

Economics Review Issue 8

Second Quarter: May 2007

Main Review	2-12
Political Background	3
World Economy	4
Current overview & immediate outlook	4
Longer term outlook & risks	5
EU regional comparisons	5
UK Economy	6
2006 – year of growth	6
2007 – year of consolidation	8
South West Economy	9
Regional productivity	9
Regional incomes	9
Regional trade	10
Regional employment	11
Regional outlook	12
Special Paper	13-36
Economic restructuring in South West England	13
Economic Indicators: UK & SW Region	37

Overview

The benign outlook is intact

The world economy is in good shape with most of its constituent parts performing strongly. The US economy may be slowing down but Europe is taking up some slack and the Far Eastern juggernaut has lost little of its momentum. Further out, the productivity surge experienced over the last decade may begin to fade but, barring policy errors, the outlook remains reasonable.

Growth may slow but the expansion will continue

The UK economy had a buoyant winter and most measures of output and demand remain good. It is expected that higher interest rates and slower real incomes growth may moderate demand in the second half of 2007 but there are few fears of anything worse than that. The corporate sector is recording strong results and should help to keep the economy moving forward.

Optimism is good and relative progress continues

Survey evidence has been mixed for South West England in 2007 to date, but the overall 'mood' is confident about the economic prospects for the near term. Despite some sector restructuring, the region remains resilient and is performing well compared with many of its rivals.

This Economics Review has been prepared by members of the South West RDA's Economics & Evidence team. The analysis is their own and does not necessarily represent the views or policies of the Agency. The Review has been compiled from sources believed to be reliable with data available up to the end of April 2007.

The Agency will accept no responsibility for errors that remain or for the results of any actions taken based on the analysis and views expressed. The document is available through the websites of the Agency and the SW Regional Observatory (Business and Economy Module).

Political Background

'political uncertainty rising for business'

International politics:

- The unpopularity of the Bush administration and the Clinton-Obama battle for the Democrat Party leadership will give US political economy an air of increased uncertainty in the second half of 2007.
- The high turn out in the French elections suggests greater decisiveness across the Channel. Nicolas Sarkozy is offering strong economic reform.
- Angela Merkel, the German Chancellor, is still trying to revitalise the EU constitutional debate but, without serious French involvement, the prospects for early success are not strong.
- Beyond Europe, debates about political economy are focused on the growing influence of the BRICS¹, Iran/Iraq, Zimbabwe and southern Africa, and the Washington and Chavez models of development in Latin America.

Domestic politics:

- The local elections provided some insight into the mood of the UK electorate: not particularly good for any of the leading parties. In the region, notable changes included the Conservatives gain of Plymouth from Labour, and Bournemouth and Torbay from the Liberal Democrats.
 - The Scottish devolved administration elections raised the prospect of an independence referendum, with potential ramifications for defence related activity in South West England.
 - In Wales, the balance of power still rests with Labour but the likelihood is that a coalition, perhaps with the Liberal Democrats, will be necessary.
 - The Northern Ireland devolved administration starts work this month with the hope of a new spirit of co-operation and the danger of the creation of isolated departmental fiefdoms.
- Nationally, Prime Minister Blair's imminent departure remains the main focus of uncertainty. Gordon Brown's likely ascendancy and the Comprehensive Spending Review, now set for the autumn, will be key ingredients for the business and market outlook later in the year.

¹ BRICS = Brazil, Russia, India, China and South Africa

World Economy

'The benign outlook is intact'

Current overview & immediate outlook

The world economy experienced a strong 2006 with world real output growing by more than 5% and inflation largely still under control (less than 2.5% for the advanced economies). Financial imbalances grew, with the US current account deficit reaching about 6.5% of GDP and surpluses in East Asia and the Middle East growing. Partly in response, the dollar has weakened against the Euro and Sterling but the necessary scale of movement against the Renminbi has not yet been evident.

The IMF's latest output projections¹ envisage the world economy experiencing further expansion in 2007 and 2008 with world real GDP growth put at 4.9% in each year. Moreover, whilst recognising some issues in the housing and other asset markets, the IMF believes the overall downside risks are weaker than six months earlier.

Within this benign overview, the IMF has moderated US growth for this year because of the housing downturn. Some believe this has the potential to trigger a recession but the likelihood does not seem high. The correction to the stock market in February proved temporary as most companies' financial results continue to outperform market expectations. In contrast, the short term prospects for the Euro zone are thought to have improved because of higher employment and better business confidence. Other parts of the world, particularly Asia, are also viewed positively.

The strong global economic performance of recent years can be ascribed to a positive boost to productivity from technological change and the opening up of the Asian behemoths (China and India) to greater participation in 'world' markets. The productivity increase has supported company profitability and real incomes without triggering significantly higher inflation. The IMF advises countries to use this window of opportunity to address structural financial imbalances and strengthen fiscal conditions.

Table WD1 summarises the IMF's latest outlook for economic output in some of the world's key economies. The brackets show the changes from the previous projections. Apart from the softening of US growth, the message for important UK trading partners is largely positive.

In policy terms, the IMF believes central banks have been successful in raising interest rates to head off the potential inflationary impact of commodity price increases without jeopardising growth significantly. The IMF looks for US target interest rates to hold steady this year at 5.25%, for EU rates to increase to 4%, and for Japanese rates to move up very slowly.

Table WD1: Real GDP growth projections (% change, year-on-year)

	2007	2008
World	+4.9 (0.0)	+4.9 (0.0)
USA	+2.2 (-0.7)	+2.8 (-0.4)
Euro zone	+2.3 (+0.3)	+2.3 (+0.3)
China	+10.0 (0.0)	+9.5 (0.0)
Russia	+6.4 (-0.1)	+5.9 (-0.2)
India	+8.4 (+1.1)	+7.8 (+0.7)
Japan	+2.3 (+0.2)	+1.9 (-0.1)
UK	+2.9 (+0.1)	+2.7 (+0.2)
Germany	+1.8 (+0.6)	+1.9 (+0.4)
France	+2.0 (-0.2)	+2.4 (0.0)

Source: IMF

¹ World Economic Outlook: IMF, April 2007

Longer term outlook & risks

The softening of the near term outlook for the US economy does not disturb the longer term view that its relative flexibility and productivity record stands it in good stead, at least compared with its partners in the developed world. For example, Consensus Forecasts for the next decade (released in April) show a clear expectation that annual real growth of 3% per annum is achievable in the United States whereas Euro zone and Japanese growth will barely reach 2% per annum, with Germany at 1.5%. The BRICS economies, of course, will continue to outstrip all these rates, although some moderation from the last decade's heady performance seems likely.

There is a strong element of projection rather than forecast in these numbers. The key question for the longer term is whether the productivity boost injected by the recent spurt in technological change and globalisation can be maintained. The IMF (op cit) points to several factors – a lessening IT boost, the impact of ageing populations on consumption and savings, increased protectionist tendencies against globalisation, and the costs of addressing environmental and energy change – that might undermine the productivity boost going forward.

Nevertheless, without a shock from political events or economic policy mistakes, there is little expectation that a complete reversal of the recent positive economic environment will occur.

EU regional comparisons

The EU has released estimates of GDP and GDP per inhabitant for the new EU27 countries in 2004. GDP per inhabitant ranged from 24% of the EU27 average in North East Romania to 303% in Inner London. For South West England (see Table WD2), the most noticeable feature is that the region's relative indices have moved higher as a result of both EU expansion and the UK's recent comparatively good economic performance. The new figures show why Cornwall and the Isles of Scilly are extremely unlikely to qualify for convergence funding after 2013, under the 'below 75% of the average' rule.

Table WD2: SWE in the EU27 context

2004	GDP € bn pps	GDP/inhabitant € pps	GDP/inhabitant Index pps, EU27=100
South West	125.7	24,971	116.1
Gloucs, Wilts, N Somerset	68.0	30,844	143.4
Dorset & Somerset	25.9	21,405	99.5
Devon	22.9	20,857	97.0
Cornwall & Isles of Scilly	8.8	17,025	79.2

Source: EU. pps refers to calculation on the basis of the purchasing power standard, which weights GDP by reference to price differentials between areas

UK Economy

'Growth may slow but the expansion will continue'

The UK economy benefited from the strong global economy in 2006 and, in line with the world outlook, looks set to slow in 2007. Recent data shows continued strength in business performance but there has been some concern about stagnation of real household disposable incomes for future demand. The upturn in recorded inflation suggests the pressure to tighten monetary policy will remain in place this summer.

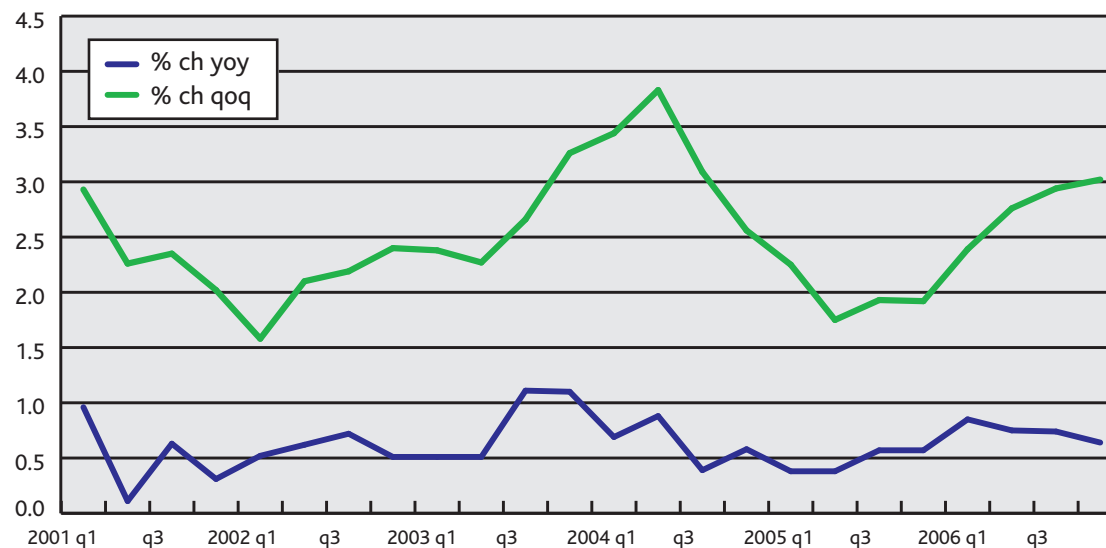
2006 – year of growth

The acceleration in UK economic growth that started in mid-2005 continued through to the end of 2006, although the rate of change was moderating by then (see Chart UK1). UK real GDP grew 0.7% quarter-on-quarter and 3.0% year-on-year in the final quarter of 2006. In the year as a whole, real growth averaged 2.8%.

Table UK1 shows some of the breakdown of growth in 2006 – variables are chained volume except for the incomes and savings figures, which are nominal. The year showed further strength in private services, robust investment and dynamic international trade, but lower savings rates.

UK productivity growth averaged about 1.9% in 2006 in terms of output per worker, 2% for output per job and almost 2.3% for output per hour. These rates accelerated last year but remained lower than desirable for further closing of international productivity gaps. Chart UK2 reveals a stalling in productivity growth at the end of last year which will be a matter of concern if it does not prove to be temporary.

Chart UK1: UK Real GDP growth 2001-2006, % change



Source: Consensus Forecasts October 2006

Table UK1: Breakdown of UK growth in 2006

Agriculture etc	-1.8	Household consumption	+1.9
Construction	+1.1	Government consumption	+2.4
Manufacturing	+1.5	Investment	+6.5
Distribution	+3.3	Exports	+11.6
Fin & bus services	+5.4	Imports	+11.8
Government services	+2.0	Employee income	+4.7
Savings ratio	4.9	Corporate income	+7.0

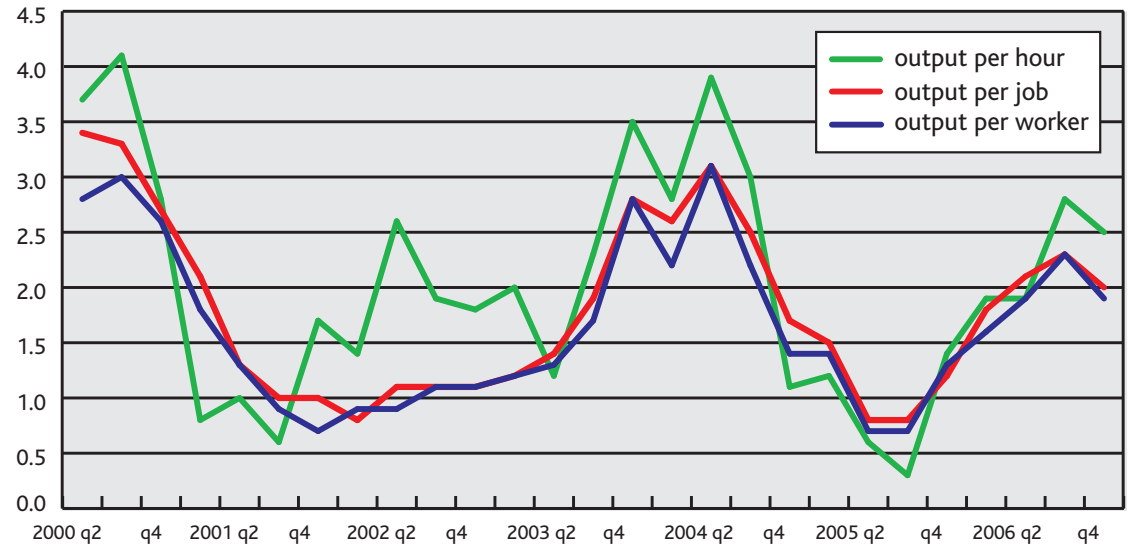
Source: ONS

Table UK1 showed that corporate and employee incomes were reasonably buoyant in 2006. In fact, corporate profitability set a new record high in terms of its net rate of return at the end of the year (see Chart UK3). The net rate of return for private non-financial companies averaged 15.1%; higher than at any point during the current economic expansion. The contrast between manufacturing (falling to 8.5%) and services (increasing 19.7%) grew stronger, although the former bounced back at the year end.

Higher profitability is driven by profits growing faster than capital employed. Some of the recent improvement will be cyclical – demand-led, whereas some will be structural – increased asset efficiency and sector shifts. High returns are attracting bidders – the mergers and acquisitions upturn – and should increase competition. Nevertheless, assuming effective re-investment of an adequate proportion of the growing surpluses, the corporate sector is expected to remain in good shape for the future.

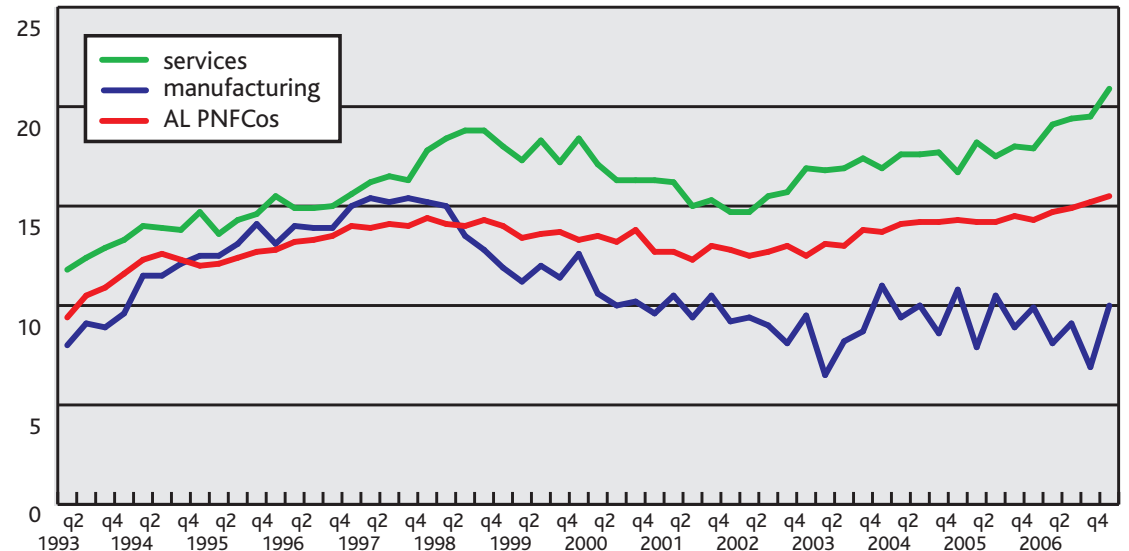
The UK current account deficit reached £43.4 billion in 2006; 49% higher than in 2005 and a worrying 3.4% of GDP compared with 2.4% a year earlier. A mounting trade deficit and a drop in inward income flows caused the surge. Net investment was a higher negative too. If these levels and rates are maintained, the UK current account will apply negative pressure on the pound sterling.

Chart UK2: UK productivity: % change year-on-year



Source ONS

Chart UK3: Corporate Profitability (net rate of return)



Source ONS

2007 – year of consolidation

With higher interest and inflation rates, high debt and low savings ratios, and moderating real wages growth, at least in the public sector, consumers may need to retrench in the year ahead.

Table UK2 shows the latest Consensus Forecasts for the UK economy. The growth picture has not really changed since last quarter, with slower growth expected in each of the next two years. The balance, however, now shows more buoyant consumption and investment this year than before. The inflation outlook is also relatively stable, with the rate forecast to be back to the 2% target before the end of 2007.

