Council. Since the 1950s at least, London's influence had spread well beyond these boundaries, with an extensive hinterland servicing the city's need for additional labour, both directly through commuting and indirectly through location of back-offices and other support services.

By the period covered in this chapter there had been an effective regionalisation of the 'London economy' with a more subtle division of labour between the core city and its hinterland. The effective labour market – the area across which the balance of supply and demand determines Londoners' wage and employment rates – now includes most of the Greater South East (GSE), including the government's Eastern and South Eastern regions. Businesses and institutions such as universities in the outer parts of this extended region now not only enjoy, but also actively contribute to, many of the key economic assets of the London 'agglomeration'. Moreover some distinctive capital and world-city functions, including research/development centres and headquarters of international businesses, have re-located outside Greater London. Relations with these neighbouring areas have a different significance for London than do those with other parts of the UK. It is important to keep this distinction in mind when appraising developments in London during this period. For this reason, references in this report to 'the London region' (or the metropolitan region) relate to the wider functional area, not to the administrative or statistical 'regions', while references to 'London' relate to the Greater London Authority (GLA) area.

The remainder of this chapter presents some key indicators highlighting distinctive aspects of the structure of and changes in the post-1980s London economy. It then looks in more detail at major trends, first in the productive economy (in output, employment and earnings), and then in London's population. Chapter 3 takes the analysis of the productive economy a stage further, looking at questions about its competitive performance, while Chapter 4 focuses on the links between the economy and London's population in terms of the housing and labour markets and the standards of living achieved by London residents of various kinds.

2.2 Headline Indicators

Although the economy of the London region is undeniably complex – and this complexity is one of its strengths – many of the key issues can be captured with a few key indicators. They compare the current attributes of the London economy with those of the UK economy as a whole, and changes in both over the past quarter-century.

Table 2.1 London's Changing Place in the UK Economy 1981-2007

Indicator	1981		2007		% change p.a.	
	000s	% of UK	000s	% of UK	Numbers	Relative to UK
Population	6,805	12.4	7,557	12.8	0.4%	0.1%
of which working age	4,325	12.8	5,117	13.7	0.7%	0.3%
Households	2,634	14.2	3,175	14.2	0.7%	0.0%
Employment	3,315	14.1	4,209	14.8	0.9%	0.1%
of which Manufacturing	649	10.2	325	9.0	-2.6%	-0.5%
Services	2,439	17.8	3,551	15.8	1.4%	-0.5%
Graduates	462	14.9	1,274	21.1	3.9%	1.3%
Gross Value-Added	£80.6	17.3	£217.5	18.8	6.0%	0.5%
Housing Stock	2,676	12.5	3,192	12.1	0.7%	0.1%
	Averages	Relative to UK (=100)	Averages	Relative to UK (=100)	Averages	Relative to UK (difference)
Weekly Earnings	£145	117	£733	133	6.4%	0.5%
Unemployment Rate	7.8	88	6.9	134	-0.7%	2.4%
Employment Rate	74.9	105	69.8	94	-0.4%	-0.7%
House Prices	£30,800	127	£342,100	153	9.7%	0.8%

Notes/Sources: 1. Population data are mid-year estimates;

2. Household data are estimates by DCLG based on mid-year population;

3. Employment data are from the 1981 Census and the Labour Force Survey (LFS) for 1st quarter 2008, and relate to those working in London;

4. GVA data are workplace-based and in current basic prices. Latest data relate to 2006, and earliest to 1989;

5. Data on graduates relate to employed London residents. 1981 data (from the Census) include degrees and vocational qualifications, 2008 data (from LFS) are for degree-level qualifications;

6. Unemployment rates and employment rates are from the 1981 Census and the 2007 Annual Population Survey, and relate to the working-age population.

7. Average earnings are from the New Earnings Survey/ASHE and relate to full-time workers on adult rates;

8. House prices are averages for sales of all types of dwellings sold with a mortgage, from DCLG/CML series;

9. Housing stock data are from 1981 Census and DCLG;

10. The relative change measure is the difference between London and UK change rates.

Important trends signalled by the indicators presented in Table 2.1 include:

- After decades of contraction, London's population and employment both increased over this 26-year period, at rates slightly above the national average;
- This trend is unique for British conurbations; hence London has retained its dominant position in terms of concentration of economic activity, workers and consumers, all of which are important to its competitive performance;

- Population growth has been concentrated within the working-age group, where growth is well above the national average – skewing London's population structure more clearly towards this age group;
- The numbers of households grew at the same rate as the rest of the country while population grew faster, suggesting increased housing-market pressure;
- London's share of employment (by workplace) is even higher than its share of the working-age population, reflecting net inward commuting. Over this period employment grew faster than the working-age population, but London's share of employment did not grow in line with its share of the working-age population;
- As in the UK as a whole, net growth in employment was the result of gains in service employment that outweighed substantial losses in manufacturing jobs. Within each of these broad sectors, rates of employment change were less favourable in London than across the rest of the country;
- Even so, because London entered this period with a rather small share of employment in manufacturing (after 20 years of contraction), it did better than other regions;
- London started with an above-average share of graduates in its working population, but managed to expand that share even faster than the rest of the country over this period. This greatly reinforced its position as the main centre for graduate employment in the UK;
- London's share of gross value added (GVA) has grown faster than either its share of employment or population. The increase in GVA in London has been above the national average rate, primarily because of a faster rate of increase in productivity/earnings, rather than because of a slightly faster increase in employment;
- Earnings rose faster than in the country as a whole, thus increasing the earnings differential. This might reflect a better qualified labour force rather than higher real pay for given levels of qualification;
- As in the country as a whole, London's unemployment rates fell between the start and end of this period, although employment rates did not increase. Despite London's relatively strong growth performance, trends in both unemployment and employment rates were less favourable than for the UK as a whole, with rates of worklessness for the GLA area well above the national average at the end of the period;
- House prices in London grew more rapidly than those in the rest of the country and were more volatile. This helped those already well-housed in London but has significantly worsened access for new entrants;
- Growth in the housing stock did not keep pace with the growth in households and was slower than in the rest of the country. As a result the pressures on the housing market have increased.

In sum, there is evidence of a city-regional economy building on its established strengths, well placed to assume an even stronger role within the UK economy. This dominance reflects London's high levels of human capital, but has not ensured employment for all. There is also evidence of growing

pressures associated with success – notably the lack of housing, but also the higher costs of living both financial and intangible.

2.3 Structural characteristics of the London economy

The 21st-century London economy is distinguished by the scale of activity within the city-region, the predominance of high-level service activities of many kinds (including some with uniquely global horizons), the stock of human capital, and the high levels of productivity and earnings achieved by its businesses and workers.

Table 2.2: London and national sectoral structures compared, 2006

Industrial Sectors	Employees in London (Full-time equivalent)	Sectoral share of London total	As ratio of sectoral share in GB total
Publishing	51.7	1.5%	2.5
Other manufacturing	128.7	3.7%	0.3
Other production	125.1	3.6%	0.5
Distribution	457.8	3.5%	0.6
Hotels and restaurants	220.3	6.4%	1.1
Air transport	40.7	1.2%	3.4
Other transport	236.9	6.8%	1.1
Insurance/pensions	24.9	0.7%	1.0
Other finance	272.8	7.9%	2.2
Real estate	81.8	2.4%	1.4
Computer services	99.5	2.9%	1.3
Other business services	737.3	23.2%	1.5
Public administration	215.5	6.2%	1.1
Education and health	538.3	15.5%	0.8
Recreation, culture, and organisations	178.6	5.2%	1.5
Other services	54.5	1.2%	1.0
Total	3464.7	100%	1.0

Source: Annual Business Inquiry (via NOMIS)

The pattern of sectoral specialisation in London compared with the national economy as a whole can be seen from the breakdown of employment in September 2006 (the last date for which detailed statistics are available). One striking feature of the comparison (in Table 2.2) is the lack of substantial manufacturing employment in the capital. This is especially clear if we discount publishing, which has traditionally been classed within this sector because of links with printing, but is now purely a cultural/business service (and one of London's specialisations). Mainstream manufacturing is no longer an activity in which London has a comparative advantage, and indeed the city has only a third as many manufacturing jobs as might be expected from the size of its overall employment. Many of the 'manufacturing' jobs which do remain are in fact managerial or sales jobs for firms with plants elsewhere. Actual production of goods in the city accounts for only a quarter of manufacturing jobs (according to the 2004 London Annual Business Survey

(LABS) 2004. In the rest of the GSE, by contrast, manufacturing is almost as important as it is nationally.

Also apparently under-represented are a range of other activities dedicated to servicing the demands of the local population (in energy, construction, distribution and education/health). Jobs in these activities tend to be under-represented relative to London employment (rather than population), at least partly because a substantial minority of London workers (19% in the most recent LFS) live outside the GLA area and satisfy most of their service requirements there. Most other service activities are more heavily represented in London than elsewhere. The most conspicuous are air transport and (on a much larger scale) financial services – apart from mainstream insurance/pensions, where the bulk of routine activity left London some decades ago.

Table 2.3: London and national occupational structures compared, 2008

Occupational Group	Workers in London	Occupational share of London total	As ratio of occupational share in UK total
Higher managerial and professional	946.0	22.5%	1.6
Lower managerial and professional	1342.8	31.9%	1.2
Intermediate occupations	462.8	11.0%	1.0
Small employers and own-account workers	409.4	9.7%	1.0
Lower supervisory and technical	262.0	6.2%	0.6
Semi-routine occupations	368.2	8.7%	0.6
Routine occupations	247.7	5.9%	0.6
Unclassified	169.9	4.0%	0.8
Total	4208.7	100.0%	1.0

Source: Labour Force Survey, 1st quarter, 2008.

London's pattern of specialisation needs to be analysed by function and occupation. In terms of broad occupational groups, the London job structure is skewed toward higher managerial and professional jobs and against all lower-level supervisory, technical, routine or semi-routine jobs (Table 2.3). This distribution is partly a reflection of the city's pattern of sectoral specialisation, but it is also strongly evident *within* many sectors. Indeed, two-thirds of the bias toward higher professional/managerial jobs in London remains, even after controlling for industrial composition at a disaggregated level. Within each industry, London firms tend to specialise in more knowledge-intensive products/market niches; in addition, the larger firms tend to export more

routine kinds of work (that do not require either face-to-face contact or London's specialised skills base) to cheaper locations either within the UK or (increasingly) to off-shore locations (Gordon et al., 2005).

A third distinction between the London economy and that of other parts of the UK is that they target somewhat different spatial markets. For London firms there is now an accumulation of data on this issue, but similar figures for other regions are less readily available. One fairly recent national source (the 2004 Workplace Employment Relations Survey), which included about 200 firms in London, pointed to two clear biases in what firms saw as their main market. Both the local market and the national market were cited about as frequently by London firms as by those in other regions (32% and 25% respectively, on an employment weighted basis), but London firms were less likely to report the regional market as their main target (7% against 14% nationally) and more likely to report the international market (36% against 20%). More precise evidence from the 2007 LABS, with some 4000 respondents, indicates however that the achieved level of exports from London businesses was more modest than this comparison suggests (averaging 10% on an employment-weighted basis). The issue is discussed further in the next chapter.

2.4 Long-term trends and changes in the London economy

The period since the early 1980s has seen a different, and more positive, pattern of changes for the London economy than the decades that preceded it. The downward trends in both population and employment have been reversed, and a wider gap has opened up between London's earnings and productivity levels and those in the regions beyond its influence.

This process of change has not been smooth or consistent, and it is still hard to distinguish longer-term trends from shorter-term shocks and fluctuations. Some of the sources of variation are macroeconomic. The first 20 years saw one-and-a-half economic cycles of conventional form but greater than normal amplitude, both nationally and more particularly in London. The recession of the early 1980s had its strongest effects in more industrial regions, but the major boom that followed from the mid-1980s was more focused on service activities and on London. Similarly, the 'bust' of the early 1990s had its sharpest effect across the London region. The path of recovery from this recession, though with a similar sectoral and regional focus, was more controlled and prolonged – but by the end of the decade, boom conditions had returned to the region.

The late 1990s boom was not followed by a 'bust' (except in the stock market). Rather, growth came back into line with the long-run rate of capacity growth, sustaining expansion of both the London and national economies through to late 2007 at least – before the credit crunch started to make an impact. After the region's volatile performance in the previous 20 years, when underlying trends were hard to discern, the last seven years or so even seemed to provide a more promising source of evidence on how London can be expected to perform over the long run.

**Table 2.4: Estimated remuneration of workers: London and Great Britain
1981 and 2007**

	1981	2007	% change p.a.
LONDON			
FTE numbers in employment (000s)	3,098	3,678	0.7
Mean weekly earnings (Full-time)	£145	£733	6.4
Total annual earnings (current prices at time)	£23,359 m.	£140,190 m.	7.1
Total annual earnings (2007 prices)	£64,534 m.	£140,190 m.	3.0
GREAT BRITAIN			
FTE numbers in employment (000s)	21,062	24,520	0.6
Mean weekly earnings (Full-time)	£124	£550	5.9
Total annual earnings (current prices at time)	£135,820 m.	£701,272 m.	6.5
Total annual earnings (2007 prices)	£375,233 m.	£701,272 m.	2.4

Sources: 1981 Census of Population; Quarterly Labour Force Survey, 2nd quarter 2007; New Earnings Survey; ONS Retail Price Index for the UK

Note: FTE is full-time equivalent.

Disturbances to trends have come not only from macroeconomic sources. Policy has also played an important part, especially the vigorous deregulation of both product and labour markets during the 1980s; the 1986 'Big Bang' for City financial services particularly affected London.

International political developments helped accelerate population growth in the region, as asylum seekers and then A8 migrants (from the EU accession countries of Eastern Europe) contributed to several upward-step changes in immigration during this period. Overall, however, this growth owed more to globalisation, because of which both temporary and permanent international moves of all types became progressively more common.

London's economy has also been affected by expectational (or speculative) cycles. These expectations were triggered by various factors: in the mid-1980s by the potential impacts of financial globalisation; in the late 1990s by the dot.com expansion (bubble); and at various points by the value of housing and its implications for the credit-financing of consumption. The pattern of change emerging from these various influences is inevitably complex and is difficult to unscramble because of major shortcomings in official data sources on key aspects of the London economy, both past and present.

Currently-accepted estimates of overall output in the region (in Gross Value Added, or GVA – approximately equivalent to GDP) go back only to 1989¹. For a second-best measure of changes in the scale of London economic activity it is, however, possible to use estimates of income paid to London workers (representing 60-65 % of GVA) calculated from figures for full-time equivalent (FTE) numbers in employment (from the Census and Labour Force Survey) and weekly earnings of full-time workers paid on adult rates (from the New Earnings Survey). Estimates on this basis for 1981 and 2007 are presented in Table 2.4.

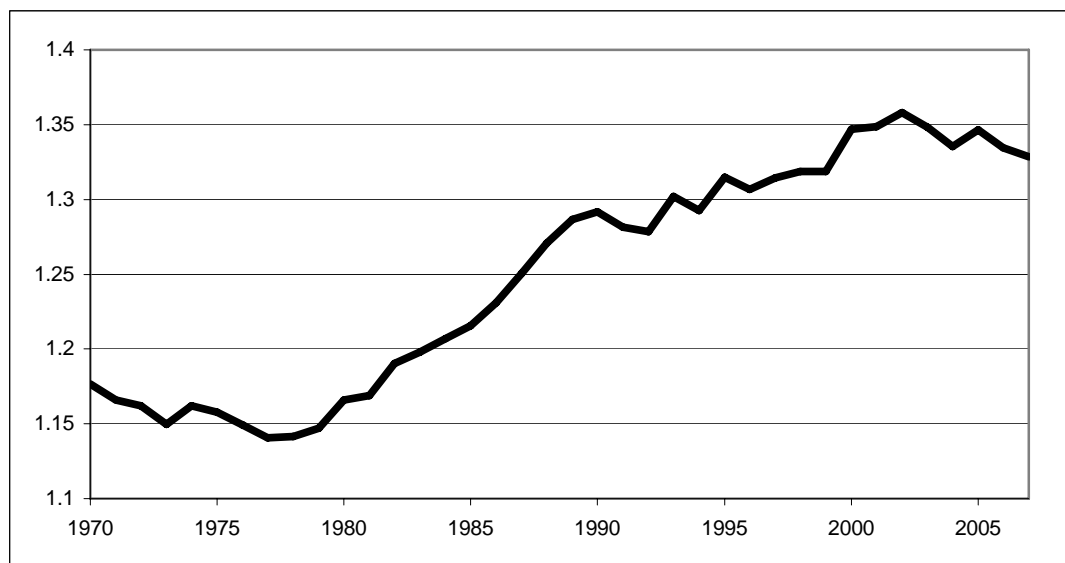
These figures suggest the London economy grew in real terms by about 3.0% p.a. over this long-run period, with three-quarters of this growth coming from higher earnings per (FTE) worker – and thus presumably from higher productivity – and only one-quarter from an increase in the volume of labour inputs. This figure compares with an estimated national growth rate over the period of 2.4%. Thus it seems that London managed to sustain a growth rate about one-quarter above that of the UK through this quarter-century, despite having only a slightly faster increase in employed labour. Of the margin of 0.6% p.a. faster growth, 0.5% came from London's faster rate of growth in real earnings/labour productivity.

One cautionary note to be emphasised is that the price adjustment considered here is based on the *national* RPI index. It may not be a bad approximation for trends in firms' output prices, which is the relevant consideration in assessing implied productivity gains. From the worker's perspective (to be considered in Chapter 4), some allowance would have to be made for what is likely to have been a faster rate of price inflation in London as compared with other parts of the country – given the evidence on relative house-price increases. A second important point is that some proportion of the faster earnings growth in London (maybe even the whole of it, as Duranton and Monastiriotis [2002] suggest) must reflect the growth in London's share of the UK's more highly-qualified workforce.

The degree to which the gap between average earnings in London and those in the country as a whole widened during this period is indicated in Figure 2.1. Before 1979, this gap seems to have been slowly reducing, but it then doubled in size in just over a decade. It is probably not a coincidence that this period was one of radical deregulation of labour markets. These years saw a general widening of earnings differentials – from which London's better-qualified workforce in high-status jobs would have benefited particularly – as well as more vigorous competition in product markets, from which more efficient firms would have benefited.

¹ Earlier figures having been discredited by Cameron and Muellbauer (2000)

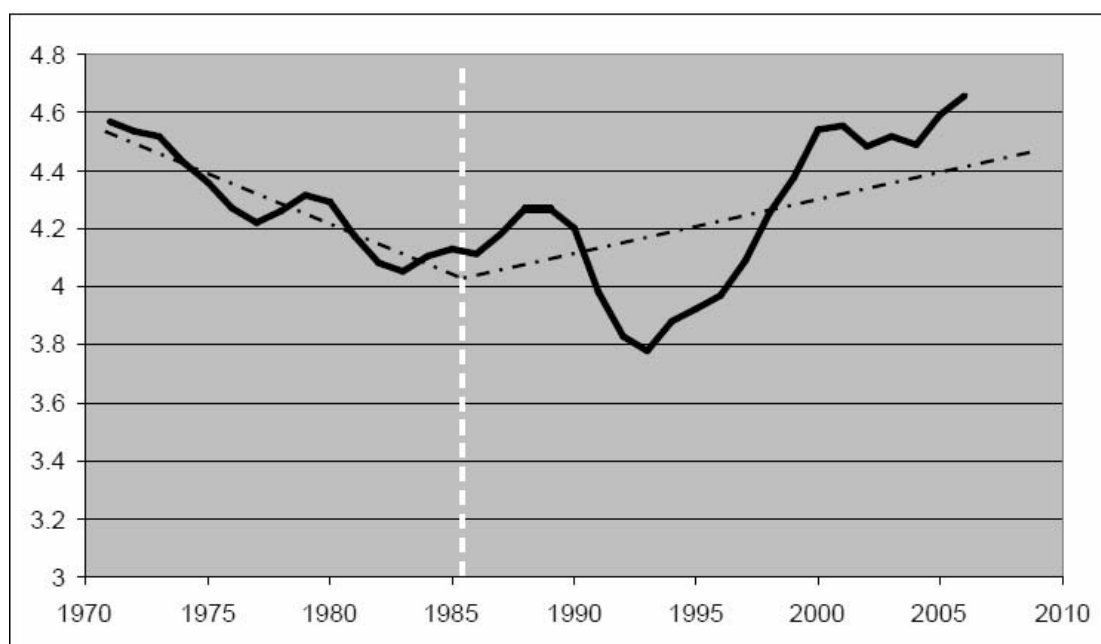
Figure 2.1: London earnings for full-time workers as a ratio of the GB average 1971-2007



Source: New Earnings Survey/Annual Survey of Hours and Earnings

Overall employment trends in the region turned around about 1980, though the point at which this change occurred is much less clearly defined. One reason is that, more or less simultaneously, the volatility of employment in London increased radically. To some extent this phenomenon was national, though it was most marked in London, which moved from having the most stable pattern of any UK (statistical) region to showing the most instability. The difficulty in identifying the turning point is compounded, however, by substantial inconsistencies in London between different indicators of job numbers/changes. From inspection of the most conventional of these data (leaning principally on the Annual Employment Census/Annual Business Inquiry series), the turning point in employment trends appears to have occurred around 1984 (Figure 2.2).

Figure 2.2: London employment trends 1971-2007



Source: Experian/GLA Economics and ONS Civil Employment estimates (NOMIS).

Note: Job numbers reported here are significantly higher than in Table 2.1, both because the annual counts are of jobs not workers and because of continuing inconsistencies between the procedures used for these and the benchmarks provided by Census and Labour Force Surveys.

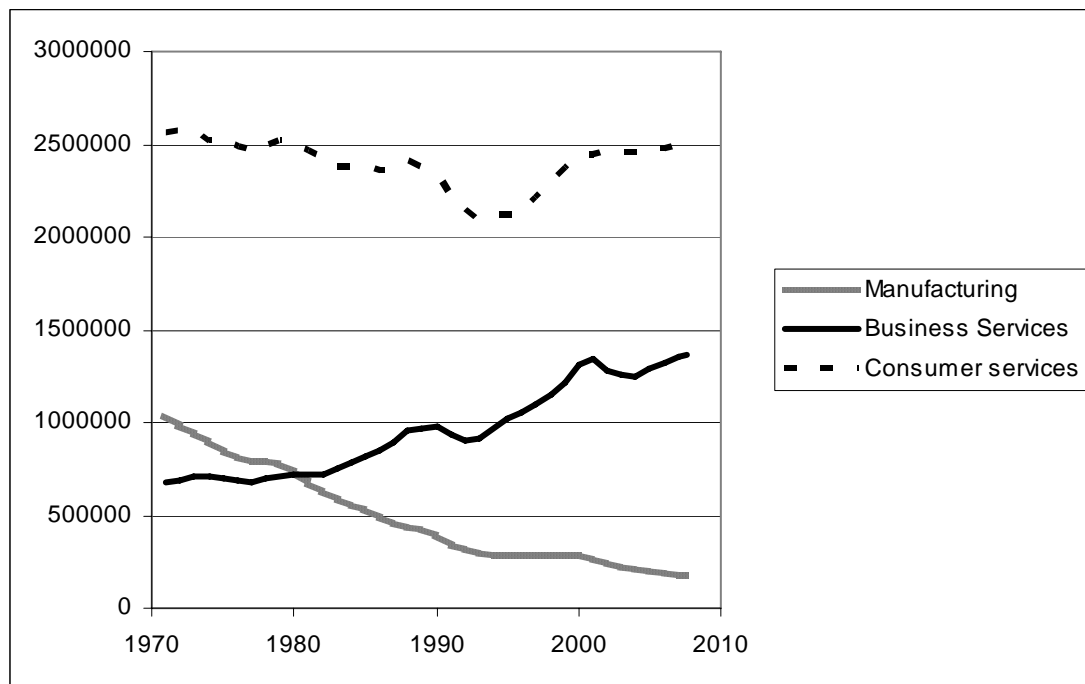
Disaggregating these employment figures to distinguish broad sectors with different economic characteristics reveals different patterns of change. It is useful to distinguish the two externally-directed sectors, manufacturing and financial/business services, from a residual, more locally-oriented, category encompassing governance, tourist and cultural services (which nevertheless also includes firms involved in externally-oriented activities).

When employment trends for these sectors are represented separately (in Figure 2.3), none individually shows the early-1980s break suggested by the aggregate data. Manufacturing displays a continuous downward trend, modified only slightly by cyclical influences. A fairly constant rate of decline, however, yields smaller absolute reductions over time, as the residue of (real) manufacturing jobs, vulnerable to such losses, shrinks. Business services on the other hand show a continuous upward trend, more subject to cyclical fluctuations. Here, a fairly constant trend growth rate yields larger absolute additions to employment, as its base expands. The two trends cross in about 1981, when business services take over from manufacturing as the lead sector in the capital's economy. Employment changes 'turn around' soon thereafter as business-service gains exceed manufacturing losses.

The picture for the residual ('consumer service') group is more confusing. Until the early 1990s it exhibited a slow downward trend with cyclical fluctuations, both of which might reflect the pattern of purchasing power in the region. The downturn in the early 1990s recession is sharper than anything evident before. This trend might follow from the character of that recession, which was disproportionately associated with service activities, with cutbacks in

credit-financed consumption, and with South East England. A gradual recovery was, however, suddenly followed in the late 1980s by a lurching upturn unparalleled by the other two externally-oriented sectors. At this point other employment series part company, with the Labour Force Survey (recommended by ONS for measures of regional employment statistics) suggesting slower growth during this second boom period than the regular source used in Figure 2.3. Since 2000, as the macro-economy has followed a more sustainable long-run growth path, this sector has shown modest but steady growth. Possible reasons for this development include immigration patterns, discussed in the next section and in Chapter 4, and an upturn in public spending.

Figure 2.3: Employment trends in three sectors of London activity



Sources: As for Figure 2.2

Note: Business services include financial intermediation

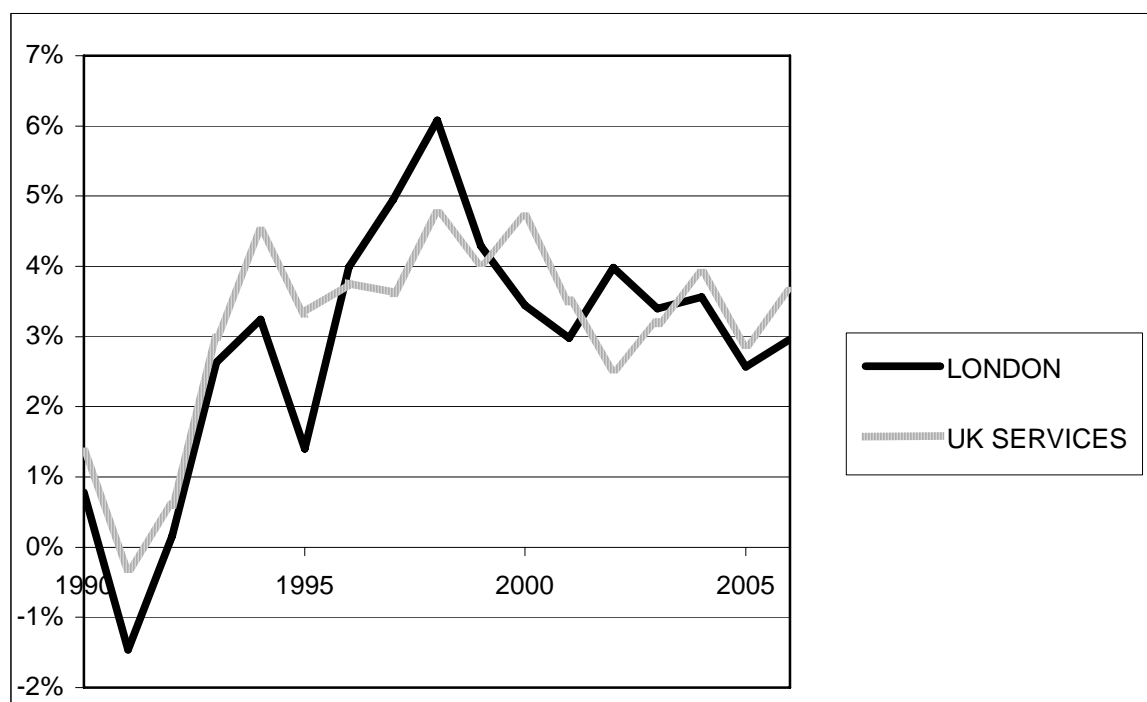
Another perspective on the pattern of change in the London economy over the later years can be gained by looking at trends in the output (GVA) data series, available for the years from 1989 onwards (Figure 2.4). The data have their limitations, but are generated in a consistent way (starting from evidence on incomes earned) that does not depend on the problematic employment series. Analysis of these data highlights two facts. The first is that London GVA growth rates are rather strongly related to growth in the wider UK economy – though (unsurprisingly) they reflect specifically service-sector output trends rather than those in goods production. This piece of evidence (and others to be discussed in the next two chapters) shows that – contrary to some claims that London became disconnected from the rest of the UK during this period – it remains strongly integrated into the national economy, and strongly affected by fluctuations in it.

The second point (evident from the figure but reinforced by statistical analyses) is that London output fluctuates more than proportionately with

swings in the national (service) economy. It appears that a change of 1% in UK service GVA is associated with a change in London GVA that is about 60% larger. Further analyses indicate that this relationship also applies to employment trends over a longer period (i.e., a 1% change in national GVA could be expected to lead to a change of about 1.6% in London employment).

One reason for the rapid growth in London employment observed in the late 1980s (and projected forward well into the future by some observers) seems to be that in this period the national economy, climbing back from recession, grew at well above the long-term 'sustainable' rate (of around 2.5 per cent p.a.). This suggests the need to focus on developments in the years since 2000, when the economy has progressed more steadily at something like its long-run potential growth rate.

