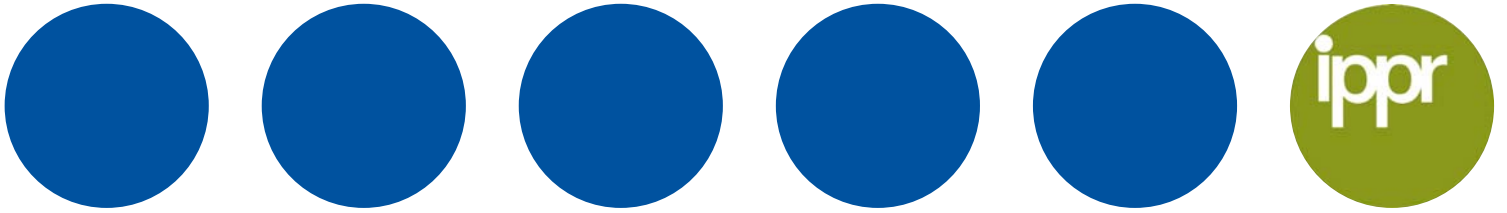


Commission
on Sustainable
Development
in the South East



Going for Growth

Comparing the South East's economic performance

PETER ROBINSON

WORKING PAPER **ONE**

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The Commission on Sustainable Development in the South East

The Commission's goal is for the South East to maintain its economic success and its position as one of Europe's most prosperous regions, while at the same time enhancing its environment and improving the well-being and quality of life of all its citizens. The Commission shall take into account the position of the South East with regards to London as a world city and as the frontier to mainland Europe, as well as considering the UK's inter-regional disparities.

The Commission will have six research and policy challenges:

- The South East is a leading growth region. Should there be limits to growth and if so where do those limits lie?
- Do we give GDP too much priority when measuring success? Should we reconceptualise what we mean by human development and quality of life so that they are not solely reliant on narrow economic indicators of success?
- Can and should the South East absorb all the new homes the Government says are needed?
- Is the South East grinding to a halt? How should additional transport infrastructure and services be paid for and should policy makers be taking radical action to tackle congestion and pollution?
- How can the South East encourage more efficient and sustainable use of resources as well as mitigate the predicted effects of climate change?
- Should we see the Greater South East as one of the world's 'mega-city' regions? Does the South East's inter-relationship with London and the other counties that make up the Greater South East require new ways of working and in what policy areas?

The Commission members include:

- Cllr Sir Sandy Bruce-Lockhart OBE, Leader of Kent County Council and Chairman of the Local Government Association (Commission Chairman)
- Cllr Nick Skellett, Leader of Surrey County Council and Chair of South East England Regional Assembly
- Richard Shaw, Chief Executive of Oxfordshire County Council
- Nick Pearce, Director, ippr
- Baroness Barbara Young, Chief Executive of Environment Agency
- Alistair Rose, Regional Chairman for the South East, PricewaterhouseCoopers LLP
- Robert Douglas, Deputy Chair of the South East England Development Agency
- Cllr Dame Jane Roberts, Leader of Camden
- Nicholas Boles, Director of Policy Exchange
- Dr Valerie Ellis, Member of the Sustainable Development Commission
- Sue Regan, Director of Policy, Shelter
- Chris Huhne, MEP for the South East region
- Bob Davies, Chief Executive, Arriva
- Nick Townsend, Group Legal Director, Wilson Bowden

The Commission will produce a final report of its findings in the summer of 2005. For more information on the Commission's work visit: www.ippr.org/research/

This working paper does not necessarily represent the views of the Commissioners.

Going for Growth: Summary

Some key points of the analysis

- The primary objective of Government policy in the South East is to increase the underlying rate of growth of output per head.
- GDP per head in the UK, Germany, France and Italy is basically identical, but the contributions of employment and productivity are different.
- Public policy cannot proceed on the basis that you can hold employment levels constant and just concentrate on improving productivity because employment and productivity are jointly determined.
- The evidence base on what drives productivity at the regional level is very weak.
- Most economic and social data is subject to a wide margin of error and can never be presented in the form of a league table.
- In making comparisons between regions it is very important whether you use GDP/GVA per head on a residence or on a household basis.
- Lack of data means that it is best to be circumspect in claiming that any particular region drives the UK economy.
- GDP/GVA per head is probably not the best measure to use when looking at sub-regional disparities. Employment is a better measure.
- The knowledge-based economy is an ill-defined concept and should not be used to advocate a sectoral-based industrial policy.