Recent ONS evidence shows that, in activity terms, the UK economy retained its forward momentum through the winter.

- The index of services has become a national statistic and is no longer 'experimental'. In the three months to February, the volume increase was 0.8% on the previous three months and 3.6% higher in February 2007 than in the same month of 2006.
- The index of production for February showed a slow down in recent months (-0.2% latest three months on the previous period and +0.3% February 2007 on February 2006). The trade deficit widened to £4.3 billion in February.
- The retail sales series for the three months to March was +0.4% higher in volume terms, with a 4.8% increase over the twelve months to March.
- The preliminary estimate of first quarter real GDP growth for 2007 was 0.7% higher on the end of 2006 and 2.8% higher than a year earlier, maintaining the momentum of the end of 2006.

The inflation story is more mixed with input price rates of increase now falling but final prices accelerating.

- The input and output price series for the year to March were +0.7% and +2.7% respectively. These show how the oil price and other commodity prices surge has now receded from the statistics.
- The equivalent retail and consumer indices were RPI +4.8% and CPI +3.1%. The CPI indicator being above 3% (more than 1% above target and triggering the Bank of England to explain itself to the Treasury) raises the spectre of another 0.25% increase in UK interest rates (from 5.5% to 5.75%) this summer, after the move on 10th May.

Meanwhile, the fiscal data for the year to end March 2007 shows a current budget deficit of £8.8 billion, nearly half as large as the previous year, with the net debt ratio up to 37.4% of GDP – its highest rates since 1998/9 but still relatively low by international comparison.

Recent surveys paint a positive picture.

- Whilst output growth has slowed slightly, the April CBI Industrial Trends survey revealed further strong demand for manufacturers, from customers at home and abroad, allowing them to rebuild profit margins. Business sentiment is robust about the near future.
- The Chambers of Commerce first quarter survey reported similar high confidence levels, though it talked of weaker net balances on some current activity measures.
- The Bank of England's regional agents summarised business conditions in April as being buoyant for output and employment with stable-to-firm demand.

Table UK2: Consensus Forecasts of UK economy

	2006	2007	2008
Real GDP	+2.8	+2.6	+2.3
Consumer spending	+1.9	+2.4	+2.2
Investment	+6.5	+5.5	+3.3
CPI	+2.3	+2.2	+1.9

South West Economy

'Optimism is good and relative progress continues'

Regional productivity

More detailed regional productivity figures have been released for 2005. Figure SW1 shows South West England's (SWE) relative indices since 1999. In this period, positive progress has been made on both the relative measures and on the rankings. Whilst the region's GVA per head ranking remains 5th of 12, the GVA per job and GVA per hour rankings have improved from 8th to 6th and 7th to 5th respectively.

This data suggests the region is performing well relative to the policy target set by government to 'make sustainable improvements in the economic performance of all English regions by 2008, and over the long term reduce the persistent gap in growth rates between regions, demonstrating progress by 2006'¹.

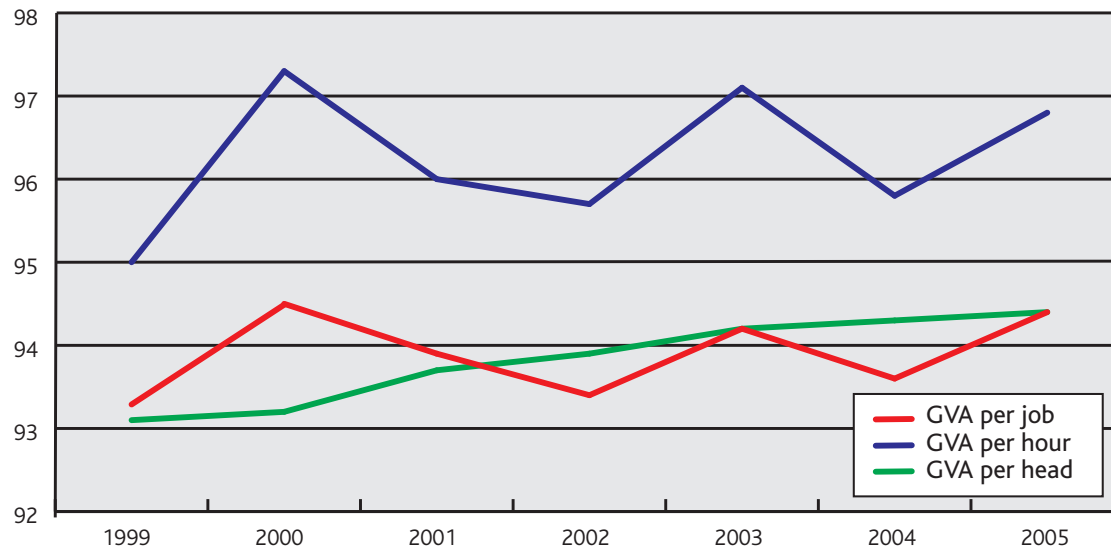
Given the difficulty in changing these relative positions over a short period of time, because of the trend correlation between the numerators and denominators in these ratios and because of the impact of 'events' in particular years, the chart suggests some, albeit erratic, relative progress is being made by SWE.

Regional incomes

The government has released regional figures on gross disposable household income (GDHI) for 2005. Table SW1 shows SWE's relative position, with the regions ranked by GDHI per head. It shows SWE ranked 4th out of 12 on this measure: one place higher than our relative output per head position. The range of variation across the United Kingdom is 34%, from London to the North East – a range somewhat narrower than that for output (58% from London to Wales). This indicates the re-distribution of wealth that occurs to an extent within the country and underlines that relative productivity and relative incomes are not entirely correlated in spatial terms.

In the last issue of this Review, we talked about the wide disparities within SWE in terms of output and output per head. These showed a distribution of output along these lines: 54% in Gloucestershire, Wiltshire and North Somerset, 21% in Dorset and Somerset, and 25% in Devon, Cornwall and the Isles of Scilly. In each part of the region, productive activity is centred on the main urban areas: Bristol and Swindon, Bournemouth and Poole, and Plymouth respectively.

Figure SW1: Trends in SW Productivity 1999-2005



¹ HM Treasury Public Service Agreements 2005-2008 (TSO 2005)

Source ONS

Table SW1: NUTS 1 GDHI and GDHI per head in 2005

2005	GVA (£bn)	% of UK	% ch on 2004	GVA per head (£)	Index
UK	800.9	100	+4.6	13,300	100
London	119.4	14.9	+4.4	15,900	120
S East	122.0	15.2	+4.3	14,900	113
East	78.7	9.8	+4.4	14,200	107
England	680.5	85.0	+4.6	13,500	102
South West	67.2	8.4	+4.9	13,300	100
Scotland	64.0	8.0	+4.5	12,600	95
E Midlands	53.9	6.7	+5.1	12,500	94
N West	83.4	10.4	+4.7	12,200	92
Yorks & H	61.8	7.7	+4.9	12,200	92
W Midlands	65.1	8.1	+4.6	12,100	91
Wales	35.1	4.4	+4.9	11,900	89
N Ireland	19.9	2.5	+5.2	11,600	87
N East	29.1	3.6	+4.5	11,400	86

Source ONS

The equivalent information about incomes and incomes per head shows that, in 2005, SWE's total gross disposable household income (GDHI), i.e. income after tax and available for spending by households, was £67.2 billion and was distributed 45% in Gloucestershire, Wiltshire and North Somerset, 25% in Dorset and Somerset, and 30% in Devon, Cornwall and the Isles of Scilly.

When compared with the output percentages in the previous paragraph, these ratios show how an element of re-distribution occurs across the region. In essence, 9% of the north and east's wealth creation is sent further south and west in the form of incomes available for consumption. In practice, of course, the flows of income are not that simple. Flows occur to and from other parts of the country and, indeed, internationally rather than directly between different parts of the region.

Table SW2 shows the incomes indicators at a sub-regional level. Again, there is a much narrower variation of incomes within the region than of output. From Wiltshire at the top to Plymouth at the bottom, the income range is 21% whereas the equivalent output range is 95% (from Swindon to Torbay). Commuting patterns, non-wage incomes, UK and EU benefits and taxes, pensions and overseas earnings, all contribute to the re-distribution of income relative to output across SWE. The importance of the differences between output and income is that the former reflects relative productivity at workplace, whereas the latter reflects relative prosperity in households.

Regional trade

The latest regional trade figures show goods exports from SWE worth almost £11 billion in 2006. The rate of growth for SW exports slowed last year in absolute and relative terms, so this represented only 5.5% of the UK total; a slight fall from 2005. The EU25 took 62% of SW exports and almost two-thirds were in the advanced engineering (aerospace) sector.

We shall be issuing research later this spring into the relatively low propensity to export amongst many SW businesses. The early evidence from this work is that the South West's 'trade gap' can be explained by regional businesses tending to be less productive and smaller, less likely to innovate and spend on R&D, and to employ fewer graduates and plant and machinery compared with the average UK businesses or foreign owned businesses in the region. Generally, the virtuous circle from productivity through innovation to international involvement and human capital, does not work as well in the region as it might, or as it does, on average elsewhere.

Table SW2: GDHI and GDHI per head within SWE in 2005

2005	GDHI (£mn)	GDHI/head (£)	UK = 100
SWE	67.2	13,258	100
Gloucs, Wilts & N Somerset	30.5	13,718	103
Bristol	5.0	13,710	94
N & NE Somerset, S Gloucs	8.6	12,446	105
Gloucestershire	7.9	13,653	103
Swindon	2.5	13,854	104
Wilts CC	6.5	14,481	109
Dorset & Somerset	16.5	13,571	102
Bournemouth & Poole	4.1	13,547	102
Dorset CC	5.6	14,037	102
Somerset	6.8	13,192	106
Devon	13.9	12,546	94
Plymouth	2.9	11,635	88
Torbay	1.6	11,807	89
Devon CC	9.5	13,029	98
Cornwall & Isles of Scilly	6.3	12,074	91

Source ONS

Regional employment

Data for the December–February period suggests unemployment may be increasing. In this period, the employment and unemployment rates were 77.7% and 4.1% respectively. These are 'better' than most regions (second highest and lowest respectively) and compare with UK averages of 74.3% and 5.5% respectively. The SW claimant count rate of unemployment was 2.0% in February 2007, ranging from 0.8% in Purbeck, East Dorset and North Dorset to 3.1% in Torbay and Penwith.

The regional economy is still generating jobs but the net increase has slowed and unemployment has ticked up. In the December–February period, 2.471 million people were employed in the region compared with 2.465 million two years earlier. During this period, however, the unemployment rate has climbed from 3.5% to 4.1%.

Industrial restructuring continues, with the announcement of the potential loss of hundreds of SW jobs at Airbus in Bristol gathering the most headlines in the last three months. The region has fared relatively well in this restructuring, however, and other news, such as plans to expand by Sunseeker in Dorset, has been more positive. Other issues, such as the region's relatively high part-time employment ratios (about 28.5% of the total) and a preponderance of relatively low wage employment in certain industries, remain important.

Regional outlook

Survey evidence suggests the SWE economy continued to perform better than most UK regions in the early months of 2007.

– Royal Bank of Scotland's Purchasing Managers' index of business confidence for March showed further strong growth for SW private sector businesses, led by strong demand and better productive efficiency. The positive balances on both output and employment were the highest of the UK's 12 regions and devolved administrations.

– The CBI Regional Trends Survey, sponsored by the RDAs, also found an upturn in SW business confidence, with new orders particularly strong. Aspects of employment and investment intentions, however, were not so positive.

– Our own soundings of the current 'mood of SW business' is positive, ranging from buoyant aerospace, with large levels of current work available, to printing and packaging under pressure from overseas competition.

Two issues seem to be affecting SW businesses at the moment. First, dollar weakness is affecting dollar denominated markets (such as East Asia) as well as exports to America itself. There is a welcome reduction in input costs for businesses importing dollar priced components or materials but sterling based exporters face exchange rate pressure on margins. Second, migrant workers are increasingly important in meeting recruitment needs, including in areas of skills shortages (e.g. engineers and complementary management). There is some suggestion that migrant workers offer an alternative to investment as a means of maintaining competitiveness in response to intense overseas competition. In the long run, unfortunately, this could have a dampening effect on pressures to improve productivity through higher and better capital investment

The latest SWE projections, using Computable General Equilibrium modelling based on the SW Regional Accounts (Table SW3), show further good growth over the longer term, with the balance of growth still focussed on a structural shift from manufacturing to private services (see following special paper).

Nigel F Jump, April 2007

Table SW3: SWE medium term economic projections

Annual average percentage change	1997-2005	2006-2014
SWE GVA	5.6	5.9
SWE GVA per head	5.0	5.2
SWE Employment	1.2	1.1
Agriculture, forestry and fishing	2.3	-2.5
Manufacturing	0.7	0.2
Construction	9.2	7.4
Hotels and catering	7.7	7.7
Financial services	8.6	5.5
Business services	8.6	8.6
Gloucestershire, Wiltshire & N Somerset	6.1	6.4
Dorset & Somerset	5.2	5.4
Cornwall & the Isles of Scilly	6.7	6.5
Devon	4.5	4.5

Economic Restructuring in South West England

Executive summary: key messages

In relative terms, SW manufacturing has been losing output and employment shares, and SW business services have been gaining since the late 1990s. This structural shift is expected to continue for the foreseeable future. There is a lot more detail at a sub-sector level, however, with relative 'winners and losers' to be found across a range of manufacturing, services and other activity sectors.

In productivity terms, the pattern of distribution across sectors has changed relatively little as output and employment trends have tended to move in step in many industries. There are some notable exceptions, however, such as in manufacturing (where employment falls have been significant relative to output stagnation – raising productivity) and in public services (where employment growth has outpaced output growth – decreasing productivity).

Spatially, positive change is more evident in the north of the region, particularly Gloucestershire and South Gloucestershire. Here again, however, the more detailed differences are interesting. Cornwall has made progress from a low base whereas Swindon and Torbay have both suffered from the comparative demise of some important electronics activities. Of course, the more diverse economic base of the former has protected it from the greater adjustment difficulties faced by the latter.

Parts of the Agency's priority sectors have done comparatively well, such as medical and precision instruments. Certain leisure and tourism areas have improved in relative terms too. Generally, recent structural change in the economy supports the choice of the various industries as ones which will benefit from help to achieve growth potential and/or sustain already important operations.

Globalisation effects on the structure of the regional economy have further to go. The key is whether the SWE economy can respond proactively, rather than merely reactively, to these competitive pressures, raising its game in knowledge based activities that offer value added growth in high productivity sectors with strong growth potential. Innovative, open, skills-based businesses are the root of such opportunity across a range of sustainable communities in the region.

Nigel F Jump

It is well recognised that the developed economies are undergoing a restructuring of output by industry. For example, manufacturing is moving, often through off-shoring or out-sourcing, from companies based in these economies to countries with cheaper labour and production costs and, as a result, western economies are increasingly dependent upon growing service sectors for their generation of wealth.

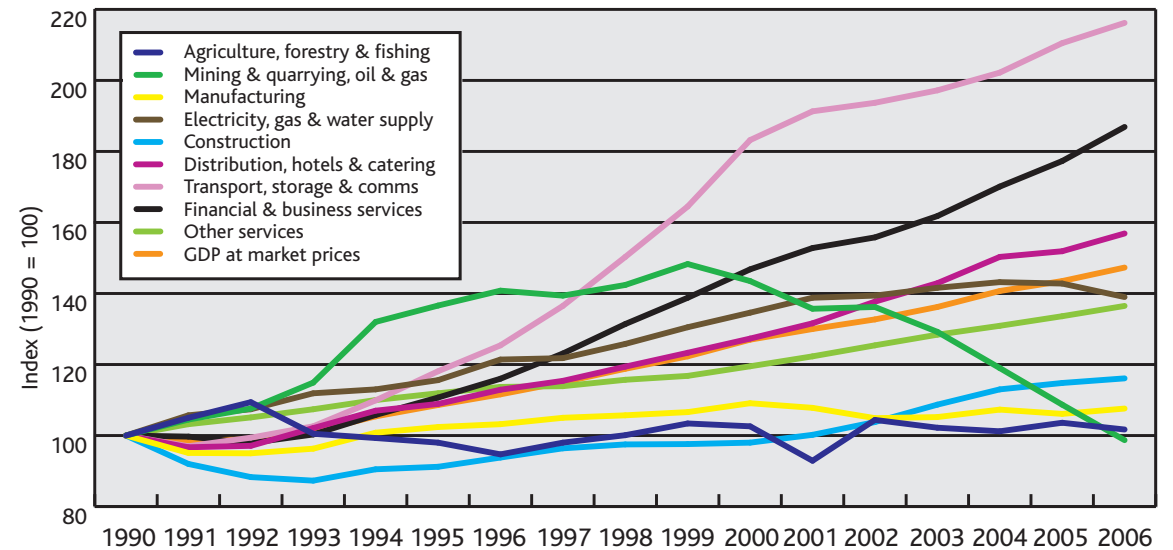
The problem is that manufacturing is perceived as being far more productive than most service sectors and these effects of the global evolution of economic structure create considerable concern, discomfort and even fear over the future of our economic performance and global status. The concern over the effect of this economic restructuring is as relevant to particular regions as it is to countries: the economic structure of South West England (SWE) is evolving too.