Figure 2.4: GVA growth rates London in relation to UK services 1989-2006



Source: ONS

2.5 Population structure and trends

From a labour-market perspective – as well as in terms of consumer and construction demand – the city's population is a key element shaping London's place in the UK economy. The issues raised by population growth are of two kinds. First, there are matters such as the need to sustain growth within the region, the practicalities of accommodating this growth, and the flexibility with which labour supply responds to volatile demands. Secondly, there are qualitative issues such as who is attracted to the region, how their skills link with its particular specialisations (especially in knowledge-intensive sectors) and the relation between selective migration and concentrations of workless individuals in parts of this strong economy. These issues will be

followed up in Chapter 4 on housing and labour-market dynamics. But first we need to consider the structural characteristics of London's population and the processes through which current population growth has been achieved.

For half a century, from 1939 until the late 1980s, London's population declined. It fell by about 1% p.a., principally through net out-migration from the city to other parts of southeast England. This process was part of a much longer-term decentralisation from the established urban core, reflecting individuals' demand for more residential space as their incomes increased.

The impact of this out-migration became particularly evident in this period because of the imposition of the London Green Belt, which served less to slow decentralisation than to push it further out, well beyond the boundaries of Greater London. During this time, despite years of strong Commonwealth immigration, the balance of international migration was as likely to be negative as positive, and net gains of younger people from northern regions were dwarfed by the outflow of families to the Greater South East.

The past 20 years have seen a turnaround in population trends, with first a halt to population losses, and then (over the last decade) strong population growth. The essential factor driving this growth has been sustained and increasing gains from international migration, though this and earlier waves of immigration have had the knock-on effect of increasing the birth rate, as larger numbers of young people come to live in the city.

The impact on birth rates tends to be felt about 10 years after immigrants' arrival in London, though it takes another 15-20 years before this increased fertility has major economic impacts on the housing and labour markets. While natural increase is now a major element in London's population growth, its main effects on the size of the working-age population are still to come. In terms of overall population growth, however, its contribution is already as important as that of net migration, since net gains from overseas migration are substantially offset by net outward migration to other parts of the country (Table 2.5).

Table 2.5: Sources of London population growth 2001-7

	Numbers (000s)	% of UK
Population mid-2001	7,322	12.4
Births	680	16.1
Deaths	327	9.2
<i>Natural change (Births-Deaths)</i>	353	50.0
Net migration from rest of UK	-575	..
Net migration from abroad	452	41.3
<i>of which: asylum seekers</i>	44	23.3
Total change	235	13.8
Population mid-2007	7,557	12.4

Source: Office of National Statistics

Note: Total change includes small changes in institutional populations and balancing adjustments.

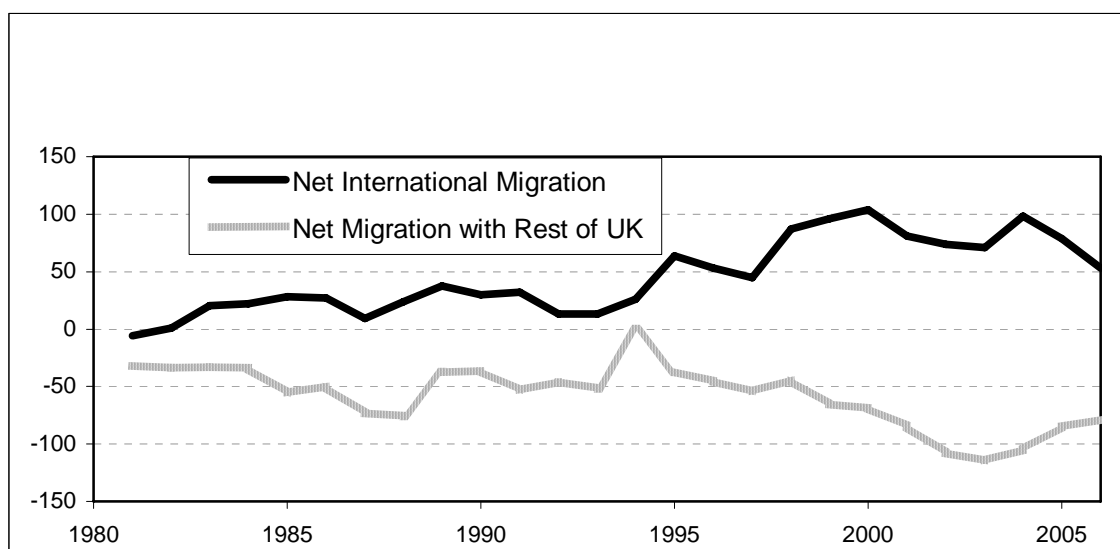
This net outflow reflects a continuing process of de-concentration *within* the Greater South East. In 2006-7, when net emigration from London to the rest of

the UK amounted to 80,000 people, the Labour Force Survey shows all the net losses occurring in exchanges with London's two neighbouring regions (Eastern and Southern). Flows with regions further afield were more or less in balance (with a small net gain to London from them).

The Impact of migration on the north-south population balance within the UK is now essentially a matter of where international flows are concentrated. The 2001 Census shows that London itself, which is particularly attractive to young migrants, had a net inflow of working-age movers from outside the Greater South East. But this trend is dwarfed by the numbers coming from overseas, with net gains in this age group that were about seven times larger in 2000-1.

The two sets of flows are not entirely independent. Rather there seems to be an association over the past 15-20 years between increasing levels of overseas migration into London and increasing net losses to the rest of the UK (Figure 2.5). One study examining this relation across all the southern regions suggests there is a 40-50% displacement effect. That is, that for every 1000 net overseas migrants received in a region, there might be an off-setting reduction of 400-500 in the balance of flows to/from other regions (Hatton and Tani, 2005). The London data on their own suggest an even stronger effect, implying that the overall impact of overseas immigration on London population levels might be less than would initially be expected. The most likely mechanism through which this displacement would occur is the housing market, and this issue will be pursued further within Chapter 4.

Figure 2.5: London's Migration Balances, International and within UK, 1981-2006



Source: ONS 2008 revisions to international migration series.

In addition to its quantitative effects on London's labour supply and housing demand, migration into the city has important qualitative implications for the labour force, which is both younger and has a much higher level of human capital than would otherwise be the case. Migration is discussed further in the next two chapters, but the strong bias of inward migration (especially

from the UK but also from overseas) toward those with higher levels of education is the reason why London has developed such a large graduate population over recent decades.

2.6 Summary

The national and economic context of the last quarter of a century has led to a revaluation of the traditional assets of London, as a large, diverse and internationally-oriented agglomeration, with flexible institutions, a strong attraction to able young workers and established strengths in advanced producer and consumer services.

London's population and employment are growing, but the strongest growth has been in earnings and productivity—at least partly because of inflows of highly-skilled labour, both from the rest of the UK and overseas. Employment growth has been consistently strong in those economic sectors where London specialises, but less consistent in other sectors where unusually strong national economic growth has been absent. Population growth has tended to depend on special circumstances, notably the push factors encouraging increasingly large numbers of migrants to come to London from poor countries.

London has benefited from factors and specialisations which suit the times, and has adapted over the past 25 years in ways that have reinforced those characteristics. Where this has left those in the local population whose capacities are less well adapted to the new economy, and how far such changes are responsible for the concentration of worklessness in the capital, are important questions which need to be addressed in the following chapters. The issue of how the credit crunch, whose real impacts post-date the evidence considered in this chapter, will affect London's resurgent economy will also be considered in later chapters.

Chapter 3: London's Competitive Position

3.1 Introduction

London operates in a competitive economic environment, and one where many cities, in the UK as well as overseas, are self-conscious about their economic potential. Since the creation of the Mayoralty, London's government has actively pursued certain kinds of competitive activity to boost its economic position. As in other cities, they include the attraction of inward-investment projects and the pursuit of high-status events or other forms of recognition by higher-level bodies.

On the whole these activities are less important for cities' success than the forms of competition pursued by firms and individuals in private markets. Thus, the success or failure of the London economy is a matter of how well London-based firms fare against competitors from elsewhere in selling their output in product markets, at home and abroad. Closely connected is the implicit competition between places to attract and retain talented (or otherwise desirable) residents who can contribute to their economic dynamism. Public policies can affect either of these factors – for better or worse – by making the city a more/less productive and attractive location. The effects of such actions are indirect.

This chapter examines how London fares in each of these forms of competition and what this competitive position indicates about its competitive strengths and weaknesses. The focus (as in the report as a whole) is on London's position compared with other parts of the UK. But, since what most distinguishes London from the rest of the UK is its international orientation, understanding its position within the hierarchy of British cities depends on some consideration of its international position.

London's government devotes little obvious attention to its competitive position vis-à-vis second/third-tier British cities (such as Manchester, Glasgow or Bristol), though *they* see themselves as competing with London. London's behaviour in this respect is different from New York City, which has long been concerned about retaining activities that want to move either to other big US cities or just further out in the region. The difference may be because of the need to avoid conflict with the government's regional policy, or because British cities don't have the fiscal incentives of many foreign cities to protect a local tax base. But the London economy competes strongly with other UK cities, both for sales into the national market and for talented workers.

3.2 Competing for Mobile Investment

Attracting mobile investment projects – bringing in factories, offices or tourist facilities, adding jobs, purchasing power and taxable assets – to a local economy are some of the most obvious ways in which cities can be seen to compete. *Think London* (the city's inward investment agency) now pursues this role on behalf of the Mayor, with well-advertised success in its international projects.

Indicators of this success are typically presented in numbers of projects choosing to locate in particular cities. The most established European source records that in 2008 no less than 8% of all international projects which located in Europe came to London. It was top of the European league, and accounted for 42% of all projects coming to the UK (Ernst & Young, 2008). The rest of the UK appeared conspicuously less successful than the rest of France, excluding Paris.

These overall averages are not very meaningful. In one respect they understate London's dominance with what are now the most numerous forms of mobile project, namely headquarters and sales/marketing offices. This phenomenon is well-illustrated by an analysis of moves to the UK by Indian firms. Over the years 1997-2004, three-quarters of them came to London, but the proportion varied between 16% for manufacturing/ R&D projects and 87% for HQs - hardly any of which went elsewhere in Europe (GLAEC/TL, 2005).

London's dominance with this kind of project fits with evidence in the annual *European Investment Monitor* (EIM) surveys of how international firms perceive European cities as business locations. They continue to place London at the top, ahead of Paris, and with other cities further behind (Cushman & Wakefield, 2007a). Five other cities from the British Isles² figure in the European top-33 on which *EIM 2007* focused, with another pair entering a 'write-in' list of other contenders. Of these cities, only Dublin came into the top third of the overall ranking, while Birmingham and Manchester came two thirds of the way down, and Glasgow and Leeds close to the bottom of the main 'league', Bristol and Edinburgh were well down in the supplementary listing (about 50th overall).

This hierarchy is clear, and is reproduced for most of the more important criteria distinguished in the survey. The largest gaps between London and the rest came over the most 'international' questions; businesses reported much less familiarity with the rest of these cities, and more doubts about their language resources. All the other British cities did better than London in terms of pollution, staff costs and office value for money (except for Manchester on the last criterion)³. Dublin was perceived as ahead of London in government attitude to business and action to improve the city. Otherwise London was so far ahead of the potential domestic rivals, that (with the possible exception of Dublin) there can be little effective competition over international projects⁴.

Counts of projects confirm this relative success for London, with even Greater Manchester recording just 11 inward investments in 2007. Nor is there evidence that this dominance is likely to change in the near future. Since 2006, Dublin had held its place (like London) while the others had slipped back slightly. Taking a longer view, since 1990 Dublin had made a leap

² Including Ireland since Dublin is arguably as much of a domestic competitor as (say) Edinburgh is, at least for private-sector projects.

³ In the corresponding domestic UK survey, however, Manchester, though coming second overall, was rated best location for a new headquarters (Cushman & Wakefield, 2007b).

⁴ In this context the notion of competition refers to whether an investor was at all likely to have considered an alternative location, not whether places actively competed to attract them.

forward from outside the top 25, and Birmingham had made some progress – but both Manchester and (especially) Glasgow had fallen back.

The types of international projects that London is so successful in attracting tend to be small, whether measured in jobs or capital investment - unlike the factories locating elsewhere. UK Trade and Investment (UKTI) returns show that over the years 2003/4-2005/6, projects recorded as going to London averaged just 14 jobs per project (Centre for Strategy and Evaluation Services, 2007). Simple counts of moves can thus grossly exaggerate their importance. In total, the UKTI data indicate that London received about 3500 jobs p.a. from this source. That represented about 11% of the national total (a bit below London's overall share of employment) – and about 0.1% of the London job stock. Even if these projects have been won competitively (which is unclear⁵), these figures should probably be put alongside counts of the corresponding jobs located abroad by London firms seeking to boost their international sales.

The overall scale of foreign ownership of London business is of a different order from this inflow of projects, which can scarcely affect it. According to the 2007 LABS, about 20% of all (private-sector) London employment is currently in businesses that are wholly or partially foreign-owned. This international business presence in London matters substantially for its image and vitality, and its role as a global business centre providing services to third parties and not just to UK-based exporters and transnationals. Many of these businesses are long-established, while others have been passed into foreign-ownership (as with City finance houses), more recently through mergers/acquisitions. Such takeovers leave a vulnerability to future disinvestment in periods when rationalisation is required. In general, however, inward investment of this kind casts a rather ambiguous reflection on the city's competitiveness. It tends to suggest that London has significant locational assets (of one kind or another) but that they are not being fully exploited by local owners/management.

3.3 Competing for Economically-Desirable Residents

London has always been a magnet for international migrants of various kinds, who contribute in different ways and different degrees to the economic vitality of the city. The scale of all these kinds of move has increased enormously over the last twenty years, and their role now has to be recognised as an important aspect (one way or another) of the competitive performance of the city.

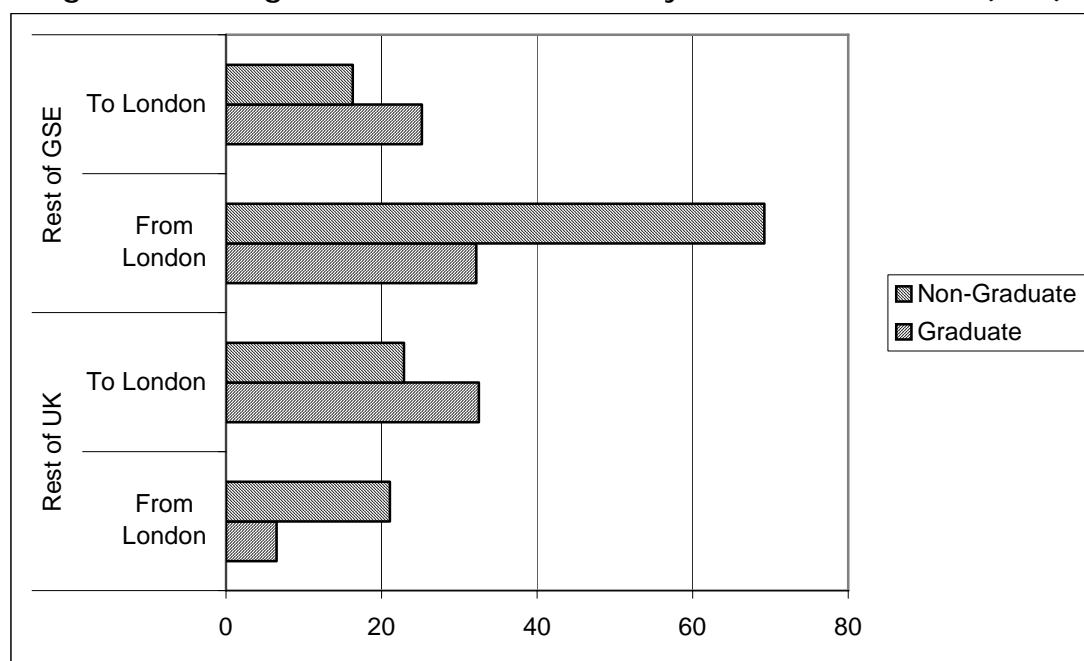
These migrants can be divided into four groups in terms of the main contribution they might make. This division reflects two distinctions. One is between those whose main benefit is boosting demand in the London economy (like some of the super-rich acquiring London residences), and those whose importance lies in what they contribute on the supply side. The

⁵ CSES (2006) report that none of a sample of 20 Think London clients indicated any contest for location of their project.

other is between those whose impact is essentially quantitative, just adding to the total of local expenditure or the size of the labour pool; and those who offer a qualitative enhancement to the sets of skills available, or the market for particularly sophisticated and innovative products.

For London, as a naturally growing city with limited space, and one which has to compete on the distinctive qualities of its offering, the qualitative potential of in-migrants is crucial. London's global city reputation and relatively liberal tax provisions are attractive to the mobile elite. But the need for the city to be attractive and competitive is more obviously an issue for the attraction and retention of those with rare skills ('talent' as it is currently referred to) for key sectors of the London economy, much larger numbers of whom are now mobile, both nationally and internationally.

Figure 3.1 UK Migrants to and from London by Qualification 2006-7 (000s)



Source: Labour Force Survey

Note: data relate to working-age migrants during the year, moving between London and the South East/East region (Rest of GSE) and other UK regions (Rest of UK)

Migration into London is now heavily focused not simply on young workers, but on those with graduate-level qualifications. According to the Labour Force Survey, in the year 2006-7 no less than 60 per cent of working-age migrants into London from other parts of the UK possessed such qualifications. This high share of migrant graduates compares with 34 per cent of those moving out of London to other parts of the Greater South East, and 24 per cent of those moving further afield (Figure 3.1). In net terms, the substantial outflow from the city to the rest of the GSE was almost entirely (87 per cent) accounted for by people with lower levels of qualification. The gain of working-age migrants from areas beyond the GSE was wholly accounted for by a net inflow of graduates – some 21,000, representing about 1.5 per cent of London's graduate stock. For those with no more than GCSE qualifications, the balance of movement was actually in the reverse direction.

The picture of international migration is different. The balance here among those arriving to London is tilted at least as strongly toward graduates as with migrants from the rest of the UK. For the single year 2000-1 the Census records 61% of new migrants from overseas as having qualifications equivalent to NVQ level 4/5 (i.e. degree or near equivalent). Information on the ages for completing education suggests the proportion is even higher among those arriving from other 'rich' countries. But even those coming from poorer nations seem to have received as much education as Londoners of their generation. There is no reason, however, to believe that outward flows from London to foreign destinations are as skewed toward those with lower levels of education as with domestic migrants.

In the return moves of those born overseas, the reverse is true, because a large number of graduate migrants (especially from rich countries) come to London on a temporary basis to acquire experience during early stages in their careers (Gordon et al., 2007). The graduate element in the net international flows is thus *proportionately* much smaller than for domestic flows. But, with an overall net inflow into London from abroad averaging about 90,000 a year over the period 1998-2006, the absolute contribution of foreign migrants to the growth of London's graduate workforce has been substantially larger (estimated at about 40% over this period). Their current share of the stock of graduate jobs in London is about 30%, compared with about 45% for those born elsewhere in the UK. If current trends continued, they would be equal by about 2020.

The city's success in drawing in young 'talent' of this kind depends on a combination of three factors. First it has a concentration of the kinds of entry-level professional jobs that recent (non-science) graduates seek. Beyond this concentration, (for reasons discussed in the next chapter) London-based jobs offer prospects of more rapid advancement and career-development for the ambitious. Finally it seems that many skilled and energetic young people are particularly attracted by the diversity, atmosphere and cultural vibrancy which London currently exhibits – in other words that they are partly drawn in by consumption factors (similarly to the ultra-rich).

One account of how such factors connect with economic development has been provided in the US context by Richard Florida (2005). He suggests that, in an era when firms must increasingly compete with distinctive product qualities, economic success depends on the recruitment of a cadre of more creatively-oriented workers, attracted to living in places with a tolerant/Bohemian aspect to their cultures.

There are difficulties with this argument, both in establishing whether a social environment of this kind is cause or effect of economic success, and because some rather dull, conservative places seem to succeed in the new economy. But this argument seems to fit London rather well. When comparing British cities on a set of indicators of 'bohemianism', London stands out well ahead of Brighton, which in turn exhibits this set of characteristics more strongly than

any other urban labour market⁶. That Londoners in annual opinion surveys for the GLA recognise the city's cosmopolitanism as an attractive feature, and that its first elected Mayor vigorously supported diversity, further support this.

3.4 Competing for Policy Supports

A more conspicuous form of competition between cities and regions is for policy initiatives and support from states and other powerful non-market institutions. They take various forms, including:

- Attraction of high-profile events, notably the Olympics, but also the UK's Millennium celebrations or European Capital of Culture;
- Eligibility for assistance with economic and social development or 'regeneration', from European Structural Funds, or the UK government's Neighbourhood Renewal Programme;
- Location of government offices, laboratories, cultural institutions or universities; and
- Financial support (whether directly or by underwriting debt) for capital investment in major infrastructure schemes, such as the PFI for London Underground upgrading, or the ongoing Crossrail scheme.

The real economic benefits from successes in some of these forms of 'territorial competition' are open to question, while effort expended in contests against other cities may be both wasteful and a distraction from efforts to enhance local performance.

Achievements such as that of the Greater London Authority in securing the 2012 Olympics for London may have three kinds of pay-off. The first is in direct injection of demand into the region's economy, on a one-off basis – in construction work on facilities over several years, and (less significantly) in servicing the needs of visitors/athletes during the event itself. For the London Olympics, LDA has estimated a profile of construction work, rising to a peak of some 9,000 jobs in 2010, with 37 thousand jobs of various kinds to support the event itself. How far they contribute to economic welfare in the city depends both on what spare capacity is available in this economy, and on the share of extra jobs secured by those Londoners who would otherwise be under-employed (LA, 2007).

The second kind of pay-off is symbolic: increasing awareness of the city's attractions and capacities among a wider global audience who might subsequently be more likely to visit, invest in or purchase from the capital. In London, such a strategy might be effective in conveying a stronger impression of how cosmopolitan the city has become. In other respects, however, it seems much less relevant than for less high profile cities and/or places which have newly emerged economically from either obscurity or economic collapse.

⁶ This comparison (across Travel to Work Areas) used Census-based indicators of proportions in the working age population who were: students living away from home; non-believers; born abroad; and/or living in a gay relationship. These four variables were correlated in a way consistent with them each reflecting a common dimension of variation, such as cultural openness or Bohemianism.

For places already successful and well known, there is a third potential gain: leveraging in investment from other agencies or levels of government, when they lack the autonomy necessary to pursue worthwhile projects on their own account. In London, this aspect seems crucial for the 'legacy-oriented' strategy for the Games, as explained by Mayor Livingstone during the election campaign earlier this year⁷. This issue is discussed further in Chapter 7 on London's fiscal position within the UK economy.

3.5 Competing for Product Markets

The real test of London's competitiveness lies in the capacity of its businesses to sell their products in contested markets. There are no simple direct measures of competitiveness of this kind, but three types of indicator - focussing on exports, growth and productivity can each provide a partial picture. They have different kinds of bias, but jointly indicate where the city does particularly well.

3.5.1 Exporting

Measures of the proportion of output sold overseas come closest to this idea of competitiveness (adopted by Porter, 1990). When places are compared in this way, there can be a problem since some specialise more than others in products that are more readily traded over long distances or across borders. In particular, this measure tends to favour places with strong manufacturing bases, since (despite the growth of trade in invisibles) these activities still generate more exports than the great majority of services. Among service centres, London is unusually export-oriented, partly because of its pattern of specialisation, including some specifically trans-national or cosmopolitan kinds of activity (notably among City financial services). This factor makes it harder to establish how far London's unusual level of service exports is the result of superior competitive performance across the range of specific service activities (rather than to its particular mix).

Overall estimates of the proportion of sales from London businesses going overseas (computed from LABS data) indicate that about 12% were exported in 2006-7. Slightly over half of these exports went to European markets, but 5% were sold in markets outside Europe which might reasonably be seen as 'global' (Table 3.1). For the country as a whole, the nearest comparison (for 2004) suggests a slightly higher percentage, of 13.6%⁸, though the export share had been steadily decreasing since 2000, and might well have been similar to London's by 2006-7. In any case, the difference between the London and UK averages is modest, given that goods traded still account for about two thirds of UK exports. Even in London, conventional manufacturing still has one of the higher export propensities⁹. The service sectors on the other hand show significantly higher export propensities in London than elsewhere

⁷ *Evening Standard*, April 24th 2008.

⁸ This figure (from the 2006 national input-output tables, ONS, 2006) represents total exports (from sectors other than public administration, education and health) as a proportion of total output at basic prices (from the same sectors). The export rate is lower than those conventionally cited since it represents a share of total output/sales, rather than value-added.

⁹ Though much lower than that implied by published HM Customs figures for regional exports, which in London cannot refer simply to goods produced in the capital.

in the UK; this finding is consistent with the pattern recorded in the last available set of survey-based cross-regional estimates – published in the 2004 edition of this report. The striking example is ‘City-type’ financial services, where about half of all sales are estimated to have gone to overseas markets (Table 3.1). Most other service activities in the capital appear at least as export-oriented as at the national level. But the higher overall incidence of export sales in the London service sector reflects its specialisation in those segments which are least tied to local markets.

Table 3.1: Exports and Domestic Sales by Market Area: London Business 2007

	Proportion of Sales Within:			
	London	Rest of UK	Rest of Europe	Rest of World
Publishing	48%	42%	5%	5%
Other Manufacturing	41%	40%	14%	5%
Construction	75%	25%	0%	0%
Distribution	83%	13%	2%	2%
Transport and Communications	70%	18%	6%	6%
Catering/Hotels	81%	11%	4%	4%
Financial Services (City type)	26%	26%	18%	30%
Financial Services (other)	50%	29%	12%	9%
Other Business Services	58%	27%	9%	6%
Other Private Services	76%	14%	6%	4%
TOTAL Private Sector	60%	28%	7%	5%

Source: LABS 2007, augmented with earnings data from the LFS.

Notes: 1. Survey responses are grossed up on the basis of establishment weights, and estimated paybill (based on employment and average weekly earnings in the activity, separately calculated for Central, Inner and Outer London); 2. Responses are included where businesses accounted in their responses for 95% or more of their sales; 3. City-type financial services were distinguished simply on basis their being located within the City itself or in Tower Hamlets.

London’s own internationalisation is one of the factors contributing to higher levels of exports. Data from the 2007 LABS shows that, apart from the sector concerned, two of the most significant influences on the export rates of London businesses both involved the pattern of ownership. One was ownership by firms from outside Europe, which was linked to higher levels of exports (particularly for non-US owners). The second was foreign-birth of a majority of the individual owners/partners of UK-owned firms, which was also associated with significantly higher export rates. This finding suggests a positive connection between in-migration into London and enhancement of its competitive position.

3.5.2 Growth

Competitiveness implies a propensity to grow, through generation of new products and extension of market share with established products. How far this potential is realised in practice depends on how readily space and labour can be found. In London, finding space and labour is not as easy as in less pressured areas. The consequence is that competitive strength gets shown

rather less in actual expansion of output, or (especially) employment, and more in rising wages and rents. The knock-on effect is that activity which does not really need the advantages London has to offer (in skills or face-to-face contact potential) is likely to be located elsewhere. Such re-location may be through out-sourcing, with work transferred to back-offices within the UK, or off-shoring, or it may be through London firms simply losing out in these markets. The net effect is to shift the impact of competitive success, with more modest output growth than would be expected elsewhere, even less job growth, and a larger increase in productivity.

Though growth rates provide important evidence about the competitive position of the London economy, and of its various sectors, they do not provide simple indicators of success and failure. Even when London employment was consistently shrinking, it was a successful and competitive economy. It has become more so since then, but the turnaround in growth since the 1980s partly reflect that in a post-industrial economy space constraints bite less tightly, allowing stronger employment trends to be realised within London at any given level of competitive performance.

As was noted in Chapter 2, most sectors of the London economy grow more slowly (or decline faster) in employment than the country as a whole. The differences are most noticeable when comparing London with the rest of the GSE. Over the decade since 1998, in terms of the numbers in civil employment, the only specific sectors of any size in which London employment grew faster than the UK as a whole were hotels/catering and retailing; yet for hotels/catering, growth was still faster elsewhere in the Greater South East. In employment, London's growth was relatively slow even in financial/business services, where its competitive strength seems obvious. Taking financial services as a single category, London's rather modest growth trend appears better than elsewhere. But this relative success occurs only because London has long ceased to be heavily involved in the pensions/insurance sub-sector which has slowed overall job growth elsewhere. In other categories of business services too, though job growth continues to be strong in London, it is even faster elsewhere.

A better test would be to compare growth rates in output terms, though even they are likely to be restrained somewhat by London's space constraints. Unfortunately, the latest estimates of regional output at a sectoral level relate to 2004, and even they are compiled on the basis of where workers live, rather than where output was produced. The series available from 1989-2004 is, however, indicative of long-run trends in the competitive position of London industries.

Over the whole of this period (starting from the high point in employment of the late 1980s boom) the London economy increased its overall share of national output, growing by 0.1% p.a. faster than the UK, in current price terms. This largely reflected a favourable structure, with London benefiting from starting with a greater share of output in those activities that grew more rapidly than others during this period. More significantly, in some activities London managed to increase its share of national output.

These sectors included elements of manufacturing:

- the paper and printing industry (because in London it was principally publishing, rather than paper where output declined); and
- textile/leather products (because in London these fashion producers were small-scale, rather than the kind of mass-producers that could be off-shored).

Overall, the long decline in London's share of national manufacturing output was halted during this period, principally because remaining manufacturing in London was focused on sub-sectors where it had some real competitive advantage (both nationally and internationally).

Changes within the services sector were of greater absolute importance. Here, London lost ground in two sectors:

- in public services of various kinds, where London's share fell notably until some time in the mid-late 1990s. This reduction was mainly a consequence of decentralisation of central-government functions, particularly through the growth of arms-length agencies which did not require proximity to parliament. In part, it might be seen as London losing-out to other regions in competition for projects and resources; and
- in goods-handling activities, both in transportation and in distribution, for which less-congested locations reinforced their comparative advantage.

