

London's Place in the UK Economy, 2005-06



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**Oxford
Economic
Forecasting**

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**CORPORATION
OF LONDON**

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November 2005

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Foreword

Michael Snyder
Chairman, Policy and Resources Committee
Corporation of London

This is the fourth annual edition of *London's Place in the UK Economy*, a report which aims to analyse 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 positive, two-way process, which benefits not just London and the regions, but the nation as a whole. The authors of this year's report, Oxford Economic Forecasting, provide further evidence of London's pivotal role in driving growth throughout the UK economy.

Central to the report is the calculation of the net contribution of the London economy to UK public finances. Employing a new more detailed method of calculation, the report concludes that London continues to make a substantial net contribution despite the deterioration in public finances at the national level. London's contribution is estimated to have been in a range of £6 billion and £18 billion for 2003/4, with a mid-point net contribution of £12.1 billion. This comparable figure for 2002/3 was some £2.5 billion higher, but given the rise in the UK budget deficit by over £14 billion over the same period, London's relative contribution has actually increased. London is financing increased investment in London, and continuing to supply a significant surplus for investment in other regions.

Londoners continue to face a high tax bill, contributing between 17% (£71 billion) and 19% (£81 billion) of UK government revenues in 2003/04 (depending on whether a residence-based or workplace-based calculation is used) despite the fact that it makes up only 12.5% of the total population. In contrast, public spending in the capital makes up 13.8% to 14.3% of total UK spending. While this might appear high in terms of London's share of population, it is not so when measured against employment or GDP. Such expenditure can be more than justified by the need to maintain a successful capital city, which demonstrably and quite rightly benefits the rest of the UK.

The report is optimistic that the London economy will withstand internal and external pressures this year and next, and will generate economic and jobs growth above the UK average. Despite this, the report notes that a number of significant structural issues

continue to impede London's faster growth – notably high unemployment and social deprivation (which particularly affect the inner London boroughs), expensive housing and increasing transport delays. These factors are likely to become even more critical given the expected increase in London's population and workforce over the next ten years. A growing population and more job generation will require accelerated investment in housing and transport, as well as sufficient job space, if the growth itself is not to be derailed. Increased social infrastructure – health care, educational and recreational facilities – will also be needed if waiting lists, queues and over-crowded facilities are to be avoided.

Finally, this year's report contains a special feature on London's position as a 'World City' and the importance of this to the UK as a whole. It concludes that London has enhanced its status as a World City over the last year, not least through its successful bid for the 2012 Olympic Games. In many ways, London can lay claim to being the archetypal World City, and most indicators point to it rivalling New York as the most globally focused and connected of all World Cities. Yet there is evidently much scope to improve.

The overall picture painted by this report is at once positive and challenging. London continues to be a major asset to the whole of the UK, and indeed to the world. For it to continue to grow and prosper we must work hard to ensure that its contribution is not just recognised, but also supported by ongoing investment and effective management of the public realm.

*Michael Snyder
London
November 2005*

Executive Summary

London consolidates its economic position

- **Despite a weaker jobs performance since 2000 than many other parts of the UK, London has consolidated its position as the largest economy of the UK Government Office Regions and a key driver of UK economic success.** The rapid growth London enjoyed through most of the 1990s – which was driven primarily by the strong expansion of the financial and business services sector – was brought to a halt by the end of the high-tech boom and its impact on global financial markets. Nevertheless, activity has continued to rise steadily, in marked contrast to the steep recession London suffered in the early 1990s.
- **Moreover, London's economic performance has remained robust this year despite the terrorist atrocities in the summer.** While tourism activity has clearly been affected by the attacks, it still looks as if there will be more overseas visitors to London this year than last. The strong recovery seen in financial markets this year, combined with more upbeat business surveys, suggests that London's GDP growth in 2005 may be slightly faster than for the UK as a whole. Employment in London is now 4.45 million, 15% of the UK total and 700,000 higher than in the early 1990s.

...with its employment set to rise twice as fast as UK over next three years

- Although overall employment growth in the UK is expected to be weaker in 2006 than in 2005 as the effects of the current slowdown in output growth feed through to demand for labour, London may buck this trend. London should benefit from renewed expansion in business services employment after three years in which this sector failed to provide the spur to jobs growth that it typically has over the past twenty years. Indeed, **we expect London to employ another 200,000 people by 2008**, with employment growth averaging 1.4% a year over the next three years – twice the jobs growth rate of the UK as a whole.

London remains highly competitive...

- **London's productivity performance continues to improve relative to the rest of the UK.** Gross value added per job was 27% higher than the national average in 2004, up from 22% five years ago. In part, this reflects the specialisation of the London economy in a range of high productivity service sectors - most notably in financial, insurance, legal and accounting services, and in media activities (e.g. advertising, TV, radio and film). However, London's productivity is relatively high in all of the major sectors, including construction, transport & communications, and distribution.
- **In part, this reflects the higher skills of the London workforce** – in 2004 nearly 32% of London's workforce had degree or equivalent level qualifications, compared with 26% for the UK as a whole. With government policy encouraging increasing university participation, the number of working-age people with degree-level qualifications in London has increased by over 27% since 1997-98. However, most other regions are seeing even faster increases in the graduate workforce, in part perhaps reflecting the relatively high cost of living in London.
- **The competitiveness of the London economy is reflected in its export performance.** Exports to the rest of the UK rose to £125.3 billion in 2004, slightly less than the rise in imports. London continues to run a substantial trade surplus with the rest of the UK, totalling £15 billion in 2004. Moreover, London exported £46 billion of goods and services to the rest of the world in 2004.

...with offshoring likely to facilitate greater specialisation in London's core strengths

- Similarly, **London remains a magnet for inward investment to the UK**, attracting 37% of all inward investment projects in 2004/05, compared with just 5% in the mid-1990s. The fall in the relative cost of commercial property in London compared with the rest of the UK suggests that the pace at which back office and support jobs move to centres such as Leeds and Manchester may ease in the short term. Offshoring is not expected to have a significant impact on overall employment in London because it facilitates greater specialisation in the activities in which London has a comparative advantage.
- **London's economic success complements and supports the economy of the rest of the UK** in various ways. For example, London's consumers and businesses imported £110 billion of goods and services from the rest of the UK in 2004, up from £108 billion in 2003.

Nevertheless, parts of London are continuing to under-perform...

- **Despite London's economic success over the last 15 years, there are still areas of significant weakness.** In particular, London's unemployment rate as measured by the Labour Force Survey has risen to 6.7%, significantly above the UK average of 4.7% and the highest of any Government Office Region other than the North East. Moreover, the employment rate – the proportion of the working age population that is in work – has remained on a downward trend over the last year.
- **These problems are typically most acute in the inner London boroughs**, reflecting a complex mix of social and economic issues, and the interactions between them. Of the ten most deprived local authorities in the UK, five are in inner London.

...London's housing and commercial property markets face major challenges...

- With London's population and workforce projected to continue to grow, **there are likely to be increasing pressures on the planning system to find ways in which this growth can be accommodated. Housing is a particular concern.** While London house prices have risen less rapidly than in the rest of the country recently, a major correction has so far been avoided. London prices remain high by historic standards both relative to other regions and to Londoners' incomes.
- With London's population projected by the GLA to grow by a further 810,000 by 2016, there needs to be a substantial increase in house building. Central London and the East – notably, the Thames Gateway - have been earmarked for the bulk of this expansion. It may be difficult, however, for the planning system and the construction sector to keep pace with expected demand. Affordability of housing is likely to remain a major issue, affecting London's ability to attract and retain key workers.
- The commercial property market faces some similar issues to the residential property market, with high land prices contributing to high rental charges. London's continued economic success is predicated largely upon on-going growth in business and financial services, which we expect in net terms to account for all the increase in employment of 450,000 we are forecasting between now and 2015. **These extra workers imply the need for significant new office developments**, even though availability is high in the office market in the short term.

...and transport delays impose a heavy cost on business and commuters

- **London's transport infrastructure also remains a major challenge.** While congestion has fallen, average traffic speeds in Central London continue to decline and most rail companies report an increased proportion of trains arriving late. Transport delays impose a substantial burden both on London businesses and workers. Although there are plans to invest £10 billion over the next five years in, for example, extensions to the DLR and East London lines, a new road bridge across the Thames and a variety of station, train, track and signal upgrades – partly associated with the Olympics - government funding for Crossrail is still not forthcoming.

London is a major net contributor to the Exchequer

- **Our estimates suggest that London continues to be a substantial net contributor to UK public finances, by between £6 and £18 billion in 2003-04,** despite the deterioration in public finances at a national level, with the mid-point of the range of estimates implying a net contribution of £12.1 billion.
- **Public spending per employed person in London is estimated to be around 7% lower than the UK average.** Public spending per capita in London is significantly higher than the UK average, but that partly reflects its relatively high unemployment and partly the unique urban nature of the region, with its large commuter belt, tourist industry and government/state functions.
- **Londoners continue to face a very high tax bill,** accounting for 17-19% of government revenues (£71-£81 billion) in 2003-04, although they make up only 12½% of the population of the UK.
- **Moreover, there is a risk that Londoners could bear a disproportionate share of any future tax increases needed to meet the government's fiscal rules.** For example, if the higher rate of income tax were raised to 50%, this would raise an additional £8.8 billion for the Exchequer, of which between £2.9 billion and £3.6 billion (i.e. up to 40%) would be paid by London.

London's international status continues to improve...

- **London has further enhanced its position as a "World City" over the last year,** reflected not least in the award of the 2012 Olympic Games. London is the UK's premier tourist destination, with many visitors then exploring other parts of the country. A third of Fortune Global 500 companies have their European headquarters in London, with pervasive links to demand, business and investment opportunities in the rest of the UK.
- **London's international status also enables it to attract foreign workers** who meet the economy's need for both highly educated staff with specific skills and for workers in more routine occupations, such as hotels & catering, office cleaning, transport services etc. Our forecasts assume that net international migration to the UK will run at around 130,000 a year over the next decade, of which around 80% will be to London – more than offsetting a continuing net outflow of existing London residents to the rest of the UK.

...and the Olympics will help encourage regeneration in East London

- Hosting the Olympic Games will require substantial capital investment in venues, the Olympic Village and infrastructure. However, this will be spread over a number of years and the sums involved are modest by macroeconomic standards. They will also be offset to some degree by increased taxes on Londoners. Nevertheless, **the**

Olympics should further raise the profile of London and the UK, and help to encourage the regeneration of Stratford and the surrounding area.

London set to be major jobs generator over the next decade

- Overall, our assessment is that London is well-placed to prosper over the next decade. While employment growth has been muted in recent years, this largely reflects a pause after the heady growth of the late 1990s, rather than a turning point in London's fortunes. The imbalances created by rapid growth – particularly in the housing and commercial property markets – have moderated. At the same time, London is uniquely competitive in the key exporting private service sectors that we expect to drive UK economic growth. Coupled with expected strong population growth - fuelled by international migration - and the local demand this generates, London is expected to create an extra 650,000 jobs by 2015, accounting for 16% of UK employment and 20% of GDP. London's success cannot be taken for granted, though, and could be undermined by potential structural constraints, notably in transport and housing.

1 Introduction

This report is the latest in a series of annual reports commissioned by the Corporation of London to look at London's place in the UK economy, how this has been evolving and how it is likely to develop in the future. This potentially covers a very wide range of issues, and the approach we have adopted here is to focus on a limited number of specific subjects of importance in determining London's place in the UK economy, alongside our latest assessment of London's economic performance and how much London contributes to UK public finances.

This report is organised as follows:

- Chapter 2 provides context on the shape of London's economy, how it is changing, and short-term economic prospects for London;
- Chapter 3 looks at the competitive position of the London economy, including the key activities in which London specialises, the skills and productivity of the London workforce, and the impact of company mobility on London through outsourcing and inward investment;
- Chapter 4 focuses on some structural issues facing the London economy, including the contrast between, on the one hand, strong overall economic performance and, on the other hand, low employment rates for some Londoners, particularly in the inner boroughs. It also discusses potential constraints on London's growth from transport infrastructure challenges and physical space constraints;
- Chapter 5 analyses London's current contribution to UK public finances, and how this might be affected by the government's plans for public spending and possible future tax increases;
- Chapter 6 looks at London's position as a 'World City' and the importance of this to the UK as a whole;
- Chapter 7 covers three topical key issues for London's future – the importance of migration in London's economic development; the possible impact of terrorism on London's economy; and the consequences of the decision to award the 2012 Olympics to London;
- Finally, Chapter 8 offers some conclusions on the long-term outlook for London.

2 The London Economy: The Context

This chapter looks at the shape of London's economy, both in terms of key long-term trends and more recent developments in the balance of economic activity. It also presents our forecast for London's short-term economic prospects, and discusses some of the ways London's economy influences the rest of the UK.

2.1 How is the London economy changing?

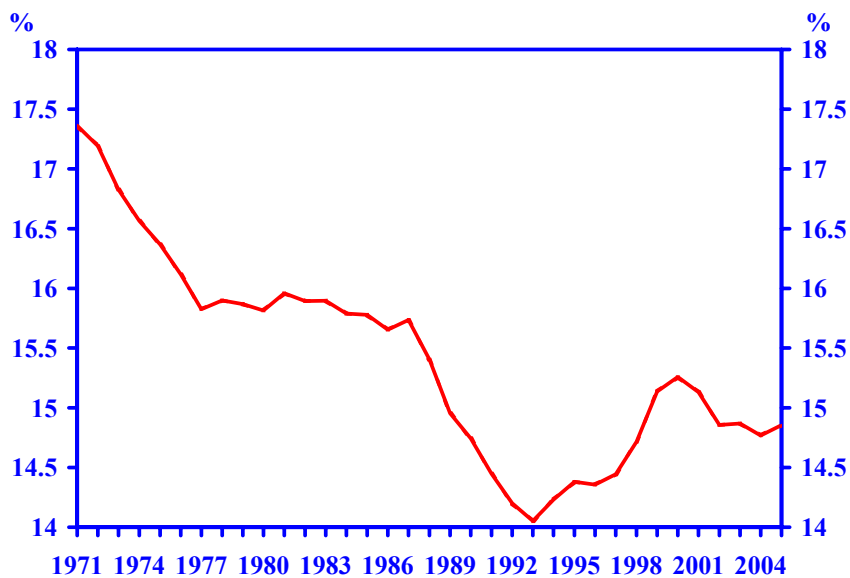
(a) Key long-term trends

London has been a key source of growth in the UK economy over the past decade. In this respect, London's recent economic performance is in sharp contrast to the experience of much of the post-war period. For nearly 40 years London lost both people and jobs, much of it due to planned decentralisation. Even after the abandonment of such planning in 1977, the trend remained predominantly downward until 1993.

The turnaround since then has been remarkable, and has transformed London's place in the UK economy. In the ten years from 1993, over 850,000 extra jobs were created in London, allowing all of the jobs lost since 1971 to be replaced. Much the same is true of population. Although the decline in the number of people living in the capital stopped in the early 1980s, rapid growth did not begin until the mid-1990s, since when London's population has risen by 600,000 (about 9%).

Chart 2.1

London employment as share of UK



Source: OEF

The growth of employment since 1993 means that London now employs 4.4 million people, nearly 15% of the UK total. As a result of relatively high productivity in the capital, London's contribution to UK GDP is even more significant: we estimate overall gross value added in London in 2004 to have been £181 billion (in 2002 prices), nearly 19% of the UK total.

Surprising as it seems today, London was until relatively recently a major industrial city. Thirty years ago, close to one in four workers in London were employed in manufacturing industry. One seventh of UK manufacturing production was also located in London, and manufactured products comprised London's main source of export earnings.

Since then, manufacturing output and employment have fallen greatly, as industry has contracted and decentralised. Today manufacturing employs just 240,000 people in London, 5½% of its total employment, compared to around 1 million in 1971. For many years London's manufacturing contracted much more rapidly than elsewhere. This was not because it was uncompetitive by UK standards, but because there was little affordable land for either new plants or for extensions to existing factories. With slowly declining industrial floor-space, rising productivity led to fast-falling employment.

De-industrialisation was almost complete by the early 1990s. Manufacturing output rose during much of the decade, although it has fallen back since 2000. Similarly, employment in manufacturing stabilised for much of the 1990s, before falling by a further quarter over the past six years. Much of what is left of London's manufacturing is in activities which rely on face-to-face contact, a need for fast-changing information or else serve local markets. Over 40% of manufacturing employment is in printing and publishing, while only 49,000 jobs are now in metals and engineering (1.1% of London's total employment). With the end of production at Dagenham, the days of the large engineering assembly plant in London are virtually over.

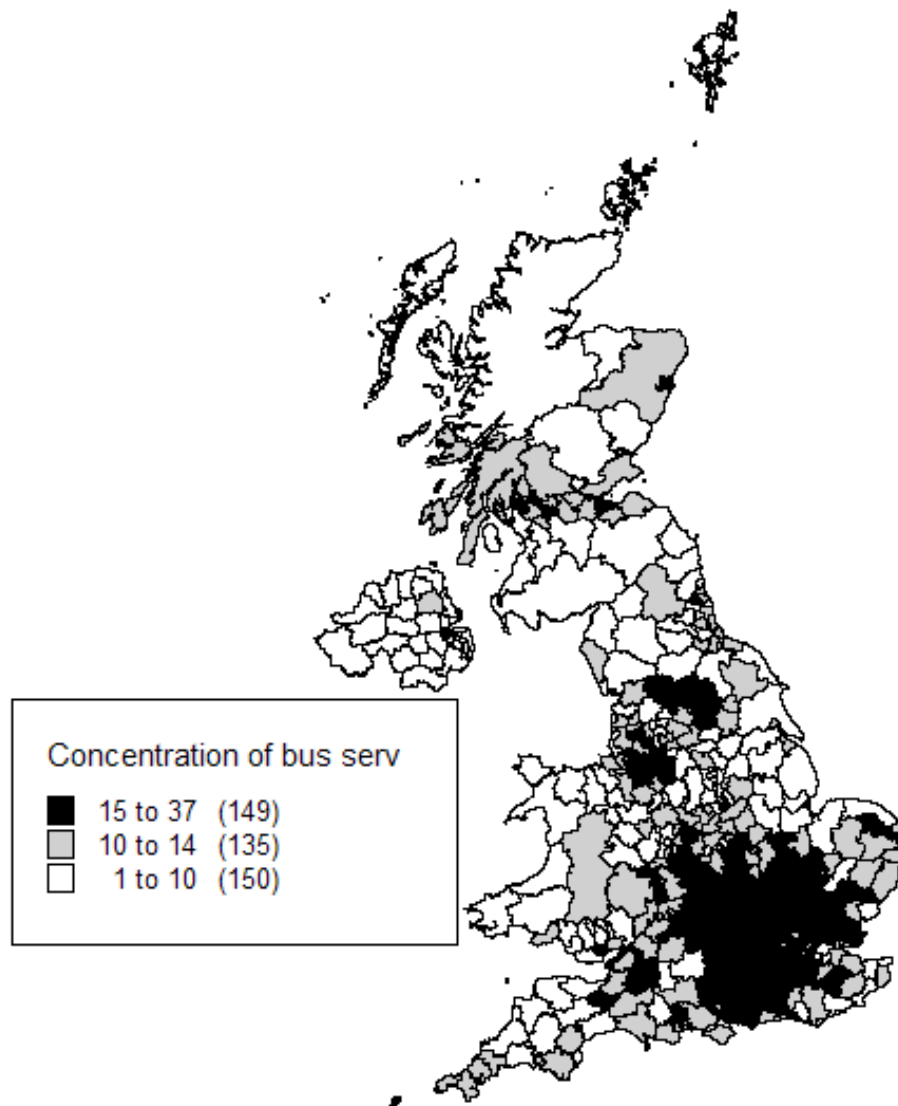
Table 2.1 London's jobs by sector (% of all jobs in London)				
	1971	1981	1991	2001
Manufacturing	22.5	16.2	9.3	6.6
Other production (inc. construction)	7.6	7.0	6.3	5.1
Distribution & hotels	19.7	20.7	20.5	21.0
Transport & communications	10.9	10.1	8.6	8.0
Financial & business services	15.9	19.1	27.2	33.1
Non-market & personal services	23.1	26.6	27.8	26.2
<i>Memo: UK shares</i>				
Manufacturing	30.5	23.6	17.4	13.7
Other production (inc. construction)	12.9	12.0	10.7	8.6
Distribution & hotels	19.4	21.4	22.5	23.2
Transport & communications	6.9	6.4	5.9	6.2
Financial & business services	9.0	11.3	15.6	19.3
Non-market & personal services	20.3	24.4	27.1	28.5

Source: ABI and LFS

At the same time, London has continued to develop as the principal international financial centre in Europe, home to one of the world's three largest financial markets alongside New York and Tokyo. Even more striking has been the way that business services have developed in London. This broad range of activities - which includes accountancy, law,

advertising, consultancy, computing, R&D, recruitment, security and office cleaning amongst a host of other services - has been the most important source of employment growth in the UK over the past thirty years, with 2½ million more employees in 2005 than in 1971. London has attracted half a million of these new jobs.

Chart 2.2: Importance of business services
(% of employment, 2003)



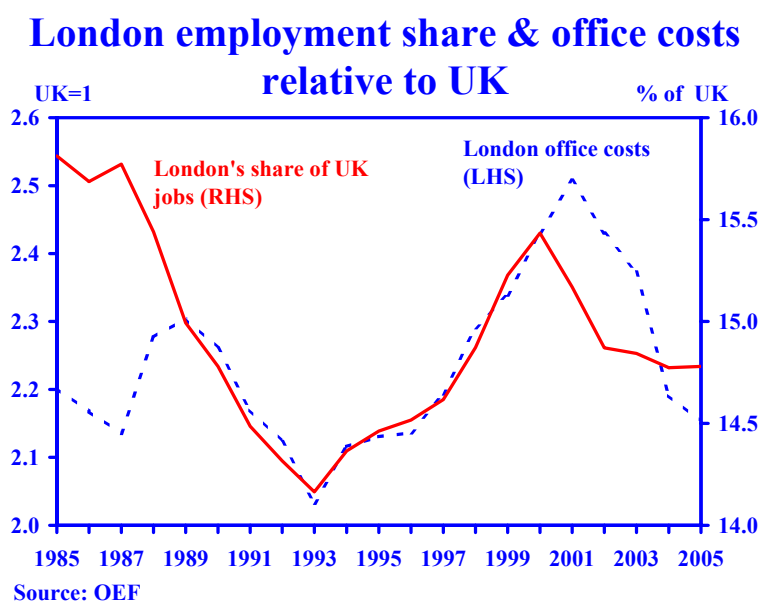
Source: ABI

There has also been a trend shift from jobs in the construction and utilities sectors of the economy towards other services sectors in London, although on a much smaller scale than the decline in manufacturing jobs and the rise in financial and business services. Utilities provide far fewer jobs in London than they did thirty years ago, while personal services, for example, provide substantially more.

The trend for de-centralisation to take certain activities out of London in response to the high cost of locating in the capital has had, and is likely to continue to have, a powerful effect. This is not necessarily just a one-way process, though, and may be reversed as cost pressures change. It is noticeable, for example, that a tendency for some northern

cities to gain significant numbers of extra jobs in business services seems to have slowed in the past year or two, which may be a result of weakness in London's office property market leading to an erosion of part of the cost advantage enjoyed by other locations – previous experience suggests there is around a three-year lag between changes in relative office rents in London and changes in London's share of office employment.

Chart 2.3



(b) Recent changes in London's economy

The rapid growth London enjoyed through the 1990s – which was driven primarily by the strong expansion of the financial and business services sector – was brought to an end by the collapse of the high-tech boom and its impact on global financial markets. Between 2000 and 2002, nearly 100,000 net jobs were lost in London. Since then, though, there has been a return to jobs growth in London, albeit – until very recently at least - at a slower pace than across the UK as a whole.

Just as financial and business services contributed most to the late-1990s employment boom, they also contributed the lion's share of the jobs shake-out that followed, with 60,000 fewer jobs by 2002 than in 2000. It is also less evident that employment has yet returned to a clear upward trend in these sectors than, for example, in hotels and restaurants, with a further shake-out in 2004 more than offsetting a recovery the previous year. As a result, financial and business services account for a smaller proportion of jobs in London in 2005 than they did in 2001 (Table 2.2).

In contrast, construction has been a key source of jobs growth in London in the last few years, with 40,000 more jobs this year than in 2000, driven partly by work on Heathrow Terminal 5 as well as office building. As in other regions of the UK, the public sector has also been an important provider of new jobs, with public administration, health and education employing over 80,000 more people in 2005 than in 2000.

Table 2.2 Recent changes in London's jobs by sector		
(% of all jobs in London)		
	2001	2005
Manufacturing	6.6	5.4
Other production (inc. construction)	5.1	5.5
Distribution & hotels	21.0	21.2
Transport & communications	8.0	7.5
Financial & business services	33.1	32.1
Non-market & personal services	26.2	28.3

Source: OEF estimates

2.2 London's economic cycle and short-term prospects

Historically the least exposed to boom and bust of the UK regions, London has since 1990 tended to lead the UK into economic downturns, and it is no surprise that this was true for the post-2000 slowdown, triggered as it was by the end of the high-tech boom and the associated recession in financial markets. On top of this, after the beginnings of a recovery in 2003 and early 2004, the slowdown seen in the UK economy over the past year has affected London as well. However, London's employment growth no longer seems to be lagging the economy as a whole - workforce jobs in London rose 0.6% (29,000) in the year to 2005Q2, compared with 0.5% for the UK as a whole. Similarly, the Labour Force Survey shows London's employment in the three months to July 1.8% (63,000), compared with 1.1% for the UK.

