

Economics Review Issue 10

Fourth Quarter: November 2007

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Overview

Storm coming...?

The **world economy** entered stormier waters this summer, perhaps heralding a significant economic turning point. The winds of growth may stay fair for a while... but are expected to slow down in due course.

Batten down the hatches...

Because the storm is centred on the financial sector, a key contributor to recent UK performance, the **national economy** is likely to lose momentum... but there is some uncertainty about when and by how much.

Trim the sails...

South West England has enjoyed a strong year to date but will not escape the effects of any economic storm to come... SW businesses need to align themselves for this change in the wind.

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 October 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

'Spending constraints at a time of economic uncertainty'

The UK party conference season and the accompanying election speculation added political spice to the late summer/early autumn. The key economic event, however, was the Government's announcement of its Comprehensive Spending Review and Pre-Budget Report in early October. Inheritance tax took the headlines, but there are deeper forces at play for the economy.

The Government acknowledged the economic slowdown to come, with its growth outlook for 2008 being lowered by 0.5% (to real GDP +2.0-2.5%). After that, however, it expects a bounce back to trend in 2009 (+2.5-3.0%, which seems to be the Treasury's underlying view of the UK economy's growth potential). This may prove to be optimistic.

The Government is planning tighter public spending over the next three years, although there is still an overall increase in real terms (+2.1% – half the rate of the last eight years and slightly below the economy's overall performance) and higher government borrowing is envisaged. Health, science and technology, and transport were relative 'gainers' compared with other areas of government expenditure.

The Pre-Budget Report's increased emphasis on science and technology, and skills and innovation sits well with the existing SW Regional Economic Strategy and the desired shift in the balance of emphasis from employment-led to productivity-led growth.

Other measures may be less welcome in the region. For example, there has been a mixed response in some localities to the planned incentives to increase housing supply and recent higher ONS population projections. Also, South West England (SWE) has a relative preponderance of small enterprises and the proposed changes to Capital Gains Tax on business assets have not gone down well amongst the small business community.

Regional development faces real cuts in government spending. For example, the nine English RDAs' budgets will drop by almost 6% over the next three years. In real terms, this could amount to more than 5% per annum. The value for money effort required, with a spur to efficiency and choice, is welcome but regional partners can expect even tighter prioritisation at a time when the RDA network is being required to take on more functions.

World Economy 'Storm coming?'

The world economy entered stormier waters this summer, perhaps heralding an economic turning point. The winds of growth may stay fair for a while... but are expected to slow down in due course.

Current overview & outlook

The world economy was strong through the first half of the year and the evidence for the next four months shows limited signs of a slowdown. The consensus view of the future has weakened, but not yet sharply, and its long term perspective on inflation remains remarkably relaxed (see Table WD1).

Table WD1: Growth and inflation forecasts (% change, year-on-year)

	Growth	Inflation
USA		
2007	+2.0	+2.7
2008	+2.4	+2.3
2009-12	+2.9	+2.3
Eurozone		
2007	+2.6	+2.0
2008	+2.0	+2.0
2009-12	+2.0	+1.9

By their nature, however, such consensus views are seldom good at picking turning points. The clouds have gathered over the US housing market and engendered financial market contagion around the globe. The dollar is falling and commodity prices are firmer. It is possible to still be fairly relaxed about the winter ahead but, in due course, the dichotomy between the real economy and the monetary economy will be resolved one way or another.

The key question is whether this summer's events were a warning or 'the real thing' in terms of becoming a significant economic turning point. There are cyclical and structural elements to this debate.

Structural change

First, we have the ongoing structural boost from technological and demographic change, best symbolised by the opening of major new countries to the world's market economy in Asia. This has added three billion potential workers and consumers to the system, boosting both demand and supply significantly as globalisation accelerates.

Whilst these stimuli may wane eventually, their positive effects should continue to be important factors in the years ahead. China and India's productivity booms should not run out of steam for a considerable time yet unless, that is, they fail to adjust their macroeconomic stabilisation policies to accommodate the rapid change in their relative economic status. It is estimated that, for the first time, China will contribute more to world growth than the United States in 2007.

The re-balancing of these economies is becoming more urgent. China, for example, is expected to 'enjoy' real growth of more than 11% this year and inflation reached 6.5% in August – an eleven year high – despite five interest rate increases and seven moves to tighten reserve ratios. The stock market has risen five-fold in two years and the current account surplus could reach a massive 12% of GDP in 2007. In a large, rapidly developing economy, it is even harder than usual to distinguish whether this is sustainable or a bubble.

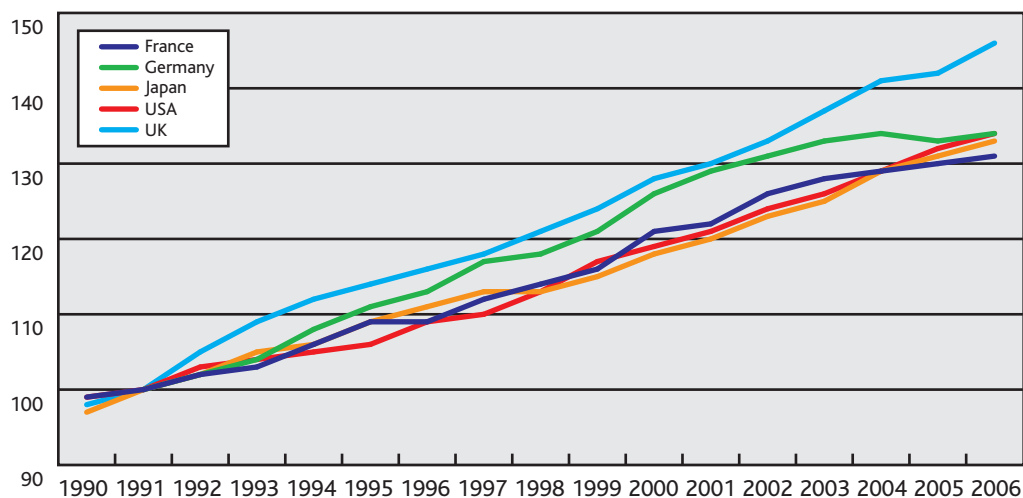
Meanwhile, as Chart WD1 shows, the latest comparisons show that international productivity has been rising steadily in the world's main developed countries since 1990. In terms of GDP per worker and GDP per hour, the UK productivity ratios were 7% and 4% respectively below the G7 averages last year. This is a marked relative change since 1991 (when they were 22% and 19% below respectively) but shows that further progress is still desirable.

The chart indicates how the pace of UK growth in GDP per hour has exceeded those of its main rivals during the current expansion, leading to this relative improvement. In absolute terms, however, the UK measure of GDP per hour was still well below US (14%), French (16%) and German (12%) equivalents in 2006. Everybody is searching for the 'holy grail' of productivity growth, and relative improvement against the competition, for countries, sectors and individual businesses alike usually takes considerable time.

Cyclical change

Second, there is a cyclical dilemma. After a world expansion that has continued for a decade and a half and not been blown off course by several shocks, including the Asian debt crisis of the late 1990s, the horrors of 9/11, and the trebling of oil prices (hitting new highs above US\$95 a barrel at the time of writing), it is tempting to suggest that the 'credit' or 'liquidity' crunch will brake, but not necessarily end, the current period of economic growth. That is the current consensus, supported by central bankers' suggestions that they have scope to loosen policy to prevent a damaging downturn if necessary.

Chart WD1: Comparisons of international productivity growth (index 1991=100, GDP per hour)



Source: ONS

The danger, however, is that the 'credit crunch' is a more fundamental symptom of the imbalances in the world economy that have built up since the turn of the century (and have been mentioned several times before in these pages). The recent build up of savings amongst Far East Exporters and OPEC members and the consequent flows of funds into western asset markets caused a narrowing of risk margins that always looked unsustainable. In that sense, the collapse of the US sub-prime mortgage market and subsequent financial contagion through collateralised debt obligations this summer was an accident waiting to happen.

The issue now is will the flow of excess savings continue and, if so, where will it be centred next? As long as global activity remains reasonably buoyant, the flow will continue. At present, it seems that some stock markets, commodities and emerging markets are the beneficiaries, with for example, direct and indirect investment by the so-called 'sovereign wealth funds' (major state-owned investment vehicles) in good western companies now on the increase. These funds are said to have holdings of up to US\$3 trillion and there are concerns about their motivation – shareholder returns versus unfair competition, asset and technology capture, and political influence. Meanwhile, whilst share valuations remain high, there is no long term benefit in shifting from one bubble (housing) to another (equities). Finally, liquid assets are likely to gain too as a 'flight to quality' of all types gets underway.

Policy mix

For things to turn really nasty, however, there is usually a policy error in the mix. Central Banks and Treasuries go into the current economic storm after several years of relative calm. There is always a fear that fiscal cycles coincide rather than counteract real economy cycles. Greater concern, however, currently surrounds the monetary authorities.

This year's Sub-Prime Mortgage and Collateralised-Debt Obligations debacles exhibited many familiar characteristics:

- Excess lending at the wrong (too low) price
- Contagion to other financial and geographical markets
- Liquidity running out in a rush for the lifeboats
- Irresponsible calls for rescue and difficult calls for regulation
- Officials treating the exposed and the culpable as 'too big to fail'.

The credit 'deleveraging' now underway was, therefore, overdue, but, when banking trust disappears, we face a potentially massive market failure and the need for policy intervention to be framed extremely carefully. The innocent are just as likely to be damaged as the guilty (i.e. not before time, higher interest rates for overdrafts, personal and business loans and mortgages but also risks to the confidence of depositors, as the run on Northern Rock showed). The bad consequences of a financial correction can spill over into the real economy.

For several years, I have been talking about the risks associated with the payments imbalance in the global economy: essentially US consumption growth funded by the savings of other countries and the question as to whether this could continue indefinitely. It was always likely that something would have to give: the difficulty was always identifying when and how.

The ideal way would have been (and still is) for China and others to let their currencies appreciate against the dollar as their economies grew, encouraging a gradual shift of funds and trade flows. At the same time, higher interest rates around the world would encourage more savings generally and allow a gradual rebalancing of debt to incomes whilst dampening inflation expectations. The trouble at the moment is that the dollar adjustment is uneven between the 'floating' currencies (e.g. euro and sterling) and the artificial 'dollar bloc' (renminbi etc).

Another danger to the world economy, however, is that, in reaction to the loss of market liquidity, the Federal Reserve may have loosened monetary policy too soon (target rate cut from 5.25% to 4.75% in September and to 4.5% on the last day of October, despite strong third quarter growth figures). In the near term, interest rates may not be high enough to avoid locking in inflationary pressures that are already evident in currencies, bonds and commodities (the long bond yield has been volatile and gold is over US\$790 an ounce). This may indicate a return to inflationary 'boom and bust'.

In October 1987, for example, interest rates were lowered around the world after a stock market 'crunch'. The underlying economy was strong, however, and lower interest rates fuelled a boom in 1988 and 1989 which led to an acceleration of inflation. Interest rates had to be ratcheted up again, arguably higher than would otherwise have been necessary, (exacerbated in the United Kingdom by the other policy error of informally tying sterling to the euro), and the inevitable recession ensued (1990-1991). At the time, people said it was the first Gulf War and the resulting rise in oil prices that triggered the recession. These events were indeed the 'straws that broke the economy's back' but the conditions for recession had been set by the earlier policy mistakes.

The current risk is that history repeats itself two decades later. Monetary policy was very lax in 2001-2004 allowing the 'bubble' to develop and the fear is that it will be again in response to its bursting¹. As a result, the economy may have a new lease of life in 2008 but the seeds of a future recession may be sown. A 'boomlet' now may require a policy correction to address higher inflation expectations later and then, perhaps, after another unforeseen 'trigger', a deeper downturn. The sustained period of low inflation supported by structural change may be starting to wane just when policy makers have trouble setting the right price for money (interest rates) because some financial markets have 'frozen'.

In 1987, the new Fed Chairman who cut interest rates after the stock market fall was Alan Greenspan. Recently he said, "I am coming to the conclusion that bubbles are inevitable. Human beings cannot avoid them... They cannot learn."² In the rush to do something about the 'crunch' in the short term, policy makers at all levels need to avoid doing something that makes things worse later on.

¹ The Taylor rule suggests the Fed got two years behind the curve in the tightening phase.

² Interview with the FT 17 September 2007.

