Employment: what's up with London?

In the first of two articles **Paul Convery** asks why London's economy is doing well but its labour market is shrinking and fewer Londoners are working.

One of the most enduring paradoxes of the UK labour market has taken a further twist. London's economy has grown strongly for more than a decade and in the period to 2000, the total number of jobs increased rapidly. Despite this, the employment rate in the Capital remained sluggishly low – typically about five percentage points below the national average – as many of the new jobs were filled by commuters and others moving to live and work in London.

Policy makers have long worried about barriers to work – especially the low skill base of a sizeable minority of the London population. They have also belatedly recognised that incentives to work are less effective in London's higher-cost environment. The conventional policy agenda for London has therefore been relatively simple: in a context of rapid growth in demand for workers, make supply side adjustments to get Londoners into these jobs.

But now there is a more worrying development. London is actually losing jobs. Over the three years 2000-2003 London lost 154,000 of its employment base. Nor was this decline caused by a single sudden drop: each of the three years registered falls in employment with the decline probably flattening-out early in 2004. Provisional data for the first three quarters of 2004 suggest a slight recovery – of about 25,000 jobs.

Significantly, the loss of almost 4% of the Capital's jobs is out of step with trends elsewhere in the country where jobs have continued to grow throughout the past three years – and have grown during 2004 at a faster rate than in London (see Chart 1).

What is astonishing, however, is that London's economic output continued to surge ahead throughout the period in which the net demand for labour shrunk. The conventional thinking amongst policy makers assumes that the London economy is more sensitive to cyclical change and therefore experiences greater extremes of economic activity than the national average. So, London enjoys stronger growth during boom periods and more severe retrenchment in times of low economic activity. But, in recent years, London has consistently outperformed the UK economy during periods of high economic growth and only slightly lagged the national average in periods of relatively low growth (see chart 1).

Since 1993, the increase in Gross Value Added (GVA) has been faster in London than in any other region except the South West. The data suggests a quite sudden drop in the rate of growth in London's GVA between 2002 and 2003 – from £170.1 billion to £174.2 billion which is a growth rate of just 2.4% following 6.4% in the previous year (these are expressed in current prices and compare the London region with the UK on a workplace basis).

But, as the worst of London's job losses has passed, a longer term trend may be emerging; 'weightless growth'. The image of a weightless economy was first coined by Alan Greenspan in 1996 remarking that economic output was literally becoming lighter. He estimated that new materials, miniaturisation and the growth of service industries meant that over the course of less than a decade, the export output of the USA had grown in real value but had halved its unit weight. Greenspan's prime concern was whether central bankers, economists and Treasury officials would be able to adequately measure the size of these newly configured outputs because the inputs – materials and labour mainly – would be smaller.

The USA saw a spectacular growth in jobs during the Clinton presidency and grew by more than 20 million new jobs. During the Bush era however, the economy has grown strongly yet the labour force has remained dead flat. This trend towards very high productivity growth in sectors that have less tangible outputs was worrying the Chairman of the Federal Reserve ten years ago. Now it should be worrying us, not simply because London represents such a large slice of UK economic activity but because the trend that can be observed in London may also be present in Britain's other cities.

A major long-term structural change is

Chart 1

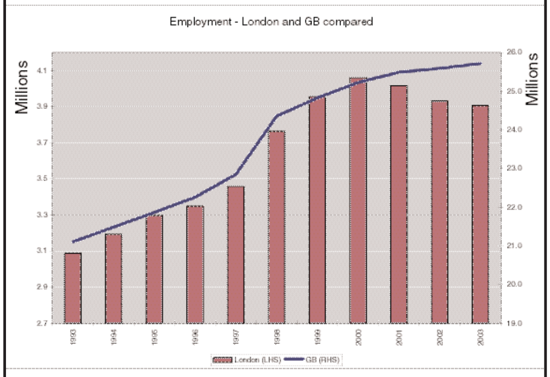
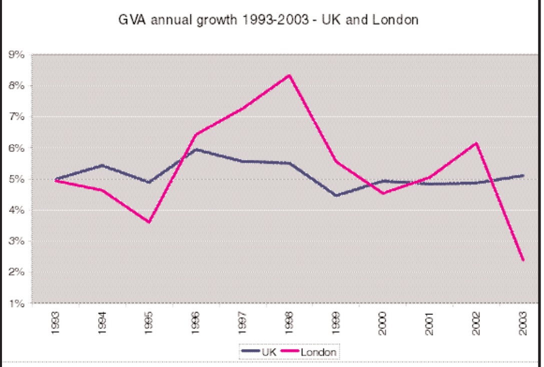