Nevertheless, recent economic indicators are mixed and are not yet pointing clearly to a return to southern-led - and more particularly London-led - growth. The Purchasing Managers' Index of business activity in London shows firms continuing to expand output, with an index of 54.3 in September (any reading above 50 on this index points to growth). For some companies, this expansion is no doubt supported by improvements in financial markets. More generally companies report that increasing activity is supported by rising new orders. However, this was the lowest index from this survey for two years, and the first time since the early part of 2004 that London companies had failed to report more robust growth than UK companies as a whole.

Similarly, property market reports generally point to stability rather than an upturn in London's economy. Drivers Jonas, for example, report rents on hold in both the West End and the City since the middle of 2004. For the West End, this represents something of a pause in recovery, since rents were rising in the first part of last year. For the City, though, it appears to confirm that the downturn in the property market is at least at an end. In addition, the quarterly survey of City agents published by the Corporation of London shows that demand for office space is increasing, with 9% more agents reporting a pick-up in enquiries in 2005Q2 than reporting a fall, and a balance of +13% expecting an increase in 2005Q3.

July's terrorist attacks in London have added to the uncertainties surrounding the short-term economic outlook. However, of the firms in the PMI survey reporting a drop in

business activity, only a handful blamed terrorism. Available indicators of tourism activity clearly point to a drop in numbers compared with the weeks before 7 July, and the abortive attacks of 21 July appear to have delayed recovery. Even so, it looks as if there will be more overseas visitors to London this year than last year.

We do not therefore expect the terrorist attacks to have a major overall economic impact on London. With London's economy dominated by private services, and these sectors still expected to be the main driver of broader economic recovery, our forecast continues to show London leading UK economic growth over the next few years. Although overall employment growth in the UK is expected to be weaker in 2006 than in 2005, as the effects of the current slowdown in output growth feeds through into labour demand, London is expected to buck this trend. We are forecasting employment in London to grow by 30,000 (0.7%) in 2006, similar to its growth in 2005. Thereafter, London's jobs growth is expected to strengthen in 2007 and 2008 with a return to solid growth in business services. As a result, we expect London to enjoy the fastest growth of employment of the UK regions between now and 2008, averaging 1.4% a year - twice the rate of growth of the UK as a whole.

Table 2.3 Forecast for London

	2003	2004	2005	2006	2007	2008
Employment (000's)						
Primary	12	12	11	11	10	10
Manufacturing	256	253	241	232	223	215
Construction	220	257	250	249	254	260
Wholesale distribution	231	221	217	212	208	204
Retail distribution	381	396	398	398	402	411
Hotels & catering	321	325	333	338	344	350
Transport & communications	343	336	339	335	335	336
Financial services	375	360	371	375	381	388
Business services	1057	1045	1062	1089	1134	1181
Public admin.	232	237	237	236	234	234
Health & education	645	662	673	685	698	711
Other services	343	326	327	327	332	342
Total employment	4424	4437	4465	4494	4563	4649
Population	7388	7429	7467	7532	7597	7669
Total GDP(basic prices, £2002bn)	175.2	181.4	185.3	190.3	197.0	204.3
% change on previous year						
Total employment	0.9	0.3	0.6	0.7	1.5	1.9
Population	0.2	0.6	0.5	0.9	0.9	1.0
Total GDP(basic prices, £2002bn)	2.4	3.5	2.2	2.7	3.5	3.7

Source: OEF

2.3 London's influence on the rest of the UK economy

London clearly plays a key role in the UK economy. Greater London accounts for a larger share of the UK's economy than any other Government Office Region, directly contributing about 19% of GDP and 15% of total employment. London has also been a key source of growth in the UK economy over the past decade.

The various ways in which London's economy complements and supports the economy of the rest of the UK were discussed in a report by OEF for the Corporation of London

last year¹. Most obviously, these include trade links – for example, firms based outside London supplying goods and services to London’s consumers and businesses - and employment links – for example, people who live in the rest of the UK commuting into London for work. Using the methodology in that report, our latest calculations show that London spent around £110 billion on goods and services imported from the rest of the UK in 2004, up from £108 billion in 2003.

Financial and business services account for the largest share of London’s imports from the rest of the UK, but these are substantially less than London’s exports of these services to other parts of the country (see Chapter 3). As might be expected, London is heavily dependent on the rest of the UK for the supply of goods, with manufactured items accounting for almost as many imports to London from the rest of the UK as financial and business services, and more than three times as much as the manufacturing output London sells to other parts of the UK.

Table 2.4 London’s imports from the rest of the UK (2004)	
Sector	Imports (£ billion)
Agriculture	2.9
Mining and quarrying	2.2
Manufacturing	38.3
Electricity, gas and water supply	3.4
Construction	11.0
Wholesale and retail trade	6.1
Transport and communication	2.6
Financial & business services	42.7
Other services	1.2
Total	110.4

Source: OEF estimates

While such links are important in their own right, there are other linkages that can be loosely described as facilitating, dynamic or catalytic in their effect, related to making things happen in the rest of the UK that would not otherwise occur but for the presence of London. A number of these influences are highlighted again in the discussion in subsequent chapters on London’s current place in the UK economy.

One example of such catalytic effects is the spending in the rest of the country by foreign tourists who would not have visited the UK but for the attraction of London. Another is the jobs located in regions outside London that support the activities of the City’s international banks - organisations that, if they were not in London, would probably be in Frankfurt or New York.

There is also a sense in which the impact of London on the UK economy is greater than that of a typical (economic) capital city on its hinterland. Without London, the UK would still have a capital that would take on many of the roles that London fulfils (e.g. as the centre of government). London’s status as a ‘World City’, though – i.e. a city that has a fluid international population and hosts a wide range of international businesses - gives it a much wider role, with knock-on effects to the rest of the UK that would not otherwise exist. For example, London is home to the lion’s share of European headquarters for

¹ *London’s Linkages with the Rest of the UK*, Corporation of London, May 2004

global companies, offering job and business opportunities that are additional and different to those that an 'ordinary' capital would provide (see Chapter 6).

2.4 Conclusions

London's economy has been transformed in the past decade. After forty years of losing jobs to other parts of the country, London has become a key source of growth in the UK economy. With most manufacturing jobs re-located from London by the early 1990s, the capital has been well-placed to benefit from the continuing growth of financial and business services. Despite a weaker jobs performance recently than many other parts of the UK, London has consolidated its position as the largest of the UK Government Office Regions and a key driver of UK economic success. The rapid growth London enjoyed through the 1990s – which was driven primarily by the strong expansion of the financial and business services sector – was brought to a halt by the end of the high-tech boom and its impact on global financial markets. Nevertheless, activity has continued to rise steadily, in marked contrast to the steep recession London suffered in the early 1990s.

Moreover, London's economic performance has remained robust this year despite the terrorist atrocities in the summer. While tourism activity has clearly been affected by the attacks, it still looks as if there will be more overseas visitors to London this year than last. The strong recovery seen in financial markets this year, combined with more upbeat business surveys, suggests that London's GDP growth in 2005 may be slightly faster than for the UK as a whole. Although overall employment growth in the UK is expected to be weaker in 2006 than in 2005 as the effects of the current slowdown in output growth feed through to demand for labour, London may buck this trend. London should benefit from renewed expansion in business services employment after three years in which this sector failed to provide the spur to jobs growth that it typically has over the past twenty years. Indeed, we expect London to employ another 200,000 people by 2008, with employment growth averaging 1.4% a year over the next three years – twice the growth rate of the UK as a whole.

Stronger growth in London will have an important impact on the rest of the UK as well – London is an important source of demand for goods and services produced elsewhere in the economy. There are much wider ways in which London influences the rest of the economy, though, with its unique role as a World City, for example, creating opportunities for other parts of the UK, too.

3 The Competitive Position of the London Economy

This chapter looks at key issues affecting the competitive position of the London economy. This includes an analysis of the key activities in which London specialises, the skills and productivity of the London workforce, and the impact of company mobility on London through outsourcing and inward investment.

3.1 London's sectoral specialisms and key business clusters

Modern economic activity is characterised by a degree of specialisation. Families, cities and even countries no longer aim to meet the majority of their needs through their own production. Instead, they specialise on a more limited range of activities, and meet other needs through trading surplus amounts of the goods and services they produce for other goods and services that are produced elsewhere.

In the same way, London's economy is driven by its specialisation in activities in which London has competitive advantages over other parts of the UK and other parts of the world. The city's success in these specialised areas provides the underpinning for support activities of many sorts – and spreads the wealth generated by the specialists across the wider community in London and to the rest of the UK. However, to see the specialist sectors as the leaders, and the supporting activities as the led, misses the important inter-relationship or symbiosis between the two. Without successful and competitive support activities – both in London and elsewhere in the UK – it is highly unlikely that the city would remain home to these specialist activities, most of which are highly mobile across national boundaries. In examining the ways in which London differs from the rest of the UK, or indeed from other European or capital cities, it is important to recognise that the city functions as an integrated entity and that highlighting and categorising its specialisms does not mean that other activities are somehow unimportant or necessarily in decline.

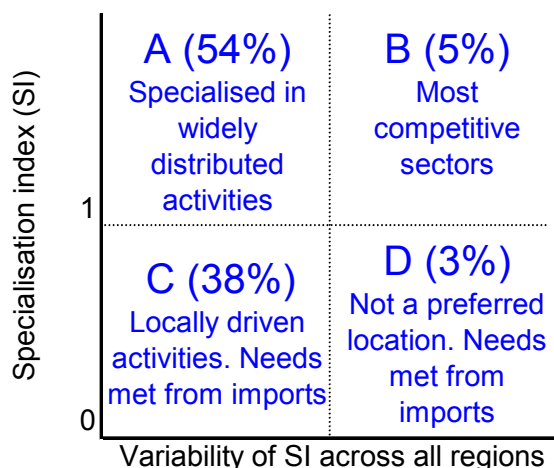
(a) Identifying specialisation

One way of identifying specialisms is to calculate how the share of an area's employment in an activity differs from that of the nation as a whole. So, if London has a high proportion of its workforce employed in financial services relative to the country as a whole then this is evidence of specialisation in this sector. This simple measure misses some of the subtleties of specialisation, though – particularly given that some activities by their very nature offer more scope for geographical specialisation than others where local production for local needs is likely to be much more the norm. For example, there is a considerable difference between, on the one hand, a sector where London is one of a small group of regions that between them account for a high proportion of overall UK employment in the sector and, on the other hand, a sector where London has a high proportion of employment but there is little variation across the other regions. In the former case there is evidence that the sector provides reasonable scope for specialisation for a minority of regions that possess the special characteristics to be competitive in the activity. In contrast, in the latter case there is a suggestion that London's specialisation is rather unusual – possibly (given the inevitably aggregate nature of the data) the result of additional activities falling within the same broad sectoral definition, in what otherwise appears to be a locally driven industry.

Chart 3.1 shows a stylised way of looking at the gradation of specialisation and the variability with which an activity is present in other regions. (The percentages in brackets

show the distribution of London's employment in 2003².) Activities that fall within quadrant A represent those which are widely and relatively evenly spread through the UK, but where London can be said – in varying degrees – to be specialised in something 'special' within the activity. Activities in quadrant B can be viewed as London's most competitive sectors: London possesses something – in terms of organisations, skills and customers – in which only one or two other regions in the UK have a real presence. Quadrant C can be seen as predominantly locally driven activities. Finally, quadrant D typifies activities whose location is discretionary and where London does not appear to enjoy particular competitive advantages – indeed, in the case of a very low index for London, activities where London can satisfy its needs from the rest of the UK.

Chart 3.1



(b) Characterising London's specialisms

Chart 3.2 identifies the five largest sectors (as measured by employment) in each of the quadrants identified in Chart 3.1. Not surprisingly, London's key specialisms – i.e. those activities in quadrant B - emerge as its capital markets, its role as an air transport hub and the home it provides for UK and international media. Table 3.1 provides more information on sectors that account for relatively high shares of employment. Other activities that fall in this "most competitive" category are generally related to these three areas. Centralised government functions – central banking and foreign affairs – and specialist manufacture of jewellery and of leather goods also rank highly in terms of the degree of London's specialisation. In total, this most competitive category accounted for 206,000 jobs in 2003 – 5% of the total.

The large sectors in quadrant A – that is, those activities that are widely dispersed across all regions of the UK but where London appears to have something extra on top of what would be required to meet 'local' demand – largely relate to business services. For example, this includes the additional employment in accountancy, law and business consulting in London required either to meet the demand for specialist inputs in these areas from other activities in London or exported from London as part of its role as a capital and World City.

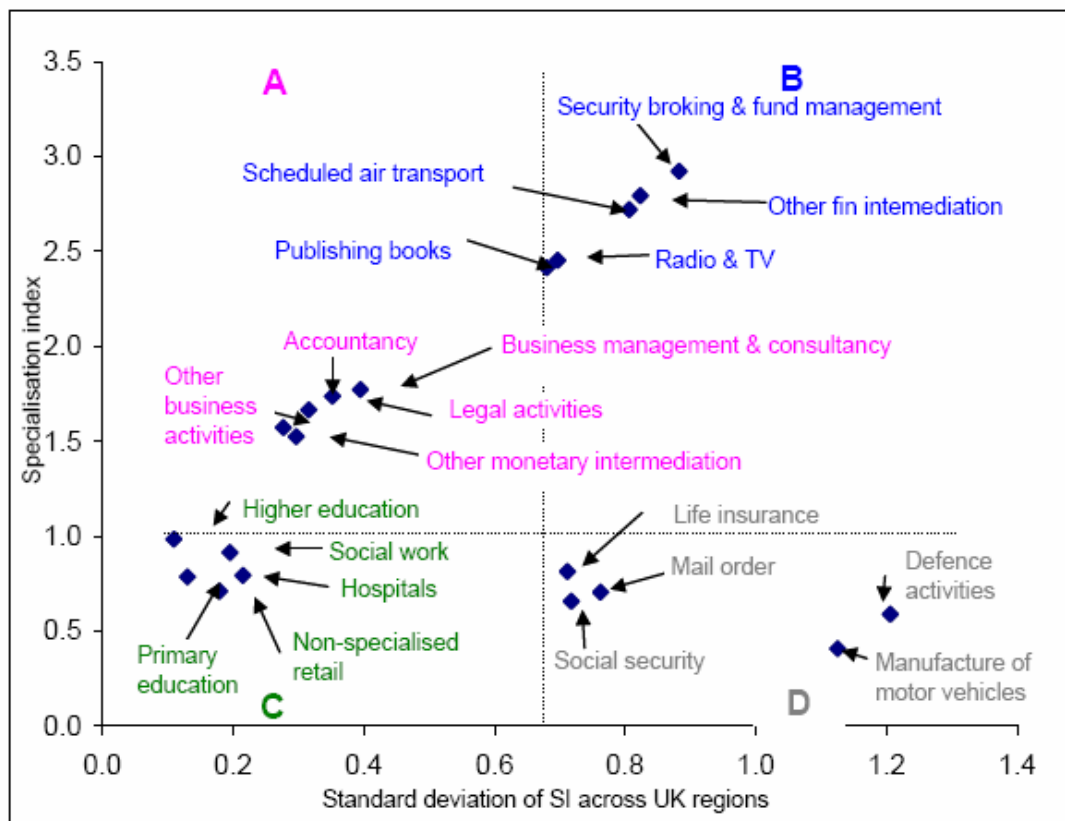
As shown in Table 3.1, the list of sectors falling into London's specialities within relatively widely distributed activities is much larger than the list of specialities within more

² Detailed employment data by sector requires the annual benchmark figures from the Annual Business Inquiry, which is only available at present up to 2003.

generally concentrated activities, embracing much of the business services sector, including some financial services and activities related to London's role as the UK's cultural capital. With 2.1 million jobs, these activities accounted for 54% of all employment in London in 2003. This is some 618,000 greater than if London had average UK employment shares for these activities³.

Given London's strengths in terms of high quality universities and specialist hospitals, it is perhaps surprising that the employment data points to a below-average number of jobs in hospitals and in higher education – both falling into quadrant C. This finding reflects the extent to which London's workforce commutes into the city, with many of their needs in terms of public services provided where they live rather than in the city itself, and to a lesser extent cost pressures in some areas of higher education. As a result, measured relative to the total number of jobs, London appears under-represented in these activities. If resident population were used as the base then a different picture would emerge.

Chart 3.2: The five largest employment categories by quadrant



³ It is worth bearing in mind, though, that the distinction between quadrants A and B to some extent depends on the degree of disaggregation in the data. A finer disaggregation of the data on, say, legal or accountancy employment would reveal that, although broad business services activities are relatively widely distributed across UK regions, leading to the classification of London's specialisms here into quadrant A, if the sectors were defined at a more detailed level then a number of smaller sectors would also be revealed as of highly varying size across regions, leading to additional activities being classified to quadrant B rather than in A. This might include, for example, M&A-related legal services or strategic management consultancy.

Table 3.1: Specialisation in London

A: London's specialities within widely distributed activities

<i>Activities with more than 3,000 employees in 2003 – ranked by employment</i>	SI*
Publishing of journals and periodicals	2.35
Market research and public opinion polling	2.30
Wholesale of perfume and cosmetics	2.29
Activities of professional organisations	2.28
Activities auxiliary to financial intermed. nec	2.23
Activities of bus. and employers organisations	2.11
Advertising	2.08
Artistic and literary creation and interpretation	2.08
Operation of arts facilities	1.91
Activities of trade unions	1.91
Other supporting land transport activities	1.81
Business and management consultancy activities	1.77
Legal activities	1.74
Data base activities	1.73
Other publishing	1.72
Accounting, book-keeping and auditing activities; tax consultancy	1.67
Management of real estate on a fee or contract basis	1.67
Activities auxiliary to insurance and pension funding	1.66
Wholesale of electrical household appliances and radio and television goods	1.63
Other scheduled passenger land transport	1.62
Publishing of newspapers	1.60
Other supporting air transport activities	1.60
Other entertainment activities nec	1.60
Management activities of holding companies	1.59
Wholesale of clothing and footwear	1.58
Other business activities nec	1.57
Photographic activities	1.56
Other computer related activities	1.54
Other monetary intermediation	1.52
Activities of other transport agencies	1.52
Investigation and security activities	1.51
Non-life insurance	1.51
Development and selling of real estate	1.50

B: London's most competitive sectors

<i>Activities with more than 1,000 employees in 2003 – ranked by employment</i>	SI*
Central banking	3.32
Motion picture and video distribution	2.98
Security broking and fund management	2.92
News agency activities	2.89
Administration of financial markets	2.87
Other financial intermediation nec	2.79
Publishing of sound recordings	2.78
Reproduction of video recording	2.78
Scheduled air transport	2.72
Motion picture and video production	2.72
Foreign affairs	2.68
Radio and television activities	2.45
Publishing of books	2.42
Reproduction of sound recording	1.93
Manufacture photographic chemical material	1.73
Cargo handling	1.53
Manufacture of jewellery and related articles nec	1.44
Research and experimental development on social sciences and humanities	1.43

* *Specialisation Index, defined as London's share of employment in the activity, divided by the equivalent UK share*

nec - not elsewhere classified

Source: OEF analysis of ABI

(c) **The future of specialisation in London**

Of course, the picture of which sectors London specialises in is not entirely static. Some of these sectors have been concentrated in London for a very long time – central banking has been a London specialism for hundreds of years, for example, and air transport for fifty years. There are also much more recent specialisms – in digital imagery for films, for example – that have only emerged in the past decade, while other specialisms have been lost over time. Many of the activities associated with how newspapers used to be printed, for example, can probably hardly be found in London anymore. The continual renewal process as old specialisms are replaced with new ones makes it difficult to be sure what London's key specialisms will be in a decade from now. However, the city's success in re-inventing its role in new high value-added activities over a long period suggests that London will continue to specialise in challenging activities that generate sufficient value-added to justify taking place in a high-cost location.

3.2 **The skill base of London's labour force**

London's role as a World City both attracts and requires a highly skilled labour force. The role of migration in shaping London's economy (see Chapter 7) is therefore strongly linked with the skills base of the workforce.

London's workforce is highly educated....

The specialisms of the London economy identified in the preceding section are typically large employers of those with high levels of educational attainment engaged in creative, knowledge-intensive tasks. As might be expected, therefore, London's resident workforce contains a large proportion of graduates. As shown in Table 3.2, in 2004 nearly 32% of London's workforce possessed degrees or degree level qualifications (NVQ level 4 and 5) as their highest educational attainment. This compares with under 26% for the rest of the UK. This implies that London includes 16% of UK graduates while making up only 13% of the overall workforce. At the most highly qualified post-graduate level, the figures are even more stark – nearly one in thirteen of London's resident workers has gained a post-graduate qualification, with 20% of the UK's highest attainers in terms of education in the London workforce.

This over-representation of graduates in the London workforce does not, however, translate into an equal under-representation across all other levels of educational attainment. Indeed, London has a very similar proportion of poorly qualified workers as the UK as a whole, with the proportion of London's workforce with no qualifications and with qualifications below NVQ level 2 almost the same in London and the rest of the UK. It is in the mid range of educational attainment (NVQ levels 3 & 2) – broadly equivalent to possessing one or more A-levels or five or more GCSE at grades A*-C at the end of education – that London's workforce compensates for an abundance of high attainers. For example, there are nearly 20% fewer in the London workforce with level 3 qualifications than in the rest of the UK.

Table 3.2 London's workforce 2004: more degrees						
NVQ Level	<i>Degree equivalent</i>		<i>1+ A-level</i>	<i>5+ GCSE</i>	<i>Other</i>	
	Level 5	Level 4	Level 3	Level 2	Below level 2	No qualifications
Share of workforce						
London	7.6%	24.3%	15.9%	19.2%	19.0%	14.1%
Rest of the UK	4.7%	20.9%	20.2%	21.8%	18.6%	13.9%
% point difference	2.9%	3.4%	-4.3%	-2.6%	0.4%	0.2%
Number by qualification						
London (000s)	364	1164	761	919	910	675
London's share of UK	19.6%	15.0%	10.7%	11.8%	13.5%	13.4%
London's share relative to working age population (UK=100)	149	114	81	90	102	101

Source: DfES estimates from the Labour Force Survey, Autumn quarter

...and Londoners are more likely to be professionals and managers...

Reflecting the larger proportion of the London workforce with high educational attainment, professionals, associate professionals and managers are all heavily over-represented in the resident employed in London. For example, 16% of employees in London are classified as professional (Table 3.3), compared with under 12% for the country as a whole. As described in Box 3.1, these occupations tend to require individuals with high levels of knowledge and to involve non-routine tasks. This non-routine, knowledge component of employment accounts for nearly 52% of all jobs in London, compared with the national figure of under 40%.

The flip side of this picture is the under-representation of process operatives, skilled trades, elementary occupations, sales and customer service representatives and personal service occupations in London. Though it is outdated to equate skills solely with managerial and professional occupations, this snapshot of the occupational distribution of London jobs for residents is consistent with a picture of London as a centre that thrives on highly skilled labour working in a high cost, high productivity environment, where the benefits of proximity to other highly skilled groups outweigh the cost disadvantages.

Box 3.1 How Are Occupational Classes Defined?

Managers & senior officials: This group covers occupations whose main tasks consist of the direction and coordination of the functioning of organisations and businesses. Most occupations in this group will require a significant amount of knowledge and experience of the production processes, administrative procedures or service requirements associated with the efficient functioning of organisations and businesses.

Professional: This group covers occupations whose main tasks require a high level of knowledge and experience in the natural sciences, engineering, life sciences, social sciences, humanities and related fields. The main tasks consist of the practical application of an extensive body of theoretical knowledge, increasing the stock of knowledge by means of research and communicating such knowledge by teaching methods and other means. Most occupations in this group will require a degree or equivalent qualification, with some occupations requiring postgraduate qualifications and/or a formal period of experience-related training.

Associate professional & technical: This group covers occupations whose main tasks require experience and knowledge of principles and practices necessary to assume operational responsibility and to give technical support to Professionals and to Managers and Senior Officials. The main tasks involve the operation and maintenance of complex equipment; legal, financial and design services; the provision of information technology services; providing skilled support to health and social care professionals; and serving in protective service occupations. Culture, media and sports occupations are also included in this group. Most occupations in this group will have an associated high-level vocational qualification, often involving a substantial period of full-time training or further study.

Administrative and secretarial: Occupations within this group undertake general administrative, clerical and secretarial work, and perform a variety of specialist client-orientated clerical duties. Most occupations in this group will require a good standard of general education. Certain occupations will require further additional vocational training or professional occupations to a well-defined standard.

Skilled trades: This group covers occupations whose tasks involve the performance of complex physical duties that normally require a degree of initiative, manual dexterity and other practical skills. Most occupations in this major group have a level of skill commensurate with a substantial period of training, often provided by means of work-based training programme.