This paper uses data on economic output – Gross Value Added (GVA) – and employment – Full Time Equivalents (FTEs) – from the South West Regional Accounts (SWRA)¹, along with national level data from the Office for National Statistics (ONS), to analyse trends in structural change for SWE.

The bigger picture – the UK economy

The structure of the UK economy, in line with economies elsewhere in the developed world, is changing. Production sectors – agriculture, manufacturing and the extractive industries – are declining in terms of their share of total output, (though not necessarily in absolute terms), and the UK economy is now more heavily reliant on its service sectors – public and private.

Figure SP1: Economic output by broad sector, chained volume indices (1990=100)



Source: ONS

Figure SP1 illustrates the changing nature of UK output by broad sector group since 1990. The figure shows basic output volume indices relative to 1990 – i.e. excluding price effects. The orange line shows average growth in output across the whole of the UK economy.

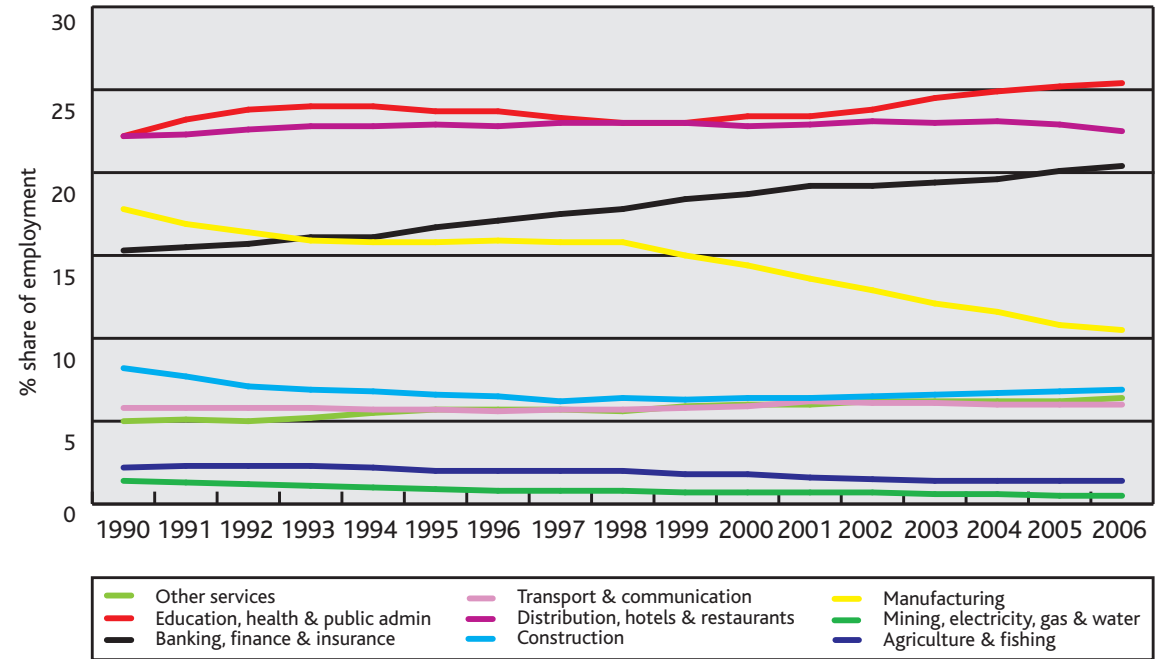
¹ SWRA – access via South West Regional Observatory Business and Economy Module website at <http://www.swo.org.uk/business/home.shtm>

The trends suggest that manufacturing, construction and agriculture have just about 'held their own', showing small and fluctuating levels of relative growth over time since 1990 – tracking the 100 index shows that the economic value of these sectors remains largely unchanged since 1990. On the same basis, the extractive industries have had mixed fortunes, with increases to the end of the last millennium and decline thereafter, perhaps reflecting the pattern of North Sea oil extraction. At the same time, however, the service sectors have all grown substantially – 'other' services (including some recreational and personal care activities) by about 40%; distribution and retail by about 60%, financial and business services by about 90%; and transport and communications has more than doubled (115%).

As Figure SP2 indicates, UK employment has followed a similar pattern. Interestingly though, while manufacturing output has been maintained over time, employment has fallen steadily since the late 1990s – from 4.5 million to 3.2 million in less than a decade. This implies a substantial improvement in workforce productivity.

As a result of these increases across the service sectors, services' share of the economy has grown since 1990 from 70% to 81% of UK employment. Meanwhile, the production sectors' share has fallen from 21% to 12% and, within that, manufacturing, which accounts for the bulk of production, from 18% to 10%.

Figure SP2: UK employment by broad sector



Source ONS

The rest of this paper considers whether South West England (SWE) has experienced similar developments, looking at the extent to which the balance of manufacturing and services is changing and the underpinning detail of where this is happening – where in the region; and in which manufacturing and services sub-sectors.

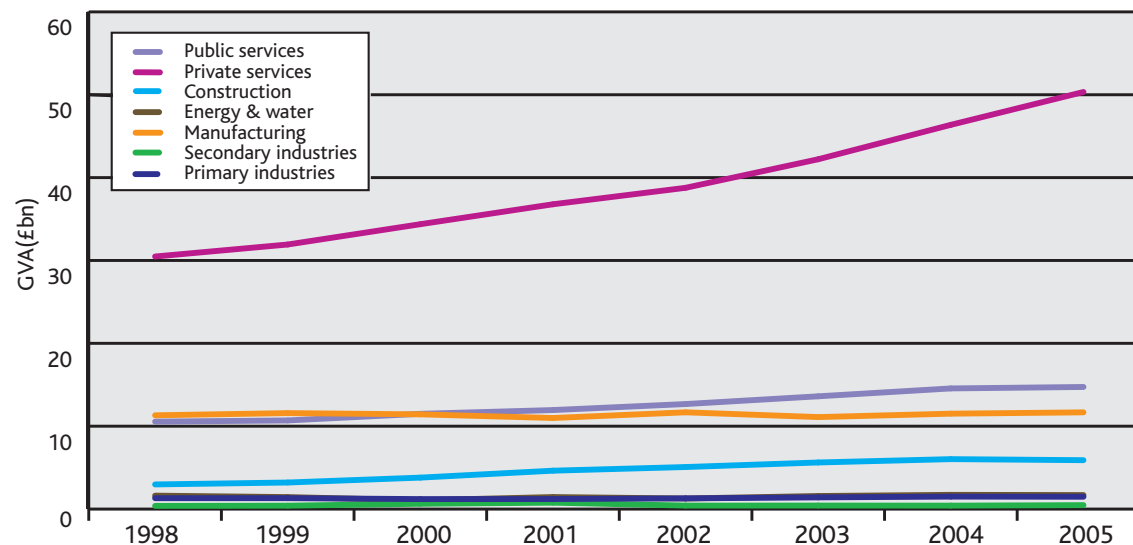
The broad SWE economy

An analysis of the SWE economy between 1998 and 2005 was carried out using data extracted from the South West Regional Accounts (SWRAs). The SWRAs are based on an input-output model of the region's – and its sub-regions' – economies. The latest available full accounts are for 2003, with estimated extrapolations made for 2004 and 2005.

While the SWRAs cover a range of economic variables – from incomes to spending; and from occupations to skills – this analysis focuses on the changing structure of the economy in terms of output (GVA); employment (full-time equivalents – FTEs); and productivity, expressed as GVA per FTE employee.

Over the period 1998 to 2005, the SW economy grew from £59 billion to £86 billion in terms of total output – growth of 5.7% per annum, compared to an average of only 5.3% per annum for Great Britain (GB). These totals are in nominal terms, i.e. including inflation. Figure SP3 shows how this change is distributed by broad sector group, with most of the share growth seen to be in private services.

Figure SP3: SWE GVA (current prices) by broad sector



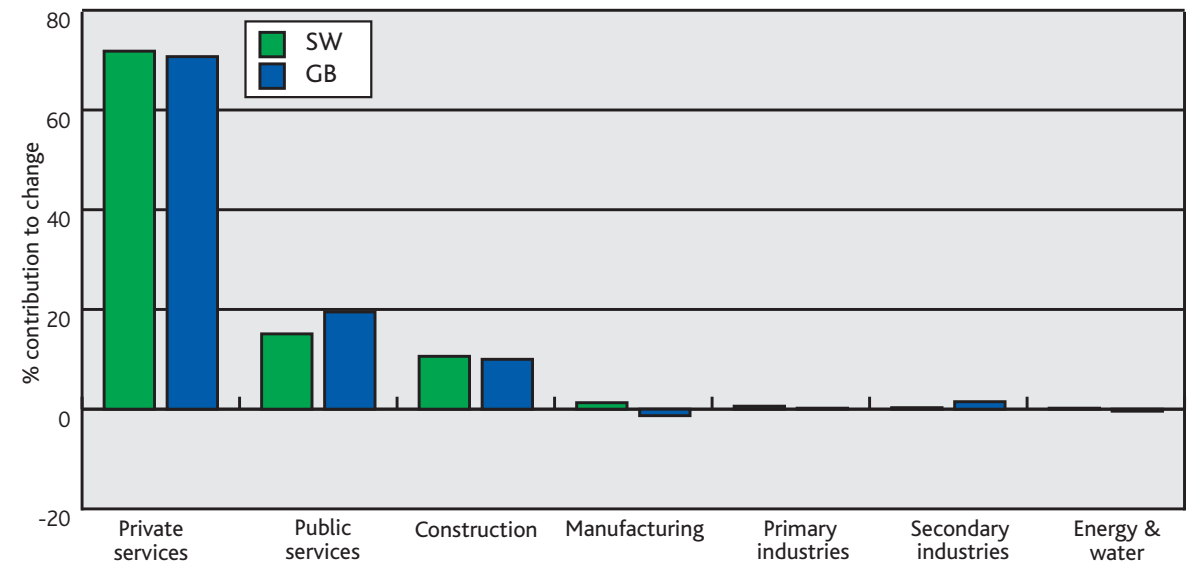
Source: SWRAs

Construction and private services in SWE grew faster than the regional average between 1998 and 2005 – 10.3% and 7.4% per annum respectively; and indeed faster than the equivalent GB growth rates – 9.7% and 6.3%, respectively. The SW construction sector doubled in size over this period; and private services increased by two thirds. Interestingly, public sector GVA for GB grew faster than the GB average, while the equivalent SW sector grew at a rate slightly below average. All of the other sector groups grew at rates well below average for both SWE and GB, with SWE out-performing GB in all except the extractive (secondary) industries. Utilities (energy and water) and manufacturing showed an overall decrease over the period for GB but a marginal increase in the South West.

Figure SP4 shows the contribution of each broad sector group to overall growth in the SW economy over this period. It reveals that growth in private services accounted for around 70% of the overall growth in both SW and GB GVA, with public services and construction making up the majority of the remainder of the growth. Private services made a slightly larger contribution to growth in SWE than in GB, while the opposite is true for public services. The remaining sector groups, including manufacturing, did not contribute substantially to growth, and in real terms probably declined over this period. This is a slightly different story than that presented by the UK data presented earlier, which is based on volume of manufacturing, perhaps showing that while volume has been maintained, prices have fallen.

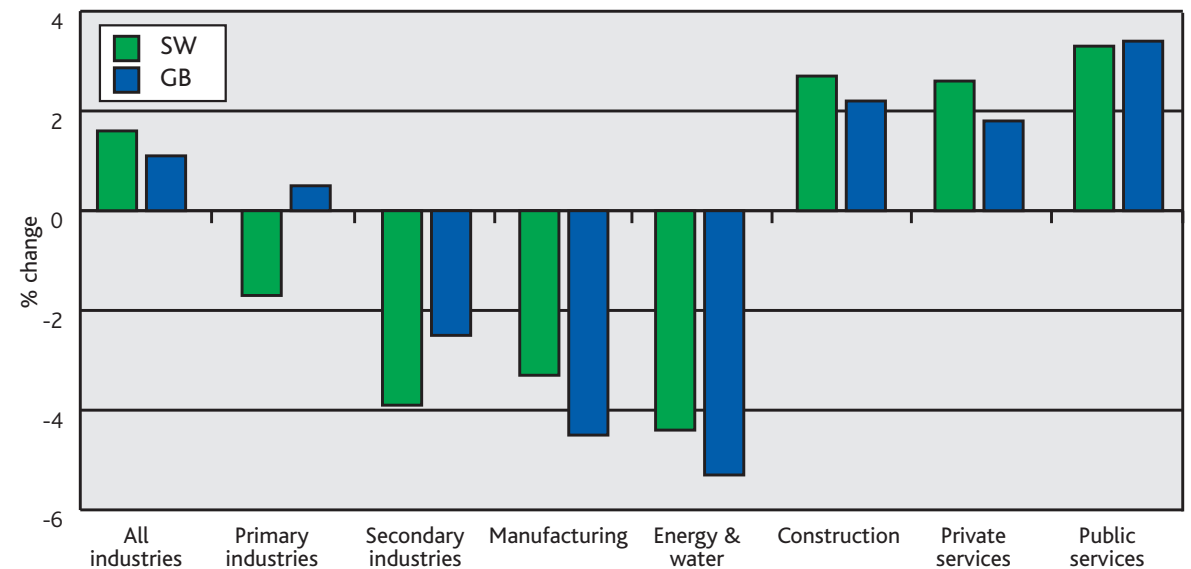
Employment trends (Figure SP5) follow largely the same pattern as GVA output. As with GVA, SW FTE employment grew faster than the GB rate – 1.6% per annum versus 1.1% per annum. This is in line with SWE’s relatively fast population growth due to relatively high levels of inward migration. Once again, construction and services experienced growth rates well above the average, and SW rates were faster than GB for both construction and private services. As with the UK economy discussed earlier, manufacturing employment fell substantially and at a far faster rate than the change in manufacturing GVA. The extractive industries and utilities sectors also fell, but the overall contribution of these sectors to the economy and hence the decline in employment is small.

Figure SP4: Contribution to SWE & GB GVA growth by sector between 1998 and 2005



Source: SWRAs

Figure SP5: Annual change in SW & GB employment by sector between 1998 and 2005



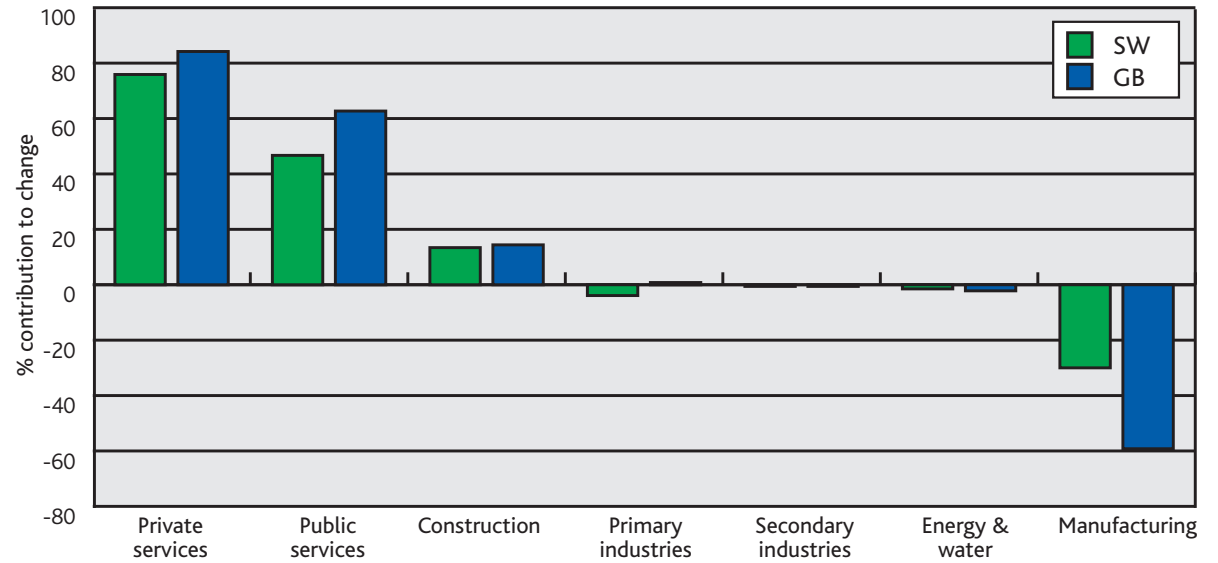
Source: SWRAs

Figure SP6 depicts the contribution of the broad sector groups to employment growth. Although construction has grown substantially in recent years, its contribution to overall growth is dwarfed by the changes seen in services. Private and public sector services account for 123% of growth in SWE and 147% in GB – offset by declines in manufacturing – while construction contributes around 13%. While the proportion of growth attributed to private and public services is slightly lower in SWE than GB, this is due to a slower rate of decline in manufacturing employment.

This could be because the South West region has a more secure manufacturing base that is more resistant or resilient to the globalisation pressures affecting manufacturing elsewhere in the United Kingdom. It could also be, however, that SW manufacturing is lagging behind in some sub-sectors because of relative isolation. It may yet feel the full winds of global restructuring with further unemployment in SW manufacturing waiting round the corner. The likelihood is that there is truth in both arguments, with our globally competitive sectors and their suppliers doing relatively well, and other sectors potentially vulnerable to further globalisation effects.