UK Economy

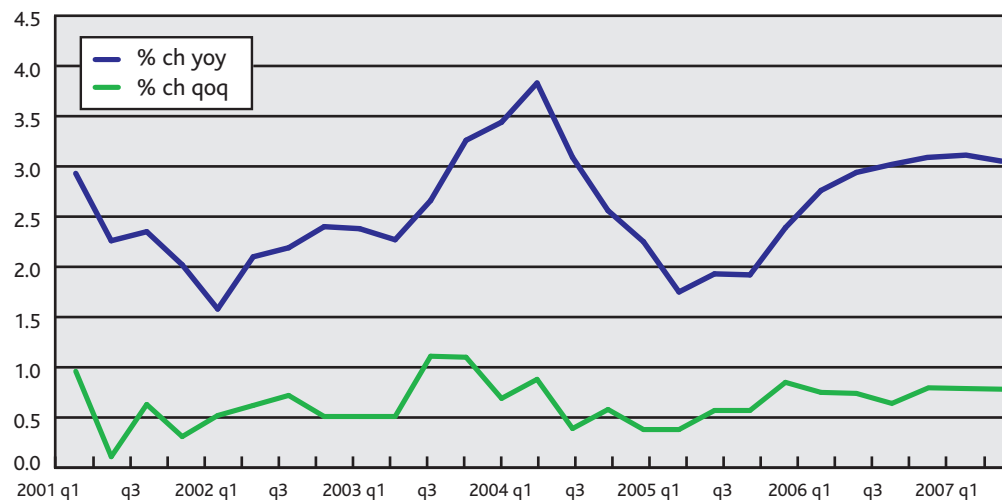
'Batten down the hatches?'

Because the storm is centred on the financial sector, a key contributor to recent UK performance, the national economy is likely to lose momentum... but there is some uncertainty about when and by how much.

2007 robust so far

In the first half of 2007, the economy maintained its forward momentum. As Chart UK1 shows, the economy has experienced year-on-year growth rates above 3% for three consecutive quarters. Indeed, the preliminary estimate for the third quarter of 2007 suggests real GDP increased by another 0.8% in July-September; i.e. unchanged from the previous three months and 3.3% year-on-year. This suggests no forward momentum was lost immediately after the 'credit crunch' and a full year of growth above 3% has been achieved. There must be some risk however, that this latest quarter is revised lower in due course.

Chart UK1: UK real GDP growth 2001-2007 (% change)

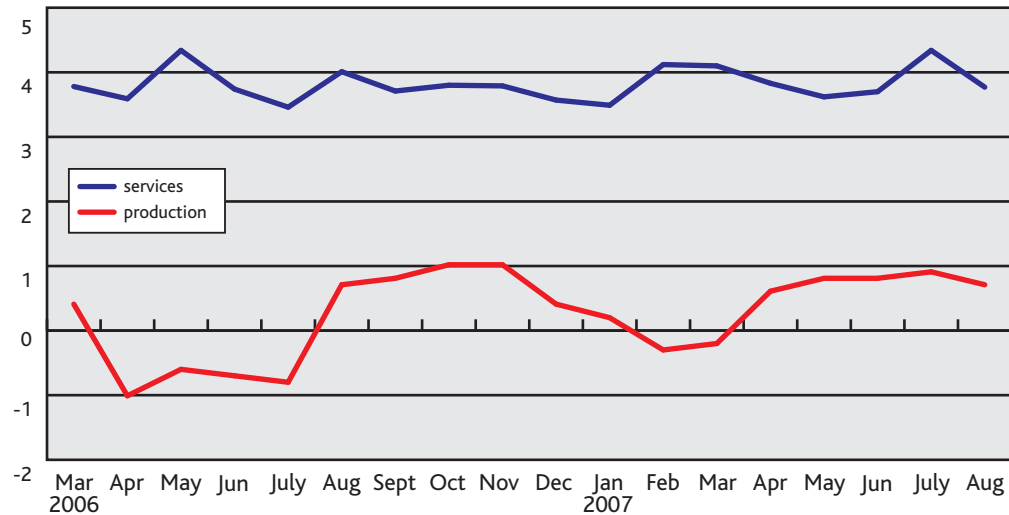


Source: ONS

Other recent evidence shows few signs of a slowdown.

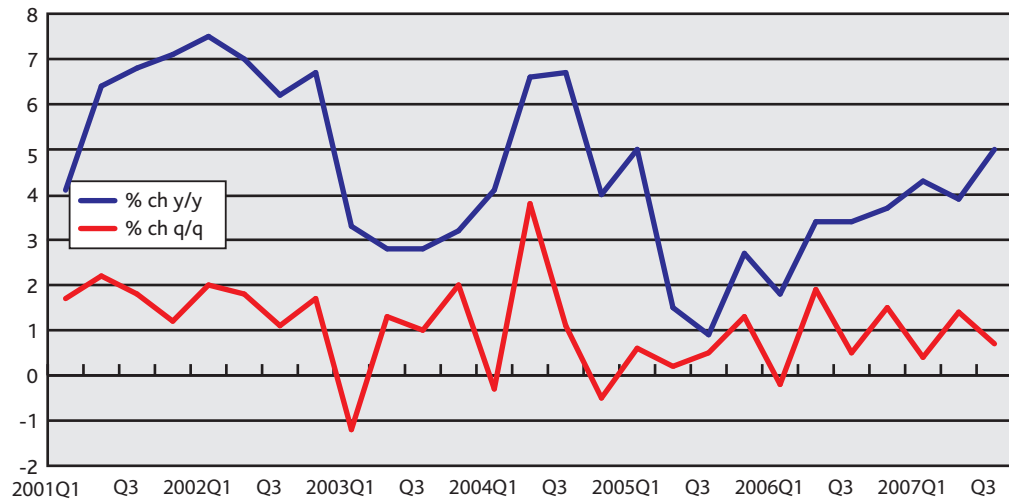
- Chart UK2 suggests little change in the forward progress of industrial production and the output of services in July and August, although the latter was a little weaker than the former.
- Chart UK3 indicates little or no moderation of retail spending growth as people's discretionary income is reduced by higher interest rates, utility bills and local taxes. The year-on-year trend bounced up in the third quarter.
- Survey evidence from a range of trade, finance or other sources has been fairly robust about business and consumer confidence through the third quarter. More concerns about the outlook have been expressed, reflecting the financial uncertainty, but there are no signs of this affecting activity... yet. For example, October's Quarterly Industrial Trends Survey from the CBI showed less business confidence about the outlook with a broad reversion to trend in the balances of opinion. It does suggest, however, weaker growth in the fourth quarter.

Chart UK2: Industrial production & services (% change year on year)



Source: ONS

Chart UK3: Retail sales volumes (% change)



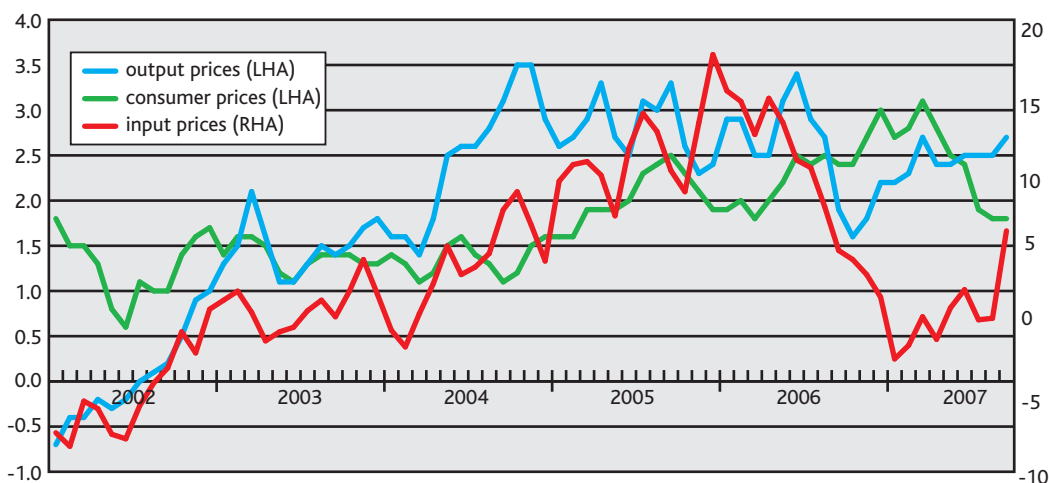
Source: ONS

Turning to inflation, UK input and output price inflation is edging higher: +6.4% and +2.7%, respectively in the year to September (see Chart UK4). Consumer price inflation was steady at 1.8% in the year to September but the inflation tide seems to be turning upwards again.

This reflects partly the renewed surge in various commodity prices, especially oil, metals and foodstuffs. For example, SW dairy product producers have complained this year that dairy inputs are harder and harder to get at reasonable prices as global demand outstrips supply. Milk, butter and pasta prices have risen by at least 25% this year according to EU sources and world cereal prices have been at record levels. These food raw material cost pressures are now moving up the supply chain through producers to the shops. At the same time, oil and some metals and minerals are at record highs, partly reflecting the dollar's weakness.

Higher inflation pressures will also reflect the new monetary environment. The 'credit crunch' affects the distribution but not necessarily the stock of liquidity swilling around the world and, with central banks more likely to be accommodative than tightening in the months ahead, control of the money supply will probably slacken, allowing supply chain price pressures to move through. There are some signs that wage settlements are edging higher in the private sector too.

Chart UK4: Inflation (% change year on year)



Source: ONS

LHA = Left Hand Axis. RHA = Right Hand Axis.

If the supply chain pressure for higher prices and wages continues and is accommodated by monetary easing, it could become a major concern for the economic outlook. The risk is that policy has to be tightened strongly in the medium term, heralding a bigger slowdown than would otherwise have been necessary.

Outlook for 2008/2009

The risk of a negative economic adjustment has risen significantly in recent months, with a greater probability that the economy will go through some 'cold turkey' before it stabilises again. At the extreme, some views are now being bandied about that UK real growth will be 1% lower than it would otherwise have been in 2008. This guesswork would seem to imply recent forecasts of about 2.0-2.5% may come down to 1.0-1.5%. If realised, these rates of growth will be painful enough to mean higher unemployment and an increase in corporate and household financial distress, but may not be too bad for the vast majority of UK businesses.

Of course, the risk now is of something more severe: the 'recession' word is going to be heard a lot this winter. It should be remembered that, even if it is only financial services that slow down as a result of the 'credit crunch', this sector has provided a significant proportion of the UK's (and South West England's) economic growth in recent years.

Furthermore, its tentacles spread widely through the rest of the economy, potentially affecting consumer demand and investment at home and abroad. The recent era of the availability of cheap and easy credit is gone and, whilst investment grade companies may actually find it easier to raise credit in the short term, most will face lenders who are keener to discriminate more strongly between relative risks. Generally, the desire and incentive to hoard cash amongst bankers, businesses and households seems to be rising. This implies less spending on consumption and investment and, therefore, slower economic growth.

Usually, as discussed in the 'world' section earlier, recessions are caused by over tight money – a direct or indirect policy 'mistake' aimed at braking 'irrational exuberance' and dampening excess inflationary expectations. The policy error is often followed by over hasty decisions to retrench by more households and businesses than is strictly necessary. The housing market may provide an early sign of trouble.

Table UK1: Consensus Forecasts of UK economy

	2007	2008	2009
Real GDP	+2.9 (2.8)	+2.0 (2.2)	+2.3
Consumer spending	+2.8 (2.5)	+1.7 (1.9)	+2.1
Investment	+5.6 (6.7)	+2.6 (3.4)	+2.8
CPI	+2.3 (2.4)	+2.0 (2.0)	+2.0

© Consensus Forecasts Economics Inc, October 2007

Nevertheless, the professional consensus remains quite calm. As Table UK1 suggests, the view up to October is that there will be higher growth this year and a more significant slowdown next compared with earlier expectations (July consensus in brackets) but not one as bad as the most pessimistic heralds are predicting. Broadly, the mood has shifted downwards on consumption and investment whilst inflation expectations are still relaxed.

As stated in the previous section, my current concern is about something harsher in 2009/2010, as a result of mistimed or misplaced policy easing that requires over-correction in due course. The Bank of England seems to be trying to resist taking this policy risk but it may face considerable pressure to comply with short term demands for accommodation in the months ahead.

South West Economy

'Trim the sails...'

South West England (SWE) has enjoyed a strong year to date but will not escape the effects of any economic storm to come... SW businesses need to align themselves for this change in the wind.

Regional conditions

We await official ONS data on the region's overall economic performance in 2006, let alone 2007. This is expected just before Christmas and may revise some of our economic 'history', though hopefully not much. Meanwhile, we can use some official data, such as the employment series, and non-official data, such as commercial surveys, to have a view about what has happened more recently.

The latest employment data for the June-August period shows an employment rate, at 78.6%, that is not significantly different from a year ago and an unemployment rate of 4.0%; up from 3.4% a year earlier. These rates are the second highest, after the South East, and second lowest, after Northern Ireland, respectively. The civilian stock of jobs in SWE reached 2.63 million in June 2007 (see Table SW1)

Despite a modest up tick in unemployment, the SW labour market has remained strong through 2007 with the economy still creating new jobs. Inward migration has contributed to this buoyant picture.

Table SW1: Employment and jobs ('000s, sa)

	Civilian jobs	Self Employed	Employed
June 2003	2512	399	2109
June 2004	2582	410	2146
June 2005	2597	397	2194
June 2006	2592	378	2211
June 2007	2630	418	2209

Source: ONS – N.B. this data is a count of jobs, not people

Surveys of economic activity in the region confirm this conclusion on employment and have been relatively strong on output and other measures of activity and confidence in the year to date.