Chart 2



occurring to London's core sectors as the share of economic activity shifts towards high value businesses in the knowledge economy. The most dramatic trends show strong growth of internationally competitive firms in financial, professional and business services, the media and creative industries, in ICT, life sciences, healthcare and advanced manufacturing. These sectors have begun to benefit from very rapid improvements in productivity. Put simply, this means more economic output from fewer workers.

Even jobs in the personal service sector that have traditionally required intensive labour inputs are beginning to shed workers as productivity gains kick-in and this is evidenced by employer demand for better skilled staff - even in traditionally low skill sectors such as hospitality, leisure and personal services.

The London economy is extremely complex and, whilst some sectors are changing rapidly, others are not. A weightless growth phenomena may be rapidly transforming the technology, science and information services sector. But it may take longer to affect other sectors including those that are more labour-intensive and policy actions based around the conventional people-into-jobs paradigm may still be relevant to some sectors.

Employment in London

The supply of jobs throughout Britain has been expanding since early 1993 and began to grow at a remarkably healthy rate in the mid-1990s. With longer hindsight it appears that labour market reforms that began in the mid 1980s may have delivered a long term competitive advantage to Britain that –- despite the acute recession of 1990-1991 – has resulted in a consistently long period of employment expansion.

Maintenance of very stable economic conditions, notwithstanding a number of external shocks in 1999 and the introduction of many new labour market measures in 1998, contributed to an accelerated decline in unemployment and a growth in employment – although the rates of economic inactivity worsened throughout most of the last decade. Whilst many other major economies experienced considerable dislocation during 2000, Britain saw a slight decline in economic output but no loss of jobs overall.

As a result, from 2000, jobs growth throughout Britain continued at slightly below the rate seen during most of the 1990s. By contrast, the number of jobs in London started to shrink in 2000 and continued to decline in each of the subsequent years, as Chart 1 illustrates.

This experience has been unique to London. No other GB region or country has experienced any loss in total employment during this period, although in a single year period between 2002 and 2003 there was a very slight loss of jobs in West Midlands and a significant loss in the South East (almost 44,000). Indeed, the loss of jobs in the South East appears to be concentrated in the larger urban centres and parts of the region more closely connected to the London economy.

It should be recognised that London's job loss trend has probably flattened out. The most current data that is available at a sector and small geographical level is from the Annual Business Inquiry (ABI) for 2003 and this article mainly relies on this source for its level of detail.[1] However, there are some London-wide estimates for the first three quarters of 2004 and these show a modest recovery – of about 25,000 jobs.[2]

These data are obtained from small scale employer surveys which, for previous years in London, have tended to over-state employment. Frustratingly, the definitive data for 2004 will not be released until December 2005 and it remains a matter of conjecture whether these preliminary data will be validated by the eventual ABI release for 2004.

The sharpest loss of jobs has been experienced in the sectors that have been the mainstay of London's economic revival that has been underway since the early 1980s. These are financial services and general business services which represent nearly a third of all London's jobs. These have declined by 116,000 since 2000 and this represents a reduction of 9% of jobs in the sector. Employment has also been lost in construction (down by 8,000 jobs or 6%) and in the retail and wholesale trades (down by 33,000 jobs or 5%). Manufacturing has continued its long historic slide and has declined by a fifth in the three years – shedding almost 60,000 jobs.

For business services and financial intermediation to decline so sharply represents a serious blow in a city where just about a third of all employment relies on these sectors. Equally, whilst the hospitality sector has flourished over this period, it represents less than one in ten jobs, so continued growth will be welcome but will deliver relatively fewer jobs.

