

OXFORD ECONOMICS

Past & future trends in trade & investment: The potential role of England's city-regions

**A report prepared for the Local
Government Association**



**OXFORD
ECONOMICS**

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1. Executive summary

- The UK's balance of trade in goods has been deteriorating for the past three decades. Some of that has been offset by an improved performance in net exports of services, but not all of it, so that the overall current account of the balance of payments has worsened.
- This has to be funded by borrowing from abroad or running down our overseas assets. That cannot continue indefinitely.
- Our forecast is that a serious crisis is averted, but only by slow growth in the UK economy, of about 2 ½% a year over the long term, and only by becoming ever-more dependent on service sector exports. That dependency is risky, and on current patterns it also means that the UK economy is likely to become even more reliant on London.
- That said, there is scope for city-regions outside of London to contribute more to our growth in service sector exports. All city regions have their specialisms, and consideration should be given to building greater export strength in those areas.
- Equally, our city regions have manufacturing specialisms. Strengthening export capability in these would be particularly good if it makes the UK economy more evenly balanced by sector as well as by geography.
- Realistically, however, radical improvements in exporting will be hard to achieve without significant inflows of inward investment. At present this investment is heavily weighted either towards London, or to a small number of sectors (and companies) in specific regions. Elsewhere, the trends are not good.
- Stronger, but also more balanced, inward investment patterns would be desirable both directly and through their beneficial impacts on exports – and also on R&D (and innovation more generally).
- For that to happen there will need to be continuing efforts to improve UK competitiveness, not least through enhancing skills. Just as different English city-regions have different sectoral structures, so they also have different patterns of skill needs.
- The linkages are such that efforts to enhance exporting, inward investment, innovation and skills are probably best considered together in an integrated way. Doing so probably requires a localised approach, most obviously by city-region local governments, local economic partnerships, and other agencies.
- It is, however, always important to consider the evidence-base on just how effective different types of policy interventions actually are, and whether interventions tend to succeed best when they are designed and delivered locally, regionally or nationally. That is beyond the scope of this report, but it represents a key issue to be addressed.
- There is also a challenge for policy-makers in terms of lack of reliable and consistent economic information, even at the broad regional level, let alone for city-regions or other local areas, of the sort that is available nationally. This absence of robust detailed information on export and investment trends inevitably makes it harder to be sure what interventions, if any, should be undertaken.

2. Introduction

Oxford Economics were commissioned by the Local Government Association (LGA) to produce a report researching long-term trends in, and prospects for, UK trade & investment, with particular reference to the role of England's city-regions in generating exports and attracting investment.

We have sought to draw attention to some of the possible policy issues raised by our analysis, but this report does not directly offer policy recommendations. However, one issue that clearly arises from, but also impedes, our analysis is that the amount of reliable data on either export performance or inward investment trends at the city-region level is very limited. This information gap may itself be part of the reason why the UK's export and inward investment performances and indeed prospects are not better than they are, or appear to be.

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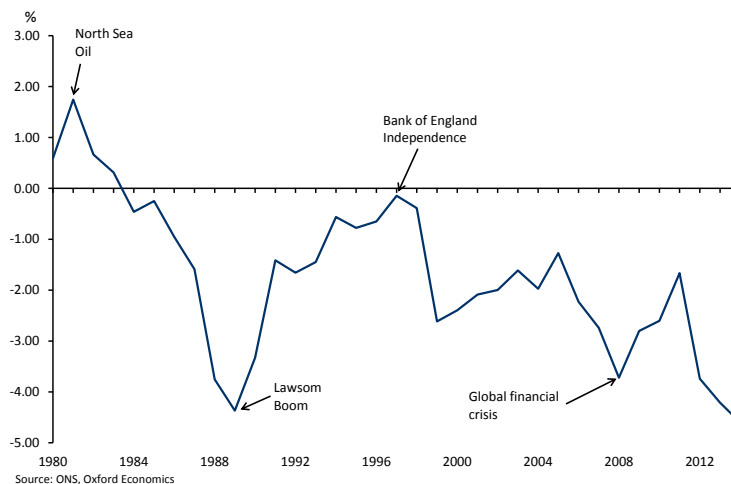
3 Findings

3.1 The balance of payments and growth in the UK economy: is there a problem?

We start with the 'big picture': the economy of the United Kingdom as a whole, and specifically the balance of payments.

As Figure 3.1.1 shows, the UK's balance of payments has been experiencing a downward trend in its current account over the past three decades, and indeed has posted a persistent deficit since the mid-1980s.

Figure 3.1.1: Current account of balance of payments as a percentage of GDP, 1980-2014



So, what does that mean, and does it matter? The balance of payments is a record of transactions between UK businesses, government and households, and those in the rest of the world. The current account therefore shows how much we sell to or buy from other countries by way of goods and services (cars, food, machinery, holidays, banking services and so on), together with such other items as overseas aid donations, payments to and from the EU, and the interest, profits and dividends that we earn on overseas investments (less any flowing in the other direction).

Crucially, these 'current account' items need to be financed by 'capital account' flows, in the form of lending to or borrowing from abroad, or accumulating or running down assets. So if the UK is running a growing current account deficit then we must be borrowing increasing amounts from abroad, or selling off our overseas assets at a growing rate, or receiving increasing volumes of new financial investments from abroad, to cover the growth in the current account deficit.

That means that our ability to continue running ever larger current account deficits will depend on our ability to attract capital account inflows, or our willingness to sell off assets. In the short term a temporary current deficit is not usually a problem, and the deficit can be financed by attracting capital flows from other countries. However, if the imbalance persists, this may become increasingly difficult – particularly since the current account deficit will become self-reinforcing, because of rising interest payments on the borrowing. The danger is a spiral of problems, so that if the situation continues and the deficit grows larger, foreign investors lose confidence in the ability of the country to repay its obligations.

Difficulties in attracting financial inflows can to some extent be addressed by raising interest rates. However, these will impact on the domestic economy, reducing spending and slowing the rate of growth of the

economy. Furthermore, they may not work, if overseas lenders and investors are losing confidence in the UK economy.

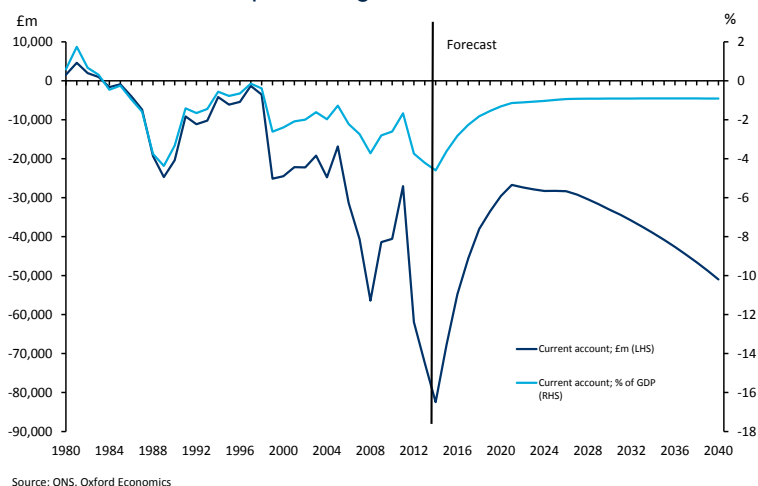
If that happens, and the necessary funds cannot be secured, then the current account has to be made to improve, either via a decline in the exchange rate, or via a squeeze on the domestic economy to reduce import demand by for example raising taxes.

All three of these adjustments (interest rates, exchange rate, tax rises etc) involve economic costs. Essentially therefore, by whichever of these routes, economic growth has to be restrained.

So why is there so little concern about the current account?¹ Our own Oxford Economics forecasts illustrate one reason. We (and most other forecasters) are suggesting that the current account will not in fact continue to deteriorate, or at least not at the same rate.

So, as Figure 3.1.2 shows, we forecast that the current account deficit will continue to worsen in absolute terms. However, we forecast that it will stabilise as a share of GDP – meaning that it ought to be manageable, since the economy’s ability to service the deficit will grow in line with the deficit itself.

Figure 3.1.2: Forecast current account of balance of payments in absolute terms and as a percentage of GDP, 1980-2040



Essentially our projection implies that, by some combination of the methods described above, the economy will grow at a slow enough rate to ensure that the current account does not become unsustainable.² In technical terms, our modelling is based on the view that the economy adjusts so as to converge on a ‘steady-state’. Our forecast for GDP growth over the next decade is therefore for an average real increase of about 2½% a year, compared with the 3% and more currently being achieved.

¹¹ “When, at a recent meeting of analysts in the City, I raised the question of the balance of payments, one of the younger economists said: ‘Oh, nobody worries about that sort of thing these days.’” Bill Keegan, *The Guardian* 23 February 2014 <http://www.theguardian.com/business/2014/feb/23/balance-recovery-better-balance-payments-net-exports>

² Other parts of the explanation are that the exchange rate gradually weakens and inflows of interest profits and dividends improve. However, the overall growth rate is the major part of the explanation.

What this effectively means is that we project that the current account problem will be hidden behind, or disguised as, a growth problem for (or at any rate a growth constraint on) the UK economy³

3.2 Why has the current account deteriorated? Could that be changed?

There is also another part to the explanation for the lack of discussion about the UK's deteriorating current account deficit, which is revealed in much of the analysis that follows: the lack of data that really gets to the heart of what is going on in the UK economy. Broad macro-economic indicators may sometimes give the impression that the economy is performing well, without identifying that this is very much dependent on a small number of sectors, or a small number of cities or regions within the UK.