- The October RBS PMI talked of weaker SW activity (output and employment) at the end of the third quarter than at the start but the region continued to expand and at relatively high rates compared with other regions.

- The Bank of England's summary of business conditions in the regions up to late September highlighted an easing of consumer demand, reflecting price discounting to shift stock, and housing demand, possibly after the introduction of HIPs. Exports remained buoyant overall but there was something of a move from weaker US markets to stronger Europe and the Middle East.
- September's Engineering Employers Federation outlook reported an 'upbeat picture' for the regions. Looking ahead three months, the SWE positive balances of confidence on output and employment were at the top of the range.

Regional projections

We have used CGE models based on the SW Regional Accounts to do our bi-annual revision of projections for the region's economy³. This assumes that, despite concerns about the financial markets in the short term, longer term growth prospects remain robust.

As a result, regional nominal GVA is projected to grow quite strongly during the period 2006-2014 (see Table SW2), roughly equal to the national average rate and the fourth fastest amongst the UK regions.

As a result, SW GVA is expected to increase from an estimated £86.4 billion in 2005 to over £98 billion in 2008, and to reach £142 billion, in current prices, by 2014. These projections are little changed from those released last spring, reflecting stronger than previously expected growth during 2007, together with the expectation that any macroeconomic impact from recent financial market volatility will be short-lived in 2008.

SWE is expected to maintain a relatively high rate of population growth, dampening growth in GVA per head. South West GVA per head is projected to grow, from around £16,700 in 2005, at an average rate of around 5.3% during 2006-2014; the 6th highest rate of increase among the UK regions. This implies that SW GVA per head will fall marginally relative to the national level. Indeed, if the very recent ONS demographic projections for the United Kingdom are mirrored in this region, our ability to raise relative growth of GVA per head may be even more difficult.

³ Produced by ESCR for the region and available through the Business and Economy Module website of the SW Regional Observatory

Table SW2: Summary of SWE projections

Annual average % change	1997-2005	2005-2014
SW GVA	+5.6	+5.9
SW GVA per head	+5.0	+5.3
SW employment	+1.8	+2.1
GVA Gloucs, Wilts & N Somerset	+6.1	+6.4
GVA Dorset & Somerset	+5.2	+5.4
GVA Devon	+4.5	+4.5
GVA Cornwall and Isles of Scilly	+6.7	+6.5

Source: ESCR for BEM

The projections predict strong growth of output from construction and from private services, education, health & social work. This is offset by more modest growth in public administration and defence, and utilities (electricity, gas & water supply), as well as zero growth in manufacturing and declining output from agriculture and extraction. These are current price projections which do not allow for the effects of inflation.

Total employment in SWE is projected to rise by around 40,000 a year on average during the period to 2014. This implies an average annual employment growth rate of 2.1 per cent a year during 2006-2014, the third fastest rate among the British regions behind Wales and the South East.

Production employment is projected to decline, whereas service sector employment will expand. The main exception is financial services, where declining output growth together with strong productivity growth imply declining employment over this period.

Recent years have seen marked differences in growth performance across sub-regions of SWE. The north-eastern sub-regions have enjoyed strong output and employment growth since 1997, as have Bournemouth & Poole and Cornwall & the Isles of Scilly. In contrast, 'rural' Dorset and Somerset, and Devon (particularly the urban parts) have grown more weakly. These differences, suggesting a harder outer ring and a softer centre, are projected to continue.

Regional outlook

The previous section deals with projections, which are essentially based on 'business as usual'. As such, it answers the question 'what if recent trends in economic conditions carry on into the future'? This section develops that approach to consider the question 'how might the economy divert from these projections?' It is more concerned, therefore, with the risks and assigning probabilities to alternative futures.

It has been suggested that SWE will be less affected by any imminent economic slowdown resulting from the global 'credit crunch' because the region's businesses are relatively less internationally engaged and regional households are less exposed to high debts. On average, this may be true but it is rather simplistic because it does not consider the range. In particular, problems with housing affordability issues are profound in SWE and government spending (now slowing too) has been an important driver of growth in this region.

In addition, the region's main centres of economic activity are those most likely to be negatively affected: the urban economic centres in and around Bristol, Swindon, Bournemouth/Poole, Plymouth, Exeter and Gloucester/Cheltenham. These are exactly the places where a lot of our most productive output and jobs have been generated in recent years.

SWE may be slightly and relatively less vulnerable to a global slowdown than a UK average biased upwards by financial services in London, but this is not the right comparison. Some of SWE's 'best bits' are part of the global economy and will be affected directly. Many others will be affected indirectly as, with a lag, the impacts spread through housing and other markets to the wider nexus of domestic consumers.

There would seem to be three broad possible scenarios for the near future.

- **Scenario 1:** a slowdown gets underway this autumn with weaker economic growth likely in 2008 – lower export demand, higher loan rates for risky borrowers, softer housing and related markets, and some rise in unemployment – followed by a modest recovery thereafter. This is consistent with the Treasury's view of the UK economy in the next couple of years, as explained in the recent Pre-Budget Report.
- **Scenario 2:** a temporary reprieve is evident during the next year or so as the economy maintains its forward momentum but this later requires a policy tightening (higher interest rates to dampen higher inflation) which threatens a policy induced recession. This hurts SWE most in 2009/2010. This is the main 'high risk' outlook.

- **Scenario 3:** a false alarm as, hopefully, scenario 1 and 2 prove too pessimistic. The current shock is brushed aside as a blip and the current long expansion, now 61 quarters old, glides on as benignly as before. Essentially, this is the projections case outlined above.

The risks attached to these scenarios have shifted significantly recently and the majority view must now be that some sort of a slowdown is coming.

First, the global 'credit crunch' seems likely to slow international trade and financial activity. This will weaken export growth for SW businesses directly and indirectly through its impacts on internationally focused customers in the Greater South East and elsewhere.

Second, there may be a drag on local consumption through lower asset values and income available for discretionary spending.

In the first round, SWE might be less affected than others because of its average, lower international involvement and personal indebtedness. As always, however, the distribution of impact will not be shared equally across this average. Important workers and businesses face greater uncertainty in the months ahead and SW firms need to be prepared to face competitive headwinds.

Nigel F Jump, Chief Economist, November 2007

Why RDAs intervene in the economy

The English Regional Development Agencies (RDAs) are tasked to 'Improve the economic performance of all English regions and reduce the gap in economic growth rates between regions'.

This is to be done in the context of two cross-cutting themes: a) sustainable development and b) economic opportunities for all. It is not straightforward to manage some of the potential trade-offs between these aims. Moreover, it is a tall order to shift the economy of South West England (SWE) in this relative way given spending power of no more than 0.2% of the region's annual output. Indeed, a sizeable chunk of our interventions with money or staff is pre-ordained for use on/by other government policies/departments and there is a growing expectation that we respond to 'shocks'. That leaves relatively little to shift the regional economy's long-run potential, relative to its peers.

Against this background, we need a framework of prioritisation that tries to get the biggest 'bang for our buck'. We can not intervene everywhere – by place or by activity – and tough choices have to be made if we are to reflect adequately the opportunity costs of alternative uses of our resources. Choice about how to allocate resources is the very essence of economics.

There is an argument as to what level of geography or political administration this sort of economic intervention should occur at. Spill-over effects from investments in one area always imply different geographies of investment and impact. As the recent Sub-National Review¹ suggests, there are cases for intervention at various levels but I will park the debate about exactly what and where for another day. Nevertheless, the definition of the English regions as development delivery units in the 1990s recognised strongly that there is something between the state and the local authority where economies of scale and scope can be captured most efficiently.

Economics principles

Economics is all about efficiency: using resources in a way that maximises returns for individuals, households, companies and states. The price mechanism in markets is the best system we have found to make these decisions. But, it is not a perfect tool. Sometimes the market fails. Moreover, with government often contributing a significant part of a modern economy's activity, governments fail too. According to the UK Government, the rationale for public intervention should be based on whether or not these 'failures' exist².

I have heard one SW academic describe market 'failure' as the 'last refuge of a scoundrel', recognising the slippery nature of the concept in practice and problems with clear definition over time and space. One person's market 'failure' can be another's market 'success'. Too rigid a focus on market 'failure' can lead to doing 'bad' things – things that the market should not be doing or certainly should not be prioritising; and not doing 'good' things – not identifying and kick-starting opportunities for future productivity growth. In particular, despite many academic studies showing the importance of informal networks to business start ups, innovation, growth and sustained competitiveness, a rigid focus on 'failure' may not recognise the need to support the softer elements of business culture and aspiration. Nonetheless, with Government departments currently putting so much emphasis on market and government 'failure', we need to understand what it means and how it relates to SWE.

¹ The report of the Sub-National Economic Development and Regeneration Review was published on 17 July 2007: www.hm-treasury.gov.uk/spending_review/spend_csr07/reviews/subnational_econ_review.cfm

² HM Treasury: The Green Book – Appraisal and Evaluation in Central Government (TSO, 2002)

We tend to measure economic performance by how much value is produced and, therefore, what is available to distribute across the population. We relate these output measures to the effort put in to produce them (inputs) and hence, as in previous issues of this Review, we often dwell on productivity as the 'holy grail' of development: the ratio of outputs to inputs and the way it is moving over time. In a well-functioning market, the outcomes will be efficient in terms of maximising that productivity, and therefore, the wealth available for distribution.

There is then a greyer area about equity: is it the brief of economists or politicians to worry about how the spoils of the economy are distributed? The answer of course is both. The economist is interested in how matters of equity interact with efficiency, whereas the politician may be more interested in wider aspects of relative social welfare. In a perfect world, the distinction would be moot but the world is not that perfect...

Market and government failure

What, then, does this term 'failure' mean? Essentially, it is when society, through the market or government, produces results that are not the most efficient and where well-informed and well-constructed intervention might make the outcome better. Economists recognise various forms of this 'failure'.

1. Externalities. Externalities is a 'catch all' phrase for cases where the market fails to account for all the costs or benefits associated with a particular activity and, therefore, too much or too little may be produced and consumed. These elements usually arise because ownership is, at best, 'fuzzy' and, as a result, price signals are biased: do not fully reflect all costs and benefits.

Externalities can be positive or negative and the state often uses taxes, subsidies or regulation to address them. In SWE, a positive externality might arise from the work the RDA does to regenerate brownfield sites, i.e. these investments create wider benefits to the community above and beyond the immediate output or jobs created on the site. Without our intervention, the private market, unable to capture these wider benefits, might not do the job at all or, at least, not to the optimal extent, leaving a negative externality of relative dereliction in place.

Another example might be related to when the RDA insists that the buildings it develops meet high environmental standards. Without that requirement, the market incentive may be to do things 'on the cheap' – not recognising the external costs of inefficient energy usage. Consequently, the ecological footprint of private developments might be higher than desired – a negative environmental externality.

2. Public Goods. Some activities create benefits which nobody pays for, or would pay for if asked, because they are shared by everyone. There is reluctance by private entities to do 'something for nothing'. RDA investments in the public realm, for example, seek to provide citizens and businesses with a community environment that adds value to their lives and activities. Done well in the right places, public realm works can attract more private investment and jobs to an area. The RDA may be able to provide this injection or the leadership to get businesses together to further the cause. Our works to improve the waterfront in Torquay are aimed in this direction. Another example would be our investment in the South West Regional Observatory – a resource of regional intelligence for the benefit of all.

3. Merit Goods. Merit goods are things that are good for all of us but the individual person or business has no incentive to provide optimally. Education and training are often seen as an example of a merit good. When the RDA invests in specific sector skills, such as our three marine training centres on the south coast, we are recognising that there are wider benefits to the labour market and the community of having well-trained, highly-skilled workers beyond the wages of those workers or the profits of the firms that employ them. The private sector may not initiate or provide all this training out of its own pockets and is more likely to engage if we help to 'kick start' the programme.

4. Information. Often the most frequent form of failure is when two sides of an exchange have different or less information than they need to make good decisions. This can mean that bad economic choices and, indeed, some 'moral hazards' occur. In these circumstances, the RDA may intervene to make things happen quicker and better than they would otherwise if individuals had to assemble all the necessary information themselves. Also, we may be able to be more long term in our assessment of the risks, as with our lead on the Wave Hub project.

On the other hand, the Agency often needs to beware of creating a 'moral hazard' whereby one of our investments creates a presumption that we will prop up an activity indefinitely. We face this issue with a few of our investments in the region where the revealed financial viability of an organisation, often one with strong non-profit motives, is less than was hoped. Generally, we need to develop a culture of making the 'exit' as well as the 'entry' to interventions easier, without attracting political opprobrium or reputation risk.