London's overall loss in jobs would have been far worse without compensating increases recorded in public sector employment – which grew by 57,000 or 7% – and by the increase in hospitality trades which have grown by 36,000 or 14%. The growth in public

Chart 3

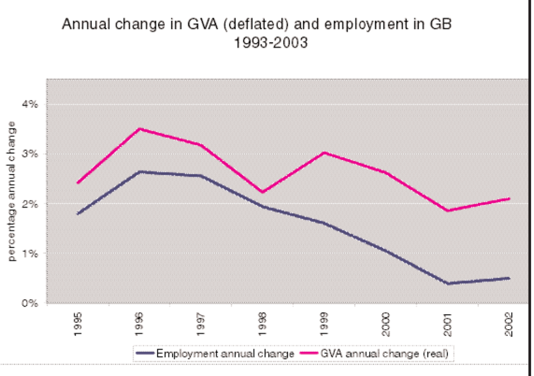
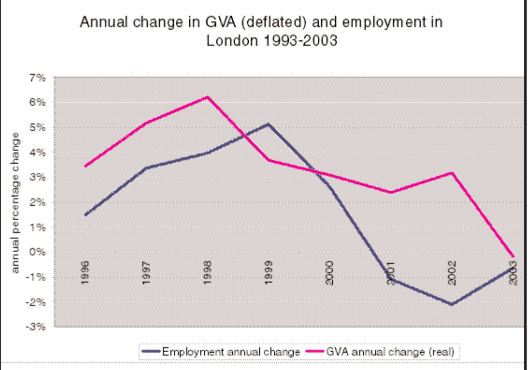


Chart 4



sector jobs was mainly recorded in education (up 28,000) in health and social services (up by 20,000), but central Government departments also increased their workforce by almost 9,000.

The smaller scale business surveys that ONS uses to produce preliminary headline figures for the first three quarters of 2004 indicate that some growth returned to financial intermediation and to business services whilst public sector jobs continued to grow. However these preliminary indications also suggest that retail, hospitality, other services and construction have shed jobs.

The key difficulty in reading London's likely future employment prospects is that trends observed prior to 2000 may not be borne-out by the subsequent period. Wholesale and retail grew between 1998 and 2000 but then declined. Similarly, transport related employment grew then retrenched to its 1998 level; both financial intermediation and business services grew and remain above their 1998 levels; 'other personal services' shows a similar pattern of long term growth punctuated by a short period of decline. It is not too easy to predict future trends based on previous patterns of activity, particularly as the productivity rates, and labour intensity, of different sectors is changing markedly.

One significant indicator is that the relationship between economic growth and the rate of demand for labour appears to be changing in London. As Chart 3 shows, the relationship between output and employment is fairly steady when looked at across Great Britain. In the mid 1990s, an annual rise of about 2.5% in output generated jobs growth of 1.8%. But by 2001, annual growth of 2% was only generating about .5% growth in employment. Admittedly employment numbers tend to lag economic growth a little, but recent evidence suggests that the labour market is fairly responsive – and after all that has been a key impact of labour flexibility policies of the last 20 years.

Nationally, the data shows that higher rates of economic growth are now required in order to generate additional employment, but the relationship between the two is reasonably consistent. Put simply, the two lines in Chart 3 track each other, although they have begun to diverge slightly.

London is different however. As chart 4 shows, the relationship between economic output and employment is less consistent. Up until about 1999, annual growth in both measures grew simultaneously – with employment growth continuing for a period despite output turning sharply downwards. Thereafter the two measures diverge with employment rather perversely seeming to recover slightly even though economic growth in 2003 went fractionally below zero (in real terms).

In fact, the chart demonstrates a pattern by which the two growth trends run in tandem albeit with a slight lagged effect. The relationship between both measures may be affected by externalities and data inaccuracies that are difficult to identify. However, the key conclusion seems to be that economic growth has to be even stronger in London in order to generate extra jobs. Nothing less than growth of 3% annually (in real terms) is therefore required in order to get any increase in jobs.

Table 1: Employment in London 1998-2003

	1998	2000	2003	change 2000-2003		Percent of all jobs in 2003
Manufacturing	286,900	282,300	223,600	-58,700	-21%	6%
Construction	134,000	134,200	126,300	-7,900	-6%	3%
Wholesale and retail trade	588,900	623,000	590,100	-32,900	-5%	15%
Hotels and restaurants	245,100	264,800	301,000	36,200	14%	8%
Transport, storage and communication	303,100	317,900	301,700	-16,200	-5%	8%
Financial intermediation	313,600	342,600	323,300	-19,300	-6%	8%
Real estate and business services	871,400	1,017,700	920,900	-96,800	-10%	24%
Public administration	219,100	218,200	227,100	8,900	4%	6%
Education	238,000	254,200	282,100	27,900	11%	7%
Health and social work	308,700	326,200	346,000	19,800	6%	9%
Other community, social and personal services	238,800	261,100	253,600	-7,500	-3%	6%
Total*	3,764,100	4,060,700	3,907,000	-153,700	-4%	100%

* The following four sectors are omitted from all tables: Agriculture, hunting and forestry; Fishing; Mining and quarrying; Electricity, gas and water supply. Together these made-up 11,400 jobs in London during 2003 (which accounted for 0.3% of all London employment).