This raises two concerns. First, if the economy is indeed very dependent on a few sectors or regions, then this confers risks, that a more balanced economy would avoid. Typically this is portrayed in terms of the UK's heavy dependence on exports of financial services, and hence on London.

Second, a focus only on headline macro-economic numbers means that opportunities foregone are not identified, and hence any potential for improving performance is unlikely to be fully identified. More comprehensive data would present a much richer and more powerful story of UK economic strengths and weaknesses – and of **potential** strengths that perhaps might be developed through focused policy interventions.

What we do know is that the deterioration in the current account over the past three decades has been principally down to an increase in the trade deficit for goods. Table 3.2.1 illustrates this.

Table 3.2.1: Composition of current account of balance of payments movement, 1980-2013

	£m
Current account of balance of payments	-72,395
Trade balance - services	78,096
Trade balance - goods	-110,196
Net Interest, profit and dividends	-13,133
Transfers, net current account transfers	-27,162

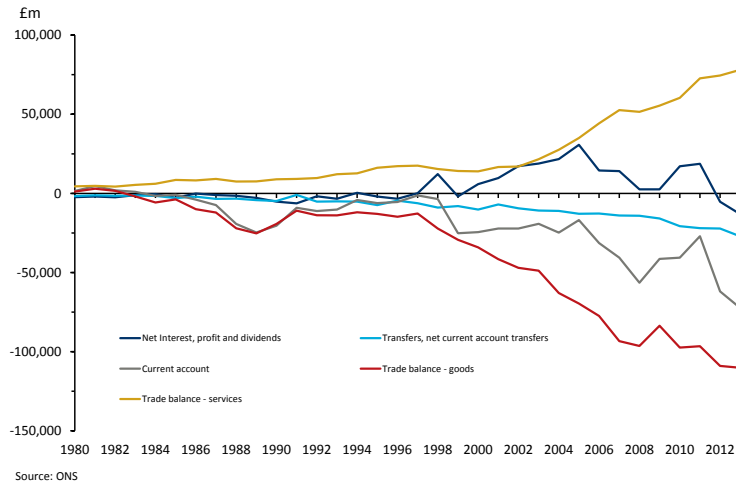
Source: ONS

Between 1980 and 2013 the current account overall worsened by £72bn, despite a £78bn rise in our net services exports. Interest, profit and dividends accounted for some of the current account deterioration, as did transfer payments, but at £110bn, worsening net exports of goods accounted for the largest part.

Chart 3.2.1 shows these movements unfolding. It can be seen how the visible trade balance has worsened, partly because of declining exports of North Sea oil, and corresponding increases in oil imports, but also because UK exports of manufactured goods have not grown as fast as our imports, despite the growth in the global economy over the period.

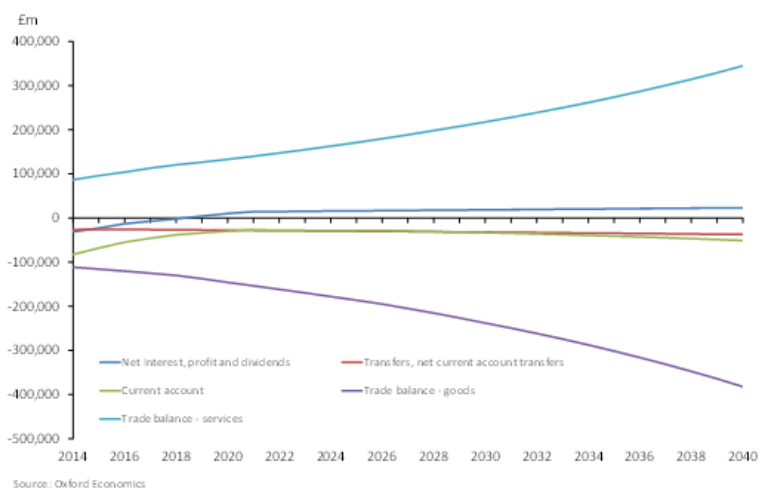
³ For a fuller discussion see Coutts K and Rowthorn R 'Update of prospects for the UK balance of payments' *Government Office for Science Future of Manufacturing Project Evidence Paper 30*, October 2013.

Figure 3.2.1: Current account of balance of payments and its constituent elements, 1980-2014



Looking forward, our view that the current account stabilises as a share of GDP relies on a forecast that future deteriorations in the trade deficit for goods are offset by a roughly equivalent rise in the trade surplus in services. Figure 3.2.2 shows that, going as far ahead as 2040.

Figure 3.2.2: Current account of balance of payments and its constituent elements, 2014-2040



This means, therefore, that UK growth of 2.5% a year in GDP relies on a very strong trend in the surplus of UK services. Furthermore, the forecast involves the economy running on a knife-edge, with large and offsetting changes in the goods and services balances. If both of those were to be worse than we forecast by only a small margin, then the combined impact on the current account could be significant – requiring that the economy grows by less than 2.5% over the medium to long term. That would clearly have adverse impacts on living standards, employment and, crucially, tax revenues, welfare payments and hence government borrowing.

The implication is that if it is possible for new policy measures to be introduced with the aim of improving the current account of the balance of payments, then it would be reasonable to introduce such policies. We consider this in more detail below, looking first at service sector net exports, and then at goods.

3.3 UK exports of services: how dominant is London?

Where improving the UK's overall export performance is concerned, a possible view to take is that, by the principle of 'backing winners', the most effective way to achieve that is to increase our exports of services.⁴

Clearly there would be benefits to the UK at the macro-economic level from achieving an even better performance on services exports than currently seems in prospect.⁵ However, one concern here is obvious and has already been mentioned: to the extent that the UK's service sector exports are largely associated with London, a strategy of improving service sector exports might simply make the UK economy more geographically skewed, as well as more dependent on just a few sectors.⁶

So just how much of UK exports of services are accounted for by London? Remarkably, there is no official data on this. A recent survey conducted on behalf of the Greater London Authority suggested that in the year to June 2014 London exported £147bn of goods and services combined. However, this figure does not include exports of financial services, which is clearly a major omission, nor of administrative and support services, whereas it does include £41bn of exports attributed to the wholesale sector, including car exports – which would more normally be attributed to the locations in which the vehicles were produced. So this data provides only limited guidance on how UK service sector exports split between London and other parts of the country.

The importance of London as a global financial centre is well known. Much has been written on this, and we will not replicate it here.⁷ In addition, London is known to be particularly important globally in professional services such as law, in digital services such as software and television production, and in sectors straddling the two such as advertising.⁸

London also accounts for a high share of the UK's visitor economy. Evidence from Visit Britain suggests that in 2013 foreign visitors spent £11.3bn in London. Amongst English regions the highest level outside of London was £2.0bn in the South East, with the North West reporting £1.1bn of spending. Furthermore, London's growth rate over the previous decade was higher than that of either the South East or the North West.

Table 3.3.1: Expenditure by visitors to the UK by region, 2003-2013

(£m)	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	Change 2003-13	Growth 2003-13 (%)
London	5,870	6,439	6,859	7,822	8,192	8,126	8,238	8,741	9,411	10,075	11,256	5,387	6.7
South East	1,295	1,467	1,470	1,679	1,578	1,799	1,863	1,714	1,908	1,898	2,000	705	4.4
North West	611	558	883	951	982	850	801	1,021	956	887	1,076	465	5.8

Source: VisitBritain

⁴ 'Backing winners' can be equated to the economic principle of comparative advantage: that trade and economic growth are maximised by specialising in those products where an economy has a comparative advantage. It could be argued that, for the UK, that means services.

⁵ As a matter of arithmetic, lower imports would have the same effect. Possible ways of achieving this include improving supply-chain linkages. In this paper, however, our focus is only on the export side.

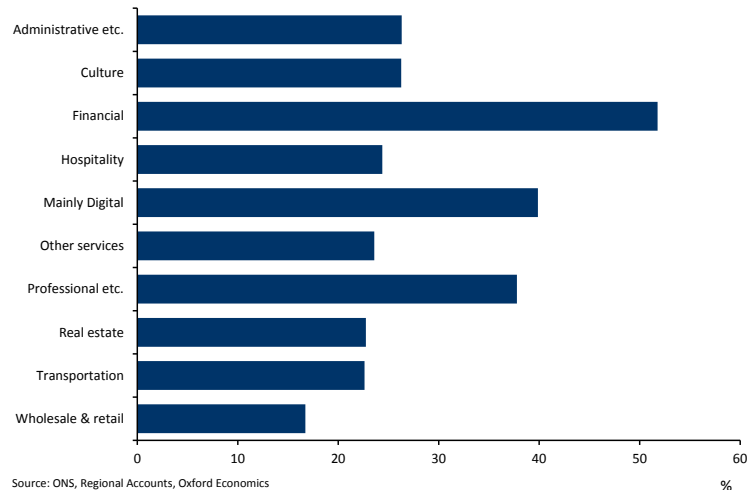
⁶ Haldane A (2010) 'The contribution of the financial sector: miracle or mirage' in A Turner et al (eds) *The Future of Finance: the LSE Report*, London School of Economics

⁷ See TheCityUK (2014) *Key facts about the UK as an international financial centre*

⁸ Ibid

Across service sectors more widely, the fact that London has high shares of output in several of them is evidence that it contributes disproportionately to exports in those sectors. Chart 3.3.1 illustrates this. London accounts for 23% of UK GDP overall, but much higher shares of output from the mainly digital information and communications sector, the professional, scientific and technical sector, and from financial services.

Figure 3.3.1: London's share of UK output by sector, 2013



Having said that, it is equally clear that in all service sectors, the majority of output occurs outside of London. Although London takes the lion's share of many internationally-traded service sectors, it does not account for all or even most of the UK's capabilities in any of them.