Some key implications for the South East

- GDP/GVA per head in the South East compares well with what are generally regarded as the EU's most prosperous substantive regions containing all the well-known centres of commerce in Europe outside of London and Paris.
- The labour market in the South East is relatively tight but it is not overheating.
- Skills shortages and skills gaps do not seem to be a bigger problem in the South East than in other English regions. The South East can pull in graduates from across the UK and to a certain extent from abroad and is not constrained by the supply of highly qualified people from within the region.
- There are serious disparities in economic prosperity within the region, with certain groups (for example, people with disabilities) and certain areas (for example, Thanet) within the South East continuing to have relatively low levels of employment.
- **Further increasing the rate of economic growth in the South East does not seem a high priority relative to dealing with disparities in prosperity within the region and coping with the problems that current levels of relative economic success pose, particularly in terms of traffic congestion, the lack of affordable housing, the use of natural resources and the quality of the environment. This is not the same as arguing for 'no-growth' or even 'lower growth'. At the very least it is merely suggesting that the current rate of growth is acceptable as an economic objective, though this will pose challenges for achieving environmental objectives in the region.**

Going for growth

"The Commission's goal is for the South East to maintain its economic success and its position as one of Europe's most prosperous regions..." (SE Commission, 2004)

"We are the most successful regional economy of the fourth largest national economy in the world, on the doorstep of one of the world's three great global cities... We must not talk this region down ... we do have problems but they are largely problems of success." (SEEDA, 2002)

Introduction

Does it make sense for a region that already has the highest growth rate of any UK region and is one of the most prosperous regions in the EU to have as its main economic objective further increasing the current rate of economic growth? That is the key policy question which this working paper seeks to address. In doing so it needs to carefully consider two further key questions:

- What framework and measures should we use for comparing the economic performance of the South East region?
- How robust is our evidence base: what can and can't we say from the available data?

Fortunately, addressing these important empirical questions is made somewhat easier by the publication in 2004 of detailed revised estimates by Eurostat of the economic performance of the EU regions, set out in the Appendix. This data was put together to provide an evidence base for the debate about reforms to EU structural and regional funds and it forms a centrepiece of the analysis presented here, alongside a range of other UK data, and with a discussion of the strengths and weaknesses of that data. Much analysis of regional economic performance, including that commissioned by government departments and regional bodies, often uses data without due regard for its limitations. However, a good understanding of the public policy choices facing the South East has to be based on a clear understanding of what the current evidence base can show us.

The objective of further increasing the current rate of economic growth in all the English regions including the South East is set out in the Government's Public Service Agreement (PSA) target relating to regional economic performance. This target was first announced in the 2000 Spending Review and the latest 2004 version is set out below.

Make sustainable improvements in the economic performance of all English regions by 2008, and over the long term reduce the persistent gap in growth rates between the regions, demonstrating progress by 2006 (joint between the ODPM, the DTI and HM Treasury), including by establishing Elected Regional Assemblies in regions which vote in a referendum to have one (ODPM target only). (2004 Spending Review)

To make the nature of this target clear, progress towards it is to be measured by looking at the trend rate of growth of Gross Value Added (GVA) per head, the regional counterpart of the most commonly used indicator of overall economic success, GDP per head¹. There are no other measures to sully this focus on a straightforward measure of economic output per head. And the target means there is an objective for the South East's rate of growth of GVA per head to be increased, along with all the other English regions.

¹ Gross Value Added (GVA) differs from Gross Domestic Product (GDP) in that GDP is measured at market prices; that is, it is GVA plus taxes/less subsidies on products. Information on taxes and subsidies is, however, not available at a regional level.

The last component of the PSA target, referring to Elected Regional Assemblies, was only added in 2004 and appears to make the strong but highly questionable assertion that elected assemblies will help improve economic performance in those regions that vote for them. The flipside of this assertion must be that regions like the South East will be put at an economic disadvantage by not having elected assemblies, which also seems highly questionable. However, just as the policymakers and people of the South East can exercise choice over whether or not to have an elected regional assembly, they also have some choice as to whether to buy into the economic objective set by this PSA target. This is despite the target being jointly held by three government departments including the Treasury and therefore taken very seriously in Whitehall.