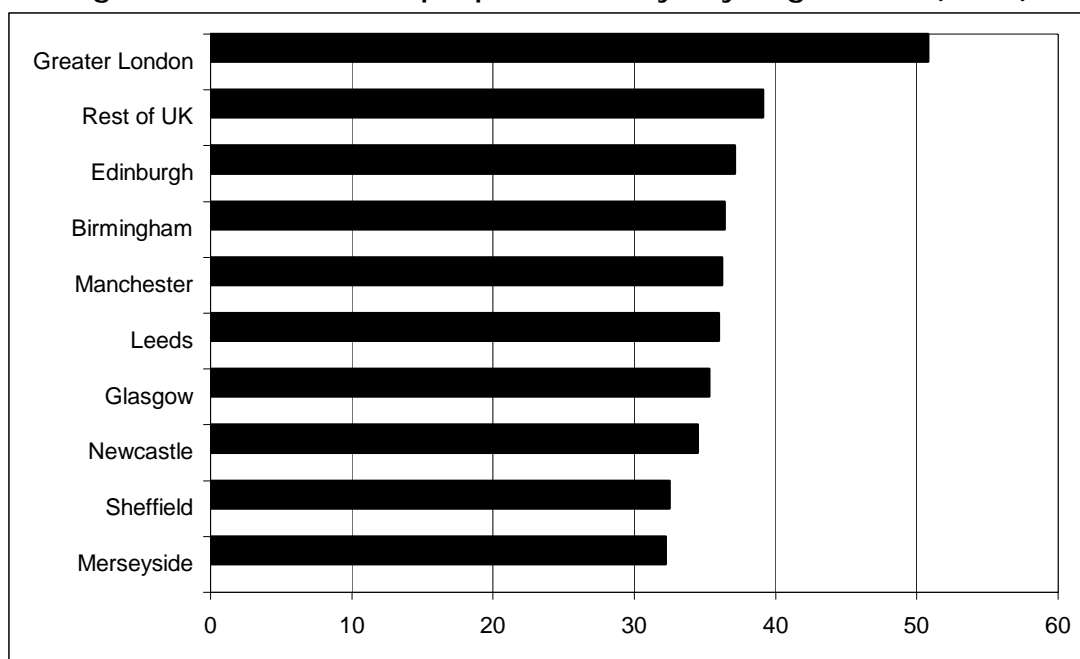
But, in all the other broad categories, both of consumer and producer services, London's share of output increased over these 15 years. In proportionate terms, the gains were most marked in the category of 'other' consumer services which includes culture/entertainment, and in (the smaller) domestic-service sector. It performed strongly in financial services, compared with other parts of the UK, though growth in this sector did not keep pace with that in the London economy as a whole. The weakest performer (among those private services that can be distinguished) was hotels and catering. This sector is labour-intensive, mostly serving a local consumer market, and sensitive to the wage-push coming from growth in other sectors.

During this period the London service-sector started off relatively weakly, because of the character of the early 1990s recession, and then bounced back. In the early 2000s, when the national economy seemed to have settled on a sustainable growth path, most of these sectors provided further evidence of their competitive strength by continuing to increase their share of national output. The education sector belatedly joined this group of competitive successes, with a surge after 2001.

3.5.3 Productivity

London's success story in terms of relative growth is basically one of productivity increases, and this success might be seen as the acid test of competitiveness for a city in its position. In levels of output per head, London stands in a class of its own among the major city-regions of the UK (Figure 3.2)

Figure 3.2: Estimated Output per Worker by City-Region 2005 (£000s)



Source: GVA data from ONS; employment data from ABI (via NOMIS)

Note: City-regions are defined as NUTS2 areas, including the named city.

On their own, however, productivity measures might be deceptive, because 'squeezing out' less productive activities raises the average, whether those that remain have done especially well or not. Conventional indicators of 'productivity', such as average output per worker (or per hour), ignore the varying value of the assets that are used in the process. Thus in London both the levels of 'productivity' achieved and their growth owe much to the increasing amounts of human capital (in the form of better qualified workers) that have been deployed, much of it as a consequence of migration from other areas.

The question of productivity and its growth are partly addressed in the next chapter, which shows that earnings levels of London workers are substantially higher than would be expected given their qualification levels (as one indicator of human capital) or even their occupational level (as another indicator). That analysis would suggest that the real productivity of full-time private sector workers in London might be between 21 per cent and 38 per cent above the UK average - depending on what credit is given to London business for developing the skills of their workforce.

Recent research has approached the issue of productivity from a perspective which sees 'agglomeration economies' as the key to the competitiveness of the larger city-regions such as London. The logic is that firms in such locations can benefit from a wider array of related services, information sources and skills, with a labour market that matches their needs more closely, and possibly a level of inter-firm competition that sharpens up performance.

Various US studies have demonstrated statistical relationships consistent with this thesis across their (more extensive) set of cities. Consistent with their results, one British study has shown that, after controlling for the occupational

mix, doubling the size of an agglomeration (in the numbers living within about 80 minutes travel time) raises productivity by about 5%. Crucially it shows that the London region forms part of a general pattern in this respect, rather than a peculiar case (Rice et al., 2006).

Essentially this conclusion suggests that London's large productivity advantage over other UK cities can be explained by the combination of high levels of human capital (i.e. highly-skilled workers) and a concentration of activity several times larger than any of the other cities. This agglomeration effect is one which, as Graham, 2007 has now shown, applies more strongly to some sectors than others. It is especially strong for the kind of business service activities in which London has come to specialise. London's current specialisations thus reflect a genuine pattern of competitive advantage.

3.6 Summary

Assessment and promotion of London's competitiveness can be approached from a number of distinct perspectives, including the attraction of investment projects, flagship events and affluent consumers. Several of these strategies reflect the internationalisation of the economy, which is significant in some *particular* respects, though others are of more marginal relevance. The direct contributions of London's success in attracting a large number of (generally small) inward investment projects, and the number of jobs, which might be directly generated by the 2012 Olympics, may be in the latter category. Substantially more important is the role of international migration in the workforce and how London's export record in services can be reinforced.

Aspects of London's competitive position which deserve emphasis are

- the centrality of productivity growth (rather than increases in worker numbers) to London's performance;
- the underpinning of this productivity by the capital's capacity to attract (and then develop) highly-qualified labour; plus
- the broad array of service-sector specialisations that the London agglomeration as a whole sustains.

Chapter 4 Labour Markets, Housing Markets and the Real Incomes of Londoners

4.1 Introduction

How far the competitive strengths and successes discussed in the last chapter actually translate into a higher standard of living for Londoners depends to a large extent on processes within the city's labour and housing/land markets. Two of the headline observations of Chapter 2, both qualified the long-term success story of London's strong performance in terms of growth and earnings. One was that housing costs had risen faster than elsewhere, eating some way into the gains made via higher money wages. The other was the, rather surprising, fact that rates of worklessness in London had moved above those in any of the other (statistical) regions. So how does the functioning of these two sets of markets impact on London's competitive performance and on London's living standards?

One simple starting point is the economists' expectation that, if people are free to move around between places, workers will not generally be any better-off in competitively successful regions. In fact, if markets operate properly, those big cities where business is most productive can be expected to pay higher money wages for a given quality of worker – but also to impose higher living costs, leaving no difference in the standard of living for the average resident. The real gains from relatively stronger economic performance in particular cities then flow to those who own land there, whether as landlords, firms and private individuals owning their own premises, or government.

In practice, labour and land/housing markets operate in rather more complicated ways than this suggests, and rather differently in large agglomerations like London from how they work elsewhere. But this simple 'model' is a useful starting point for thinking about the links between competitive performance and living standards in this city, relative to those in other parts of the UK.

4.2 The London Labour Market

London's labour market is one of its key assets, both in terms of the range and depth of skills and employment opportunities available and its flexibility. But a combination of high rates of worklessness with reported skill shortages suggests that there are shortcomings in how it functions. To investigate these, four topics are examined in turn:

- The balancing of overall labour supply and demand;
- Skill development and occupational attainment;
- Relative earnings levels in the city; and
- The incidence of worklessness.

4.2.1 *Demand pressure and labour market balances*

Pressure in a labour market reflects the balance between local employers' desire to recruit labour and the willingness of potential workers to take on jobs there. At national level it is usual to monitor this through the ratio of vacancies

to unemployment, since this takes account of the variations in labour market efficiency which should have similar effects on both. At a more local level, where jobs can be filled by commuters or migrants from elsewhere, this procedure does not work, because differences between areas in the competitive strength of workers only affect the unemployment rate, not vacancies. For cities and regions then, vacancy rates on their own provide the best indication of how the pressure of demand varies between places – where these are available on a comprehensive basis¹⁰.

For London, the latest measure on this basis, from the 2007 Employer Skills Survey, shows the city as having a higher vacancy rate than any other official region, at 3.5%, compared with 2.9% for England as a whole (and 3.1% for the rest of the Greater South East). Demand pressure thus appears relatively strong in London. Yet this contrasts strongly with the evidence on its high rate of worklessness, which will need to be explained in some other terms.

This overall balance of supply and demand is the outcome of a number of different components, changes in which over the past decade are set out in Table 4.1, using data from the only consistent source.

Starting from the supply side, these show a large growth in the working age population (14% over 9 years), almost entirely accounted for by growth in the foreign-born population (up 42%). By 2007 this group comprised 39% of the city's working-age population (and 37% of the economically active). The economically active population (i.e. those either in work or effectively seeking it) grew slightly less rapidly – at least partly because of an increasing number of over 16s still in education. Over the period as a whole (though not for all parts of it), this increase in the labour supply from London residents was close to that in London-based jobs (up by 416 thousand, or 12%).

¹⁰ Simple counts of vacancies registered with the employment service (currently accounting for about 60% of the total) particularly understate the level of vacancies in London, where most recruitment occurs through private channels.

Table 4.1: Labour Supply and Demand Changes in London, 1998-2007 (000s)

	1998	2007	Change 1998-2007
Working Age Population	4410	5,037	627
of which foreign-born	1396	1983	587
Economically Active residents	3374	3,779	405
of which foreign-born	958	1400	442
Jobs	3548	3,964	416
In-commuters	692	771	79
Out-commuters	242	325	83
Net commuters	450	446	-4
Residents in Employment	3098	3,518	420
Unemployed	276	261	-15
Inactive	1036	1258	222

Source: Labour Force Survey, 4 quarters averaged

Notes: for consistency with the measure of economic activity, the count of jobs (and of commuters) only includes the main job held by any person, not any subsidiary jobs they may have held.

For London, commuting patterns are another important element in the picture, since about 10% of London residents work outside Greater London, while about 20% of London workers live elsewhere. The volume of commuting grew substantially over the ten year period. But with a close match between job and labour supply growth within London, inflows and outflows grew by very similar amounts (up by 79 and 83 thousand respectively). In proportionate terms, this meant a much larger percentage growth in the outflows (up by 34%, against 11% for the inflows). This has been the pattern for some time now, though the rate at which outflows have increased seems to have accelerated.

The simultaneous growth of work-related travel both into and out of London is not simply a case of 'wasteful commuting'. In large part it reflects differences between inner and outer areas in *both* commuting patterns and employment trends. The longstanding pattern is that commuter inflows into London are disproportionately directed at the Central area, while outflows come predominantly from among Outer London residents (Cambridge Econometrics et al., 2004). There has been strong employment growth in and around Central London over the past decade – boosting (longer-distance) inward commuting – while employment in Outer London has notably failed to match the growth in areas beyond the GLA boundary – thus strongly boosting (shorter-distance) outward commuting.

This illustrates the importance of seeing London in its wider labour market setting, since even with balanced growth in supply and demand across London as a whole, changes in external commuting patterns played an important role in ensuring balance in different parts of the capital.

4.2.2 Skill supply and occupational attainment

The contemporary London economy is a very skill-intensive economy. Rather narrowly this may be seen in terms of high levels of formal educational qualification required for advanced service activities in which it now specialises. More broadly, the point is that activities¹¹ will only remain in this high cost location city if they depend on some combination of rare skills, kinds of tacit knowledge only available here, or crucial forms of interaction between their staff and clients, suppliers or collaborators. From this perspective, the skill issue has as much to do with the capabilities and connections that workers manage to acquire on the job, in a suitable environment.

In terms of formal qualifications, London's skill-intensity is demonstrated by its share of those occupations (notably higher professionals) where most workers are expected to be graduates. Currently, according to the LFS, 22% of all British jobs of this kind are located in London (rising to 30% of those held by younger, 25-35 year-old, workers), compared with just 13% of non-graduate jobs. This segment of the labour market has grown rapidly and accounts for all the growth in the London workforce. As a result the number of graduates employed in London has increased by three quarters over the last 10 years.

For a broader indication of the human capital-intensity of London jobs, the average pay level of an occupation can be used. Grouping occupations on this basis it emerges that 25% of employment in the top quintile of jobs nationally are located in London, as compared with just 9% for jobs on below-average pay.

Meeting the needs for a strong supply of talent to such jobs in London depends on three factors:

- education attainment among the city's home-grown population;
- migration of qualified workers from elsewhere; and
- skill development and experience acquisition within the London workforce.

At the top end of the labour market, the first of these is clearly the least important. Survey data indicate that only about one quarter of London's graduate workforce were born and bred there¹². This low figure partly reflects the fact that the graduate population, whether born in London or elsewhere, is highly mobile. Mostly, it follows from the fact that London's share of graduate jobs is very much greater than its share of those passing through UK universities. Young people born in London are slightly more likely to receive higher education than those born elsewhere, simply because they are more likely to come from middle class family backgrounds with relatively well-educated parents. After controlling for this factor, school exam performance

¹¹ apart from a few untransportable service functions.

¹² This estimate (and those below relating to UK- and foreign-born graduate migrants into London) comes from a synthesis of recent British Household Panel Study (BHPS) and Labour Force Survey (LFS) data. The BHPS data identifies birthplaces of UK-born graduates resident in London, but under-represent foreign migrants, whose share of the London graduate workforce is calculated from the LFS.

(and thus eligibility for higher education) tends to be significantly worse across London, and in neighbouring areas, than in regions outside the GSE (Gordon and Monastiriotis, 2007)

Most of London's highly-skilled workers have thus migrated to the city from elsewhere, typically in young adulthood. On our (BHPS/LFS-based) estimates 45% come from other British regions and 30% from overseas. The UK element reflects a highly selective pattern of in and out movement, such that the net inflow to London consists solely of graduates. The international inflow is not as selective (more or less replicating the mix of educational levels among young Londoners; Gordon et al., 2007). Even so, it is the growing volume of international migrants which has been more crucial to the rapid expansion of London's graduate workforce. During the last decade the overseas-born share has gone up by a half (from 20%) and has contributed 40% of the overall increase.

London is thus heavily dependent on immigration (from inside and outside the UK) for a supply of well qualified entrants to its labour market. But it also adds a great deal of value to this labour 'on the job', a major factor drawing ambitious young people to the city. The well known 'London escalator' (Fielding, 1992), not only takes individuals up the ladder more rapidly than in any other part of the UK, but in the process it also creates human capital and raises productivity levels both nationally and locally. This is rather less a matter of further formal training being provided (where London is not especially strong), than of the combination of three factors:

- an unusually large proportion of jobs in advanced, specialised and/or strategic roles, that require rapid learning 'on the job', and effective networking;
- a 'thick' and highly competitive labour market offering opportunities for the value of such learning to be converted into higher earnings; and
- the drawing power which the city thus exercises for more ambitious young migrants.

Evidence specifically on the escalator effect suggests that it only really works for those who start with quite strong formal qualifications (A levels or above) and who are in the 20- to 40- age group (Buck et al., 2002). A simpler cross-sectional comparing individuals' occupational standing and formal qualifications (indexed by national pay rates), with what would be expected elsewhere, suggests a rather broader effect, at least within the private sector. Results presented in the next section, where earnings levels are examined, (Table 4.2) suggest that the London boost to the post-qualification development of its workforce adds rather more value to its human capital stock than does the simple importation of well-qualified young people from elsewhere.

Despite this, survey data still tend to suggest that it suffers from worse skill shortages than other regions. The 2007 (English) Employers Skills Survey (IFF, 2008), for example, identified a stock of vacancies in London equivalent to 8% of the numbers actually in jobs which were hard to fill because of 'skill shortages'. This compared with 7% in the South East and 4-6% in the other

(administrative) regions. Among those in work, London also topped the league in terms of the proportion seen as lacking some significant skill, though the margin over the national average was much smaller in this case (7% against 6%). What is evident, however, is that skill shortages (and to a lesser extent skill gaps) are a general feature of high demand regions.

This means that workers in London tend to occupy jobs rather above what might be expected from their qualifications. In the main the effect appears to be (within a highly competitive labour market) more one of allowing workers to develop their potential than of restricting productivity levels.

4.2.3 Earnings

As noted earlier, average earnings levels for full-time London workers are well above the national average. On an hourly basis, Labour Force Survey results for the first quarter of 2008 indicate average earnings for those working in London some 52% above those in the rest of the UK. This difference is rather greater than suggested by the NES/ASHE figures used to measure changes in Chapter 2, at least partly because the LFS includes low-paid workers outside the PAYE system.

If we control for the higher level of educational qualifications possessed by London workers (as well as differences in the age/sex composition of the workforce), the difference – on a ‘like for like’ basis – reduces to 39%. This adjustment still does not allow fully for the higher level of human capital actually deployed by London workers, much of which will clearly have been acquired on the job. Introducing further controls for the specific occupations in which they are employed, and whether workers exercise managerial/supervisory functions, lowers the London margin in terms of hourly pay to just 18%.

The relationship between London earnings and those elsewhere in the country varies with the type of job, being less favourable for part-time positions and within the public sector (Table 4.2). Public sector pay rates tend to be set nationally, with the addition of a fixed London ‘weighting’. They are therefore much less responsive to market conditions. As a result, public sector earnings elsewhere in the country are often rather higher than those for comparable private sector positions, while in London the reverse is the case. This may well have important implications for recruitment to such jobs in the capital.

Table 4.2: Elements in London-UK Earnings Differentials by Job Type, 2008

	Full-time Jobs		Part-time Jobs	
	Private sector	Public sector	Private sector	Public sector
Average Hourly pay in London:	£21.0	£17.0	£10.7	£15.6
Percentage higher than rest of UK	62.3%	26.0%	25.1%	41.6%
Sources of higher relative pay:				
Age distribution	1.9%	-0.2%	2.4%	2.2%
Qualification levels	12.5%	3.5%	8.1%	10.5%
Occupational Attainment	16.6%	5.7%	2.7%	7.7%
Higher pay rates (within occupation)	21.3%	15.5%	10.0%	16.4%

Source: Analyses of unpublished micro-data from the Quarterly Labour Force Survey, January-March 2008.

Notes: 1. Each of the identified sources of higher London pay (apart from the age structure) is defined after controlling for the previous ones, e.g. occupational attainment represents the expected effect (given national wage rates) of London's particular occupational structure, within the particular category of jobs (private/public, full/part-time), over and above that expected from the formal qualifications of the workers concerned. 2. The identified sources of higher pay combine multiplicatively, so the overall effect is larger than their sum.

The position with part-time jobs is less simple. This group tends to earn less almost everywhere, but in London the disparity is substantially larger – though only for those in the private sector. There are also a substantially lower proportion of part-time jobs in London, so this relatively low pay for part-timers seems mostly to reflect a stronger preference for full-time workers by London employers. This is not explicable simply in terms of the city's particular industrial and occupational mix, but it could be that part-timers are less attractive in the non-routine activities in which central London firms (particularly) specialise. But it may also be that in its dense '24 hour' economy, the use of part-timers to cope with fractional demands or highly concentrated peak hours is rather less salient.

There is a much wider spread of earnings rates in London than anywhere else in the country, particularly at the top end of the distribution. This is most conspicuous when comparisons are made on an annual (rather than weekly) basis, because of the substantial bonuses accruing to many of the highest paid workers in central London. While mean annual earnings of full-time workers in London are about 50% above the national average, at most points

in the distribution the differential is only about 30% (Table 4.3). It is smaller still at the very bottom, even though London has fewer people in routine jobs than other parts of the country. Earnings in these jobs appear to have been quite substantially depressed by the entry of new migrants from poorer countries (Gordon et al., 2007).

Table 4.3: Distribution of Annual Earnings London versus UK, 2007

	Annual Earnings		London relative to UK
	London	UK	
Percentiles of the earnings distribution			
90th	£72,600	£47,700	152%
75th	£45,100	£33,900	133%
50th (median)	£31,300	£24,000	130%
25th	£22,500	£17,000	132%
10th	£16,200	£12,900	126%
Mean	£45,300	£30,000	151%

Source: Annual Survey of Hours and Earnings

4.2.4 Worklessness

Worklessness in London has long been a matter of concern, but it has attracted much more national attention in the last two years, with important special reports accompanying the last two pre-Budget statements (HM Treasury, 2006 and 2007). The rate of worklessness (defined to include inactivity as well as unemployment) in London has actually moved above even that in Northern Ireland.

A natural line of explanation is that London is just part of a much wider economic region (making comparisons with other regions invalid), and that it happens to include within it a disproportionate share of that region's most vulnerable population groups. On this argument, Greater London's relatively high rate of unemployment is mostly indicative of the degree to which the risks of being out of work are concentrated within groups such as ethnic minorities, the least educated and those with health problems – who are dependent on access to low-rent accommodation within the inner areas.

**Table 4.4: Economic Activity in the Working Age Population:
London compared with GSE and UK, 2006-7**

	London	Greater South East	U.K.
Employed:			
Full-time	55.7%	57.6%	56.4%
Part-time	13.8%	17.1%	17.7%
Unemployed	5.3%	4.2%	4.2%
Economically Inactive	25.2%	21.1%	21.7%
of whom			
<i>students</i>	7.2%	5.4%	5.1%
<i>looking after family</i>	8.0%	6.6%	6.1%
Total	100%	100%	100%

Source: Annual Population Survey October 2006-September 2007

Notes: 1. All figures represent percentages of the resident working-age population. Hence figures for the unemployed are lower than for conventional unemployment rates which are expressed as percentages of the active population (employed and unemployed) only; 2. Figures for part-time work relate only to individuals' main job.

A simple comparison of employment rates among the working age population (Table 4.4) shows London having a proportion in full-time jobs which is slightly below the national average, while that for part-time jobs is substantially lower. The proportion unemployed is about one quarter above the UK rate, but most of the short-fall in employment is reflected in a higher rate of economic inactivity. The largest group in this category comprises people who say they do not currently want a job, but it also includes people who are looking for work though not currently available for it, and also those who would like a job but are not currently taking steps to find one. London's higher inactivity rate (both among those reportedly wanting/not wanting jobs) is concentrated among students and those caring for families, with fewer long-term sick or early retired than elsewhere.

The contrasts are as sharp, or even sharper, when figures for London are compared with those for the Greater South East as a whole, rather than the national average. This is not unlike the pattern in those other regions that include conurbations, and London's employment, unemployment and inactivity rates are actually around the average for the metro counties. This is still not impressive, considering where London is, and that (on the evidence of vacancy rates) its pressure of demand for labour is particularly strong. But if there is some general tendency for larger cities to have lower employment rates among residents of their inner areas, it might not be surprising that in the largest of UK cities this factor outweighs that from a strong pressure of demand.

What is perhaps more concerning is that employment rates in London have fallen further behind those in other (official) regions. In fact, there have been two quite distinct shifts during this period, as can be seen when changes in London are compared both with those across the Greater South East as a whole (Table 4.5). One of these shifts is in the relative positions of the northern and southern regions. Across the Greater South East, the overall employment rate has scarcely changed over this period. But there was a strong upwards

shift in the northern English regions, Wales and Scotland, which pushed the national average up. This catching up process in the north did not reflect improvement in their competitive position as regards private sector employment. Rather it was the result of a concentration of international migration in the south boosting labour supply growth there, plus a continued movement of public sector jobs from south to north.

**Table 4.5: Changes in Employment, Unemployment and Inactivity Rates:
London compared with GB and GSE, 1997-2008**

	London	Greater South East	Great Britain
Employment rate			
1997	69.7%	75.1%	73.2%
2007	69.8%	74.9%	74.4%
Change 1997-2007	0.1%	-0.2%	1.2%
Unemployment Rate			
1997	9.0%	6.4%	6.6%
2007	6.9%	5.3%	5.3%
Change 1997-2007	-2.1%	-1.1%	-1.3%
Inactivity Rate			
1997	23.4%	19.8%	21.5%
2007	25.0%	20.9%	21.4%
Change 1997-2007	1.6%	1.1%	-0.1%

Source: LFS quarterly average June 1997-may 1998; Annual Population Survey 2007.

Notes: 1. All data relate to working-age residents; 2. the employment rate is the proportion of this population in employment; the inactivity rate is the proportion of this population neither employed nor actively seeking work; the unemployment rate is the proportion of the active population (employed plus unemployed only) who are unemployed seeking work (on ILO definition).

The second shift was in London's position relative to the Greater South East as a whole. Here, the gap in unemployment rates which had opened up during the recessions of the early 1980s and 90s continued to narrow (with the gap down to half its 1995 size). On the other hand, rates of inactivity among the working age population increased, particularly among people who said they 'do not want work'.

These include many with family care responsibilities, study commitments, or religious affiliations which discourage outside work by married women. But 'not wanting' work may also be influenced by the lack of part-time jobs, depressed pay in the bottom tier of jobs increasingly occupied by immigrants, and/or the disincentive effect of housing benefits in a high cost city.

Some relevant evidence can be found by looking (with micro-data from the APS) at how the chances of being in work (on a full or part-time basis), unemployed and seeking work, or economically inactive vary in relation to individuals' other characteristics, and where they live (whether within London or elsewhere in the GSE).

This analysis confirms that a range of characteristics which are more common within the London population than those living outside are associated with

much higher chances of being unemployed and/or inactive. Some important examples include:

- being young and single;
- still being in education;
- living in social housing;
- being Muslim (particularly if female); and
- being a recent immigrant.

Controlling for these factors, and others including ethnicity, health status, and education level, had the effect of accounting *completely* for the difference in unemployment rates between London and the rest of the GSE, and for 70% of the difference in inactivity rates (Table 4.6). In relation to unemployment, there thus appears to be no specific 'London' problem – just a series of problems associated with particular groups. The proportion of working age people who are inactive (and mostly 'not wanting work') is, however, rather higher (by about 1.3%) than that for similar people elsewhere in the GSE.

Table 4.6: Employment Rate Differentials and the Effects of Personal Characteristics: London in relation to the Greater South East, 2006-7

	Greater South East	<i>Greater London</i>	Greater London adjusted for personal characteristics
Working Age Residents: In Employment	74.7%	69.4	73.4%
Unemployed	4.2%	5.3%	4.2%
Inactive	21.1%	25.3%	22.4%

Source: Annual Population Survey micro-data

4.3 The Housing Market

4.3.1 *Increasing Pressures*

The housing market in London over the last decade has been one of consistently increasing pressure, arising from both population and income growth. But there has also been evidence of some capacity to adjust to this pressure, notably through more effective use of the existing stock.

The core issue is that the number of households accommodated in the capital has grown rapidly over the decade, while the housing stock has grown more slowly. As a result, the density of occupation of the available stock has increased, particularly in the private rented sector. The latest estimates suggest that over the five year period 2001 – 2006 this has resulted in a disproportionate decline in the number of vacant dwellings as compared to the country as a whole, with some 16,000 units being occupied (over one quarter of the reduction across the country). At the same time, the number of households living in shared dwellings has gone up by perhaps 33,000 (almost 40% of the increase in the country as a whole). Moreover, the increase in the number of households over the five year period has probably

still been under 125,000 - almost 20,000 below the growth expected in government household projections (Holmans and Whitehead, 2008).

4.3.2 Tenure Change

The most fundamental change in supply over the last decade has come from the growth of private renting by almost 20% over the decade (Table 4.7). At the same time, owner-occupation, with its associated relatively low densities of occupation, has grown more slowly in London than elsewhere in the country. Finally, the proportion of the stock in the social rented sector has fallen at a similar rate to the rest of the country. Overall this has helped to enable a more flexible use of the available stock.

Table 4.7: Tenure (Dwelling Stock)

	1997		2006	
	London %	England %	London %	England %
Owner-occupied	57	68	58	70
Private rented	16	11	19	12
RSL	7	5	9	8
Local authority	21	16	14	9

Source: DCLG

The expansion of the private rented sector has been a major factor in enabling London to accommodate the rapid growth in international immigration. Private renting houses the vast majority of new migrants particularly among those from rich countries who are often going into well paid jobs. Even in the longer term the proportion renting remains high. Private renting is also the most usual initial tenure among those from poorer countries. Over time, however, these households are disproportionately accommodated in social housing, which plays a more significant role providing housing for those in low paid employment in London than it does elsewhere in the country (Gordon et al, 2007).

4.3.3 Housing Completions

Private completions have generally increased (Table 4.8) but have only outperformed the country as a whole in 2003/2004. By 2007 London was losing out relative to the rest of the country as developers faced increasing difficulty in finding profitable opportunities.

Table 4.8 Housing Completions 1997 – 2008

	Total		Private		social	
	London	% England	London	% England	London	% England
1997/8	13.6	9.0	9.2	7.2	4.3	19.8
1998/9	14.4	10.3	11.0	9.1	3.4	17.8
1999/2000	13.7	9.7	10.4	8.4	3.3	19.1
2000/1	14.5	10.9	10.3	8.8	4.1	24.7
2001/2	13.9	10.7	10.5	9.1	3.4	23.9
2002/3	15.7	11.4	11.5	9.2	4.1	30.8
2003/4	19.4	13.5	15.1	11.6	4.3	30.9
2004/5	24.1	15.5	17.9	12.9	6.2	36.9
2005/6	18.8	11.5	13.6	9.4	5.2	28.1
2006/7	22.0	10.0	13.6	9.5	8.4	37.8
2007/8	19.9	11.9	12.2	8.4	7.6	32.9

Source: DLGG

The position with respect to completions in the social sector has been very different, with rapid growth in the proportion of all social housing built in the capital from under 20% in 1997 to over 30% in mid 2008. This success has come about as a result of disproportionate increases in government funding as well as a strongly enforced Mayorial policy requiring affordable housing as part of planning agreement under Section 106. Even so, social sector output has not been enough to offset the sluggish response in the private sector and indeed may have exacerbated these difficulties through the pressure for S106 requirements.

London's housing policy calls for overall output levels of 33,000 plus, in order to meet the increase in the number of households and to improve housing conditions. At more than 50% above levels achieved in 2006/7, this target appears unrealistic.