Personal service: This group covers occupations whose tasks involve the provision of a service to customers, whether in a public protective or personal care capacity. Most occupations in this group require a good standard of general education and vocational training. To ensure high levels of integrity, some occupations require professional qualifications or registration with professional bodies.

Sales and customer service: This group covers occupations whose tasks require the knowledge and experience necessary to sell goods and services, accept payment in respect of sales, replenish stocks of goods in stores, provide information to potential clients and additional services to customers after the point of sale. Most occupations in this group require a general education and skills in interpersonal communication.

Process, plant & machine operatives: This group covers occupations whose main tasks require the knowledge and experience necessary to operate and monitor industrial plant and equipment; to assemble products from component parts according to strict rules and procedures and to subject assembled parts to routine tests; and to drive and assist in the operation of various transport vehicles and other mobile machinery. Most occupations in this group do not specify that a particular standard of education should have been achieved.

Elementary occupations: This major group covers occupations which require the knowledge and experience necessary to perform mostly routine tasks, often involving the use of simple hand-held tools and, in some cases, requiring a degree of physical effort. Most occupations in this major group do not require formal educational qualifications.

Source: Standard Occupational Classification 2000

Table 3.3 London - lots of professionals but not so much routine
(2004/05)

	London employment (000s)	Share of total London employment (%)	London's share relative to working age population (GB=100)
Managers & senior officials	611	17.8	123
Professional	549	16.0	135
Associate prof. & technical	616	18.0	135
Administrative and secretarial	459	13.4	107
Skilled trades	283	8.3	70
Personal service	225	6.6	84
Sales and customer service	217	6.3	77
Process, plant&mach. operatives	163	4.8	61
Elementary occupations	306	8.9	74

Source: Labour Force Survey four quarter average Mar 2004 – Feb 2005

...but less growth in knowledge jobs than might be expected...

Given this view of the London economy, it is perhaps somewhat surprising to find that the short run of consistent time-series data available shows that it is skilled trades and process operatives that have made the biggest gains in job numbers in London relative to the experience in the rest of the country since 2001 (Table 3.4). For example, given the experience in Britain as a whole, London could have expected to lose over 1000 jobs in skilled trades. Instead, London gained 36,000 of these jobs – in other words, a gain of 15% on the 2001/02 base compared to the position had national trends prevailed in London. In two of the leading London occupational specialisms – managers and professionals – the growth in the number of jobs in London was below the national average. In the associate professional grouping, the number of jobs in London shrunk at a time of growth in the country as a whole.

Table 3.4 Changing occupational mix

	Actual change in employment 2001/02 to 2004/05	Relative gain / loss	Relative gain/loss as % of 2001/02 employment
Skilled trades	36,000	37,342	15.1%
Process, plant&mach. operatives	8,000	22,430	14.5%
Personal service	18,000	-28	0.0%
Elementary occupations	-9,000	-1,972	-0.6%
Managers & senior officials	46,000	-11,613	-2.1%
Professional	30,000	-17,060	-3.3%
Associate professional & technical	-22,000	-48,423	-7.6%
Sales and customer service	-9,000	-17,228	-7.6%
Administrative and secretarial	-67,000	-43,580	-8.3%
Total	31,000	-44,652	-1.3%

Source: Labour Force Survey

The most recent past has been a period of strong employment growth in the public sector – with the peripheral regions tending to enjoy the most rapid of this growth. In contrast, London’s employment is more private sector driven. With many of these new public sector jobs likely to be in managerial or professional roles, London’s recent under-performance in these occupations can be viewed as a temporary phenomenon related to the emphasis on public sector growth in the UK economy – a phase that is expected to draw to close as government spending growth subsides to a more sustainable rate. Nevertheless, it is possible that, given the policy emphasis on education and the changing nature of the UK economy, London’s lead in terms of the proportion of jobs in these knowledge-based occupations may have peaked – even if the absolute numbers and proportions continue to grow.

...and other regions enjoying faster growth in graduates in the workforce...

London’s lead in the proportion of its workforce possessing degree level qualifications may also be beginning to erode. With policy aimed at raising the proportion of the population who attend university, all regions have seen strong growth in the number of graduates in the working age population. For example, between 1997/98 and 2004/05 the number of graduates grew by 30% for the UK as a whole, but only by 27% in London, putting the city in third bottom place in terms of mainland UK regions.

These figures clearly demonstrate the general expansion of higher education in the UK. From its starting point as the area with the highest concentration of graduates in the workforce, it is not entirely surprising that London should be towards the bottom of the league in terms of growth - the starting base is simply higher. There may also be cost pressures at work. With higher living costs in London, only the best graduates or those with the most sought after skills can earn enough initially to enter the labour force – or take a job early in their career in London. With more graduates available, the range of starting, and indeed average career, earnings is likely to widen, making London viable for only a subset of all graduates. It would therefore not be surprising if London’s lead in terms of graduates in the workforce continues to erode. A more difficult, and contentious, question to answer is the relative quality of graduate skills available in London compared with the rest of the UK.

Table 3.5 Growth in working-age people with NVQ level 4+ qualifications	
(% change from 1997/98 to 2004/05)	
Eastern	39.3%
East Midlands	37.4%
Scotland	34.0%
North East	32.6%
Wales	32.0%
West Midlands	31.9%
Rest of GB	31.0%
South East	29.7%
North West	28.0%
London	27.2%
Yorkshire and The Humber	25.7%
South West	23.5%

Source: Labour Force Survey – four quarter averages

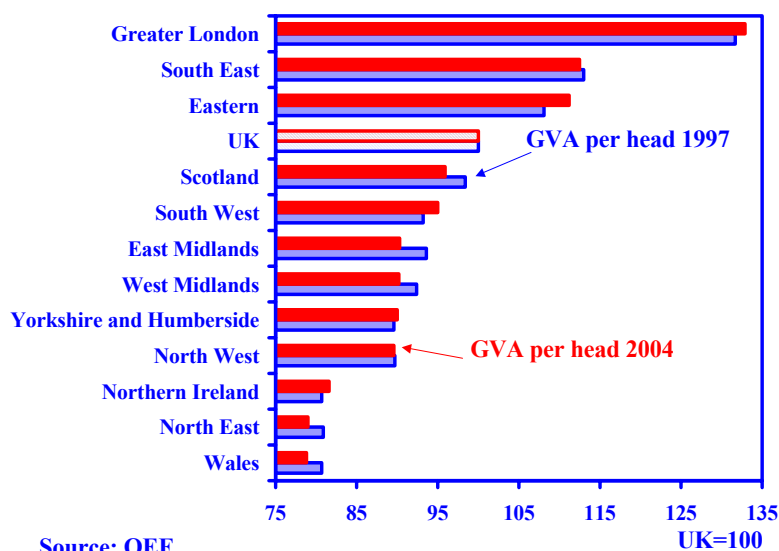
3.3 The productivity of the London economy

Productivity levels in the London economy outstrip those of any other UK region or city. Many factors contribute to productivity levels and growth. These include the skills and

experience embodied in the labour force; endowments of capital – both at the level of the individual firm or organisation and in terms of social infrastructure; benefits flowing from proximity with other businesses (known as agglomeration economies); and the openness of the economy to competition. While the exact contribution of each of these factors in London is difficult to quantify, the lead that London has on the rest of the UK is well entrenched – and may even be widening in some sectors.

Chart 3.3

London's productivity lead



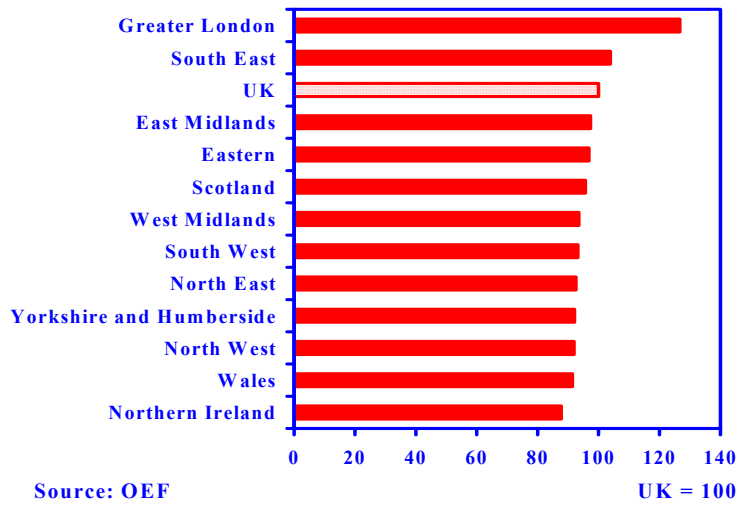
The widest measure of productivity is GDP (or GVA⁴) per head of population. As Chart 3.3 shows, GVA per head in London in 2004 was around a third higher than in the UK as a whole, and nearly 20% ahead of the next most prosperous region, the South East. The lead over Wales, the region with the lowest GVA per head in the UK, is close to 70%. Moreover, the evidence suggests that London's lead over the regions with below-average GVA per capita has been tending to rise – with only the South West and Northern Ireland bucking the trend since 1997.

While an accepted measure, GVA per capita will tend to overstate London's lead. The contribution commuters make to London's economy is captured by the GVA figures, but as they live outside the boundaries of the city, these regular travellers are not included in the denominator of the GVA per head calculation. It can therefore be argued that expressing GVA per job in a region is a preferable means of making inter-regional productivity comparisons. As Chart 3.4 shows, while this does change the magnitude of the gap between London and the other regions, London continues to show a substantial lead. GVA per job in London was 27% ahead of the UK average in 2004 – and 22% ahead of the South East (the only other UK region with productivity above the UK average). The gap with the lowest ranked region, Northern Ireland, was 44%, with all other UK regions 30-40% behind London. These figures underline how different the London economy is from the rest of the nation.

⁴ Gross Value-Added differs from Gross Domestic Product in some minor technical ways. The biggest difference, though, is that GVA is normally measured at basic prices, which exclude VAT and other taxes less subsidies on production, while headline GDP is measured at market prices. The two can often be used interchangeably, though – for an industry or region, its value-added corresponds to its contribution to the UK's GDP.

Chart 3.4

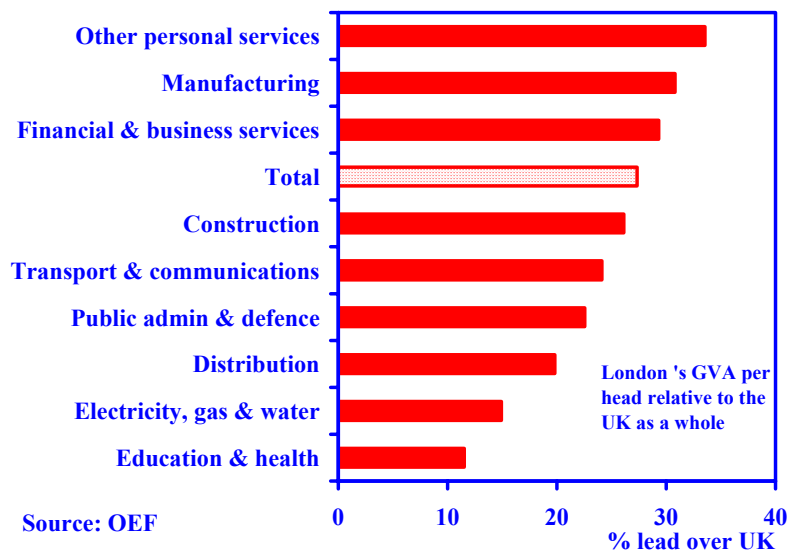
Productivity - GVA per job, 2004



London's aggregate productivity lead does not simply represent the presence of a greater concentration of sectors that typically generate higher productivity anyway. Rather, it is built up from a stronger productivity performance in each of the major sectors (Chart 3.5). Even the 'poorest-performing' sectors in London in terms of GVA per job – extraction and health & education – outstrip the UK average by 10% or more. If London had the same employment make-up as the UK as a whole, but achieved its current output per job levels, then it would still have a lead of 20% in output per job levels, compared with the prevailing gap of 27%. In other words, the structure of London's economy and its specialisation accounts for only about one quarter of its productivity lead.

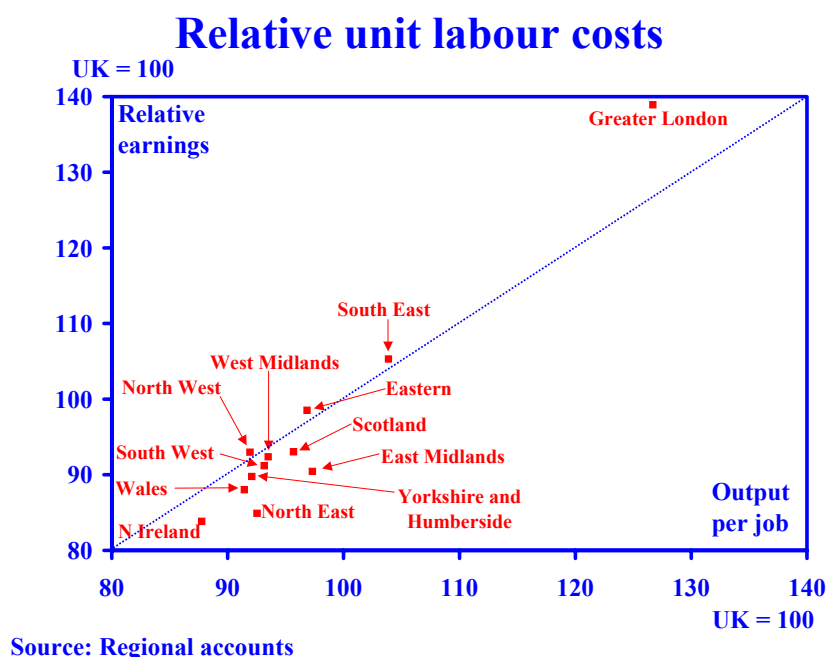
Chart 3.5

London's productivity lead by sector



London's high productivity is associated with high wages as well (Chart 3.6). Indeed, the wage differential between London and the rest of the UK is higher than the productivity differential, measured in terms of GVA per person employed, implying that unit wage costs are higher in London than in other parts of the country. At the same time – whether as one of the reasons why London employers have to pay higher wages or partly as a consequence of higher unit wage costs in London – average prices are also higher in London. In 2004, based on national consumption patterns, average prices in London were 9.7% higher than the UK average⁵ - the highest of any of the regions, and up from a 7.6% differential in 2003. Although housing costs are the biggest factor behind higher prices in London (see Section 4.2), prices are also higher in all but one of the 14 groups studied by the ONS.

Chart 3.6



3.4 Other influences on London's competitiveness

London's productivity performance is driven by a myriad of interconnected influences. Some of these are shared with the rest of the UK – for example, economic policy and regulation – but others are unique to London. Obvious differences in conditions in London compared with the rest of the UK relate to space costs and the impact of congestion, both of which act as a significant constraint on London.

(a) Property costs

Space costs in London – whether prime offices, retail premises or more general commercial property – are expensive, both in UK terms and internationally. Office costs relative to other parts of the UK are quite cyclical (see Chart 2.3), but are typically at least twice as high in London as the UK average. Internationally, the West End is the most expensive office location in the world (Chart 3.7).

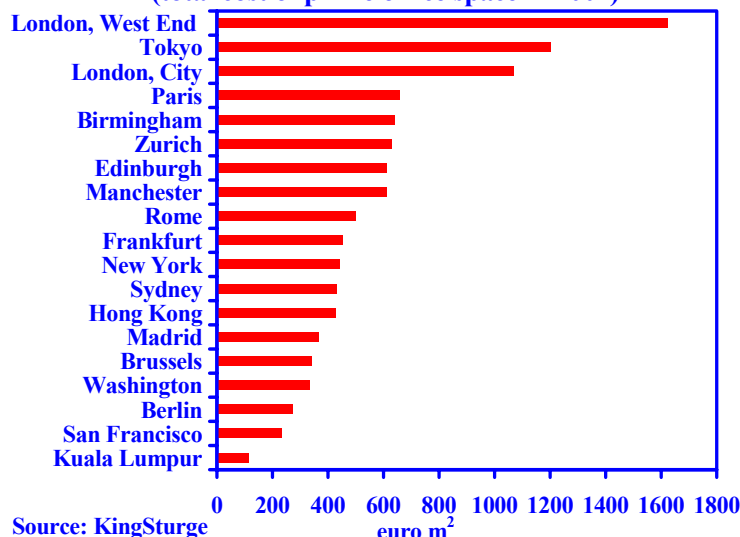
⁵ Office for National Statistics, 'Relative regional consumer price levels in 2004', *Economic Trends* February 2005.

Space costs are a key influence on the performance of the London's economy, particularly as they vary in a counter-cyclical fashion – with softening space costs encouraging activity in London during downturns and vice-versa. They also have an important influence on productivity developments. High costs drive a search for different ways of doing things to economise on the expensive resource. Some of London's dynamism is therefore likely to come from the innovation that is associated with reducing the need for space – for example, from restructuring processes to allow outsourcing or from applying technology to reduce the need for people. The net effect of this is to increase London's specialisation in highly productive tasks and raise the overall labour productivity of the city. Apart from the more direct effects – such as outsourcing to other parts of the UK or the demand generated in the rest of the UK by a highly competitive London economy - some of this innovation also feeds over time into the rest of the UK economy.

Chart 3.7

Office rents

(total cost of prime office space in 2004)



(b) Congestion

Congestion is another feature of London's economy that has a pervasive impact on activities carried out in the city. As discussed in Chapter 4, congestion bears on both businesses and individuals, with over 97% of City of London companies believing that the productivity of their staff is either seriously or somewhat reduced by problems faced in commuting⁶. Congestion imposes costs on businesses and workers, and reduces efficiency relative to what would be possible in an uncongested city. It also has the effect of driving the search for better ways to do things – through the use of technology and the search for new processes - to minimise the costs.

While space costs and congestion do have a positive effect on productivity growth as businesses seek to overcome the constraints they impose, this does not mean that providing appropriate space as cheaply as possible or finding ways of easing congestion pressures on London should not be a priority. Reducing space costs and easing congestion would allow more activity to take place in London. The activities attracted

⁶ *The Economic Effects of Transport Delays on the City of London*, Corporation of London, July 2003.

would tend to be high productivity in UK terms; would benefit from and contribute to the agglomeration of specialist functions in London; and many of them would have other city locations worldwide as alternative locations rather than other parts of the UK.

(c) **Entrepreneurship**

Entrepreneurial activity is increasingly seen as one of the key drivers of productivity and growth, with government policy oriented to stimulating new business formation. This stems from the belief that the drivers of productivity – innovation, skills, investment, competition and enterprise – all benefit from higher business start-up rates, while also recognising the UK trails many other developed economies in terms of the levels of entrepreneurial activity undertaken.

London is the most entrepreneurial of the UK regions⁷, with a significant lead over the country as a whole. For example, in 2003 entrepreneurial activity rates in London were more than 50% above the average⁸.

Chart 3.8

Total entrepreneurial activity, 2003 by UK region



While the individual and cultural drivers of entrepreneurial activity are complex, London's unique socio-economic composition plays a big role in explaining its higher rates of business start-ups. Individuals with higher incomes, more education and from the ethnic minorities are all more likely to begin new businesses, although there are significant differences between different groups within the ethnic minorities. On each of these scores London leads the rest of the UK, while the size and concentration of buying power for products and services of all types no doubt boosts the incentives for starting a new business. Without London and its special attributes, the UK as a whole would miss out on the significant benefits that flow from the higher overall rates of entrepreneurial activity than would otherwise be the case.

⁷ *Global Entrepreneurship Monitor*, United Kingdom 2003, London Business School

⁸ *Ibid.*

3.5 How competitive is London?

(a) The performance of London's exports

One sign of the competitiveness of London's economy is its success in generating exports. As might be expected given the structure of London's economy, exports of goods are relatively low as a share of the UK total. London's £22.4 billion exports of goods in 2004 accounted for slightly less than an eighth of all UK exports of goods (Table 3.6). On the other hand, our estimates show that London generated almost a quarter of all UK exports of services in 2004⁹.

Table 3.6 London's exports (2004)		
	£ billion	% of UK
Goods to EU15	9.0	8.5
Goods to non-EU15	13.4	15.8
Goods – total	22.4	11.8
Services	24.1	24.3

Sources: HMCR (goods); OEF estimates (services)

London's specialisation in financial and business services is confirmed by estimates of the composition of goods and services supplied to the rest of the UK – over half of these 'exports' from London are financial and business services of one type or another (Table 3.7). In total, London exported £125.3 billion of goods and services to the rest of the UK in 2004, up from £124.4 billion in 2003¹⁰.

Table 3.7 London's exports to the rest of the UK (2004)	
Sector	Exports (£ billion)
Agriculture	0.0
Mining and quarrying	0.2
Manufacturing	13.8
Electricity, gas and water supply	2.2
Construction	6.3
Wholesale and retail trade	13.0
Transport and communication	10.4
Financial & business services	66.3
Other services	13.1
Total	125.3

Source: OEF estimates

⁹ These estimates are produced as part of the exercise to estimate London's trade with the rest of the UK, discussed below.

¹⁰ For the methodology used to produce the exports estimates and the 2003 calculation, see *London's Linkages with the Rest of the UK*, Corporation of London, May 2004

(b) **London's balance of trade**

Our estimates of trade between London and the rest of the UK imply that London ran an overall surplus on trade in goods and services of around £15 billion in 2004 (Table 3.8). With imports having grown rather more rapidly than exports since 2003, this is down slightly on the surplus of £17 billion estimated for 2003.

The surplus is derived purely from the service sector of the economy, with London importing substantially more manufactures and other goods than it exports, underlining the extent to which London acts as the hub of financial and business services for the UK. Offsetting this trade surplus, there must be a flow of 'capital' from London to the rest of the UK. Some of this arises from the working of the tax and public expenditure system in the UK (see Chapter 5), but there are also likely to be offsetting flows of private capital.

Table 3.8 London's balance of trade with the rest of the UK (2004)

Sector	Exports less imports (£ billion)
Agriculture	-2.8
Mining and quarrying	-2.0
Manufacturing	-24.6
Electricity, gas and water supply	-1.2
Construction	-4.8
Wholesale and retail trade	6.9
Transport and communication	7.8
Financial & business services	23.6
Other services	11.9
Total	14.8

Source: OEF estimates

(c) **Trends in outsourcing from London**

Outsourcing and offshoring may seem like relatively new terms, but in reality they are part and parcel of national and international specialisation, driven by trade and globalisation, and have a long pedigree. In itself this should assuage the fears of headline writers that they are processes that destroy jobs and economies. Rather, they are a normal process in healthy, open economies. Like any economic change, there may be identifiable losers – at least in the short-term. What are sometimes much less visible are the powerful, widespread benefits that bolster growth in living standards and economic dynamism, both in the economy that is doing the outsourcing and in the recipient.

Nor are outsourcing and offshoring a finite process. As technologies and economies evolve there will always be pressures to move activity to the location where the same, or even higher-quality, products or services can be delivered at lower costs. This benefits the consumers of these products – many of whom will be other producers whose products in turn become more competitive; boosts returns to shareholders above what they would otherwise have been; reduces price levels; adds to demand in the region that is doing the outsourcing; and may even lead to new inward investment in the outsourcing region – as demonstrated for example by the increasing number of Indian investment projects in the financial service sector in London¹¹.

¹¹ *From the Ganges to the Thames: An Analysis of Indian FDI into London*, June 2005, GLA Economics and Think London

One way of gauging the exposure of an economy to future outsourcing or offshoring is to identify the extent of activities currently carried out within its boundaries that could, with current technology and processes, conceivably be located elsewhere. An approximation to this exposure can be derived by categorising employment across the UK regions into three categories - activities clearly staying where they are, those already moving overseas and those currently at risk - and mapping these onto each region's employment structure. In the charts below, distribution, retail, non-market services, utilities and construction are classified as activities staying in the UK; manufacturing, agriculture and extraction are defined as moving; and market services (business and financial services, transport and communication services) are deemed to be 'at risk'. This classification is necessarily crude. There are some non-market services that may be vulnerable to offshoring – for example Wipro has started offering remote radiology diagnostic services from India, while some MRI diagnostics are now supplied to the NHS from Belgium¹². Equally, there are market-based services that face little immediate threat.