5. **Market power.** Markets work best when participants have equal power to influence the outcome. Intervention may wish to reduce barriers to competition and co-operation. Hence, governments often have anti-monopoly legislation to prevent anti-competitive behaviour that exploits their citizens. A different example might be the way the RDA invests in new technologies in order to make sure that the results are open to as many parts of a supply chain as possible and not just for the benefit of the 'primes'. Our investment in the Composite Materials Centre at Filton is a case in point, where a condition of our involvement is that a range of players have access to the Centre's facilities.
6. **Government.** The public sector often skews markets itself. Both unintended and intended consequences of policies can 'crowd out' good behaviour and 'crowd in' bad behaviour. There is some debate at the moment, for example, that the Government's plans to simplify Capital Gains Tax on businesses will affect the timing of business sales before next April. Also, the regulatory/bureaucratic nature of public administration can sometimes distort activity and the Government can create its own information and other externalities by pushing the market in sub-optimal directions. Most of these sorts of failures are unlikely to be fixed at a regional level by the RDA.

Equity and environment

The 'failures' discussed above have been couched in terms of intervention to increase economic efficiency and these are the main reasons for RDA activity in SWE. There are also issues of equity – equality of opportunity, outcome and process – and environment – inter-generational and inter-spatial aspects of development with respect to resource productivity and welfare. These factors can coincide or cut across any analysis of 'failure'. In most cases, the trade-offs and complimentary relationships between efficiency, equity and environment need to be considered. The paper later in this Review on a Regional Indicator of Sustainable Economic Well-being is one approach to these issues; trying to measure relative regional performance by looking at wider sustainability issues in welfare creation.

The economics of place³

There are two broad views on the 'economics of place'.

- The first is convergence. As one part of an economy heats up, attracting jobs, boosting wages and pushing up other living costs, there is an incentive for future economic investment to be diverted elsewhere to less expensive locations. On a global scale, this is seen to happen when tasks or businesses move from high cost locations to low cost locations. Within a fairly homogeneous economic geography like England, however, there are barriers to such shifts and economic 'divides' tend to persist for many years.
- The second is agglomeration. There are benefits to 'networking' and companies, workers and the wider community benefit from 'clustering' together and concentrating economic activity in what have come to be called 'city regions'.

Technology, fashion and other factors can mean that the spectrum between convergence and agglomeration waxes and wanes through time. This fluctuation can make it very difficult for regional development investments to produce quick results. Wealth, knowledge, behaviour, and barriers or trends in mobility may be conspiring to work against the overriding goal for narrowing growth differentials as outlined at the start of this paper.

Place is a public good itself. SWE has some great places which we do not want to alter just for the sake of economic development. On the other hand, 'nimbyism' can get in the way of some good development opportunities. The tensions that different motives and values can create means even greater need to base investment choices on sound intelligence and analysis. The 'failure' framework is one tool for this but there are other factors at work. In an era of rapid globalisation and climate change, all regional partners need to assess the right scale and place of intervention in a co-ordinated way that avoids unintended negative outcomes within and without SWE.

Nigel Jump, Chief Economist

³ Communities and Local Government: A Framework for Intervention – Economics Paper 1 (September 2007)

Regional Index of Sustainable Well-Being

A complimentary measure of Regional Economic Development⁴

Introduction

There are many different measures of economic performance. The most commonly used at a national level is gross domestic product (GDP). At a regional level, partly because of the problems in measuring regional trade flows, gross value added (GVA)⁵ is the equivalent measure.

Economists and statisticians have always made it clear that GDP and GVA are measures of economic activity (output, income and expenditure) and not equivalent to final welfare. Nevertheless, they are commonly used to proxy this ultimate goal because measurement techniques for GDP and GVA are relatively well-developed, and even when they do not capture all the elements of economic well being, they tend to be correlated with both the level and trend of underlying economic performance.

Increasingly, however, the 'externality' effects of economic growth that are not captured by GDP or GVA have become more widely recognised (see market failure analysis in previous article). It has been argued that 'externality' effects (positive and negative) increase in relative and absolute importance as standards of living increase beyond basic sustenance and shelter.

The development of a Regional Index of Sustainable Economic Well-being (RISEW) is an attempt to take account of social and environmental factors of well-being more explicitly than in standard regional accounts. Although far from perfect, the RISEW is a step forward in estimating regional outcomes more closely aligned to how individuals assess that their quality of life has changed.

Rationale

The research was commissioned by a number of English RDAs because they have a remit to pursue sustainable economic growth. An alternative measurement to GVA that factors in the non-market aspects of economic growth would be useful to inform their understanding of whether regional growth is sustainable.

Governments have previously tended to adopt non-monetised indicator sets without aggregation, such as the UK's Sustainable Development Indicators⁶, which cover a wide range of issues but make no attempt to measure them on a comparative basis. These sets of indicators suffer from not having a common unit of measurement, avoiding hard choices about how to weight different variables and their respective directions of travel, and not providing regional comparators. Real monetary value remains the best available standardised unit of account. An index that adopts a monetary comparison of sustainability is, therefore, potentially valuable.

Results

The main findings of the research are that, for the period between 1994 and 2005:

- English GVA per capita grew by 31% to £18,000
- The national RISEW per capita grew by 44% to £10,700
- As a result, the absolute gap between these measures widened from £6,400 to £7,500

The report paints this last point as a bad thing but this is partly misleading. In real terms, the gap has closed somewhat and, in proportionate terms, the well-being measure rose from 52.9% of the output measure to 59.4%. So, by 2005, the country was 'better off' in traditional terms than ten years earlier and, relatively, even more 'better off' in sustainability terms.

The rising trend in RISEW over the period has been driven primarily by strong growth in consumption, increased public expenditure on health and education, and significant reductions in air pollution. The most important countervailing forces (tending to keep the RISEW below GVA) are the costs associated with resource depletion, the growing impact of income inequality and the costs of failing to provide for long-term environmental damage from climate change.

⁴ Produced by the New Economics Foundation (NEF) for a consortium of English RDAs - July 2007.

⁵ GVA = GDP – product taxes + product subsidies

⁶ UK Government Sustainable Development Strategy, Securing the future (March 2005).

Some regions do significantly better than others in terms of RISEW. In particular, South West England (SWE) comes out relatively well. It is the region with the highest RISEW per head in 2005 and with the smallest gap between GVA per head and RISEW per head. Chart SEW1 shows the South West RISEW per capita against its equivalent GVA per capita. It shows a fairly consistent and positive relationship between the two. The second chart (SEW2) shows the upward trend in England's RISEW per head and SWE's position well above the average. Again, the apparent correlation is positive for the use of the index going forward.

Technicalities

As with any evolving measurement, there are technical issues to be clarified about the index. A few of the problems that can be associated with the RISEW are:

- Availability of regional data is poor for some of the sustainability measures
- Methods to approximate and apportion these regional indicators are open to dispute
- Timeliness – the data needs to be up to date and capable of projection for meaningful evaluation and decision making
- There could be an element of double counting – for example, a car accident is a 'negative' adjustment but, if a person in the accident then receives health treatment/expenditure, this can count as a 'positive'
- Constant price adjustment – the GDP deflator is used in the absence of regional price deflators, yet the whole premise is not to use GDP as the base measure. Price deflators for the other factors are also largely not available.

Therefore, the use of the index needs to be carefully considered and further efforts made to improve the index in the future as data sources improve.

Chart SEW1: SWE GVA and RISEW per capita, 1994-2005 (£ per head)

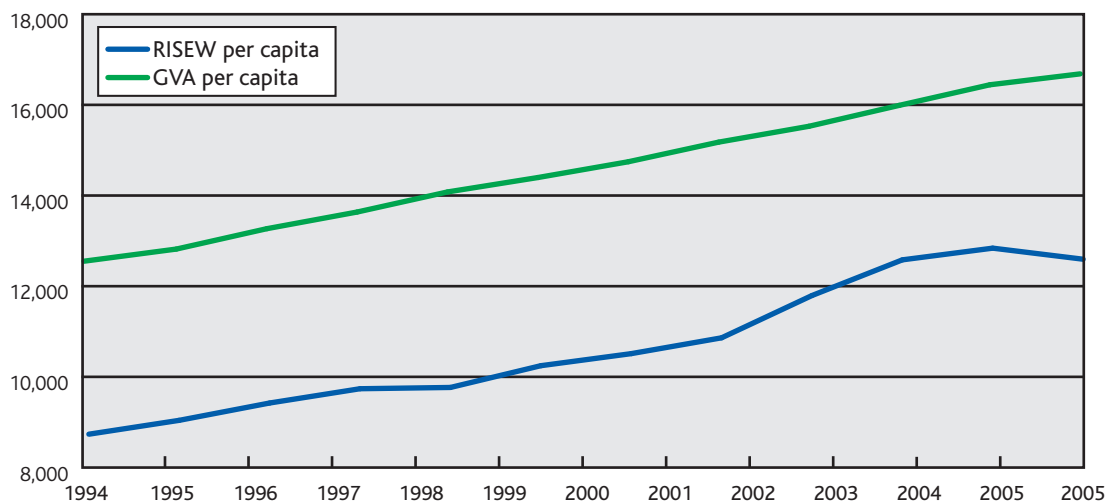
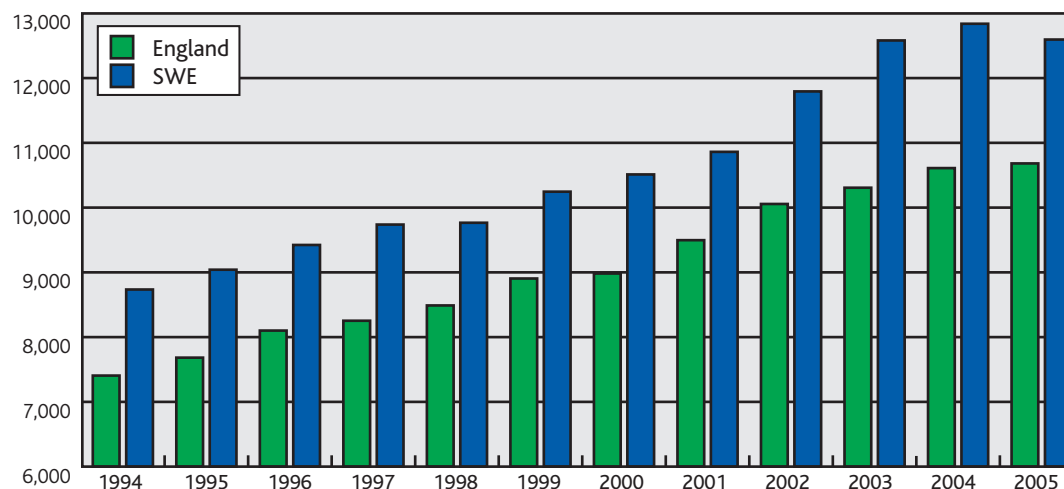


Chart SEW2: Trend in SWE RISEW relative to England's average, 1994-2005 (£ per head)



Components

In this section, we make brief comments about the separate variables that constitute the RISEW in order to highlight some of the 'grey' areas that still need to be addressed.

Economic variables:

1. Consumer expenditure. This is a suitable proxy for current living standards but may underestimate the total because it does not capture everything that households 'value' or 'consume'.
2. Net capital growth – physical capital in relation to human capital is considered but there are data issues.
3. Net international position – it is not clear how this is measured at a regional level. Goods data only are used to weight national figures and GVA is used to weight incomes/transfers.
4. Durables adjustment – some of 'current' consumption is in fact a purchase of services flows over more than one period. Depreciation and obsolescence factors have to be incorporated but are not known so a simple assumption is made.

After adjustment for these four measures; England's overall economic welfare is reduced by about 5-7%. Some regions move more than others however, so regional disparities remain significant. Nevertheless, the total welfare range between the regions is narrower after this adjustment.

Social variables:

The elements in this section attempt to account for social sustainability.

5. Unpaid activities, such as domestic chores or volunteer activity, are added by using regional time use data and national opportunity cost wage rates to get a shadow wage. There is room for debate about this approach.
6. Public spending on health and education can be seen as positive or defensive (i.e. repair the social and environmental damage of economic growth). Here, all are taken as positive. Therefore, the surge in such public expenditure from 1997 onwards is a key element.

These first two positive social factors tend to push the index above average English GVA.

7. Income inequality – this is crudely taken as a negative factor on the assumption that society is averse to inequality. This is too simplistic: there are really different ranges of income distribution: occasions when greater income inequality may be seen as positive – rewarding talent; neutral – fair distribution of rewards for relative effort; and negative – excess returns to certain activities.
8. Crime – the research uses costs of crime and incidence rates. The well-recognised difference between recorded and actual crime is a complicating factor. This measure tends to reflect urbanisation but gaps between areas are narrowing over time.

9. Divorce – this is assumed as negative, potentially exposing a gap between micro (individual) and macro (society) perception. If divorce is a net negative, why do more and more people do it? The logic that all break ups of personal relationships should be considered as a cut in welfare because it creates costs is debatable. It suggests a classic externality problem between individual and social well-being that may be contentious.
10. Commuting and car accidents – for commuting, there may be an element of double counting because these costs are already in people's decision to work and consume in a particular pattern. In particular, the inclusion of lost leisure time seems odd – unless people are behaving irrationally – if they chose to commute at the expense of leisure, it must be because the net value of the consequences of the former outweighs the net value of the latter. If this element just looked at the externality effects that were included, it would be easier to justify.
11. Industrial accidents – it is not clear what is driving regional trends and disparities in this area.