So, while London may be disproportionately important in terms of output, it does not follow that improving UK exports of services would simply benefit London exclusively, or even mainly, relative to other parts of the UK. That might be true, but it is not necessarily so. That in turn means that concern over geographical imbalances in the UK should not be offered as a reason to preclude efforts to raise UK exports of services. It is **at least possible** that UK service sector exports could be raised without further increasing London's share of the UK economy overall, particularly if there is exporting potential in other geographical locations which is not being fully utilised for some reason. We discuss this in the next section.

3.4 Could English city regions significantly improve their service sector exports?

The idea of actively seeking to promote exports of services from outside of London must clearly depend on there being policy interventions which would have a reasonable chance of success.⁹ It is beyond the scope of this paper to assess the evidence on this, which involves considering how successful various policy initiatives have been in the past at boosting exports of services (or indeed goods), and then drawing conclusions about how successful they might be in the future.¹⁰

⁹ DTI (2006) International trade & investment – the economic rationale for government support' *DTI Economics Paper* no 18

¹⁰ A major research centre has been established at the London School of Economics to collect robust evidence on 'what works'. See <http://whatworksgrowth.org> For another example of the kind of analysis involved see Criscuolo C et al (2012) 'The casual effects of an industrial policy' NBER working paper No 17842. See also DTI (2004) 'Raising UK productivity – developing the evidence base' *DTI Economics Paper* No 8.

However, it is useful to note the broad range of initiatives that might be undertaken, and (given the suggested focus on improving performance outside of London) the levels of government that might be responsible for them, assuming that the evidence suggests that the initiatives in question would indeed be effective.¹¹

As a starting point, setting the right **macroeconomic**, tax and regulatory frameworks are clearly important. By definition much of this has to be done at the national level, although it is possible that there could be greater devolution of powers than has historically tended to be the case in the UK. There is widespread support for doing that with respect to the devolved nations, and potentially it might be done within England too.

A second kind of intervention that might be potentially important is investment in **infrastructure**. For the service sector this is particularly likely to mean air and high speed rail transport, and digital connectivity. Such investment is likely to require at least some central government funding, direction or at the very least coordination.¹² Nevertheless there is also a case for significant local or regional involvement in, and perhaps leadership of, infrastructure investment.

A third type of policy intervention, **business support** via grants, advice and other methods can be both designed and delivered locally, or designed centrally but delivered locally, or indeed both designed and (via the internet) delivered centrally. All three have been tried, and it is a matter for investigation which approach has been most successful. The current government's approach centres on different locations bidding for funds on a project-by-project basis, with the decisions made centrally based on the perceived qualities of the bids and some limited evidence on local economic circumstances. This approach places little importance on the potential interactions between different projects, infrastructure investments, and so on.

Another possible area of intervention is the development of strong business groupings, whether in terms of **sector groups, clusters or supply-chains**. This is likely to include such initiatives as the development of business networks to boost knowledge-exchange and collaboration, and also branding ('Silicon Valley', 'Tech City', 'Scotch Whisky'). In this case, since 'groupings' implies at least some geographical proximity, there is likely to be a presumption in favour of doing this locally or regionally.¹³

As we have already noted, evidence on the exporting capabilities of sectors and locations outside of London is sketchy. However, as we have argued for London, so too for other places: looking to see if a particular city or region has a disproportionately high level of **output** in a sector is a useful measure of whether it has a strong base on which to build an increased exporting capability

In addition, if a city or region has particularly high productivity in any sector, relative to the national average for that sector, then this is likely to imply particularly high performance from the companies concerned, and hence potentially an especially high capability to export.

Underlying this is the view that specialisation is good for economic growth – so if specialisation exists, then building on it is more likely to generate stronger growth than diluting it. The notion of there being gains from specialisation is rooted in Adam Smith's division of labour. Smith was thinking in terms of the work of

¹¹ A more conceptually rigorous categorization is provided in Crafts N (2010) 'Overview and policy implications in *Learning from Some of Britain's Successful Sectors: An Historical Analysis of the Role of Government*, BIS Economics Paper No 6

¹² Helm D (2013) 'British industrial policy and the gradual return of the state' in *Oxford Review of Economic Policy* 29(2) 287-306

¹³ Rice P & Venables A (2004) 'Spatial determinants of productivity: analysis for the regions of Great Britain' *Journal of Economic Literature*

individuals and small companies rather than locations, but the same arguments may apply geographically.¹⁴ The implication is that if a particular location has strength in a particular type of activity such as (for example) TV production, or legal services, then seeking to strengthen the exporting capability of that type of activity in that place might bring particular dividends.¹⁵

We have looked at patterns of service sector specialisation for the 10 English city-regions (excluding London) defined by the City Growth Commission.¹⁶ #table 3.4.1 shows how much of national output of each of the mainly private service sectors is attributable to each city-region. The top three are highlighted in each case, so that Bristol, for example, has particular strength in financial services, hospitality and mainly personal services (such as health clubs). The East Midlands is also strong in personal services, and also in support services (essentially lower-valued added outsourced business services) and in wholesale and retail. And so on.

Table 3.4.1: Service sectors output as share of UK total for English city-regions, £m 2010 prices, 2013. Top 3 highlighted in blue.

	Culture	Financial services	Hospitality	Mainly digital	Personal services	Professiona l etc	Support services	Transport & storage	Wholesale & retail
Bristol	0.7	1.6	1.3	1.1	1.3	1.2	1.2	0.9	1.0
East Midlands	1.6	0.7	1.5	1.1	1.9	1.3	2.3	1.6	2.3
Greater Manchester	1.6	1.7	2.0	1.3	1.5	2.0	2.4	2.8	1.7
Leicester	0.5	0.2	0.4	0.2	0.6	0.3	0.7	0.4	0.6
Merseyside	2.6	2.0	2.7	1.3	2.9	1.6	2.6	2.9	2.9
Potteries	0.5	0.2	0.4	0.3	0.3	0.2	0.4	0.6	0.6
South Dorset Mero	0.5	0.9	0.8	0.3	0.6	0.4	0.5	0.5	0.6
South Hampshire	1.4	1.2	1.5	2.4	1.8	1.5	2.2	1.9	2.1
South Sussex	0.9	0.8	0.8	0.9	1.0	0.7	0.8	0.4	0.8
South Yorkshire	1.6	0.8	1.2	0.9	1.0	0.8	1.2	1.8	1.6
Teesside	0.3	0.2	0.3	0.2	0.2	0.3	0.3	0.4	0.4
Tyne and Wear	1.8	1.0	1.8	1.3	1.5	1.0	2.0	1.6	1.7
West Midlands	2.1	3.3	3.0	2.0	2.6	2.5	3.6	3.1	3.7
West Yorkshire	2.3	2.2	1.8	1.7	1.7	2.2	2.4	2.6	2.3

Source: Oxford Economics

Table 3.4.2 shows how productivity in each sector compares with productivity in that sector in London – invariably the standard-setterr in this regard. Again we have highlighted the top sectors in blue. So for the Bristol city-region, for example, productivity in personal services is 88.5% of the London level, while in support services it is 86.1% and in the transport & storage sector it is an impressive 94.8%, probably reflecting the logistics facilities within the city-region.

¹⁴ See Krugman P (1991) 'Increasing returns & economic geography' *Journal of Political Economy* 99, 483-99

¹⁵ Excessive specialisation may, however, be damaging in the long term if it locks a local economy into a single technology or market. See Glaeser E et al (1992) 'Growth in cities' *Journal of Political Economy*, 100(6),1126-52

¹⁶ Royal Society of Arts (2014) *Unleashing metro growth: Final report of the Cities Growth Commission*

Table 3.4.2: Productivity by service sectors
in each English region, as % of London's productivity in that sector, 2013

	Culture	Financial services	Hospitality	Mainly digital	Personal services	Professional etc	Support services	Transport & storage	Wholesale & retail
Bristol	56.7	57.6	83.9	65.4	88.5	65.6	86.1	94.8	74.9
East Midlands	73.5	50.4	74.1	61.1	67.9	60.4	76.1	75.1	80.8
Greater Manchester	80.9	46.9	77.9	67.7	82.7	62.5	73.3	81.8	77.3
Leicester	68.0	41.7	65.7	49.2	57.6	52.3	62.8	61.4	68.0
Merseyside	78.5	49.4	76.5	56.8	87.0	58.3	68.1	77.5	78.5
Potteries	55.5	47.7	73.7	58.4	63.5	50.3	67.9	70.7	68.5
South Dorset Mero	48.2	46.3	72.9	56.8	78.2	57.0	76.7	83.7	66.6
South Hampshire	66.8	45.1	67.2	78.1	74.2	59.4	76.0	77.9	77.6
South Sussex	60.6	42.4	67.2	73.9	72.0	60.6	73.2	79.3	76.2
South Yorkshire	59.6	41.5	65.9	51.9	55.3	50.0	66.2	73.7	66.9
Teesside	51.0	48.3	63.8	60.1	57.9	50.7	66.9	66.4	64.8
Tyne and Wear	55.8	44.3	59.7	55.5	50.6	52.8	72.2	63.7	66.4
West Midlands	60.6	48.9	79.9	64.6	69.9	63.1	73.2	70.4	72.2
West Yorkshire	61.4	46.4	71.4	58.8	64.9	54.6	73.5	77.2	74.9

Source: Oxford Economics

Clearly no simple policy conclusions can be drawn directly from these results – we are not seeking to suggest that in any specific city-region there should necessarily be a particular focus on encouraging exports from the particular sectors that we have highlighted. One reason is that in many cases the sector involved may have a low propensity to export – although that said, even retail and personal services can be exported in so far as they can be used to foster stronger tourism growth. In addition, there are many factors to be taken into consideration as well as the two that we have covered here, including the basic issue of whether the interventions that might be undertaken would be likely to work.