Chart 3.9

Regional employment - 1980

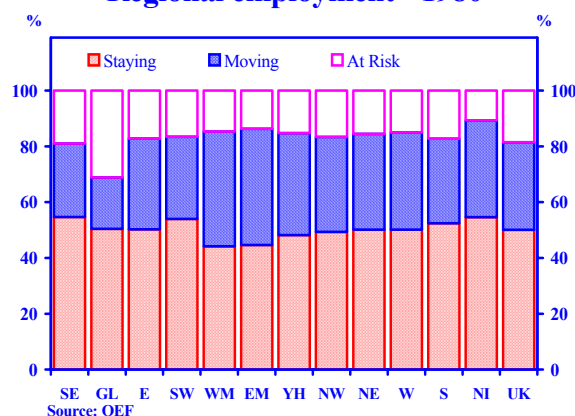
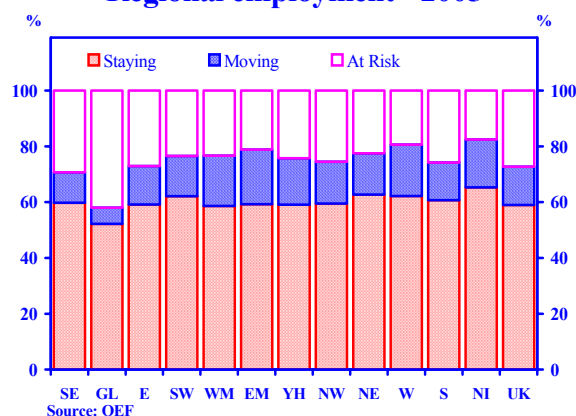


Chart 3.10

Regional employment - 2005



If anything, as the proportion of London's employment classified in the 'staying' category has edged up from around 50% in 1980, the immediate issues for London of outsourcing/offshoring appear to have diminished slightly over the medium term – this largely reflects the extent to which manufacturing has moved away from the city in the last quarter century. However, the 'at risk' segment – largely financial and business services - has grown somewhat to over 40% of the total. As a result, it is likely that headlines will continue to focus on the movement of activities away from London. However, the much more robust health of the London economy now – and the much higher living standards enjoyed by its inhabitants – is testament to the city's ability to thrive and grow through differing economic environments.

In comparison to the other UK regions, London continues – as in 1980 - to have more of its employment in 'at risk' sectors, compensated by a very low proportion in the moving category. Strikingly, since 1980 the proportion of employment in the 'staying' category has both increased across all of the regions - to almost 60% from just over 50% - and become much more evenly spread.

Looked at in another way these charts give an insight into London's competitiveness. London has successfully exited from activities that are inevitably moving away from the UK, but manages to attract and retain activities that are at a much earlier stage of internationalization. With hard to replicate advantages – 'World City' status, critical mass

¹² *Offshoring & the UK Public Sector*, Egov Monitor, April 2005, <http://www.egovmonitor.com/node/706>

in a wide diversity of knowledge-based industries, and an affluent consumer base – London should remain a location of choice as long as infrastructure and labour supply issues can be addressed. Moreover, research on offshoring and the City¹³ concludes that restructuring of City-based operations is a necessary condition for delivering the next generation of value-based products which will in turn draw on the skills base of locally staffed functions and associated process support. The net employment effect of City offshoring is likely to be negligible. Current evidence does not suggest the likelihood of substantial job losses in core wholesale services as a consequence of the offshoring of work from financial services. At the same time, any offshoring that does occur should allow the Central London financial services sector to increase its productivity further by encouraging greater specialisation in the activities in which London has a comparative advantage.

However, there is also a warning implicit in the snapshot of recent UK economic history presented in Charts 3.9 and 3.10. The regions with the biggest shares of ‘moving’ employment in 1980 are those that have faced the most painful adjustments since then – exemplified by higher unemployment rates than in the most dynamic parts of the UK. Competitive edges once lost are hard to regain – arguing for careful consideration of London’s investment needs if it is to maintain its ability to compete.

(d) **London’s ability to attract inward investment**

In a globalising world the UK enjoys a high degree of success in attracting inward investment. In this overall picture London plays a key role, as a location of choice for many businesses, as a specialist service provider and as a ‘World City’ (see Chapter 6). Without London’s particular attractions the UK as a whole would be a net loser in terms of investment and jobs by foreign-owned enterprises. One particular aspect in which London dominates is as a home to headquarters, which is discussed further in Chapter 6.

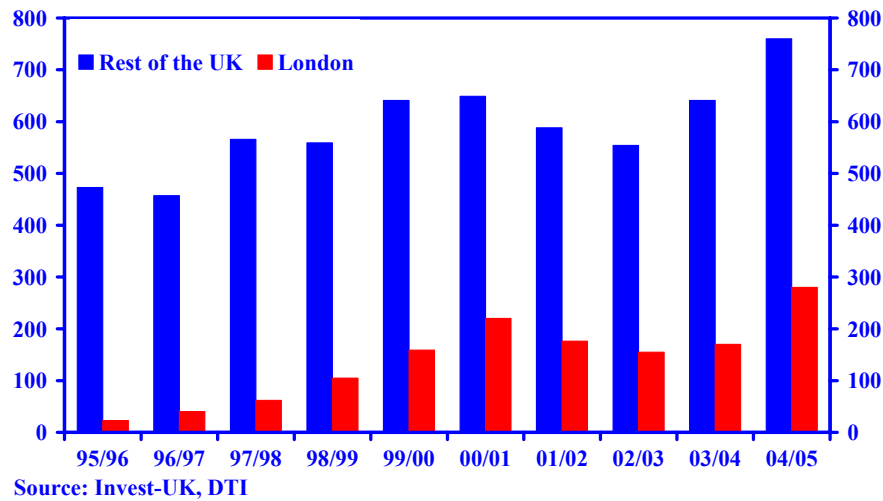
Measured by the stock of inward investment, the UK lies second only to the US. According to UNCTAD, the value of this stock stood at US\$772 billion at the end of 2004 – nearly 50% higher than the equivalent figure for France and more than twice Germany. In terms of flows of investment, the Ernst & Young European Investment Monitor ranks the UK ahead of all other European locations, and UNCTAD shows that the UK has a market share of 30% of inward investment to Europe in 2004. Forward-looking indicators also place the UK in a favourable light. The UK was ranked fourth behind China, the US and India by the A T Kearney 2004 FDI Confidence Index®. Reasons put forward by UK Trade & Investment for this success include the openness and flexibility of the UK economy. Arguably, however, London plays an important, if difficult to quantify, role in this success.

Since the mid-1990s, London has played an increasing role in direct investment projects coming to the UK (Chart 3.11), enjoying a sharp pick-up in inward investment projects from 23 in 1995/96 to 280 in 2004/05. The rise in projects coming to London has not resulted in a drop in the number of projects going to other parts of the country. Over the same period inward investment projects to the rest of the UK rose from 473 to 760, underlining the UK’s overall success in an increasingly competitive marketplace.

¹³ *Off-shoring and the City of London*, Corporation of London, March 2005

Chart 3.11

Inward Investment Projects

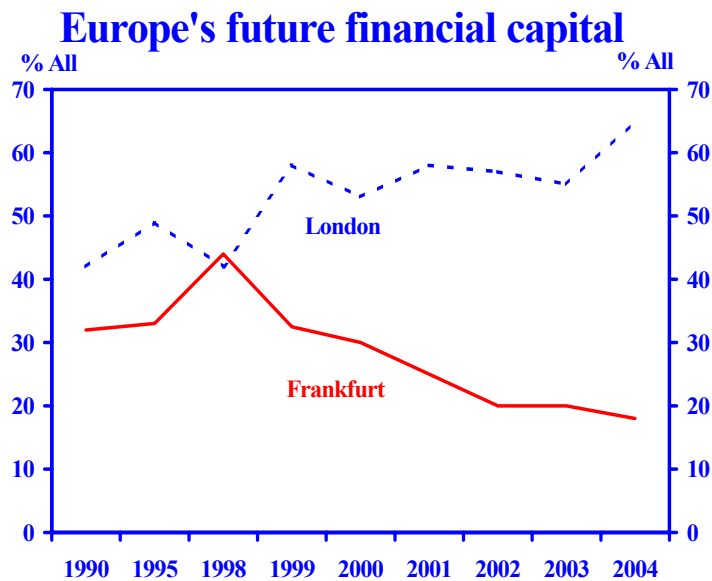


This reflects both a shift in the nature of the projects away from manufacturing towards the service specialisms of London and the success that London has had in adding to the overall number of projects coming to the UK. For example, the survey-based Cushman & Wakefield, Healey & Baker, 2005 European Cities Monitor ranks London first out of 30 European cities as a location for business. In 15th place, Manchester is the next highest ranked UK city. And in terms of market share, the Ernst & Young Monitor identifies London as receiving 20% of all software and 18% of financial services projects coming to Europe in 2003. Finally, according to Cushman & Wakefield, London's perceived lead as the future financial capital also now stands at an all-time high (Chart 3.12). There was a brief period in the run-up to EMU when the UK's position outside the single currency meant that more companies expected Frankfurt to take over London's pre-eminent position as the financial capital of Europe. But there are now more than three times as many companies seeing London continuing in this role in the future rather than see Frankfurt taking over¹⁴.

Inward investment projects bring many benefits. In addition to output, jobs and demand for locally sourced inputs, there is evidence that foreign-owned establishments contribute to the level and growth of productivity in the UK – for example, by introducing new methods and techniques, adding to the skills embedded in the labour force and encouraging adaptation by suppliers, competitors and customers. They also enhance the dynamism of the London and UK economies, helping to maintain the UK's strong relative economic performance among developed nations.

¹⁴ 2004 was the last time this question was asked in the Cushman & Wakefield, Healey & Baker survey.

Chart 3.12



Source: Cushman & Wakefield, European Cities Monitor, 2004

Inward investment to London will benefit the UK as a whole from each of these routes. Recent research helps to quantify some of these effects¹⁵. Over 500,000 jobs – approximately one in seven of all jobs in London, spread across a wide range of key London sectors – results from London's stock of inward investment. The productivity of employees of inward investors is around 60% higher than in domestic companies – with evidence of a much higher proportion of graduates in their workforce and typically higher than average wages. The tax take from London's inward investors is estimated at £3 billion – 36% of the total paid by London companies and higher than their share of output of nearly one quarter.

With few of these inward investors in London possessing other UK locations prior to arriving in London, there is a clear contribution to overall income and wealth in the UK. The UK as a whole gains to the extent that these inward investors:

- make better use of UK resources – workers, property, investment
- provide cheaper, higher quality outputs
- demand greater quantities of locally sourced inputs
- pay more to the Exchequer
- pay higher wages

than would be the case if the same resources were deployed in domestic establishments. Moreover, through the linkages between London and the rest of the UK economy these net benefits are widely spread.

London's higher cost base makes it likely that projects that choose the city are not a loss to other parts of the UK that enjoy lower costs. Rather, the alternative for London's inward investors is likely to be other capital cities in Europe or even major centres in the

¹⁵ *One in Seven - The Economic Impact of Inward Investment on the London Economy*, Think London, November 2004

US or Asia. In looking for threats to inward investment to London, it is therefore the competition from these centres that needs to be taken into account. Particular concerns for current inward investors are property costs, the transport system and quality of life issues such as crime and pollution.

3.6 Conclusions

London clearly remains highly competitive in a number of ways. London's productivity performance continues to improve relative to the rest of the UK, with gross value added per job 27% higher than the national average in 2004, up from 22% five years ago. In part, this reflects the specialisation of the London economy in a range of high productivity service sectors - most notably in financial, insurance, legal and accounting services, and in media activities (e.g. advertising, TV, radio and film). But London's productivity is relatively high in all of the major sectors, including construction, transport & communications, and distribution.

In part, this reflects the high skills of the London workforce – in 2004 nearly 32% of London's workforce had degree or equivalent level qualifications, compared with 26% for the UK as a whole. With government policy encouraging increasing university participation, the number of working-age people with degree-level qualifications in London has increased by over 27% since 1997-98. However, most other regions are seeing even faster increases in the graduate workforce, in part perhaps reflecting the relatively high cost of living in London.

The competitiveness of the London economy is reflected in its export performance. Exports to the rest of the UK rose to £125.3 billion in 2004, slightly less than the rise in imports. But London continues to run a substantial trade surplus with the rest of the UK, totalling £15 billion in 2004. Moreover, London exported £46 billion of goods and services to the rest of the world in 2004.

Similarly, London remains a magnet for inward investment to the UK, attracting 37% of all inward investment projects in 2004/05, compared with just 5% in the mid-1990s. The fall in the relative cost of commercial property in London compared with the rest of the UK suggests that the pace at which back office and support jobs move to centres such as Leeds and Manchester may ease in the short term. Offshoring is not expected to have a significant impact on overall employment in London as it facilitates greater specialisation in the activities in which London has a comparative advantage.

4 Structural Issues Facing the London Economy

This chapter focuses on some structural issues facing the London economy, including the contrast between, on the one hand, strong overall economic performance and, on the other hand, low employment rates for some Londoners, particularly in the inner boroughs. It also discusses potential constraints on London's growth from transport infrastructure challenges and physical space constraints.

4.1 Where does London's economy under-perform?

A number of the preceding sections have illustrated the strengths of London's economy relative to the rest of the UK. However, London's economy is not an unqualified success and in this section we turn our focus to areas of under-performance.

Despite having the highest per capita income of the UK regions and typically recording the fastest rate of economic growth over the past fifteen years, London's labour market performance is in many ways much poorer than the UK average. For London as a whole, the unemployment rate as measured by the Labour Force Survey (LFS) currently stands at 6.7%, significantly above the national average of 4.7% (Chart 4.1). Indeed, the North East, with an unemployment rate of 6.9%, is the only other UK region with a rate above 5.5%. London also has the lowest employment rate in the UK - i.e. the proportion of the working age population that is in work. London's employment rate is currently just 69.8% against a national average of 74.8%, and has been falling steadily over the past five years (Chart 4.2). The poor performance of this aspect of the London economy is even more stark when compared to the neighbouring regions of the South East and East where, in each case, the unemployment rate is under 4% while the employment rate is close to ten percentage points higher, at 79.1% and 78.4% respectively.

Chart 4.1

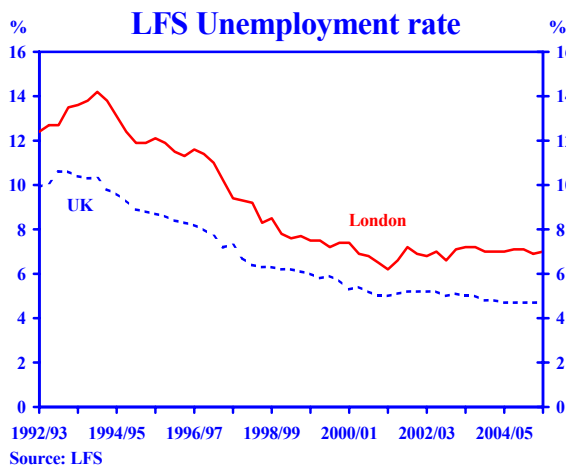
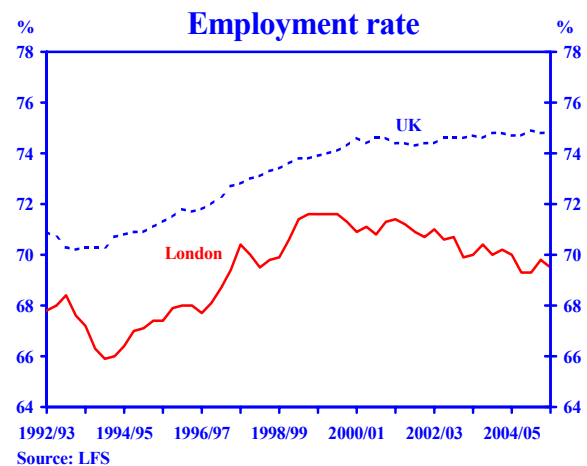


Chart 4.2



Closer examination reveals a very significant divergence in labour market performance across the London boroughs. Excluding the City of London, which has a working age population of just 6,000, the average unemployment rate in the inner London boroughs is 8.3%, with the average employment rate just 64.3%. Moreover, none of the inner boroughs has a labour market performance that is better than, or even as good as, the national average. Tower Hamlets and Hackney have the worst unemployment rates, of 12.6% and 11.9% respectively, while Tower Hamlets, Newham, Hackney and Haringey

all record employment rates that are below 60% - indeed, these four boroughs have the lowest employment rates of any local authorities in the UK. The boroughs that currently come out worst in this analysis typically occupied similar positions ten or even twenty years ago, indicating the persistence of labour market under-performance.

The outer London boroughs have stronger labour markets on average, with unemployment and employment rates averaging 5.9% and 72.5% respectively. Here, the lowest employment rates are in Waltham Forest and Barking & Dagenham, at 63.5% and 64.4% respectively. Moreover, in half of the nineteen outer London boroughs, the employment rate is similar to or above the national average.

The comparison is perhaps even more stark if some other people not in employment are included, such as those on long-term sickness benefits or on government training schemes (Table 4.1). London has almost as many local authorities with 'true' unemployment rates above 15% as the North West, and only the North East has a significantly larger proportion of local authorities in this category. Indeed, levels of 'true unemployment' in inner London compare with some of the worst hotspots in the northern conurbations, and those in other parts of London are still well above surrounding parts of the South East, particularly to the west of London.

Table 4.1 'True unemployment'			
(local authorities, 2002)			
	No. of LAs with rate above 15%	Total LAs in region	% of LAs with rate above 15%
North East	10	23	43%
North West	8	43	19%
London	6	33	18%
Yorks. & Humber	2	21	10%
East Midlands	2	40	5%
Eastern	1	48	2%
West Midlands	0	34	0%
South West	0	45	0%
South East	0	67	0%
-----	-----	-----	-----
England	29	354	8%

Source: Beatty, Fothergill et al., *The Real Level of Unemployment*, 2002

What is the cause of these pockets of labour market under-performance? In some cases, such as Barking and Dagenham, recent weakness can be attributed to cutbacks in manufacturing employment. In common with the rest of the UK, London has seen significant declines in manufacturing employment as firms have shed labour and or closed plants.

However, in a number of boroughs the explanation is much more complex and encompasses social and economic issues, and the interactions between them. For example, even in the poorest London boroughs, the cost of living is relatively high compared to the UK average. This brings additional social problems in terms of the recruitment and retention of teachers, medical staff and other 'key workers'. Boroughs such as Hackney, Tower Hamlets, Newham and Southwark not only under-perform in the labour market, but also feature towards the top of the Office of the Deputy Prime Minister's Government's 'Indices of Deprivation'¹⁶. The Indices of Deprivation represent deprivation through a range of measures covering not just income and employment, but also health, education, crime, barriers to housing and living environment. Indeed, of the ten districts ranked as the most deprived in the UK, five are in inner London.

Table 4.2: Deprivation by district	
Average rank, 2004	
1	<i>Hackney</i>
2	<i>Tower Hamlets</i>
3	Manchester
4	<i>Islington</i>
5	Liverpool
6	<i>Newham</i>
7	Easington
8	Knowsley
9	Nottingham
10	<i>Haringey</i>

Source: ODPM

More generally, there is no necessary contradiction between a strong growth performance in London employment co-existing with low employment rates for Londoners. First, London's population has grown rapidly at the same time as employment has risen, leading to more people looking for jobs at the same time as an increase in the number of jobs available. Second, many jobs in London are, of course, not filled by Londoners but by workers commuting into London from surrounding areas, with commuting adding in net terms around half a million more people to London's labour supply (see Section 4.3). We saw in Chapter 3 that, while London has a higher proportion of graduates in its workforce than the UK average, it also has a slightly higher proportion with no qualifications or only qualifications below NVQ level 2 (see Table 3.2). At the same time London has significantly fewer jobs in relatively unskilled occupations than the UK average proportion (see Table 3.3). With relatively few jobs for London's less well-qualified workforce to do, it is perhaps no surprise that much of London's success in generating new jobs has primarily benefited inward commuters rather than those living in some of the underemployed inner London boroughs.

Indeed, despite our forecast that London will employ another 450,000 people by 2015, we still expect London's unemployment rate to be around 3.5% of the labour force on the claimant count basis or around 6.9% on the ILO definition used in the LFS, similar to today's rate. If that turns out to be the case, it is difficult to see a successful London economy on its own being enough to correct the big inequalities between the more prosperous and more deprived areas of London.

¹⁶ *The English Indices of Deprivation 2004 (revised)*, Office of the Deputy Prime Minister, April 2004.

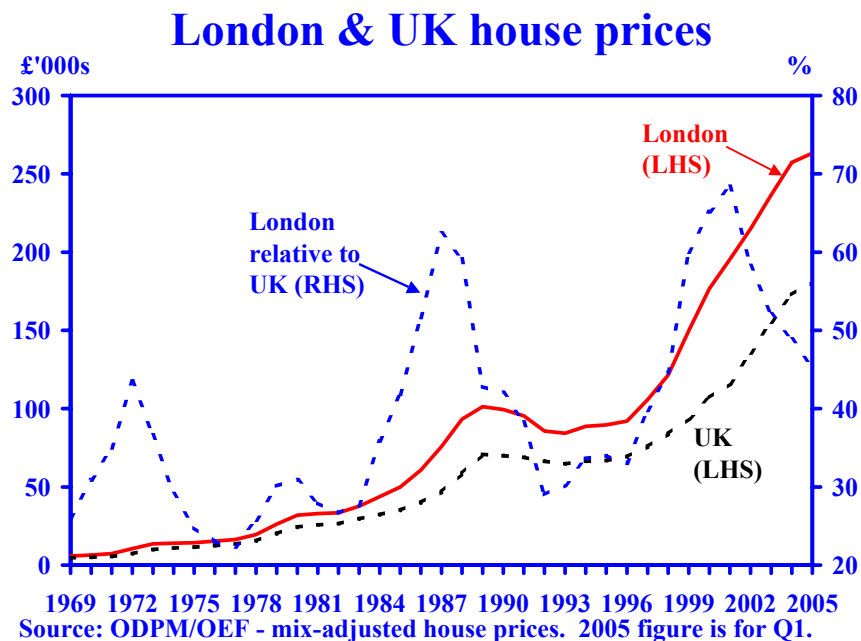
4.2 Accommodating London's growth

The continued growth in both population and jobs projected for London over the next decade is likely to generate increasing pressures on the planning system to find ways in which this growth can be accommodated. In part, this means that there is likely to be a recurring discussion around the role of the Green Belt in London's planning system, with questions raised over whether increasing the scope for development in certain parts of the Green Belt might allow London's economy to function more efficiently. It also suggests that competition between residential and commercial use may intensify, particularly in areas immediately surrounding the commercial centre of the city.

(a) The pressures on the housing market

London residential property prices are the highest in the UK, with ODPM figures showing average prices 48% higher than in the country as a whole in 2005Q1. Although prices in London have grown by less than the UK average in recent years, when looked at over a longer time horizon it is clear that the gap between London and the rest of the country has been widening (Chart 4.3). In the early 1970s housing market peak, average London prices were nearly 44% higher than UK prices, but this percentage rose to over 62% in the late 1980s peak and to more than 68% in 2001. This widening differential is a potential handicap to the London economy, as it can hinder the movement of workers from lower-priced parts of the country to high-priced London and/or force businesses to pay higher salaries in order to attract and retain staff.

Chart 4.3



Within London, there is a wide range between average house prices in the most expensive and the cheapest boroughs, ranging in 2004 from an average of £715,000 in Kensington and Chelsea at the top of the range to an average of £164,000 in Barking and Dagenham at the bottom of the range (Table 4.3). But it is striking that this is the only borough in which average prices in 2004 were lower than the average across the

whole of England – the next lowest London borough was Bexley, where prices averaged £189,000 in 2004 compared with an English average of £181,000.

Table 4.3 Average house prices in London boroughs (£000's, 2004)			
England	181		
London	276		
Highest		Lowest	
Kensington & Chelsea	715	Barking & Dagenham	164
Westminster	508	Bexley	189
Camden	414	Newham	191
Richmond-upon-Thames	385	Waltham Forest	195
Hammersmith & Fulham	384	Lewisham	199

Source: Land Registry

Essentially, high London prices reflect the high average incomes of London residents as well as the relatively fixed supply of land on which to build new homes. The shortage of available land contributes to a marked differential in the price of land that has outline planning permission, which in January of this year cost £8.4 million per hectare in London compared to £3.3 million for England as a whole. As noted above, even the relatively poor areas of London still have high residential prices by national standards, which present particular problems for those on low incomes. Despite an increase in the resident population of close to 400,000 over the past decade, the number of new homes built in London has totalled just 156,000. Clearly, housing supply has barely matched growth in demand and has been a significant contributor to the large increase in house prices.

Looking ahead, our forecast shows London's population rising by a further 615,000 between 2005 and 2015, broadly consistent with GLA planning assumptions in the London Plan, which show a population of 8.1 million in London in 2016. In order for London to sustain this population increase, significant investment in new housing is needed. The GLA has identified the need for some 22,000 additional homes a year to meet the growth in population, plus a further 11,000 pa to eliminate the stock of sub-standard housing. The resulting goal of adding some 33,000 new homes pa is significantly above current construction rates. The London Plan calls for new homes to be built across London, but two areas, Central London and the East, are planned to account for the bulk of the increase, with 107,000 and a minimum of 104,000 respectively. East London incorporates many of the most deprived London boroughs and is a priority area for development, regeneration and infrastructure improvement. Much of the development will be focused on the Thames Gateway, with development for the Olympics seen as a catalyst for the area.

The plans for future development are ambitious and, if it proves difficult to increase house building on the scale envisaged, then this could prove a constraint on London's future growth. It is also worth remembering that providing the housing needed to

accommodate London's growth is not just about the volume of new houses keeping pace with demand. There is also a significant issue of affordability – it is no use having extra houses if they are too expensive for key workers to be able to buy or rent them. This is not an easy situation to resolve. Work on modelling regional housing markets in the context on affordability targets suggests that large increases in construction may be needed to have any significant impact on affordability¹⁷. The problem is that in areas of relatively high demand for housing like London, the price of houses has to act as a constraint to choke off enough demand to maintain some sort of balance with supply. If an increase in house building put downward pressure on prices, this would lead enough people back into looking to live in London to limit any downward movement in prices and any corresponding improvement in affordability.