Table 4.9: The Changing Composition of Completions

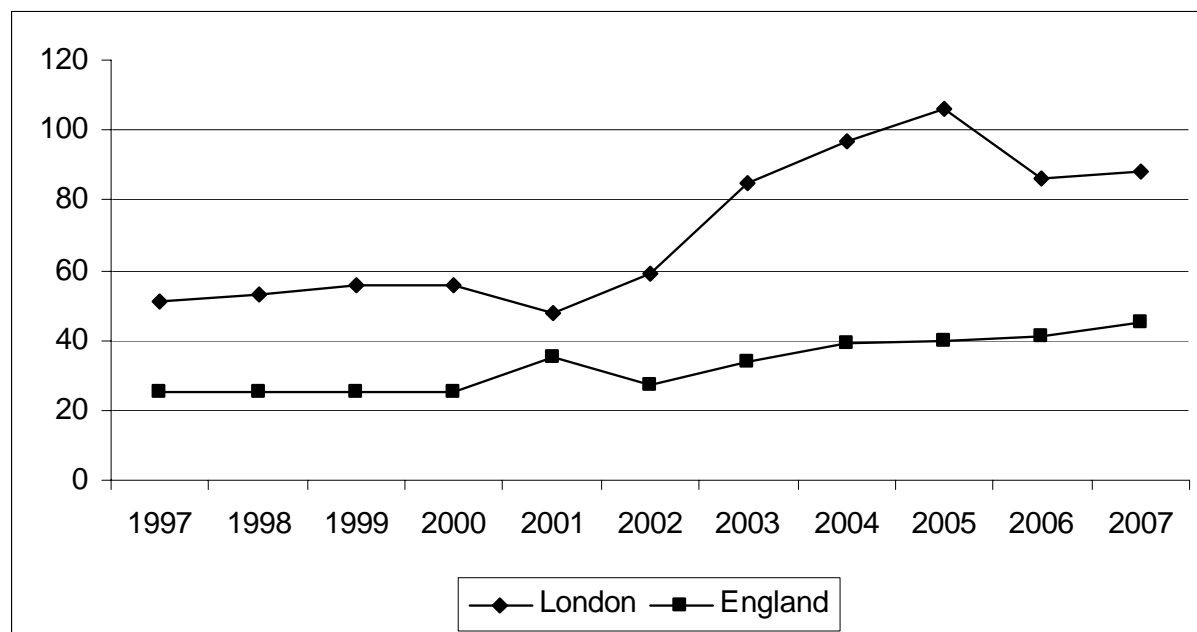
	1997/8		2006/7	
	London %	England %	London %	England %
1 bed	23	7	28	11
2 bed	44	27	57	42
3 bed	24	36	9	27
4+ bed	8	30	6	20
Houses	46	85	12	53
Flats	54	15	88	47

Source: DCLG Housing Statistics

One important trend in the last decade has been in the make-up of new housing investment. In 1997/98, almost half of new dwellings built in London were houses and almost a third had three bedrooms or more (Table 4.9). By 2006/07, the proportion of houses was down to 12% and that of 3+ bedroom units had more than halved to 15%. Thus the typical new unit has become a

one or two bedroom flat. Room sizes have also declined while densities increased by at least 70% over the decade (Figure 4.1).

Figure 4.1: Density of New Dwellings (dwellings per hectare)



Source: DCLG Planning Statistics

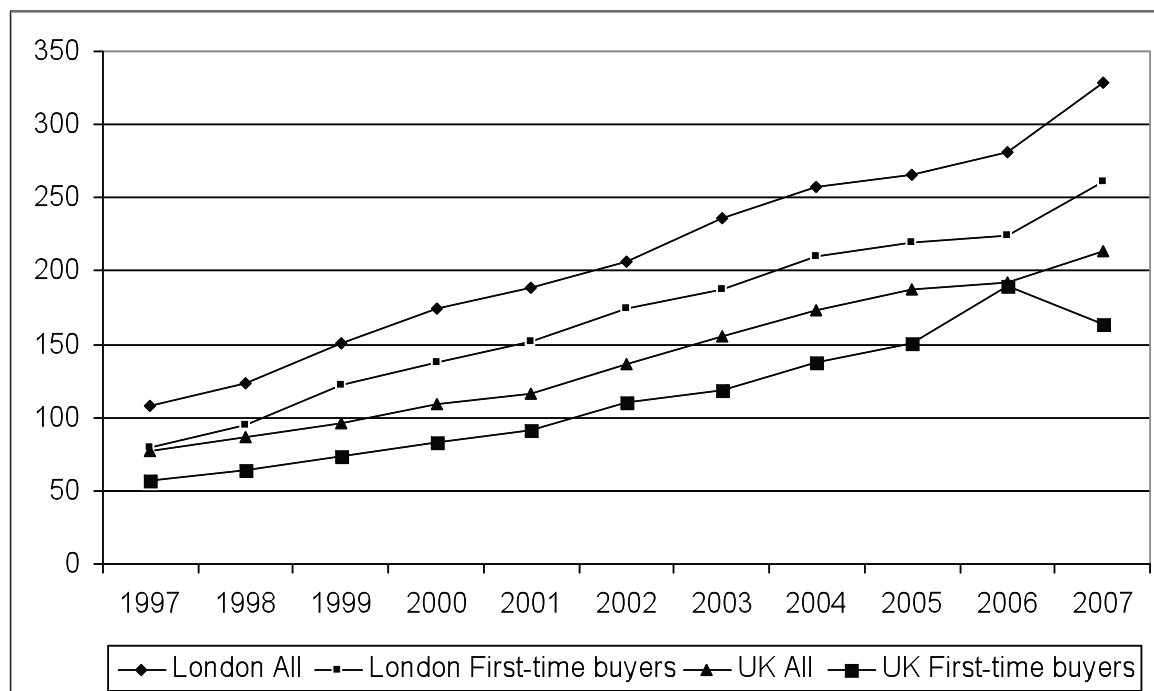
The reasons for this very rapid decline in size and the associated increase in density are not hard to find. First, government planning policy guidance has required local authorities to seek higher densities in all types of areas but particularly in inner urban areas. Second, the relative importance of S106 affordable housing requirements in London, which are often provided through small flats, sold to key workers in the form of shared ownership. Third, the very rapid growth in the Buy-to-Let market, particularly since the turn of the century, has increased the profitability and lowered the risk of developing apartments. Finally, the pressures to expand output on brownfield sites tend to shift development profitability towards smaller, denser, units.

4.3.4 House Prices

The most obvious trend in the housing market over the last decade has been the near continuous growth in house prices, which has only been reversed in 2008 (Figure 4.2). Between 1997 and 2007, the average price of a dwelling in London sold with a mortgage rose by just over 200%. The average price for first time buyers rose even more, by nearly 230%. This compares with rather lower increases of around 175% and 185% respectively in the country as a whole. It should also be remembered that the average price in London relates to a smaller unit, while across the rest of the country the average dwellings has more rooms and is more likely to be a terraced house.



Figure 4.2 House Prices 1997-2007 (£000s)



Source: DCLG Housing Statistics Table 507

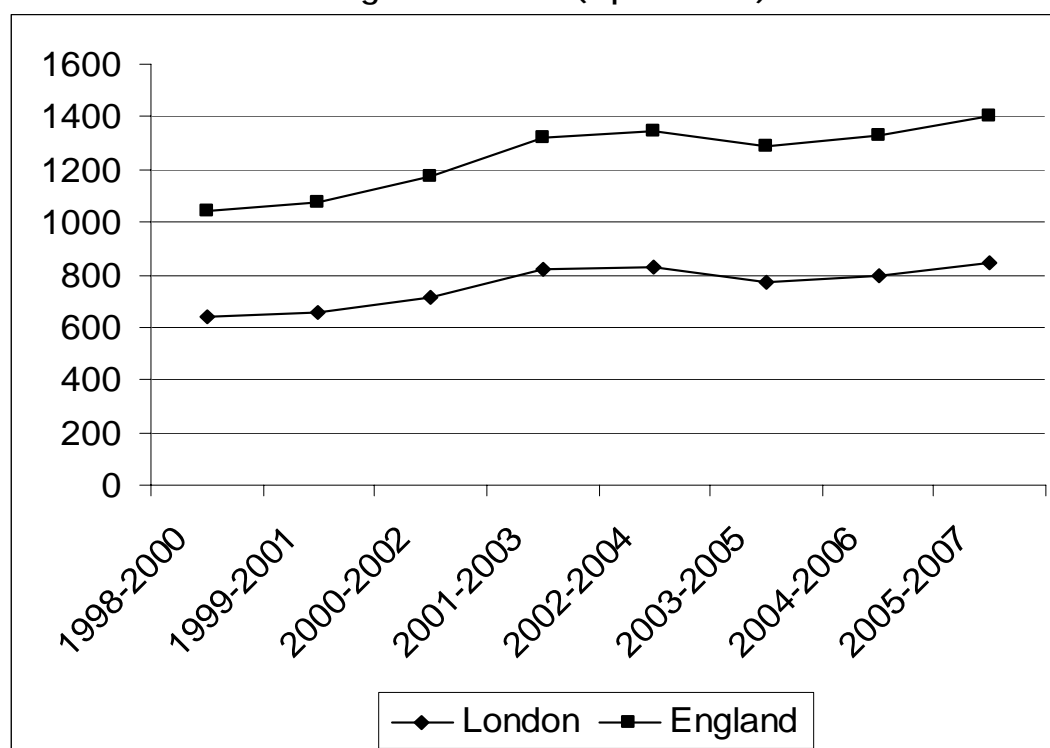
Note: These figures are adjusted for the changing mix of dwellings sold in each region.

London house prices grew particularly rapidly in the later part of the 1990s but were more affected by the general downturn in the market which slowed house prices in the early 2000s. Thereafter prices picked up rapidly particularly as a result of increased investment in Buy to Let and investment demand.

The position for first time buyers in London has become considerably more difficult since the turn of the century both in absolute terms and in comparison to the country as a whole. The ratio of prices paid by first time buyers as compared to all buyers also worsened significantly. As a result many potential purchasers have been excluded from the market, while others have overstretched their borrowing capacity. Yet, even in 2007 the market in London was buoyant while there were signs of decline elsewhere in the country.

Again however the private rented sector has acted as a safety valve. Over the period from 1998 to 2007 private rents in London have only risen by about 30% (Figure 4.3), a rather smaller increase than observed across the country. Thus the expansion in the supply of private rented accommodation in London appears to have kept pace with expanding demand, even though there have been such significant increases in demand particularly from international migrants.

Figure 4.3: Rents (£ per month)



Source: DCLG Survey of English Housing

4.3.5 Residential Mobility

An important element in the health of the London economy lies in the capacity of workers to move into the region as well as for households to be able to move up and, where necessary down, the local housing market. Historically periods of economic growth have been associated with increases in both long and short distance mobility. This was the case in the later part of the 1990s, particularly with respect to long distance moves which tend to be job, training and education related (Figure 4.4a). Long distance mobility in all tenures declined significantly, however, in the early 2000s. The change was far more dramatic in London than in the rest of the country both in terms of early increases and later declines.

Figure 4.4a: Long distance residential mobility (50 miles plus)

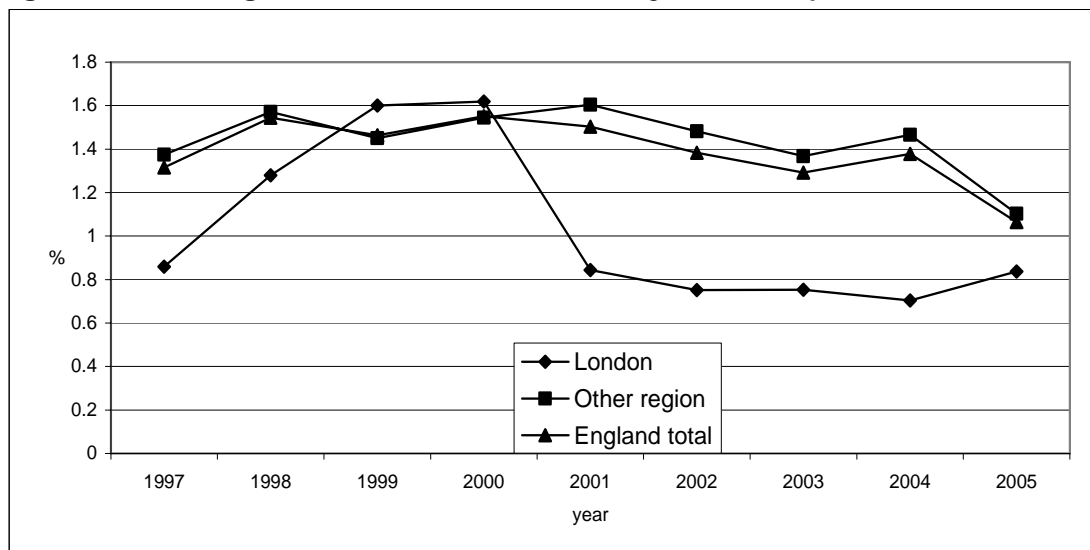
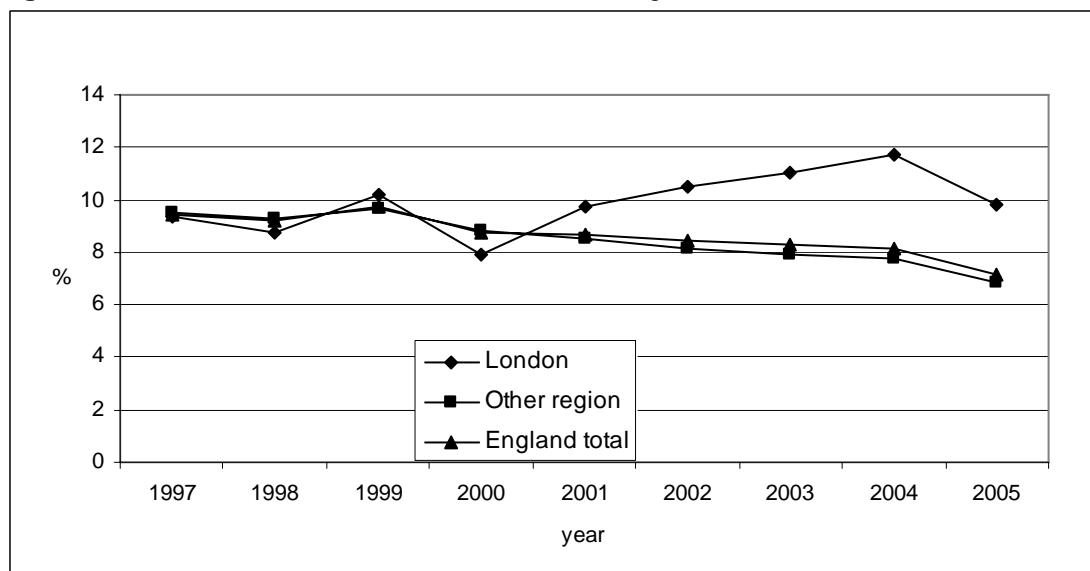


Figure 4.4b Short distance residential mobility



Source: DCLG Survey of English Housing

Short distance moves have also declined across the country in the last few years, particularly in the social sector where worsening affordability and increased market pressure have reduced opportunities for tenants (Figure 4.4b). London bucked this trend, partly because of the growth in private renting in the early 2000s.

4.3.6 Summary

Over the last decade the growth in demand for housing has everywhere been reflected more in house price increases than in additional investment. This has been particularly true in London even though the capital has been more successful than the rest of the country in increasing output, improving the use of the existing stock and gaining government assistance. As a result, Londoners both pay increasingly more than those elsewhere and face greater access problems when they try to buy.

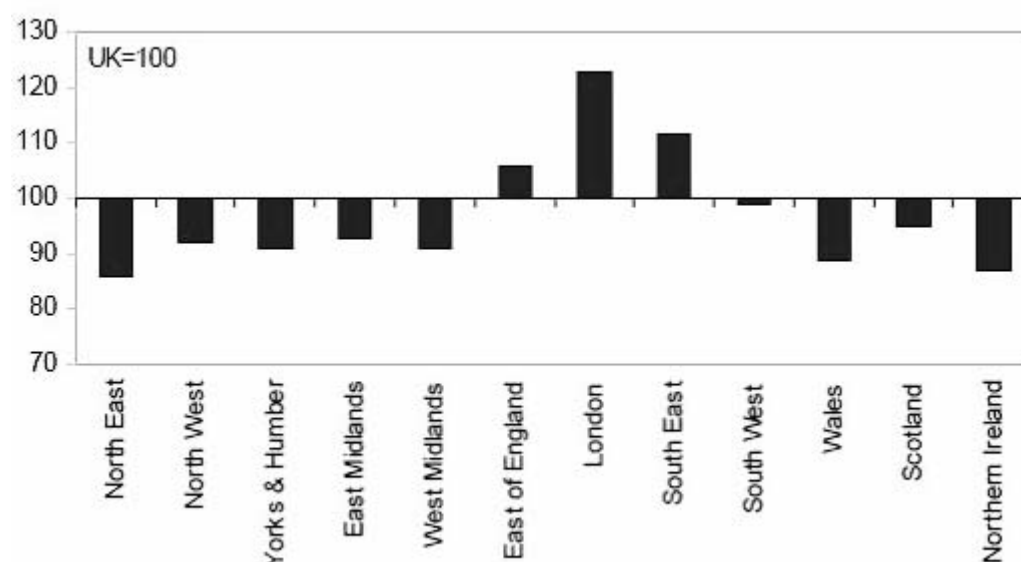
4.4 The Standard of Living in London

4.4.1 Household Incomes

The average private resident in London received some £ 23,900 income from all sources in 2006, about 40% above the national average (Office for National Statistics, 2008). After adjusting for taxes and benefits, their average disposable income was reduced to some £17,000, 24% above the UK average.

Income per head on this measure was the highest of any region (Figure 4.5), although three of the seven standard (NUTS2) sub-divisions of the South East and East regions came close (between 2-6% lower). The relationship has changed little over the last eight years.

Figure 4.5 Personal Disposable Incomes per Head by Region 2006



Source: ONS

4.4.2 Living Costs

To assess the standard of living of Londoners, an adjustment needs to be made for the higher cost of living in London. There is substantial uncertainty about how large the actual difference is, mainly because it is not clear how the housing costs of owner-occupiers should be measured. Taking actual levels of expenditure on mortgage payments as a starting point, one problem is that this depends heavily on when they bought their current properties.

Equally it can be argued that a significant part of mortgage payments represents an investment expected to yield a return in future, rather than simply a payment for housing services.

The latest published ONS estimates of regional consumer price levels are for 2004 (Wingfield et al., 2005). These suggest that, overall, costs in London were 9.7% above the UK average and 13-17% above those in the northern regions. Apart from fares/travel, which were 1% below the national average, all other categories of expenditure were more costly in London (and generally more

costly than in any other region). The largest cost differences were for housing, estimated at 28.6% above the UK average, and household services where costs were 14% above the UK average.

The estimated housing cost differential is only about half that observed for private sector rents¹³ so it almost certainly underestimates the cost of living differential, at least for younger households. Were the effective differential for owner-occupiers (in terms of like-for-like costs of housing services) to be comparable to that for private tenants, it would raise the overall price premium for living in London from 9.7% to 12.3%¹⁴ above the UK level.

4.4.3 *Living Standards*

Thus, for the average person in London, it appears that disposable incomes might be 10-14% above the national average. This is not a large margin, considering the differences in levels of human capital. Taking account of the cost of living differential of, say, between 10-12% the average person in London is probably little better off than elsewhere.

These figures are (rather indicative) averages. The distribution is as important to consider. Regional 'cost of living' measures which effectively focus on new purchasers (such as the commercial *Regional Reward* series which is linked to current house prices) can, for instance, indicate a London cost premium of over 30 percent¹⁵. On the other hand those who purchased their homes decades ago will have far below average expenditures. Equally, many people in the capital have benefited substantially from working in London's labour market, gaining experience and progressing up the occupational ladder more rapidly than they could elsewhere. Equally there are substantial numbers of people – those who have not had this positive experience, progressing less (perhaps because they worked in part-time or public sector jobs) or being unable to gain/retain employment or adequate housing – who are significantly worse off in financial terms than their peers in areas with lower living costs.

¹³ Mean rents of free market private tenancies were estimates at 52% above the English average, which probably equates to about 57% above the UK average.

¹⁴ This can be calculated from the relationship between the ONS overall estimate of 9.7 and their estimate excluding owner-occupation costs which is 7.1%; if the relevant cost differential were twice as great as expenditures on mortgages etc indicate this would add a further 2.6% on to the overall cost estimate.

¹⁵ This Croner series explicitly aims to reflect consumption patterns among the top 4% of income-earners (Hayes, 2005).

Chapter 5: Recent Developments

5.1 Introduction

This chapter focuses on evidence about change in the London economy, and its relation with the rest of the UK since the start of 2007. There are two reasons for looking separately at this period. Monitoring where the London economy has moved on to since 2005/6 depends on interpretation from a rather wider set of indicators, because very few of the key regional data series on which previous chapters relied are yet available. Mid-year population estimates for 2007 *have* just appeared. Some more recent economic data are available from the Annual Survey of Hours and Earnings, and the Annual Population Survey/Quarterly Labour Force Survey. Up-to-date information on housing activity is provided regularly but is often revised significantly. Generally, the margin of sampling error at regional level is too great for confident conclusions to be drawn about short-term change.

The more positive reason for looking closely at developments over the last 18-months or so is in search of evidence of significant shifts in trend. Typically, over the past ten years or so, this meant asking the question whether London might return to the boom and bust cycle that had affected it so strongly in the 1980s/90s. Favourable international circumstances and effective macroeconomic management had translated the late 1990s boom into a steady growth path close to (what seems to be) the underlying growth in economic potential. This seemed to be the case in London as well as nationally. A significant difference, however, was that the metropolitan region emerged from the boom with a tight labour market, while flexibility was maintained with the help of migration, and a more flexible housing market. The London stock market did go through a complete cycle between 2000 and 2007, with the FTSE All Share index falling by a third and then regaining its previous value. But none of these financial uncertainties translated into significant downward shocks on demand or productive activity in London.

The issue this year is not whether there are some signals from the recent performance of the London economy to suggest a disturbance of the steady growth trend. Rather it is obvious from external evidence that things have happened; the international 'credit crunch' of last summer and the strong upward shifts in commodity/energy prices this year reverse the trend. How long and how deep the downturn will be cannot be readily assessed, but there are some other things which may be learned. The first is simply about how far, when and in what ways the London economy can be seen to have already been affected. A second is whether there are any signals as to ways in which impacts of a wider economic downturn will be experienced in London. Finally, there is the question of how healthy the London economy appeared to be immediately before the crunch struck, and thus how well it might be expected to perform when the crisis is over.

The more speculative aspects of these questions will be picked up in Chapter 8, alongside consideration of likely longer-term trends. Here the focus is on available evidence of actual change in London's position, relative to that of the UK economy as a whole.

5.2 Population Growth

London's population growth slowed slightly during 2006-7. This was entirely as a consequence of smaller gains from international migration, since births increased again, while losses through deaths and net outflows of migrants to the rest of the UK changed very little (Table 5.1).

The net inflow from overseas was actually at its lowest level for over a decade (and only half that of the peaks reached in 2000 and 2004). In-migration scarcely changed, however. The change was due to an estimated 20% increase in out-migration. Trends were rather different elsewhere in the country, with small increases in both inflows and outflows which did not affect the level of net in-migration. This reflects what seems to be a continuing trend for the impact of overseas migration to be spread more widely across the country, with less concentration in London than there was 5-10 years ago.

Table 5.1: Comparison of London Population Changes 2005-6 and 2006-7
(000s)

	2005-6	2006-7
Births	118	123
Deaths	52	50
Natural Increase	+66	+73
Net migration with rest of UK	-81	-81
Net international migration	+70	+51
TOTAL CHANGE	+55	+46

Source: ONS Mid-year estimates

Note: All figures relate to changes between one mid-year and the next

As far as domestic flows within the UK were concerned, the net population export from London, involving 81 thousand people in 2005-6, was close to the average of the previous 5 years. But, with reduced gains from overseas, there was a significantly larger overall net outflow from London – amounting to some 30 thousand people in 2006-7, compared with 11 thousand in the previous year. Because of the age mix of international migrants, the slowing of population growth was concentrated within the working age range. In this economically significant group, the rate of increase in proportion halved between the two years (coming down from 51 to 26 thousand p.a.).

This reduction of London's net population inflow from overseas (and of working-age population growth) pre-dates the onset of the credit crunch or any other sign of potentially reduced activity in the London economy except in housing. It also substantially pre-dates reports (from spring 2008) that the 'A8 migrants' – those arriving from the Eastern European EU accession countries after May 2004 – were now 'going home' (Pollard et al., 2008). What exactly is happening to this group is unclear, since the great majority of those arriving in the country come as working visitors and do not stay very long. At the national scale the numbers arriving and registering for work have fallen by a quarter or so over the past year. The falling value of the pound against A8 currencies may also have discouraged some migrants who were attempting to accumulate capital from staying on – and recession would

clearly make a big difference. But there is very little hard evidence as yet of longer-term migrants leaving London.

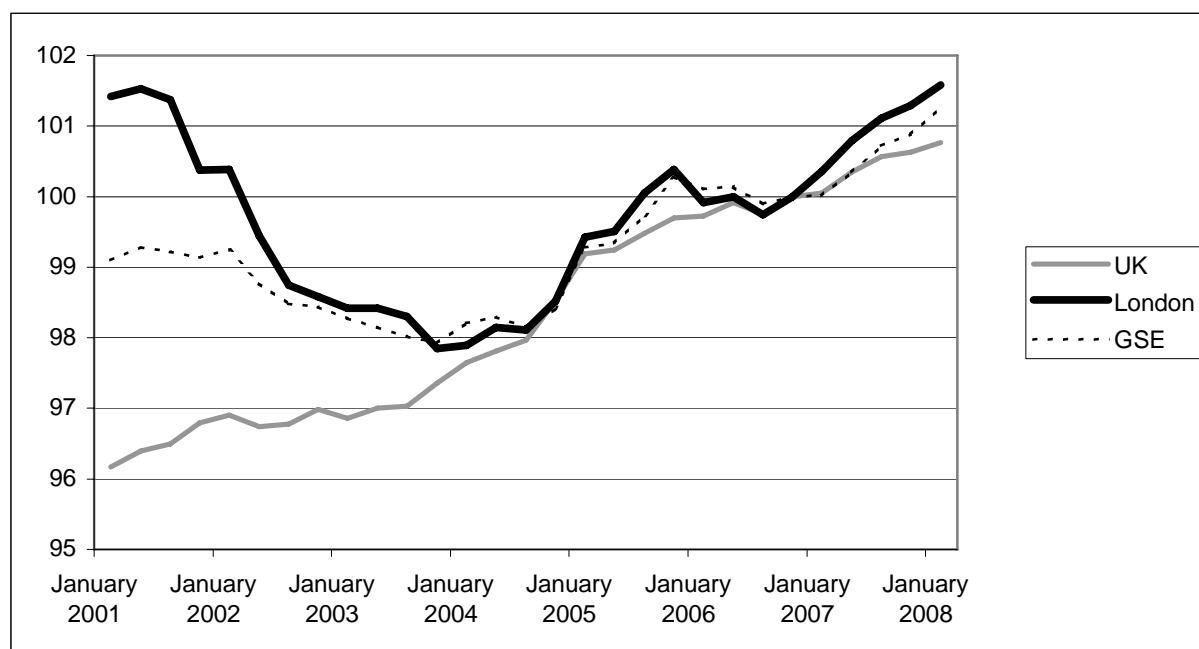
The rate of population growth reported here is significantly lower than indicated in last year's report. This is partly because of actual changes in migration patterns. But it is also (indeed rather more) because ONS made substantial downward revisions to their estimates of London population increase over the years 2001-5. The effect of these adjustments (paralleling those made for earlier years when 2001 Census results were released) was to reduce estimates of in-movement to London from abroad by 15-20 thousand p.a.

5.3 Employment and Labour Market indicators

5.3.1 Employment

Quarterly employment estimates (compiled by ONS) show employment in London continuing to grow, on a seasonally adjusted basis right up to March 2008 (Figure 5.1). The growth rate over the previous 15 months was quite steady at about 1% p.a., around double the UK average, and somewhat ahead of that for the Greater South East. The number of employees in London was by then only slightly below the previous peak, reached in December 2000. Total employment was actually above that peak, because of the strong growth in self-employment during these years, although this appears to have halted in late 2006. There is no evidence, however, up to March 2008 of actual downturn or of impacts of the credit crunch.

Figure 5.1: Employment Trends 2001-8: London, in comparison with UK and the Greater South East (indices: December 2006=100)



Source: NOMIS

Note: Data are quarterly, relating to employees jobs only on a seasonally adjusted basis

Disaggregation by broad sector shows only a continuation of established differentials, with manufacturing employment falling faster than nationally, and aggregate service employment growing a bit faster (Table 5.2). A more detailed sectoral breakdown suggests widespread continuing growth across the service sector (except for public administration and education), in the year March 2007-March 2008. This was most notable in financial and other business services, distribution, catering, surface transport - and in construction. In business services, and in retailing, growth appeared to have slowed as compared with the previous 12 months. But in some sectors, growth in this year actually reversed declines reported for the previous one.

Table 5.2: Changes in Workforce Jobs by Sector, March 2007-March 2008

	London		Greater South East	Great Britain
	000s	%	%	%
Manufacturing	-4	-2.0	-0.9	-1.2
Services	+46	+1.2	+1.1	+0.8
Other	+10	+7.4	+9.3	+2.5
Total	+52	+1.3	+1.3	+0.7

Source: NOMIS

Focusing on the most recent changes presents complications in allowing for normal seasonal patterns in certain sectors notably retailing. In retailing and (non-financial) business services there was evidence of a particular slowing in the first quarter of 2008, and of financial services in the last quarter of 2007. Together this involved job losses in London of about 12,000 in excess of those observed in the same quarters a year earlier. It is notable that there was a comparable deterioration of employment trends across the London public sector, where credit crunch factors would have been less relevant.