Instead, we are simply seeking to draw attention to the existence of strength in service sectors in locations outside London, and specifically in the English city-regions, and also to the way in which such strengths vary from place to place.

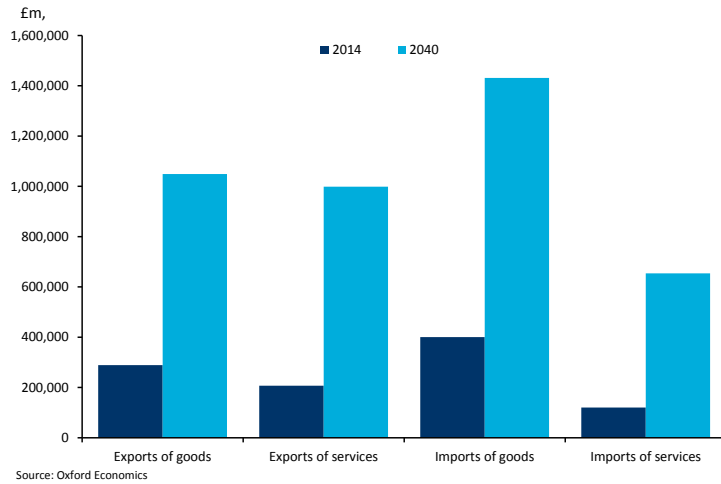
This raises the **possibility** that efforts could be made in those city-regions – and implicitly therefore **by their relevant local governments, local economic partnerships (LEPs) and other agencies**, to build exporting capacity, focusing on local strengths. It is at least possible that such an approach would have better results than a blanket, undifferentiated, and centrally-led approach.

3.5 Improving UK exports of goods

Clearly, a second possible way forward is to seek to improve the UK's exports of **goods**.

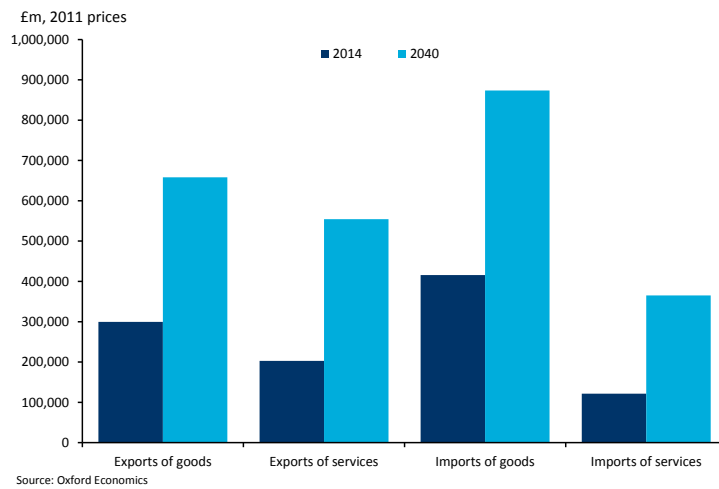
It is worth noting that (as with services) these are already likely to rise significantly, at least in value terms. We project that between 2014 and 2040 the value of exports of goods will rise four-fold, while for services the increase will be five-fold. (See Figure 3.4.1.) In other words, where exporting of goods is concerned, there is plenty of prospective success to build on – even if other countries can perhaps say the same or better.

Figure 3.5.1: Trade in goods and service, nominal prices, 2014 and 2040



Admittedly some of that increase will reflect higher prices. However, adjusting for that still implies a 3% a year increase in exports of goods, and a 4% a year increase in exports of services – both of them significant uplifts. (See Figure 3.5.2.)

Figure 3.5.2: Trade in goods and service, real prices, 2014 and 2040



So how much scope is there for increasing exports of goods still further? The data on past performance is a little better here than it is for services – it is available from the ONS for broad regions. What this shows is that over the period 1996 to 2013, growth rates for exports of goods have varied markedly. Unsurprisingly, London has seen slow growth. The East of England has seen the fastest reported growth. (See Table 3.5.1.)

Table 3.5.1: Exports of goods, average annual growth, 1996-2013

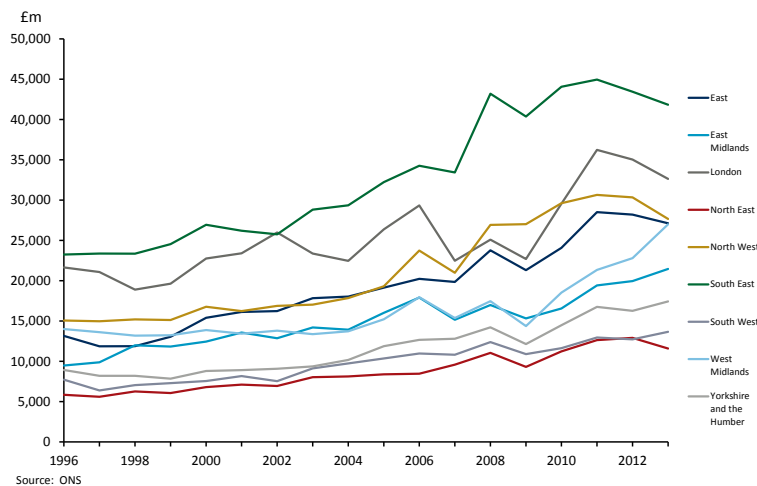
	Year-on-year (%)
East	4.3
East Midlands	4.9
London	2.4
North East	4.1
North West	3.6
South East	3.5
South West	3.4
West Midlands	3.9
Yorkshire and the Humber	4.0
England	3.7
UK	3.4

Source: ONS

That said, it is also the case that the South East, partly by virtue of its size, has consistently been the largest exporting region for goods in absolute terms. (See Figure 3.5.3.)

Importantly, therefore, while encouraging growth of exports of goods (assuming it can be done) may have the benefit that it will encourage growth across different parts of the country, there is no reason to think that it will result in a significant geographical rebalancing of the economy between north and south – and the reverse is a possibility.

Figure 3.5.3: Exports of goods by broad region, 1996-2013



However, a more detailed analysis suggests that in many cases much of a region's performance is driven by only one or two sectors – and in those cases that may also mean just one or two firms.

For example, as Table 3.5.2 shows, several regions have seen very large increases in the export of road vehicles, most notably the West Midlands with exports rising by £8.4bn. The East Midlands has seen a boom in the export of power generators (aero- and other engines) with an increase of £6.3bn, outclassing all other

regions. And while exports in aerospace, trains and ships have increased by £7.2bn across the UK between 1996 and 2013, the table shows that over 60% of that was from the South West.¹⁷

Table 3.5.2: Top 3 sectors for exports of manufactured goods in each English region, £m, 1996-2013

	East of England	London	North East	South East	South West	West Midlands	East Midlands	North West	Yorkshire & Humber
Basic materials						631		1,562	
Pharmaceuticals	1,022		930	1,671				2,181	1,675
Other chemicals	1,289			2,547			668	1,693	986
Metal & mineral products	1,845	2,451	947		671				
Power generators					770		6,323		
Industrial machinery						958			622
Communications equipment		1,288							
Road vehicles			3,273	4,092	4,539	8,391	1,601		
Aerospace, trains, ships									
Clothing		868							

Source: ONS

The reality is that in most cases these sub-sectoral strengths do not apply to the entire regions, any more than they apply to the entire UK. Instead they reflect quite specific industrial operations. So, if there is an argument for fostering faster growth in manufactured exports, then it probably needs to be couched in quite specific sub-regional terms, such as at the city-region level, for which the idea of a cluster or a sectoral specialisation may be more meaningful than at the broad regional level.

Unfortunately we do not have export data at that level, and output data for city regions is only available at the level of total manufacturing. However, we can look at employment by manufacturing sub-sectors, to see the extent to which the English city-regions have their own manufacturing specialisms.

It can be seen from Table 3.5.3 that, for example, both Bristol and the East Midlands city regions have strength in road vehicles, while Bristol is also strong in communications equipment and in scientific equipment, while the East Midlands is (very) strong in power generation and especially aerospace, trains and ships.

Table 3.5.3: Top 3 manufacturing sub-sectors by employment in each English city-region, 2013

	Bristol	East Midlands	Greater Manchester	Leicester	Merseyside	Potteries	South Dorset	South Hampshire	South Sussex	South Yorkshire	Teesside	Tyne and Wear	West Midlands	West Yorkshire
Pharmaceuticals									1,305					
Other chemicals			2,554		5,354		1,060				2,288			
Power generators		3,727		1,261										
Industrial machinery						670				2,487	306	3,676	3,576	4,006
Communications equipment	1,216			1,647					700	1,955				6,623
Electrical products			1,180		2,318			2,091		2,427		4,367		4,457
Road vehicles	1,132	3,573			8,026	690						12,484	23,681	
Aerospace, trains, ships		14,556					2,304	5,298			779		4,261	
Clothing			2,019	5,513										
Scientific equipment	968					712	1,995	3,856	830					

Source: BRES, Oxford Economics

¹⁷ A limitation of the data is that goods produced in one region and then sent to another region for final assembly as part of a larger product get attributed to the latter region. So some of these regions are more or less effective at exporting than they appear to be.

In addition, we have estimates for the likely growth of exports by the relevant trade sub-sectors at the UK level.¹⁸ By comparing these with each city-region's sub-sector specialism, we can get a sense of the potential for those sub-sectors to see rapid export growth in those city-regions.