(b) **Issues for the commercial property market**

The commercial property market faces some similar issues to the residential property market, with high land prices contributing to high rental charges. As discussed in Chapter 2, the shakeout of employment in London after 2000, and the limited recovery since then, had a substantial impact on rents. In conjunction with a boom in the completion of Central London office developments, which peaked with over 1 million square metres of office space being completed in 2003, this has led to a substantial increase in vacant property, together with falls in office rents.

However, office development activity has slumped in the past couple of years. Completions fell to less than 500,000 square metres last year and are projected to average less than 250,000 square metres per annum between now and 2007¹⁸. At the same time, London's continued economic success is predicated largely upon on-going growth in business and financial services, which we expect in net terms to account for all the increase in employment of 450,000 we are forecasting between now and 2015. These extra workers imply the need for significant new office developments, even though availability is high in the office market in the short term. The GLA estimate the stock of London office space at 27.4 million square metres in 2002 and project the need for an additional 7-9 million square metres of office space by 2016.

One way of helping to meet this demand is through building taller office blocks, and there have been a spate of proposals for high-rise towers in the City. Apart from developments in the traditional centre of London, Docklands provides an important means of meeting some of this potential demand, with Canary Wharf having recently secured planning permissions to develop an additional 7 million square feet (around 0.7 million m²) of office space. With current rents also substantially lower in the City (and even more so in Docklands) than in the West End (see Chart 3.7), it looks at least possible that commercial property will be more of a constraint for London's growth in the western part of the city centre than the east. This in turn has potential implications for the sectors that have traditionally clustered in different parts of London, with commercial property constraints potentially less of an issue for financial and related services centred round the City than for some of the core business service activities located more often in the West End.

¹⁷ See *Affordability Targets: Implications for Housing Supply*, draft final report to ODPM, Geoff Meen *et al.*, April 2005

¹⁸ *Central London Market Report, 2005Q2* Jones Lang LaSalle.

4.3 London's transport infrastructure challenges

(a) Commuting patterns and the costs of transport delays

The transport infrastructure is vital to the operation of London's economy, enabling the resident workforce to commute within London, as well as enabling non-residents to commute in.

Each year in the Greater London area there are around 2.5 billion work-related journeys, with Central London accounting for 40% of these. There is a marked difference in modes of transport used in Central London compared to the rest of London. Within Central London, public transport networks support over 70% of all work-related journeys, with cars/motorcycles accounting for under 16% (Table 4.4). However, outside of Central London, cars/motorcycles are the single most important form of transport at just under 50% of the total, while public transport networks are used for just under 27% of journeys.

	Central London		Rest of London		Greater London	
	Millions	% share	Millions	% share	Millions	% share
Bus	114	11.5	247	16.3	361	14.4
Underground	379	38.2	42	2.8	421	16.8
Rail	212	21.3	110	7.2	322	12.8
DLR	8	0.8	10	0.7	18	0.7
Car/motorbike	156	15.7	728	47.9	884	35.2
Taxi	10	1.0	8	0.5	18	0.7
Walk	104	10.5	348	22.9	452	18.0
Bicycle	10	1.0	26	1.7	36	1.4
Total	993	100.0	1519	100.0	2512	100.0

Source: London Travel Report 2003; TfL Custom Analysis

Inward commuting plays a significant role in providing London's economy with the workforce it needs, with around 725,000 people commuting into London¹⁹. This amounts to 17% of the jobs in London. Moreover, two-thirds of in commuters are employed in managerial, professional or technical occupations, emphasising the reliance of London's high-value added service industries on commuters and, therefore, an efficiently functioning transport network. Unsurprisingly given their geographic proximity, the South East and East of England account for the bulk of inward commuters, 52% and 39% respectively according to the 2001 Census, with the rest of the UK contributing the remaining 9%.

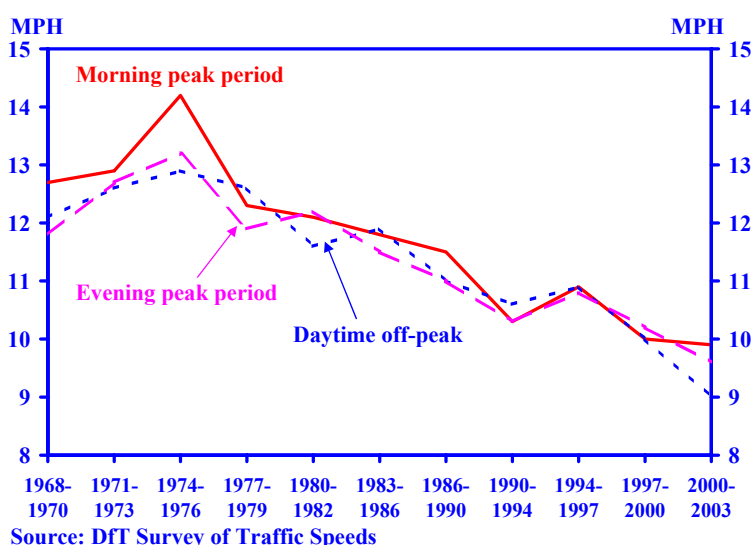
The commuting story, however, is not just one of workers travelling into London from neighbouring regions. Almost 240,000 people, 5% of the working age population, commute out of London – this is a 60% increase compared to the early 1990s. The net

¹⁹ *Growing together: London and the UK Economy*, GLA, January 2005

commuting balance of almost 500,000 was relatively flat from 1997 onwards, but appears to have fallen in 2003, both as in-commuting fell and out-commuting rose further. The flat trend in the net commuting balance between 1997 and 2002 occurred at a time when employment in London rose by 250,000. The London labour market was relatively weak post 2000 as the City, especially, shed labour, which probably accounts for the decline in net commuting in that period.

London's transport infrastructure challenges are well known. Average road traffic speeds in Central London have been on a downward trend for several decades (Chart 4.4). At the same time, delays, cancellations and overcrowding are frequent occurrences on Underground and overland train services – most rail companies have seen a fall in the proportion of trains arriving within five or ten minutes of their scheduled arrival time in the past few years.

Chart 4.4
Average traffic speeds in Central London



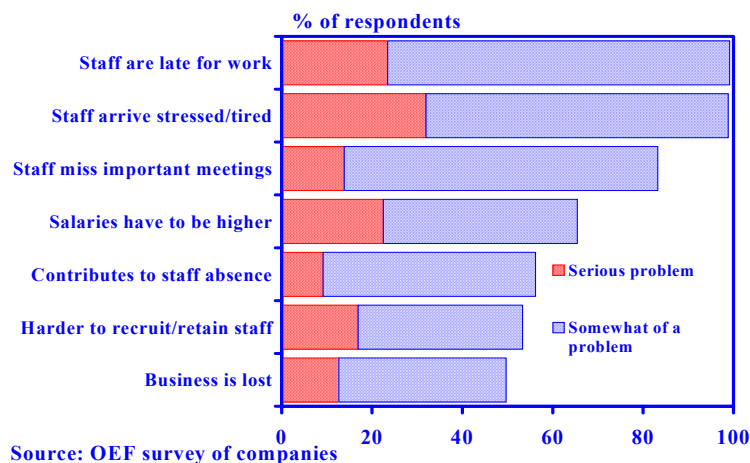
Clearly, transport in densely populated urban areas will inevitably be less rapid than elsewhere and is one of the costs that must be borne in exchange for the benefits urbanisation brings. However, a poorly functioning transport network imposes a range of additional costs to businesses, to individuals and ultimately to the economy. Some of these costs can be quantified by placing a value on the time lost due to transport delays. An OEF study into the cost of delays²⁰ estimated these based on the importance of different transport modes for travel in Central London, the average length of delay on each mode, and the value of the time involved, with this value depending, for example, on whether the time would otherwise have been used for leisure or work purposes. So, time lost while on business travel was typically assumed to be lost to the employer, while time lost travelling home from work was assumed to be lost leisure time. (Time lost travelling to work was split between the two, according to the extent to which employers and employees said that the company expected workers to make up the time or not.) Even using deliberately conservative assumptions, the study estimated the costs of delays for commuting into Central London to amount to £870 million for commuters and £320 million for businesses. A further £560 million cost was borne by those travelling for non-work reasons such as tourism or shopping.

²⁰ *Time is Money: The Economic Effects of Transport Delays in Central London*, produced by OEF for GLA Economics, January 2005.

However, these costs are only part of the true overall cost. For example, an unreliable transport network may mean that commuters have to allow additional time for their journeys in case they are held up. Individuals also bear additional burdens from transport delays and overcrowding that are harder to place a value on, such as stress, tiredness and a negative impact on family life.

Similarly, businesses may experience reduced levels of productivity if their staff arrive in a tired or stressed state, or if they need to factor in possible transport delays into their plans. Moreover, transport delays can result in business being lost if important meetings are missed or delivery times not met. In addition, businesses are likely to need to pay higher wages to compensate employees for the additional stresses of commuting on unreliable transport networks, as well as face difficulty in recruiting and retaining staff. Ultimately, the additional costs imposed on businesses from an inefficiently functioning transport network can lead to new investments being made outside of London and even the relocation of existing operations outside of London. Although recruitment /retention was not reported as a problem in our survey by as many companies as commented on stress and missed meetings (Chart 4.5), nevertheless 53% of respondents in our survey of companies saw the impact on recruitment and retention as a serious problem or somewhat of a problem, while 65% saw the need to offer higher salaries to compensate as a problem.

Chart 4.5
Is your organisation affected by problems your staff face in commuting to work?



Clearly, then, transport delays are a serious issue for business, workers and residents in London. There are clear long-run risks to the London economy if the performance of the transport network fails to improve, particularly given the projected increase in population and employment numbers. Our forecast shows jobs in London growing by an average of nearly 1.4% a year over the next decade, compared with growth in the working-age population averaging around 1.1% a year, implying a growing demand for commuting. Even if population growth exceeds employment growth, this will only reduce the demand for commuting into London if there is a reasonable match between the skills required for the additional jobs and those available from the resident workforce, which is by no means a given (see Section 4.1 above). It is also worth bearing in mind that commuting into London from surrounding areas only accounts for a minority of the commuters suffering from transport delays – the bulk of commuters are travelling from within Greater London to jobs in the central business district.

It is likely therefore that, with the overall number of jobs in London expected to grow significantly, the difficulties caused by transport delays will only get worse unless considerable efforts are made to tackle the issue. While there are plans to invest £10 billion over the next five years in, for example, extensions to the DLR and East London lines, a new road bridge across the Thames and a variety of station, train, track and signal upgrades – partly associated with the Olympics - government funding for Crossrail is still not forthcoming.

(b) **The impact of the congestion charge**

One measure that has been introduced in order to reduce congestion in central London is the congestion charge, which came into effect in February 2003. The charge, now set at £8, applies on weekdays between the hours of 7am and 6.30pm. Central London congestion fell 30% soon after the charge was introduced²¹ (Table 4.5). This reduction was, by and large, maintained through to the summer of 2004, but recent figures do indicate some pick-up in congestion since September 2004, albeit remaining well below levels experienced prior to the introduction of the charge. Traffic from central London may have been expected to be displaced onto other routes, but this appears not to have been the case, with traffic levels elsewhere more or less unchanged since the charge was introduced.

Table 4.5: Congestion in Central London, 2000 (seconds lost per vehicle km)			
	Weekday peak periods	Weekday off-peak	All periods
2000 estimates:			
Central London	120.0	134.3	69.3
Inner London	109.8	68.1	53.7
Outer London	50.1	30.3	27.1
Greater London	65.8	45.5	35.7
2004 estimates:			
Congestion Charge Zone ²²	92.3	103.3	53.3
Central London ²³	98.0	110.0	57.0

Source: 'Time is Money: The economic effects of transport delays in Central London', produced by OEF for GLA Economics, January 2005.

The charge has therefore been successful in reducing congestion to some degree. At the same time, there has been a cumulative increase of close to 30% in the number of bus passengers entering the central London area during weekday mornings. In part, this growth is a continuation of an upward trend seen in recent years arising from improvements in bus services in the whole of London. However, the congestion charge appears to have contributed to an above-average improvement in bus services in and around the charging zone, at least in 2003, with 'excess waiting time' – the additional waiting time at bus stops experienced by passengers due to service irregularity – falling by 30% compared to a 24% decline in Greater London. Subsequently, continued improvements in and around the charging zone have been in line with those for Greater London. The improvements in excess waiting times have been helped by significant reductions in disruption to services caused by traffic congestion.

What has been the cost of the congestion charge to businesses in and around the charging zone, though? It must be said that it is not easy to identify the specific impact of

²¹ Transport for London, *Congestion Charging: The Third Annual Monitoring Report*, April 2005.

²² The 2004 Congestion Charge Zone estimate is the 2000 figure reduced by 30%, as a result of the fall in congestion measured since the introduction of the Congestion Charge.

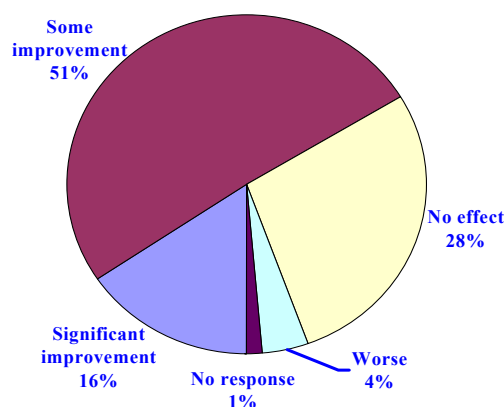
²³ Assuming that 75% of car journeys to/from/within Central London (by distance) are inside the Congestion Charging Zone.

the congestion charge on businesses from all the other factors that can have a bearing on their performance. This is especially the case given that the London economy experienced a pronounced slowdown in the early part of this decade. An additional complicating factor is that any negative economic impact that the Iraq War had on the number of tourist visitors to London would likely have impacted at a similar time as the congestion charge was introduced. However, with those caveats in mind, the available quantitative evidence suggests that the introduction of the congestion charge has been more or less neutral for businesses overall in and around the zone.

If it is difficult to place too much weight on hard, quantitative indicators, perhaps survey evidence can provide a clearer guide to the impact of the congestion charge on businesses. TfL survey evidence for 2004 found that, of businesses that reported a decline in sales, 27% cited the congestion charge as a negative influence, second as a cause only to 'economic conditions'. A net balance of firms also reported that the congestion charge had increased the cost of running a business in central London. Offsetting these negatives is the fact that 12% of firms that reported an increase in sales cited the congestion charge as a positive influence. In addition, firms on balance indicated that it is now easier to move around central London, citing benefits such as journeys being more reliable; it being easier to get to business meetings; and easier for customers to visit and for suppliers to deliver, and also easier for firms to send deliveries to customers. Overall, the TfL survey found that 58% of firms support the congestion charge scheme provided that there is investment in public transport.

OEF's survey of transport delays²⁴ showed a much clearer perception among companies that the congestion charge has affected business travel than there is among employees that it has affected commuting, and there is also a perception that it has led to some improvement in journeys for servicing or deliveries. 67% of respondents reported that the introduction of the congestion charge has led to at least some improvement in business travel in Central London (Chart 4.6).

Chart 4.6
What impact has the introduction of the Congestion Charge had on business travel in Central London?



Source: OEF survey of companies

²⁴ Reported in *Time is Money: The Economic Effects of Transport Delays in Central London*, produced by OEF for GLA Economics, January 2005.

Overall, then, it would appear that businesses perceive the benefits of the congestion charge to outweigh the negatives, but this perception is not uniformly held across business sectors. Of the six sectors identified in TfL's survey for monitoring the impact of the scheme, one sector, restaurants and cafes, did not support the scheme, having a survey balance of 6% against it. Meanwhile, the retail and distribution sectors had only small balances in favour of the scheme, of 2% and 6% respectively. By contrast, the leisure and hotels sector, the financial sector and the miscellaneous sector were much more supportive, with balances in favour of 43%, 38% and 40% respectively.

With the decision to extend the charging area westwards from 2007 to include substantial parts of Kensington & Chelsea in particular, the significance of the congestion charge for London's economy is likely to increase further.

4.4 Conclusions

Despite London's economic success over the last 15 years, parts of London are continuing to under-perform. In particular, London's unemployment rate as measured by the Labour Force Survey has risen to 7.2%, significantly above the UK average of 4.8% and the highest of any Government Office Region. Moreover, the employment rate – the proportion of the working age population that is in work – has remained on a downward trend over the last year. These problems are typically most acute in the inner London boroughs, reflecting a complex mix of social and economic issues, and the interactions between them. Of the ten most deprived districts in the UK, five are in inner London.

Looking forward, with London's population and workforce projected to continue to grow there are likely to be increasing pressures on the planning system to find ways in which this growth can be accommodated. Housing is a particular concern. While London house prices have risen less rapidly than in the rest of the country recently, a major correction has so far been avoided, and London prices remain high by historic standards both relative to other regions and to Londoners' incomes. Affordability of housing is likely to remain a major issue, affecting London's ability to attract and retain key workers.

At the same time, London's transport infrastructure also remains a major challenge. While congestion has fallen, average traffic speeds in Central London continue to decline and most rail companies report an increased proportion of trains arriving late. Transport delays impose a substantial burden both on London businesses and workers. While there are plans to invest £10 billion over the next five years in, for example, extensions to the DLR and East London lines, a new road bridge across the Thames and a variety of station, train, track and signal upgrades – partly associated with the Olympics – government funding for Crossrail is still not forthcoming.

5 London's Contribution to UK Public Finances

Previous reports on London's place in the UK economy have consistently shown that London contributes more to the Exchequer through its share of tax payments than it receives through its share of public spending, although the exact scale of this contribution depends on the precise methodology used to estimate it, and varies from year to year as the overall state of the UK's public finances changes. Our estimates suggest a net 'tax export' from London in the range of £6-18 billion in 2003/04 (the latest year for which final outturn data for expenditure by region are available).

5.1 The regional distribution of public expenditure

The bulk of public spending in the UK is undertaken by central government departments, with only a small fraction of spending directly by regional government authorities (and the bulk of that is by the devolved administrations). However, the regions benefit from central spending even though there is no direct way of accounting for the spending on a regional basis. Indeed, there is no definitive way of allocating central spending to regions even conceptually. This can be done in two distinct ways: first on the basis of where the spending occurs ("**in**" the region) and, second, on the basis of which region actually benefits from the expenditure ("**for**" the region). There is a case for using either of these techniques, as detailed in appendix A.

Here we follow the Public Expenditure Statistical Analyses 2005 (PESA 2005) publication which defines public spending by Government Office Regions on a "**for**" basis as far as is possible, with final data available to the fiscal year 2003/04. Specifically, PESA 2005 allocates £367.1 billion of Total Managed Expenditure (TME) in this way, amounting to 81% of total TME of £455.2 billion. Of the remainder, roughly £8.8 billion is identified as being "outside the UK"²⁵.

This leaves a total of £79.3 billion of other spending, comprising unallocated spending and accounting adjustments, which needs to be allocated to regions. We do this in three ways, giving a range of values, which are presented in Table 5.1. First, aiming for consistency with the identified spending on services, we distribute the entire £79.3 billion according to the shares of identified spending on a "**for**" basis. Next, we use additional information in PESA 2005, which looked at the regional impact of the non-identifiable spending on an "**in**" basis as far as possible. We apply these shares to allocate the total. Finally, we share the total according to the regional population distribution, based on the assumption that each member of society benefits equally from this spending on services.

For London, the smallest estimate of spending comes from apportioning the unallocated spending according to each region's share of the UK's population, while the largest comes from the allocation on an "**in**" basis. This gives a range of possible values around the calculation on a "**for**" basis. This is in line with previous calculations, although the range is narrower, since arbitrary bands are not used.

²⁵ Following PESA (and previous work) we do not allocate the £8.8 billion of spending that is classified as being "for" outside the UK, seen to directly benefit non-UK residents. For example, this sum includes the UK contribution to the EC, a transfer payment subsequently spent by the EC. Excluding this amount of public expenditure clearly gives a lower estimate for London's share of total spending, and therefore a higher estimate for London's overall fiscal contribution to the UK, than would otherwise be estimated. A case could be made for including this expenditure - since the sum is funded by all of the UK regions and is made by the UK it must also be of some benefit to the UK and its regions. If this were to be included, London's public expenditure would rise by around £1 billion to £64-66 billion (14.0% - 14.5% of total UK public expenditure). This would reduce London's estimated net contribution to public finances in 2003/04 to somewhere in the range £5-17 billion.

Table 5.1 Total government expenditure by region (2003/04)				
	Min	Max	Min	Max
	(£ bn)	(£ bn)	(£ per head)	(£ per head)
North East	19.8	21.0	7,800	8,300
North West	48.8	53.7	7,200	7,900
Yorks & Humber	35.6	36.6	7,100	7,300
East Midlands	27.0	28.9	6,400	6,800
West Midlands	35.2	38.1	6,600	7,200
Eastern	34.2	35.4	6,300	6,500
Greater London	62.8	64.9	8,500	8,800
South East	50.7	58.0	6,300	7,200
South West	33.7	41.1	6,700	8,200
Wales	22.4	24.7	7,600	8,400
Scotland	42.5	45.2	8,400	8,900
Northern Ireland	15.8	16.4	9,300	9,700
<i>Memo: London, East, S East</i>	<i>147.7</i>	<i>158.3</i>	<i>7,100</i>	<i>7,600</i>
UK	455.2	455.2	7,200	7,200

Source: PESA 2005, OEF calculations

Although London as a region receives a far greater share of public spending than any other UK region, it is also one of the most highly populated regions. Spending per capita is closer to the UK average but is the highest in England. However, it is close to levels received in Wales and Scotland on all methods and is lower than in Northern Ireland. It is possible that the above figures give a distorted view of the amount of public expenditure from which London benefits due to the unique urban nature of the region. Looking at a wider southern region, including London as the metropolitan centre, spending per capita is actually below that for the UK as a whole.

5.2 Public spending as a proportion of London's economy

Of course, there are other ways of looking at public spending in different regions besides relative to population. Public expenditure attributable to London is well below the UK average relative to the region's employment and GVA (based upon expenditure as the mid-point of the ranges expressed in Table 5.1), and also lower than the average for England (Table 5.2). To the extent that public spending is necessary to support wealth-generating activities, higher expenditure per capita in London is therefore no surprise, and potentially benefits the wider UK. This is particularly so when the number of visitors to the region are considered. In addition to the number of commuters and other visitors from neighbouring southern regions, London is an important tourist destination and commercial centre both domestically and internationally.

Looking at the identifiable expenditure per capita on services split by function supports this view. Table 5.3 shows spending per capita on selected key functions in all of the regions. The functions selected represent around 80% of the total identifiable expenditure on services and explain much of the regional distribution of expenditure.

Table 5.2 Total government expenditure (mid-point) & wealth generated (2003/04)				
	Total Expenditure (£ bn)	Expenditure relative to:		
		Employment (£ per employed)	GVA (UK=100)	Income (UK=100)
Greater London	63.8	14,400	90	102
England	345.3	14,200	94	95
Wales	23.5	18,400	140	123
Scotland	43.9	17,400	125	125
Northern Ireland	16.1	20,400	161	152
UK	428.8	14,800	100	100

Source: PESA 2005, OEF/RF Regional Economic Outlook

London receives far greater public funding than the UK average for public order & safety to help to police the large urban population as well as to protect the seat of government and support tourism and state visit activities. London also receives much higher transport funding than any other region, as a result of the need to maintain the greater infrastructure requirements of a large urban centre.

Together, public order & safety and transport contribute to 60% of the difference in expenditure per capita between London and the UK as a whole. The rest largely consists of additional funding for health and education and training. This is probably the result of the presence in London of large training hospitals and universities, which are of benefit not just to London but all of the UK.

Table 5.3 Identifiable expenditure by region & function (2003/04) (£ per capita)						
	Public order & safety	Enterprise & emp. policies	Transport	Health	Education & training	Social protection
North East	377	367	188	1,317	1,116	2,943
North West	370	238	256	1,349	1,046	2,782
Yorks & Humber	313	218	189	1,239	1,044	2,548
East Midlands	306	126	193	1,091	975	2,344
West Midlands	309	162	213	1,174	1,033	2,558
Eastern	259	87	190	1,098	895	2,232
Greater London	596	104	683	1,440	1,210	2,541
South East	301	76	174	1,127	910	2,175
South West	299	118	183	1,144	901	2,434
Wales	367	342	220	1,345	1,047	2,921
Scotland	360	290	341	1,456	1,102	2,874
Northern Ireland	692	243	210	1,367	1,322	3,103
UK	366	174	273	1,255	1,031	2,550

Source: PESA 2005

On the other hand, London receives less funding per capita than the UK average on enterprise, economic development and employment policies - other regions receive more government encouragement to promote new business and employment. Spending on social and benefit payments is also high in London (despite the low employment and serious deprivation issues facing parts of London, as discussed in Chapter 4): per capita payments in this category are roughly the UK average.