Importantly, the main part of the target has two components to it: firstly, to improve growth rates in all regions and, secondly, to reduce the gap in growth rates between the regions. The latter is not, however, a commitment to reducing absolute disparities in economic prosperity between the regions, even though, as Table 1 below makes clear, those disparities are currently widening further.

The PSA target includes the word 'sustainable', but it is worth pondering over the meaning of the term in this context. The word 'sustainable' means different things depending on the context in which it is used. When economic policy makers refer to 'sustaining' economic growth they are usually using the term in its macroeconomic sense, that growth is to be sustained without a boom-and-bust cycle, without generating accelerating inflation or an 'unsustainable' current account deficit or being built on the back of an 'unsustainable' fiscal deficit. That seems to be the meaning implied in this PSA target: that growth will be steady, that it will not consist of a spurt in growth which generates the economic imbalances that will bring that growth to a shuddering halt. It does *not* appear to be a use of the term 'sustainable' in the sense of the prudent use of natural resources.

Table 1: Trend real growth rates, GVA per head, 1989-2000, % p.a.

Region	% Growth
South East	2.75
West Midlands	2.25
London	2.00
East of England	2.00
North West	2.00
Scotland	2.00
Northern Ireland	2.00
East Midlands	2.00
Yorkshire & the Humber	1.75
South West	1.75
Wales	1.50
North East	1.25

Note: Differences of one quarter of one percentage point from the UK/England average of 2 per cent should not be regarded as significant.
Source: Experian Business Strategies (EBS)

One key problem is that there is no agreed methodology for measuring the trend growth rate of GVA per head. One set of plausible estimates from a respected consultancy is set out in Table 1, but you could get different estimates from other sources. The Government's own estimates differ somewhat from those set out in Table 1 and indeed do not include figures for Scotland, Wales and Northern Ireland as the UK government's PSA target applies to England only.

Given the uncertainty over these estimates, the only safe thing to conclude from Table 1 is that the South East is the only UK region with a trend growth rate significantly above the UK or England average, with the North East and probably Wales the only regions with growth rates significantly below the average.

Of course, this focus on one measure of economic success immediately leads us into the fundamental debate over what are the end goals of public policy? GDP/GVA is a very good measure of economic output and the notion that there is an economic component to welfare and well-being is undeniable, but it is only one component. Many other factors are important in terms of enhancing the welfare and well-being of individuals and households and giving fair weight to those various factors is the subject of an ongoing debate. These issues are addressed further in the second working paper of the Commission on Sustainable Development in the South East. This first working paper, however, looks at the different measures of economic success that might be appropriate for different spatial scales, that is at the level of the nation, the region and within regions.

The components of GDP/GVA per head

In straightforward accounting terms, the level of output or GDP in an economy will be a function of the amount of labour that is being used in an economy and the efficiency with which that labour is being used. That is why the level of *employment* and the level of *productivity* are the other two main economic measures that are frequently reported and are the subject of public policy designed to lead to their improvement. Employment is usually measured as the proportion of the working age population that is in paid employment. Productivity is best measured as output per hour worked, but often output per person employed is used in international comparisons, because of problems with measuring hours of work. This is one problem with the data that really matters in policy terms. Depending on the data used, around one-fifth of the gap in GDP per head between the US and the UK is the result of the Americans working significantly longer hours. If the focus of public policy is on individual well-being and quality of life, longer working hours may not be desirable, and indeed closing the gap with the US by getting the British to have only two weeks vacation a year is not government policy.

The most important 'killer fact' of the European economies is that GDP per head in the UK, Germany, France and Italy is basically identical. In making comparisons between countries, an adjustment is made for the *estimated* difference in price levels between countries, leading to a purchasing power parity (ppp) or purchasing power standard (pps) estimate of GDP. However, because these are *estimates*, they are subject to a wide margin of error. Indeed, when these PPP/PPS estimates are periodically revised by the OECD and Eurostat, it is not uncommon to see revisions to a particular country or region's relative level of GDP of plus or minus 5-10 percentage points. This leads to a critical rule of thumb for all international comparisons: small differences in estimates of GDP per head (in PPP terms) between countries and regions should be discounted. This leads to a further critical rule of thumb: most economic and social data can never be presented in the form of a 'league table' where it is asserted that, for example, a region lies 34th out of 40 regions under consideration using some measure of performance. League tables in sport allow for tiny differences in a team's performance to be reflected in that team's position. Economic and social data is too fragile to allow for such fine distinctions. That leads to a further useful rule of thumb for public bodies commissioning research: if that research presents a set of league tables, this reveals that the authors either don't understand the nature of

the data they are dealing with, or are pulling the wool over policymakers' eyes for reasons of presentation.