The other independent source of evidence on London employment trends, namely the Labour Force Survey, is rather insensitive as a monitor of all but the most dramatic short-term trends, because of the margins of sampling error inherent in its design. The data series also suffered from a major discontinuity during 2006/7 (reflecting revisions to national population estimates). Even so, it appears that the strong growth in London employment, evident during 2006 (and running according to this source at about 2% p.a.) continued through into early 2008. During 2006 and 2007, about a third of this rapid growth in London jobs appears to have been achieved via an increase in inward commuting. The bulk of the rest of the increase was clearly accommodated as a result of the increase in London's population secured through the net in-migration from overseas (plus the growing number of working visitors).

Anecdotal evidence and statements by individual firms and commentators point to a very rapid decline in confidence and to growing numbers of redundancies notably in the upper end of the banking sector and in construction and real estate.

5.3.2 Earnings

The last official earnings data (from ASHE) relate to April 2007. At this point (as indicated in Figure 2.1), average hourly earnings for full-time workers in London were recorded as 36% above the national average. This margin was unchanged from that in 2006, though significantly below the peak (of 39%) reached in 2002. In London, the mean is raised particularly by very high earnings among the top 10% of the workforce, which were 52% above those in the top decile across the country as a whole in 2007. A more representative measure of general earnings in London is the median figure of full-time workers, which was 27% above the UK average in 2007, about 1% down on the previous year and significantly below the average of the previous five years.

There is a clear issue in that the publication of statistical series must lag reality especially as the credit crunch only started to be strongly felt in early 2008. The statistical evidence so far available suggests some slowdown before the financial crisis.

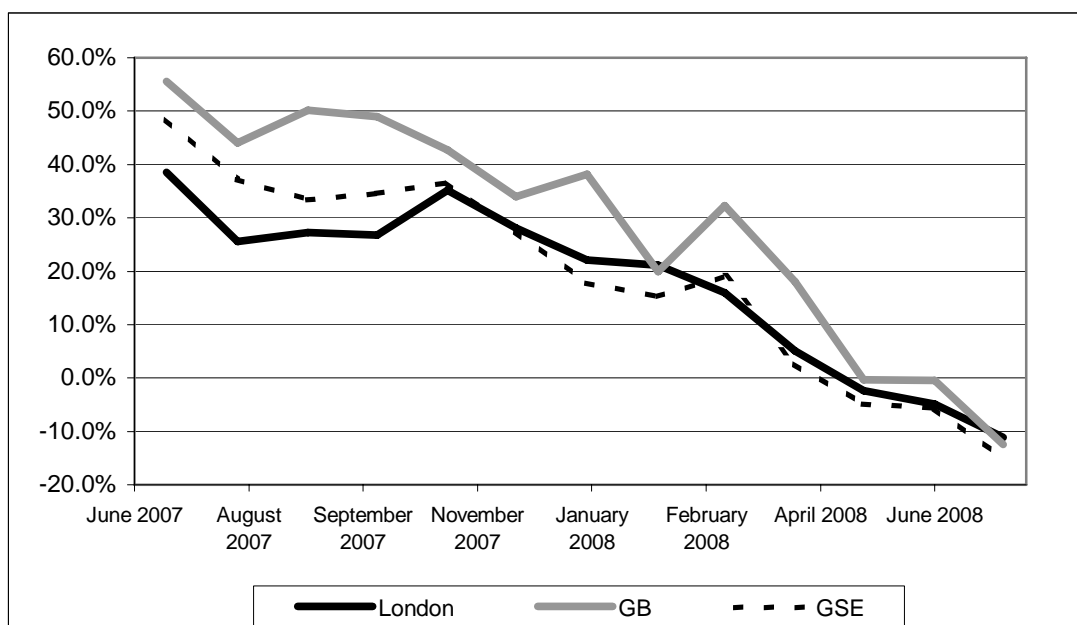
5.3.3 Unemployment and Vacancies

More up to date evidence on the state of labour demand and supply in London relative to the UK as whole are available from administrative statistics on those registered to claim benefit as unemployed, and on those job vacancies registered with the public employment service (Job Centre Plus, JCP).

Claimant Count Unemployment in London represented just 2.7% of the resident working age population in July 2008, down from 2.9% a year earlier, still above the national average (of 2.3%), but with the gap now less than half that observed in July 2004. On a seasonally adjusted basis, unemployment in London only actually stopped falling in April, three months after the rest of the country, and by July (when it was just 3600 higher) it was still showing much smaller increases than either the UK as a whole or its neighbouring regions.

The Job Centre Plus (JCP) vacancy data are partial, with changing coverage, continuing under-representation in London, and a major discontinuity in May 2006. In particular, it should be noted that few City vacancies are included. The series are, however, of real interest in monitoring short term changes in demand. There is no seasonally adjusted regional vacancy data, but comparisons of monthly unfilled vacancy figures with those a year earlier show London demand growth slowing at the end of last year, but with healthy increases continuing up to March 2008. Decreases start to be registered from May, accelerating in the two months which followed (Figure 5.2). The actual level of vacancies in July 2008, was however still well up on the same month in 2006, while the number of jobs being filled via JCP was actually about 15% above that for July 2007. The picture is one of an economy which has been slowing down sharply in the previous 6 months or so, but with mixed evidence employment was yet falling – in the kind of jobs that JCP cover. In terms of these vacancies, the indications are of employment demand slowing more dramatically in regions outside the GSE, while recent falls in numbers of unfilled vacancies show up most clearly in parts of the GSE outside London.

Figure 5.2: Changes in Unfilled JCP Vacancies over previous year, quarterly, 2007 - 2008



Source: NOMIS

5.4 Output

Estimates of changes in regional output produced by Experian Business Strategies show the London economy growing strongly through 2007. For the year as a whole, the reported growth rate is 4.1% against a national average of 3%. This represented an increase on the 3.4% recorded for 2006 – though with a similar differential over national trends (GLAEC, 2008a). London growth is indicated as having peaked in the middle two quarters of the year, and has since fallen back to 3.4% in the first quarter of 2008 compared with 2.5% for the national economy (GLAEC, 2008b). This still appears very healthy, but it should be noted that all of these figures represent year on year changes. Were a seasonally adjusted series available for individual quarters, this might very well indicate significantly weaker growth.

These figures suggest that output growth was notably healthy right up to the point of the credit crunch. Moreover, the Experian series suggests that London growth had been consistently above the national average since late 2004. This is a characteristic of boom periods, though peak growth in London was clearly below that reached at the top of the previous three upturns, while the differential over the national average was substantially smaller than in the late 1990s boom (GLAEC, 2008b).

Comparison with Experian's estimates of employment change in London indicates that the strong performance during 2007 was achieved very largely through output per head rather than employment. Real output per head in London appears to have increased by 3% in 2007, as compared with 2% in the previous year (GLSEC, 2008a)

Finally, looking at business expectations, which perhaps better pick up the very latest trends, optimism among London company directors (as surveyed

by the London Chamber), which had remained quite strong since early 2006, fell back sharply with the onset of the credit crunch in the third quarter of 2007. The balance of opinion about the direction of change only became clearly negative in the second quarter of 2008 (after the commodity price rises). Six in ten businesses thought London's economic prospects would worsen (a proportion rising to 85% among business service firms). This judgement seems to have been based more on a reading of economic news than any personal experience.

Importantly, respondents were substantially more optimistic in relation to their own firms, and much more pessimistic about the national economy than about London. In terms of actual changes, output levels still appeared generally stable and firms not expecting immediate changes in employment levels (LCCI, 2008). The CBI/KPMG (2008) London report, however, points to substantial variation around this average picture, with many retail, finance and catering businesses reporting decreased sales, while business services continued to enjoy normal growth.

Somewhat similar findings were reported by the Royal Bank of Scotland in their Purchasing Officers Report which showed that there had been declines in most indicators earlier in the year across the country but only in London was there some improvement in August (RBS, 2008). They also noted, however, that cost inflation and financial concerns were still resulting in job cuts.

5.5 Activity in Key Sectors

5.5.1 Banking

Though buoyant until last autumn, financial services are at the heart of the current crisis and the first to report impacts on profits, falls in activity and plans for job cuts. Major international banks are reported to be seeking some 60,000 job cuts¹⁶, both as a reaction to falls in business levels and as a cost-cutting measure. There is little hard evidence as yet of the scale of cut, and in most cases it is quite unclear how these will be distributed between centres. Nationally, the March 2008 CBI/Price Waterhouse Coopers survey of the financial services industry was forecasting some 10,000 job losses in the sector over the following quarter. The June survey indicated that job losses would continue, though they had been less bad than predicted. Current appraisals from City-based analysts are discussed in Chapter 8.

5.5.2 Tourism

Provisional estimates for 2007 (based on the International Passenger Survey) suggest that overseas visits to London fell as compared with the previous year. Visitor nights fell rather more (by 5%), after at least four years of continuous growth, though visitor spending continued to grow (by 5% in current price terms). Trends in London (for nights and spending) were significantly less disappointing than across the country as a whole. Most of these figures pre-date the substantial fall in sterling against the euro, which is

¹⁶ 'Job Losses League Table (Updated)', *Here is the City News*, 30th June 2008.

likely to have boosted short-haul travel into London this year (though probably with more effect on numbers than on nights or expenditure).

5.5.3 Commercial Property

The commercial property market has been one of the first to respond to declining confidence and lower rates of activity. Floor space under construction in central London had been increasing since the blip in 2003/04 and continued to do so until the end of 2007. Availability had also been declining consistently until late 2007. In the first half of 2008, the trend reversed, with availability increasing as more newly completed property came on the market. At the same time the amount of floor space under construction started to fall quite sharply. Finally, take-up which had remained buoyant in 2007 has fallen sharply in 2008.

Quarter on quarter falls in take-up have been of the order of a third in Central London and as high as 50% in the City. On the other hand, take-up in the West End actually continued to increase, although rents in the West End fell for the first time since 2005 – by 4% in the first half. In the City the decline in rents was far greater, at over 10% since the beginning of the year. Finally the position on rents in London is seen as significantly worse than in other regions.

The overall picture is therefore one of both declining investment activity and declining demand. Moreover all the indicators on rental and capital growth across all types of property point to decline in 2008. Benign renting conditions are not expected to return until 2009 at the earliest.

5.6 The Residential Market

The most direct impact on the housing market over the last two years has clearly been the credit crunch. The immediate pressure was felt via financial institutions' capacity to lend: first through the removal of Northern Rock from the market and more generally through the closure of the Mortgage Backed Securities (MBS) market. As a result of this decline in liquidity, both the range of mortgages and the numbers of providers have fallen drastically. Particularly important for the first time buyer market is that very few lenders are prepared to lend above 90% of valuation and many are now requiring deposits up to 75%. Equally there is very limited funding available for Buy-to-Let investment.

The second major impact has been on developer capacity to fund their investment through borrowing and more generally on confidence in the industry. Linked to this has been an increase in risk associated with the reduction in pre-completion sales to Buy-to-Let purchasers which impact both on preparedness to maintain the pipeline and more generally on cash flow.

Another concern in the development market has been the increasing costs associated with regulation, notably with respect to zero carbon requirements. These are seen by developers as reducing profitability and the benefits of continuing development.

Because the situation is very fast moving, most of the evidence is anecdotal and what there is, is often not London specific. The general pattern, however, appears to be that activity levels have been affected first, while prices have only started to fall. Particularly concerning though, is the fact that any significant reduction in prices will feed back both to the liquidity of financial institutions and to consumer confidence.

What does the evidence show? First, mortgage activity (as opposed to remortgaging) has fallen dramatically over the last year. It is now projected by the Council of Mortgage Lenders that overall net lending will fall by at least a half to £50-55 billion in 2008.

Direct evidence on sales volumes (Table 5.3) shows that sales have actually been falling since 2006, well before the full impact of the credit crunch, across the UK and particularly in London. Activity levels are declining strongly too. Anecdotal evidence from developers suggests that viewing levels are holding up quite well but that these are not turning into reservations at the expected rates and cancellations are increasing. Some of this is put down to an inability to obtain a mortgage but increasingly it seems to be reflecting lack of confidence in the market and therefore low demand.

Table 5.3: Volume of Residential Sales

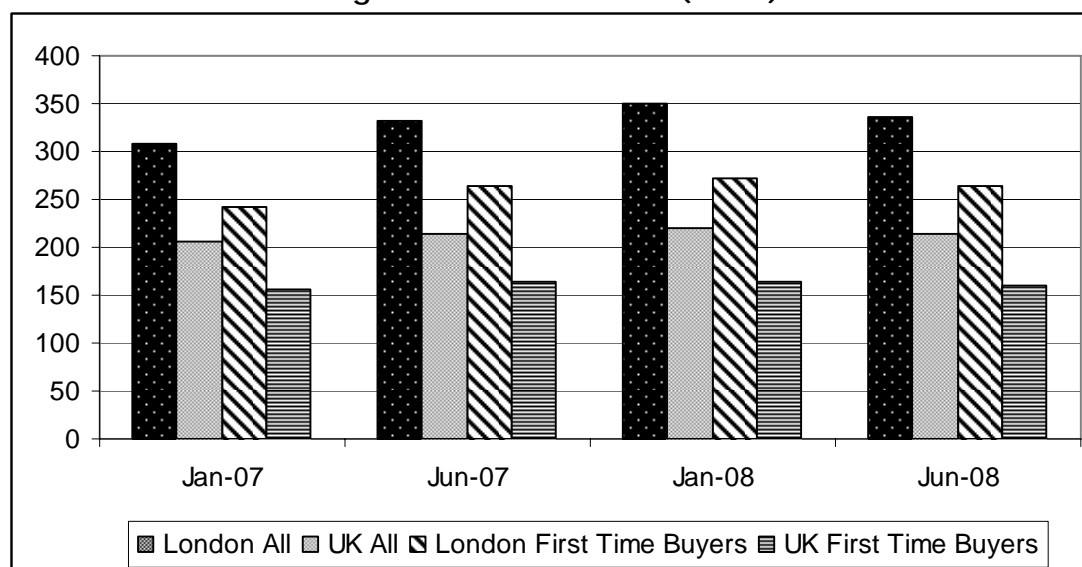
		Greater London	UK
2006	Q3	46.7	354.3
	Q4	43.6	352.4
2007	Q1	37.9	280.4
	Q2	40.7	326.2
	Q3	44.9	338.1
	Q4	35.2	280.9
2008	Q1	22.7	168.3

Source: H.M Land Registry

Levels of output in London had also started to fall before the financial crisis of 2007. Housing starts in London have now declined from a peak of over 25,000 in mid 2006 (based on 12- month rolling totals) to around 17,000 in the first quarter of 2008. The pattern has been very similar to England as a whole but measuring from the peak to March 2008 the fall in London has been twice as fast. What is perhaps the first sign of improvement however came in the second quarter, when London bucked the continuing downward trend in other regions to show a small increase in starts.

Evidence on house prices in London on the other hand shows that prices continued to rise throughout 2007 both for all dwellings together and for dwellings being sold to first time buyers (Figure 5.3). The pattern in London is not dissimilar to that for the country as a whole, except that prices for first time buyer property started to fall a little earlier outside London.

Figure 5.3: House Prices (£000s)



Source: DCLG Table 507

Note: These figures are adjusted for the changing mix of dwellings sold in each region.

While significant actual price falls were not observed until 2008, confidence has declined across the country very rapidly. The RICS housing market survey shows with some small monthly variations, that surveyors are observing either falls in house prices (81% of surveyors in the UK observing falls over the previous three months in August 2008 as compared to only 23% in October 2007) or at the best regard the market as stable. Even so London stands out as having only 74% observing falls (RICS, 2008a).

Housing market activity in terms of sales has also fallen dramatically, with an average of just over one per week per Estate Agent across the UK. Activity in London has fallen even more and is now only 75% of that level.

One area of the housing market where the evidence suggests increases in both demand and supply (although not new investment) is private renting. The latest RICS Lettings Survey suggests increased activity, arising both from sellers holding their properties off the market and from potential purchasers deciding to rent. As a result there is some evidence of rental and yield increases.

Overall the evidence suggests that the market slow-down in terms of transactions and housing starts has been considerably more rapid in London than elsewhere. On the other hand, house prices have started to fall dramatically, although these relate to relatively small numbers of transactions. There are some slight indications that declines in output and activity may be beginning to plateau with an upward blip in starts and stable surveyor expectations. Current predictions for house prices on the other hand still suggest significant further declines.

5.7 Summary

The statistical evidence available at the time of writing points to a generally healthy London economy right up to 2008 – except in housing where declines in activity could be identified well before the credit crunch. Both output and employment were indeed still reflecting real growth to the middle of the year.

Many other indicators have become far more negative and large numbers of job losses have been announced. The credit crunch and declining demand have clearly impacted heavily on particular sectors – notably banking and housing construction. Significant elements of the asset base in both these sectors have been lost, making recovery that much more difficult. Even in these areas, however, there are signs that the bottom may have been reached at least for the moment. This is not to say that there will not be further disruption and the continuing possibility of recession – but not all of the signs are negative; on many indicators London's economy still looks resilient. As the latest Government Office for London publication states "So far, while the tougher economic conditions have clearly affected London's property markets and financial services sector, the capital's economy has generally been resilient with employment remaining high. But it is clear that, after the strong growth of recent years, London – like the rest of the country – will need to prepare itself for a more challenging economic climate."

Chapter 6: The Boroughs' Place in the London Economy

6.1 Introduction

One of the positive effects of London's scale as a metropolitan economy is the opportunity that this provides for areas to specialise - in the mix of economic activities and population groups that they accommodate, and in the types of housing, environment and service provision that they offer. Statistical sources reveal that local areas differ in terms of growth, business performance, wages, housing standards and the degree of affluence or deprivation of local populations.

London differs from smaller British cities and towns in that these variations show up on a borough or district scale, rather than only more locally. Some variations are detectable even when Greater London is compared with outer parts of its economic region.

Because disparities within London relate to much wider areas than elsewhere they *may* well matter more, and deserve closer attention. The problem, however, is in disentangling how far measured disparities in outcomes reflect:

- different weightings of population groups and business types, each with different characteristics that they display wherever they locate; and/or
- real differences in the circumstances under which firms, people and public agencies have to operate in different parts of the city-region; and/or
- local variations in how well localities respond to the challenges presented by these circumstances and more global forces.

From the wider perspective of the functional economic region, two broad patterns have been evident in the past. The first is that growth has tended to occur at some distance from the city centre. London can be seen as a series of distinct rings:

- Central London
- The rest of Inner London
- The outer boroughs of Greater London
- An Outer Metropolitan Area (outside the GLA territory, but within the functional urban region)
- The Remainder of the Greater South East (the outer parts of the East and South East administrative regions).

These rings differ particularly in the age and density of their development, and in the cost of land, which naturally falls further away from the centre. Outer rings have thus tended to accommodate more recent growth, with higher proportions of more affluent, owner-occupying households, and more space-extensive kinds of business activity.

The second pattern is that the western half of the metropolitan area (both inside and outside London) performs better on a range of indicators. This is partly a reflection of the historically different make-up of residential areas in west London. But its economic advantage is also a consequence of superior access, both to national markets and international airports. The eastern side

of the region has thus tended to perform less well in terms of growth, productivity and innovation, and its residents are less affluent.

Both of these patterns have been subject to some recent change. In the inner-outer case, this reflects the impact of two market developments – population gentrification and Central London office employment growth. In the east-west case, there has been less change, but this has been more affected by public sector activity, particularly the Docklands re-development and major investments in transport infrastructure.

Table 6.1 Economic Contrasts between Sub-regions: within Greater London and across the Greater South East

	Sectoral Employment Shares 2006		Employment Growth Rate	Average Hourly Earnings 2007	Employment Rate 2007	Highly Qualified 2007
	Manufacturing	Business Services	1998-2006	By Workplace		In Resident Population
Inner London:						
Central	2%	52%	5%	£28	64%	54%
East	5%	35%	16%	£16	65%	37%
West	6%	28%	6%	£14	70%	45%
Outer London						
East	8%	20%	-3%	£15	72%	26%
South	5%	29%	2%	£15	77%	39%
West	5%	22%	2%	£15	70%	33%
Outer Met Area (OMA)						
East	10%	19%	9%	£15	78%	23%
North	10%	24%	-1%	£12	76%	31%
South	7%	28%	6%	£16	80%	36%
West	7%	33%	5%	£20	80%	34%
Outer GSE	11%	20%	10%	£15	78%	28%

Sources: Employment from Annual Business Inquiry; Earnings from Annual Survey of Hours and Earnings; Employment rate and qualifications from Labour Force Survey – all via NOMIS databank.

Notes: 1. Sub-regions as defined here in relation to areas' socio-economic roles differ from those used at different times by GLA, and from the NUTS classification of the ONS. Within Greater London, borough groupings are as shown in Table 6.2; outside this area, the OMA is as defined by planners in the 1960s (stretching from Gatwick to Stevenage, and Reading to Southend); OMA East is the part of this in Essex and Kent; OMA South that in Surrey and Sussex; OMA West that in Buckinghamshire and Berkshire and OMA North in Hertfordshire and Bedfordshire. The Outer GSE comprises the remainder of the Greater South East, i.e. those parts of the Eastern and South East regions outside the OMA. 2. The employment rate is the proportion of the locally resident working age population who are in work; 3. The highly qualified element of the working age population is defined to include those with NVQ levels 4 and 5 (broadly those with degree-level qualifications).

The current scale and pattern of variation is indicated in Table 6.1 with selected economic indicators for a set of sub-divisions of the 'rings' of the Greater South East (representing London's extended region). In terms of the balance of economic activities, it shows that business services employment

now outweighs manufacturing as a component of the economic base throughout this region and not solely in its core. This pattern of specialisation is still most marked in Central London, but in second and third place now are the Inner East (because of Canary Wharf), and OMA West (because of the Thames valley concentration of IT/business services). The areas where manufacturing activity retains some significance are further out from the centre, especially on the eastern/northern sides.

The pattern of employment change now includes strong growth around the centre (most notably in the Inner East) as well as out at the fringes of the region. The weakest growth performance now is across Outer London, where employment levels seem generally static – though actual declines were recorded in the Outer East during the 1998-2006 period of general expansion.

Earnings levels (by place of work) show surprisingly little variation across the Greater South East as a whole, which is consistent with the idea that this is an integrated labour market area. The two main exceptions are in Central London where earnings levels appear roughly double those elsewhere, and in OMA West where a second local peak is now evident. Both are actually areas with highly qualified workforces, and pay rates for comparable skills will clearly vary less than this overall comparison would suggest.

Looking at where potential workers live, we see a quite different (and more traditional) pattern than that of employment rates, which are a key influence on income levels of local residents. These are still generally higher in areas further from the centre, especially on the south and west sides – and actually much lower around the business service centre (in Central and Inner East London).

Finally (in terms of these summary indicators), the residential distribution of graduate-level workers, another key influence on local prosperity, shows a strong concentration in the very centre, and a continuing east-west divide, with the lowest representation of graduates in Outer East London and OMA East.

Against the background of this wider regional geography – with its contrasting patterns of workplace and residential variation – the remainder of this chapter focuses attention on the patterns of variation within London (at the level of boroughs or groups of these) and the reasons underlying these. It looks first at productive activity in these areas, then at the relative prosperity and/or deprivation of their resident populations.

6.2 Local Business and the Productive Economy

The most obvious feature of the geography of productive activity within London is its very strong concentration within a few boroughs in and around the centre. Since the 1980s, the effective London central business district (CBD) has been extended well beyond the traditional confines of the Circle Line, out east to Canary Wharf (in Tower Hamlets) and west to White City (in Hammersmith). All or substantial parts of eight boroughs now fall within this CBD. But the densest concentrations of activity are still clearly in the two

central boroughs/Cities, Westminster and the City of London. The concentration of jobs in the centre is very much greater than that of population, so the City and Westminster stand out not only in their (physical) density of employment but also in their ratios of jobs to residents (Table 6.2).

The City is an extreme case, having fewer than 10,000 residents, but some 300,000 jobs. Taking the two districts together, just 1.5% of London's area, with 3% of its population, accommodates 22% of its jobs. Looking wider, what are effectively the eight core boroughs – these two plus Camden, Islington, Hammersmith, Kensington, Southwark and Tower Hamlets – currently include a full 46% of London jobs.

The only other boroughs with employment densities above the London average are the cluster around Heathrow, in the outer west, where Hillingdon, Hounslow and Kingston together account for another 10% of total employment.

The remaining 45% or so of jobs are spread much more evenly across the other boroughs, each of which boasts at least 50,000. Part of the reason for this wide spread of economic activity across the city is that demand from borough residents – including commuters working in the CBD or Heathrow economies – provides the basis for a substantial level of activity in locally-oriented services.

An estimate of the scale of this has been derived from the London Annual Business Survey data on the proportion of sales accounted for by the local (borough) market, and by household (rather than business or government) demand – supplemented by judgements on the elements of public sector employment serving *local* needs. Overall these suggest that for every 1000 residents in a borough, demand is generated for about 150 local jobs (split roughly 40:60 between the private and public sectors) – slightly more in richer areas¹⁷ and fewer in poor ones. These naturally account for a larger *proportion* of jobs away from the major concentrations of activity, but represent 40% or so of total employment in the majority of boroughs (see Table 6.2).

This is a rather large share, but it still implies that across both outer and inner boroughs, the majority of employment is generated by non-local demands, which firms in each area successfully meet. The range of such activities in different places is indicated in Table 6.3, which identifies the specialisations of particular boroughs — that is, those sectors where employment is at least twice what would be expected given local employment or population levels.

One significant fact is that the majority of boroughs have at least one such specialisation. Westminster is the extreme case with a wide range of service specialisations. Areas in the outer west and outer east are at the other extreme, with more boroughs lacking any strong specialisation. Inevitably

¹⁷ The figures in Table 6.2 suggest that the City is an extreme case in this regard, but local job estimates here are based on a small sample of respondents and cannot be regarded as reliable.

most of the activities identified are services of one kind or another (mostly business, public or cultural in character), or quasi-services such as publishing. Among 'real' manufacturing industries, printing is still important in four boroughs within reach of the CBD. Otherwise the sector is represented only by the engineering trades in the outer east (Barking) – and other manual trades only by wholesaling there and transport in the outer west (around Heathrow).

Across London as a whole, financial and other business services clearly represent the most substantial component of London's externally-oriented businesses. Several of these (including law/accountancy and IT/telecoms, as well as finance and the 'other' category) figure among the specialisations of a quarter of the boroughs. It is only in the City of London and (since development of Canary Wharf) in Tower Hamlets, however, that the majority of jobs lie within this sector (Table 6.2). In other central areas (including Westminster), the share of jobs in this sector is 30-40%, indicating that it is one among a portfolio of advanced service activities in which core areas specialise. Kingston, within the Heathrow complex, and the Thames Valley areas, further west within the OMA, are similarly placed, indicating that centrality is not the only possible base for competitive success in these activities.

Borough performance in terms of employment change – the most readily available indicator of relative economic growth over the past decade – is extremely variable. Between 1998 and 2006, when total London employment expanded by 6% according to the ABI, at borough level this ranged from a 56% net increase in Tower Hamlets (with another large gain, of 33%, in Hammersmith) and a contraction of 18% in Barking (Table 6.2).

Some of the variations look random (and might even reflect idiosyncrasies in the statistics). But there are evident patterns. The most notable is the fast growth occurring at the frontiers of the CBD (including the eastern and western markers, just referred to). This indicates the degree to which, in periods of steady growth (rather than sudden booms), additional employment in the business centre has been accommodated through extension of its area, rather than further densification.

At the other extreme of performance, Barking's sharp contraction stands out largely because (with its Ford plant) it represented the main surviving element of 'real' manufacturing in London, vulnerable to the kind of competitive pressures which removed most of the rest in the 1970s/80s. The Ford factory has subsequently been very much reduced. Hounslow, at the opposite edge of the city lacked such a headline case, but suffered a severe shrinkage for similar reasons. Elsewhere in outer London the picture was less dramatic, and not simply attributable to inexorable deindustrialisation. Rather, relatively low growth appears to have been the result of locational disadvantage caused by being neither part of the central cluster of activities nor part of the less congested yet well-connected areas further out of London (Gordon, 2007).

Table 6.2 Business Activity and Performance by Borough

	Employment density (jobs per hectare)	Workplace employment: resident population ratio		Proportion of jobs in business services	Average Hourly Earnings	Employment growth 1998-2006
		All jobs	Ex local services			
Central						
City	1252	32.87	31.68	81%	£28	5%
Westminster	285	2.30	2.08	37%	£22	5%
Inner East						
Greenwich	17	0.28	0.12	18%	£16	4%
Hackney	49	0.37	0.24	33%	£17	-6%
Haringey	28	0.27	0.15	18%	£15	2%
Islington	129	0.91	0.71	36%	£22	21%
Lambeth	52	0.44	0.27	28%	£18	13%
Lewisham	23	0.24	0.12	22%	£15	2%
Newham	23	0.29	0.16	19%	£15	14%
Southwark	70	0.61	0.42	40%	£19	9%
Tower Hamlets	100	0.90	0.73	54%	£25	56%
Inner West						
Brent	27	0.34	0.23	16%	£14	-6%
Camden	134	1.11	0.93	38%	£19	6%
Ealing	25	0.39	0.28	25%	£16	-2%
Hammersmith	84	0.64	0.46	30%	£21	33%
Kensington	112	0.56	0.38	24%	£15	-4%
Wandsworth	36	0.38	0.20	22%	£17	12%
Outer East						
Barking	15	0.27	0.17	14%	£15	-18%
Bexley	13	0.28	0.15	23%	£14	-1%
Havering	8	0.32	0.19	21%	£14	0%
Redbridge	15	0.25	0.12	21%	£16	-2%
Waltham Forest	19	0.26	0.13	18%	£14	1%
Outer South						
Bromley	8	0.35	0.20	28%	£15	13%
Croydon	17	0.37	0.23	24%	£14	0%
Kingston	22	0.56	0.37	41%	£16	14%
Merton	22	0.32	0.21	23%	£15	-1%
Richmond	16	0.35	0.22	26%	£14	3%
Sutton	16	0.33	0.19	25%	£15	-1%
Outer West						
Barnet	14	0.33	0.20	18%	£13	-3%
Enfield	16	0.31	0.20	26%	£15	2%
Harrow	17	0.72	0.57	19%	£17	16%
Hillingdon	25	0.54	0.39	26%	£17	-8%
Hounslow	15	0.36	0.22	33%	£17	-15%
Greater London	30	0.53	0.38	34%	£19	6%

Sources: as for Table 6.1, except local consumer service estimate derived from London Annual Business Survey (with ABI), and population figures from ONS.

