

Executive summary

Globalisation and its impact on London's economy

London's economy has been shaped by globalisation – the increasingly connected and integrated nature of the international economy. This integrated international economy has, in large part, arisen through increases in trade over time. As a result, globalisation has led to structural change in the UK economy, as well as across the world; resources have moved from less productive to more productive uses.

Taking advantage of this increase in globalisation, London's exports in 2013 totalled around £139.9 billion according to GLA Economics estimates, up by £64.7 billion compared to 2003. This trend was mainly driven by a rise in service exports. In 2013, monetary finance was the largest service export sector with exports worth around £24.9 billion. The second largest service export sector was personal travel worth around £11.0 billion, followed by business management and management consulting with an export value of around £9.0 billion.

Globalisation has led to a specialisation in those areas where London has a comparative advantage over other competitor areas. Relative to the other G7 economies, it is evident that the UK's service exports currently specialise in: personal, cultural and recreational services; financial services; insurance & pension services; telecommunication, computer and information services; and other business services. It is in these service sector areas that London specialises.

London's position as an internationally competitive centre for global business services brings trade not just to London but to the UK as a whole. London's trade is not just international; there is significant trade with other UK regions. The more international trade London engages in, the more trade there is likely to be for the rest of the UK. London's international trade results in a net injection to the UK economy with total exports exceeding imports by around £28 billion in the year to mid-2014, according to the London Business Survey 2014¹. Other GLA Economics research suggests² that to service this international trade, London imports a significant level of goods and services from the rest of the UK across different sectors.

As a result, this net injection to the economy doesn't just benefit the capital but generates wider economic activity in the other UK regions. According to GLA Economics estimates, based on results from the London Business Survey 2014, London imported around £405.2 billion worth of goods and services from the rest of the UK in the year to mid-2014.

Chapter 1 of the Draft Economic Evidence Base has more detail on the impact of globalisation on London's economy and the specialisations in London's economy.

The spatial nature of London's economy

Urbanisation and the trade of goods and services often go hand in hand. Cities benefit from agglomeration economies, external benefits that arise when economic activity takes place in a concentrated space. The spatial nature of London's economy is the product of more than a century of trade and agglomeration at work. Central London is and will likely remain the most significant employment centre in the Greater South East region, with over two million jobs in the Central Activities Zone, Northern Isle of Dogs and their fringes

alone. London's specialised, globally competitive activities tend to locate here, and in fact some locate almost exclusively in Central London because they benefit so greatly from these internationally competitive agglomeration economies.

Central London offers a range of factors that are not found in combination in many other places. As shown by a number of surveys (see Chapter 3 of the Draft Economic Evidence Base for more details) on a range of factors, businesses see London as the best place in Europe to locate – with the top one of these being availability of qualified staff. A large number of firms therefore locate within central London with 40 per cent of the world's largest 250 companies basing their European headquarters in London. London's nearest European rival is Paris with 8 per cent³. This concentration of businesses at the centre of London brings benefits to the economy over and above those that accrue to the individual firms themselves: so-called agglomeration benefits. These agglomeration benefits are the positive externalities which arise when specialised economic activity takes place in a spatial concentration – such as in Central London.

Such agglomeration benefits support the development of economic activity by providing firms with access to a deep and highly-skilled labour force, a range of complementary input and output markets and the benefits of spill over effects such as the rapid transfer of innovation and knowledge. These agglomeration benefits are also greater in certain industries such as finance, insurance and business services⁴, areas in which London specialises. The economies of agglomeration have a degree of circular causality – existing spatial concentration results in forces that encourage further spatial concentration.

The development of London's radial public transport network has enabled the growth of Central London by reducing the cost of accessibility to a significant proportion of the region's population. The implementation of Crossrail and HS2 will advance this accessibility further.

As a result of agglomeration, there is very high competition for space in Central London, by both businesses seeking shops and offices and people seeking housing. In theory, businesses can often pay more for land than people seeking land for housing, since employment land generates output and the area in which agglomeration benefits are highest is very narrow. Given this, the highest value businesses, that benefit most from agglomeration, are most willing and able to pay for offices in Central London and outbid others for land in Central London⁵.

As in most cities, land prices tend to be highest in the centre and generally decline with distance from the centre, reflecting the appeal of central locations when compared to peripheral ones. Tough competition for limited space drives up land values and acts, along with urban costs such as congestion and other diseconomies of spatial concentration, and planning controls, as a check on further concentration⁶.