As the populations of France, Italy and the UK are very similar, and their GDP per head is also very similar, it follows that the overall size of their economies is very similar. Arguing over who holds the position of the fourth largest OECD economy is therefore a bit pointless. Regional disparities in the UK, while serious, are similar in magnitude to disparities in Germany and France, but not as serious as in Italy (see Adams, Robinson and Vigor, 2003). This pattern is mirrored in the disbursement of EU structural funds: over the period 2000-06, the UK, France and Germany will receive a similar level of funding as a proportion of GDP, but Italy will receive twice as much.

Britain's level of GDP per head relative to its European partners is in straightforward accounting terms the result of a relatively high level of employment and a relatively lower level of productivity, measured in terms of output per hour worked. In Germany, France and Italy, it is the other way round: lower levels of employment but higher levels of productivity. This has led many UK policymakers to argue for priority to be given to improving the UK's productivity performance and indeed this is the subject of a separate PSA target. However, the levels of employment and productivity in an economy are jointly determined by the structures and policy framework in place in that economy. For example, the tax structure or the structure of product and labour market regulation might favour more or less capital or labour intensive forms of economic activity in an economy. The OECD has observed an overall inverse relationship between productivity and employment amongst the most successful industrial economies (OECD, 2004). Overall, countries that have high levels of employment tend to have lower levels of productivity; high levels of productivity are associated with lower levels of employment. Only four countries have levels of productivity significantly higher than in the UK and levels of employment that are as good as or better than the UK's: the US, the Netherlands, Norway and Denmark. Public policy cannot proceed on the basis that you can hold employment constant and just concentrate on improving productivity. That is true for the UK as a whole, but is also true for region like the South East where employment rates are particularly high.

Some would argue that the Government's PSA target for improving regional economic performance is there primarily to help the Government with its target for closing the UK's productivity gap. Ask not what your country can do for your region, but what your region can do for your country. Only slowly has the Government articulated an argument based on equity for trying to reduce regional economic disparities. Unfortunately, much official analysis of those disparities tries, somewhat unsuccessfully, to use the framework for analysing productivity differences between countries to understand the differences in economic performance between regions (for further discussion see Adams, Robinson and Vigor, 2003). For example, differences in private sector investment do seem to help explain some of the differences in productivity between countries, but they do not seem to explain any of the differences between the regions of the UK.

The drivers of performance

Table 2 sets out what the most rigorous economic analysis might tell us about the 'drivers' of productivity performance between the UK and the US, Germany and France. Much of the gap between the UK and Germany and France can be explained in simple accounting terms by differences in the capital intensity of these economies. However, the flipside of the greater capital intensity of production in Germany and France is their lower labour intensity: so higher productivity but lower employment. Around a fifth of the gap might come from differences in skills, but we do not know from this analysis what type of skills; indeed, comparisons of skills and qualifications (outside of higher education) across countries are bedevilled by lack of clear comparability. Around a third of the UK-US productivity gap might also be the result of

differences in capital intensity, but most appears to be the result of differences in ‘total factor productivity’, which is the term that captures the impact of innovation, enterprise and the efficiency with which an economy and the relationship between the economy and the state is organised.