After all the social factors are incorporated, the index is below GVA but above simple consumers' expenditure. The SWE 'lead' is enhanced because of our relative lack of the social negatives which may largely reflect the region's greater rural characteristics: some of the social negatives tend to be worse in urban areas.

Environmental variables:

12. Water pollution – effects tend to be small and falling, based on river quality.
13. Air pollution – effects are large but falling, especially in regions of high fossil fuel based power generation.
14. Pollution abatement – again tends to be related to power and industry concentration.
15. Noise pollution – largely related to cars and planes. The latter tends to be relatively small and very concentrated but may be growing with the growth of regional air traffic.
16. Loss of farmland and natural habitats – It is not clear why the loss of farmland is assumed to be negative. There seems to be no attempt to objectively assess whether there is 'too much' or 'too little' to start with and the relative value of the 'new' use that land is put to is very relevant as well. SWE has seen an increase in this measure: is that unequivocally good? Soil erosion and habitat loss are similar but because of relative scarcity probably more justifiable as a negative – accurate valuation, however, is very difficult.
17. Climate change – measured as green house gas emissions (largely from road, power generation and industry). Regional measurements on this are notoriously difficult and there may be other elements to it besides emissions.
18. Resource depletion – this measure seems to be entirely energy focused – hence the South West is the lowest on this measure of cost. End-use is more relevant and what about the non-renewable material content of consumption?

Conclusion

The RISEW is an improved attempt at measuring sustainable welfare and reflects the growing sustainable development agenda. We feel that it will encourage debate but recognise that some of the detailed measures within it need more thought. Importantly, we feel that the issue of weightings between the variables needs to be considered carefully. The weightings have a big impact upon the end result. There is also the fundamental problem of defining 'whose welfare'? As outlined earlier, do divorce or loss of farmland necessarily represent welfare loss and does spending on salaries in defence or health necessarily result in overall welfare gains?

Generally, however, SWE does relatively well on the RISEW because it has high levels of consumption and unpaid work, but lower crime and pollution. It is also aided by its population structure and density.

Shane Vallance, Evidence Manager

South West RDA 'Mood of Business'

Through our colleagues with direct contact with SW business, we try to capture the 'mood' of SW business in an up to date but, necessarily, anecdotal way.

Our latest taking of the business temperature suggests that fears about contagion from the uncertainties in the financial markets have yet to percolate down significantly to the region's businesses. There is little evidence of widespread company-level concern about the risks associated with the weak dollar, volatile credit markets, falling property markets or weakening growth. Indeed, the mood amongst some of our most dynamic sectors is upbeat with aerospace activity at an all time high, bio-medical technologies described as 'buoyant' and ICT/digital services 'positive'. There are some general comments about a slowdown in the commercial property market.

Within this generally positive current picture, there are some emerging concerns and some issues that are more longstanding. For example, there is concern in the aerospace sector over the future of the Filton site and the prospect of environmental taxes on aviation. Moreover, cuts at the BBC are expected to have a negative impact on the Digital Content sector.

The inadequate supply of land and buildings remains an issue in most areas, as do skills shortages. With respect to the latter, there is a perception that responsibility is shifting to employers (demand) rather than a simple focus on Government agencies (supply). Some companies, however, are not happy with this and it raises an issue about the balance of risk and social benefit – a potential market failure problem (see relevant previous article). Although not generally an issue, one firm reported a moratorium on the recruitment of migrant workers to avoid an imbalance with the indigenous workforce.

There are a number of interesting sector developments in the offing, including: potential collaborations in the Biotech and Medical Technology sector with the Chiba region of Japan following successful mutual trade missions; the forthcoming sale of communications spectrum by Ofcom and a new supply chain initiative led by the Society of British Aerospace Companies.

Sub-regionally, in Somerset, the impact of the recent foot and mouth disease restrictions; global credit and US export markets were mentioned as constraining factors on business activity. From Devon, there was some mention of a reversal of off-shoring (Plymouth), and a shortage of skills (wider county), as well as confusion over environmental issues, transport, land and premises around Exeter. In Dorset, the shift to more mixed commercial/residential zoning is said to be pushing up land prices. Here, dollar weakness and skills gaps for engineers were also highlighted as elements holding back expansion. Meanwhile, parts of Gloucestershire are still recovering from the negative effects of the summer's floods.

To support this assessment of the 'mood' of SW businesses, we also monitor the following surveys of economic conditions from other organisations. The dates refer to the latest editions we have seen

- Agents' summary of business conditions, October 2007, Bank of England
- Engineering Outlook, September 2007, Engineering Employer's Federation (EEF)
- Forecasts for the UK Economy, October 2007, HM Treasury
- PMI South West Report, October 2007, Royal Bank of Scotland
- Employment Outlook Survey, Q4 2007, Manpower
- Quarterly Survey of Small Businesses in the UK, Q2 2007, Small Business Research Trust (SBRT)
- UK Business Confidence Monitor, Q3 2007, Institute of Chartered Accountants in England and Wales (ICAEW)
- UK Economic and Property Market Review, Q3 2007, GVA Grimley
- CBI Quarterly Industrial Trends Survey, October 2007

Outlook for the United Kingdom

Forecasts for the UK Economy (HMT) for October 2007 reflects the predictions of 28 forecasting organisations. The report suggests a predicted fall in real GDP growth over the next year to 2.0% following the recent global 'credit crunch', after a sustained period of quarterly growth.

The **Bank of England** reported a number of UK 'mood' changes in October. Growth in consumer spending slowed, reflecting heavy discounting by retailers as a result of the need to reduce stocks following the impact of adverse weather conditions on summer sales. Service sector investment intentions fell sharply, while demand for housing continued to ease, but it is too soon to blame these developments on recent financial turbulence. Companies' employment intentions eased in September, mainly due to developments in the service sector. In contrast, according to **Manpower's Employment Outlook**, the fourth quarter of 2007 will show more positive hiring trends. Finally, the **Bank** said that input price inflation fell, reflecting falls in energy prices, and output price inflation rose.

October's **CBI Quarterly Industrial Trends Survey** talked of manufacturing resilience to the credit squeeze. Sentiment has deteriorated but not yet to any worrying extent. Investment intentions are being reined back but show no signs of a marked drop: the balance of motive has shifted, however, with a higher percentage of respondents looking to increase efficiency and replace old equipment and less looking to expand capacity. The upward trend in inflation pressures remains evident in costs and prices.

According to **EEF's Engineering Outlook** (September 2007), the future for the manufacturing sector is optimistic with output and orders remaining healthy in the third quarter. Domestic demand outweighed export demand for the first time since the fourth quarter of 2002, perhaps pointing to the United Kingdom's strong relative position against the United States which is experiencing a weak dollar and an economic slowdown. In addition, falls in profit margins eased as a result of the changes in input and output inflation reported by the **Bank of England**. Manufacturing investment intentions remained buoyant despite the developments in the financial services sector.

SBRT's Quarterly Survey of Small Businesses reported buoyant growth for smaller businesses in the second quarter of 2007, with increased growth in sales and a solid investment performance. On the other hand, micro businesses (1-2 employees) have been performing less well with falling employment levels and easing investment growth. This trend is likely to continue in the short term, with the **Barclays' Small Firms in Britain** report predicting that, though the rate of economic growth may slow, it will take a while for this to feed through to the small business sector. For now, small firms can expect further growth in sales and investment, while the outlook for micro businesses is steady.

The **Economic and Property Market Review** published by **GVA Grimley** forecasts all property rental growth to peak at the end of this year, following strong service sector performance in early 2007. Rental growth is forecast to fall by 4% per annum (pa) in 2008 and then 3% pa by the end of 2011. In terms of investment and property yields, the report comments on exceptionally high levels of return witnessed between 2004 and 2006, which are now beginning to level off and are expected to fall next year before returning to normal levels by 2009. Total property returns are set to average 7.3% per annum over the period from 2007 to 2011.

Outlook for South West England

According to the latest **RBS PMI South West Report**, private sector output eased after August's high, but remained above the UK average (the fourth strongest of the twelve regions). Encouragingly, South West England (SWE) experienced an increase in employment for the twenty-first consecutive month, and remained the strongest region for job creation. Input prices continued to rise, for the sixty-eighth consecutive month, attributed mainly to commodity prices, in particular steel, oil and dairy products.

The **Manpower Employment Outlook Survey** predicts that SW employment growth will slow in the fourth quarter of 2007 but will remain strong relative to the rest of the United Kingdom. In contrast, the **Quarterly Survey of Small Businesses in the UK** (SBRT) reports that, in the third quarter, SWE was among the most pessimistic in terms of employment which may point to a future slowdown in the region.

Both manufacturing and service sector growth slowed in September, with the effect on the latter being greater due to general uncertainty following the recent turmoil in credit markets. **Engineering Outlook** (EEF) is optimistic about the future of the manufacturing sector with a strong SW performance predicted in the next quarter, in terms of output, total orders, and employment.

However, the future of the service sector does not look positive, with the 2007 Q3 **UK Business Confidence Monitor** (ICAEW) reporting the lowest business confidence levels in over a year and a half. This is attributed to negative house price growth and higher interest rates. Turnover growth in the region is expected to fall in the next twelve months, and the amount by which profits are set to increase (by 4.4%) is the lowest of all the regions. Sales volume growth is also set to rise by the lowest amount, with export sales affected by the weak dollar. Consequently, finance professionals have reduced their expectations of capital investment growth, and this has again sunk to the lowest rate of growth across all regions. As a result of these changes, the study mirrors the expectations of the **Manpower** survey, predicting an easing of employment growth in the coming months.

Conclusion

National and regional economic conditions have eased in recent months but remain at good levels. In SWE, confidence about the future is not as strong as it was but a slowdown is expected rather than something worse. Skills and infrastructure remain long-term concerns in the region and there are specific issues for certain sectors and places. The cyclical risks of slower growth, however, have yet to affect the broad 'mood' of the region's companies.

Donald Barr, Evidence Adviser
Ian Jepson, Economics Assistant

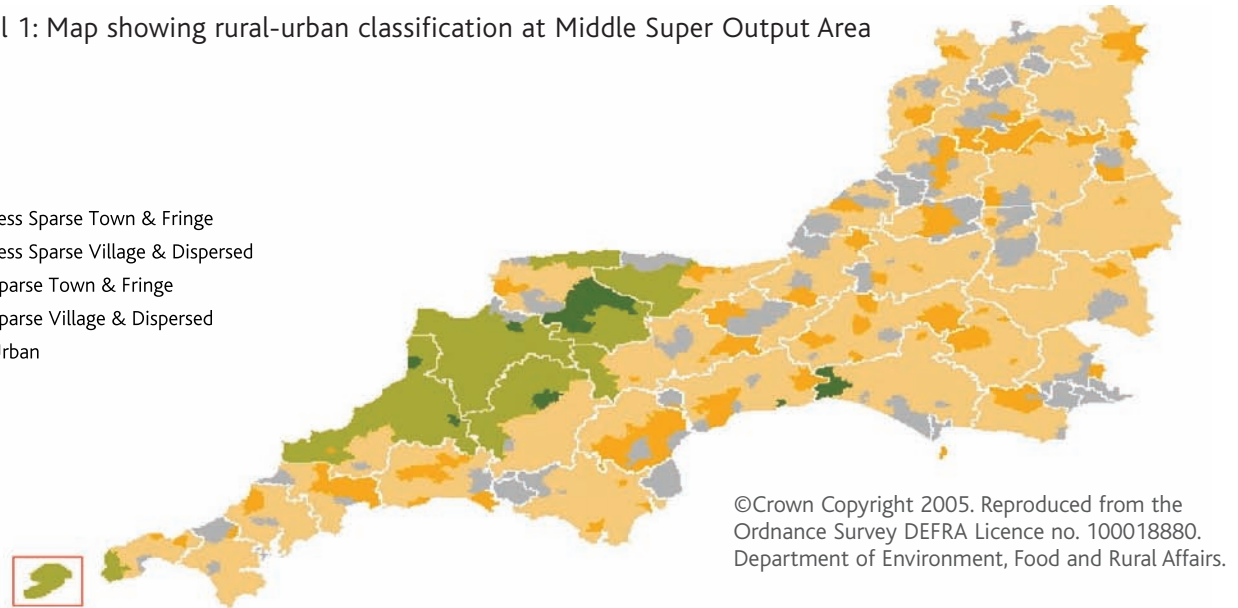
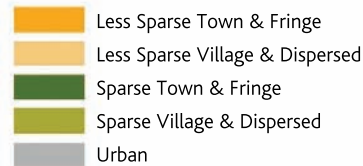
SW Rural Economy

The rural economy or the economy in rural areas?

Much is spoken of the 'rural economy' and its importance to the South West, the most peripheral and most rural of the English Regions. But, is there such a thing as the 'rural economy'? Do rural areas have sufficiently different an economy to their urban counterparts that this term can have any sensible meaning? Or when we talk about the 'rural economy' do we really mean the 'economy in rural areas'?