Table 6.3 Sectoral Specialisations by Borough

Borough	Specialisation
Central City	Finance; Law/accounting; Other business services
Westminster	Catering; Education; Finance; Government; Health; Other business services; Publishing; Recreation/culture; Retail
Inner East	
Greenwich	
Hackney	Other business services; Printing
Haringey	Recreation/culture
Islington	IT/R&D/telecoms; Law/accounting; Publishing
Lambeth	Other business services
Lewisham	Printing
Newham	
Southwark	Law/accounting; Other business services; Publishing
Tower Hamlets	Finance; Publishing
Inner West	
Brent	
Camden	Education; Law/accounting; Other business services; Publishing; Recreation/culture
Ealing	
Hammersmith	Publishing; Recreation/culture
Kensington	Catering; Publishing; Recreation/culture
Wandsworth	
Outer East	
Barking	Engineering; Wholesale
Bexley	
Havering	
Redbridge	
Waltham Forest	Printing
Outer South	
Bromley	Utilities
Croydon	Government
Kingston	
Merton	Printing
Richmond	Other business services; Publishing; Recreation/culture
Sutton	Publishing
Outer West	
Barnet	
Enfield	
Harrow	
Hillingdon	Air transport
Hounslow	Air transport; Surface transport; Recreation/culture
Central City	

Source: based on ABI employment data for 2006

Note: specialisations are defined in relation to 23 pre-defined sectors; the criteria for inclusion are either (i) a local employment share at least twice the national average for the sector or (ii) a level of employment at least twice that expected from the locally resident population, and 25,000 jobs or more.

The geography of business performance in different parts of London is, however, unlikely to be simply a matter of inherited economic structures and more or less advantageous locations. For a more qualitative perspective we draw on evidence from the 2007 round of the LDA's London Annual Business Survey. This is based on a comparatively large sample, but (as was discussed in Chapter 3) there is a great deal of variability between individual plants, both large and small. In order to identify significant geographic patterns it is safer then to concentrate on the sub-regional level, rather than present indicators for each borough. A selection relevant to the main dimensions of product market competitiveness is displayed (for the set of sub-regions used previously) in Table 6.4.

Table 6.4 Business Performance by Sub-Region

	Businesses with growth 2006-7 in		Proportion of output exported	New or improved products as proportion of current sales	Low prices as competitive priority
	Employment	Productivity			
Central	53%	52%	19%	7%	40%
Inner East	50%	54%	7%	9%	34%
Inner West	44%	55%	8%	6%	41%
Outer East	25%	47%	3%	4%	51%
Outer South	35%	57%	8%	7%	37%
Outer West	39%	48%	13%	8%	54%
Greater London	44%	53%	10%	7%	40%

Source: London Annual Business Survey 2007 (LDA)

Notes: 1. Responses are weighted so that results should represent percentages of overall (private sector) employment in each area; 2. The final variables relates to firms which said low prices were a high/very high priority in ensuring product market competitiveness.

Inner areas of London – especially the centre and inner east – seem to have a higher proportion of businesses experiencing recent employment increases; there were strikingly fewer in the outer east. In productivity growth there is much less variation, though outer east (again) and outer west exhibit the weakest performance. In terms of the proportion of sales exported, the centre stands out with almost double the London rate, while a second major area of activity in the outer west is also clearly above average. Once more it is the outer east which shows the weakest performance, with only one-third the success in selling overseas. The proportion of sales involving significantly new or improved products (over the previous year), shows rather little variation across London, except for the outer East, where it was

proportionately much lower. The final indicator relates not to performance as such but to businesses' choice of competitive strategy. As discussed in chapter 3, the expectation is that in this expensive city, offering strong agglomeration economies, firms will focus on quality enhancement as a competitive strategy, or more particularly on product differentiation. And in fact the data show that only a minority of London firms see low prices as a priority in pursuing their competitive advantage, which is consistent with this expectation. The two exceptions in this case are the outer east (once more) and the outer west. Given that even outer locations are expensive by regional (let alone national) standards, this seems to be a sign of competitive weakness, and a likely predictor of weak performance.

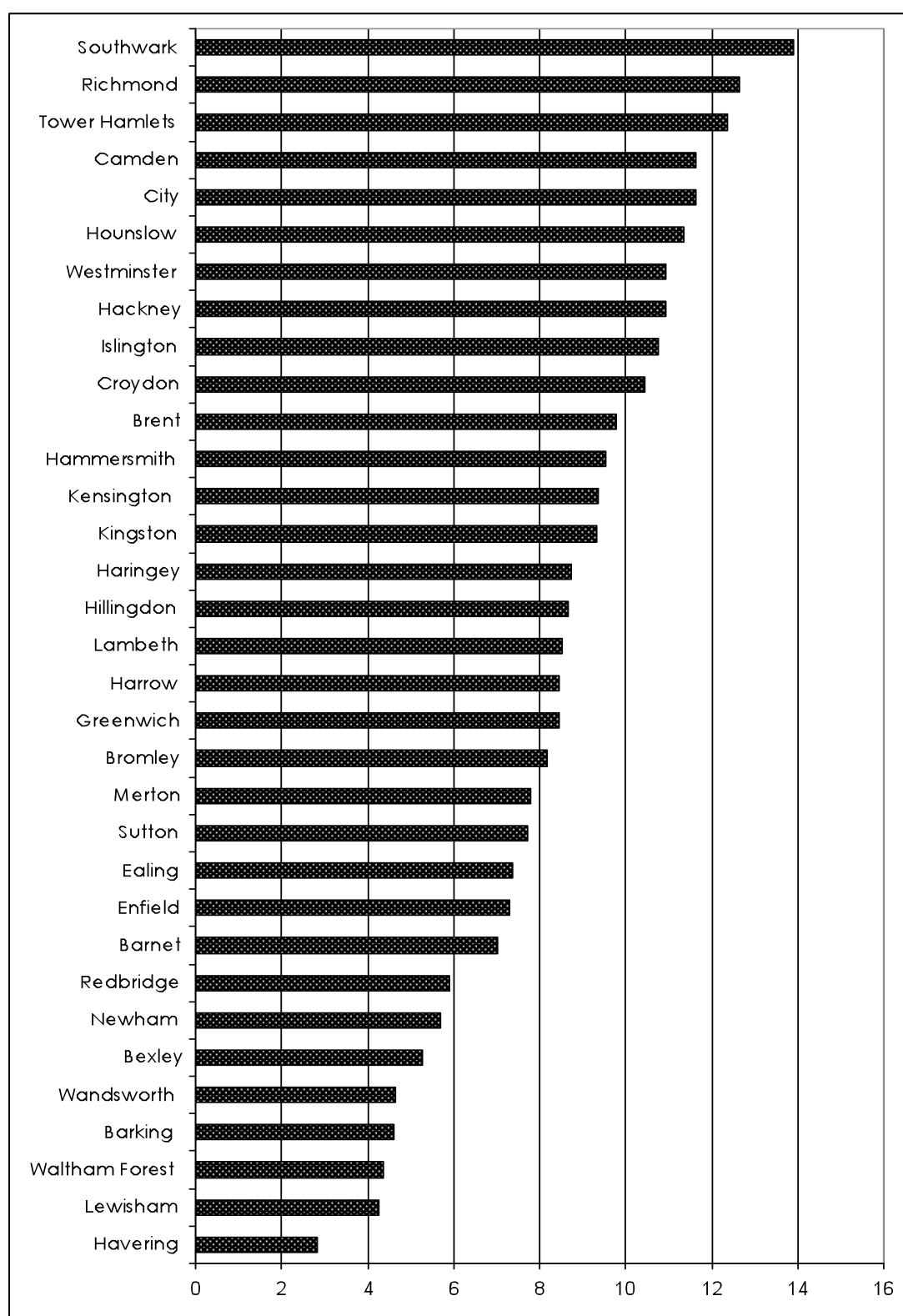
A possible explanation of any of these sub-regional variations within London is that they simply reflect the characteristics of different types of activity which are unevenly distributed across the city. To test this, a more detailed analysis was undertaken¹⁸. The results suggested that in every case that location made a significant difference. The patterns were not always the same as for the simple averages presented in Table 6.4. But in every case the strongest performance was associated either with the central area or the inner east. In four out of five cases the weakest performance was associated with the outer east, the exception being for employment growth where the outer south was in this position.

Figure 6.1 shows an overall measure of borough business competitiveness, bringing together the indicators in Table 6.4 and applying them to each borough. Southwark, Richmond, Tower Hamlets, Camden and the City appear at the top, with predominately eastern boroughs at the other end of the scale.

¹⁸ With observations being weighted by employment size.



Figure 6.1 Borough Business Competitiveness Index



Source: based on data from LABS 2007

Note: this index is the sum of standardised values for the indicators presented for sub-regions in Table 6.4 (after reversing the sign of the low price indicator)

6.3 Residents, employment, income, prosperity and deprivation

The pattern of variation between boroughs in the affluence of their residents is quite distinct from that in terms of business performance. This can most clearly be seen in relation to earnings levels among those in work, for which comparable data are available (from Annual Survey of Hours and Earnings) both by borough of workplace and borough of residence. These turn out to be only very weakly correlated, and with many boroughs being quite differently positioned on the two rankings.

The most conspicuous examples are within Inner London, where at one extreme, median earnings among residents of Kensington and Chelsea are 52% above those received by those working in the borough, while (at the other extreme) median earnings of Tower Hamlets workers are 28% above those of its residents. Other inner east London boroughs inside the extended CBD show the same kind of differential as Tower Hamlets, though to a much lesser degree. At the other end of the spectrum, apart from Kensington it is outer boroughs – most conspicuously Bromley, Kingston and Richmond – which record much higher earnings among local residents than for local workers.

Figure 6.2 shows variations in median weekly earnings by borough residents in map form. Kensington & Chelsea and Richmond stand out, though there are examples of relatively high incomes in Westminster, Camden, Islington, Tower Hamlets and Bromley. The lowest incomes appear in Barking & Dagenham, Newham, Lewisham and Brent.

Figure 6.2 Median Weekly Earnings by Borough of Residence

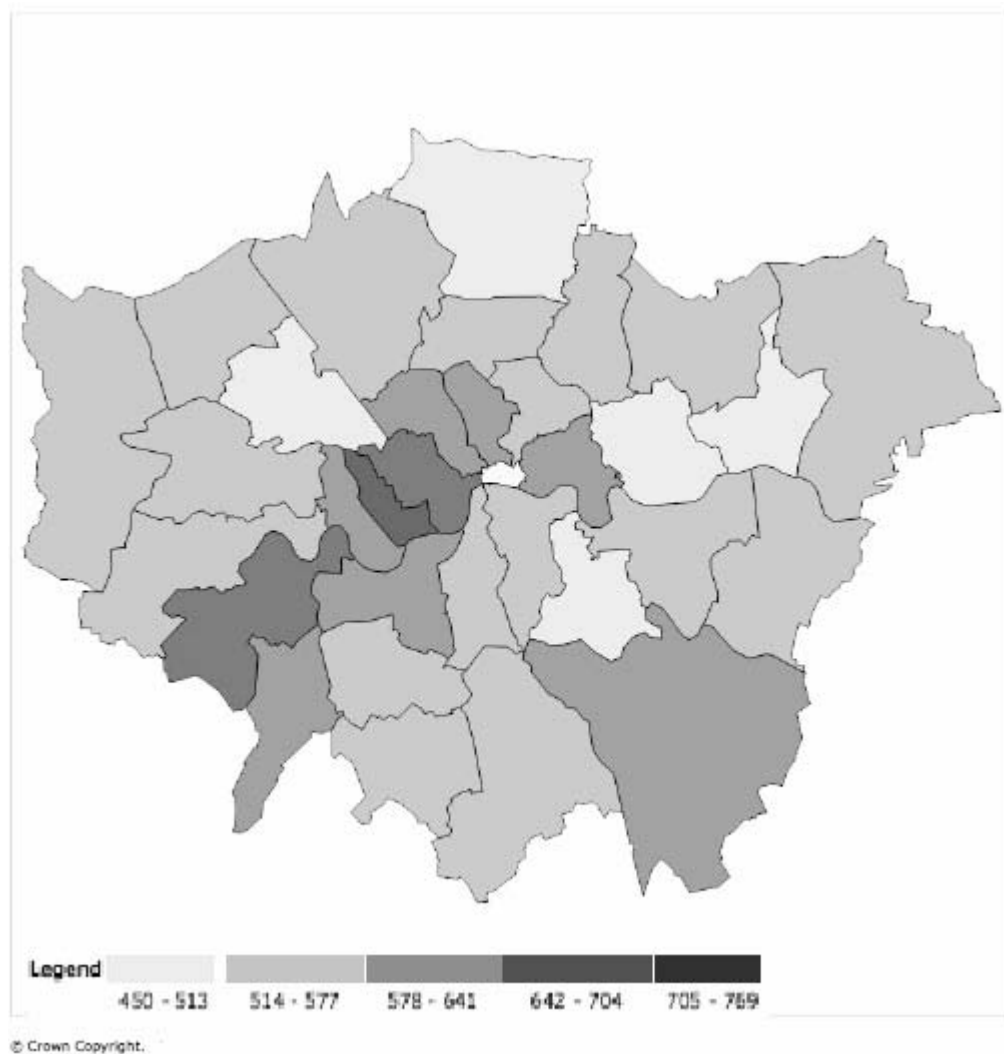
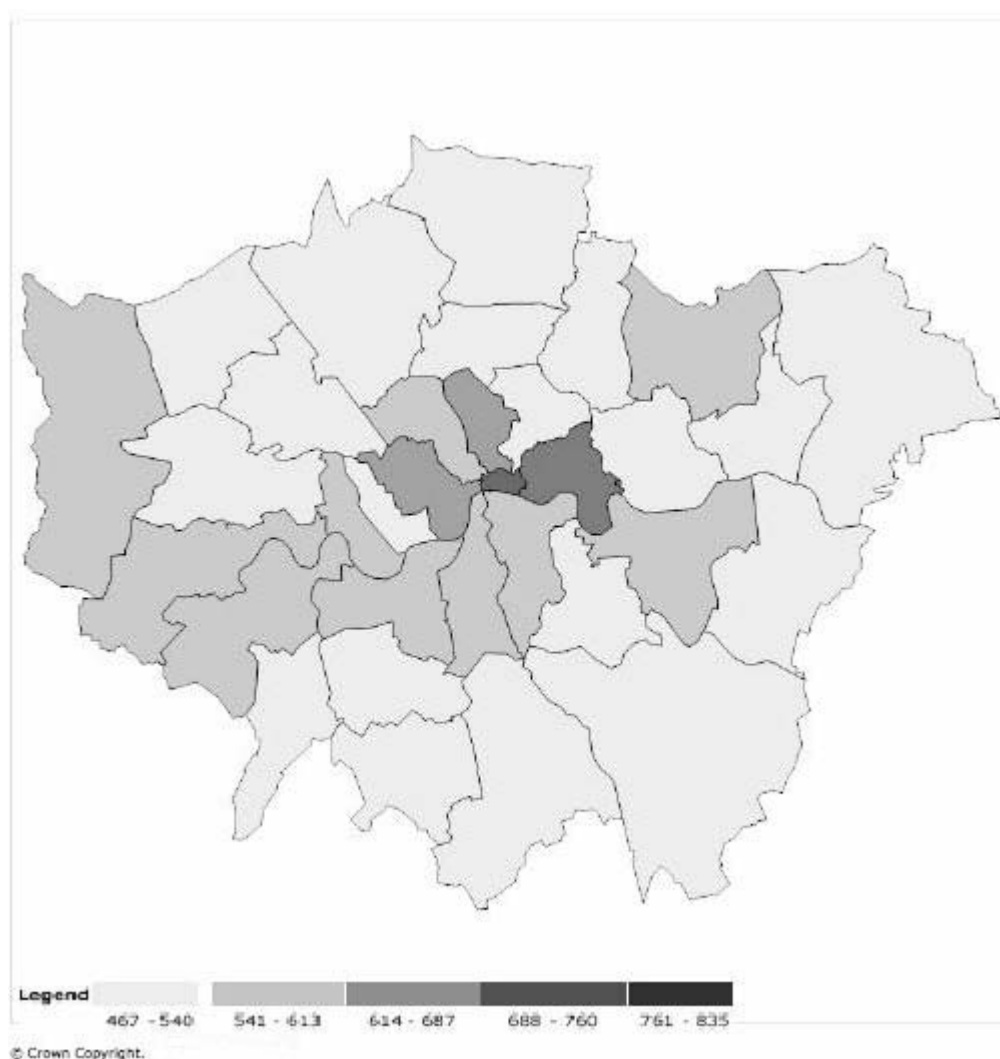


Figure 6.3, by contrast, looks at median weekly earnings by workplace. Here, the City of London and Tower Hamlets appear as the boroughs with the highest earnings, followed by Westminster and Islington. Most of the other boroughs with higher incomes are to the west of the city centre. The implication of Figures 6.2 and 6.3 is that significant levels of income are generated in the centre, notably in the City, Tower Hamlets and Westminster, with commuters taking home the incomes to boroughs such as Bromley, Richmond, Kingston and many other outer boroughs.

Figure 6.3 Median Weekly Earnings by Borough of Workplace



In the league table of residents' weekly earnings, Kensington & Chelsea stands on its own, almost £100 ahead of any other borough, with the next highest paid groups of residents found *either* among some of its neighbours in the inner west and central area or in the outer south (Table 6.4). At the other end of the distribution, none stands out like Kensington & Chelsea at the top. Newham appears at the bottom of the distribution. Of the others with below average residents earnings, a majority were on the east side of the city, but with various exceptions including Brent and Hounslow in the west – and Croydon in the outer south.

Estimates of average employment incomes from tax returns show a similar ranking but with a wider spread, with a mean value recorded for employed taxpayers in Kensington five times that in Newham. The implication is that earnings of those in the highest bands are not effectively covered by ASHE data. Adding in other sources of income further increases the proportionate disparity between the richest and poorest boroughs, since unearned income is especially concentrated in those areas whose residents receive the highest earnings from work.

In terms of mean income per taxpayer the ranking of boroughs is similar to that on pay rates. But the gap between the most affluent boroughs (Kensington, Westminster and the City, all over £68,000), and those with the lowest incomes (Newham, Barking and Waltham Forest, at £22,000 or below) is much more striking (Table 6.4). At the top end, however, these averages are clearly pushed up greatly by a minority of extremely high earners, notably in Kensington – where the income of the median taxpayer is only a quarter that of the recorded mean – and in Westminster where the equivalent ratio is 40%.

None of these indicators (focused on earners and taxpayers) convey much information about borough variations at the bottom end of the income distribution, which are better represented by simple employment and unemployment rates. In these terms, the boroughs whose residents are clearly doing least well are particularly concentrated in the inner east (including all five boroughs with double digit unemployment rates in 2007). The proportion of working age residents in jobs was actually lowest in Tower Hamlets (at 57% against a London average of 70%), even though average earnings of those in work there were clearly above the London average). Newham was almost as bad, followed by Hackney, continuing a long-established pattern of East End-deprivation. But Westminster (though with below average unemployment) also displayed one of the lowest employment rates, as a result of a concentration of economically inactive residents, for example, in wards around Maida Vale and Church Street, alongside its large numbers of high earners.

Table 6.4 Residents' Affluence and Employment by Borough

	Median Resident Earnings per week 2007	Employment Rate (working age) 2007	Unemployment Rate (working age) 2007	Annual Income 2005/6 (000s)		
				Mean per taxpayer	Median taxpayer	Estimated Mean per resident
Central						
City	n.a.	89%	n.a.	£90.6	£49.3	£116.2
Westminster	£668	64%	6%	£68.1	£27.1	£30.8
Inner East						
Greenwich	£540	68%	9%	£25.5	£18.2	£12.5
Hackney	£520	63%	12%	£24.6	£19.3	£10.9
Haringey	£526	66%	8%	£29.5	£18.8	£15.3
Islington	£580	69%	8%	£39.0	£22.8	£19.3
Lambeth	£537	69%	10%	£28.7	£20.7	£14.1
Lewisham	£506	68%	11%	£25.2	£20.0	£12.2
Newham	£449	58%	11%	£19.2	£15.2	£8.4
Southwark	£559	67%	8%	£29.5	£20.0	£14.6
Tower Hamlets	£594	57%	12%	£31.5	£19.8	£13.2
Inner West						
Brent	£475	70%	9%	£23.2	£17.6	£11.5
Camden	£636	68%	7%	£56.2	£24.2	£24.0
Ealing	£536	69%	7%	£26.9	£19.0	£14.5
Hammersmith	£613	71%	8%	£43.1	£23.0	£21.9
Kensington	£768	67%	5%	£109.0	£27.3	£45.3
Wandsworth	£613	75%	6%	£44.1	£24.5	£24.5
Outer East						
Barking	£494	68%	9%	£20.6	£17.9	£10.3
Bexley	£546	76%	4%	£24.0	£19.4	£13.1
Havering	£548	79%	3%	£25.0	£20.2	£14.8
Redbridge	£566	67%	6%	£26.5	£20.0	£12.8
Waltham Forest	£514	68%	7%	£22.0	£17.7	£11.3
Outer South						
Bromley	£605	82%	4%	£31.4	£22.4	£18.2
Croydon	£525	74%	7%	£25.8	£19.6	£13.2
Kingston	£611	74%	3%	£33.4	£22.4	£18.4
Merton	£548	79%	5%	£34.8	£20.5	£18.1
Richmond	£671	79%	5%	£47.5	£25.8	£27.0
Sutton	£540	76%	7%	£26.3	£20.2	£14.4
Outer West						
Barnet	£549	71%	4%	£35.6	£21.2	£17.4
Enfield	£511	67%	6%	£25.8	£18.9	£11.9
Harrow	£558	75%	5%	£29.2	£20.7	£15.8
Hillingdon	£531	66%	6%	£26.3	£20.2	£13.3
Hounslow	£515	70%	5%	£26.9	£18.8	£14.4
Greater London	£553	70%	7%	£32.8	£20.3	£16.5

Sources: earnings from ASHE; employment and unemployment rates from APS; income and taxpayer numbers from HMRC Income Distribution report; population estimates from ONS

Note: income per head estimates assume taxpayers file from their area of residence.

These two aspects of income and employment variation across the boroughs can be put together in a single (approximate) estimate of taxable income per resident by combining the HMRC data on incomes and taxpayer numbers with mid-year estimates of the resident population. This could be distorted in places (including the City) which accommodate many people with multiple addresses, and whose tax returns may not be filed from places of 'usual residence'. In general, however, the adjustments from a per taxpayer to a per resident basis compare well with the evidence on variations in employment rates.

The results (in the final column of Table 6.4) should thus provide a reasonable picture for most boroughs of the scale and pattern of variations in the income of residents. Even if the very high figure suggested for the City is discounted, they suggest considerable variations in prosperity between borough populations, at local as well as sub-regional scale. The half dozen least affluent boroughs thus seem to include not only Hackney and Newham (in the inner east), together with Barking and Waltham Forest (in the outer east), but also Brent (in the inner west) and Enfield (in the outer west).

Within London's strongly integrated labour and housing markets, these differences in economic outcomes primarily reflect patterns of residential differentiation, fitting groups with specific combinations of characteristics into places offering different types of housing opportunity. Three of the significant dimensions on which local populations vary are highlighted on the left hand side of Table 6.5. The extent of social housing within the overall housing stock is still a key influence on the social class mix of boroughs, and more specifically of disadvantaged groups including poorer lone parent families.

There is a significant element of social housing still in all boroughs, even in the outer south. Barking has a notably high proportion of social tenants. But the strongest concentrations are still in the inner east, in boroughs close to the CBD. These concentrations slow down the pace of change in social composition in boroughs where gentrification has also been occurring. Many of these new east authorities are also areas which have been strongly affected over the years by immigration and the continuing change in London's ethnic mix, which represents a second influence on differences between areas. Ethnic minority populations form a significantly smaller part of the population in some outer boroughs, Bexley, Havering and Bromley in particular. But there are major concentrations of various minorities in boroughs throughout the city and a substantial 'minority majority' in two, Brent and Newham, respectively on the western and eastern edge of inner London.

A third important dimension of population variation is that of 'life cycle stage' and household structure, one significant aspect of which is the balance between couple-based and other households. In inner areas household composition is very different from the national norm while in suburban boroughs, couples predominate. Boroughs differ in many more subtle ways in terms of their housing stock, residential environments and the groups who concentrate in different places. But combinations of these three basic

dimensions provide some of the key background to the different social outcomes realised in each.

The right hand side of Table 6.5 shows three indicators of 'problem' facing borough residents. The broadest of these, by design, is general social deprivation, summarised in the DCLG Index of Multiple Deprivation. This summarises a wide range of different kinds of outcome, but with a geographic pattern rather similar to that of unemployment. Variations are evident within each of the sub-regions, and both Waltham Forest and Barking in outer London score relatively highly on this, but high levels of measured deprivation are especially concentrated in the boroughs of the inner east, most prominently in Hackney, Newham and Tower Hamlets.

The second, logically distinct, problematic outcome for which data are presented is that of violent crime. There are some evident similarities in the distribution of this indicator and multiple deprivation, with both particularly affecting the inner east. But there are indications that this is more generally an 'inner city' problem, with the highest incidence in the central boroughs where deprivation is not so high, followed by Islington and Southwark (with lower deprivation scores than some other inner boroughs. Camden also has a relatively high violent crime rate, as do Brent, Hounslow, Waltham Forest and Barking. Finally, measures are presented for the age-standardised mortality rate in each borough (which when inverted represents life expectancy). These vary quite strikingly between 57 in the City (or 65 in Kensington to take a bigger example) and 117 in Lewisham. There are some unexpected variations in the borough by borough figures. But the broad areas which do best are the outer south and the outer west, other than Hounslow.

In each of these cases a simple generalisation might be that inner areas still have worse outcomes. Experimental correlation of each with the three indicators of variations in social/demographic composition presented on the left hand side of Table 6.5 indicates, however, that there are actually quite different patterns and associations. The deprivation index seems to reflect a combination of social housing and minority ethnic representation. The distribution of violent crime is, however, apparently associated more with the share of non-couple-based households. And, finally, higher mortality rates seem to be associated with a combination of more social housing and more couple-based households. There is no straightforward relationship between the relative disadvantage of a population and any particular negative (or positive) outcomes affecting it.

Table 6.5 Indicators of Borough Social Structure and Outcomes

	Social Housing Owner 2006	Minority Ethnic Population 2005	Couple-based Households 2004/5	Crimes of Violence Per 1000 residents	Index of Multiple Deprivation	Standardised Mortality Rate
Central						
City	15%	30%	25%	120.4*	12.84	57
Westminster	22%	51%	31%	51.1	26.3	79
Inner East						
Greenwich	35%	33%	41%	41.3	33.94	113
Hackney	48%	53%	32%	47.3	46.1	97
Haringey	30%	52%	38%	41.8	35.73	94
Islington	44%	42%	31%	48.7	38.96	107
Lambeth	41%	46%	32%	46.9	34.94	107
Lewisham	31%	44%	39%	45.1	31.04	117
Newham	31%	67%	38%	45.7	42.95	115
Southwark	47%	47%	35%	49.1	33.33	98
Tower Hamlets	41%	56%	37%	45.5	44.64	107
Inner West						
Brent	24%	69%	46%	40.8	29.22	88
Camden	36%	48%	32%	41.9	28.62	100
Ealing	20%	54%	49%	33.7	25.1	93
Hammersmith	33%	40%	34%	37.0	28.07	89
Kensington	22%	50%	31%	24.1	23.51	65
Wandsworth	22%	34%	39%	29.4	20.34	103
Outer East						
Barking	32%	27%	47%	38.4	34.49	112
Bexley	13%	16%	57%	23.0	16.21	90
Havering	14%	12%	59%	21.5	16.07	100
Redbridge	9%	47%	54%	22.3	20.36	96
Waltham Forest	22%	47%	44%	42.8	33.19	107
Outer South						
Bromley	12%	17%	55%	22.4	14.36	85
Croydon	17%	40%	47%	29.3	21.31	93
Kingston	11%	28%	52%	24.7	13.1	90
Merton	14%	39%	49%	23.4	14.62	84
Richmond	12%	24%	49%	16.1	9.55	81
Sutton	15%	20%	53%	21.2	13.98	91
Outer West						
Barnet	14%	42%	51%	24.3	21.16	87
Enfield	16%	43%	51%	25.0	26.19	93
Harrow	11%	53%	57%	19.1	15.59	85
Hillingdon	18%	32%	54%	29.9	18.56	93
Hounslow	22%	46%	49%	35.6	23.2	104
Greater London	24%	42%	44%	34.1		

Sources: DCLG Survey of English Housing; ONS; DCLG; Home Office; DCLG/ONS; and ONS.

* This seemingly high level reflects the low number of residents in the City of London

Chapter 7: London's Position within UK Public Finances

London is often described as the 'engine' of the UK economy. In fact, the capital and its wider region – including the South East and the Eastern regions – together constitute the wider 'London' economy. This area is referred to in common parlance (and in this report) as the Greater South East. This super-region, with a population of over 21 million, is analogous to the 17-county New York-New Jersey region in population, size and economic importance. Public debate in the UK generally treats London as a 'region', whereas it is really a built-up area at the centre of a much larger regional economy.

7.1 Public spending within each region

A large proportion of taxation in the United Kingdom is set centrally. The Chancellor of the Exchequer sets rates of income tax, Value Added Tax, customs and excise duties, national insurance payments and many other revenues (HM Treasury, 2008a). Locally raised income – the council tax – is, in effect, capped because the government pre-determines a maximum tax increase each year. If councils exceed this norm, they face being capped. Thus there is discretion in setting tax levels only at central government level. Regional institutions in England, with the exception of the Greater London Authority, have no tax-raising powers.