What effects have these broad sector changes had on SW productivity, as expressed by GVA per FTE employee? Because SW GVA and FTE growth are both higher than the average equivalent GB rates, they tend to cancel each other out, and overall productivity relative to the GB average has changed very little over this period, fluctuating around 92% of the GB average.

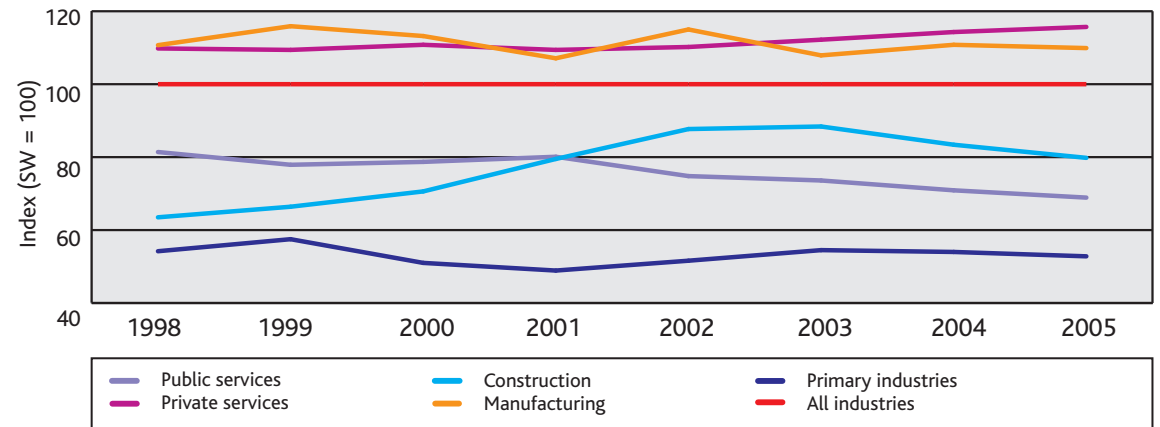
Figure SP6: Contribution to SW & GB FTE employment growth by sector between 1998 and 2005



Source: SWRAs

Figure SP7 shows the trend in productivity of broad SW sectors relative to the SW average. For clarity of presentation, extractive industries and utilities have been excluded, as these sectors are relatively small and have very high productivity rates. The chart shows that both manufacturing and private services have relatively high levels of productivity, though as indicated earlier, the relative share of the manufacturing sector's contribution to the economy is declining. Construction has showed relative improvement but this appears to be waning in recent years. Public sector productivity declined over the period as jobs growth exceeded output growth – perhaps the 'tight' Comprehensive Spending Review expected later this year will start to redress this.

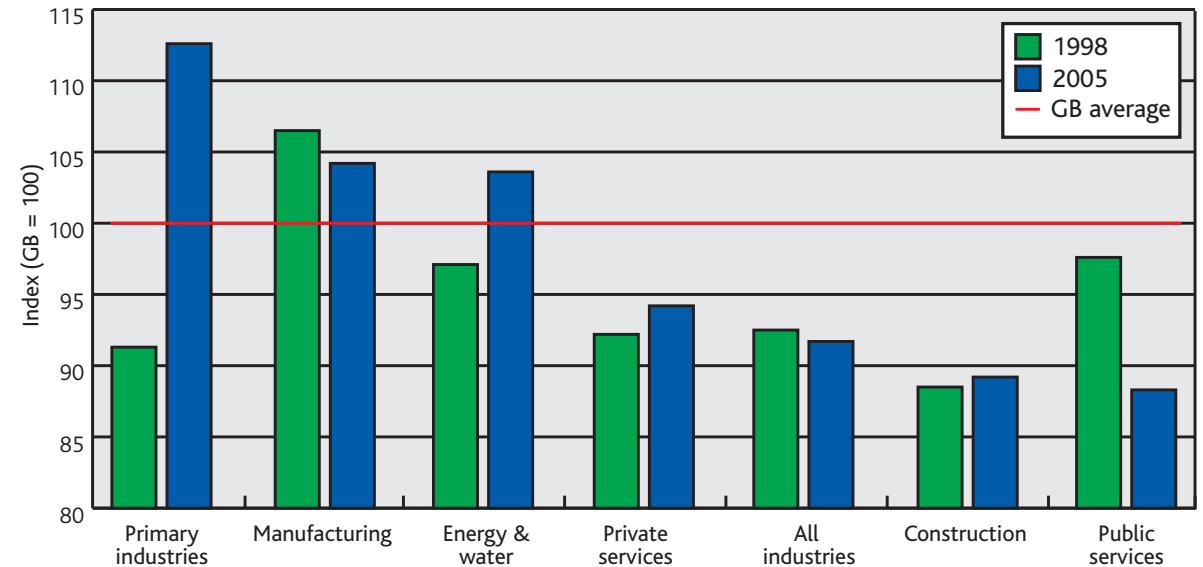
Figure SP7: SW sector productivity relative to the SW average



Source: SWRAs

Figure SP8 shows SW productivity changes relative to GB averages for each of the broad sectors. Manufacturing in SWE has consistently been more productive than GB over the period analysed. In addition, agriculture (primary) and utilities (energy and water) have improved productivity rates to above the national average. All other sectors are well below the average, which tends to be driven upwards by London and the Greater South East. Once again, a sharp decline in public sector productivity is evident between 1998 and 2005.

Figure SP8: SW sector productivity relative to GB



Source: SWRAs

Focussing on SWE sectors

An analysis at a more detailed sector level was carried out to compare the relative performance of sub-sectors of both manufacturing and services. For ease of presentation, only those sectors with a greater than 1% contribution to the SW economy in GVA and employment (in 2005) are discussed. These sectors cumulatively account for 98% of both GVA and employment in SWE (97% and 96%, respectively for GB).

Figure SP9 shows the contribution of these narrower sectors to both GVA and FTE employment in SWE. Business services, part of the private service sector discussed above, clearly accounts for the majority of growth in SWE for both GVA and jobs – 38% and 43%, respectively. These levels far exceed the relative size of the sector – 26% and 15%, respectively. While business services is the largest sector in terms of GVA, the distribution and retail sector is slightly larger in terms of employment in the South West (but not GB) – however, its contribution to growth is markedly less than that of business services.

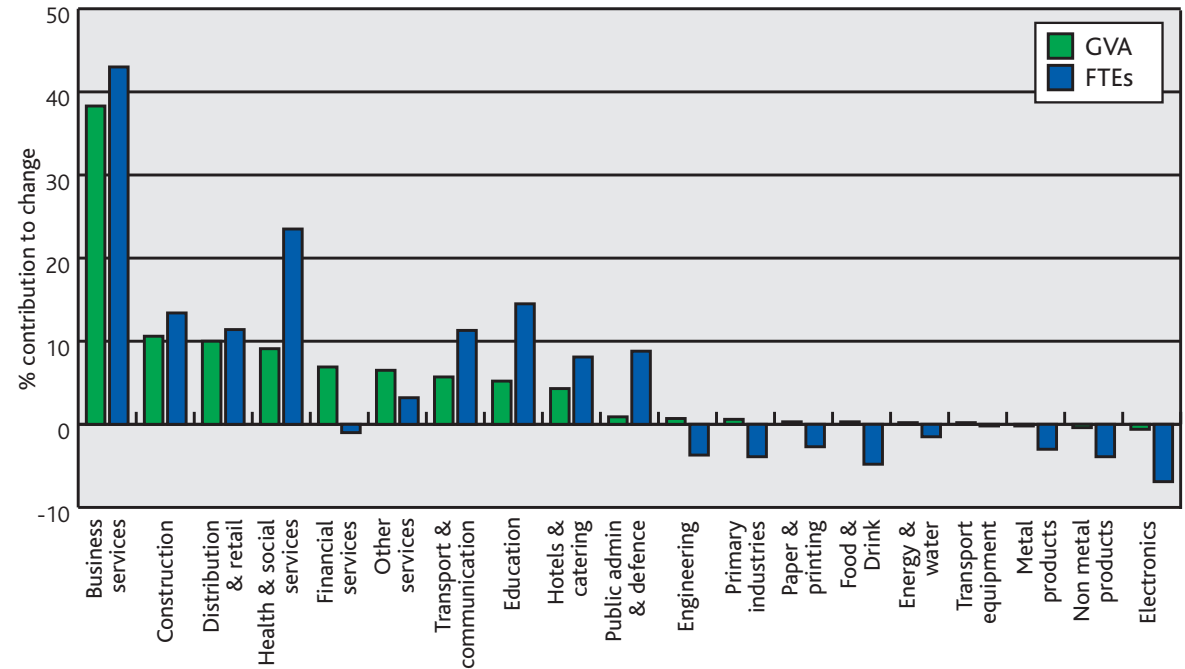
As Figure SP9 shows, services – private and public – along with construction, are distributed to the left hand side of the chart, i.e. contribute to growth, while production, including manufacturing fall to the right, either not contributing to growth (GVA) or indeed contributing to decline (employment).

There are some differences in the rank order for GVA and employment – for example, on employment growth the largely public sector services, health and education, are the second and third largest components (from fourth and eighth for GVA), while finance and other services drop down to eleventh and ninth (from fifth and sixth).

There are only minor differences between SWE and GB. Growth in finance GVA is ranked as the second largest component for GB (fifth for South West) with a greater than 10% contribution to GVA growth, while for employment, distribution and retail (the second largest GB employer) ranks ninth (compared to fifth in for the South West).

It is important to consider the above levels of contribution relative to size. The industrial classification system currently in place is skewed towards evaluation of manufacturing, thus drilling down quickly into relatively small sub-sectors. The classification of service sectors, however, is more 'broad brush', hence the larger groupings.

Figure SP9: Sector contribution to SW GVA and employment growth between 1998 and 2005



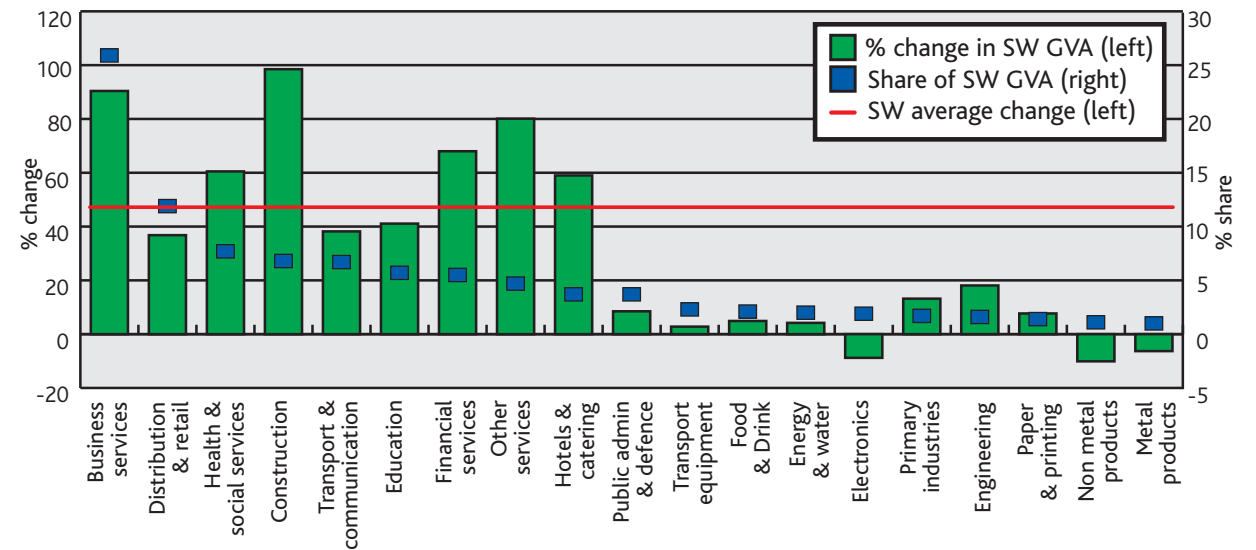
Source: SWRAs

Figure SP10 confirms that the manufacturing sub-sectors, though relatively small in size compared with the service sector groupings, are indeed growing at well below the SW average, this picture being repeated for employment.

Figures SP11 and SP12 show productivity by sector – the first SW productivity by sector relative to equivalent GB sectors and the second SW sectors relative to the SW average.

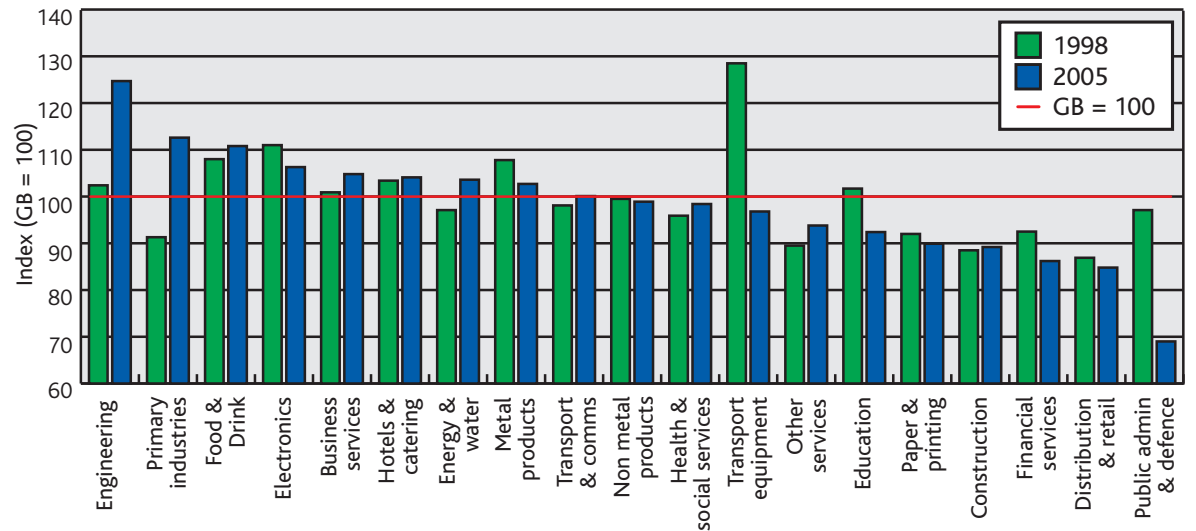
As Figure SP11 shows, the separation of manufacturing and service sectors is far less distinct at this level of analysis – there are relatively productive manufacturing and service sectors, e.g. food and drink, and hotels and catering; and relatively unproductive manufacturing and service sectors, e.g. paper and printing, and distribution and retail.

Figure SP10: Increase in GVA (1998 to 2005) by relative sector size (2005)



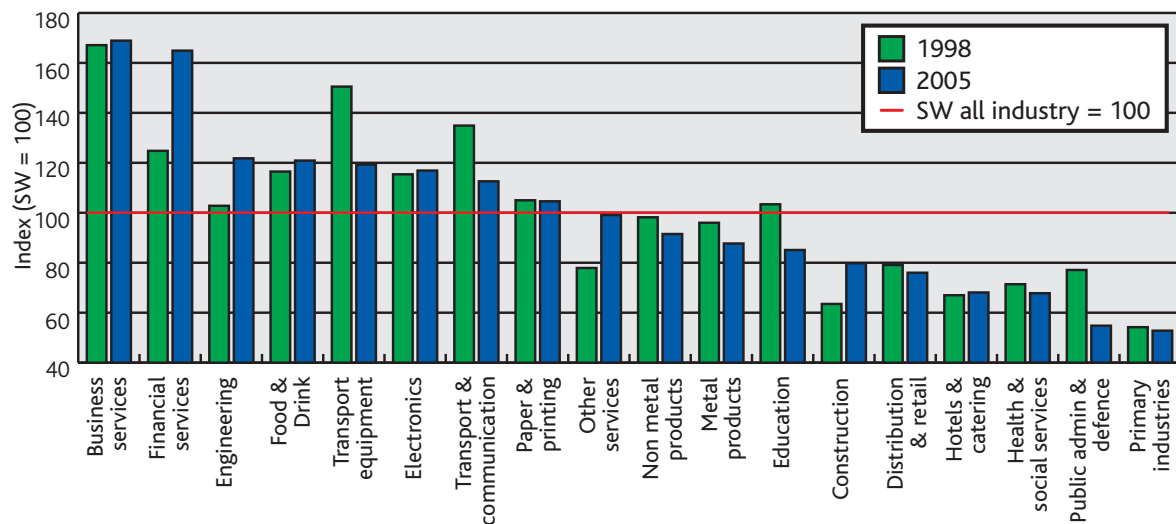
Source: SWRAs

Figure SP11: SW productivity by sector relative to GB



Source: SWRAs

Figure SP12: Productivity as percentage of SW average



Source: SWRAs

In 2005, nine of the 19 sector groupings had higher than or similar productivity to GB productivity in the equivalent sector – the SW average for all SW sectors is 92% of GB. Three of these sectors have reached or overtaken the average since 1998; agriculture et al., utilities, and transport and communications. Meanwhile, three have fallen below the GB average – non-metal products, transport equipment and education.