5.3 The performance of public services in London

With public spending above the UK average in some key areas, we look briefly at the performance of these services relative to the rest of the UK.

As noted above, transport funding is significantly greater than in any other region and over twice as large as the UK average, due to the additional public transport requirements of a large urban centre. For example, (according to the Labour Force Survey) in London 44% of people regularly use public transport to get to work (defined as bus and rail transport), while only 42% travel by car. In Central London, these shares are 76% and 12%. Public transport use is much lower outside of capital. For Great Britain as a whole, only 14% regularly use public transport, while 71% travel by car. This means that, according to the Strategic Rail Authority, 47% of passenger rail journeys in Great Britain in 2003/04 were taken to get to London. In addition, non-rail journeys are more likely to involve other forms of public transport than elsewhere in the UK. The number of bus and light rail (including trams) journeys per capita in London is well over double those in any other region.

As discussed in Chapter 4, London faces ongoing transport infrastructure challenges. With the congestion charge successfully dissuading some casual use of cars, the challenge to maintain the public transport infrastructure will only increase, requiring further high funding. According to Transport for London, the share of people using public transport to enter Central London during the peak morning period has increased in recent years, from 84% in 2000 to 88% in 2003.

Along with transport, public order and safety accounts for a large share of the difference between London and UK funding. Some of this is attributable to the different requirements of policing a large tourist centre, as well as a large commercial centre, which unfortunately makes it a potential target for any terrorist activity.

The ODPM indices of deprivation (which include crime as an indicator) indicate that, although London contains some very wealthy areas, it also contains a large number of deprived areas. London contains more areas that are classified as being among the 20% most deprived than any other region apart from the North West. More significantly, London is the most deprived region in terms of crime in England.

The same source shows that London performs relatively well in terms of the Health and the Education & Skills categories. The region still receives greater funding per capita in these areas than the UK average, but this is partly due to the different requirements of the region with its concentration of large teaching hospitals and universities. The level of service received by Londoners is not necessarily better for these particular services. For example, average class sizes in London's maintained schools are roughly in line with UK average class sizes.

Overall, it seems clear that higher public spending in London in key areas reflects the costs and challenges involved in the city/region being greater than in other parts of the country, rather than higher standards being set for service delivery.

5.4 London's contribution to UK tax revenues

Looking at the other side of the balance of public finances, it is clear from our calculations, as from previous estimates, that London provides a significant share of UK tax revenues, and more than would be suggested by its share of the population.

Unfortunately, there are no regular official data that provide a regional breakdown of tax revenue, although data for some direct taxes in 1999 were included in the May 2002 Economic Trends publication. As the only reported readily available source, previous calculations of London's contribution to tax revenues have relied on this data. This year, we have revisited the assumptions behind this source to produce consistent, updated estimates of tax revenue (see Appendix A for more details). Other taxes are calculated using a more detailed methodology than in previous estimates. For tax categories that provide significant shares of public revenues, as well as those with significant regional diversity, we separately estimate London's contribution, by applying shares to UK tax revenue by category. Calculations are summarised below (and in Tables 5.4 and 5.5), with more detailed explanation in Appendix A:

- **Income Tax** data are available from HM Revenue and Customs (HMRC) Survey of Personal Incomes (SPI), with latest data available for 2002/03. This suggests that income taxes paid by London residents accounted for 18.8% of the UK total.
- **NICs** data are determined by household payments reported in the Family Expenditure Survey (FES), which suggests that London residents paid 17.7% of UK total NICs.
- These estimates can be argued to underestimate the total contribution of London for these categories, since they overlook the contributions of people that work in London, but commute in from outside the region. **Workplace-based** shares of UK taxes are calculated using the Annual Survey of Hours and Earnings (ASHE), which gives us the earnings distribution in the UK and regions on both a workplace and residence basis.
- Calculations suggest that, on a workplace basis, London's contribution to these two taxes on income is even greater (23.6% for income tax, 20.8% for NICs). And the difference is larger than applying the difference in employment or output on the different measures due to the earnings distribution. Each of these estimates can be argued to be valid and mean that we report a range of possible values for London's contribution to UK taxes.
- **VAT** is also calculated in two ways. On a residence basis according to regional household consumer spending shares reported by ONS and projected to 2003 by OEF, we calculate that 15.7% of VAT was generated by London. This share rises to over 18% when calculated on a business basis, which uses shares of retail turnover that takes place in London, including both London residents and visitors.
- For other categories of taxation (Table 5.5) there is a much stronger case for only calculating the residence-based contribution of London. It is the residents who pay the taxes, which are more related to activities other than working or associated wealth generation.
- **Council tax** paid in London represented 15.5% of all council tax paid in the UK in 2003/04. This was calculated by looking at average spending on this tax by households in the UK regions.

Table 5.4 Taxes on residence, workplace and business basis in London (2003/04)		
	Tax paid in London	
	(£ bn)	(% UK)
Income tax (UK total revenue = £118.4 bn)		
- Residence-based	22.2	18.8%
- Workplace-based	27.9	23.6%
NICs (UK total revenue = £72.5 bn)		
- Residence-based	12.9	17.7%
- Workplace-based	15.1	20.8%
VAT (UK total revenue = £69.1 bn)		
- Residence-based	10.9	15.7%
- Business-based	12.5	18.1%

Source: HM Treasury Budget Report, HMRC, SPI, ASHE, EFS, ABI, OEF

- **Vehicle Excise (VED)** paid in London is only a small part of total taxes paid, but is calculated separately since it differs from spending in other regions. London stands out since it actually pays less per capita on this form of tax than the UK average. The share of total UK VED paid is only 9.1%, compared with a population share of 12.4%, as car ownership is relatively low. This also explains why **fuel duty** paid in London is relatively low.
- **Corporation tax** is another large component of total UK tax receipts, which has been split across regions according to the number of firms within regions as reported in the Inter Departmental Business Register (IDBR). Not only does London house a large share of UK businesses, it also includes a disproportionate share of companies with high profits, which face higher rates.
- This calculation suggests that London accounts for around 22% of total **corporation tax** payments, an estimate which is corroborated by alternative calculations using other sources.
- The amount of **stamp duty** paid in London has risen strongly over time according to data reported for regions by the HMRC. But in recent years, the share of UK stamp duty derived in London has fallen from over 30% to 26% in 2003/04, as housing markets in the rest of the country catch up with London.
- **Other duties**, such as alcohol and tobacco duties, generate a significant share of UK revenue. Like VAT, they are split across regions based upon relevant consumer spending shares for appropriate goods categories.
- **Business rates** are also calculated separately for London, based on the large share of UK firms within the capital according to the IDBR.
- The London-specific **congestion charge** obviously generates 100% of the UK revenue for the tax of this type, although it makes an insignificant net contribution to UK funds. Revenues are allocated to London transport improvements.

Table 5.5 Other taxes paid by type in London (2003/04)			
	London	United Kingdom	London
	(£ bn)	(£ bn)	(% UK)
Council tax	2.9	18.8	15.5%
Vehicle Excise Duty	0.4	4.8	9.1%
Corporation tax	6.2	28.6	21.8%
Stamp duty	2.0	7.5	26.4%
Other duties	13.6	99.2	13.8%
- fuel duty	2.1	22.8	9.3%
- tobacco duty	0.9	8.1	11.5%
- alcohol duties	1.1	7.6	14.2%
- business rates	2.8	18.3	15.3%
- other duties	6.7	42.4	15.9%
Congestion charge	0.1	0.1	100%
Total "other" taxes	25.3	158.9	15.9%

Source: HM Treasury Budget Report, HMRC, SPI, ASHE, EFS, ABI, OEF

5.5 London's contribution to UK public finances

Our estimates imply that London continues to make a significant contribution to UK public finances in net terms (Table 5.6), particularly notable while the total budget balance has deteriorated.

Table 5.6 Final contribution of London to UK public finances (2003/04)			
	London's contribution	UK total	London's share of UK
	(£ bn)	(£ bn)	(% UK)
Total Revenues		418.9	
- Residence-based	71.2		17.0%
- Workplace-based*	80.7		19.3%
Total Expenditure		455.2	
- Minimum (pop shares)	62.8		13.8%
- Maximum ("in" shares)	64.9		14.3%
Total Contribution		-36.3	
- Minimum	6.3		
- Maximum	17.9		

*Including Business-based VAT calculation

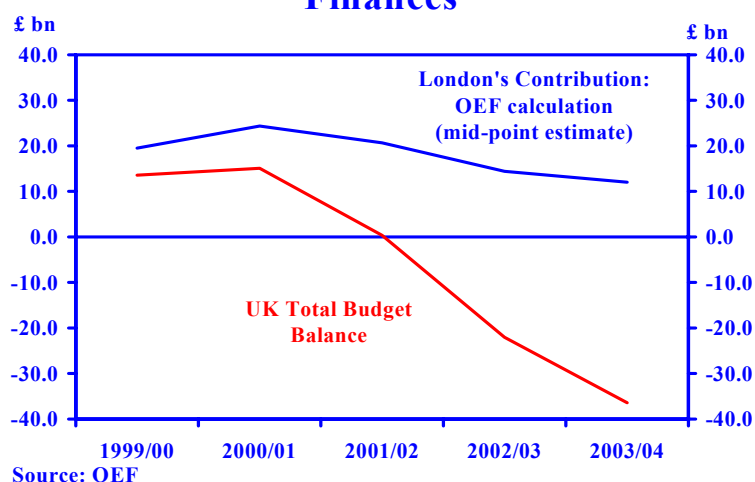
Source: HM Treasury Budget Report, OEF calculation

The city receives a greater share of public expenditure than any other region. This is partly explained by the high population, but spending per capita is still high compared with the rest of the country. However, looking at the components of the higher spending, it is clear that the region does not take a disproportionately large share of government spending. And relative to wealth generated in terms of GVA or household incomes, London receives a low proportion of total UK spending.

Tax receipts in London also represent a large share of the UK total. The mid-point of our estimated range suggests that around 18% of UK taxes are generated in London, and possibly as high 19% (£71-81 billion). This compares with a much lower share of total expenditure received, of around 14% (£63-65 billion). As a result, London made a net positive contribution to UK public finances in the range £6-£18 billion in 2003/04, with the mid-point of the range of estimates implying a net contribution of £12.1 billion.

Extending our calculation back to earlier years shows that London's fiscal balance deteriorated in 2003/04 (Chart 5.1), but if anything this was by less than might be expected given the deterioration in the UK as a whole (see below for further explanation of estimates for previous years): in 2003/04, London's net contribution to UK public finances, at the mid-point estimate was almost £2.5 billion lower than in 2002/03. At the same time the total UK budget balance deteriorated by over £14 billion.

Chart 5.1
London's Contribution to UK Public Finances



5.6 Comparison with previous estimates

The estimates presented here show that the range of figures for London's contribution to UK public finances in 2003/04 are centred around a higher value than those presented in last year's report for 2002/03 (£12.1 billion compared with £7.7 billion). This does not reflect the actual change in London's contribution over time, though. The latest calculations are designed to produce our best estimate of London's contribution in the latest year for which we have data, and in order to do this we have not followed exactly the same methodology as was used for last year's calculations – key differences are set out in the Box below. The range of values is also narrower for the same methodological reasons, and mainly due to a narrower range of values for estimated expenditure. Our methodology, however, provides a wider range of values for revenues.

Box: Changes in the methodology for calculating London's contribution to UK public finances

Expenditure

Calculation of public expenditure by region and specifically within London is derived here from PESA, the same source that has been used in previous calculations. This is not completely comprehensive, but offers the best available coverage. This identifies over 80% of spending on services according to the region that it is "for".

Calculation here differs from previous estimation in the regional allocation of the remaining expenditure (spending on services of benefit to the UK as a whole, rather than inhabitants of a particular region). We allocate this residual using three techniques to give a range of values, rather than placing an arbitrary confidence band around one estimate.

Firstly, and in line with previous calculation, we allocate the remainder pro rata according to the shares of identified spending. As a second estimate, we use further information provided by PESA, which allocates the "pay cost" components of the non-identified spending on the basis of which region it is "in". Finally, we assume that each member of society benefits equally from the non-identified spending and allocate it according to population shares.

For Greater London, we have a range of values for the non-identifiable spending, with the upper limit formed by the estimate using pay cost shares on an "in" basis and the lower limit from calculation using population shares. This range around the initial calculation using the identifiable "for" shares is significantly tighter than applying a 50% tolerance and is a more accurate estimate.

Revenue

Differences here are more marked than for expenditure, involving more detailed calculation than in earlier work. Previous work was heavily reliant on some old 1999 data (published in May 2002 Economic Trends), in the absence of any regular regional tax data. Our approach gives estimates consistent with this earlier published data, but uses more timely data and also includes more detail for other taxes and duties.

Previous work also used the Economic Trends source for 1999 to allocate social contributions to regions. However, this source is skewed by the inclusion of pension contributions.

For income taxes and National insurance contributions, we also calculate payments on a workplace and residence basis, using relative employment and earnings distribution data. These are the only two taxes that it is reasonable to impose this difference on. It is a refinement of previous work, which took the simplifying assumption of imposing published GVA differences on total taxes. We also look at VAT on a business basis as well as on a residence basis.

Further differences in calculation here from previous work relate to some of the lesser, but still significant taxes. For example, stamp duty (generating around 3% of UK total tax revenues) and corporation tax (13% of UK tax revenues) were included as part of a general "other" receipts category in earlier work. UK totals for these were allocated to regions according to the GVA distribution. Our calculation suggests that this significantly underestimates the relative impact of such taxes in London. On the other hand, fuel duties (10% of UK tax revenues), were being overestimated by such calculation.

The higher contribution that London makes to UK public finances than estimated in last year's report on London's Place in the UK Economy expressed at the mid-point figure may appear slightly surprising since the overall UK balance of spending over revenue has deteriorated. However, this increase in London's contribution is due to our updated methodology, rather than any change in trends. Recalculating London's contribution to UK public finances for previous years using our new methodology gives a result that is more in line with the evolution of total UK finances. It is clear that London still provides a significant fiscal surplus although the net "tax export" has followed roughly the same profile as in previous calculation, falling from a peak in 2000/01.

We estimate that the net "tax export" in 2003/04, at the mid-point, was around £2.5 billion lower than in 2002/03, rather than being over £4 billion higher as suggested by direct comparison with last year's figure. Indeed, at the mid-point estimate, we calculate that London contributed almost £7 billion more to UK public finances in 2002/03 than according to previous methodology. This difference is largely due to the improved methodology for calculating tax revenues – the expenditure calculation is broadly in line with previous estimates. In fact, any differences in estimates of public expenditure in London are primarily due to data revisions for public expenditure estimates.

At the mid-point, we estimate that just over 18% of UK tax revenue was generated by London in 2002/03, compared with only around 17% under previous calculation. Note, though, that our calculation does not suggest that London's estimated tax revenues are higher for all tax types than previously (see Table 5.7).

Revised estimates of London's tax revenues are the result of using more detailed indicators to share UK total tax revenue by type. For example, under the previous methodology London's Income tax, Council tax and VED were derived from combined calculation of these three taxes for 1999 by ONS. Referring to the sources behind this ONS calculation, we see that the share of each of three taxes differs. Applying the same share overestimates London's revenue from Council tax and VED. More importantly, revisiting the assumptions behind the ONS calculation allows us to use more timely indicators. In 2003/04 London generated 18% of UK tax for these three categories rather than 17.5% in 1999. This is due to a growing share of Income Tax being generated within London, clearly shown by HM Revenue and Customs Survey of Personal Incomes.

London also makes a significantly larger contribution to UK public finances than in previous calculation for NICs, Stamp Duty and Corporation Tax. In each case we use more specific indicators to give a more accurate estimate of the tax generated within London.

Further differences from previous work are visible in calculating the difference between residence and workplace-based tax revenues, in part due to extra revenue streams being included, notably VAT. This difference is also significant for income tax, for which we use an alternative technique. We calculate that the difference here is more than that implied by GVA on a workplace and residence basis. The number of employees on a workplace basis is around 13% higher than on a residence basis, but we estimate that the amount of income tax paid is almost 26% higher. This is because there are a greater proportion of high earners (and therefore more people paying the higher rate of income tax) on a workplace basis than on a residence basis.

Table 5.7 Differences from previous calculation for tax revenues (2002/03)		
	Residence-based	Workplace-based
	(£ bn)	(£ bn)
Income tax	1.4	3.7
NICs	1.2	2.6*
VAT	0.4	2.3
Council tax	-0.3	-0.3
VED	-0.4	-0.4
Corporation tax	1.7	1.7
Stamp Duty	0.8	0.8
Other	-2.2*	-2.2*
Total	2.6	8.2

**Used as balancing item to give total difference, since previous methodology is unclear for these categories*

5.7 How might London's contribution to UK public finances change?

(a) The implications of possible tax increases

Many forecasters, including Oxford Economic Forecasting, believe that tax increases are going to be needed over the next few years if the sustainability of public finances is not to be put at risk, and this is likely to have implications for London's contribution to UK finances.

Although income tax is not necessarily the most likely tax to see rate increases, it does help to illustrate how the burden of tax increases may fall disproportionately on London with the large share of higher earners in the city, and similar results might be expected, for example, if the upper earnings limit for employees NICs were to be abolished. A hypothetical increase in the higher rate of income tax from 40% to 50% would lead to a significant increase in London's share of UK income tax receipts. On a residence basis the share is estimated to rise from 18.8% to 19.7%, and on a workplace basis from 23.5% to 24.7%.

Behind this increase in London's share of income tax payments, lies an even larger share from London of the increase in tax payments. For 2003/04, it is estimated that such a change in rates would have raised an additional £8.8 billion for the UK as a whole. Of this, London would contribute between £2.9 billion and £3.6 billion (residence & workplace estimates), roughly 30%-40% of the additional funds raised.

A further possible change to the current income tax system would be the imposition of a flat tax rate, an option that has been adopted by several European countries and currently being considered by the shadow chancellor. It has been proposed that a flat rate of 30% faced by all taxpayers, with a personal allowance of £10,000, would be revenue neutral for the UK as a whole. Such a measure would favour London's large number of high earners (as well as those on low incomes with the higher allowance). However, this would be offset by a larger tax bill for others, and our calculation suggests

that London would account for the same share of total UK income tax as under the current system.

(b) The implications of possible council tax rebanding

The proposed Council tax rebanding in England has now been postponed until the next parliament, while there is the possibility the system may be changed completely. Nevertheless, it is interesting to look at the potential implications of any council tax rebanding for London's contribution to tax revenues. While there would be boroughs within London that do better or worse, our estimates suggest that there would be little impact on London as a whole under a revenue neutral rebanding - it would pay the same share of UK council tax revenues as under the current banding system. This primarily reflects the fact that between 1991 Q1 and 2005 Q1 (broadly the time periods used for initial banding and the proposed period used for the cancelled rebanding), London house price inflation has been in line with the national average, although this would not necessarily be the case if other time periods were selected.

In the UK as a whole, the fastest house price inflation over the period has been for houses in the lower price brackets, taking available price data for flats and maisonettes as a proxy. Inflation for properties with a higher initial value has been lower, taking data for detached houses as a proxy here, while inflation for semi-detached and terraced properties (with mid-priced initial values) has been between the two. However, in London the distribution has differed, with some very high inflation in the more expensive properties.

This implies that a large number of houses in London will move into the higher price brackets. While this clearly disadvantages boroughs with a large share of high value housing such as Kensington and Chelsea, which could see total council tax contributions increase, the net effect for London will be offset by an increase in the number of properties in lower bands in less affluent boroughs.

(c) The implications of future spending commitments

There are also a number of policy developments and spending commitments that are likely to affect the share of public spending taking place in London. For example:

- The Lyons review recommended moving 20,000 jobs in public administration out of London and the South East, which would reduce the share of the public sector wage bill accounted for by London.
- The holding of the 2012 Olympic Games in London will require both investment spending to construct the required infrastructure and additional spending during the games on staffing, security, and so on.
- Building Crossrail would have a significant impact on the already relatively large share of the transport budget being spent in London.

It is worth bearing in mind, though, that extra spending in London on things like the Olympics and Crossrail would not necessarily reduce London's net contribution to the UK's public finances. That would depend on how they are financed. To the extent that Londoners themselves pay for these, either through the Council Tax for the Olympics, for example, or through some mechanism for getting London businesses that would benefit from Crossrail to help finance it, then the net impact on London's contribution to UK finances would be small.

The extent to which London might be expected to pay for its own spending in these sort of areas raises more general questions about the balance of funding between central and local government for spending that clearly benefits a particular area. A review set up by

the government into the balance of funding concluded last year that there are strong arguments for shifting the balance towards more local funding, although it acknowledged that this depended on the feasibility and desirability of any measures that might be used to achieve this. From London's point of view, however, there would inevitably be questions about the extent to which the capital should continue to contribute to the cost of spending elsewhere in the country if it was also expected to finance most of its own spending.

5.8 Conclusions

Our estimates suggest that London continues to be a substantial net contributor to UK public finances despite the deterioration in public finances at a national level, with a net contribution between £6 and £18 billion in 2003-04 and the mid-point of the range of estimates implying a net contribution of £12.1 billion. We have developed the methodology used to produce these estimates, so figures are not directly comparable with those produced previously for 2002-03. However, applying our methodology to 2002-03 suggests that London's net contribution has fallen by around £2.5 billion, compared with a £14 billion deterioration in the balance at a national level.

Public spending per employed person in London is estimated to be around 7% lower than the UK average. Public spending per capita in London is significantly higher than the UK average, but that partly reflects its relatively high unemployment and partly the unique urban nature of the region, with its large commuter belt, tourist industry and government/state functions.

The main reason for London's net fiscal contribution is that Londoners continue to face a very high tax bill, accounting for 17-19% of government revenues (£71-£81 billion) in 2003-04. Moreover, there is a risk that Londoners could bear a disproportionate share of any future tax increases needed to meet the government's fiscal rules. For example, if the higher rate of income tax were raised to 50%, this would raise an additional £8.8 billion for the Exchequer, of which between £2.9 billion and £3.6 billion would be paid by London.

6 London's Position as a World City

"There is no city like London. It is a wonderfully diverse and open city providing a home to hundreds of different nationalities from all over the world. I can't think of a better place than London to hold an event that unites the world." Nelson Mandela commenting on London's successful Olympic bid.

6.1 What is a World City?

London is widely regarded as a World City. Indeed, it was one of only four cities cited by all 15 sources covered in a 1999 literature review on World Cities²⁶. However, there is no easy definition of what is meant by 'World City'. The term suggests an openness to the rest of the world, a vast geographic footprint in terms of its influence, a significant presence of globally facing activities and a multicultural population – indicating its attractiveness as a place to live in world terms. A World City is therefore likely to attract international migrants; contain a large and varied stock of foreign nationals; hold significant attractions as an international tourist destination; provide a base for international business management functions; foster high degrees of entrepreneurship; serve an international market place; possess internationally recognised seats of higher education; provide a home for internationally recognised cultural assets; and, as a result, enjoy higher levels of output per capita than in the rest of its national economy. Strong economic growth on the back of these attributes, backed by a dynamic population, also characterises cities that might be regarded as 'World Cities' (see Chapter 7 for a discussion of the role of migration in London's economy). Few cities worldwide boast all these attributes. London, New York, Los Angeles, Paris, Hong Kong and, perhaps in the future, Shanghai might claim membership of this exclusive club.

6.2 London's performance compared with other World Cities

(a) How successful is London by international standards?

Comparing London with other cities that might be regarded as World Cities is not straightforward, since information on city performance is fragmentary. Indeed, there is no accepted definition of what constitutes a city in geographic terms, as opposed to the administrative definitions that are used for the majority of the data that are available. However, information that is published across the range of attributes set out above, suggests that London and New York should be regarded as the leading World Cities (Table 6.1).

London has the biggest world footprint among the five cities compared in Table 6.1. Personal contact is possible within working hours with Japan in the East and the Pacific coast of North America in the west. This area encompasses 99% of world GDP²⁷. Paris misses out on the window with the Pacific coast, while New York misses China, South East Asia and India – giving an estimated footprint of 72% of world output. Los Angeles, while gaining on New York in terms of China, misses out on continental Europe. Hong Kong misses out on office hours contact with the eastern third of North America. Geography in terms of world time zones is therefore a key attribute of London's success. Moreover, if economic power is shifting inexorably towards Asia, London remains a crucial bridge to the eastern United States.

²⁶ Beaverstock, J.V, Smith, R.G. and Taylor, P.J. 'A Roster of World Cities', published in *Cities* 16, pp445-458(1999).

²⁷ 2004 estimates on a purchasing power parity basis

World Cities are not necessarily the largest conurbations in the world – though much depends on definitions whose origins lie in administrative structures dating from historic times. Rather than population itself, the extent to which cities have become home to foreign-born citizens gives a measure of their attractiveness to the rest of the world. Here, New York and Los Angeles are in the lead. In both cases nearly 36% of their populations are foreign-born. London lies next with around 27% - well ahead of Paris at 18%. Hong Kong is very much the laggard – though much depends on whether mainland Chinese-born residents are classified as foreign born in this case.