Table 2 Decomposition of comparative labour productivity levels (output per hour worked, UK=100), 2000

	US	Germany	France
Market economy	137.4	124.7	122.1
Percentage contribution to comparative labour productivity:			
Physical capital	33.5	73.1	75.8
Skills	1.6	16.4	22.9
Total factor productivity	64.9	10.5	1.3

Source: Broadberry and O’Mahony (2004)

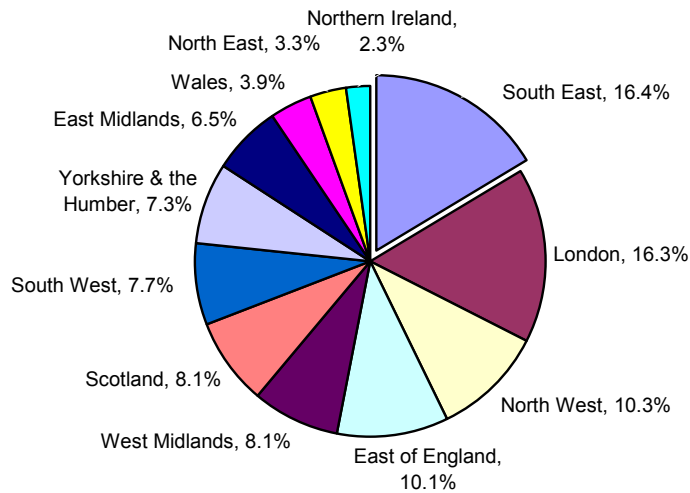
What we do *not* have is the same kind of rigorous analysis which would allow us to account for any differences in productivity between the regions within these or other countries. Indeed, as we discuss in more detail below, we do not even have any reliable data on the scale of productivity differences between regions. This is a key reason why focusing on productivity differences in regional policy is very problematic if not indeed dangerous, given the need to consider productivity and employment together. Moreover, many of the key policies that are likely to impact on productivity are national policy tools, relating to competition policy, the tax and regulatory structure and fiscal support for investment and science and innovation, a fact that regional agencies are well aware of.

A final point is worth emphasising. We care about productivity growth because it is over the long term the main component of the growth in GDP per head. However, we care about levels of employment in their own right as a separate objective for public policy. Involuntary unemployment and the fear of unemployment have one of the biggest adverse impacts on self-reported measures of well-being and objective indicators of physical and mental health (Di Tella *et al*, 2002). In the UK context, employment at the household level is strongly related to income poverty. Any analysis of regional economic performance should therefore give due weight to the employment dimension, even in a region like the South East with relatively high overall levels of employment.

Benchmarking the South East

In 2002, the South East was responsible for just over 16 per cent of the overall output or GVA of the UK economy, when the output of commuters is assigned to where they live (a residence-based measure – Figure 1) and around 15 per cent when the output of commuters is assigned to where they work (a workplace-based measure – Figure 2). The South East’s economy is either about the same size as London’s or is slightly smaller, depending on how you want to account for the economic contribution of the 11 per cent of those in employment living in the South East who commute to work in London.

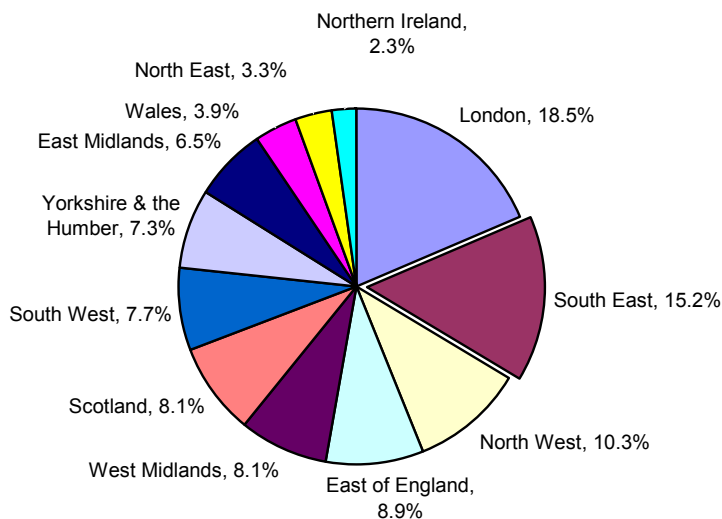
Figure 1: Share of GVA by region (%), residence based, 2002



Source: Office for National Statistics (ONS)