A commonly held perception seems to be that manufacturing is highly productive and therefore essential to the healthy functioning of an economy, and conversely that service sectors are relatively unproductive. The conclusion reached being that a move to a more service dominated economy can only be detrimental for future growth potential and wealth generation. Figure SP12, however, shows that there is evidence both in support and against this view. There is a relatively wide distribution of productivity across both services and manufacturing, ranging from 88% (metals) to 122% (engineering); and 55% (public admin) to 169% (business services). Indeed, the most productive SW sectors are in services – business and finance. Thus, the declining share of the manufacturing economy can be more than compensated for by high value added services industries.

The Decline of Manufacturing

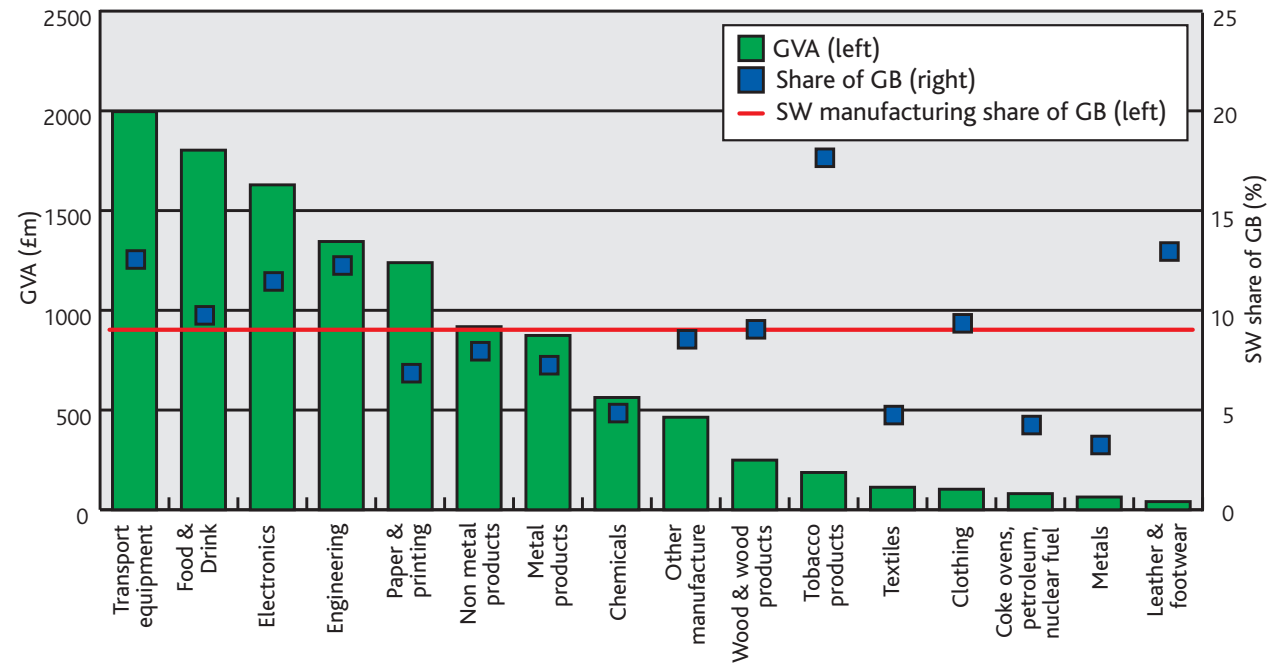
National data show that in volume terms, UK manufacturing has held its own, but the contribution to and the share of GVA in real terms declined between 1998 and 2005. SW manufacturing GVA has declined at a slower rate, but like the national picture has seen substantial losses in manufacturing employment – by a quarter nationally and a fifth regionally. But which sectors and sub-regions have been affected?

Figure SP13 shows the distribution of the manufacturing sector in the South West by sub-sector GVA (bars) and the relative share of the equivalent GB sector (points).

The South West has a 9% share of GB manufacturing (red line), compared to an 8% share of all GB industry. The top four SW manufacturing sectors are transport equipment, food and drink, electronics and engineering – which account for 58% of manufacturing and 8% of the SW economy. SWE has a clear comparative advantage in these sectors as a whole, which account for only 46% of GB manufacturing and 5% of the GB total. Indeed, all four are relatively important to the region, with a greater share than average; and all four

include parts of three of the regional priority sectors – advanced engineering, food and drink, and ICT. An equivalent chart showing employment is similar, though the printing sector moves up into fourth place, displacing engineering. This sector is also relatively large but, while important in some parts of the region, is small compared to the GB sector as a whole.

Figure SP13: Manufacturing in the South West – GVA and share of GB, 2005

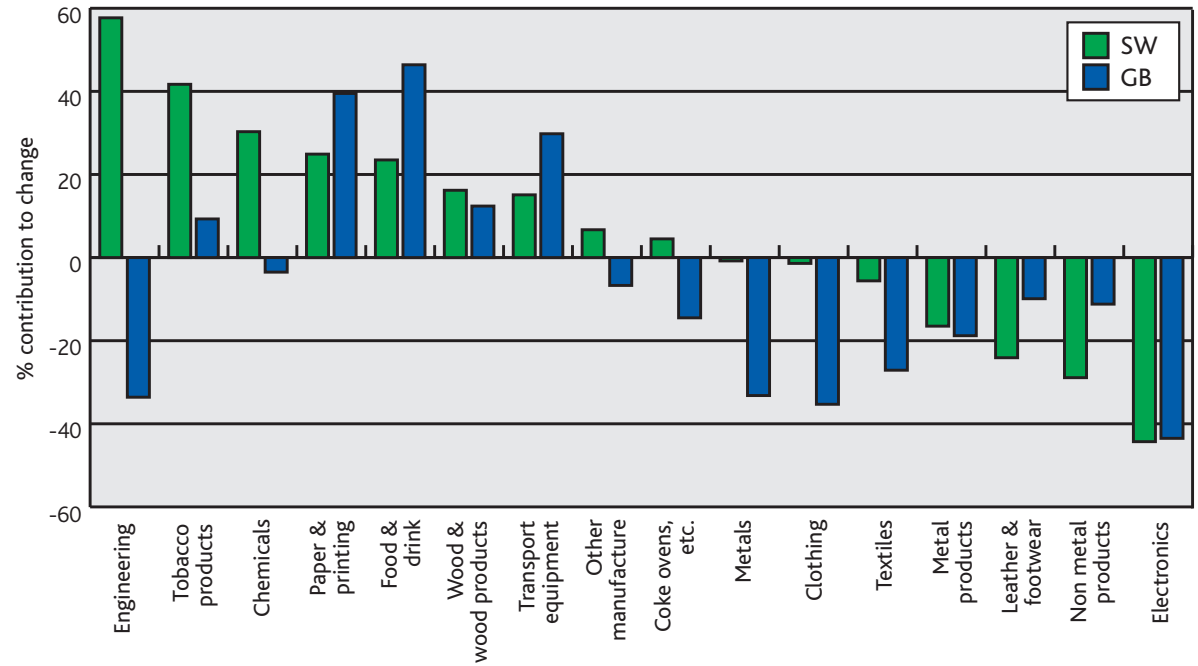


Source: SWRAs

Figure SP14 shows the contribution of the various manufacturing sub-sectors to the change in manufacturing between 1998 and 2005 – SW manufacturing GVA increased by 3% over this period while GB saw a 3% decrease. Bars above the x-axis represent sectors contributing to an increase in manufacturing, while bars below show a contribution to a decrease in manufacturing – thus for the region the weight of bars above exceeds the weight below (by 3%), and vice versa for GB.

Performance has been very mixed with about half of the SW sub-sectors increasing and the other half decreasing – thus restructuring is occurring within the manufacturing sector as well as across the economy as a whole. This may be explained by increased specialisation, driven by globalisation and the region's revealed comparative advantage.

Figure SP14: Contribution to change in manufacturing GVA between 1998 and 2005



Source: SWRAs

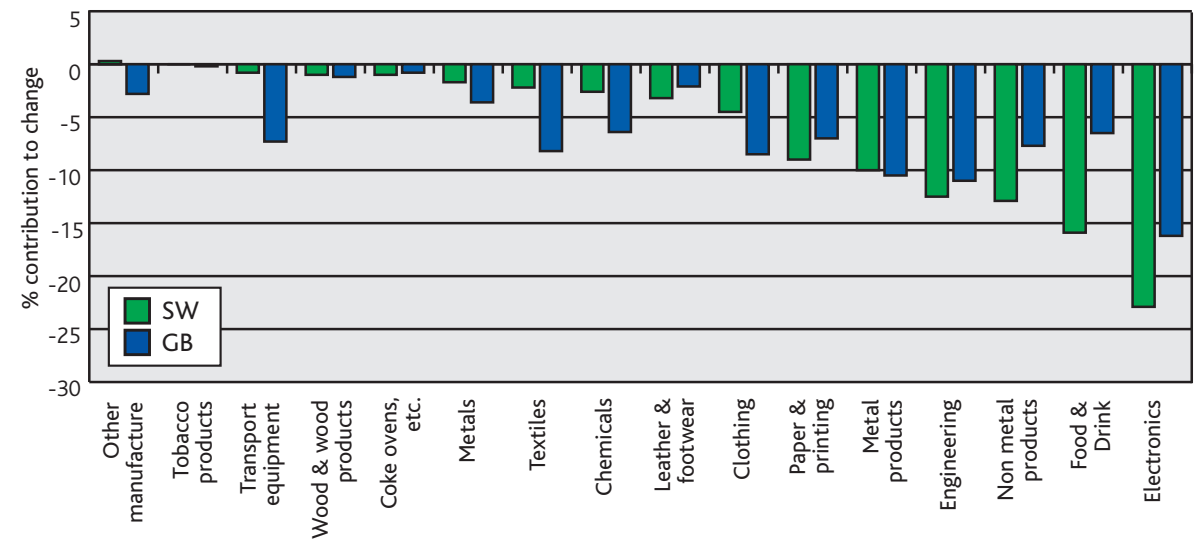
There are differences in the pattern shown by SWE and GB. While engineering provided the largest positive contribution to manufacturing change in the South West, the GB sector declined – the chemicals sector, though relatively small in SWE, follows a similar pattern and provided the second largest contribution to growth. GVA from tobacco products almost quadrupled over the period, and therefore also makes a substantial contribution to growth. (We suspect head office effects played a role in this result.) A large number of manufacturing sectors declined in both the South West and GB.

Significantly, electronics, one of the largest manufacturing sub-sectors, declined over the period. As a sector comprising many high tech manufacturing industries, this is of concern both regionally and nationally.

In terms of employment, there is decline across the manufacturing sectors both in the South West and GB, with relative differences between the regional and national pictures less apparent. Again, electronics contributed most to the decline in manufacturing employment (see Figure SP15), along with food and drink – another key and sizeable sector in the region.

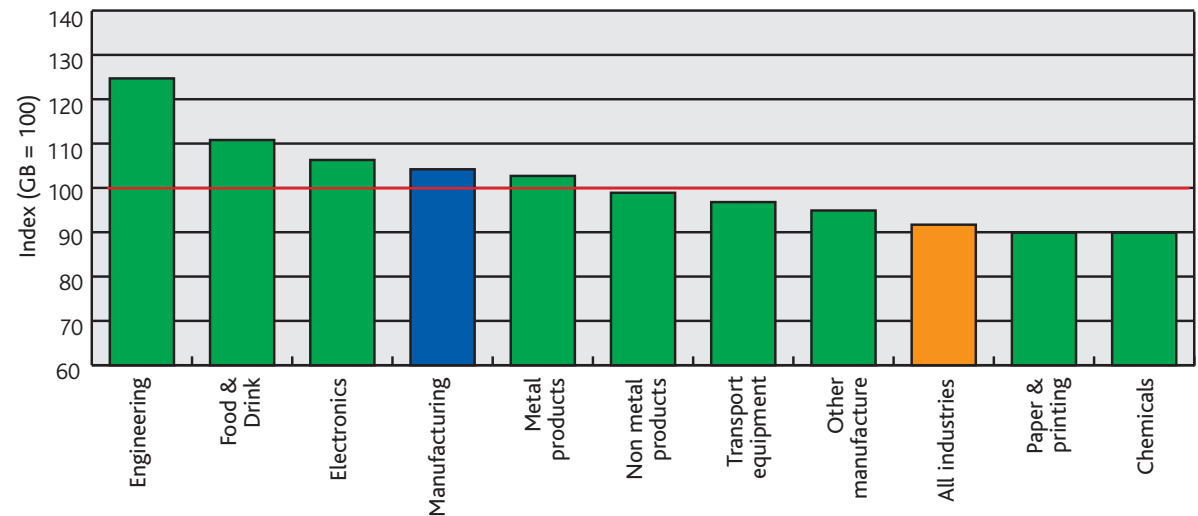
Figure SP16 shows the differences in SW productivity across the various sub-sectors of manufacturing in 2005, expressed as a percentage of the equivalent GB sector. On average, SW manufacturing was more productive than GB, due to relatively high productivity in all of the three largest manufacturing sectors – engineering, food and drink, and electronics. The South West was also relatively productive in metal products, while paper and printing and chemicals were significantly below the GB average.

Figure SP15: Contribution to change in manufacturing employment between 1998 and 2005



Source: SWRAs

Figure SP16: SW manufacturing productivity (GB=100), 2005



Source: SWRAs

As Figure SP17 shows, productivity in five of the nine manufacturing sectors was higher than the South West average, within a range from engineering at 117% to paper and printing at only 72% of the SW average in 2005. Engineering, and food and drink are both well above the GB average for those sectors and above the SW average.

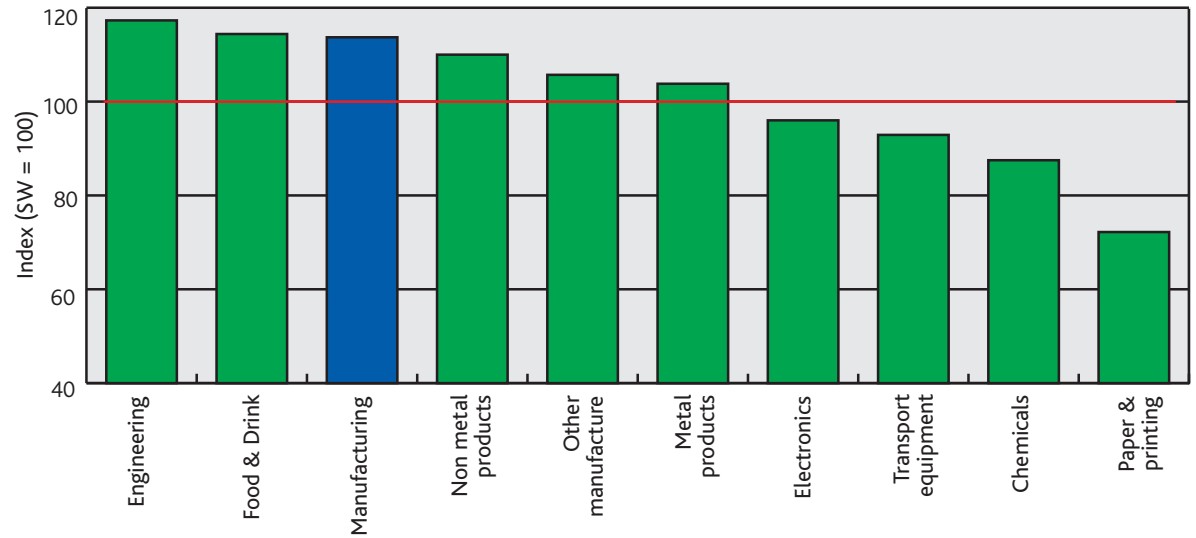
Engineering & electronics

Further analysis was carried out on the engineering and electronics sectors: both key contributors to changes within manufacturing.

Engineering is a significant component of the growth in SW manufacturing, while declining across GB. SW engineering GVA grew by 18% compared to a 12% decline in GB over the period. Figure SP18 shows the distribution of the change by engineering sub-sector. At this level, some of the sub-sectors are very small and, therefore, more sensitive to statistical volatility.

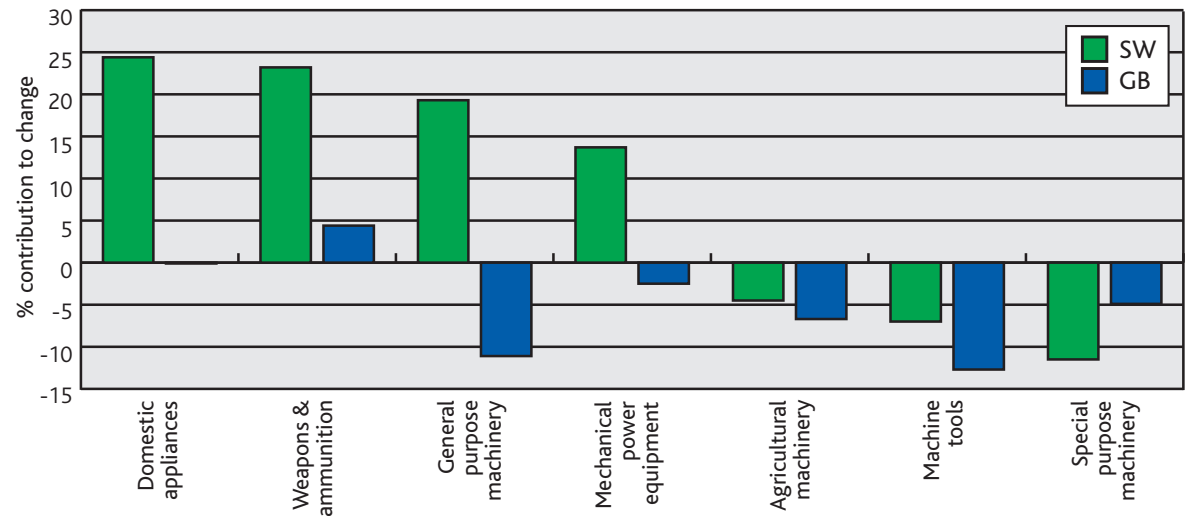
However, the chart suggests that those sectors in which the South West appears to have a competitive advantage (i.e. relatively high share of the GB sector) are performing well (i.e. domestic appliances and mechanical power equipment), while those where the South West accounts for only a small share of the GB sector are not (e.g. agricultural and special purpose machinery). The fear is that some of these sectors remain vulnerable to future globalisation pressures. The weapons sector is difficult to comment upon due to its small size, though in terms of employment it is the only sector to grow over the period.