The centralised nature of tax determination has the effect of ensuring that the allocation of United Kingdom public expenditure is also centrally determined. Public expenditure on social security, the National Health Service, defence and on many other aspects of government is wholly determined within Whitehall. Local government has some discretion over its budgeting, though overall levels of expenditure are heavily influenced by powerful equalisation grants that redistribute resources from area to area. Regional bodies depend for 100 per cent of their income on Treasury allocations.

Spending blocks allocated to the devolved governments and administrations in Scotland, Wales and Northern Ireland are based on the 'Barnett formula', which from the late-1970s onwards has determined the share of public expenditure (making allowances for population changes) given to each country within the UK. In England, the regional share of public expenditure is determined by a number of resource allocation mechanisms for local government, health authorities, further and higher education and via the social security system. There are many one-off and special-purpose grants for central and local government projects. Thus, for example, a major rail or tramway project may receive Exchequer support, as may disaster relief following floods or other natural events.

Efforts to allocate public expenditure on an area-by-area basis have long been rendered problematic by the lack of data about some allocation systems. The only reasonably comprehensive source is the Treasury's annual *Public Expenditure Statistical Analyses* volume, which includes a region-by-region breakdown for just under 83 per cent of public expenditure.

The Treasury has often been cautious about the precision of this kind of analysis, particularly because of the difficulty of allocating spending to reflect the benefits accruing to those living in a particular area (HM Treasury, 2003). Nevertheless, the government undertakes an annual exercise to estimate public expenditure on services within every region of the UK. Even this operation has limitations, as some elements of expenditure, e.g., defence and overseas representation, are often not identifiable with a particular location. But, as the Treasury's data are currently the only ones available – and official – it would be eccentric to use any others. There have from time to time been reviews of how this exercise is undertaken and improvements are made to the methodology (Cameron et al, 2004).

The government undertakes its annual exercise to allocate public expenditure to each country and region within the UK, taking account of where money is actually spent. This exercise covers all expenditure by central and local government and also social security payments. Earlier volumes of *London's Place* (City of London, 2007) have considered the two ways of allocating expenditure: where spending occurs (the 'for' basis), or which region actually benefits (the 'in' basis). As the Treasury adopts the 'for' basis, which is anyway the superior method, this report does the same (see Appendix 1).

It is now possible to make calculations for 2006-07. Part of the overall spending total cannot be allocated because data do not exist to allow such an attribution to each country or region. In 2006-07, the unallocated margin amounted to £96 billion. As in earlier LPUK documents, we have attempted to make a reasonable allocation so as to allow a region-by-region comparison of overall spending with taxes paid.

A number of less-than-perfect methods can be used to attribute this total to the nations and regions. The two most reasonable are (a) using population, or (b) allocating the non-identifiable 'margin' on the basis of the 'identifiable' shares. A third method, using public-sector pay as a basis, has been attempted in the past, though it is not clear how this approach avoids the difficulty of merely reflecting much of the 'identifiable' allocation method once again. In the end, the relatively small margin-on-margin differences between the approaches make little difference to the final results.

The Treasury's *Public Expenditure Statistical Analyses* (PESA) series (HM Treasury, 2008b), published annually, provides public expenditure allocations by nation and region for the whole of the UK. In recent years, the publication has been expanded so as to include more detail about current and capital expenditure on individual services. It is these figures that are the basis for the 'expenditure' totals shown in the following paragraphs.

The results for 2006-07 are shown in Table 7.1 below. Numbers are shown for the 'identified' total of expenditure and for the two variants of 'unallocated' expenditure. The resulting range shows the expected maximum and minimum spending totals for each nation and region.

Table 7.1: Public expenditure by region, 2006-07 (£billion)

	'Identifiable'	Non-Identifiable (a)	Non-identifiable (b)	Total
North East	20.17	4.35	4.04	24.21-24.52
North West	53.15	11.49	10.81	63.96-64.64
Yorkshire & Humberside	36.57	7.90	8.11	44.47-44.68
East Midlands	28.23	6.10	6.88	34.33-35.11
West Midlands	38.05	8.21	8.48	46.26-46.53
East	34.63	7.48	8.86	42.11-43.49
London	64.23	13.88	11.86	76.09-78.11
South East	50.78	10.98	13.01	61.76-63.79
South West	33.37	7.21	8.08	40.58-41.45
'Greater SE'	149.64	32.34	33.82	181.98-183.46
Scotland	43.72	9.44	8.08	51.80-53.16
Wales	24.24	5.23	4.69	28.93-29.47
Northern Ireland	15.66	3.38	2.75	18.41-19.04
Outside UK	11.66	0	0	11.66
United Kingdom	454.45	95.65	95.65	550.10

Source: Public Expenditure Statistical Analyses 2008, Table 9.1. For consistency, population figures used in 'Non-identifiable (b)' calculated from Table 9.1 and 'per capita' figures in Table 9.2

London has the largest total of public expenditure, with about 14 per cent of that for the UK as a whole, while the city's share of UK population is 12.5 per cent. Thus, while the London share is above a crude population-based one, it is not significantly higher. Scotland, Wales and Northern Ireland are in a similar position, with a spending share in excess of their population share. These comparisons ignore the fact that while London is viewed as a 'region' for UK governance and planning, it is actually a large city. The capital's 'region' is probably better defined as London, plus the South East and East regions. The totals for the Greater South East area are also shown in Table 7.1. The GSE has 33 per cent of UK public expenditure, which is close to its share of the country's population. Given the relatively high costs of service provision in this part of the country, the implication is that overall spending is not significantly out of line, or 'unfair', as compared with a reasonable expectation for the delivery of broadly similar services from place to place within the UK.

Using the figures given in Table 7.1, it is possible – for ease of comparison – to work out a notional mid-point between the maximum and minimum expenditure level for each region and country of the UK. Table A-1 in Appendix 1 shows these mid-point figures.

7.2 Regional spending on services

The government has in recent years expanded the scope of its analysis of national and regional expenditure analysis. Table 7.2 compares total per capita spending on different functions within each region in 2006-07. It is worth repeating, however, the point made above about the difference between London as a 'city region' and other regions that are a mixture of urban and rural areas. The GSE, as London's region, is shown in Table 7.2 so that London's 'regional' position can be more appropriately compared with other regions.

London has an above-average spending per head in all the service-groups shown except 'housing and community amenities', where it is slightly below the UK average. London spends almost double the average figure on 'public order & safety', which reflects the high costs of security, diplomatic and royal policing within the capital. Unsurprisingly perhaps, within the 'economy, development' sub-head, London's transport spending is almost double the UK average (£641 per head compared to the UK average of £326), reflecting the significant costs of maintaining and improving the rail and Underground networks in the city.

Public expenditure on health and education varies less from region to region than the equivalent figures for other services. Because both services are under pressure to provide equal outcomes from place to place, there is less room for variation in spending than in, say, transport. London's health spending is about eight per cent above the UK average, while education spending is 18 per cent higher – the highest of any nation or region, including Scotland.

Overall, London's public expenditure per head is higher than that of every other country or region except Northern Ireland. Scotland's spending per head is slightly lower than the London total. Though figures for 2007-08 suggest Scotland has again 'overtaken' London in recent years, the two areas have generally had very similar levels of expenditure per head. The position for the GSE is significantly different however. Overall expenditure per head is shown as £7,007, 4 per cent below the UK average. Given the high costs associated with provision in London and many parts of the South East, the fact that GSE spends less per capita than the UK suggests the level of public expenditure in the 'London region' is not out of line with reasonable expectations.

Table 7.2: Identifiable public expenditure, by function and region, 2006-07 (£ per head)

	Public Order & safety	Economy, Developm't	Housing	Health	Education	Social Protection	Other	Total
North East	476	629	208	1678	1280	3260	361	7892
North West	500	591	169	1657	1206	3136	497	7756
Yorkshire & H'side	441	531	129	1534	1191	2887	398	7111
East Midlands	367	486	101	1383	1145	2653	333	6468
West Midlands	442	502	90	1531	1232	2915	378	7090
East	345	438	35	1368	1066	2548	377	6177
London	808	886	105	1677	1440	2954	680	8550
South East	366	426	28	1402	1080	2470	393	6165
South West	343	500	44	1417	1077	2753	379	6513
'Greater SE'	516	591	57	1490	1203	2661	489	7007
Scotland	419	945	192	1771	1388	3123	706	8544
Wales	445	761	258	1664	1255	3241	548	8172
Northern Ireland	780	743	138	1671	1372	3363	923	8990
United Kingdom	470	607	111	1548	1216	2876	480	7308

Source: PESA, Table 9.11

7.3 Public Expenditure within the Wider Economy

Countries and regions within the UK have widely different economies. The variations in public expenditure per head shown in the tables above need to be set in the context of the whole economy of each locality. Table 7.3 expresses the mid-point estimate of public expenditure (see Table A-1 in Appendix 1) as a percentage of the Gross Value Added of the whole regional economy. Using this measure, public spending is a relatively small share of the capital's economy (35.4 per cent), with relatively low numbers in the South East and East as well.

Public expenditure represents just under 38 per cent of the GSE economy, significantly lower than any other region or country within the UK. Given the size of the whole economy in the GSE, the implication of this analysis is that the private sector economy in the wider London region is very much larger

(within a relatively small geographical area) than anywhere else in the country. Going further, the implication is that for a given amount of public sector input, the London and GSE private sectors produce a far greater level of output.

Thus, levels of public spending can also be expressed as an amount per job in the region. Using this measure, public expenditure 'per person with a job' in London is below the national average. This suggests that despite the need to invest in public transport and other services related to operating within a city, the level of spending in relation to economic activity appears relatively low.

Table 7.3: Public expenditure within the regional economy, 2006-07

	Public Expenditure		
	Mid-point estimate (£bn)	As % of GVA	Per employee (£)
North East	24.36	62.8	20,600
North West	64.30	57.8	19,400
Yorkshire & H'side	44.58	54.3	17,400
East Midlands	34.72	46.8	16,100
West Midlands	46.39	52.1	17,300
East	42.80	43.2	15,300
London	77.10	35.4	16,500
South East	62.78	37.5	14,300
South West	41.02	45.8	15,800
'Greater SE'	182.72	37.8	15,400
Scotland	52.48	57.7	19,700
Wales	29.20	68.3	20,700
Northern Ireland	18.73	70.1	22,600
Outside UK	11.66		
United Kingdom	550.10	47.6	17,600

Sources: (i) Public Expenditure: As Table 7.1 above; (ii) GVA taken from *Regional Trends* 40, Table 12.1; (iii) Employee numbers from *Regional Trends* 39, Table 5.5

A further implication of the figures in Table 7.3 is that the private sector within London and the GSE will be very significantly bigger than elsewhere. The London and South East economies are the largest in the UK, so if public expenditure is a relatively small share of the total, the overall scale of private enterprise must be absolutely and relatively greatest within the country as a whole. The corollary of this is that in the Midlands and northern regions, the scale of the private sector economy will be far smaller and, indeed, more geographically dispersed.

7.4 A regional analysis of tax and other revenues

The UK government does not produce systematic analyses of taxes paid within each region. There is also the issue, raised above in the context of

public expenditure, of whether the taxes paid in a region should be wholly attributed to the region. In particular, the question of 'residence' and 'workplace' is particularly important in London, though not so if the GSE is treated as a single unit. With income tax and National Insurance, in particular, commuting makes a significant difference to London's regional total of tax paid. There are good arguments for taking both 'residence' and 'workplace' totals as indicative of the tax paid, albeit as the answer to rather different questions. Thus, the income tax and NICs paid by residents provide an answer to the question "how much tax was paid by people who live in this region?". The relevant totals thus provide evidence about the level of private resources available within the area. The equivalent totals for the local workforce answer the question "how much tax was paid by everyone who works in the region?" and are therefore a better guide to the overall economic importance of the area.

There are good figures for income tax, council tax, national non-domestic rates and stamp duty, but very few reliable numbers for most other taxes. It is therefore necessary to rely on reasonable proxies to allocate many taxes and revenues between nations and regions. Moreover, in the GSE, where hundreds of thousands of people commute from the South East and the East into London each day, estimates based both on 'residence' and on 'workplace' are crucially important. Income tax and national insurance contributions earned in London (i.e., 'workplace' taxation) will be greater than those of residents.

Tables 7.4a and 7.4b show taxes and other revenues attributed to each region and country. Table 7.4a is on a 'residence' basis and Table 7.4b on a 'workplace' basis. 'Other' taxes are allocated as shown in Appendix Table A-2 and then summarised in the right-hand column of Tables 7.4a and 7.4b.

Table 7.4a: Public revenues – residence basis, 2006-07 (£bn)

	Income tax		NI		VAT		Other		Total	
	£bn	%	£bn	%	£bn	%	£bn	%	£bn	%
North East	4.3	2.9	3.0	3.4	2.6	3.4	7.2	3.6	17.1	3.3
North West	13.0	8.8	9.5	10.9	7.7	9.9	21.0	10.4	51.2	10.0
Yorkshire & H	9.6	6.5	6.6	7.6	5.7	7.3	14.6	7.3	36.5	7.1
East Midlands	8.9	6.1	5.9	6.8	5.1	6.6	13.3	6.6	33.2	6.5
West Midlands	10.3	7.0	7.2	8.3	6.1	7.9	16.1	8.0	39.7	7.7
East	15.7	10.6	8.6	9.9	7.5	9.7	18.8	9.3	50.6	9.9
London	29.5	19.9	14.1	16.1	13.5	17.4	32.5	16.1	89.6	17.4
South East	27.1	18.3	12.7	14.5	12.2	15.7	30.1	14.9	82.1	16.0
South West	10.9	7.4	6.9	7.9	6.1	7.9	17.1	8.5	41.0	8.0
<i>'Greater SE'</i>	72.3	48.8	35.4	40.5	33.2	42.8	81.4	40.3	222.3	43.3
Scotland	10.7	7.3	7.4	8.5	6.2	8.0	17.5	8.7	41.8	8.1
Wales	4.9	3.3	3.4	3.9	2.9	3.8	8.0	4.0	19.2	3.7
Northern Ireland	2.9	1.9	1.9	2.2	1.8	2.3	5.2	2.6	11.8	2.3
United Kingdom	147.8	100	87.3	100	77.4	100	201.4	100	513.8	100

Table 7.4b: Public revenue – workplace basis, 2006-07 (£bn)

	Income tax		NI		VAT		Other		Total	
	£bn	%	£bn	%	£bn	%	£bn	%	£bn	%
North East	4.3	2.9	3.0	3.4	2.6	3.4	7.2	3.6	17.1	3.3
North West	13.0	8.8	9.5	10.9	7.7	9.9	21.0	10.4	51.2	10.0
Yorkshire & H	9.6	6.5	6.6	7.6	5.7	7.3	14.6	7.3	36.5	7.1
East Midlands	8.9	6.1	5.9	6.8	5.1	6.6	13.3	6.6	33.2	6.5
West Midlands	10.3	7.0	7.2	8.3	6.1	7.9	16.1	8.0	39.7	7.7
East	13.9	9.4	7.7	8.8	7.5	9.7	18.8	9.3	47.9	9.3
London	32.8	22.2	15.7	18.0	13.5	17.4	32.5	16.1	94.5	18.4
South East	25.6	17.2	12.0	13.7	12.2	15.7	30.1	14.9	79.9	15.6
South West	10.9	7.4	6.9	7.9	6.1	7.9	17.1	8.5	41.0	8.0
'Greater SE'	72.3	48.8	35.4	40.5	33.2	42.8	81.4	40.3	222.3	43.3
Scotland	10.7	7.3	7.4	8.5	6.2	8.0	17.5	8.7	41.8	8.1
Wales	4.9	3.3	3.4	3.9	2.9	3.8	8.0	4.0	19.2	3.7
Northern Ireland	2.9	1.9	1.9	2.2	1.8	2.3	5.2	2.6	11.8	2.3
United Kingdom	147.8	100	87.3	100	77.4	100	201.4	100	513.8	100

Sources: See Appendix 1 for fuller discussion of sources and methods

Detailed figures, taken from HMRC, show London making relatively large contributions to income tax yields. On a 'residence' basis, London pays 19.9 per cent of income tax, while on a 'workplace' basis, the figure increases to 22.2 per cent. Both of these figures are well above London's 12.5 per cent population share and clearly reflect the relatively high incomes of Londoners and those who commute in. National Insurance Contributions and VAT are also well above a population-based share, though by a smaller margin.

Indeed, the capital makes a contribution above its population share in virtually all cases, including the smaller revenues examined in more detail in Appendix 1. The exception is taxation relating to vehicles, where because of relatively low levels of ownership and use in the capital, tax payments are well below a population-based share.

The taxes paid in the GSE, which remove all cross-border commuting flows between London and the South East/East, suggest the super-region's taxpayers are paying approaching 45 per cent of all UK income tax, even though the area includes only about 35 per cent of the population. This finding provides an early hint as to why the GSE is a significant net contributor of resources to the rest of the UK.

7.5 Contributions to and receipts from UK public finances

Table 7.5 brings together the 'expenditure' figures from Table 7.1 and the 'revenue' totals from Tables 7.4a and 7.4b. The 'difference' between the two figures is a measure of the likely net 'receipt' from the Exchequer or, in London's case, the net 'contribution'. London's net contribution to the UK public finances in 2006-07 will have been in the range £11.5 to £18.4 billion, though this is likely to be a conservative estimate. The actual number could be several billions higher. We have taken care, where there is a choice, to use the most cautious (i.e. anti-London) numbers on the grounds that we

would not wish to be seen to have made decisions that could be interpreted as favouring the capital's financial position.

This figure is in line with the equivalent numbers calculated over a number of years, both in London's Place and elsewhere. For example, Figure 5.1 in LPUK 2007, (undertaken by Oxford Economics), showed a virtual flat line 'mid-point' contribution of between £10 and £15 billion in each year since 2002-03 (OEF, 2007, also GLA Economics, 2005). London's economy, with its concentration of relatively high earners and companies with high value added, tends to make a significant contribution to UK public revenues. Public expenditure in London, though relatively high, is closer to the UK average than its tax payment. The fact that different researchers, over a number of years, have calculated consistent figures for the balance between London's tax payments and its public spending suggests there is broad agreement the capital is acting as a generator of resources for the country as a whole.

It is important to point out that there is no right or wrong total for the scale of the transfer of resources implied. But it is also worth noting that the existing 'net contribution' is a number that, by chance, falls out of the many thousands of decisions made from year to year about taxation and public spending. No public policy attention is given to the scale of the net contribution, a number that would have no existence were it not for publications such as LPUK. But once the calculations have been made, it is possible to ask whether the transfer of resources from London and the GSE to the rest of the country is or is not appropriate. The annual 'net transfer' in recent years has been equivalent to between five and ten per cent of the London GVA. The scale of this transfer probably should be considered alongside the issue of whether London's infrastructure needs to be better maintained or extended.

The economic slowdown that started in 2007 and which continues during 2008-09 is expected to have a particular impact on the financial and business services industry. If this turns out to be the case, it is possible that London's contribution to public revenues will decline, relatively or absolutely. If this were to happen, London's 'net contribution' to UK public finances would fall back to figures below the £11.5 to £18.4 billion suggested here. Assuming, however, that the economy starts to grow again during 2009-10 or 2010-11, the capital's net contribution would be expected to grow once more. Changes in the size of London's 'net contribution' depend to a significant extent on the growth of the London economy in relation to that of the rest of the country.

The three GSE 'regions' each make a net contribution to the UK public finances. Table 7.5 suggests the overall figure is close to £40 billion per annum, though because the assumptions made throughout this report have, where there is any doubt, acted to reduce London's net contribution, the figure could be higher. There is clearly a substantial, annual, shift of tax-funded resources from the southern regions to the northern ones. The calculations undertaken for this report suggest that outside the GSE, the South West and the East Midlands come close to 'breaking even' – that is, their tax payments are broadly the same as public expenditure in those regions, largely because spending is relatively low. The three northern regions,

Scotland, Wales and Northern Ireland are all, on the basis of the current configuration of UK tax revenues, net recipients.

Table 7.5: The revenue/expenditure balance, 2006-07

	Tax paid (£bn)	Public expenditure (£bn)	Difference (£bn)
North East	17.1	24.2 - 24.5	-7.1 to -7.4
North West	51.2	63.9 - 64.6	-12.7 to -13.4
Yorkshire & H'side	36.5	44.5 - 44.7	-8.0 to -8.2
East Midlands	33.2	34.3 - 35.1	-1.1 to -1.9
West Midlands	39.7	46.3 - 46.5	-6.6 to -6.8
East	47.9 - 50.6	42.1 - 43.5	+4.4 to +8.5
London	89.6 - 94.5	76.1 - 78.1	+11.5 to 18.4
South East	79.9 - 82.1	61.8 - 63.8	+16.1 to +20.3
South West	41.0	40.6 - 41.5	+0.4 to -0.5
'Greater SE'	223.3	182.0 - 183.5	+37.4 to +47.2
Scotland	41.8	51.8 - 53.2	-10.0 to -11.4
Wales	19.2	28.9 - 29.5	-9.7 to -10.3
Northern Ireland	11.5	18.4 - 19.0	-6.9 to -7.5
United Kingdom	513.9	550.1	-36.2

Source: derived from Tables 7.1, 7.4 and 7.4b

Note: A range of 'tax paid' is shown for the East, London and the South East because of the difference between 'workplace' and 'residence' tax payments. In other regions, there is no need for such an adjustment because net cross-boundary commuting is de minimis.

7.6 The impact of redistribution from area to area

Previous studies have calculated the 'net contribution' of resources from London to the rest of the UK. This estimated total is a broad-brush attempt to show how far the capital's economy provides resources for the rest of the country. But the implication that Londoners are paying more in tax (and other revenues) than they receive in public expenditure does not tell the full story. If London, because of its relatively high incomes and economic productivity, pays relatively large amounts of tax, how are its citizens left – after tax – in terms of their disposable income? Do they find themselves taxed in such a way that they are left with higher, similar or lower levels of disposable income, as compared to those in other regions, once they have paid their taxes?

A tax and expenditure system that sought to deliver equity between regions might hope to ensure that household disposable incomes were broadly similar from place to place. Or, more plausibly, to ensure increases in disposable income were similar from region to region (or authority to authority). To achieve the former objective, transfers would probably have to be great enough to hold down increases in disposable incomes in faster-growing areas to below those for lagging regions. To deliver on the latter objective, the balance between taxation and public spending ought to be such that 'net

contribution' regions and 'net receipt' regions ended up with similar increases in household disposable income from year to year.

By comparing the increase in the size of each region's economy (as measured by GVA) with the regional increase in gross disposable household income, it is possible to show how growth within a regional economy can be transferred to other parts of the country. Table 7.6 shows GVA growing fastest in London – and the GSE – between 2000 and 2005, while gross disposable household income rose most slowly in London. The implication of this finding is that the tax and public expenditure systems transferred resources from the part of the country where the income was generated (London and the GSE) to those with slower growth and GVA per head – at a rate faster than would have been required merely to ensure that growth in household disposable income was the same in each region.

As stated earlier, there is no 'right' or 'fair' amount of redistribution from region to region. Public policy under successive governments has accepted that taxation should, overall, be progressive. Consequently, relatively affluent regions will expect to pay more in taxes than they receive back in public expenditure – in the same way that well-off individuals pay more in tax than the value of the public services from which they benefit. But if it were the case that transfers from region to region led to gross disposable household incomes rising faster in places with slower-growing economies than those with faster-growing ones, it would be important that such an objective were fully understood.

Table 7.6: Growth in GVA (Workplace) compared to gross disposable household income per head, 2000 to 2005 (%)

	GVA increase 2000-2005	GVA per head 2006	GDHI 2000-2005
North East	+30.1	15,177	+22.6
North West	+26.3	16,234	+22.1
Yorkshire & H'side	+28.6	15,968	+22.4
East Midlands	+32.2	16,962	+25.6
West Midlands	+25.0	16,583	+22.0
East	+32.1	17,652	+21.5
London	+33.4	26,959	+18.2
South East	+30.8	20,316	+19.4
South West	+32.8	17,467	+22.7
Scotland	+28.5	17,789	+23.5
Wales	+27.6	14,396	+25.6
Northern Ireland	+30.2	15,175	+24.5
United Kingdom	+29.5	19,063	+21.8

Sources: GVA: *Regional Trends 40*, Table 12.1; DHI: *Economic and Labour Market Review*, Vol 2, No 5, May 2008

7.7 The Barnett Formula

The distribution of public expenditure from area to area within the UK is the result of several formulae and innumerable individual decisions by ministers and their civil servants. But the allocation of public expenditure to Scotland, Wales and Northern Ireland is determined by the so-called Barnett Formula, which has been in place since the late 1970s (House of Commons Library, 2007). The Formula ensures that any increases in overall public expenditure within England are reflected in the other UK nations. Broadly, the Barnett Formula ensures that any rise in public spending in England is matched by an equivalent one for Scotland, Wales and Northern Ireland, allowing for changes in population from year to year.

From time to time, official and other reports examine the Barnett Formula and criticise its continued use. In particular, critics point to the fact that the Formula simply maintains per capita public spending relativities between England, Scotland, Wales and Northern Ireland over time. For example, the House of Commons Treasury Committee has stated that it...“was disappointed that no Government studies have been made in relation to the appropriateness of the Barnett Formula and how it relates to needs” (Treasury Committee, 1997). There have also been criticisms of the capacity of Whitehall departments accurately to attribute existing expenditure to nations and regions (McLean, 2003).

After 30 years of operation, there is little political enthusiasm for a review of the Barnett Formula, despite a growth in interest about ‘regional’ public expenditure and the improvement of the figures produced in PESA. The difficulty facing the government is that any review could lead to pressure for a different distribution of resources from the current one. That, in turn, would produce a political response from any regions that lost resources.

It is, therefore, impossible to make any kind of objective judgement as to whether the level of public expenditure in Scotland, Wales, or indeed London, is appropriate.

7.8 Paying for London’s Investment

London’s share of the UK’s population, GVA, taxation and public expenditure is shown below:

Table 7.7: London’s share of UK population, GVA, taxes and expenditure

	% of UK
Population	12.5
Public expenditure	13.8 to 14.1
Taxes	17.4 to 18.4
Gross Value Added (Workplace)	18.8

Sources: Population: ONS; Taxes and Public expenditure: Calculations based on Table 7.6 above; GVA: Focus on London 2008, Table 4.9

London’s population is 12.5 per cent of the UK total. The capital’s GVA is 18.8 per cent of the UK’s, while taxes paid are in the range 17.4 to 18.4 per cent.

Public expenditure as a percentage falls between the population share and the tax and GVA shares. This position, between the population and GVA figures, is to be expected. As explained in earlier sections, parts of London's capacity to generate economic activity is being removed – via tax – and redistributed to other parts of the UK. The key issue for London is whether the share (and thus level) of public spending is sufficient to maintain the capital's capacity to generate taxation in the longer term.

One way of assessing whether or not existing levels of investment in London are appropriate is to analyse levels of capital expenditure as a share of the economy, particularly for services such as transport and housing. It is also possible, using official data, to compare capital expenditure in London with that of the other UK regions. Table 7.8 looks at trends in public sector transport and housing investment, while Table 7.9 compares capital spending in London with that in the other nations and regions.

Table 7.8: Public capital spending as a proportion of GVA, 2001-02 to 2006-07: transport, housing, London

	Transport		Housing	
	£m	% of GVA	£m	% of GVA
2001-02	1188	0.73	623	0.38
2002-03	1658	0.95	613	0.35
2003-04	1874	1.01	754	0.41
2004-05	1844	0.94	1009	0.51
2005-06	2218	1.08	1610	0.78
2006-07	2613	1.20	2074	0.95

Sources: Public Expenditure Statistical Analyses 2006, Cm 6811, Table 7.6b and Public Expenditure Statistical Analyses 2008, HC489, Tables 9.5b, 9.6b, 9.7b, 9.8b and 9.9b; Focus on London, 2008, Table 4.9

Table 7.9 shows that transport capital spending as a proportion of GVA has been growing in recent years. It has ranged from 0.73 per cent in 2001-02 to 1.20 per cent in 2006-07. Housing capital expenditure has shown a broadly similar trend, albeit from a lower base. There is no 'right' or 'wrong' level of public investment in transport or housing in London, but the relatively small percentages shown beg the question of whether such numbers are big enough, particularly during a period when the capital's economy has been growing rapidly.

**Table 7.9: Public capital spending as a proportion of GVA,
2001-02 to 2006-07, all services, UK regions**

	Capital spending as % of GVA
North East	4.1
North West	4.2
Yorkshire & Humberside	3.5
East Midlands	2.7
West Midlands	3.4
East	2.6
London	3.4
South East	2.6
South West	2.6
<i>Greater South East</i>	<i>3.0</i>
Scotland	5.2
Wales	4.8
Northern Ireland	4.7
United Kingdom	3.5

Sources: *Public Expenditure Statistical Analyses 2008, HC489, Table 9.9b; Focus on London, 2008, Table 4.9*

Table 7.9 suggests that overall public sector capital investment in London and GSE is below the UK average. In London's case, investment is equivalent to 3.4 per cent of GVA, slightly below the UK figure of 3.5 per cent. But investment in the whole of the London super-region is 3.0 per cent, significantly lower than the average. Scotland's figure of 5.2 per cent, Wales at 4.8 per cent and Northern Ireland at 4.7 per cent are all significantly above the UK average, suggesting that their governments and administrations give investment a higher priority than Whitehall does for England.