Understanding the difference in the underlying meaning of these two expressions, and which one we are really talking about when we use the term 'rural economy', could help to determine where and how public sector interventions might be made to help rural business more appropriately and effectively. If rural economies are fundamentally different from urban economies, then support mechanisms and other interventions may need to be radically different. If not, it is more a matter of adapting development for more dispersed areas.

Chart Rural 1: Map showing rural-urban classification at Middle Super Output Area



Clearly, the South West is a rural region – more than a third of the population live in rural areas (2001 Census), compared to a 19% average for England. Issues that acutely impact upon rural areas frequently make the regional headlines. For example, housing affordability is particularly acute in attractive, rural areas, where prices can be relatively inflated and wages relatively depressed. There are consequent sustainability issues – both around sustainable communities being maintained in the long run and also around environmental sustainability as people commute longer distances for work. But, these are not necessarily rural-specific: housing affordability, travel to work and congestion are also issues in urban areas. 'Rurality' presents severe accessibility issues... for some – to jobs, skills, and other services, but so does urban deprivation. On the other hand, rural areas may offer higher quality of life for some, offsetting higher urban wages for others.

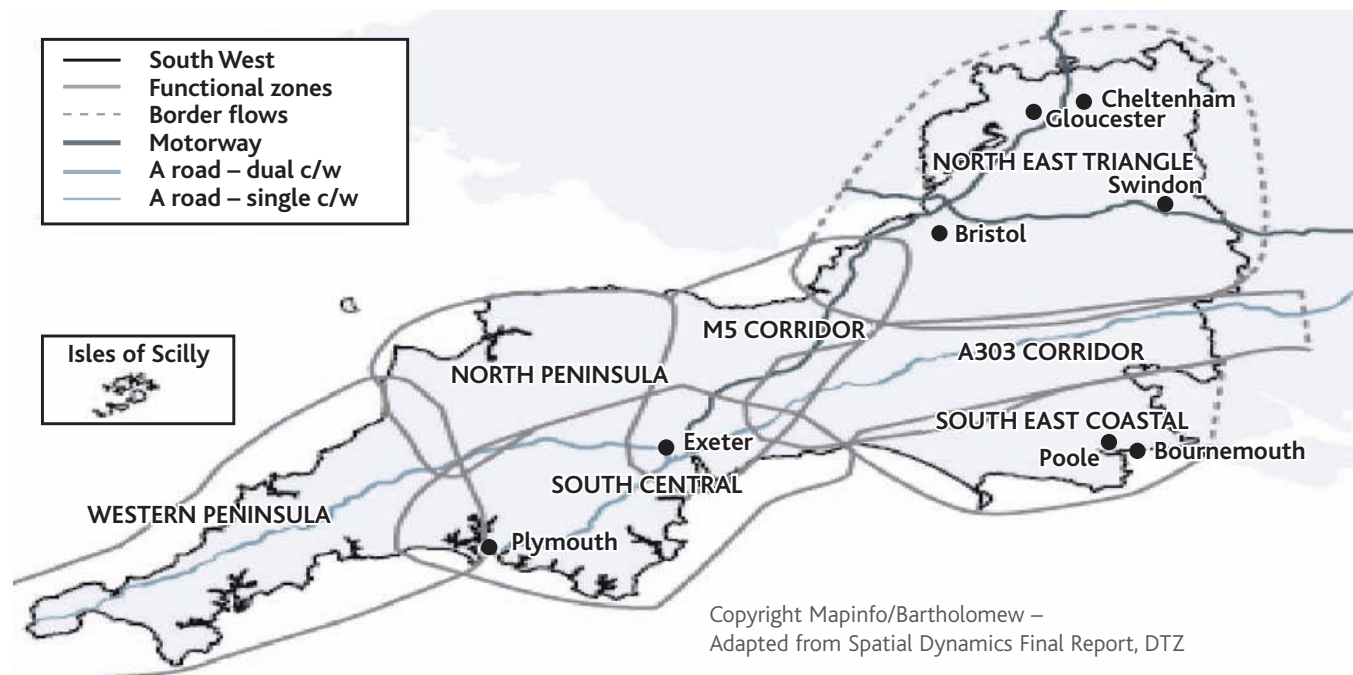
Definition of rural

Rural can be a rather subjective term – what might be rural to some, may not feel rural to others? Indeed, what is rural to the United Kingdom is vastly different from what is rural in many other countries. Only a small proportion of the UK population live in rural areas as defined by the OECD – less than 100 people per square kilometre.

Defra has attempted to address this subjective issue in an objective way. A classification system for a range of small area geographies (wards, super output areas, etc.) has been produced which allocates these small areas to six rural and two urban classes depending on the population size of the settlement in which they lie, and on the sparseness of the population in the surrounding area¹. The distribution of different types of rural areas in South West England (SWE), according to the Middle Super Output Area (MSOA) classification, is shown in Chart Rural 1. The majority of the land area of the South West is defined as rural by this classification, with much of North Devon and North Cornwall sparsely populated.

¹ See Defra website for more details - www.defra.gov.uk/rural/ruralstats/rural-definition.htm

Chart Rural 2: SW functional economic zones



While this classification system gives a detailed picture of the distribution and extent of rural and urban areas across England – and more detailed maps than this are available – a major drawback at present is lack of readily available robust statistics at the small geographic level underpinning the system. Fortunately, Defra has also produced a local authority level definition – also based on a spectrum of rural/urban areas based on population sizes. While this produces a much coarser definition, it does allow assessment of a far wider range of data.

Comparing rural and urban areas

To try and address the question of whether a rural economy exists, an analysis was carried out to determine the relative size, composition, and attributes of economies in rural and urban areas. As we already know that there is huge variation across SWE, the analysis compared rural and urban areas within seven functional economic zones – over-lapping parts of the region defined based on common economic characteristics². These are shown in Chart Rural 2.

A range of data was assessed, including information on VAT registrations, employment by industry, labour market characteristics and earnings. For conciseness, the eight urban and rural sub-classes were merged into three classes – urban (population greater than 10,000), 'town and fringe', and 'village, hamlet and isolated dwellings'.

² Spatial Dynamics, 2004, DTZ for South West RDA. The functional economic zones were originally defined on the basis of 1998 ward boundary definitions. For this analysis, a 'best fit' mapping of middle level Super Output Area and Local Authority boundaries was carried out, and the appropriate Defra classification applied.

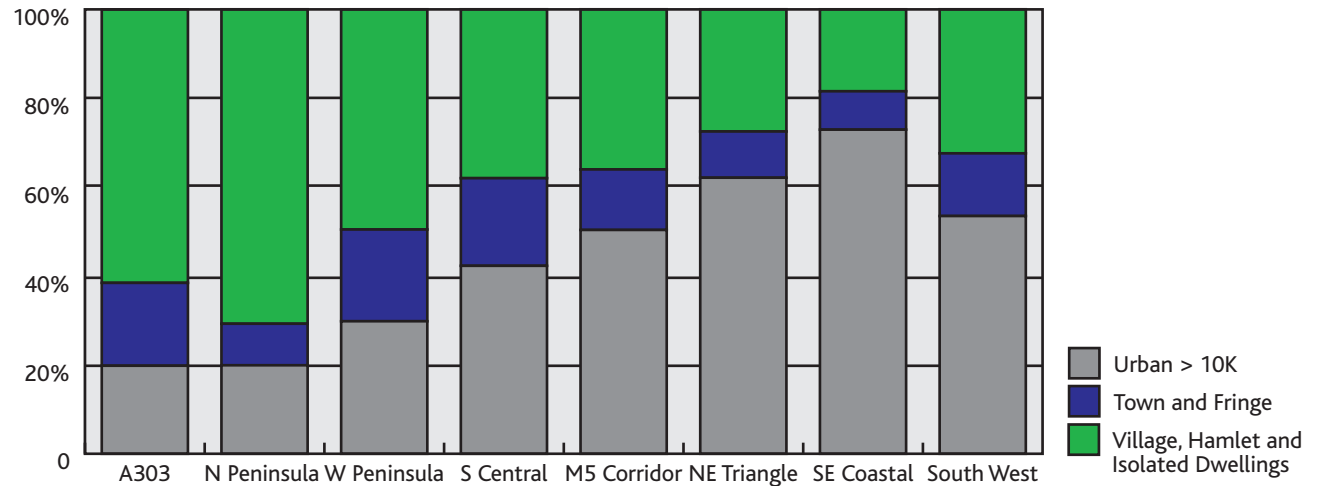
Distribution of businesses

On average, 46% of VAT registered businesses in SWE are in rural areas – 14% in town and fringe, 32% in villages and hamlets. Chart Rural 3 shows the variation in this balance across the seven functional zones. The A303 zone and the North and Western Peninsula zones have high proportions of businesses in rural areas – 70%+. Unsurprisingly, the NE triangle (Bristol, Bath, Swindon, Cheltenham and Gloucester) and the SE coastal (Bournemouth and Poole) zones are mainly urban. SW businesses are concentrated in the NE triangle zone – 44% of all SW businesses and 36% of rural SW businesses.

Broadly speaking, rural businesses are smaller (in terms of employment) and older, though the relative proportions vary across the region. 73% of SW urban businesses have less than five employees, compared to 83% for village and hamlet areas. This trend is seen across all functional zones, though the North Peninsula sticks out with 83% of all businesses in this category – compared to the SW average of 76% – and as high as 86% in village and hamlet areas.

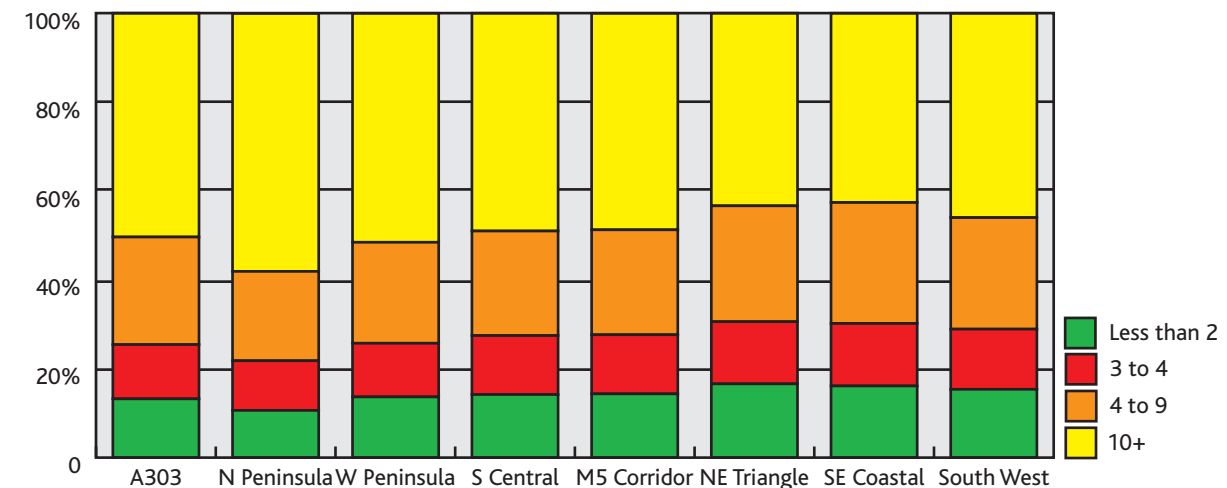
41% of SW businesses in urban areas are aged over 10 years old, while in village and hamlet areas this figure grows to 54%. Propensity of older businesses is an indicator of low business turnover rates, in turn a sign of depressed competitiveness. This suggests possible stagnation of businesses in rural areas. Again, the North Peninsula stands out (see Chart Rural 4) – 58% of all businesses are 10 years or older. The A303 zone, however, despite having the highest proportion of businesses in rural areas, fares somewhat better, having only 50% of businesses aged older than ten years.