Figure SP17: Manufacturing productivity (SW average=100), 2005



Source: SWRAs

Figure SP18: Contribution to growth in engineering GVA between 1998 and 2005



Source: SWRAs

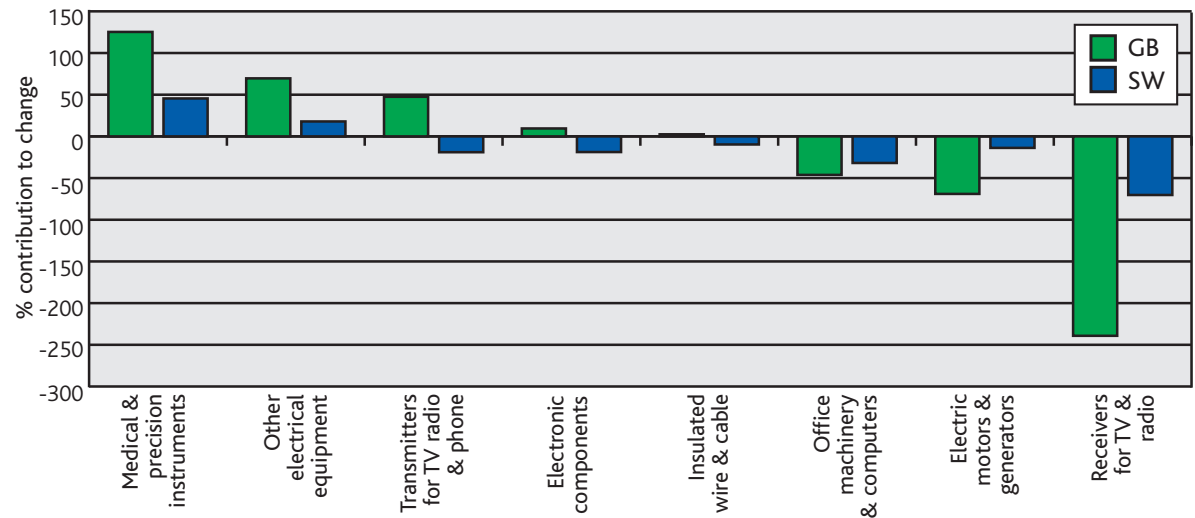
Figure SP19 shows a similar analysis of the electronics sector, which declined in GVA by 9% and 12% in the SWE and GB, respectively, between 1998 and 2005. The employment decline has been faster – 31% and 37%, respectively. In part, this decline is explained by the decline in the ICT sector from around 2000 onwards.

Interestingly, there has not been decline across the electronics sector. The medical and precision instruments sector has contributed to growth – this is part of the biomedical sector, one of the region’s priority sectors because of its perceived growth potential. The major component of decline has been in radio and TV transmitters, a key component of the wider ICT sector.

Manufacturing in the sub-regions

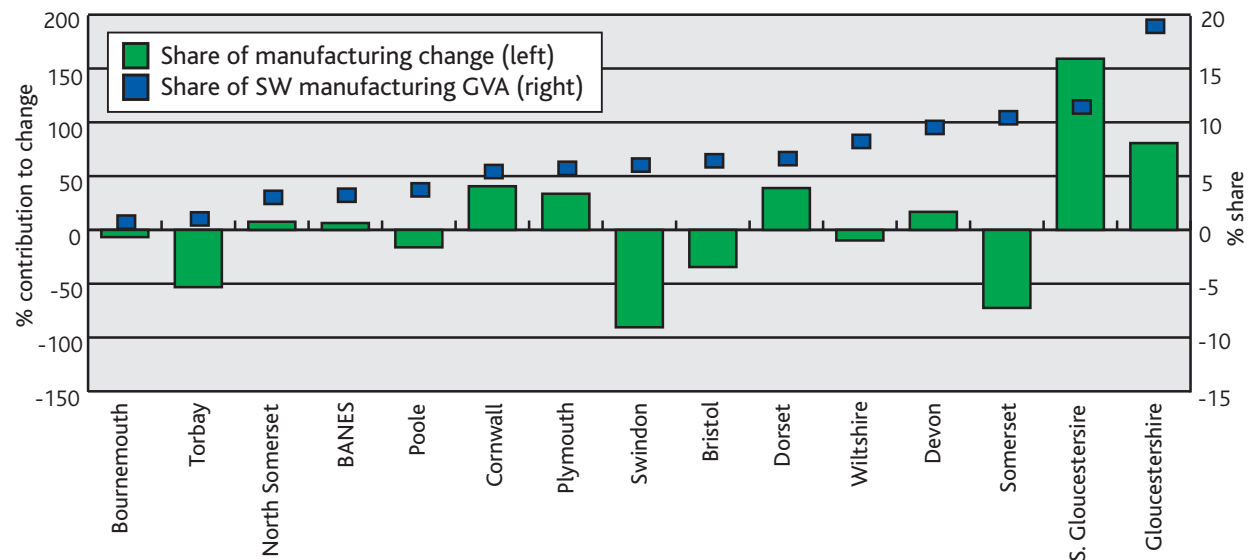
Figure SP20 shows the contribution of SW sub-regions to manufacturing change in the region. There does not appear to be a clear pattern – some rural county areas have performed well, others poorly; and growth is spread geographically. Both the far South West (Devon and Cornwall) and the North of the region have contributed to growth, with the majority of manufacturing growth in South Gloucestershire and Gloucestershire area, the two largest areas. Somerset, also a fairly large manufacturing sub-region, saw a decline. Significantly both Swindon and Torbay contributed substantially to decline – both of these areas suffered losses during the ICT downturn.

Figure SP19: Contribution to change in electronics GVA between 1998 and 2005



Source: SWRAs

Figure SP20: Contribution to manufacturing GVA change between 1998 and 2005

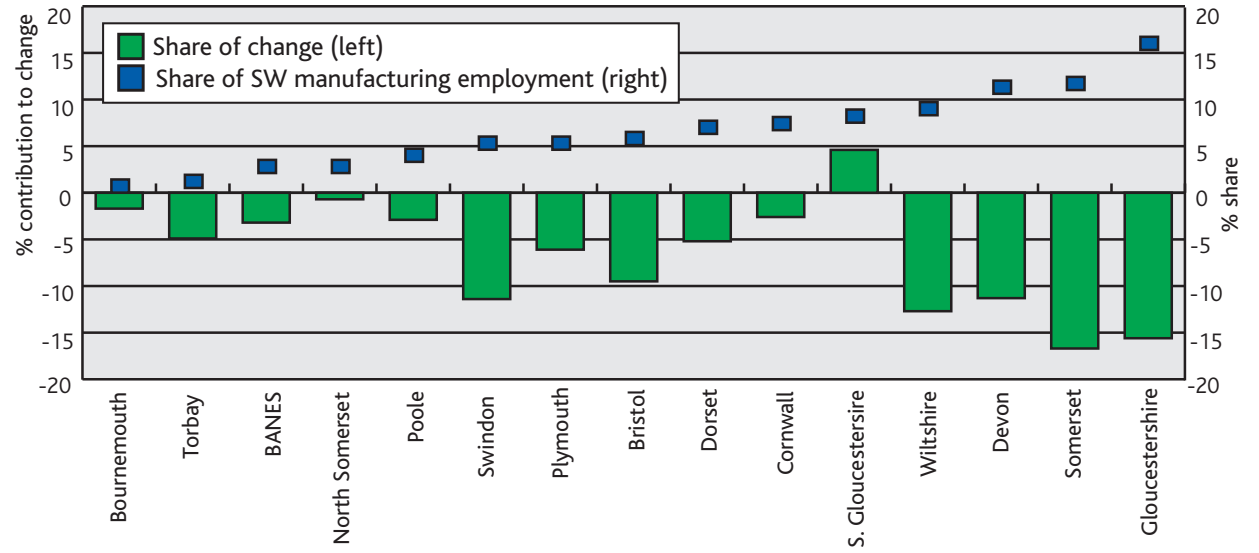


Source: SWRAs

Similarly, Figure SP21 shows the pattern for employment in manufacturing across the region. Unsurprisingly, those regions with the largest share in manufacturing have seen the largest changes in employment – Gloucestershire, Somerset, Devon and Wiltshire. Swindon and Bristol, though smaller in share, have also contributed substantially to losses in manufacturing employment. Only South Gloucestershire showed an increase.

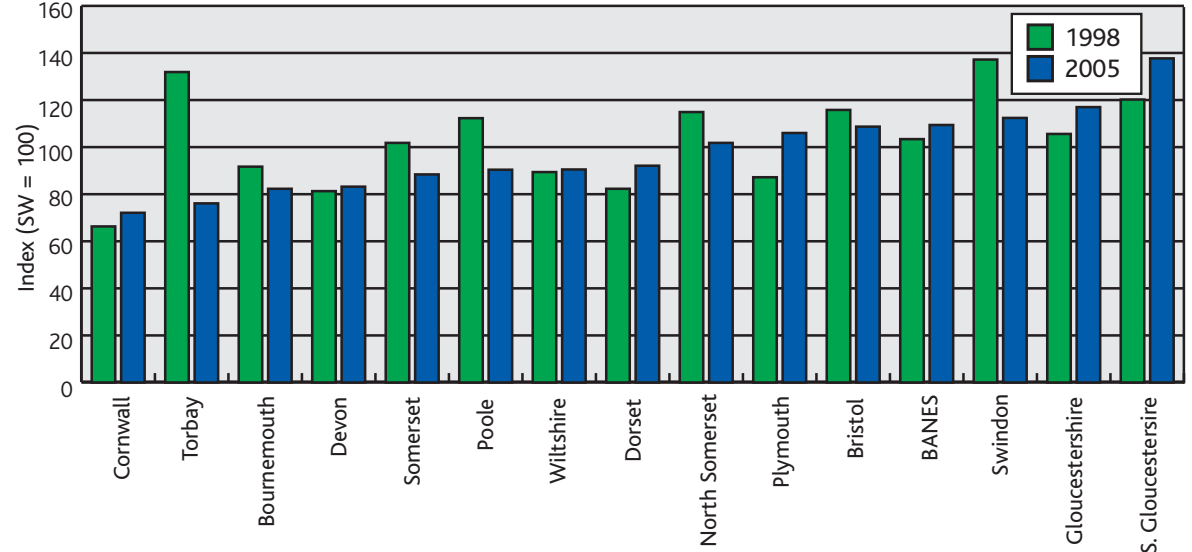
Figure SP22 shows the change in manufacturing productivity between 1998 and 2005, relative to the South West average. The most striking feature is the large fall in relative productivity in Torbay from manufacturing productivity at 132% of the South West average in 1998 to 76% in 2005. Poole and Swindon have also seen relatively large falls in productivity. Cornwall, which is relatively unproductive in absolute terms, did see an increase over the period, however, as did other southern parts of SWE – Devon, Dorset and Plymouth.

Figure SP21: Change in manufacturing employment across the region between 1998 and 2005



Source: SWRAs

Figure SP22: Change in manufacturing productivity in the South West



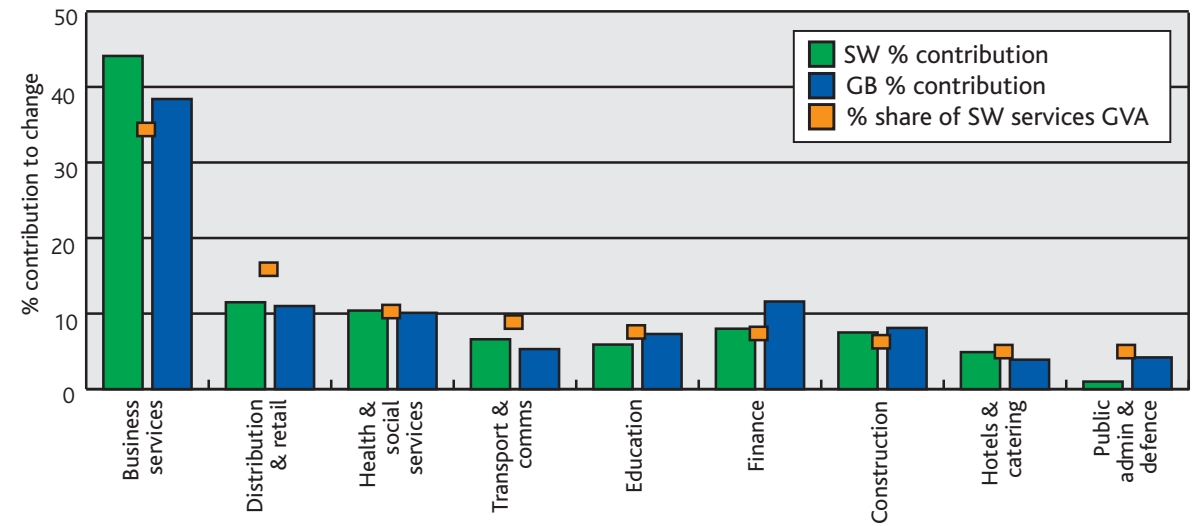
Source: SWRAs

The Rise of Services

The rise of services, in terms of both employment and GVA, across the United Kingdom and in the South West has already been demonstrated above. As with manufacturing, further analysis of the service sectors was carried out to determine the relative importance of service sub-sectors and sub-regions to this growth. The contribution of service sub-sectors to GVA growth is largely in line with relative size of sub-sector, as shown in Figure SP23, with the largest contribution coming from business services.

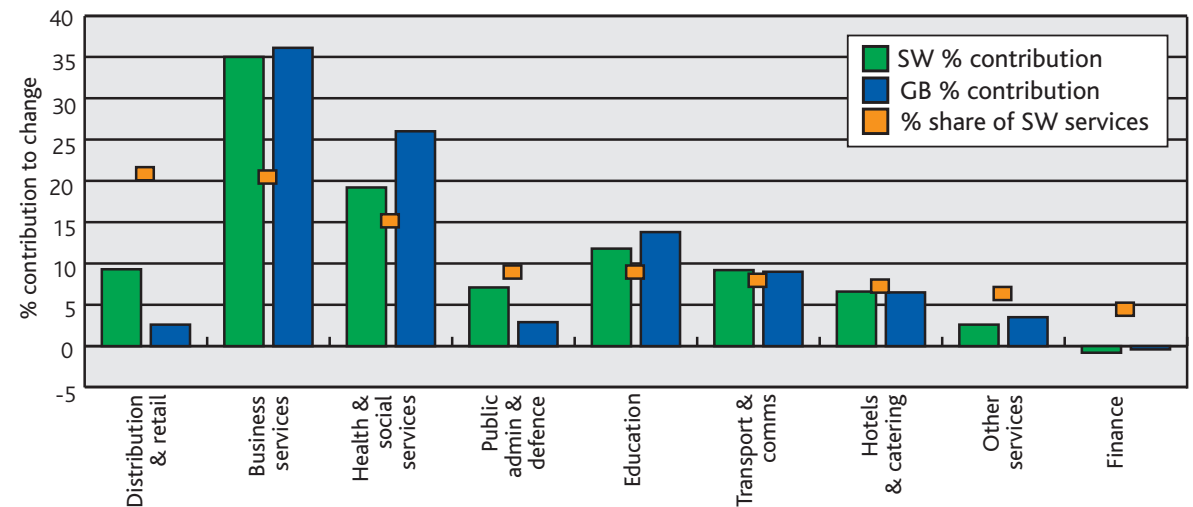
Interestingly, the picture given by employment growth over the same period is somewhat different – see Figure SP24. Distribution and retail made only a small contribution to growth in services, although they are the largest of the SW service sectors. Business services on the other hand made a disproportionately large contribution, while at the other end of the spectrum finance declined slightly in employment both in the South West and GB as a whole.