So, as Table 3.5.4 illustrates, although South Hampshire has strength in office equipment, this is a sector which the evidence suggests is likely to see declining export sales at the national level. In contrast, scientific equipment is not only another specialism of the city-region, but is set to see very rapid export growth. Or to take another example, West Yorkshire's strength in the drink and tobacco sector may be harder to turn into enhanced export performance than its strength in metal-working machinery and industrial machinery, given the differences in the projected growth rates for those sub-sectors. And so on.

Table 3.5.4: Export Growth by trade category, 2014-2030

	Export Growth 2014 - 2030		Largest absolute industrial structure	Largest relative industrial structure
	(\$millions)	(% per annum)		
Food	15,250	3.6	Merseyside metro	Greater Manchester metro
Drink & tobacco	8,883	3.4	West Yorkshire	Greater Manchester metro
Basic materials	131	0.1	West Yorkshire	South Sussex metro
Fuels	12,456	1.1	Merseyside metro	Teesside metro
Pharmaceuticals	49,533	5.6	Tyne and Wear metro	South Sussex metro
Other chemicals	58,864	5.3	Merseyside metro	Teesside metro
Metal & minerals	52,043	4.3	West Midlands metro	Potteries metro
Power generators	101,099	8.1	East Midlands metro	East Midlands metro
Specialised machinery	27,154	7.0	Tyne and Wear metro	Tyne and Wear metro
Metal-working machinery	4,261	7.8	West Yorkshire	West Yorkshire
Industrial machinery	47,755	7.4	West Yorkshire	West Yorkshire
Office equipment	-2,476	-2.3	South Hampshire metro	South Sussex metro
Communications equipment	16,561	5.8	West Yorkshire	Bristol metro
Electrical products	32,215	6.5	West Yorkshire	West Yorkshire
Road vehicles	117,024	7.2	West Midlands metro	West Midlands metro
Aerospace, trains, ships	4,185	7.9	East Midlands metro	East Midlands metro
Clothing	-582	-0.3	Leicester metro	Leicester metro
Scientific equipment	35,091	7.8	South Hampshire metro	South Dorset metro
Other manufactured	99,655	5.8	West Midlands metro	South Hampshire metro

Source: Oxford Economics

¹ City-region with largest national share of the sub-sector's employment

² City-region in which the sub-sector has largest share of the city-region's employment

Just as with exports of services, these variations across city-regions, and in many cases strong specialisations, may imply a case for city-region responsibility for the design and/or delivery of export-promotion strategies and interventions.

However, and again just as with exports of services, we cannot say that for sure without considering two linked factors. First, there is a need for evidence about whether export promotion efforts actually work. Second, a range of other factors needs to be taken into consideration, before deciding just what tier of government is best placed to deliver any support.

If, for example, the most useful support is market intelligence, or the provision of export credit guarantees, then national delivery of that is probably the most effective, whereas if the most effective support comes from building networks of exporters willing to exchange knowledge, then city-region efforts may be more appropriate. This replicates the points already made with respect to support for service sector exports.

¹⁸ Trade data are collected according to a different classification system than output and employment data. We have made some approximations to allow for this.

3.6 How well are we doing on inward investment?

Inward investment, in which a foreign-owned company invests in new production facilities in the UK, is often seen as a second powerful source of economic growth, alongside exports.

In reality that may not always be the case, if the new investment simply displaces an existing business – although even when that happens there may be some benefits if a low productivity operation is replaced by one with higher productivity and hence competitiveness, and therefore more scope to grow. In general, however, the greatest benefit from inward investment is likely to come when the operation concerned has been established particularly to sell to export markets outside the UK, since that implies least risk of the investment being a ‘zero-sum’ contributor.

Indeed, from an exporting perspective the arrival of inward investors may be particularly attractive. The reason is that a significant transformation in any local economy’s export capacity is likely to be difficult to achieve if it is purely based on the **existing** stock of companies. Even with effective support, many of those that already export may just make incremental rather than radical gains as a result of the support. And many of those that do not already export are likely to find the transition to exporting very challenging. There is evidence that for many companies the benefits of becoming a successful exporter do not justify the capital cost and management time involved.¹⁹

So if a transformation in export capability is to be achieved then it is likely to depend on a significant increase in the stock of companies. This could come via new starts, but that is not likely, given that the vast majority of new starts are very small and remain so, at least for several years. In contrast, inward investments can be very large, and hence can have a large impact on export performance, almost immediately.

Survey data on inward investment is available from EY, on a consistent basis for the UK compared with other countries. As Table 3.6.1 shows, it suggests that inward investment projects into the UK rose by 15% in 2013, and that the UK was the leading economy in Europe for inward investment.

Table 3.6.1: Top 10 European countries by number of inward investment projects: EY survey evidence

	2012	2013	Share 2013 (%)	Change (%)
UK	697	799	20	15
Germany	624	701	18	12
France	471	514	13	9
Spain	274	221	6	-19
Belgium	169	175	4	4
Netherlands	161	161	4	0
Russia	128	114	3	-11
Ireland	123	111	3	-10
Finland	75	108	3	44
Poland	148	107	3	-28

Source: EY’s European Investment Monitor

However, London attracted almost half of the UK total reported in the EY survey, reflecting the high number of projects reportedly launched in the software sector, which grew by 55%, and which is particularly London-based. The EY evidence therefore suggests that inward investment is concentrated in London (and to a

¹⁹ Das, Sanghamitra, Roberts, Mark J. and James R. Tybout. (2007) "Market Entry Costs, Producer Heterogeneity, and Export Dynamics" *Econometrica*, 75, 837-873.

lesser extent the South East). Furthermore, excluding these two regions, the total number of projects across England was 20% lower in 2013 compared to 2010. For much of England, therefore, the evidence from the survey is that the most recent trend has been adverse.

Evidence from UKTI provides a longer-term and somewhat different perspective. It suggests that inward investment fell sharply from 2008/9 to 2011/12 but has since recovered to nearly its peak level, although the recovery has been a little stronger in London and the South East than in the rest of the UK.

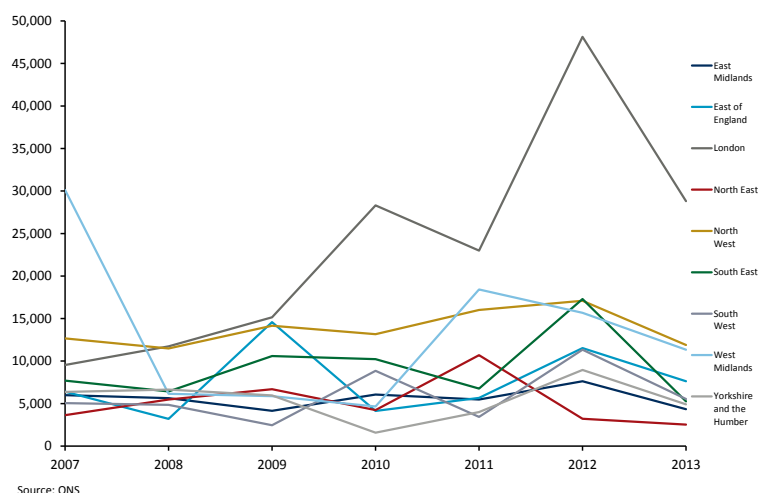
Table 3.6.2: Number of inward investment, projects, UKTI data

	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14
United Kingdom	1573	1744	1619	1434	1406	1559	1773
UK ex London	1150	1203	1090	951	823	971	1117
UK ex London & South East	930	983	945	798	657	751	937

Source: UKTI

The UKTI database also shows the number of jobs reportedly created or safe-guarded by these projects. As Chart 3.6.1 shows, London stands out, with a reported cumulative total of 165,000 jobs between 2007/8 and 2013/14. However, this represents just 21% of all jobs that the UKTI data attribute to inward investment, compared to 34% of the projects over the same period. So the London projects tend to be relatively small – again probably reflecting the large number of them attributable to the digital industries. On this measure, all of the other English regions tended to have broadly similar performances to one another.

Figure 3.6.1: Jobs created (or safeguarded) by inward investment, UKTI data, 2007-2013 (fiscal years)



It is worth noting that these two sources give very different estimates of the number of inward investment projects in the UK. This has to be a matter of concern: if it is correct that inward investment is important, then having such contradictory evidence on it may lead to inappropriate policy decisions.

However, there is enough agreement in the data to suggest that, while the UK has benefitted from significant inward investment, a large number of the projects have been concentrated in London. A linked observation is that outside of London (and also the South East) large numbers of the jobs created by inward investment are likely to have been associated with a small number of very large projects. The West Midlands in particular shows sharp changes from year to year, which is suggestive of a small number of projects having a big impact on the overall numbers. The implication is that if these big investments are excluded, then inward

investment has been making only a small contribution to raising the productive potential (and for the reasons discussed above, the exporting capacity) of the UK economy. That in turn implies that there may be significant scope for enhancing the UK's inward investment performance.

3.7 Inward investment – the opportunities to attract more

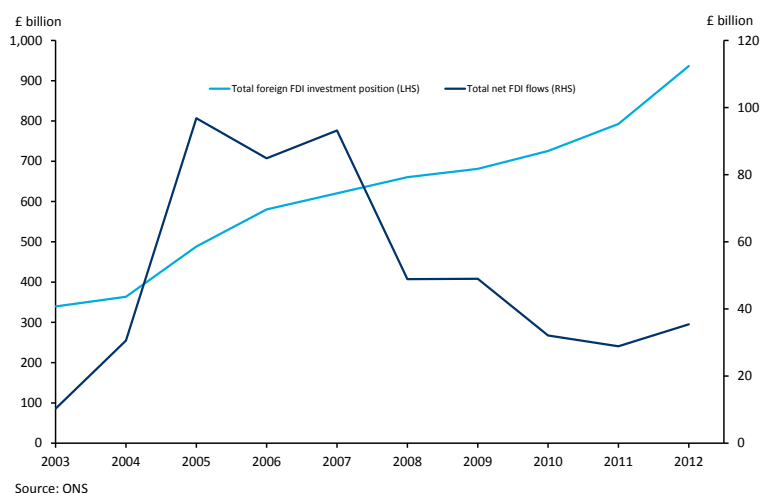
In this section we consider possible evidence that the UK might be able to 'raise its game' in terms of inward investment, over-and-above the investment attributable, either to London and the South East, or to occasional 'mega-projects' elsewhere.