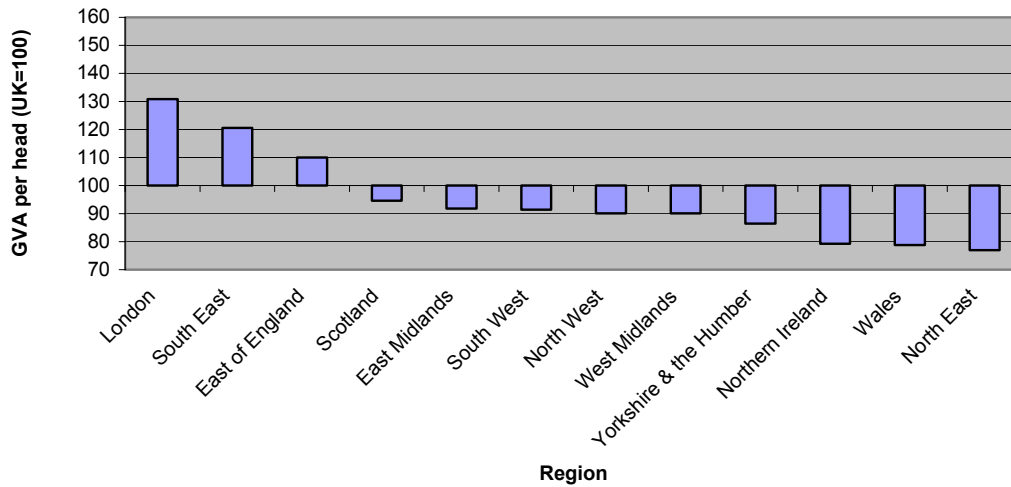
Of course, the welfare or well-being of individuals and households will be related to the level of GVA per head, that is adjusting for the size of the population in the regions. In 2002, GVA per head in the South East was either 20 per cent above the UK average (on a residence-based measure – Figure 3) or 12 per cent above the UK average (on a workplace-based measure – Figure 4). As a plausible assumption is that about 85 per cent of the expenditure of London commuters takes place in the region in which they reside (OEF, 2004), the residence-based measure might be more closely associated with a measure of well-being and welfare which is ultimately what we are concerned with.

Figure 2: Share of GVA by region, workplace based, 2002



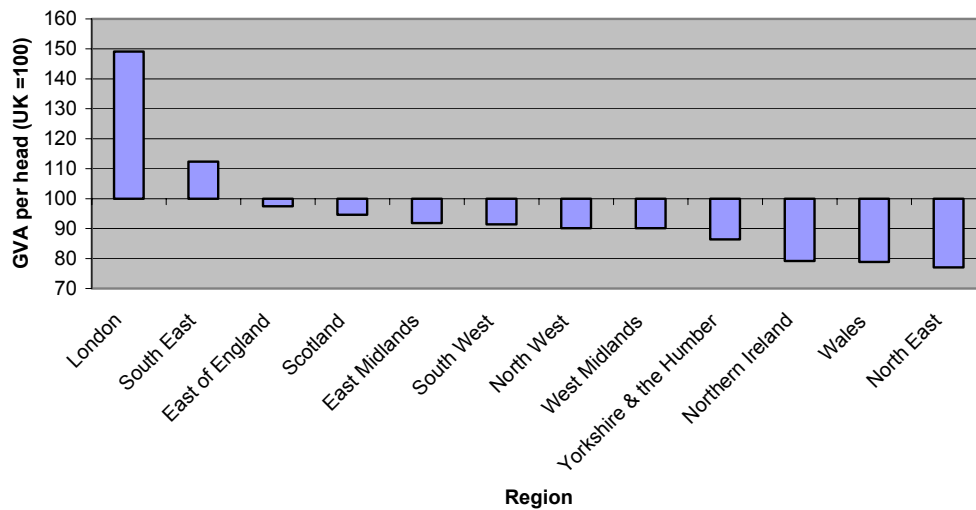
Source: ONS

Figure 3: GVA per head by region, residence based, 2002



Source: ONS

Figure 4: GVA per head by region, workplace based, 2002



Source: ONS

This difference between measuring GDP/GVA on a workplace or a residence basis is critical to any comparison of the South East's economic performance with other regions, in the UK or the EU, and tells us something important about the economic relationship between the South East and London. The relative economic performance of any city will be significantly flattered by the use of a workplace-based measure. One could think of an extreme hypothetical example where nearly all the people who worked in a city lived outside that city's administrative boundaries. On a workplace-based measure, GDP/GVA per head in that city would be very high, in the surrounding region very low; on a residence-based measure it would be the other way round.