Figure SP23: Contribution to growth in services GVA between 1998 and 2005



Source: SWRAs

Figure SP24: Contribution to growth in services employment between 1998 and 2005



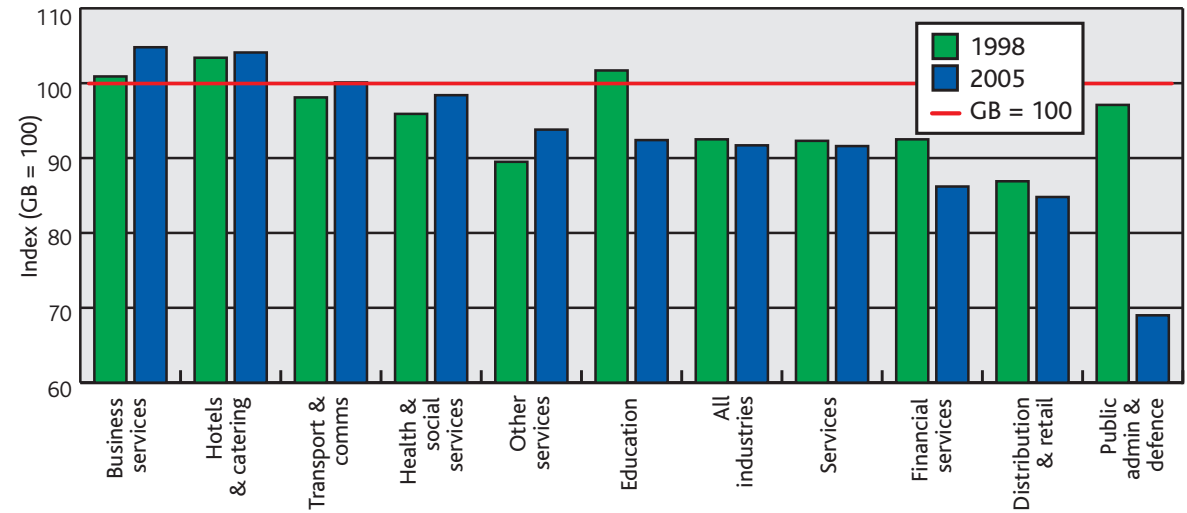
Source: SWRAs

SWE rates fairly poorly in terms of services productivity. Figure SP25 shows SW productivity by sector relative to GB. Only two sectors had a seeming comparative advantage in 2005 – hotels and catering, and fortunately in business services, the highest productivity and largest services sector. Public administration and defence rates particularly poorly at only 69% of the GB average for this sector, a substantial fall relative to a better than average 97% in 1998. Similarly, education productivity has fallen from better than GB to well below.

The five top sectors in terms of productivity have all shown relative improvement against the GB average since 1998, while all of the remaining sectors have lost relative position.

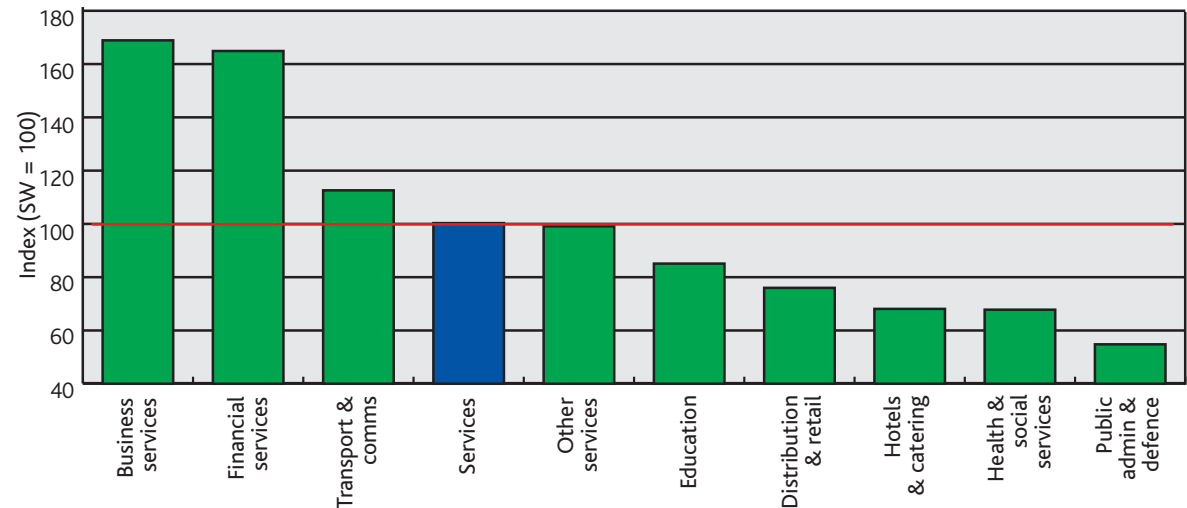
Figure SP26 shows the relative productivity of SW service sectors compared to the SW average. Business services and finance both perform well. While business services has largely maintained its relative position since 1998 (around 68% above the average), finance has grown from around 25% above in 1998 (though with a decline in the years following) to 65% above in 2005.

Figure SP25: Relative productivity across services between 1998 and 2005 (GB=100)



Source: SWRAs

Figure SP26: Relative productivity of SW service sectors (SW average=100), 2005



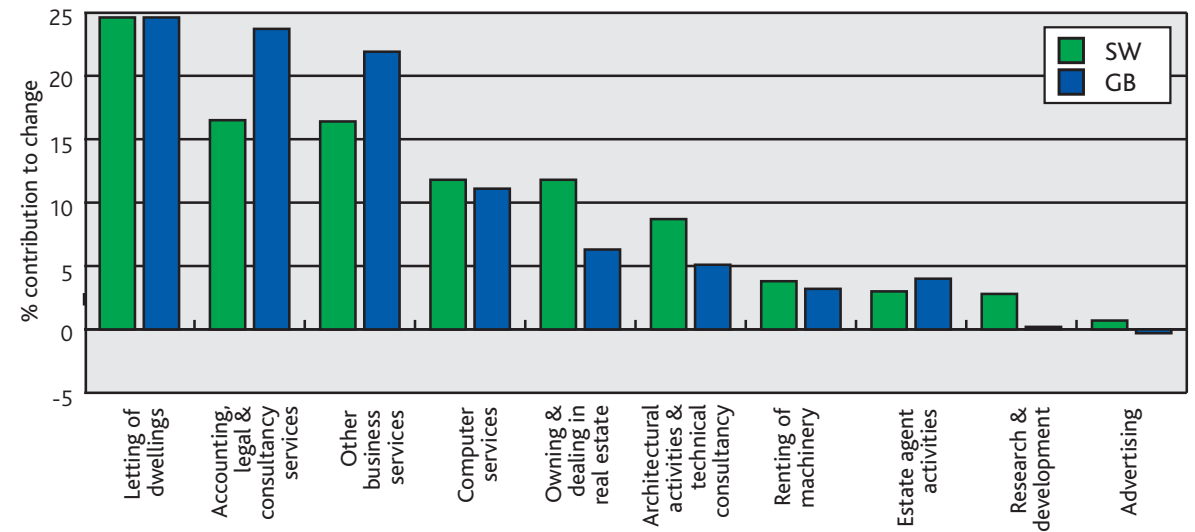
Source: SWRAs

Business services

All of the analysis above points to the importance of business services to the national and regional economies. Further analysis of business services shows that growth is more dispersed for the South West than GB – see Figure SP27. While 57% of SW services growth is concentrated in lettings and dwellings, (reflecting strong housing market growth) accounting et al., and other business services, this figure is around 70% for the GB average. SWE has also seen substantial growth in computer services, real estate and architectural services et al.

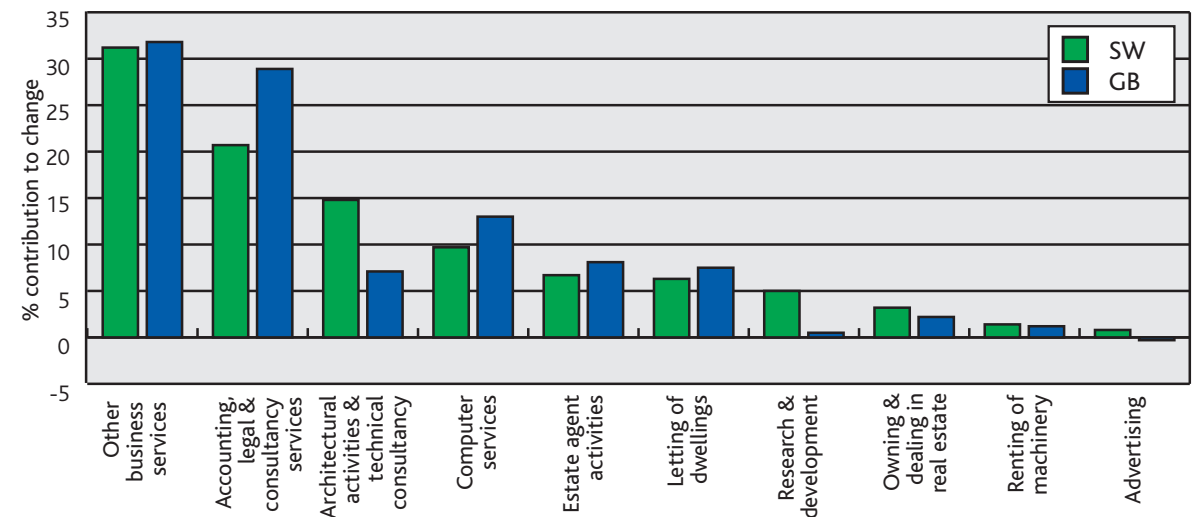
The employment picture is rather different, with more than half of SWE and GB growth due to 'other' business services (for example, recreational services, membership organisations, etc.), and accounting and legal services, etc. (see Figure SP28). Growth in architectural and design services also provided a substantial component of growth in SWE. Furthermore, the data suggest that the region has substantially improved its position in Research and Development over this period – moving from a 3% to 10% share of GVA, and a 4% to 9% share of employment. This will be essential if SWE is to successfully exploit the growing importance of the 'knowledge economy'.

Figure SP27: Contribution to business services GVA growth between 1998 and 2005



Source: SWRAs

Figure SP28: Contribution to business services employment growth between 1998 and 2005



Source: SWRAs

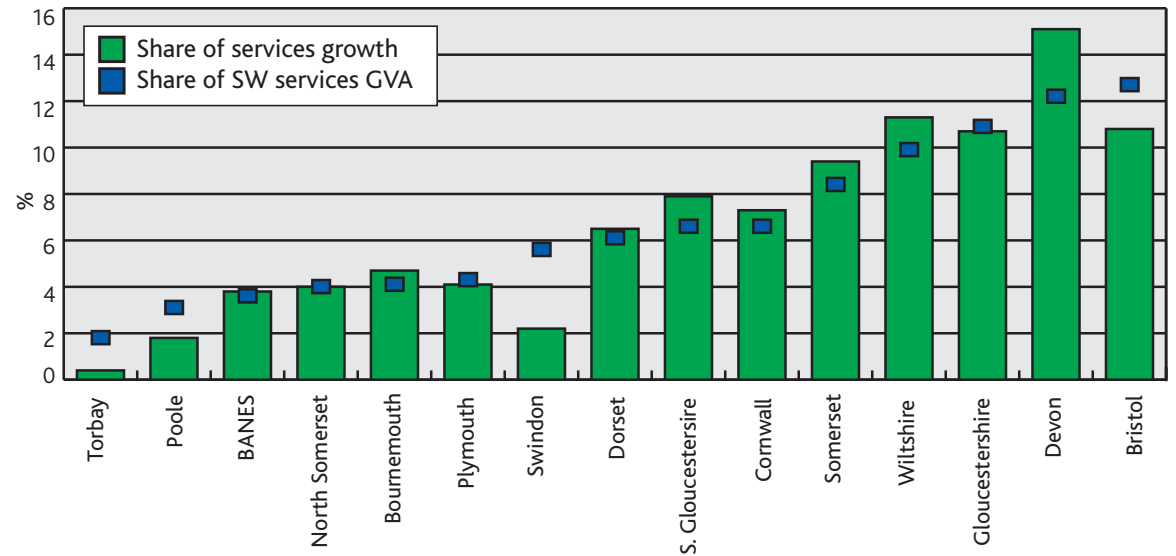
Services in the sub-regions

As with manufacturing, an analysis of services growth across the region was carried out. Generally, contribution to growth increases with share of GVA – see Figure SP29. Devon appears to have benefited from a relatively large share of the growth, along with Wiltshire. In contrast, Swindon, Poole, and Torbay contributed little to service growth, even relative to share.

Again with employment, contribution to growth largely follows share of employment, although the distribution is perhaps more uneven – see Figure SP30. Those areas with the smallest shares in service have grown somewhat slower than expected relative to size, perhaps due to some issues around economies of scale. Bristol, Swindon and Gloucestershire are clear exceptions with extremely low levels of growth relative to size.

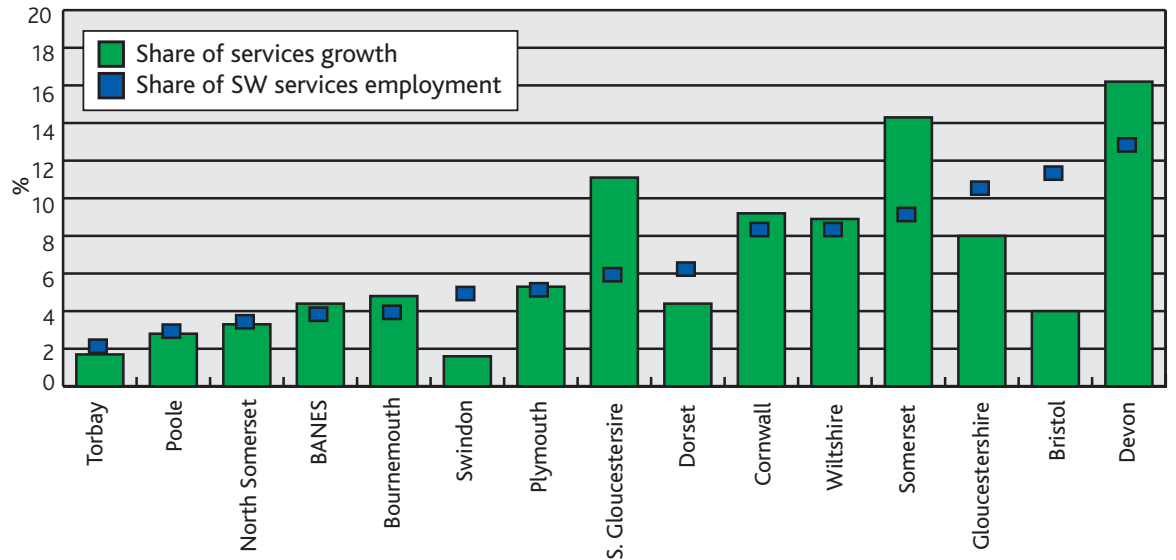
Changes in productivity across the region are shown in Figure SP31. This figure shows that four sub-regions – Torbay, Poole, S. Gloucestershire and Swindon – have seen substantial falls in services productivity, although of these only Torbay is now below the SW average. S. Gloucestershire, Bristol, Swindon, N. Somerset and Wiltshire were higher than the GB average in 2005.

Figure SP29: Contribution to services GVA growth by sub-region, 1998 to 2005



Source: SWRAs

Figure SP30: Contribution to services employment growth by sub-region, 1998 to 2005



Source: SWRAs

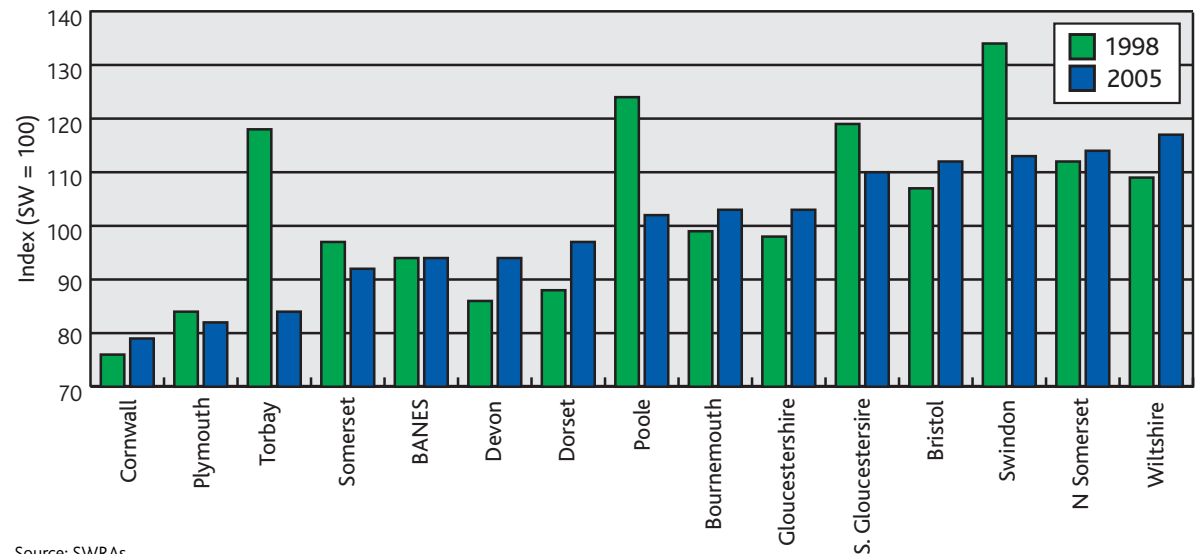
SW Priority Sectors

A number of sectors have been identified in the Regional Economic Strategy as potential priorities for intervention, based on their comparative advantage, size, growth potential, and importantly, the capacity for realistic economic interventions to be made at a regional level.