Housing and commercial uses compete for land in a similar way to how different types of employment bid against one another for land. Highly productive employment tends to crowd out residential development. Agglomeration economies bring very large benefits to firms and cause great concentrations of employment in very small areas. Since businesses prefer to be clustered together and significant economic benefits derive from such concentration, other land uses like housing tend to locate further out. But residential land, particularly that land inhabited by the most productive employees – who earn considerable salaries – can even crowd out less productive businesses, pushing these businesses further from the centre.

More detail on the spatial nature of London's economy and some of the forces acting on it, for instance the pressure from residential housing on land for commercial development, can be found in Chapter 2 of the Draft Economic Evidence Base.

London's attractiveness to businesses and people

On many measures, London is a competitive international location for business. The capital figures prominently across a range of city ranking indices; ranking as the leading global city according to the PWC Cities of Opportunity and the Global Financial Centres Index. London has a highly skilled workforce, with over half of all workers in the capital being educated to at least degree level.

London has higher net business start-up rates than for the UK as a whole. It is a prominent destination for inward investment, particularly in those areas where London has industrial specialisation, such as information and communication, financial services and professional services.

The economic opportunities that businesses locating in London offer, in part, encourage people to live and work in the capital. Given its international competitiveness, many around the world look to London to fulfil their career ambitions. International migration to London is significant with 37 per cent of London's population born overseas (similar rates to other major global cities like New York, Hong Kong and Singapore).

London's culture and heritage provides another attraction to people, both residents and tourists with London being the most visited city in the world. The capital not only attracts people to work in the capital, it attracts students to study in its universities; which feature prominently in international rankings. There are over 100,000 international students in the capital, comprising almost a quarter of all international students in the UK.

Chapter 3 of the Draft Economic Evidence Base provides more detail on the attractiveness of London to businesses and people.

The outlook for London's economy and risks

Projections for London's population and employment suggest London will continue to grow over the next few decades. However, there are upside and downside risks to these projections, which themselves are subject to a number of assumptions, which could mean London follows a different growth trajectory. In the near term, risks to global economic growth which could impact on London include the ongoing Eurozone crisis, a slowdown in the Chinese economy and other emerging markets, or geopolitical events. Similarly, London's economy could be affected by events in the UK such as a tightening of monetary policy, reductions in government spending, or the outcome of the forthcoming referendum on Britain's membership of the EU.

Looking longer term, the agglomeration benefits currently enjoyed by firms in London may be tempered by the diseconomies of agglomeration (or so-called 'congestion costs') that are the consequence of a mass of businesses and people competing over scarce resources. If the costs of agglomeration begin to exceed the benefits then future growth and/or wellbeing in London could be undermined. Some of the more significant risks include:

- The cost of living (including housing costs) and its impact on labour supply. Housing costs have increased significantly in London in recent years and other costs like childcare are higher in London than elsewhere in the country. Higher living costs make it more difficult for people to live and work comfortably in London.
- The cost of business accommodation. Office occupancy costs in prime central markets are higher than many other competing global cities. Such high costs for business space risk losing businesses to other internationally competitive business locations.
- Pressures on the transport network. Many parts of London's private and public transport networks suffer from significant congestion and overcrowding; London also has limited airport capacity.
- Pressures on other parts of the infrastructure network. The scale of growth expected in London has significant implications for its infrastructure. For instance, London's growth is estimated to increase overall energy demand by 20 per cent by 2050. Moreover, without intervention it is predicted that London will have a deficit in water supply of half a billion litres of water over this period.

If London's international competitiveness is to be maintained, sufficient investment in London's infrastructure will be necessary. As noted earlier, such investment, by maintaining London's international competitiveness and so maintaining the net injection into the UK economy which London's international trade brings, will benefit the rest of the country (as well as London).

Chapter 4 of the Draft Economic Evidence Base looks at the range of risks to London's economy in more detail.

London's environment

London's environment impacts upon the health and quality of life of Londoners, but it also has an important role in the function of the London economy, as its resources are used by people and businesses to produce goods and services. Maintaining high environmental standards and developing infrastructure that both meets the needs of London's economy and is resilient to current and future environmental challenges is essential to ensure London's continued competitiveness.

Development of the concept of natural capital has been undertaken by the Natural Capital Committee (NCC), which was established by Government and reported to the Economic Affairs Committee.⁷ The NCC has produced three reports on the State of Natural Capital exploring the natural capital concept and new valuation techniques, accounting and appraisal methods that can help reveal the real value of the natural environment and the benefits that are provided by environmental assets.⁸ For example, by maintaining the atmosphere (the asset) free of pollution, the benefit that is derived from this is clean air, therefore mitigating the negative externalities (and hence costs) associated with poor air quality.