Critically for any international comparisons, Eurostat only collects data on GDP/GVA on a workplace-based measure; this is the data set out in the Appendix. So any comparisons using the Eurostat data will overstate the relative economic performance of any European region containing a city whose administrative boundaries fail to cover its full economic reach in terms of commuting patterns. The corollary of this is that Eurostat data will understate the economic performance of any region which is next to a major city and sends a part of its workforce to work in that city, including of course the South East.

The Appendix sets out the economic performance in 2001-2 of the 'regions' of the fifteen states that made up the EU before the current enlargement. The accession states are excluded for ease of comparison because their GDP/GVA per head is much lower than existing member states. Some countries are, because of their small size, treated as 'regions' in the way Eurostat sets out the data. In the other countries, the regions are defined using the administrative boundaries of those countries, so there are twelve for the UK. Three of these UK regions are entered twice – for the South East, London and the East of England, we have both the measure of GDP/GVA per head on a workplace basis as reported by Eurostat, and the residence-based measure converted by ippr from national data into a measure of GDP/GVA per head in PPS terms relative to the EU-15 average. It would be nice to have this measure for all the EU regions, but Eurostat does not provide this.

The Appendix is *not* a league table. It is separated out into three parts – those regions where GDP/GVA per head is significantly above levels in the South East on a workplace or residence-based measure; those regions where it is not significantly different; and those regions where GDP/GVA per head is significantly lower. The Appendix also has data on the average annual GDP growth in the EU regions over the period 1995-2001 and the employment rate, expressed as a proportion of the working age population in employment. It also has the populations of the regions, based on the intuition that it only makes sense to compare regions with broadly similar populations rather than, say, Bayern (Bavaria) and Luxembourg.

Only six EU regions have levels of GDP/GVA per head significantly higher than the South East when we use both the workplace and residence-based measures. One of these is London; another is the French region containing Paris; the cities of Brussels, Hamburg and Bremen and the country of Luxembourg are the others. Intuitively it does not seem right to compare the South East region with any of these and certainly not the world cities of London and Paris. The other European cities will suffer from the same city-measurement upward bias to their levels of GDP/GVA per head that we discussed earlier and anyway their populations are too small to constitute a valid comparison.

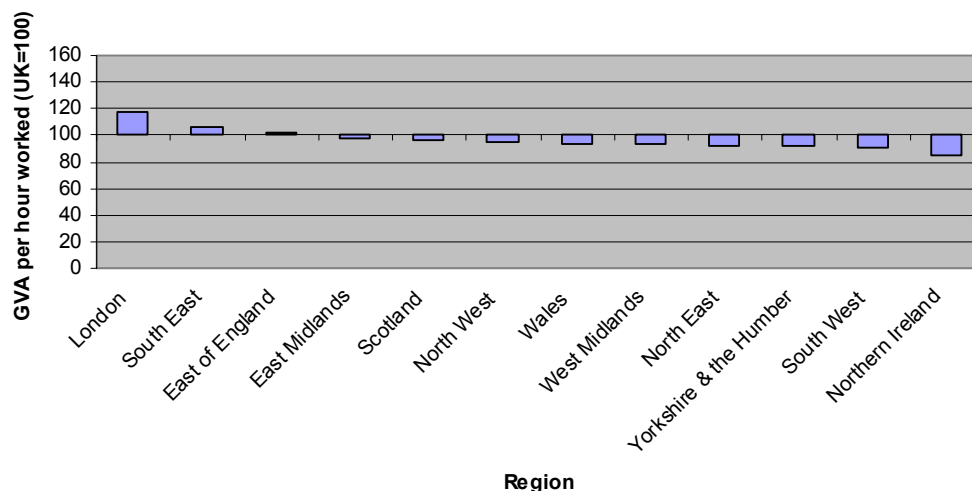
Around fifteen EU regions have levels of GDP/GVA per head similar to the South East. These include the nations of Ireland and Denmark; the region containing Spain's capital city; the region containing Italy's capital and the northern Italian regions that contain the cities of Milan, Turin, Bologna and Venice; the German regions that include the cities of Frankfurt, Munich and Stuttgart; the Dutch region that includes Amsterdam; and the Austrian regions that include Vienna and Salzburg. One should be cautious in making comparisons between the South East and other small countries and with regions that include their country's capital city. However, as all these regions do include their main city, their measure of GDP/GVA on a workplace basis will either be biased upwards or will include their commuter belt and so not be biased, but a comparison with the South East's GDP/GVA measured on a residence basis, taking into account the contribution of commuters to London, may be fairer. Most of these regions have substantial populations that are broadly comparable with the South East. Only Ireland has had a faster GDP growth rate over the period 1995-2001 and Madrid has grown at a similar rate. Denmark and the Dutch region containing Amsterdam have rates of employment approaching those in the South East.