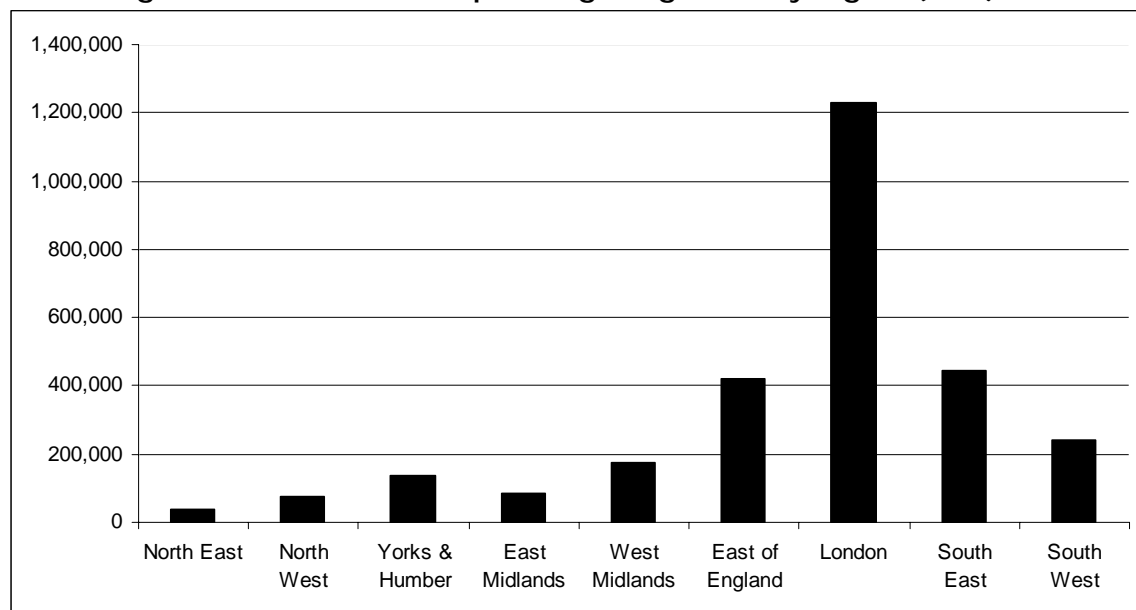
The position of the GSE should be seen against the background of the relatively rapidly growing economies of London, the South East and the East, and the increasing density of population within the core of the super-region. Regions with fast-growing economic activity, particularly where population and economic activity are concentrated within a small area, would normally expect to experience above-average public investment. In the UK, the opposite appears to be the case.

Moreover, London is now expected, in a way that differs from other parts of the country, to contribute directly towards the funding of major infrastructure projects. Thus, the capital's council-tax payers must make an annual contribution towards the cost of the 2012 Olympic Games. Crossrail is largely to be funded by London taxes and fares. At least two-thirds of the £16 billion cost will be financed by a levy on the capital's non-domestic ratepayers, plus borrowing against future fare income. The City of London is also making a direct financial contribution. The East London Line extension will also be partly funded by Transport for London borrowing. Many of the improvements to the

capital's commuter rail system will be funded under an agreement with Whitehall that implies real long-term fare increases.

The value of (S106) planning obligations agreed in London was measured at over £1.2 billion in 2005/06. This accounted for some 43 per cent of all planning obligations across England including over 50 per cent of those for affordable housing but less than 20 per cent of other types of obligation (Figure 7.1).

Figure 7.1: Total value of planning obligations by region (000s)



Source: Crook et al (2008)

The new Community Infrastructure Levy (CIL) is expected to come into force in 2009. It will give local authorities the power to make a formula-based charge for infrastructure on most types of development. One objective is simply to raise more funding for infrastructure; another is to unlock bottlenecks in infrastructure provision; and a third is to increase predictability for developers. S106 will continue for site-specific mitigation and particularly for affordable housing. In the longer term this may increase the amount of funding available although government recognises that the main burden must continue to fall on other funding streams.

In the short term, the economic downturn is likely to significantly reduce the yield of S106 and later the CIL as compared with what might otherwise have been raised. It is impossible to be certain about the extent of the reduction in available resources, particularly because there are two distinct effects – from reduced activity and from less optimism about the future. But because the levy comes from available surpluses, the negative impact is likely to be considerable over the next few years.

Chapter 8: Future Prospects

8.1 Introduction

As ever, the question of London's future prospects has both long-term and short-term aspects to it, which need to be kept distinct. This is especially true in the context of the credit-crunch which has been looming over the city for the past 12 months, without producing much in the way of visible outcomes until recently. Simply put, there is every reason to believe that London's long-run economic prospects are good, even though the immediate future will be extremely challenging. There are also signs that London's economy is showing more resilience than the rest of the country.

In practice the distinction between short and long term perspectives is not quite so simple. This is because underlying trends can only be picked out when appropriate allowance is made for short-term fluctuations, which is more difficult in the absence (these days) of regular cycles. Since 1980 London and the UK have experienced just two clear-cut 'bust and boom' cycles – of rather different characters – followed by a decade of much more modest fluctuations around what appeared a sustainable growth path. In City of London markets, however, the pattern has been rather different, with a full cycle in share prices between 2000 and 2007 – while house prices have continued growing at an above average rate. Such unevenness makes it hard to judge what is normal, especially when there are serious questions about the reliability of key data.

8.2 Long Term Prospects

8.2.1 Forecasts of the London Economy

From its establishment in 2000, the GLA has taken a very positive view of the city's prospects, underpinning its strategies with forecasts of strong long term growth in both population and employment. In the case of population these have rested both on the high birth rate of London's young population and on the last decade's high rate of international immigration. In the case of employment the growth projection rests very largely on a continuation of large scale job growth in business services (mostly outside the financial sector) and in private consumer services. Similar fundamental assumptions are embodied in the long term forecasts produced by other independent consultants. Rather than evaluate all of these existing forecasts, this section simply reviews the two major sets of forecasts emanating from the GLA (in relation to issues discussed earlier in this report) before discussing a new set of long term economic forecasts produced by Oxford Economics for the City of London corporation.

8.2.2 Population and Households

The GLA's most recent population projections present two variants, identified as Post London Plan (PLP) 'High' and PLP 'Low'. The first of these parallels the national government (ONS) projections in assuming that recent migration

patterns into and out of London will continue¹⁹. The second, however, starts from estimates of the numbers of households which could be accommodated within the GLA area, according to the latest London Housing Capacity Study assessments.

Table 8.1: GLA Projections of London Population Change 2006-2026

	Projected change 000s p.a.	
	PLP High	PLP Low
Total population	+53 (0.7%)	+40 (0.5%)
Of which net migration	-16 (-0.2%)	-33 (-0.4%)
Working Age Population	+33 (0.5%)	+24 (0.6%)
Economically Active	+30 (0.8%)	+23 (0.6%)
Households	+35 (1.1%)	+28 (0.9%)

Source: GLA_DMAG (2008)

The difference between these two projections is sizeable, involving over a quarter of a million people by 2026. Together they point to a further significant increase in the pressure of demand for housing in London despite the best efforts of London planners to find potential sites, which it is assumed will be effectively taken up. In effect, the PLP High estimates assume that this will have no impact on migratory behaviour and people will contrive somehow to live inside the GLA area – presumably by limiting the rate of separate household formation or by increased sharing. This was broadly the assumption of the original London Plan, and the PLP High projections take forward much the same rate of population growth as was envisaged there up to 2016.

On the other hand, the PLP Low estimates imply a strong migratory response, with rather fewer people choosing to live inside London in the face of limited housing availability and a further upward pressure on housing costs. Central government population projections have been revised this year further increasing projected population to 2026. In part because of the revised location pattern of migration away from London and in part because of the costs of living in London, population in London is expected to grow more slowly than in the country as a whole. This applies even more strongly to the projected number of households because of the relative tightness of the housing market.

8.2.3 Employment and Output

The latest set of GLA long term employment projections (Spooner and Cooper, 2007) are shown in Table 8.2. These are based on an *assumed* trend growth rate in London GVA growth of 2.5% p.a. (corresponding to the traditional estimate of capacity growth nationally) and historic evidence about the relationship between output and employment growth in London. That evidence shows output per head in London growing by about 1.5per

¹⁹ They actually precede publication of ONS's 2006-based sub-national projections, but aim to show the implications for London of the corresponding projection for England, assuming London's share of international migration continues as in 2001-6.

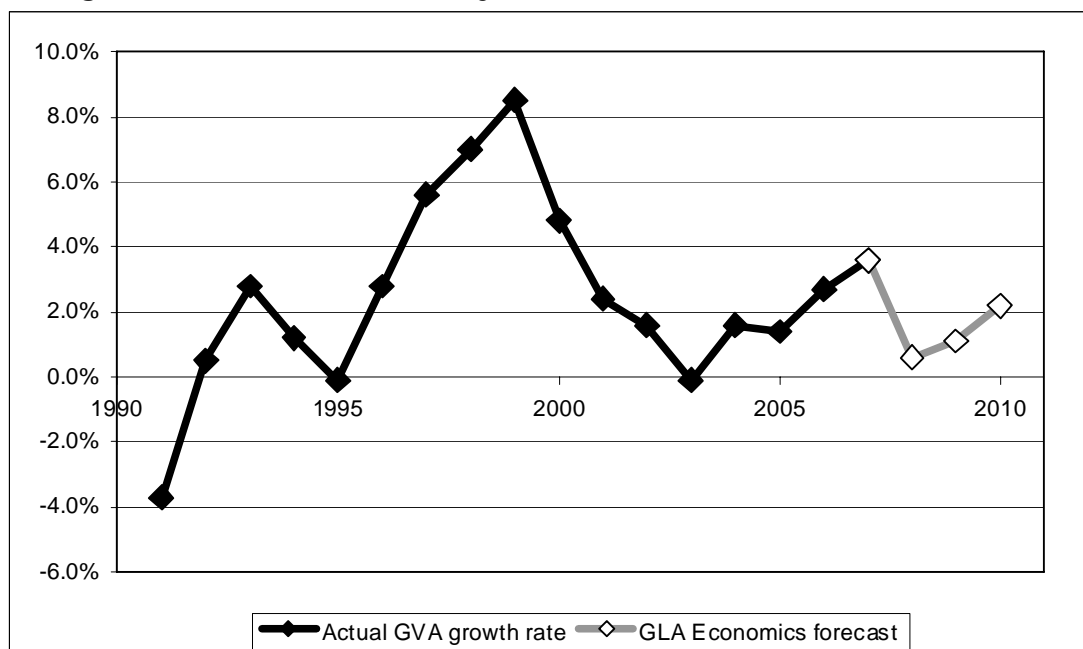
cent p.a. – implying that employment in the city is only likely to increase while GVA grows above this rate. The projected overall rate of employment increase then works out at the difference between this rate and the assumed future GVA growth rate (of 2.5%) – i.e. about 0.9%.

On this basis London employment is projected to grow by 46,000 p.a. over the next two decades. This is half as fast again as the growth of the economically active population envisaged with the High version of the population projections and double that indicated on the Low version. If the Low version really represents the acceptable limits of housing growth, the projected increase in employment might only be achievable with a massive increase of inward commuting.

One obvious question about these projections is whether the assumption about London GVA growth is realistic. The GLA projection is reasonably close to the average which has been recorded since the peak of the 1980s boom. But the record over this period showed a great deal of variability in London's output growth as compared to the economy as a whole even though output in the London economy appears to be tightly tied into fluctuations in the UK macro-economy (especially to service sector output levels).

During the period since 1985 a 1% change in service sector GVA nationally has been associated with a change of about 1.7% in London output. This does not matter for long term projections, so long as the UK economy keeps to its long term growth path. But it does have major implications for the short-medium term.

Figure 8.1 GLA Economics May 2008 Forecasts of London GVA Growth



Source: GLA Economics London's Economic Outlook Spring 2008

Over this time-horizon, the latest forecasts from GLA Economics (2008), published in May, envisage that output growth in London will continue through 2008-9. But the average growth rate would be about 1per cent p.a.

below the trend rate over these two years, before returning more or less to trend in 2010. This would be a rather gentler downturn for the economy than in 2000-02 and much milder than the bust of the early 1990s. Then there were some two years of standstill in GVA, followed by two years of actual recession.

In employment terms, the GLA Economics forecast is essentially one of stability up to 2010, with a possible loss of 20 thousand or so jobs at the worst point, although with some further downside risks are noted for financial services. The most likely outcome was seen as involving rather few job losses (all in 2009). In fact, the most substantial effect was envisaged for other business services, continuing through 2008-10, based on a sharp slowing of expansion, rather than actual contraction in employment. GLA Economics note that these forecasts are below the consensus average of four independent forecasting groups. This might, however, be largely a matter of timing, since expectations have clearly worsened during this year – making the GLA Economics forecasts themselves now (3-4 months later) also seem decidedly optimistic.

Table 8.2: GLA Long Term Employment Projections 2004-2016

	Average Annual Change 0000s and %	
	2004-2016	2016-2026
Production Industries	-8 (-2.3%)	-11 (-2.4%)
Wholesale and Transport	-1 (-0.1%)	-0 (-0.1%)
Business Services and Finance	+27 (2.5%)	+34 (1.5%)
Public Services	-1 (0.1%)	0 (0.0%)
Private Consumer Services	+29 (2.2%)	+24 (2.1%)
Total	+46 (1.0%)	+46 (0.9%)

Source: GLA Economics/Volterra (2007)

Note: Production industries are manufacturing, construction and utilities; public services are public administration, health and education, private consumer services are retail, hotels/catering and 'other services'

8.2.4 Oxford Economics September 2008 Medium Term Assessment

The two GLA long-term forecasts just discussed are both entirely based on data preceding any real impact of the credit crunch on the London economy. A new set of forecasts produced by Oxford Economics (OE) in September 2008 (for the City of London Corporation) incorporates the latest, necessarily limited, statistical information and provides a quantitative assessment of how this crisis may affect longer term trends in the London economy. The results, presented in Table 8.3 (below), may be directly compared with their forecasts from 12 months ago in the previous report in this series (Table 7.1 in OE, 2007).

The OE forecasts last year suggested significantly faster rates of GVA growth than anticipated by GLA Economics. After 3 years in which growth was estimated to have been running at 3.6% p.a., they envisaged it settling back only slightly to a fairly consistent rate around 2.9% over the decade from 2007. The new forecasts, naturally, predict rather slower growth in the next few

years, but still involve an average over the 3 years 2008-2011 of 2.2%p.a. – actually not far below what the GLA took as the long term trend rate of growth. The implication is that, even if growth were to be seriously reduced in the next year or so it would start to make good the ground soon after. In fact, the OE forecasts involve sufficiently rapid growth from 2011 on, to put the London economy back on track for the decade as a whole (with an average growth rate over 2008-18 almost identical to that previously forecast for 2007-17).

Table 8.3: Oxford Economics medium-term forecast for London

	2008	2011	2014	2018
Employment ('000s)				
Primary	18	18	18	18
Manufacturing	224	207	192	175
Construction	219	228	256	265
Distribution	629	621	639	651
Hotels & catering	311	320	329	331
Transport & comms.	340	340	343	342
Financial services	338	306	325	329
Business services	1243	1215	1352	1503
Public admin.	230	233	238	246
Health & education	753	767	788	816
Other services	403	422	441	464
Total employment	4712	4683	4928	5146
Population	7611	7749	8011	8354
Total GVA (£2003bn)	216.8	231.1	260.6	295.7
average annual % change	2005-08	2008-11	2011-14	2014-18
Total employment	0.8	-0.2	1.7	1.1
Population	0.7	0.6	1.1	1.1
Total GVA (£2003bn)	3.4	2.2	4.1	3.2

Source: Oxford Economics (2008)

This is a bullish view, given the scale of adjustment already expected within financial services and construction and the possibility of a more serious general recession. Were the economy to turn down sharply and to take rather more time to recover than projected on current information, capacity would be lost and the trajectory might be expected to be considerably lower.

The sectoral detail provided in OE's employment forecasts suggests some significant differences in the type of growth which OE now project. Over the first three years they see some reduction in London employment (by 29,000) - but this is nothing like the scale observed in the early 1990s downturn. From 2011, if not before, substantial employment growth is projected to resume, yielding a net increase of 434,000 jobs over the decade. This is only about 40,000 lower than forecast last year for the decade to 2017. The increase envisaged across financial and business services is some 90,000 less than was being forecast last year (with no net growth in financial services on their own). This is substantially offset by more positive views now about job prospects in distribution, manufacturing, public services, the 'other services' category (including most cultural/entertainment activities) and perhaps most

surprisingly construction. To achieve these growth rates the London economy would have to recover rapidly – and from a relatively modest down-turn – in terms of both activity and confidence. To achieve this, it would need strong support from government, notably with respect to counter-cyclical infrastructure investment.

8.3 The Current Crisis and its Impacts

The current economic crisis has two, quite separate, aspects. First, in sequence, is the 'credit crunch' which emerged (rather suddenly) in August 2007. This essentially involved a massive reduction in the capacity of financial institutions to lend and the closure of securitisation markets as uncertainties increased about underlying assets, principally in the United States. The subsequent rationing of credit has had its most immediate effects in the housing market, with the drying up of sales and knock-on effects on prices, as concerns about price stability lead potential purchasers to 'wait and see'. More fundamentally interest rates and other costs of borrowing have gone up to reflect increased risks.

Because London's economy is disproportionately focussed on financial and business services, it might be expected that the global credit shock would, equally disproportionately, reduce activity in City industries.

The most concentrated impacts of the crisis so far have evidently been within financial services and related business. The scale of potential job cuts here is indicated in two April 2008 reports by City-based analysts. In the first of these, cebr, (2008) predicted 11,000 job losses in the City during 2008 with a further 8,000 in 2009 – leading to net reductions of 17,000 over the two years. In the second JP Morgan estimated a 40,000 reduction in 'City' jobs (defined slightly more broadly than by cebr). In percentage terms this would be about one quarter less than the aftermath of the dot-com boom, though in absolute numbers it would be a larger reduction because of growth during the last decade.

The finance-related impacts of the crisis will by no means be confined to the City, although the wider ramifications will take time to emerge. The slow release of information about the scale of financial impacts on banks and other institutions has slowed the downward revision of expectations. This process may well still have a long way to go. One reason is that there needs to be a structural shift in confidence to reverse the current 'speculative' lack of demand. Another is that a substantial part of the eventual impact on consumer demand is likely to come as a second round consequence of job losses in those sectors where demand initially contracts.

One sector that has been particularly badly hit is the residential property market where it will take time for the over-adjustment in prices that has occurred in the last few years to unwind and for confidence to return. The downward adjustment could also overshoot. These changes have adverse effects on consumer spending with knock-on effects across the economy.

Into the medium term housing demand pressures depend not so much on short run issues of timing and confidence but on incomes, inflation and unemployment. At the present time these fundamentals are looking less healthy than they were a year ago. In particular, affordability has structurally worsened as a result of the re- evaluation of risk and general inflation. In the longer term, however, supply is highly unlikely to keep pace with either household formation or increasing incomes – so real house prices will rise again.

Such protracted dynamics were evident in the early 1990s recession, which had several similar aspects to the present one, though the immediate trigger at that time was different. Similarities between the early 1990s and the present situation include low savings rates and high house prices, and the concentration of immediate impacts on services, consumption and within affluent regions. In that case the downturn in employment terms went on for almost five years (between the start of 1989 and late 1993) with the majority of the overall 15% contraction in London employment coming in years 3 and 4. In the private sector, financial services lost 50,000 jobs; another 100 thousand went from distribution and catering. Public sector employment also fell. As significantly, other business services which had grown by 18,000 jobs a year over the previous decade went four years without significant growth. London house prices only bottomed out after four years and fell 40 per cent in real terms.

The present situation has a second, different, element, in the sharp upward shift in global energy, food and other commodity prices. There are underlying structural dimensions to these, associated with the demand from an expanding global economy. Yet the rapidity with which prices and investment moved in the early part of 2008 suggests a speculative element, which may well have exaggerated the underlying price shift. In that case the worst impacts from this source may come more rapidly than with the credit crunch, and ease relatively quickly thereafter. In the meantime some industries especially those reliant on oil are facing real difficulties.

There are also likely to be some qualitative differences in where the main impacts of the two shocks (credit crunch and price rises) fall. One aspect of the price rises which is already being felt is to lower real incomes and depress consumption, as people try to rebalance their budgets. This will affect many of the same sectors (and places) as the credit crunch, notably London's service economy.

A second relevant effect is the likely shift of demand. In this respect London should be relatively protected (as it was after the 1970s oil price hikes), since its core sectors are less reliant on such inputs. The one major exception would seem to be the tourist industry (both in respect of long-haul visitors, and discretionary short-term breaks), which does not account for a large proportion of the city economy.

Overall, if these two shocks lead to a slow-down in national growth extending beyond one or two years and/or actual recession, the impact on output and employment levels in London can be expected to be disproportionately

strong. Other parts of the Greater South East would also be substantially affected. But, as in the past, these effects are almost certain to become especially concentrated among groups heavily represented in the inner London population – pushing London unemployment further above levels in other regions.

So far, there is no immediate compelling evidence that the capital's economy has suffered more than the UK as a whole. Unemployment – both in finance and more generally – has not risen more sharply (or earlier) in London than in the rest of the country. Tube and bus use continues to increase strongly. West End property rentals have remained firm. The capital has a number of counter-cyclical, large-scale, investments under way in the Olympics, Thameslink, the East London Line, the Underground PPP and Crossrail. Social housing investment will be significant in London in the period 2008-09 and 2010-11.

8.4 The Long Run View

The origins of the current slow-down in the London economy lie outside the London region, and the UK as a whole, in that commodity markets are global and it was lending in the US (rather than British) housing market which triggered the credit crunch. In normal circumstances, there is no reason why even a sharp downturn in the next year or two should signal any weakening in London's long term economic performance.

The reputations, however, of both British and US finance houses have been seriously damaged by recognition of the processes leading up to the crunch and the inadequacies of the regulatory system in managing both the problems in the wholesale market and more general lending behaviour. There is now serious criticism of the regulatory regime that is seen as having allowed the creation and use of financial instruments that have been at the core of the global financial problems that have gathered pace during 2008. Declining asset values further impact heavily on the capacity to increase liquidity – so declining real estate prices in particular reduce the capacity of financial institutions to respond.

The City of London, which has in recent years made the case that it is the leading centre of global finance, now faces serious challenges to this role. The collapse of leading banks and the need for state aid for other major institutions in the UK and the US will do reputational damage to both London and New York. Although the latest (September) Global Financial Centres Index still shows London and New York as the only truly global financial centres, the gap between these two and Singapore which is now third is narrowing. There can now be little possibility that London's economy can avoid the consequences of these unprecedented difficulties. Moreover there are further risks which cannot be ignored, including in particular the possibility that future governmental efforts to 're-regulate' the finance sector will not take adequate account of the flexible and creative elements of the 'City' economy which have been so important in recent years.

Looking beyond finance, it seems that the potential volatility of the 'new' London economy is about to be exposed once again. But this volatility is linked to the same features that continue to make London a highly competitive economy. London and the Greater South East form a major agglomeration of private sector business activity beyond financial and business services. There is nothing in recent experience which challenges the understanding that scale, diversity, flexibility, international connections and the power to attract talented young workers are crucial assets in the contemporary economy, and ones where London has few rivals internationally – and none within the UK.

Appendix 1: PUBLIC FINANCE CALCULATIONS

A1.1 Allocation of expenditure between regions

The method used in this report, consistent with that used in earlier LPUK volumes, uses the total of expenditure 'for' each region. The Treasury has from time to time considered the merits of both the 'in' and 'for' approaches to public expenditure allocation, concluding that each method has potential uses. The 'in' method would be useful in showing where government locates its output and activities. But it does not show which members of the public benefit from the services and expenditure concerned. Thus, for example, expensive medical care provided in a London teaching hospital will often benefit individuals from outside the capital. The 'for' method records the benefits of public expenditure where the patient lives; not where the service is provided. The 'in' method, on the other hand, will attribute the spending to the home region of the patient.

For the purposes of this study, the 'for' method offers a most appropriate guide to the attribution of expenditure to each nation and region. The purpose of the research is to make an estimate of the amount of public spending benefit in each part of the country and then to compare this with the amount of tax paid. The 'for' method thus provides a more helpful answer to this question.

Table A 1 'Mid-point' public expenditure estimate, by region, 2006-07 (£billion)

North East	24.36
North West	64.30
Yorkshire & Humb'side	44.58
East Midlands	34.72
West Midlands	46.39
East	42.80
London	77.10
South East	62.78
South West	41.02
<i>'Greater SE'</i>	<i>182.72</i>
Scotland	52.48
Wales	29.20
Northern Ireland	18.73
Outside UK	11.66
United Kingdom	550.10

Source: LSE calculation from Table 7.1 in main report

Table 7.1 of the report shows the 'identifiable' total of expenditure within each nation and region, according to the Treasury's most recent PESA calculations. On the right-hand side of Table 7.1 a 'range' of estimated expenditure is shown. Table A.1 below simply estimates the 'mid-point' between the maximum and minimum totals shown in Table 7.1. This figure is then used in subsequent tables.

A.1.2 Regional contributions to UK taxation

The taxes and other revenues shown in this report are derived from a range of sources:

Income Tax totals are taken from Table 3.13 of HM Revenue & Customs's 'Personal incomes by tax year' tables for 2005-06, but using 2006-07 UK tax totals. 2005-06 yields for each nation and region scaled up to 2006-07 UK total.
(See:http://www.hmrc.gov.uk/stats/income_distribution/menu-by-year.htm).

Value Added Tax calculations, reflecting both 'residence' and 'workplace' estimates are based on data taken from the Regional Accounts published by ONS and on retail turnover figures for each region reported by the Annual Business Inquiry.

National Insurance Contributions are derived from ONS publication *Family Spending*, Table A.35, published by ONS. The methodology adopted this year has produced a marginally different (lower) total for London than in the previous document.

Council Tax data are taken from Communities and Local Government Council Tax statistics, adjusted to remove council tax benefit totals which are, in turn, derived from Department of Work & Pensions data on benefit payments and recipients

Non-domestic rate totals are taken from CLG published statistics

Stamp Duty numbers derived from HMRC data published at:
http://www.hmrc.gov.uk/stats/stamp_duty/menu.htm.

Vehicle Excise Duty numbers derived from motor vehicle registration numbers taken from *Regional Trends 40, 2008*, Table 10.1

'Other' revenues allocated between nations and regions on the basis of either residential population or workplace GVA. The purpose of using both a 'population' basis and a 'workplace' GVA basis is to provide numbers that reflect the likely range of revenues contributed by each region. 'Population' based shares will reflect the plausible possibility that 'other' revenues are directly proportional to the share of each region's population. 'Workplace' based shares reflect the possibility that 'other revenues' in London, the East and South East are likely to be higher than a population-based share

because economic activity levels are higher because of commuting. The results are shown in Table A.2 and A3 below.

Table A.2 Minor revenues (for totals, see 'Other' column in Tables 7a and 7b)
(£bn)

	Council Tax	NNDR	Stamp Duty	VED	Corp Tax	Other (GVA)	Other (Pop)
North East	0.71	0.66	0.19	0.19	1.43	3.18	3.94
North West	2.55	2.05	0.69	0.59	4.52	9.24	10.56
Yorkshire & Humber	1.78	1.49	0.52	0.40	2.55	6.81	7.92
East Midlands	1.66	1.23	0.50	0.38	2.78	6.16	6.72
West Midlands	1.94	1.62	0.64	0.49	3.09	7.38	8.28
East of England	2.47	1.74	1.33	0.52	4.12	9.09	8.65
London	3.08	4.63	3.59	0.47	9.32	16.25	11.58
South East	4.12	2.85	2.84	0.81	6.81	14.66	12.70
South West	2.28	1.37	2.10	0.48	2.96	7.37	7.89
'Greater SE'	9.67	9.22	7.76	1.80	20.25	40.00	32.93
Scotland	1.83	2.11*	0.52	0.40	4.70	7.47	7.89
Wales	0.84	0.74*	0.25	0.25	1.25	3.55	4.58
Northern Ireland	0.22	0.68*	0.25	0.15	1.25	2.15	2.68
United Kingdom	23.40	21.17*	13.40	5.10	44.80	93.30	93.30

Sources: HMRC, ONS, CIPFA, DCLG

Table A.3 Minor revenues – shares of total (%)

	Council Tax	NNDR	Stamp Duty	VED	Corp Tax	Other (GVA)	Other (Pop)
North East	3.0	3.1	1.4	3.7	3.2	3.2	4.2
North West	10.9	9.7	5.1	11.1	10.1	9.9	11.3
Yorkshire & Humber	7.6	7.0	3.9	7.8	5.7	7.3	8.5
East Midlands	7.1	5.8	3.7	7.4	6.2	6.6	7.2
West Midlands	8.3	7.6	4.7	9.6	6.9	7.9	8.9
East of England	10.5	8.2	9.9	10.2	9.2	9.7	9.2
London	13.1	21.9	26.8	9.2	20.8	17.5	12.4
South East	17.6	13.5	21.2	15.9	15.2	15.6	13.6
South West	9.7	6.5	15.6	9.4	6.6	7.9	8.5
'Greater SE'	41.3	43.6	57.9	35.3	45.2	42.8	35.2
Scotland	7.8	10.0	3.9	7.8	10.5	8.0	8.5
Wales	3.6	3.5	1.9	4.9	2.8	3.8	4.9
Northern Ireland	0.9	3.2	1.9	2.9	2.8	2.3	2.9
United Kingdom	100	100	100	100	100	100	100

Sources: As Table A.2

Abbreviations used in the report

ABI	Annual Business Inquiry
APS	Annual Population Survey
ASHE	Annual Survey of Hours and Earnings
CBD	central business district
CBI/KPMG	Confederation of British Industry/KPMG
cebr	Centre for Economics and Business Research Limited
CIL	Community Infrastructure Levy
CSES	Centre for Strategy and Evaluation Services
CML	Council of Mortgage Lenders
DCLG	Department of Communities and Local Government
EIM	European Investment Monitor
FTE	full-time equivalent
GDP	Gross Domestic Product
GLA	Greater London Authority
GLAEc	GLA Economics
GSE	Greater South East
GVA	gross value added
HMRC	HM Revenue and Customs
IFF	IFF Research
JCP	Job Centre Plus
LA	Local Authority
LABS	London Annual Business Survey
LCCI	London Chamber of Commerce and Industry
LDA	London Development Agency
LFS	Labour Force Survey

MBS	Mortgage Back Securities
NES	New Earnings Survey
NOMIS	Official labour market statistics published by ONS
NUTS2	Nomenclature of Territorial Units for Statistics level 2
OE	Oxford Economics
OMA	Outer Metropolitan Area
ONS	Office for National Statistics
PESA	Public Expenditure Statistical Analyses
PLP	Post London Plan
RICS	Royal Institution of Chartered Surveyors
TfL	Transport for London
TSO	The Stationery Office
UKTI	UK Trade and Investment

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