World Cities attract visitors. Their transport hubs act as portals for international visitors, but survey evidence suggest that the cities themselves are a big part of the draw. Business travellers – a very important part of the total in terms of spend – are clearly drawn by the business activities of these major cities. While data on international visitors are not necessarily fully comparable or complete, statistics published for 2004 put Hong Kong and London well out in front with 15.5 and 13.4 million international visitors respectively, compared with just under 9 million for Paris. New York and Los Angeles lag well behind, with 5.3 and 4.2 million respectively.

With their wide range of specialist services, deep, talented labour pools and financial markets, World Cities are natural attractors of the headquarters of the world's biggest companies. Eighty-nine of the world's 500 biggest companies²⁸ are located in the five cities compared here. The extent to which the world's largest companies base their strategic decision-making functions in World Cities is underscored by the market capitalisation of these companies – though those based in the World Cities represent under 20% of the all the top 500 companies worldwide, in market capitalisation terms the proportion rises to over 40%. Within these five World Cities, New York and London are the clear leaders – with 29 and 28 headquarters from the top 500 companies. This lead is even clearer in market capitalisation terms – where at 15.6% New York just pips London's 15.4%. Though Paris features strongly in terms of numbers of headquarters of these elite companies – with 20 - its share of market capitalisation is only 6%. Both Hong Kong (8) and Los Angeles (6) are weak on this metric.

It is more difficult to compare World Cities in terms of the extent to which they act as a magnet for entrepreneurial talent - the comparative information on entrepreneurship from the Global Entrepreneurship Monitor is incomplete at the level of cities, for example. As discussed in Chapter 3, London scores well in domestic terms – with a Total Entrepreneurial Activity Index²⁹ 40% above the UK average in 2003. This, however, lags the reading for the US as a whole, and is therefore likely to be substantially below the readings for New York and Los Angeles. On the other hand the reading for London in 2003 is nearly three times that of Hong Kong, and the UK measure tends to lie above that for France – though there is no comparative information on London's relative position with Paris.

World Cities are trading places. One insight to the relative position of the five World Cities compared here is provided by the regular surveys on foreign exchange trading carried out by the Bank of International Settlements (BIS)³⁰. Foreign exchange trading is essentially international and therefore gives a better measure of the international exposure than, say, equity or bond market turnovers, which have both domestic and international components. While the BIS data does not give any details of turnover at a city or regional level, it is a reasonable working assumption that the financial centres of London, New York and Paris will account for the majority of foreign currency trading in the UK, US and France respectively. On this basis, London's dominant role – partly

²⁸ *FT Global 500*, March 2005

²⁹ A standardised questionnaire is used across the countries participating in the Global Entrepreneurship Monitor's surveys to create an index for each country / region studied.

³⁰ *Triennial Central Bank Survey, Foreign Exchange and Derivatives Market Activity in 2004*, March 2005

reflecting its world footprint - is demonstrated by the finding that nearly one-third of all foreign currency transactions in 2004 were undertaken in the UK. By comparison the US accounted for just under 20% - implying that London and New York dwarf Hong Kong (4.1%) and Paris (2.6%) in this regard. Indeed, to the extent that their contribution to world financial markets characterises World Cities, Tokyo would overshadow those considered here other than London and New York.

Although readily available figures do not cover all the cities studied here, trading in foreign equities provides an even clearer indication of the dominance on London and New York in some aspects of international financial trading – in 2004 London accounted for 45% of all market turnover in company equities that took place on exchanges other than the companies' domestic exchanges, with New York accounting for 32%, including the Nasdaq³¹. Most of the rest was in Switzerland, rather than in the other World Cities being compared.

It might be expected that as highly productive, populous conurbations, but with relatively high cost bases, World Cities would not necessarily be an ideal location for higher education institutions. Nevertheless, the World Cities in North America and Europe each possess some of the most highly ranked universities in the world. According to the rankings produced by Shanghai Jiao Tong University³², Los Angeles has 4 of the top 100 universities in the world – with the lowest ranking among these sitting just outside the top 50. London and Paris come next with 3 apiece – though the average London ranking is above that for Paris. New York has two universities in the top 100 – though both of these rank below the best two in Los Angeles and London. Hong Kong has no representation in the top 100.

Table 6.1: World Cities

	London	New York	Los Angeles	Paris	Hong Kong
World footprint	99%	72%	85%	95%	73%
Population (million)	7.387	7.903	9.696	2.143 ³³	6.899
Foreign nationals	26.5%	35.5%	35.8%	18.0%	0.5%
International tourist arrivals (million)	13.4	5.3	4.2	8.7	15.5
FT 500 headquarters - number	28	29	6	20	8
FT 500 headquarters - % market cap.	15.4%	15.6%	1.5%	6.3%	2.0%
Financial market volumes (% world FX)	31.3%	19.2%	0.0%	2.6%	4.1%
Universities in top 100	3	2	4	3	0

Sources: OEF, ONS, US Census Bureau, INSEE, CIA Factbook, VisitBritain, NYC Statistics, LA Inc, Paris Convention & Visitors Bureau, Hong Kong Tourism Board, FT, Bank of International Settlements, Shanghai Jiao Tong University

Overall, then, the available evidence tends to confirm that London and New York are the first among equals in terms of World Cities. Each is beaten in particular aspects by the other cities, but across the diverse range of indicators examined both perform strongly on every measure. When considered in the round, therefore, it is clear that they play a rather different role from other cities in the world – even those with world status.

³¹ IFSL, *Securities Dealing*, July 2005, derived from the World Federation of Exchanges

³² *Top 500 World Universities 2004*, Institute of Higher Education, Shanghai Jiao Tong University

³³ The administrative area covered by Paris is only a part of the wider city. The broader area of Ile de France had a population of 10.98 million in 2000.

One specific indicator of London's role as a World City might be the number of Olympic Games held there. Although not all Olympic Games are held in cities that have a particularly global focus, nevertheless there seems to be a tendency always to regard World Cities as serious contenders to hold the Games, and London, Los Angeles and Paris have all hosted the Olympics twice. The decision to hold the 2012 Olympic Games there means that London will be the only city to have hosted the Games three times, reflecting the very special 'World City' status with which London is perceived.

(b) London as a base for international companies

Although serving as a location for global headquarters is often a sign of a World City, the impact on company location extends much more widely than just global headquarters. Not only do 28 companies in the FT Global 500 have headquarters in London (with a further 5 located just outside the capital), London is also the location of choice for the European headquarters of international companies. Over one quarter (129) of the companies ranked in the FT European 500³⁴ have UK headquarters. Of these, 75 are located in London and a further 25 in the vicinity of London – in other words, one-fifth of the major companies in Europe use London as a strategic base.

Company headquarters are a key driver in regional economies. The concentration of headquarters of international companies in and near to London creates a symbiotic relationship with a wide range of London's specialisms – such as legal, accounting, design and media services. Without the London effect, there seems little likelihood that as many international businesses would be headquartered in the UK. In turn, this would undermine the market for specialist services that contribute to the efficiency and effectiveness of international and domestic businesses alike. Nor would the UK attract as much international talent and the base for both economic growth and taxation would be impoverished.

There is some concern, however, that too many UK companies have their headquarters in London to the detriment of the rest of the country. Sometimes moves are made voluntarily, but typically merger & take-over activity acts as the driver of loss of headquarters from the rest of the UK. The results of a Monopolies and Mergers Commission inquiry in the early 1980s saved the Royal Bank of Scotland from take-over by what is now HSBC. Arguably, if this merger had gone ahead, Scotland would have lost the headquarters activities of the only truly large and global company now managed from north of the border. However, in a globalising world the question is no longer location in the regions of the UK or London, but the UK or other locations worldwide. Without London, the UK would be much less well-positioned to attract these crucial building blocks of a modern economy – to the detriment of living standards in the UK as a whole.

(c) Connectivity

In many ways, the essence of a World City is not just the concentration of activities there, but its openness to the rest of the world – hence the diversity of population, the cultural dynamism, the range of talent available, and so on. The importance of openness to the rest of the world in a corporate, as well as a personal, sense means that it may be equally valid to look at World Cities in terms of the connectivity between companies in a city and elsewhere in the world, rather than simply the location of companies in the city itself. Indeed, as more and more business is conducted electronically, the concept of a World City as a location for businesses that are exceptionally well plugged into a global network is likely to be of increasing importance.

³⁴ March 2005

Although this is a rather different way of thinking about World Cities, the evidence points to a similar conclusion about London's place as perhaps the most global of all World Cities. Quantification of network connectivity is not straightforward, but data have been put together by members of the Globalisation and World Cities Study Group and Network based on information about internal networks within 100 large international corporate service firms, defined in terms of the contribution of offices in different locations to the global business of the group³⁵. This approach shows London as the World City with the greatest global network connectivity (Table 6.2), closely followed by New York, with other World Cities some way behind. London similarly tops the table if the focus is just on connectivity within the banking network, with New York second, though in this case Tokyo ranks a reasonably close third.

Table 6.2 Global network connectivity		
Rank	World City	Score (relative to most connected city)
1	London	1.000
2	New York	0.976
3	Hong Kong	0.707
4	Paris	0.699
5	Tokyo	0.691
6	Singapore	0.645

Source: Taylor et al, *op. cit.*

6.3 The benefits of London as a World City to the UK economy

The evolution of London as a World City has had important effects on the rest of the UK. London's economy is different in structure to the rest of the UK, with much of this difference driven by London's role in the world economy. As a consequence, London tends not to compete in the same product markets as the other UK regions. Without its world role London would look more like the rest of the UK in terms of economic structure and would squeeze out some activities currently undertaken elsewhere in the UK.

At the same time, the success of London in world terms results in demand spillovers for the rest of the UK. The fact that London's economic structure is different sets up trading opportunities with the rest of the UK to the benefit of both areas. And with London successful in fast-growing service industries, the nature of its demand for ancillary activities supports structural change across the UK away from slower-growing to faster-growing sectors, building comparative advantage for the UK as a whole. A significant part of the UK's relative economic success in terms of growth rates in recent years must therefore stem from the pervasive influence of London through all parts of the country.

³⁵ See Taylor, P.J., Catalano, G. and Walker, D.R.F., 'Measurement of the World City Network', *Urban Studies* 39 (2002) for more details of the methodology.

Finally, London's worldwide status is likely to boost demand from outside the UK for other parts of the UK, through both inward investment and tourism to the UK. As well as being a magnet for inward investment in its own right, the familiarity of London, the wide range of services available, the presence of brand name, international legal, accountancy and consultancy firms in the city and its international transport hub facilitate investment by overseas companies in the rest of the UK.

Equally, the increase in immigration over recent years has added to London's already diverse population. The Census in 2001 showed that 29% of London's population, or 2.1 million people, belonged to ethnic minorities, and there are resident communities in London of over 10,000 people from 34 countries. This stock of international residents increases tourism to the UK by those whose primary reason for travel is visiting friends and relatives, while the cultural diversity of London may help attract both tourists and businesses alike. International visitors to UK use London as a gateway – with many citing London as the main reason for their visit – even if they also spend time in the rest of the country. So, London's position as a World City is likely to attract visitors to the rest of the UK as well as to the capital itself.

6.4 Conclusions

London has further enhanced its position as a 'World City' over the last year. Indeed, in many ways London could be considered the archetypal World City, and most indicators point to London and New York clearly being more globally focused than other World Cities. London's status as a World City was reflected not least in the award of the 2012 Olympic Games. London is the UK's premier tourist destination, with many visitors then exploring other parts of the country. A third of Fortune Global 500 companies have their European headquarters in London, with pervasive links to demand, business and investment opportunities in the rest of the UK.

7 Key Issues for the Future

There are a multitude of issues that will affect how successfully London's economy develops over the next ten years. A number of these have been discussed in earlier chapters on London's competitiveness and structural issues facing the London economy. Here we focus on a few areas that seem particularly topical for this year's report.

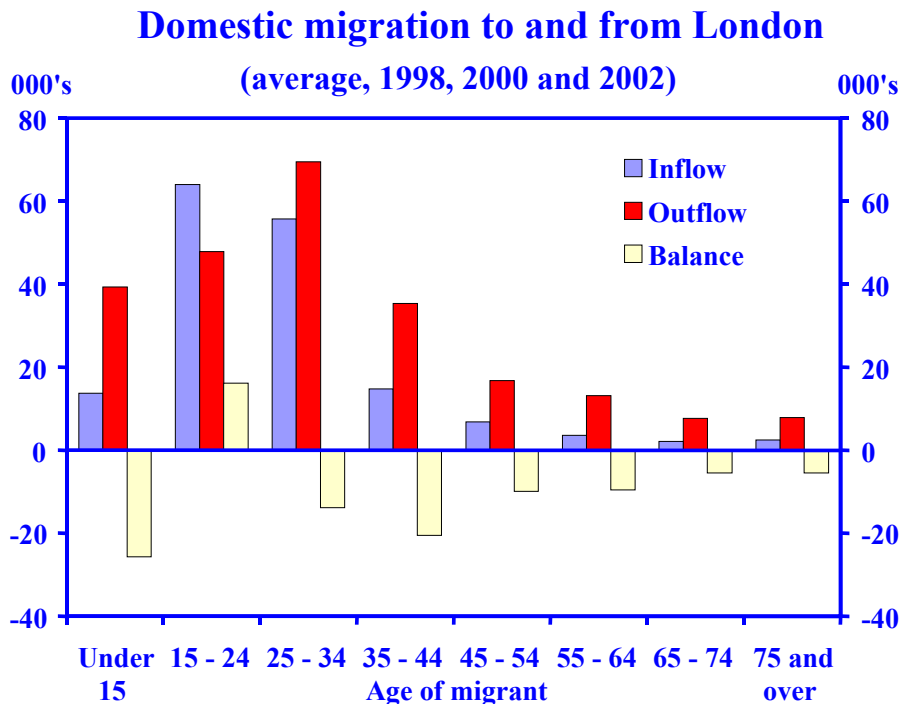
7.1 Migration

Patterns of migration have played a large part in the way London's economy has developed, and the scale on which foreigners continue to come to London to live and work will be a key issue for how it continues to develop.

In terms of domestic migration, the perception of London is often as a drain on labour supply elsewhere in the UK, as higher unemployment rates in the north encourage people to move south in search of jobs. In fact, as discussed in Chapter 4, unemployment rates in London are not particularly low, although these will not necessarily be applicable to young graduates who are often the focus of most concern in regions worried about out-migration to London.

In aggregate, migration to and from London to the rest of the UK reflects a complex set of drivers, including the search for suitable jobs by young people, opportunities for promotion, life cycle decisions by young families moving to commuter areas and retirees moving out of the city, etc. Migration flows by age group (Chart 7.1) confirm the popular perception that many young people from the rest of the UK move to London at an early stage of their careers to take advantage of the job opportunities available, with a net inflow of people aged 16-24 into London.

Chart 7.1



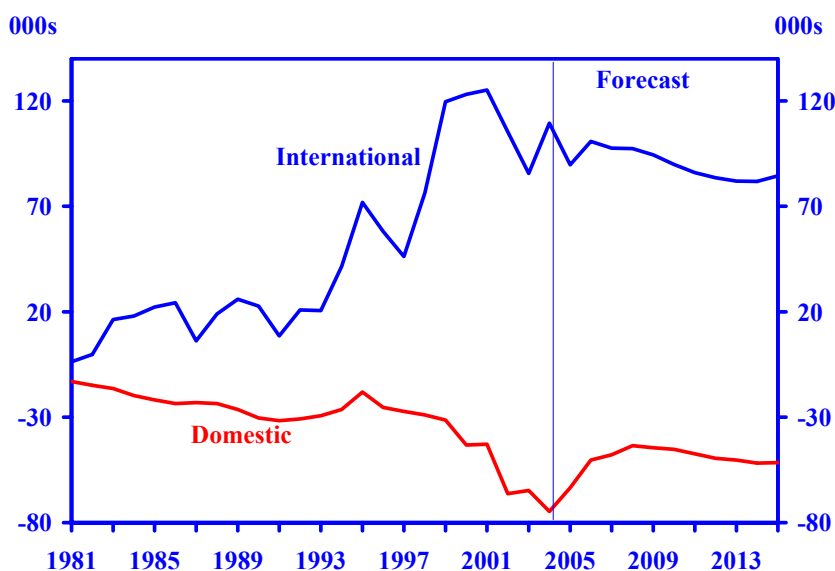
Source: ONS (based on NHSCR)

One consequence is that London's workforce has a significantly higher proportion of relatively young workers than the rest of the UK. At the other end of the age spectrum, there is a net outflow of older people from London to the rest of the UK, including both working age groups (25--64) and people of retirement age (65+). Overall, though, there is on average a significant net outflow of people from London to the rest of the UK.

Of even greater significance to London over the past decade than domestic migration flows have been the numbers of people migrating to and from London internationally (Chart 7.2). London has been the most important destination within the UK for the inflow of international immigrants seen in recent years. This has a profound influence on the capital – in 2001 25% of the city's population was born abroad, compared with 6% in 1991³⁶ – and contributes strongly to London's role as a 'World City' (see Chapter 6). It also has an impact in differentiating London from the rest of the UK. With between 80% and 90% of new immigrants to the UK moving into London in the first instance, 40% of all foreign-born people living in the UK in 2001 were living in London.

Chart 7.2

Net working-age migration to London



Source: OEF

The scale of this international migration has had a big impact on London's overall population. Overall net migration – adding both domestic and international together – has pushed up London's population rather than reduced it. Indeed, analysis of Census data³⁷ shows that if no additional foreign-born people had come to live in London between 1991 and 2001 then London's population would have fallen, rather than the increase of nearly half a million actually seen.

This may be something of an over-simplification, however, since it assumes other things would have remained the same. It is likely, though, that without the pressures created by strong international immigration into London, there would have been lower domestic migration out of London. Pressure on house prices or rents in London from growing

³⁶ *Born Abroad: An Immigration Map of Britain*, BBC September 2005 (http://news.bbc.co.uk/1/shared/spl/hi/uk/05/born_abroad/html/overview.stm)

³⁷ *Ibid.*

numbers of inward international migrants, for instance, will have discouraged some UK residents from moving to London and encouraged others to move out to surrounding regions. Competition from immigrants for jobs in London may also have contributed to greater outward domestic migration from London than would otherwise have been the case. Equally, some of the rise in outward migration to the rest of the UK that has accompanied rising international immigration to London in the past decade may also have been caused by international immigrants themselves having moved first to London then moving on to other parts of the UK.

Migration flows have always played an important role in how London's economy has developed over time, with significant outward domestic migration lying behind falling population in London throughout much of the 1970s and 1980s before rising international immigration reversed this trend during the course of the 1990s. Our forecasts for London are based on a continuing strong impact on population from international migration, with net international migration of working-age people into the UK assumed to run at around 130,000 a year, and the majority of these people going to London. If for any reason there were to be a substantial fall in international migration to London, this would make it much more difficult for employers to attract the staff they want in a variety of different occupations, including investment bankers and doctors as well as catering and hotel staff and office cleaners.

7.2 Terrorism

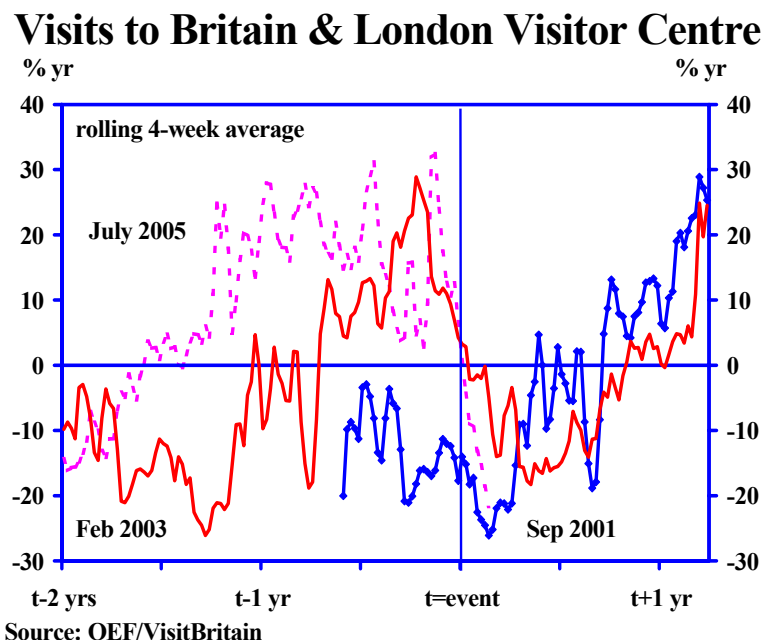
The extent to which terrorism can affect the economic development of London has been pondered before. In the immediate aftermath of the attack on the World Trade Centre in New York on 11 September 2001, for example, there was speculation that high-rise offices might be a less popular location for financial and business services than they had been, with obvious implications for central London. The bombings in London on 7 July, and the abortive attacks two weeks later, however, provided a grim reminder that terrorism can strike at London. Although London's workers appear to have carried on as usual after the short-term disruption caused, there is more uncertainty over whether worries among potential tourist visitors to London could have a longer-lasting impact on London's economy.

It is worth bearing in mind that tourist visitor numbers were very strong before the July bombs. Foreign visitor arrivals to the UK and the amount they spent in the UK (in current prices) were at record levels. In the year to June 2005, arrivals totalled 29.3 million while spending amounted to £13.7 billion over the same period. In the first half of 2005 alone, arrivals to the UK increased by 12.4% on the same period of 2004, with spending up by 12.1%. For London, which is typically the destination of half of all foreign visitors, data are only available through to 2005Q1 but these figures show visits up 13.8% on a year earlier and spending up 14.3%. While visitors from the US and Canada were in decline (dropping 5.7%), visitors from Western Europe rose by 12.1% in the first half of 2005 compared with a year earlier and visitors from other areas surged by 29.8%.

Given this strong start, we still expect London's tourism economy to be larger this year than last year. Nonetheless, the attacks have disrupted UK and London tourism and it will take time for the visitor economy to recover fully – high frequency data on a number of indicators that are correlated with the number of tourists (such as VisitBritain's short-term trip tracker; enquiries to the Britain & London Visitor Centre; surveys of hotel occupancy and room rates; visits to museums and royal places; and sales of one-day off-peak travelcards) suggest that a significant impact from the bombings has been felt and that any recovery is still at an early stage.

The impact of past events offers some guide to the likely recovery path for the tourism economy – Chart 7.3 compares visits to the Britain and London Visitor Centre in the periods around 9/11 and the build-up to the 2003 Iraq war in order to give an idea of the time frame for recovery.

Chart 7.3



This analysis suggests that, although a large part of the initial impact can reverse quite quickly, it can take up to two years for the visitor economy to recover fully to the level of activity that would have been achieved in the absence of any attack. Overseas visitor numbers this year and in 2006 are expected to be 5 percentage points below expectations ahead of the attacks, before bouncing back onto track in 2007/08. Nevertheless, it is clear that there is a risk that any further terrorist attacks on London could undermine the recovery in tourism.

More generally, it is not just tourism (and related shopping activity) that can be affected by terrorism. 9/11 caused huge disruption to business operations for companies with offices in the World Trade Centre, and led some companies to think again about the costs and benefits of concentrating corporate activities in one place compared with a more dispersed organisation of business. It also led to some speculation that high-rise buildings would be less popular in future. However, although demand for office space in London has weakened since 9/11, this is likely to be a result of the general economic situation (see Chapter 2) rather than a result of concerns about terrorism, and there appears to be greater interest in high-rise office development London now than for many years. It is, of course, impossible to be sure about how future terrorist attacks might affect London's place in the UK economy. It is worth remembering, though, that cities have overcome these sort of events before, and there are no signs that the earlier threat (and reality) of IRA terrorism hit London's economic development.

7.3 The Olympics

The decision has now been made to award the 2012 Olympic Games to London. The city's bid for the event laid stress on the regeneration and legacy effects of holding the Games in London. It is therefore natural in thinking about London's future place in the UK economy to think about what the impact of the Olympic Games will be on London and the UK economy.

(a) Preparations for the Games

Much of the impact of the Games is likely to be felt in the build-up to 2012, owing to the expenditure on the various construction projects to get London ready. The Olympic village is budgeted at just over £650 million, while the stadium is estimated to cost £281 million. The next most costly sports project is construction of the aquatic centre, at £73 million. A number of other projects and construction of the associated infrastructure brings the total (non-transport) capital investment directly related to the Games at £2.7 billion.

Table 7.1 The Olympic budget	
(£ million)	
Capital investments:	
Sports venues	560
Olympic Village	650
Olympic infrastructure	1312
Total non-transport investment (including smaller projects)	2670
Operating expenditure	1539

Source: London 2012

As a benchmark, the Gross Value Added of the UK construction sector in 2004 was £67.6 billion. So, if the capital expenditure for the Games was spread evenly between 2006-2011 that would equate to around 0.7% of construction GVA per year. Given the current level of UK construction sector employment, that estimate could imply around 14,600 extra jobs. This is likely to be a lower bound for the peak increase in construction employment for a number of reasons. First, the construction activity will not be evenly spread, but instead it is likely to be front-loaded, with most activity between 2007-2010. Second, the estimate only reflects the direct construction employment as a result of planned Olympic investments. If there are substantial private sector investments, as firms such as hotel chains position themselves to benefit from the Games, then construction employment will increase by more. Third, the types of big infrastructure projects that the Olympics entails tend to be more labour-intensive in any case. Finally, of course, the initial cost estimates may well turn out to be inaccurate. All in all, it is not difficult to imagine the peak increase in construction easily exceeding 50,000 jobs in the build up to 2012.