One possibility is that places that have already attracted significant amounts of inward investment in the past are well-positioned to attract more. Reasons for this include reputation effects, and the possibility that companies from abroad prefer to locate in proximity to companies that they already have relationships with in their home markets. If such existing nodes exist widely across the UK, then the opportunities for focusing on them are clearly greater than if they are rare.

The concentrations in question are perhaps most likely to be found where companies from abroad have bought outright, or have taken significant stakes in, UK companies. Such transactions, known (somewhat misleadingly) as foreign direct investment (FDI) do not in themselves necessarily increase the productive potential of the UK economy, since they are purely financial deals, but that will sometimes, and perhaps often, be the indirect consequence of the transactions. FDI often creates an opportunity for production to be shifted to the UK subsidiary/associate from abroad, if the subsidiary/associate in question is internationally competitive. Furthermore, the presence of such partially or entirely foreign-owned businesses may act as a 'magnet' for new inward investors.

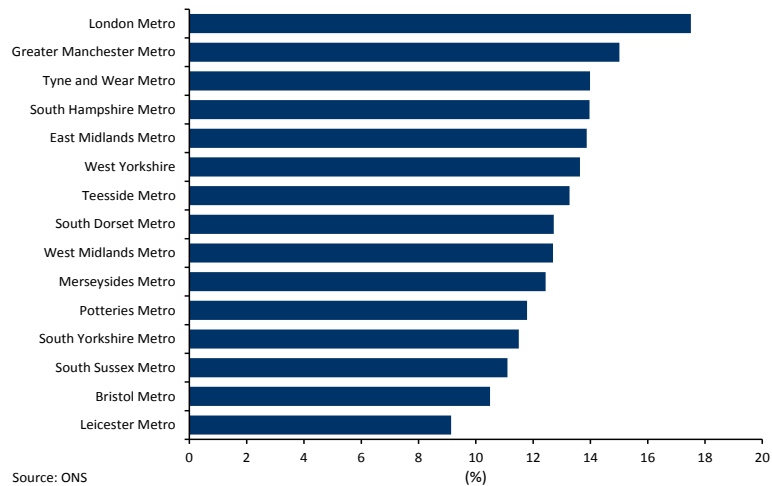
Unfortunately, evidence from the ONS suggests that, at the national level, the trend in new FDI has not been hugely impressive in recent years. As Figure 3.7.1 shows, net FDI inflows by foreign companies (defined to mean the purchase of at least 40% of a company's equity) peaked at £97bn as long ago as 2005. Nevertheless the cumulative value of UK companies owned by foreigners has risen throughout the last decade, boosted by rising equity prices, from £340bn in 2003 to £937bn in 2012 (the latest year for which information is available).

Figure 3.7.1: FDI stock and net inflows into the UK by foreign companies, 2003-2012



In terms of geographical distribution, evidence on the foreign ownership of companies in the UK is only available for 2010. Figure 3.7.2 reports on the data for London and the English city-regions. It shows that of these, London had the greatest proportion of employment in foreign-owned companies, at 17.5%.

Figure 3.7.2: Employment in foreign-owned companies as a percentage of total employment, 2010



Nevertheless, most other English city-regions had significant shares of their economies accounted for by foreign-owned companies. The data suggests that in 2010, all but one of the English city-regions had over 10% of its private-sector employment provided by foreign-owned companies (or companies with at least 40% of their ownership in foreign hands). It is likely that since then the numbers will have increased.

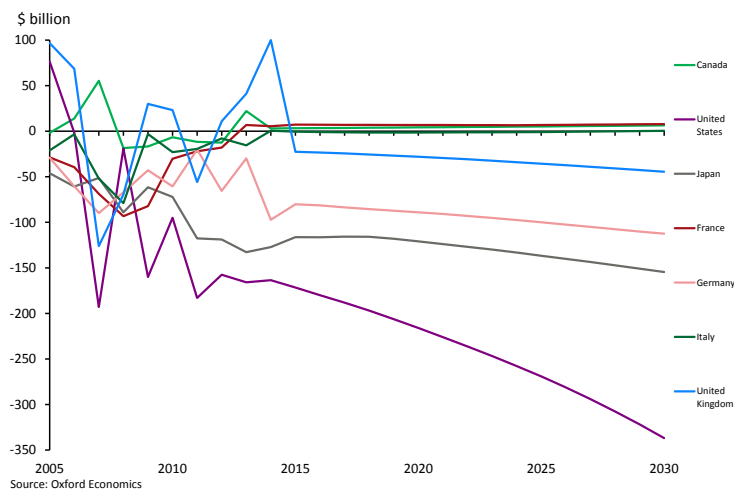
It is true that not all of these companies will have exporting potential, perhaps because they represent a UK business that has been bought or set-up specifically and only to sell into the domestic market, by an overseas parent that sells internationally from elsewhere.

However, these are likely to be a minority, and in many cases the UK operation of a foreign company will represent an opportunity for production to be shifted to the UK to serve that company's global business. And as noted above, it may also help to attract new inward investors. The potential base for encouraging greater inward investment flows is therefore significant, and is not confined to London.

A clear note of concern is nevertheless needed. We estimate that in 2014 the UK is experiencing a very positive net FDI inflow of \$100bn. Moving into the longer term, however, we expect that net FDI will become negative, as FDI outflows by UK companies increasingly outweigh inflows into the UK.

As Figure 3.7.3 illustrates, this is not a phenomenon that we think will be confined to the UK, and indeed our projections show it being more marked for some other major economies, notable the United States. Net outflows of FDI are expected to be a pattern seen across most advanced economies, as companies from those economies invest in operations in emerging economies.

Figure 3.5.1: Annual net FDI, 2005-2030



To the extent that these FDI flows tell us about inward investment, and to the extent that our forecasts for FDI are well-founded, (which we believe they are, within the inevitable large margins of uncertainty) this suggests a possible need to increase significantly the amount of government support for inward investment, or to increase significantly the effectiveness of that support.

We say ‘possible’ rather than ‘definite’ because, as with initiatives to encourage exports, a lot depends on the extent to which any support actually works. Again, this question is beyond the scope of this paper, but we repeat our observation that the effectiveness of government support, the appropriate type of support, and the appropriate geographical level of government that has responsibility for the support, are all inter-connected.

With respect to that, our argument has been that existing concentrations of inward investment and/or FDI may be particularly likely to attract new inward investors. So one possible route would be to recruit existing foreign-owned companies to help attract new arrivals. If so, then this probably represents a presumption in favour of a degree of local direction and delivery, most probably at the city-region level.

3.8 Inward investment and innovation

We have argued that inward investment is particularly beneficial if it leads to **exporting**, since that is less likely to displace employment in other UK companies than if the inward investment is targeting the domestic market. Equally, we have argued that inward investment may be the most realistic route to achieving a step-change in exporting, sufficient to allow the UK economy to operate at a higher rate of demand growth without encountering a balance of payments constraint.

In addition, inward investment may be particularly desirable if it leads to an increase in **innovation**, since innovation like exports is a key source of growth in any economy.²⁰

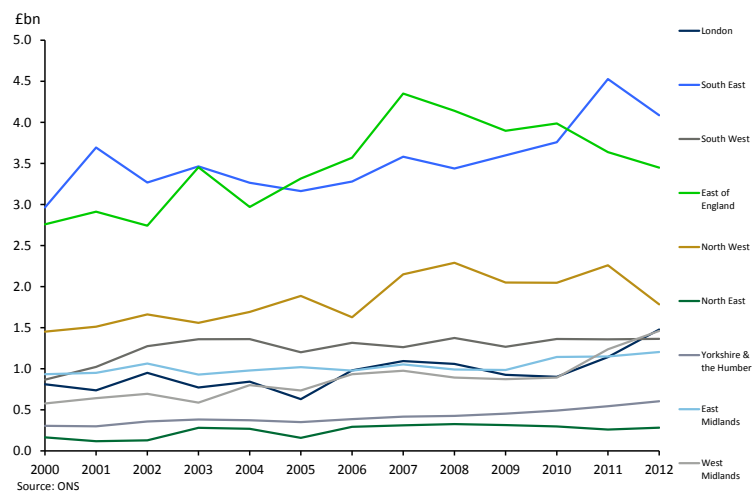
There is indeed evidence that inward investors are more likely to innovate than indigenous companies – at least if spending on research and development (R&D) is used as a proxy for innovation overall.²¹

²⁰ See Romer P (1990) ‘Endogenous Technological Change’ *Journal of political economy* , 98(5), Part 2, S71-102, and Aghion P and Howitt P (1992) ‘A model of growth through creative destruction’ *Econometrica* 60, 323-51

In addition it is also likely that companies that engage in R&D are better placed to export than those that do not. So the linkages are potentially three-way between inward investment, exporting and R&D.²²

We have no data on R&D at the city-region level. However, at the regional level there is official data, which shows that the South East and East of England account for large shares of UK R&D. (See Figure 3.8.1.) R&D expenditure has risen by over £1bn in the South East, from £3.0bn in 2000 to £4.1bn in 2012. Though R&D expenditure in the East of England has fallen from its £4.4bn peak in 2007, the region still attracts over twice the expenditure than any other region with the exception of the South East.