Productivity and employment

As Chart 4 shows, output generally rises faster than demand for labour. This is primarily because year-on-year most employers increase their productivity. The strongest influences that appear to affect the aggregate employment totals for London by 2000 seem to have earlier roots.

Throughout the 1990s, sharp rises in productivity were recorded in every major industrial sector (with one exception). Comparing the period from 1995 to 2002 (see table 2) it shows that real output for all of London grew by 32% whilst total employment increased by just 14%.[3]

Looking at individual sectors we see that the pace of GVA growth outstripped the growth in jobs by a factor of more than five to one in financial intermediation, whilst in general personal services, output grew three times faster than the growth in jobs. Even in manufacturing – a sector that is reducing output and shedding jobs – productivity gains mean that GVA output has only fallen by 4% whilst the decline in jobs has been four times faster. Only in construction and hospitality have output and jobs growth been roughly proportionate.

In the public sector, of course a slightly different story emerges. Output attributable to central government has declined by 13% but the number of jobs has fallen by slightly less. The same phenomena applies to parts of the public sector that have grown – with output growing slightly slower in education than the increase in size of the employed workforce.

Table 2: Change in output (real GVA) and employment 1995-2002

	GVA change	Jobs change
Manufacturing	-4%	-16%
Construction	45%	36%
Wholesale and retail	23%	8%
Hotels and restaurants	42%	29%
Transport, storage and communication	20%	10%
Financial intermediation	37%	7%
Real estate, renting and business activities	67%	25%
Public administration	-13%	-9%
Education	30%	42%
Health and social work	34%	18%
Other community, social and personal services	55%	18%
Total	32%	14%

Table 3: Output per London employee by sector

	Average GVA per employee in 2003 (London)	Change in output per employee 1995-2002: London	Change in output per employee 1995-2002: Rest of England (exc. London)
Manufacturing	£61,000	14%	2%
Construction	£50,700	7%	5%
Wholesale and retail trade (including motor trade)	£29,500	13%	11%
Hotels and restaurants	£21,100	10%	21%
Transport, storage and communication	£50,700	9%	3%
Financial intermediation	£67,000	28%	18%
Real estate, renting and business activities	£59,700	33%	15%
Public administration and defence	£26,000	-4%	9%
Education	£29,200	-8%	0%
Health and social work	£25,700	13%	12%
Other services	£46,600	31%	11%
Total	£39,500	16%	7%

However, the reverse is evident in health and social work. As public sector GVA predominantly consists of wages, in the case of education, if job numbers are growing faster than output, more people are being employed but at lower average wages. The opposite case will be true with health and social services where productivity improvements are more like the private sector.

With output increasing by a third and employment growing by less than a sixth, productivity per employee therefore must show significant rises. In fact between 1995 and 2002, the overall rise in real output per London employee rose 16% and this rate of productivity growth was twice the rest of England average.

At just under £40,000 per employee, average output reflects the very high absolute levels of GVA recorded for London. This in turn reflects the dominance of high GVA industries particularly financial intermediation and business services (at respectively £67,000 and £60,000 respectively) and manufacturing (£61,000). The sectors with the lowest output per employee are health and social work (£25,700) and hospitality (£21,000) although these sectors represent only 9% and 8% respectively of all jobs in London.

In most sectors, London's productivity per employee has improved at a rate that is faster than the England average. As Table 3 shows, every sector is significantly ahead of the England average except hotels and restaurants and two of the public sector employment categories. It should be noted that the England comparator figures are for the rest of England and exclude London. It is also important to emphasise that these GVA estimates are calculated on a residence basis which means it measures the output work undertaken by London residents and allocates the output of commuters who work in London to the region in which they live. The difference between the two measures is relatively small in most other UK regions, but for London, the sizeable population of commuters is significant.