These sectors are Advanced Engineering, Creative Industries, Food and Drink, Leisure and Tourism, Environmental technologies, Marine technologies, Information and Communications technologies, and Bio-technologies. Some modifications have been made to the sectors since the definitions were originally derived, e.g. biotechnology now contains part of engineering – manufacture of medical and surgical equipment – in order to expand this sector to include biomedical companies. For the purpose of this analysis, however, the original definitions were used¹.

The eight priority sectors account for around a fifth of the SW economy both in GVA and employment terms. The region has a substantial comparative advantage in advanced engineering (particularly in the aerospace sub-sector), food and drink, and marine (12%, 12% and 24% of GB GVA, respectively).

Figure SP31: Change in SW services productivity (SW=100)



Source: SWRAs

¹ The State of the Sectors, 2004 – Arthur D Little, for the South West RDA

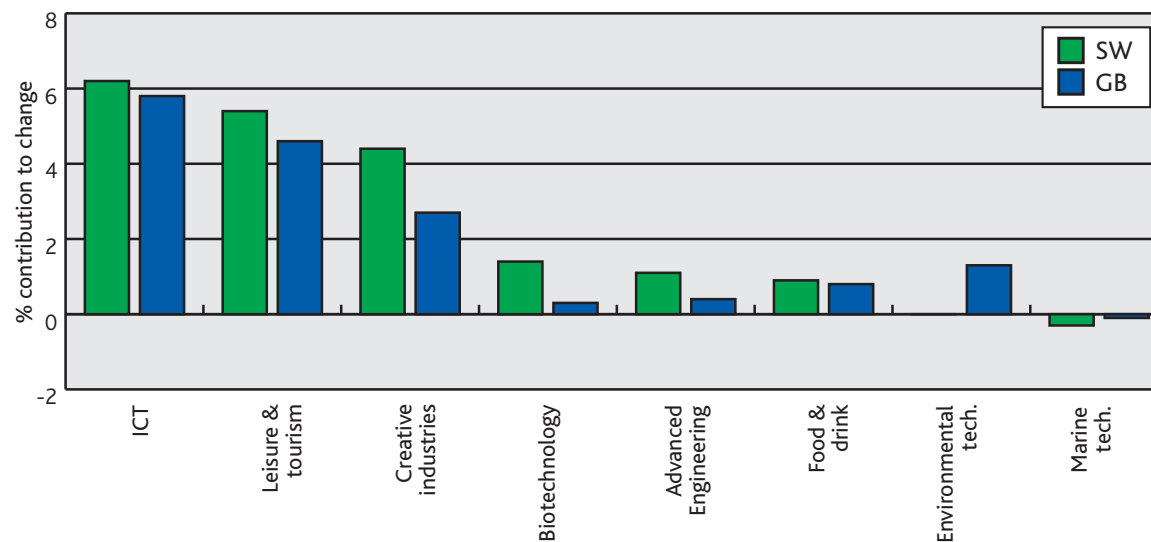
Similarly around a fifth of GVA growth from 1998 to 2005 can be attributed to these priority sectors (see Figure SP32) – in line with their contribution to the economy. ICT, and leisure and tourism have performed particularly well, accounting for more than half of the growth in the SW priority sectors (6% & 5% of SW growth respectively), while only accounting for 8.5% of the SW economy.

Relative to sector size, biotechnology and the creative industries also made above average contributions to GVA growth. All of the SW priority sectors – except environmental and marine technologies – outperformed the GB average.

Biotechnology grew by 170% between 1998 and 2005 compared to a SW average of 47%, although the sector is relatively small – 0.7% of SW GVA. Creative industries, ICT, and leisure and tourism also showed above average levels of growth over this period.

Interestingly, in contrast to GVA growth, only 2% of employment growth was in the priority sectors, both in SWE and in GB as a whole, with variable performance across the different sectors. Substantial declines in employment in advanced engineering, and food and drink were offset by increases in all of the other sectors except environmental technologies.

Figure SP32: Contribution to SW growth in GVA between 1998 and 2005

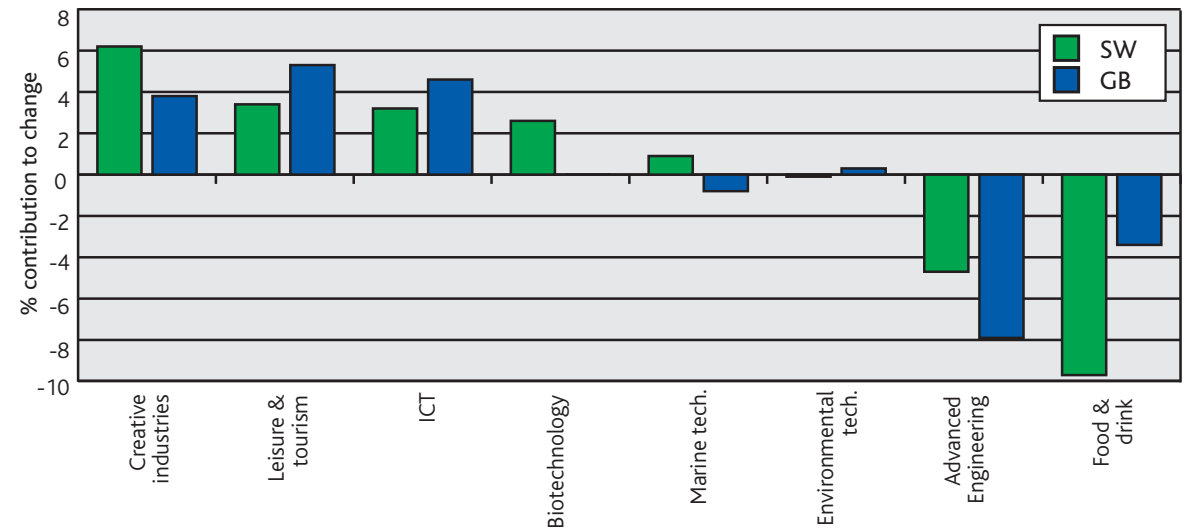


Source: SWRAs

Again, there was strong growth in biotechnology (92% over the period). While this sector accounts for less than 1% of employment, however, it accounted for 2.6% of the increase in SW employment, and outperformed the GB sector (see Figure SP33). Creative industries, leisure and tourism, and ICT also contributed to growth.

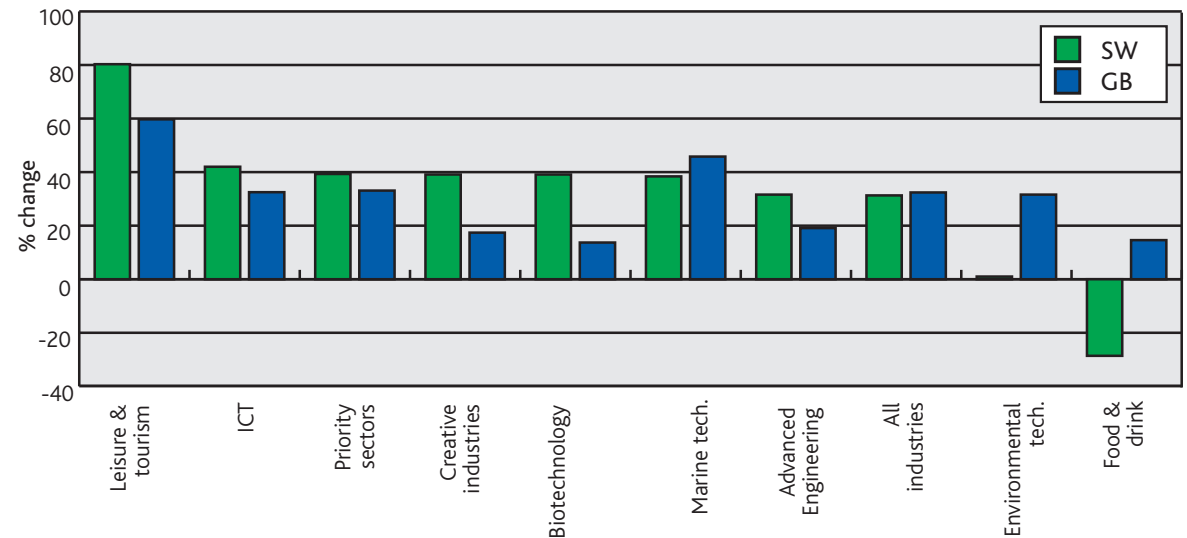
Because of the marked difference in GVA and FTE growth, substantial productivity gains were made in some of the priority sectors. Productivity of all priority sectors, except environmental and marine technologies grew above the average rate – see Figure SP34. Leisure and tourism increased by 80%, compared to 31% for SW average, which is good news for a sector traditionally characterised by seasonal and poor quality employment, and low productivity. Most of the priority sectors outperformed GB averages in terms of productivity growth, although advanced engineering, which showed strong productivity growth in absolute terms was slightly below its equivalent GB average.

Figure SP33: Contribution to SW growth in employment between 1998 and 2005



Source: SWRAs

Figure SP34: Growth in productivity between 1998 and 2005



Source: SWRAs

Conclusions

The question posed at the outset was: is the South West following the UK economy's trend away from reliance on production and manufacturing and towards increasing importance of the service sectors; and, if so, to what extent, in what sectors, and where in the region?

The simple answer is yes – SWE generally mirrors the UK trend, albeit sometimes with a lag. Manufacturing is declining in relative share terms – faster in employment than in output, and at a slower rate in the South West than nationally – and services, in particular business and other private services, are on the increase.

Undoubtedly, the dynamics of the change in the regional economy are complex, both by sector within manufacturing and services, and by sub-region. Some positive restructuring is going on within the manufacturing sector – some sub-sectors are growing thereby offsetting much of the decline that might otherwise be happening. Similarly, rates of change across the service sectors vary considerably, particularly between the growing private sector and public sector services.

The assumption that the relative loss of manufacturing and the increase services is bad for SW productivity has been shown to be somewhat simplistic – many private service sectors are highly productive, and much of the talk around improving and exploiting the knowledge economy will hopefully centre around maintaining and improving many of these productive (business and other) services in the region.

Importantly, many of both the manufacturing and service sectors that have been performing well are major components of the region's priority sectors, reinforcing the argument for boosting those areas in which the region has a comparative advantage and/or potential for growth in the future, rather than supporting those declining sectors, over which little influence can be exerted on a regional or even national level.

It is interesting that SW manufacturing appears to be declining at a lower rate than nationally. While reassuring that the region's relative position nationally is strong in some industries (notably aerospace and marine technologies), it is of concern that perhaps there may be simply a lag in response of SW manufacturing companies and supply chains to wider global change because SW businesses have been relatively less directly engaged. SWE can be characterised as a somewhat peripheral region with a high proportion of small and medium sized enterprises, that have a rather low propensity (either through capability or ambition) to be involved in international trade, innovation and investment in skills and capital.

The region also has a lower proportion than average of foreign owned companies to lead productivity/export growth. Because foreign-owned companies are already working globally, they are in a better position than 'locals' to respond to global competitive trends, including moving investment and production to other countries to take advantage of efficiency savings elsewhere in the world. Non-global UK- or SW-owned companies tend not to work globally in this way as readily.

Comparative advantage that may currently exist in domestic markets, therefore, may dwindle over time, and companies not prepared to think and act 'global' may be at risk in future years, even if their business model is to stay predominately 'local'. It is important that through technological and process innovation and development of the so-called 'knowledge' economy that, where they exist, sector comparative advantages are sustained and developed. These, then, are more likely to build positive agglomeration effects, attracting large UK and foreign-owned companies into the region through inward investment and offsetting outward movements to some extent.

The impact of globalisation – not just on manufacturing, but across the SW economy – is currently under discussion across the region as part of a 'SW debate' to explore both the opportunities and threats arising from changes to the global economy. This will inform the next iteration of the South West Regional Economic Strategy. Further information on the debate can be found at www.swdebates.info.

Allison McCaig, April 2007

Economic Indicators: United Kingdom & South West England

United Kingdom		1999	2000	2001	2002	2003	2004	2005	2006	2005	2006				2007	
										Q4	Q1	Q2	Q3	Q4	Q1	
Real Gross Domestic Product – growth (% ch.) ¹		3.0	3.8	2.4	2.1	2.7	3.3	1.9	2.8	1.9	2.4	2.7	2.9	3.0	2.8	
Inflation – Consumer Price Index (CPI) (%)		1.3	0.8	1.2	1.3	1.4	1.3	2.1	2.3	2.1	1.9	2.3	2.4	2.7	2.9	
Trade balance (£bn)		-15.5	-19.4	-26.8	-30.9	-29.4	-35.0	-45.3	-54.1	-11.4	-13.8	-15.4	-12.7	-12.2	-	
Bank base rate (%) ²		5.50	6.00	4.00	4.00	3.75	4.75	4.50	5.00	4.50	4.50	4.50	4.75	5.00	5.25	
Exchange rates ³		€:£	1.519	1.642	1.609	1.591	1.446	1.474	1.463	1.467	1.471	1.457	1.454	1.471	1.485	1.492
		\$US:£	1.618	1.515	1.440	1.504	1.635	1.832	1.819	1.843	1.748	1.753	1.830	1.875	1.915	1.955
Employment rate (%) ⁴		73.8	74.4	74.6	74.4	74.7	74.8	74.7	74.6	74.5	74.6	74.6	74.5	74.5	-	
Unemployment rate (%) ⁵		6.1	5.6	4.9	5.2	5.0	4.8	4.7	5.4	5.1	5.2	5.5	5.6	5.5	-	
South West England		1999	2000	2001	2002	2003	2004	2005	2006	2005	2006				2007	
										Q4	Q1	Q2	Q3	Q4	Q1	
Gross Value Added (GVA)	Total nominal GVA (£bn)	60.8	63.7	67.5	71.6	76.4	81.3	84.6	-	-	-	-	-	-	-	
	Annual growth (% ch.)	5.0	4.6	5.9	6.0	6.7	6.5	4.0	-	-	-	-	-	-	-	
	GVA per head (UK=100) ⁶	93.1	93.2	93.7	93.9	94.2	94.3	94.4	-	-	-	-	-	-	-	
	GVA per filled job (UK=100)	92.1	93.3	94.5	93.9	93.4	94.2	93.6	-	-	-	-	-	-	-	
	GVA per hour (UK=100)	93.4	95.0	97.3	96.0	95.7	97.1	95.8	-	-	-	-	-	-	-	
Gross Disposable Household Income (GDHI)	Total GDHI (£bn)	50.3	53.1	56.9	59.0	61.8	64.1	67.2	-	-	-	-	-	-	-	
	Annual growth (%)	4.7	5.7	7.1	3.6	4.9	3.6	4.9	-	-	-	-	-	-	-	
	GDHI per head (UK=100)	99.5	99.1	99.3	99.5	99.7	99.6	99.8	-	-	-	-	-	-	-	
Trade	Total goods exports (£bn)	7.3	7.6	8.2	7.5	9.1	9.7	10.3	10.9	2.9	2.7	2.8	2.6	2.6	-	
	Annual change (%)	3.6	3.6	8.1	-7.7	21.0	6.8	6.3	5.7	13.2	13.9	11.5	2.8	2.8	-	
	Share of UK exports (%)	4.4	4.0	4.3	4.0	4.8	5.1	4.9	4.5	5.0	4.2	4.0	5.0	5.0	-	
Labour market	Employment rate (%) ⁴	78.3	78.9	78.9	79.0	78.8	78.7	78.4	78.2	77.8	78.1	78.4	77.8	78.4	-	
	Unemployment rate (%) ⁵	4.5	4.1	3.7	3.8	3.4	3.3	3.6	3.8	3.9	3.6	3.7	3.9	3.8	-	
House prices	Average house price (£k)	91.5	106.2	119.8	144.9	170.0	191.7	199.1	-	199.9	199.3	205.4	217.3	217.3	-	
	Annual change (%)	16.2	19.8	7.0	14.2	7.6	9.5	5.9	-	4.4	5.6	9.1	9.7	11.2	-	
	Index ⁷	94.5	97.8	100.3	104.7	108.6	107.2	104.8	-	104.0	103.1	102.5	102.3	104.4	-	
	Affordability ratio ⁸	5.9	6.4	6.9	7.9	8.9	9.8	9.6	-	-	-	-	-	-	-	

-Data unavailable; ¹ Percentages represent annual changes unless stated otherwise; ² Rate at end of period; ³ Annual and quarterly average rates; ⁴ As percentage of working age population;

⁵As percentage of economically active population aged 16+; ⁶ UK GVA per head for 2004 is £16,802; ⁷ England & Wales=100 latest quarter provisional only; ⁸ Ratio of average price to average total gross annual earnings Sources: Exchange, interest rates – Bank of England; Trade – UK TradeInfo; House prices – ODPM (from Land Registry data); All other – ONS



South West of England Regional Development Agency

Sterling House, Dix's Field, Exeter, Devon EX1 1QA

Phone: 01392 214747 Fax: 01392 214848

www.southwestrda.org.uk

This document has been printed on Greencoat Velvet, Recycled from 80% post-consumer fibre, 10% TCF (Totally Chlorine Free) virgin fibre, and 10% ECF (Elemental Chlorine Free) fibre. FSC certification. NAPM recycled certification.

Design: Proctor & Stevenson Ltd. Phone: 0117 9232282

Print: TL Visuals Ltd. Phone: 01454 319555