With construction industry jobs in London currently numbering around 160,000, it is clear that the scale of the Olympic projects will entail drawing in employment from outside London to meet the demand. Some of this extra employment may be met from neighbouring regions, but it seems likely that both internal and external migration will have to make up some portion of the increase. With the industry already reporting skills shortages, it is likely that there will be upward pressure on wage rates. Alongside the desire to pass on cost increases, construction firms will also find they are able to charge higher prices for their services. Consequently, construction is likely to become a more expensive activity in London and the UK more widely in the build up to the Games.

The run-up to the Games will not simply impact on the construction sector. Higher construction prices will impact on firms' and individuals' decision-making more widely, perhaps leading to some non-Olympic construction and investment expenditure being deferred or displaced. However, there should be positive indirect effects on demand and employment from the spending of those directly employed in Games-related activity. Rising construction costs and higher spending could also conceivably lead to higher house prices. Studies of the impact of previous Games differ considerably in their assessment of the effect on the economies of host nations. Most point to fairly significant regional effects, but these become considerably smaller at the national level. A study of the Sydney Olympics estimated there would be 90,000 new jobs, while one for Atlanta estimated the job gain at 77,000.

(b) During the Games

The preparations for the Games should be largely over by 2012, but there will then be a further boost to demand during the course of the Olympics itself. The running costs of the Games are estimated to be nearly £1.5 billion. Much of this, though not all, will be incurred during the course of the event. That equates to around 0.1% of UK GDP in 2012, on the basis of our latest long-term projections. Potentially dwarfing this direct expenditure should be the increase in exports from the inflow of visitors into London. This will have both a regional aspect, with visitors from the rest of the UK flowing into London, and also an international aspect as foreign visitors are expected to make up 10 to 20% of the total attendance. However, some of the additional tourism from Olympic visitors will probably displace tourists who decide not to travel to London during the Games, so the overall boost may be smaller. It is also important to keep in mind that ultimately a large part of the cost of the Games may be borne by London taxpayers, with some offsetting effects on the level of demand.

(c) After the Games

As noted above, London's bid to host the Olympic Games laid stress on the legacy effects of the Games in terms of regenerating a deprived area of London's economy. At its most tangible, there will be a legacy from converting the Olympic village into around 3,600 new homes, and the park will accommodate around 12,000 new jobs. There should also be lasting effects from improvements in the transport infrastructure, and it is hoped that the availability of improved facilities will have a big impact on those living in the area.

The economic significance of these developments is not easy to assess, but some interesting analysis from the Halifax on house price movements in recent Olympic cities suggests that some positive impact is likely.³⁸ Of course, increases in house prices themselves are not necessarily helpful, particularly for a city like London which already has the highest average house prices in the country (see Section 4.2). Where they reflect improvements in the quality of life from living in an area, however, higher house prices are a sign of things getting better.

³⁸ Halifax plc, *House prices go for gold in Olympic host cities*, Press release 6 July 2005

In all of the last four Olympic host cities, house prices rose faster than in the country as a whole, by an average of 18% in the five years prior to the Games being held (Table 7.2). The Halifax also conclude that within cities, too, areas close to the Olympic complex usually see the largest increase in house prices as a result of seeing the biggest gains in facilities and transport links. Such effects in London would certainly go some way towards reducing the structural problems faced by some of the more deprived parts of the city that were discussed in Chapter 4.

Table 7.2 House prices in Olympic cities			
Olympic Games	% change in five years leading up to the Games in:		
	Host city	Host nation	Difference
Barcelona (1992)	131	83	49
Atlanta (1996)	19	13	7
Sydney (2000)	50	39	11
Athens (2004)	63	55	8
Average	66	47	18

Source: Halifax, based on national sources

The legacy after the Games, while important for the residents of Stratford, is likely to be quite limited as far as London and the UK more generally is concerned. These figures are small in relation to UK and London total dwelling stock and employment. Some cities such as Barcelona have benefited from the rise in their international profile from the Games, and have enjoyed permanently higher tourism thereafter. But London already has a significant profile as a tourist destination and, while there may be a short-term impact, the longer-term impact on visitor numbers is likely to be small.

Overall, therefore, the economic impact of the Olympics on the UK economy should not be exaggerated. The greatest impact is likely to be felt in the run-up to the Games, with the effects on the construction sector most apparent. But even here some of the extra construction will most likely displace other projects both within London and elsewhere in the UK. And the total anticipated capital expenditure (spread over a number of years) and the operating expenditure of the Games combined only equates to a few tenths of UK GDP in any year. Even if there are significant indirect effects from higher spending elsewhere in the economy, including greater tourism, the overall size of the impact will be fairly limited. Of course, the impact on London's economic performance relative to the rest of the UK will be greater, as the capital stands to gain most from the Games.

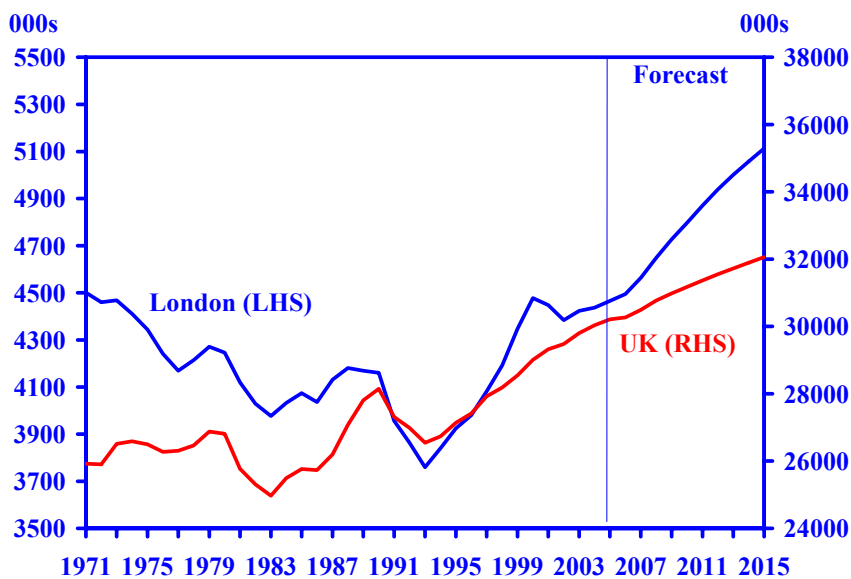
8 Conclusions – The Long Term Outlook for London

It is, of course, impossible to know what the outcome of all these issues will be for London's economy. Our overall assessment, though, is that London is well-placed to prosper over the next decade³⁹.

There are three main reasons for this. First, as has been stressed at various points in this report, London is uniquely competitive in the key exporting private service sectors that we expect to drive UK economic growth, and this favourable sectoral balance provides a strong stimulus to future jobs in London. Second, some of the imbalances created by rapid growth – particularly in the housing and commercial property markets – have moderated during the slowdown that has followed the heady growth of the late 1990s. This means, for example, that rental costs in London relative to other parts of the country are much more competitive than they were three or four years ago (although London is inevitably still a higher cost location than most of the UK), and this is likely to moderate some of the rapid growth in business service jobs seen in parts of the north of England in the past few years. Third, international migration into London is likely to continue to fuel strong population growth, which itself will generate local demand and a knock-on effect on labour demand.

Chart 8.1

Employment



Source: OEF

As a result, we expect London to create an extra 650,000 net jobs by 2015 (Chart 8.1). Perhaps half of the net increase in jobs will be in business services, with health & education and retailing expected to provide the next largest contribution to rising employment (Table 8.1). Perhaps inevitably, manufacturing employment is likely to decline further, although the job losses will be much lower than over the 1970s and 1980s given the much smaller size of the sector in London now. As a result of this

³⁹ The medium-term forecasts here are consistent with OEF's regular *Regional Economic Outlook* forecasting service, produced in association with Regional Forecasts Ltd

growth, by 2015 London is projected to account for 16% of UK employment and 20% of GDP.

Table 8.1 Long-term forecast for London

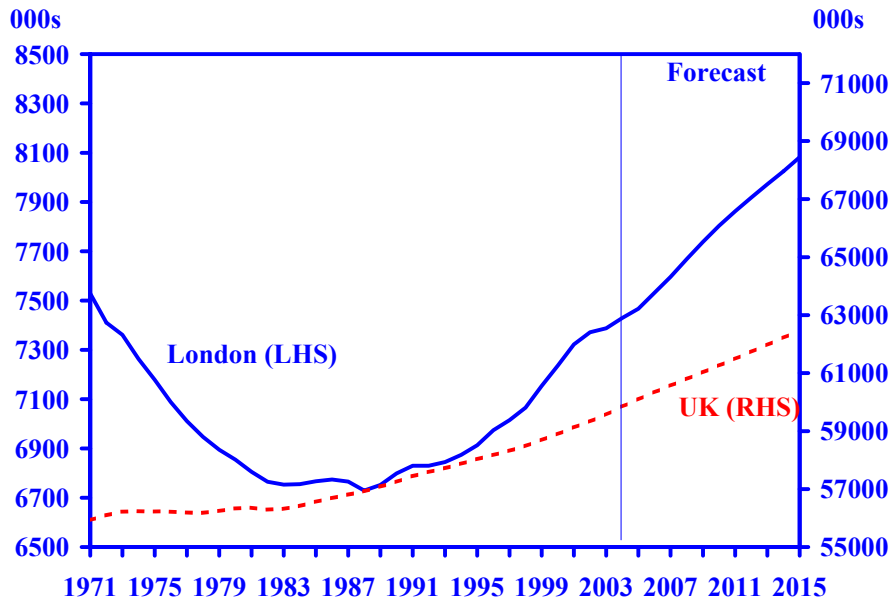
	2005	2008	2011	2015
Employment (000's)				
Primary	11	10	9	7
Manufacturing	241	215	193	168
Construction	250	260	272	287
Wholesale distribution	217	204	192	177
Retail distribution	398	411	433	456
Hotels & catering	333	350	368	394
Transport & communications	339	336	331	327
Financial services	371	388	405	420
Business services	1062	1181	1330	1492
Public admin.	237	234	231	227
Health & education	673	711	739	775
Other services	327	342	360	376
Total employment	4465	4649	4870	5112
Population	7467	7669	7862	8082
Total GDP(basic prices, £2002bn)	185.3	204.3	224.6	253.2
average annual % change	2002-05	2005-08	2008-11	2011-15
Total employment	0.6	1.4	1.6	1.2
Population	0.4	0.9	0.8	0.7
Total GDP(basic prices, £2002bn)	2.7	3.3	3.2	3.0

Source: OEF

Population growth is an important part of this economic strength, with London's population forecast to reach nearly 8.1 million by 2015 (Chart 8.2). As discussed in Chapter 7, our forecasts for London are based on a continuing strong impact on population from international migration, with net international migration of working-age people into the UK assumed to run at around 130,000 a year, and the majority of these people going to London. Without this influx of people, there would be an impact both on the level of demand in London and the ability of employers to attract the staff they want in a variety of different occupations, including investment bankers and doctors as well as catering and hotel staff and office cleaners. Equally, London's success in meeting the challenges of rising population and employment cannot be taken for granted, and could be undermined by potential structural constraints, notably in transport and housing.

Chart 8.2

Population



Source: OEF

Appendix: Public Finance Calculation

(a) Expenditure “for” rather than “in” a region

In a joint note by HM Treasury and ONS examining these methodologies it was acknowledged that there are benefits in using both measures of spending, and that the appropriate method depends partly on the type of spending being examined.

Looking at spending “in” a particular region based on the location of the government unit making the transaction is a useful statistical methodology when looking at the regional distribution of the output of government-supplied services and in particular the relevant employment and pay costs. It is also a useful way of looking at direct spending on intermediate purchases or investment goods and the impacts on the supply chain. Calculation of spending on the “in” basis also has the benefit of being relatively easy to calculate.

The second method identifies the spending on the basis of residence of the “counterpart” for transactions, i.e. identifying the location of the recipients of services or transfers that government expenditure finances irrespective of where this expenditure takes place.

This technique of calculating expenditure “for” a region is best applied for distributive transactions: the provision of public services to individuals and transfer payments. In this analysis we are primarily concerned with the benefits accrued by London as a region from public finances relative to payments. Using the allocation of public spending “for” the region is best suited to this.

(b) Regional distribution of public expenditure

Calculation of public expenditure by region is based on Public Expenditure Statistical Analysis (PESA) 2005 which identifies expenditure on services where possible according to the region that benefits from spending, i.e. spending on a “for” basis. Around 81% of Total Managed Expenditure (TME) is allocated in this way, shown in table A.1.

Some of the expenditure on services that is not allocated to regions in this source is best regarded as not affecting regions in any way, such as that identified as being “outside the UK” and specifically of benefit to non-UK residents.

The remainder of non-identifiable spending on services, totalling some £61.7 billion (14% of TME) refers to services provided by the government that are of benefit to the UK as a whole. This sum is dominated by Defence (45%), with significant shares accounted for by the Home Office (8%) and the Chancellor’s Departments and Central Exchequer Functions (37%). Such services are clearly of some benefit to all UK residents and we regard it as preferable to estimate a distribution across regions.

PESA 2005 attempts to allocate this other non-identifiable spending to regions, but on the basis of spending “in” particular regions. This technique gets around the problem of determining who benefits from such central government functions by looking at direct regional impacts in terms of pay costs.

Table A.1 Total identifiable expenditure on services by region (2003/04)			
	Identifiable Expenditure (£ bn)	Share of UK spending	
		% Identifiable Services	% Total Expenditure
North East	17.3	4.6%	3.8%
North West	44.2	11.8%	9.7%
Yorks & Humber	30.0	8.0%	6.6%
East Midlands	23.2	6.2%	5.1%
West Midlands	31.0	8.3%	6.8%
Eastern	28.1	7.5%	6.2%
Greater London	52.9	14.1%	11.6%
South East	41.7	11.1%	9.2%
South West	27.7	7.4%	6.1%
Wales	20.3	5.4%	4.5%
Scotland	37.2	9.9%	8.2%
Northern Ireland	13.5	3.6%	3.0%
UK	367.1	97.7%	80.6%
Outside UK	8.8	2.3%	1.9%
Total Identifiable	375.9	100.0%	82.6%
Non-identifiable	61.7	-	13.6%
Total expenditure on services	437.6	-	96.1%
Accounting adjustments	17.6	-	3.9%
Total managed expenditure	455.2	-	100.0%

Source: PESA 2005

However, of the total unallocated £61.7 billion, the pay cost components that are distributed on the “in” basis in PESA 2005 only sum to £17.4 billion (including payments outside UK). This leaves a further £44.3 billion in non-pay, non-identifiable costs. For example, less than 40% of the total non-identifiable Defence costs are pay costs that can be attributed to specific regions in this way. However, the remainder also benefits regions in the same way and the figures would be more meaningful if this were allocated across regions.

This additional spending, along with £17.6 billion of accounting adjustments is allocated to regions here using three different techniques (shown in table A.2). No single estimate is definitive and instead we present a range of possible expenditure values for each region.

First, aiming for consistency with identified spending on services in the previous table, we distribute the entire £79.3 billion according to the shares of identified spending on a “for” basis. Next, we use the additional information in PESA 2005 on non-identifiable spending on an “in” basis, using these shares to allocate to total. Finally, we share the £61.7 billion according to the regional population distribution, based upon the assumption that each member of society benefits equally from this spending on services.

Table A.2 Non-identifiable expenditure apportioned to regions (2003/04)				
	“for” basis	“in” basis	Population shares	Expenditure range
	(£ bn)	(£ bn)	(£ bn)	(£ bn)
North East	3.7	2.5	3.4	2.5 - 3.7
North West	9.5	4.6	9.1	4.6 - 9.5
Yorks & Humber	6.5	5.6	6.7	5.6 - 6.7
East Midlands	5.0	3.8	5.7	3.8 - 5.7
West Midlands	6.7	4.2	7.1	4.2 - 7.1
Eastern	6.1	7.2	7.3	6.1 - 7.3
Greater London	11.4	12.0	9.8	9.8 - 12.0
South East	9.0	16.3	10.8	9.0 - 16.3
South West	6.0	13.4	6.7	6.0 - 13.4
Wales	4.4	2.1	3.9	2.1 - 4.4
Scotland	8.0	5.4	6.7	5.4 - 8.0
Northern Ireland	2.9	2.3	2.3	2.3 - 2.9
UK	79.3	79.3	79.3	

Source: PESA 2005, OEF calculations

(c) Regional distribution of tax revenue

Total taxes paid and social contributions by region and sub-region (to NUTS 2 level) were reported up to 1999 in the May 2002 Economic Trends publication, replicated in table A.3. This calculation has not since been repeated for later years, but formed the basis of previous regional tax calculations.

As the only readily available official source of regional tax data, it gives a good idea of the regional distribution. As such the data forms the basis of our calculation here, largely as a check on our estimation, as we replicate this first for 1999 and then for 2003/04, to match expenditure data. We aim to use the same original sources for these where possible, otherwise we aim for consistent calculation.

Taxes included in the table primarily relate to those on income, but also include Council Tax and rates, as well as taxes on vehicles. These taxes comprise less than 40% of total UK tax receipts (excluding social security flows) as measured in the budget, but cover some of the largest tax categories with regional diversity.

We first calculated shares of UK tax revenue generated by London for these categories for 1999 to check the methodology against the above data. Shares were applied to total UK revenues by tax type as published in the Budget Report for 1999/2000.

This gives an estimate of £19.9 billion of tax generated by London (for the three taxes examined), only very slightly different from the £19.8 billion reported above by ONS for 1999, a difference that can easily be accounted by the difference between using calendar and fiscal years.

We then replicate this for 2003/04, with further calculation for the other tax streams, since the three taxes included before are far from a comprehensive coverage of tax revenue. We also look at the impact of London on VAT, corporation tax, stamp duties, various other customs and excise duties or other smaller taxes. The methodology is detailed below.

	Taxes paid (£ bn)	Social contribution (£ bn)	Taxes paid (% UK)	Social contribution (% UK)
North East	3.4	5.1	3.0%	3.6%
North West	10.8	14.8	9.5%	10.5%
Yorks & Humber	7.7	10.7	6.8%	7.6%
East Midlands	7.1	9.5	6.3%	6.7%
West Midlands	8.6	12.3	7.6%	8.7%
Eastern	11.9	14.0	10.5%	9.9%
Greater London	19.8	22.3	17.5%	15.7%
South East	20.8	21.2	18.4%	15.0%
South West	8.9	10.7	7.8%	7.6%
Wales	3.7	5.5	3.3%	3.9%
Scotland	8.5	12.1	7.6%	8.5%
Northern Ireland	2.0	3.1	1.7%	2.2%

Source: *Economic Trends*, May 2002

We first look at Income taxes and National Insurance Contributions (NICs). These are initially calculated on a residence basis, e.g. the income tax paid by people who live in London. We have subsequently calculated these on a workplace basis, e.g. the taxes paid on incomes earned in London. We also calculate VAT on a residence basis as well as on a business basis. This is the difference between the tax paid by London residents and the tax paid in London stores.

National Insurance Contributions calculated here are very different from the social contribution data calculated by ONS in table A.3, and used in previous calculation. This is largely because the ONS calculation includes payments into pension funds, which clearly do not contribute to UK tax revenues and are not of interest here.

For the three taxes mentioned above, a case can be argued for both types of calculation. We report both estimates, giving a range of values for total tax revenue from London.

(i) Income Tax

Income tax data on a residence basis are derived from the HM Revenue and Customs (HMRC) Survey of Personal Incomes (SPI). For 1999/2000, £93.2 billion was paid in income tax in the UK according to this source, compared with £95.7 billion in the budget report. London accounted for 18% of this, equivalent to £17.6 billion on a budget basis.

In 2002/03 (the latest year for which data are available), London contributed 19% of total UK income tax revenue. This ratio can be applied to the UK total for 2003/04 from the budget report to give total residence based income tax payments in the region of £22.2 billion.

The Annual Survey of Hours and Earnings (ASHE) gives the earnings distribution in the UK and regions on both a workplace and residence basis. From this and estimates of the differences in employment levels on the two different definitions (derived from the Labour Force Survey) we have calculated the number of earners within different income bands. Applying relevant tax rates to average income within these bands allow us to

estimate the difference between income tax revenue for London on a residence and workplace basis, giving an estimate of workplace based income tax payments from London of £27.9 billion.

(ii) National Insurance Contributions

Social contributions in table A.3 are distorted on the upside since they also include payments to pension funds. According to the SPI, UK pension payments in 1999/00 were £51.6 billion while £5.7 billion was paid in London.

Social security contributions as reported in the budget for the UK as a whole give a smaller, more relevant figure. In this report we use reported UK budget data and split this using shares of the UK total calculated from average weekly expenditure data supplied by the Family Expenditure Survey (FES). This only looks at the household contribution share, but the employers' contribution is expected to be symmetric. Using this, we estimate London's NICs payments in 2003/04 to have been £12.9 billion.

This calculation is also on a residence basis, and a similar adjustment to that for income tax, using ASHE data, can be performed to give national insurance contributions based on incomes earned in London. This suggests that the share of UK NICs rises to around 21% from 18% on a residence basis.

(iii) VAT

VAT represents around 16% of total tax receipts and should be carefully split across regions with different regional spending patterns evident. Data on regional spending by category are only available up to 1999 and OEF Regional Consumer spending forecasts are used for later periods.

Consumer spending data by region reported by ONS and used as the basis for this calculation are derived from surveys of household spending. This share relates to the share of consumer spending and therefore the share of VAT on a residence basis: the amount of VAT paid by households that are based in London (15.7% of the total, or £10.9 billion).

Further calculation is undertaken based on shares of retail turnover in London reported by the Annual Business Inquiry (ABI). This share relates to the amount of consumer spending that takes place in London, incurring VAT, regardless of where the person spending is resident. This business-based estimate of VAT is larger than the residence based calculation, at 18.1% of the total or £12.5 billion.

(iv) Council Tax

The council tax and rate payments component of tax reported for 1999 in the May 2002 Economic Trends was calculated by ONS from specific data from local Government and the Regions (as well as devolved administrations).

Similar data can be obtained by splitting the UK council tax take reported in the budget using weekly household tax payments as a share of the UK derived from the Expenditure and Food Survey (EFS). Directly this gives average weekly household spending on council taxes, and in total. Applying this to total consumption expenditure data and forecasts from the OEF Regional Trends publication gives the share of total council tax payments that come from each region.

This implies that council tax payments in London represent over 15% of the UK total, equivalent to £1.9 billion in 1999 rising to £2.9 billion in 2003/04.

(v) Vehicle Excise Duty

Driver and Vehicle Licensing Agency (DVLA) and Department for Transport (DfT) data are used to derive vehicle taxes based upon average rates and the number of registered vehicles.

The number of registered cars and other vehicles are available for London and other regions from DfT. Rates for different types of vehicles are available from the DVLA. Applying these rates gives total revenue from this stream. As before, this is calculated as a share of the UK total, and applied to UK total revenue as reported in the budget.

These data suggest that London only contributes around 9% to total vehicle excise duty. Tax receipts from this source for London are only worth £0.4 billion in 1999/00.

(vi) Other Taxes and Duties

Corporation tax is another large component of total UK tax receipts, which can be split across regions according to the number of firms within regions. The number of firms within regions are reported in the Inter Departmental Business Register (IDBR), also defined by turnover bands as an indicator of firm size. Shares of total UK corporation tax by region are estimated from this.

The regional distribution across turnover bands is used to estimate the number of firms within London and the UK that fall in different profit bands for which different corporation tax rates apply. This calculation suggests that London accounts for around 22% of total corporation tax payments. This is consistent with a similar share of UK profits and turnover according to the ABI.

Stamp duty paid is also reported for the UK in the budget but is also reported for regions by HMRC over time and available to 2003/04. This data show that the amount of duty paid in London has risen strongly over time. But in recent years, the share of UK stamp duty derived in London has fallen from over 30% to 26% in 2003/04, as housing markets in the rest of the country catch up with London.

Other duties, such as fuel and tobacco duties are a significant share of UK revenue. Like VAT, they are split across regions based upon relevant consumer spending shares for appropriate goods categories. Business rates are also calculated separately for London, based on the share of UK firms within the capital according to the IDBR.

The London specific **Congestion charge** must also be considered. In the latest financial year, total revenues have been £190 million. Net of costs, revenues were £97 million. Although these figures are small compared to UK revenues, they are an important element of London's revenues especially since revenues are hypothecated and must be spent on London transport improvements. 80% of this fund was spent on bus network improvements.

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Alongside its promotion of the business community, the Corporation has a host of responsibilities which extend far beyond the City boundaries. It runs the internationally renowned Barbican Arts Centre; it is the port health authority for the whole of the Thames estuary; it manages a portfolio of property throughout the capital, and it owns and protects 10,000 acres of open space in and around it.

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