Chart Rural 3: VAT-registered businesses by rural-urban class, 2007



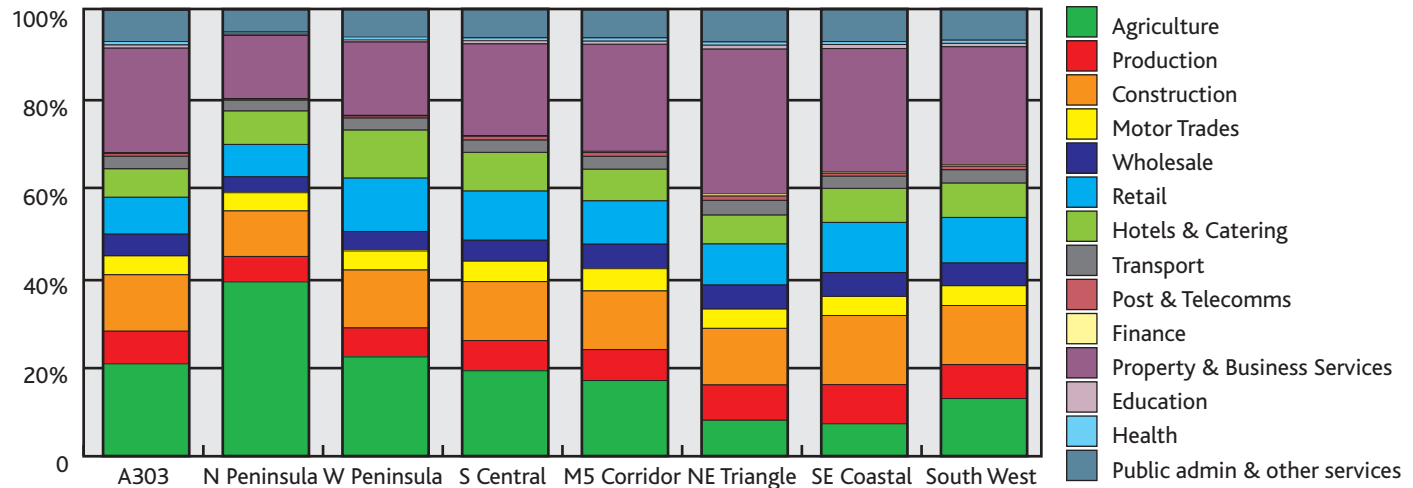
Source: VAT based enterprises, Neighbourhood Statistics, ONS

Chart Rural 4: VAT-registered businesses by age and rural-urban class, 2007



Source: VAT based enterprises, Neighbourhood Statistics, ONS

Chart Rural 5: VAT-registered businesses by broad sector, 2007



Source: VAT based enterprises, Neighbourhood Statistics, ONS

VAT registrations

In terms of broad sector composition, unsurprisingly there is greater reliance on agriculture in more rural areas. Indeed, in the North Peninsula 39% of businesses are in the agriculture sector – see Chart Rural 5. This represents a fifth of SW agriculture, although the North Peninsula contains less than 7% of all SW businesses. However, when agriculture is excluded from the analysis, there appears to be little difference between rural and urban areas. Differences are more apparent between zones – for example, the distribution of property services, hotels and catering, and retail varies substantially by zone.

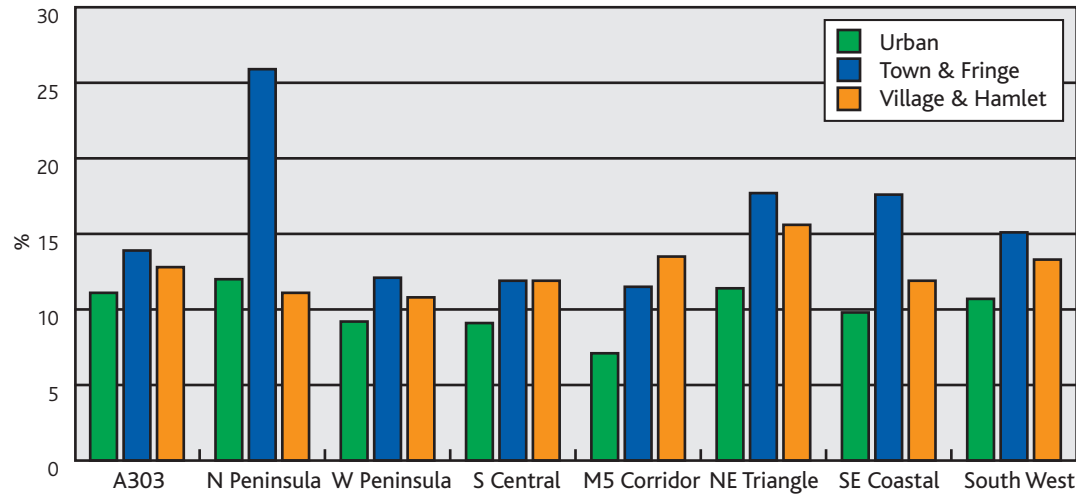
An analysis of business VAT registration and de-registration rates was carried out to compare business 'churn' across SWE using Defra's local authority level rural-urban classification³ and data on business start ups and closures (DBERR).

On average, and across most of the zones, VAT registration and de-registration rates are lowest in rural areas. This is directly linked to the finding that rural businesses tend to be older, possibly due to lower competitive pressures.

Since 1994, looking at the trend in registration rates over time by rural-urban class and by zone, a gap has been maintained between rates for urban and rural areas – though the spread of rates amongst rural areas has closed – perhaps due to increased urbanisation over time. The two most urban areas – NE triangle and SE coastal zones – have higher rates than the SW average and than all of the other zones. The two peninsular zones fall below all the others, though again the gap has closed, and it appears that until 2004/2005, the rates for these areas were increasing.

³ Classifies local authorities in South West as large urban (250,000 to 750,000 popn), other urban (<37,000 or 26% popn in rural settlements), significant rural (>37,000 or 26% popn in rural settlements), rural 50 (50% - 80% popn in rural settlements) or rural 80 (>80% popn in rural settlements). See www.defra.gov.uk/rural/ruralstats/rural-definition.htm

Chart Rural 6: Share of employees in manufacturing, 2005



Source: Annual Business Inquiry, ONS

Employment

Annual Business Inquiry (ABI) employment data from ONS were used to further examine the industrial composition of rural and urban economies. However, at the geographic level used, this largely excludes the agriculture sector (i.e. 27,100 rural jobs).

Broadly, the share of employment in service sectors is lower in rural areas than urban areas, though the relative size of services in towns and villages varies across the different functional economic zones. Service sector businesses prefer urban areas, which serve as centres of employment, and have appropriate buildings and infrastructure.

⁴ As this only includes three Super Output Areas, these figures may be prone to distortion effects of a small number of large (for that area) employers.

De-registration rates have fallen substantially over this period in all zones and all rural-urban classes, with the gap between rural and urban areas closing. As a result, there has been a resulting net growth in business stock, which is higher in the north and east of the region than in the west.

Churn rates – turnover of business stock – are also highest in the north and east, particularly urban areas (19% per annum in NE triangle), and lowest in the more rural areas and far south west – 13% to 14% in the A303, North and West Peninsula zones.

Chart Rural 6 shows the share of manufacturing employment by zone and rural-urban class. Again there is considerable variation, both between classes and between zones. Most manufacturing is found in town and fringe areas; in particular, more than a quarter of employment in town and fringe areas in the Northern Peninsula is in manufacturing⁴. This may be of concern to this particular part of SWE, given the trend employment decline of both UK manufacturing and agriculture.

When you look at a breakdown of manufacturing by sub-sector for each zone and for each rural-urban class, the variation between zones and between rural-urban classes is considerable, suggesting that different rural areas across SWE, just like different urban areas, have rather diverse characteristics, at least in manufacturing.

A relatively large amount of food and drink manufacture occurs in more rural areas (10,000 jobs and 29% of the sector) – this corresponds to around 3% of employment in these areas, compared to nearer 1% of all SW jobs. Also, despite its reliance on agriculture, the North Peninsula has surprisingly low shares of food and drink employment (around 3% of the sector). Compare this to the Western Peninsula (i.e. Cornwall and the Isles of Scilly) where 19% of SW food and drink employment is located (though only 8% of total SW employment). Indeed the North Peninsula sector distribution appears to be very different from the other zones – remember that this zone corresponds to the sparsest rural areas of the region, which will influence the types of sectors that are located there.

The same level of service data is not (yet) obtainable and, using the broad categories that are available, a similar extent of variation between rural-urban and zones is not apparent. Distribution and retail, and health are concentrated in urban and town and fringe; and the North and Western peninsulas have the highest employment shares for hotels and catering, regardless of rural-urban class.

Economic output

Broad estimates of gross value added (GVA) were obtained using output data from the SW Regional Accounts and rural and urban shares of employment by sector at 2-digit SIC code (and business numbers for the agriculture sector). This assumes that productivity levels in any particular sector are equivalent in rural and urban areas.

The estimates (based on 2003 GVA data) suggest that around three quarters of SW GVA arises in urban areas, and that the 'rural economy' accounts for a quarter (see Table Rural 1). This corresponds to around £21 billion (in 2005) – 60% of the rural share arises in remote areas, rather than town and fringe. Naturally this rural-urban balance varies across the region – the A303 corridor and the two peninsular regions produce 50% or more of economic output from rural areas. This compares to 53% of VAT registered businesses in urban areas but 76% of employment (a slight overestimate, as agriculture is excluded).

Yet again, the North Peninsula zone is somewhat different from the other two most rural zones, with 90% of output divided fairly evenly between the urban, and village and hamlet areas. Higher shares of output from the other two areas come from town and fringe areas. For the other four zones, around 70% up to 83% of output comes from urban areas.

Table Rural 1: GVA estimates by rural-urban class and functional zones (% shares)

	Urban	Town & village	Hamlet & isolated dwelling
A303	44	18	39
N Pen	43	12	45
West Pen	51	21	28
S Central	69	14	16
M5	74	8	18
NE Triangle	79	6	15
SE Coastal	83	6	11
South West	74	10	16

Source: Estimated from SW Regional Accounts, Business and Economy Module of SW Observatory and Annual Business Inquiry, ONS

Table Rural 2: GVA estimates by broad industry group (% shares)

	Urban	Town & village	Hamlet & isolated dwelling
Agriculture, etc.	13	14	73
Mining, etc.	20	15	65
Manufacturing	71	12	17
Water, electricity, etc.	81	2	17
Construction	68	12	20
Services	77	9	14
All industry	74	10	16

Source: Estimated from SW Regional Accounts, Business and Economy Module of SW Observatory and Annual Business Inquiry, ONS

As expected, most agriculture output arises in rural areas, as does extractive sector GVA (both 80% or higher) – see Table Rural 2. Construction and manufacturing also have relatively high shares of output in rural areas (32% and 29%, respectively), while services and utilities are under-represented (23% and 19%, respectively).

Interestingly, when aggregating the data to broad sector groups (manufacturing, services, etc.), productivity on average in rural and urban areas are similar – services and manufacturing productivity do not appear to be affected by any differences in the sector mix in rural and urban areas.

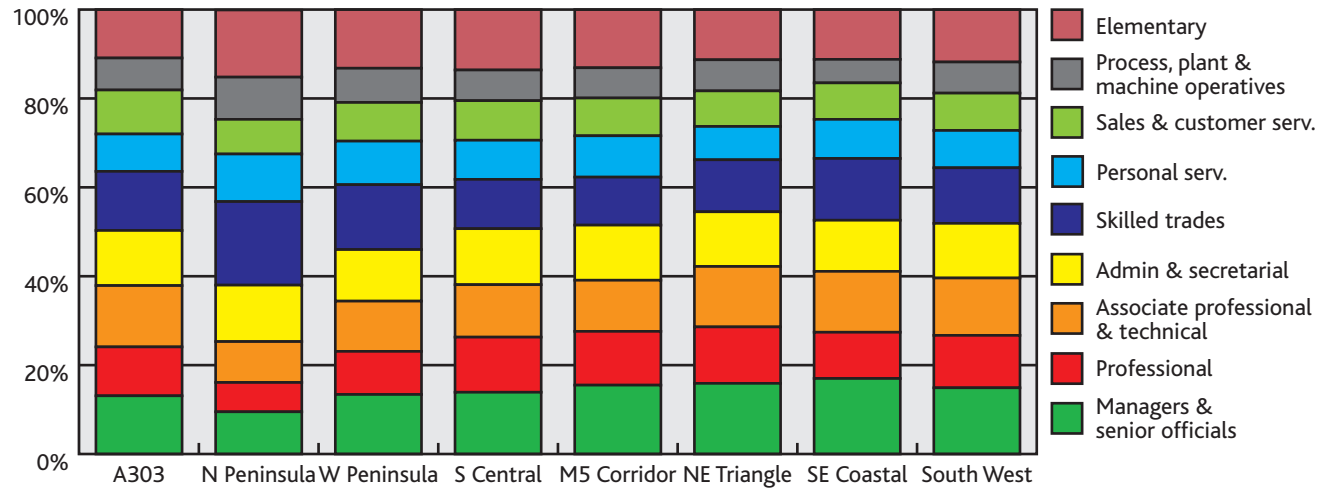
Of course, the assumption of equal productivity at the sub-sector level does not necessarily hold in practice: competition, agglomeration effects, access to skilled labour and to markets, infrastructure, etc. will always make urban working more productive. Also, we know from the ONS and the SW Regional Accounts that the more rural west is less productive than the more urban north and east. Other research shows that much of this 'productivity gap' is explained by the greater distances from London and other major urban markets. But, without good low level data, it is impossible to tell whether it is 'rurality' per se or 'peripherality' that is the issue. These often (but not always) go hand in hand but, if it is 'access to markets' that matters, it may mean a different policy approach than if it is 'inherently rural'.

Labour market

A rather crude analysis of labour markets was carried out, again using Defra's local authority level rural-urban classification and Annual Population Survey data for 2005. This analysis suggests that the differences between zones are more substantial than the differences between areas falling into different rural-urban classes: pointing to 'peripherality' rather than 'rurality' as the issue.