Figure 3.8.1: Regional R&D expenditure, 2000-2012

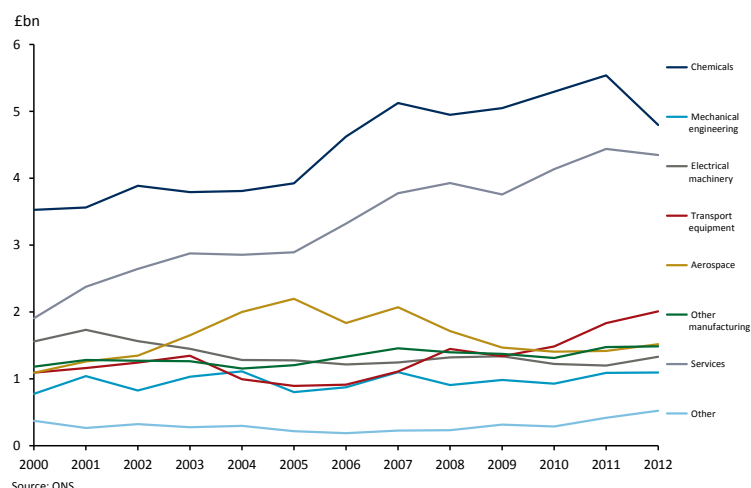


As with inward investment, there is significant 'lumpiness' in the data. That is to say, the large shares for the South East and the East of England are closely linked to the importance of two sectors for overall R&D growth. As Chart 3.8.2 shows, these sectors are chemicals (and in particular pharmaceuticals) and services (and in particular software and other digital activities). Both of these sectors are important in the South East and the East of England.

²¹ Main S (2013) 'Leverage of public funding of science and research', *Department for Business, Innovation & Skills*

²² Ganotakis P and Love J 'R&D innovation and exporting: evidence from UK new technology based firms' *Aston Business School*.

Figure 3.8.2: UK R&D expenditure by sector, 2000-2012



In addition, other regions have important concentrations of R&D spending, but again associated with particular sectors (notably automotive and aerospace) and indeed particular companies, and with a tendency for significant volatility from year to year. Table 3.8.1 gives a snapshot of this, for 2012. It shows the main concentrations of R&D by sector for each English region in that year: for example transport equipment in the West Midlands, and chemicals (which includes pharmaceuticals) in the North West, East of England and South East.²³

Table 3.8.1: Largest R&D expenditure by top 3 sectors within English regions, £mn, 2012

	East of England	London	North East	South East	South West	West Midlands	East Midlands	North West	Yorkshire & Humber
Chemicals	1,183	447	87	1,551			99	958	212
Mechanical engineering						125			
Electrical machinery		36		419	197				
Transport equipment	386					851	293	193	
Aerospace					413				
Other manufacturing			45					229	112
Services	1,056	896	70	966	344	209	164		119

Source: ONS

This suggests that, if there is a role for government support for R&D, and if there is merit in building on existing strengths, then the support needs to take account of sectoral and also of geographical dimensions. Different regions need to approach different sectors in different ways.²⁴

This is likely to be all the more true at the city-region level, given that variations between regions will probably be all the more apparent between city-regions – though unfortunately the data does not exist to establish that beyond doubt.

As a matter of completeness it is also important to note that R&D is just part of innovation. However, evidence on broader innovation is poor. Table 3.8.2 shows ONS survey information on a very broad measure of innovation, including for example investment in new marketing methods and organisational reform.

²³ Because it is sometimes possible to draw inferences about particular companies from this data, the ONS suppress the information in some of the cells. In particular, the aerospace and transport sectors that are dominated by a few large companies.

²⁴ Aghion P et al 'Science, Technology and Innovation for Economic Growth' *Research Policy*, 38, 681-93

Table 3.8.2: Firms engaging in broad innovation, 2010-12

Region	Firms engaging in broad innovation (%)
East Midlands	48.8
Eastern	46.0
London	42.2
North East	46.6
North West	41.8
South East	45.8
South West	47.2
West Midlands	43.4
Yorkshire and the Humber	43.0

Source: UK innovation survey 2013

On the basis of this evidence, at least at the English regional level, geographical variations appear modest. However, the fact that London ranks as the least innovative region in England must cast some doubt on the value of the results.²⁵

3.9 Improving performance: the importance of competitiveness

Looking forward, the ability of English city-regions to ‘raise their games’ with respect to both exports and inward investment will depend in part on how competitive they are, and how much more competitive they can quickly become. There are challenges as well as opportunities here.

Competitiveness has many dimensions, some related to non-price factors and some related to price differences. A central concept is relative unit labour costs. There are three elements to this: movements in relative pay, compared to competitors; movements in relative productivity compared to competitors, and exchange rate movements. We set out below our forecasts for the first two of these for the main cities within the English city-regions, covering the next five years.

²⁵ Corrado C et al ‘Innovation and intangible investment in Europe, Japan and the US’ *Oxford Review of Economic Policy* 29 (5) 261-286

Table 3.9.1: Growth in Unit Labour Costs in City-region cities, 2014-2019

Metros by city	Earnings (% per annum)	Productivity (% per annum)	Unit Labour Costs (% per annum)
Bristol			
Bristol	3.9	3.0	1.3
East Midlands			
Derby	3.8	3.0	1.3
Nottingham	3.8	3.0	1.3
Greater Manchester			
Manchester	3.9	2.9	1.4
Wigan	3.7	3.1	1.2
Leicester			
Leicester	3.7	3.0	1.3
Liverpool			
Liverpool	3.8	3.0	1.3
Potteries			
Stoke	3.7	3.0	1.2
South Dorset			
Bournemouth	3.8	3.0	1.3
Poole	3.8	3.0	1.3
South Hampshire			
Portsmouth	3.9	3.0	1.3
Southampton	3.8	3.0	1.3
South Sussex			
Brighton and Hove	3.9	3.0	1.3
Worthing	3.9	3.0	1.3
South Yorkshire			
Rotherham	3.7	3.2	1.2
Sheffield	3.9	3.2	1.2
Teesside			
Middlesbrough	3.8	3.0	1.3
Stockton	3.8	3.0	1.3
Tyne and Wear			
Newcastle	3.8	3.0	1.3
Sunderland	3.8	3.0	1.3
West Midlands			
Birmingham	3.7	3.0	1.2
Coventry	3.7	3.0	1.2
Wolverhampton	3.7	3.0	1.2
West Yorkshire			
Bradford	3.9	3.2	1.2
Leeds	4.0	3.2	1.2
Wakefield	3.7	3.2	1.2

Source: Oxford Economics

The key message here is that we forecast that average earnings rise faster than productivity, implying that unit labour costs rise. Table 3.9.2 shows the same analysis for a selection of European cities. It shows a similar story, but with some cities performing better than most of our city-regions (Barcelona, Madrid) and some performing worse (Rome, Warsaw, Moscow).

Table 3.9.2: Growth in Unit Labour Costs across Selected European cities, 2014-2019

	Earnings (% per annum)	Productivity (% per annum)	Unit Labour Costs (% per annum)
Amsterdam	2.4	1.6	1.5
Barcelona	1.2	3.1	0.4
Berlin	3.3	2.2	1.5
Brussels	2.6	2.2	1.2
Bucharest	6.3	5.5	1.1
Budapest	4.8	2.5	1.9
Frankfurt	3.3	2.6	1.3
Hamburg	3.3	2.0	1.6
Lodz	5.3	3.5	1.5
Luxembourg	3.7	2.6	1.4
Madrid	1.2	2.8	0.4
Milan	1.6	1.2	1.4
Moscow	8.2	4.1	2.0
Munchic	3.3	1.9	1.7
Naples	1.6	1.9	0.8
Oslo	4.2	2.4	1.7
Paris	2.4	3.9	0.6
Rome	1.6	0.7	2.3
Sofia	7.3	5.7	1.3
Stockholm	4.0	3.5	1.1
Turin	1.6	1.6	1.0
Vienna	3.1	4.2	0.7
Warsaw	5.3	2.7	2.0
Zurich	1.9	2.1	0.9

Source: Oxford Economics

Earnings growth for European cities is calculated using the year-on-year quarterly earnings growth for the domestic economy

Clearly, one way to improve the productivity performance of UK city-regions is to improve the skills of the workforce. This should therefore be seen as a key component of improving export performance and inward investment success. In this regard it is unlikely that exactly the same pattern of skills will be ideal for every city region, and hence different city-regions are likely to have different priorities.

In particular, a key issue for all city-regions will be the extent to which they can rely on **incremental** improvements to skills to facilitate the growth in both exports and inward investment that we are suggesting are needed, versus the extent to which they need to **radically reconfigure** their skill sets.

Different city-regions currently have different patterns where skills are concerned. For example, as Table 3.9.3 shows, South Sussex currently has particular strength in NVQ4 and above, while East Midlands is strong in NVQ3 and Tyne and Weir in apprenticeships. Whether they need, either to **change** these patterns, or alternatively to **reinforce** them, will depend on the kind of export growth or inward investment success that they can best achieve.²⁶ This implies connecting the different policy strands together, linking skills investment to export promotion to the attraction of inward investment, which may be easier to achieve at the city-region level than nationally.