In 2004, the estimated GVA for London

measured on a residence basis was £155.1 billion whilst on a workplace basis it was £174.2 billion – some 12% greater. This is because London has a net in-commuting total of 617,000 which represents the balance between the number who are employed in London and the total number of London residents who are employed (including those who are out-commuters from London to surrounding regions).

An interesting feature of the last three years is that the (net) in-commuting figure for London shows a decline of 140,000 since 2000.[4] So whilst the number of jobs has declined in London, so too has the number of people filling London jobs who live outside the Capital.

Why does it matter?

There are currently just 3,290,000 Londoners employed – out of a working age population of 4,750,000. So, non-employment in London is significant. At present, just 69% of the Capital's working age population is in work - compared with slightly over 74% for Great Britain. The employment rate for the two regions surrounding London is some ten percentage points higher: at fractionally under 79% in each region.

Although both of these regions themselves have areas of low employment they are nevertheless regarded as being very close to a level that may be described as 'full employment'. Indeed this is the definition announced by the Prime Minister as a level of employment that would 'close the gap between the regions' and be a target for Government to ensure that 'everyone who wants to work has the help, support and encouragement they need to get into work.'[5] This 80% target now forms a part of the five year strategy for the Department of Work and Pensions announced in February 2005.

A key problem in London is quite simple. Just a handful of London's Boroughs are anywhere near achieving an 80% employment rate. The tiny and very affluent 'Square Mile' covered by the City Corporation is the only local government area that has hit 80%. More seriously, Boroughs such as Newham (52%), Tower Hamlets (55%) and Haringey (57%) have extremely low employment rates and reaching an 80% target in London would be extremely challenging.

Until recently, the Treasury had argued for a target that would bring Britain's low employment regions up to the national average of 75%. The new target, however, takes as its starting point the possibility that all regions might reach the level of the best currently performing regions. In London's case, these are the regions that are adjacent to the Capital and which have economies very closely linked to London. Many of the local authority areas in the South East and East that have the highest employment rates are those closest to London and which, arguably, form a part of the wider functional urban area that stretches east-west from Reading to Southend and north-south from Stevenage towards Brighton.

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For London this means that just over half a million people need to enter work for the Capital to reach 'full employment'. We estimate the current 'job gap' in London to be 508,000 and would require the number of people working to increase by almost a sixth – from the current total of 3,290,000 – to reach 3,906,000. This job gap in itself is equivalent to 13% of the total stock of jobs located in London, so the absolute number of jobs in the Capital would clearly have to grow substantially.

The latest data also shows that some Boroughs that have a considerable job gap and have low numbers of jobs located in the Boroughs will need to both increase jobs and 'export' significant numbers of people to work in central London and elsewhere. In places such as Newham and Haringey the job gap is equivalent to more than half of all jobs located within the Boroughs. Similarly, for Waltham Forest and Hackney, the jobs gap represents more than a third of the currently available jobs in the Borough.

Table 4 shows, on a Borough by Borough basis, how the job gap target might be quantified and how it compares with the scale of jobs located in each Borough. For example, in Barking and Dagenham, 64,000 residents in work represent 65% of the working age population. The 15% gap between this employment rate and the target of 80% represents some 14,000 people who are not in work. As a scale comparison, the table shows that, when compared with the 48,600 jobs located in Barking and Dagenham, the 14,000 job gap is equivalent to 29% of all jobs located in the Borough. A small number of Boroughs are already at or close to the 80% target – such as the City, Havering and Kingston upon Thames.

What does it all mean?

The key to London's employment growth prospects seems therefore to depend on the complicated relationships between growth in output, productivity change and the relative scale of each sector.

Between 1993 and 2003, real GVA growth in London has averaged nearly 4.75% per year whilst employment growth has only been 2%. This trend seems to be worsening to such an extent that London can grow economically without requiring many more people in work. Firms in London's dominant sectors are able to sustain their growth by improving their productivity rather than by recruiting more staff. Meanwhile the more labour-intensive enterprises and sectors are either relatively small or are growing more weakly – or are in the public sector.