For example, the A303 zone (all of which falls under Defra's 'significant rural', 'rural 50' or 'rural 80' categories) had the highest economic activity rates in the region (83.4% vs. 80.6% SW), while the Western Peninsula (all rural) had the lowest (78.1%); meanwhile, urban areas in the South Central zone had the lowest rates of all at 76.5%. Unemployment was highest in the Western Peninsula, but second highest in the NE triangle.

Chart Rural 7: Occupational structure of labour market, 2005



Source: Annual Population Survey, ONS

Rates of full-time working were highest in the North East triangle, especially in the urban areas – 75.5% in 'large urban' (i.e. Bristol) and 77.7% in 'other urban' areas, against a SW average of 72.4%. Even the rural areas in the NE triangle had higher levels of full-time working than the average (73%), though Bath and NE Somerset (classed as 'significant rural') was only 68.2%. On the other hand, low rates were observed in the far South West – 67.8% in the North Peninsula, 68.8% in the South Central zone, and 69.8% in the Western Peninsula.

Self-employment varied more by rural-urban class than by zone – in every zone, highest levels of self-employment were found in areas classed as 'rural 80' – more than a fifth of workers in 'rural 80' parts of both the North Peninsula and the M5 corridor. Lowest levels were seen in 'other urban' areas of SWE – less than 10% on average. Self-employment by zone ranged from 12.0% in the NE triangle to 18.4% in the Western Peninsula.

The differences in occupational structure were more pronounced between zones, than between rural-urban classes – see Chart Rural 7. Professional occupations make up only 6.6% of the workforce in the North Peninsula, compared to the SW average of 11.8%, and 12.7% in the NE triangle, while skilled trades accounted for 11.1% of workers in the South Central zone and 18.8% in the North Peninsula. In line with this, qualification levels also varied across the different zones; while 18.6% of workers in the North Peninsula were educated to degree level (or higher), the figure was around 30% for the NE triangle. Although urban areas on average have highest levels of workers with no qualifications, the rural North Peninsula had the highest levels for any of the zones (11.8%).

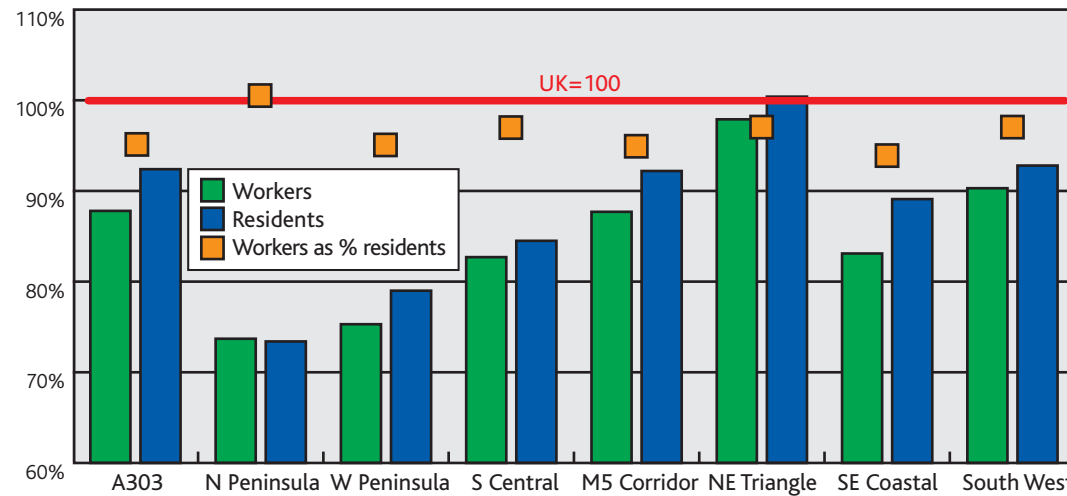
Earnings

A similar analysis of gross weekly worker and resident earnings at local authority level based on 2006 data from the Annual Survey of Hours and Earnings (ONS) was carried out. Chart Rural 8 shows the distribution of average worker and resident earnings across the South West, and the ratio between these figures. This shows that workers and residents in the north and east of the region generally earned more than those further south and west. However, although fairly rural, the A303 zone has earnings equivalent to the more urban M5 corridor zone. Again, perhaps, it may be 'peripherality' rather than 'rurality' that matters.

Only workers in urban areas of the NE triangle earned wages at or above the UK average – with the SW average at only 90% of the UK figure. While on average, workers in rural areas earned less than urban workers – 79.2% of UK in rural 80 areas up to 98.3% in large urban areas – there was not a clear pattern across the functional economic zones of the region. Undoubtedly, worker wages are lowest in the peninsular zones (74% and 75% in North and West, respectively), and as low as 67% in 'rural 80' parts of the North Peninsula, but 'rural 50' parts of the A303 zone earned 91% of the UK (i.e. higher than the SW average), suggesting that there are good employment opportunities in some rural areas.

There is, however, a clear difference in distribution of worker and resident earnings. While on average, residents in the most rural areas had lowest earnings (89% of UK, compared to SW at 93%), for those zones with an urban local authority area (i.e. excluding A303, North and West peninsula), rural resident earnings were higher than urban. Resident earnings above the national average were observed only in 'rural 50' and 'significant rural' parts of the NE triangle (104% of UK).

Chart Rural 8: Worker and resident earnings by functional economic zone, 2006 (UK=100)



Source: Annual Survey of Hours and Earnings, ONS

Residents in 'rural 80' parts of the A303 and NE triangle zones earned 98% of the UK average. Meanwhile, residents in the peninsular zones earned only 73% and 79% of the UK average (North and West, respectively).

SW worker earnings are only 97% of resident earnings, suggesting net commuting of higher skilled workers out of the region. This ratio decreases with rurality, from an average of 103% in large urban areas to only 89% in the most rural areas – there is a net flow of skilled (higher paid) workers from rural to urban. This pattern broadly holds for most of the zones. Higher earners 'prefer' to live in more attractive rural surroundings but work in the towns.

Interestingly, looking at the ratio of worker to resident earnings across the zones, only the North Peninsula had roughly equivalent worker and resident earnings (the points on Chart Rural 8), suggesting that the labour market for the zone as a whole may be fairly well contained. However, this hides a degree of disparity – while workers in the 'rural 80' areas earned 89% of resident earnings, in the remaining 'rural 50' areas workers earned 7% more than residents, suggesting that there is still net commuting of (skilled) workers from more rural to relatively less rural (i.e. more urban) areas within this zone.

All other zones have worker earnings that are lower than resident earnings, suggesting a flow from west to east and out of the region; SE coastal workers earn only 93% of resident wages, probably due to net commuting to Southampton and beyond.

Conclusion: is there a 'rural economy'?

On the one hand, the evidence suggests that there are some fundamental differences between rural and urban businesses: rural businesses are older, with lower turnover of stock, and thereby potentially less competitive than their urban counterparts. Rural workers earn less than urban workers, while rural residents earn more; this is linked to differences in occupational structure and qualifications. So yes, on average, rural businesses are less competitive and therefore probably less innovative with lower investment in capital and investment, leading to lower productivity.

On the other hand, sector composition, particularly manufacturing, varies both by rural-urban class and by zone. Each area has evolved its own manufacturing niche, which will be dependent upon a range of characteristics including: resources, labour, history, and infrastructure. With the exception of agriculture, it is hard to say what sectors characterise a rural area.

Also, even if 'rural' sectors could be defined, these will undoubtedly be dependent upon urban-located sectors both up and down-stream in the supply chain, for distribution, retail, finance, etc. And vice versa – urban businesses will often be dependent upon rural-located business or consumers. Furthermore, urban areas are dependent upon rural areas for supply of (often skilled) labour. Higher earnings of rural residents are pumped into these rural areas (as well as urban areas). As such, it is impossible to draw a circle around an economy and define it as 'rural'.

Many of the differences shown in the analysis can be as readily explained as being due to 'peripherality' as much as 'rurality' – the most peripheral parts of the region, the Western and North Peninsular zones have lagging economies, and it is difficult to differentiate which impacts are due to rural and which are due to distance from market. In many instances, rural areas in the A303 zone, which has the highest proportion of rural businesses, are fairing better than those in the two peninsular zones, suggesting that this area may be doing better as it is less peripheral and has better access to skilled labour, markets, etc.

On balance then, it is difficult to talk about a separate SW 'rural economy'; this 'rural economy' is made up of so many diverse parts with different characteristics and different locations, and inextricably linked to neighbouring urban areas.

We can talk about the Northern peninsular rural economy. In many of the charts, this zone stands out as being different from other parts of the region. This 'rural economy' depends on different sectors from say the A303 'rural economy' and many of the issues need place-dependent solutions, rather than 'rural' solutions. We need to understand what makes this economy different and whether or not specific approaches are necessary to address its, often longstanding, deficiencies. As such, the increasing emphasis from Government on 'place' – sustainable communities, city regions, etc – is welcome.

There is also pressure to help rural businesses. Arguably, we don't need to develop specific policy to help rural businesses because 'rurality' makes them different. Instead, we should be ensuring that policies developed to help business as a whole will encompass those businesses located in rural areas. The drivers of a successful, productive economy will be the same in rural and urban areas: rural and urban businesses experience the same problems – skills, transport, regulation; and the 'rural economy' has the same drivers as the 'urban economy'. Due to concentration of businesses in urban areas, of course, support mechanisms may be easier to target in these areas. The emphasis should be on rural proofing rather than rural policy as such, based on greater understanding of the differences between areas, whether they are rural or not.

Allison McCaig, Evidence Adviser

Economic Indicators: United Kingdom & South West England

United Kingdom		1999	2000	2001	2002	2003	2004	2005	2006	2006				2007			
										Q1	Q2	Q3	Q4	Q1	Q2	Q3	
Real Gross Domestic Product – growth (% ch.) ¹		3.0	3.8	2.4	2.1	2.8	3.3	1.8	2.8	2.4	2.8	3.0	3.2	3.1	3.1	3.3	
Inflation – Consumer Price Index (CPI) (%)		1.3	0.8	1.2	1.3	1.4	1.3	2.1	2.3	1.9	2.3	2.4	2.7	2.9	2.6	1.8	
Trade balance (£bn)		-15.5	-19.4	-26.8	-30.9	-29.4	-35.0	-44.2	-48.4	-12.0	-11.5	-12.6	-12.3	-12.4	-11.5	-	
Bank base rate (%) ²		5.50	6.00	4.00	4.00	3.75	4.75	4.50	5.00	4.50	4.50	4.75	5.00	5.25	5.50	5.75	
Exchange rates ³		€:£	1.519	1.642	1.609	1.591	1.446	1.474	1.463	1.467	1.457	1.454	1.471	1.485	1.492	1.473	1.471
		\$US:£	1.618	1.515	1.440	1.504	1.635	1.832	1.819	1.843	1.753	1.830	1.875	1.915	1.955	1.987	2.021
Employment rate (%) ⁴		73.8	74.4	74.6	74.4	74.7	74.8	74.7	74.6	74.6	74.6	74.5	74.5	74.3	74.4	-	
Unemployment rate (%) ⁵		6.1	5.6	4.9	5.2	5.0	4.8	4.9	5.5	5.2	5.5	5.6	5.5	5.5	5.4	-	
South West England		1999	2000	2001	2002	2003	2004	2005	2006	2006				2007			
										Q1	Q2	Q3	Q4	Q1	Q2	Q3	
Gross Value Added (GVA)	Total nominal GVA (£bn)	60.9	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	11.0	2.7	2.8	2.7	2.8	2.6	2.5	-	
	Annual change (%)	3.6	3.6	8.1	-7.7	21.0	6.8	6.3	6.0	14.1	11.6	4.4	-4.3	-3.5	-10.3	-	
	Share of UK exports (%)	4.4	4.0	4.3	4.0	4.8	5.1	4.9	4.5	4.2	4.0	4.9	5.0	5.0	4.8	-	
Labour market	Employment rate (%) ⁴	78.3	78.9	78.9	79.0	78.8	78.7	78.4	78.2	78.1	78.4	77.8	78.4	78.0	78.0	-	
	Unemployment rate (%) ⁵	4.5	4.1	3.7	3.8	3.4	3.3	3.6	3.8	3.6	3.7	3.9	3.8	3.9	4.0	-	
House prices	Average house price (£k)	91.5	106.2	119.8	144.9	170.0	191.7	199.1	210.6	199.3	205.4	216.7	216.9	218.8	-	-	
	Annual change (%)	11.5	16.0	12.9	21.0	17.3	12.8	3.9	5.8	0.9	5.1	7.0	8.5	9.8	-	-	
	Index ⁷	94.5	97.8	100.3	104.7	108.6	107.2	104.8	103.1	103.1	102.5	102.3	104.4	103.8	-	-	
	Affordability ratio ⁸	5.9	6.4	6.9	7.9	8.9	9.8	9.6	9.7	-	-	-	-	-	-	-	

-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 2005 is £17,677; 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 – UKTradeInfo; House prices – ODPM (from Land Registry data); All other – ONS



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