With population and economic activity projected to grow in the next thirty years, the pressures on resources and natural capital will continue to grow. To maintain and improve quality of life for Londoners, as well as safeguarding future economic growth, interventions to protect the natural environment will need to be undertaken.

Chapter 5 of the Draft Economic Evidence Base looks in more detail at specific aspects of London's environment and related issues.

London's people and labour market

London's population is now larger than it ever has been with approximately 8.7 million residents living in London. London's population tends to be younger than the rest of the UK (driven by the tendency for young adults to move to London to study and to work). London's population is projected to continue to grow to over 10 million inhabitants by 2036. By 2036, 15 per cent of London's population is projected to be over the age of 65, compared with 11 per cent in 2015. At the same time, London's school-age population is growing and is projected to number nearly 1.4 million by 2036. London's population growth has been driven by a considerable rise in the number of births and, most significantly, large inflows of international migrants.

The percentage of London residents who are in work is at record levels; latest estimates show over 72 per cent of Londoners in employment. That is almost six percentage points higher than the lows recorded in 2011 and 2012. Similar positive trends have been seen with unemployment, which is now down to 6.4 per cent (amongst the lowest levels for decades). Despite the improvement in London's labour market, the employment rate remained below and unemployment remained above those for the UK (although these gaps have narrowed in recent years). Moreover, the employment rate gap between London and the UK could be due to the characteristics of London's population, such as its ethnic diversity and age structure.

Parents in London have historically had a lower employment rate than parents across the rest of the UK, though this gap has halved from 11.9 percentage points in Q4 2007 to 5.3 percentage points in Q4 2013. This difference mostly reflects women in London with dependent children having a lower employment rate than the rest of the UK. For example, despite the employment rate for women with dependent children rising 6.6 percentage points since 2007 in London, it was still 8.9 percentage points lower than for the rest of the UK (in 2013).

Educational attainment in London is generally high and better than in England as a whole or other English regions as measured by the percentage of pupils achieving 5 or more A*-C grades including English and Maths at GCSE. However, the educational outcome of London's pupils also varies by borough, ethnicity and disadvantage status.

Chapter 6 of the Draft Economic Evidence Base looks in more detail at London's demographic profile and the performance of London's labour market over time.

Socio-economic issues in London

Despite London's economic success in a number of areas, it also faces many socio-economic issues. In particular the cost of living in London can be very high. Indeed, London was ranked as the 6th most expensive international city to live in according to a 2015 survey of 71 global cities by UBS. Housing is a particularly expensive part of living in London. Whereas median properties in England and Wales sold for more than six times the median gross annual household income, in London, the same ratio was more than ten times in 2014 after having risen sharply over the 2000s.

The impact of housing costs can be seen when considering household incomes. Median household weekly income (in gross terms) is around £80 higher in London than the UK as a whole. However, after accounting for housing costs, median household weekly incomes in London stood at £398 compared to £390 in the UK as a whole. Indeed over the past decade or so there has been a convergence of median household income in London and the UK as a whole.

Poverty levels, after taking account of housing costs, are much higher in London than the UK as a whole. Up to a third of all Inner London residents are in poverty by this measure and nearly a quarter of Outer London residents, which is also higher than for any other region. As a consequence, around 300,000 children in Inner London are living in poverty (after accounting for housing costs), with a further 400,000 in Outer London. The Inner London child poverty rate remains particularly high, at 46 per cent and whilst the Outer London child poverty rate is lower, at 33 per cent, it is still higher than for any other region.

Chapter 7 of the Draft Economic Evidence Base looks in more detail at such socio-economic issues including health, crime and education in London.

Executive summary endnotes

- 1 GLA Economics, 'London Business Survey 2014: Exports', November 2014.
- 2 GLA Economics, 'Growing Together II: London and the UK Economy', September 2014.
- 3 GLA Economics, September 2014, '[Growing Together II: London and the UK economy](#)'.
- 4 Graham, D. (2007) "Agglomeration, productivity and transport investment" *Journal of Transport Economics and Policy*, 41(3)
- 5 Henderson, J. 2009, "Cities and Development", *Journal of Regional Science*, 50th Anniversary issue.
- 6 Cavailhes, J; Gaigne, C; Tabuchi, T; & Thisse, J. 2007. "Trade and the Structure of Cities", *Journal of Urban Economics*, Volume 62(3) p. 383-404
- 7 Natural Capital Committee - <http://www.naturalcapitalcommittee.org/why-we-were-set-up.html>
- 8 State of Natural Capital Reports - <http://www.naturalcapitalcommittee.org/state-of-natural-committee-reports.html>