²⁶ It also fundamentally depends on corporate strategies. See Finegold D and Soskice D (1988) 'The Failure of Training in Britain' *Oxford Review of Economic Policy* 4(3), 21-53

Table 3.9.3: Top 3 city regions by qualification level

Qualification	Top 3 Metros 2013		
	1	2	3
NVQ4+	South Sussex	Bristol	Greater Manchester
NVQ3	Teesside	South Hampshire	East Midlands
Apprenticeship	Tyne and Wear	South Yorkshire	Teesside

Source: ONS, Oxford Economics

Table 3.9.4 looks at a different dimension of skills and makes much the same point. For each city-metro the table shows which specialist managerial, professional, associate professional or skilled occupations are the most important (but with occupations which are dominated by the public sector, such as teachers, excluded). While corporate managers are the largest of these occupations in almost all the city-regions, in Bristol technical professionals are the most important, while cultural and media professionals are the third most important in the city region – also an unusual result. Skilled electrical workers are important in several city-regions but not all, and the same is true for skilled construction workers.

Table 3.9.4: Top 5 managerial, professional, associate or skilled occupations in each city-region (excluding those mainly in the public sector)

	Top 5 occupations				
	1	2	3	4	5
London metro	Corporate Managers	Technical professionals	Culture & Media	Other Managers	Skilled construction
Greater Manchester metro	Corporate Managers	Technical professionals	Skilled construction	Other Managers	Skilled Electrical
West Midlands metro	Corporate Managers	Skilled Electrical	Technical professionals	Skilled construction	Other Managers
West Yorkshire	Corporate Managers	Technical professionals	Skilled Electrical	Skilled construction	Skilled Textiles & Printing
Merseyside metro	Corporate Managers	Technical professionals	Skilled construction	Skilled Electrical	Other Managers
Tyne and Wear metro	Corporate Managers	Skilled Electrical	Technical professionals	Skilled construction	Other Managers
South Yorkshire metro	Corporate Managers	Skilled Electrical	Technical professionals	Skilled construction	Other Managers
East Midlands metro	Corporate Managers	Other Managers	Technical professionals	Technical associates	Culture & Media
South Hampshire metro	Corporate Managers	Technical professionals	Skilled Electrical	Skilled construction	Other Managers
Bristol metro	Technical professionals	Corporate Managers	Culture & Media	Other Managers	Skilled construction
Leicester metro	Corporate Managers	Other Managers	Skilled Electrical	Technical professionals	Skilled construction
South Sussex metro	Corporate Managers	Culture & Media	Technical professionals	Other Managers	Skilled construction
South Dorset metro	Corporate Managers	Technical professionals	Skilled construction	Skilled Electrical	Other Managers
Teesside metro	Corporate Managers	Skilled Electrical	Technical professionals	Skilled construction	Technical associates
Potteries metro	Corporate Managers	Technical professionals	Skilled construction	Skilled Textiles & Printing	Skilled Electrical

Source: Oxford Economics

Again, we cannot make policy recommendations based on data of this sort alone – not least because consideration needs to be given to how feasible it is to incrementally improve, let alone radically alter, skill sets. This itself may vary from city-region to city-region, not least because it depends partly on the ability to attract suitably skilled people into the city-region. These are matters that are beyond the scope of this paper.

3.10 Policy effectiveness – evidence from the rest of Europe

In this paper we have repeatedly made the point that the scale of improvement that can be achieved in exports and inward investment depends in significant part on whether policy interventions actually work. It is not within the remit of this paper to answer that question, but some examples from elsewhere in Europe may provide some insights.²⁷

Google datacentre, Eemshaven, Netherlands

²⁷ OECD (2013) 'Delivering local development: New growth and investment strategies' contains a number of city-level case studies

In late September 2014 Google announced plans for a new datacentre in Eemshaven. The company says that the project will involve a €600m investment over the next few years. The datacentre will house data servers and specialised computers to help Google with the running of online services such as the Google search engine, Google Maps and Gmail.

Google say that they will invest up to €600 million euros in the acquisition, building and fitting out of its new facility, generating over 1,000 jobs at the peak of the construction phase, to be sourced from local and national firms. They also say that when the facility is operational it will employ more than 150 people in various full-time and contractor roles, including computer technicians, electrical and mechanical engineers, and security and catering staff.

The decision to invest in Eemshaven builds upon Google's established presence in the port, currently at a leased facility which will continue to remain operational once the new datacentre opens. This provides evidence to support or suggestion that new inward investment often builds on previous inward investment or FDI.

The investment has apparently come about, at least in part, as the result of activist government policy – though it is always difficult to be sure whether a particular investment might have occurred anyway. It is nevertheless clear that the Dutch government has been trying to attract technology firms such as Google to Eemshaven, which it has designated a key economic region. Measures have included securing Eemshaven as the landfall point for a new high-speed transatlantic fibre-optic cable which connects the US and Europe.

Infrastructure investment may also have been an important factor in Google's decision. Eemshaven's large number of power stations and growing off-shore wind industry provide for reliable energy supply on a large scale, which the Dutch government says makes it ideal for technology firms. The Dutch Minister of Economic Affairs, Henk Kamp has been quoted as saying that the investment was secured by Eemshaven offering, "... a well-educated, technical workforce, reliable energy and the infrastructure necessary for the industry." This tends to reinforce the suggestion that these factors need to be considered in-the-round, rather than independently of one another.

Ericson expansion, Dublin and Athlone (Ireland)

Ericson announced in May 2014 that it would be expanding its current Irish operations with the creation of 120 additional jobs throughout 2014. A number of the new roles are in Mediaroom, Ericsson's recently acquired TV business unit.

The jobs being created are described as highly-skilled, including software developers, consultants, solution architects and programme managers. Some graduates will be hired from MSc programmes in Ireland sponsored by Ericson, which are designed to equip students with the necessary skills for a future at the firm. These include an MSc in Applied Software Technology at Dublin Institute of Technology and an MSc in Applied Software Engineering at the Athlone Institute of Technology.

Ericsson's Managing Director in Ireland cited the current team of high-skilled people with a culture for dynamic thinking and creativity as a reason for the expansion in Ireland. He has been quoted as saying: "Ireland is a major research and development hub for Ericsson globally. We have a track record of ingenuity, with 87 patents developed in Ireland over the past 5 years."

This case again highlights the importance of building on past investments, and also tailoring workers' skills to the needs of inward investors. The evidence suggests that, once foreign firms become established in an area, the locality along with the workforce can gain a reputation in specific sectors. That may be particularly true where investment such as this one are in sectors with a high reliance on R&D.

The investment was supported by the Department of Jobs, Enterprise and Innovation through IDA Ireland. The CEO of IDA Ireland, Barry O'Leary, said "Ericsson has long been an integral part of the ICT sector in Ireland since it first set up an operation here in 1957. Ericsson provides excellent career opportunities to both

graduates and experienced ICT professionals. The R&D activity carried out in Ireland by Ericsson is at the cutting edge of technology and contributes to Ireland's position as a location of choice for ICT."

Infineon research centre at Villach (Austria)

Infineon Technologies is a German semi-conductor and systems solutions company operating in three markets: energy efficiency; mobility and security. Infineon's expansion plans for its research centre in Villach foresee investments and research costs amounting to a total of €290 million over the next three years. The company says that its investment will create 200 additional jobs by 2017, with the majority of those in R&D. Infineon says that it will construct a 'leading-edge' building complex for research, production and measurement technology workstations.

The expansion is part of the company's broader plan to advance strategic developments and production-ready innovative technologies, using Villach as a research and knowledge centre. The strategy appears to be that once developed, new technologies and designs will be transferred to other Infineon sites located globally for manufacturing.

Infineon has cited the many years of growth that it has experienced in Villach, and the support and close collaboration of the city and governing province, as the influencing factors in its investment decision. More generally, the support offered to businesses by local as well as by federal government has been widely credited with the growing high-tech sector in the south of Austria.

One implication is that building a reputation, and branding, can be an important factors in attracting inward investment. In this case Villach is the central town of the so-called ME2C cluster: an electronics, microelectronics and mechatronics cluster in Austria. For decades these sub-sectors have been the main drivers for employment and technological progress in the area, which has become known for its highly innovative workforce, with strong R&D skills. It seems likely that such reputation-building and branding approaches to economic development cannot be dropped-in from above: to have credibility, they must arise locally.

3.11 What if macroeconomic prospects change?

Our core propositions are, first, that future trends in exports and inward investment cannot be taken for granted, and second, that there are reasons to take seriously the twin possibilities that policy interventions might be able to improve those prospects, and that at least some of those interventions might best be designed and/or delivered at the local (essentially, city-region) level.

As we have noted, confirming or refuting the second of those two core propositions goes beyond the scope of this paper. With regard to the first, there is an outstanding question of how likely it is that a different macroeconomic environment to the one that we are expecting might significantly alter the prospects for either exports or inward investment, or both.

Clearly that has to be a possibility. However, we make two concluding points.

First, much stronger or weaker growth in the global economy would have direct implications for the UK's export performance. A slump (however temporary) in the Chinese economy, a severe crisis in the Ukraine, or major debt and austerity problems in the Eurozone occasioned by falling consumer prices in Europe, would all have negative effects. Against that, a continuation of falling oil prices could be very helpful to most though not all economies around the world. However, the historical trends and challenges that we have identified are largely unrelated to such cyclical macroeconomic fluctuations, and so need addressing regardless.

Second, there are also uncertainties in the domestic economy. The main ones concern the likely combination of wages and productivity, the prospects for public finances, taxes and spending, and the outcome of the 2015 election and any policy changes that might follow. Export trends are probably

particularly influenced by the first two of those and inward investment trends by the third. There is a case for saying that the greater are the macroeconomic uncertainties, the more important it is to have well-functioning policies at the sub-national level.

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