The new Economic Development strategy for London presumes that London's international city status and its fundamental position in relation to the rest of the UK and Europe mean that continued growth can be expected –

Table 4: Employment rates in London Boroughs 2003

	Number of employed residents	Full employment target	Jobs gap	Jobs located in the area	Gap as % of all jobs
Barking and Dagenham	64,000	78,000	14,000	48,600	29%
Barnet	151,000	169,000	18,000	106,800	17%
Bexley	104,000	108,000	4,000	63,400	6%
Brent	113,000	138,000	25,000	99,200	25%
Bromley	137,000	146,000	9,000	104,000	9%
Camden	97,000	112,000	15,000	248,300	6%
City of London	4,000	4,000	0	311,300	n/a
Croydon	161,000	171,000	10,000	131,400	8%
Ealing	147,000	163,000	16,000	115,100	14%
Enfield	124,000	139,000	15,000	93,000	16%
Greenwich	91,000	110,000	19,000	62,600	30%
Hackney	80,000	110,000	30,000	81,600	37%
Hammersmith and Fulham	89,000	98,000	9,000	104,800	9%
Haringey	85,000	118,000	33,000	59,800	55%
Harrow	95,000	110,000	15,000	67,600	22%
Havering	108,000	109,000	1,000	75,500	1%
Hillingdon	116,000	126,000	10,000	168,400	6%
Hounslow	100,000	111,000	11,000	119,800	9%
Islington	79,000	97,000	18,000	155,000	12%
Kensington and Chelsea	80,000	94,000	14,000	113,000	12%
Kingston-upon-Thames	80,000	81,000	1,000	66,500	2%
Lambeth	116,000	142,000	26,000	120,200	22%
Lewisham	113,000	132,000	19,000	64,600	29%
Merton	98,000	102,000	4,000	65,700	6%
Newham	81,000	124,000	43,000	63,600	68%
Redbridge	110,000	122,000	12,000	68,400	18%
Richmond-upon-Thames	87,000	94,000	7,000	65,500	11%
Southwark	103,000	129,000	26,000	142,800	18%
Sutton	87,000	91,000	4,000	62,400	6%
Tower Hamlets	73,000	106,000	33,000	150,100	22%
Waltham Forest	88,000	110,000	22,000	55,900	39%
Wandsworth	141,000	148,000	7,000	103,900	7%
Westminster, City of	85,000	107,000	22,000	547,400	4%
Total	**3,290,000**	**3,798,000**	**508,000**	**3,906,200**	**13%**

providing that a range of supply side measures are implemented. These include improved infrastructure, a better supply of skilled workers, sufficient affordable housing, and major a programme of support to encourage innovation-based enterprise growth.

The Mayor's vision for London is unambiguous that Londoners must benefit from the success of a growing vibrant economy. But, this strategy could be fundamentally weakened if the conditions of growth are accelerated, yet productivity advances fail to produce sufficient jobs to ensure that prosperity is more equally distributed. The political strategy of both the Mayor and of central Government is to ensure that income re-distribution is achieved through the labour market – ensuring disadvantaged populations having access to work is the primary tool for equitable distribution.

But London may be in real danger of experiencing a weightless growth phenomena – buoyant economic growth accompanied by a stagnating labour market. With an already low employment rate, the Capital risks excluding even more of its residents from work and fundamentally weakening the political strategy of the Mayor and Government.

Furthermore, this may not really be just a London problem anymore. Some of the evidence suggests that the London growth model described here might already be affecting regional cities where a similar structural change seems to be occurring.

References

1. Annual Business Inquiry for 2003, ONS (Dec 2004) available via NOMIS

2. ONS First Release, Labour Market Statistics January 2005, London.

3. ONS First Release, Regional gross value added, November 2004.

4. The net in-commuting figure for 2000 was 860,000 (being the difference between 3,202,000 employed London residents and 4,061,000 jobs located in London). The equivalent 2003 figures of 617,000 represents the difference between 3,290,000 employed Londoners and 3,907,000 jobs located in London.

5. Speech to the Institute of Public Policy Research, 11/10/04

6. *Sustaining Success*, London Development Agency, January 2005.

The author, Paul Convery, was a founding Director of Inclusion and is currently an Associate Director of the economic consultancy firm, SQW (www.sqw.co.uk). The second part of this article to be published in the April edition of Working Brief will examine the supply-side dynamics in London and define a series of policy conclusions for London and Britain's other core cities.