All the other 54 EU regions have levels of GDP/GVA per head significantly below the South East. The conclusion, that the South East compares well with what are generally regarded as the EU's most prosperous substantive regions containing all the well-known centres of commerce in Europe outside of London and Paris, is a very positive one.

There is no measure of productivity – in terms of output per hour - across the EU regions in the Appendix. Eurostat does not report one. It does report a measure of GDP per person employed, but this will be distorted by sharp differences in average hours of work across the EU regions, driven in large part by differences in the incidence of part-time work. There is a range of productivity measures that are available from different consultants, but recent work by GLA Economics, looking at productivity measures for a sample of cities, suggests that the range of estimates from these different sources is so wide as to seriously call into account their utility (GLA Economics, 2004a). On the current evidence base it is safest to conclude that we do not have a satisfactory basis for making comparisons of productivity at the sub-national level across countries; indeed, comparisons at the national level are still subject to some debate, in part because of deficiencies in data on hours of work.

We can compare levels of productivity across the UK's regions with more confidence (Figure 5). In 2002, GVA per hour worked in the South East was 6 per cent higher than the national average, with only London having higher levels.

Figure 5: Productivity by region, 2002



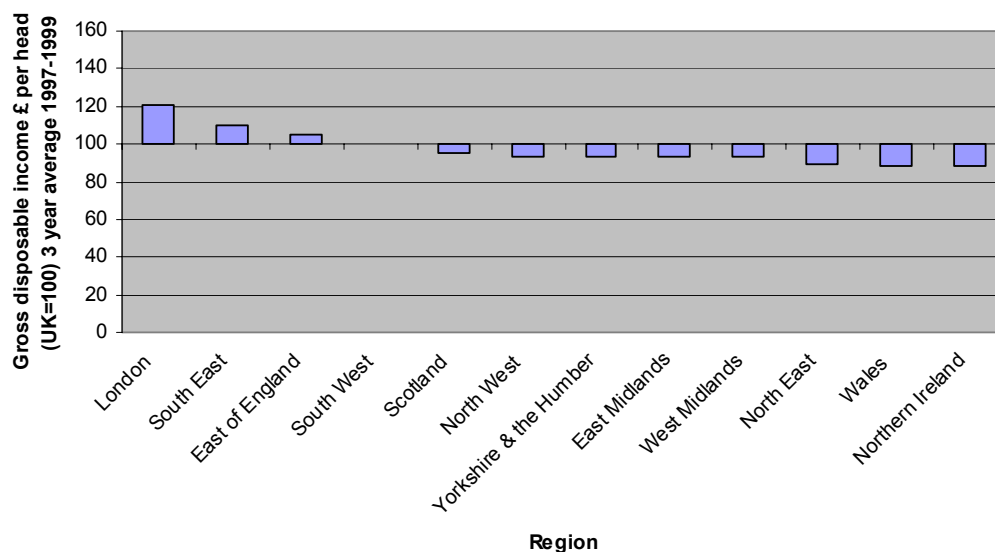
Source: ONS

Another very useful measure for comparing economic prosperity across regions is gross disposable household income per head (Figure 6). This is by definition a much more direct measure of the welfare or well-being of households. (Indeed, the Americans use personal income per head for inter-state comparisons rather than a measure of Gross State Product per head.) It includes the income derived from current economic activity, but also the income from past economic activity in the form of pension payments. Areas with a large pensioner population will compare less well on a measure of GVA per head than on a measure of disposable household income per head. The latter also includes the redistributive impact of the tax and benefits system, one reason why the differences on this measure across the regions are significantly smaller than when using GVA per head. Importantly for the South East, the measure of gross disposable household income in Figure 6 already takes into account interest

payments on home loans. So it makes some adjustment for one of the biggest differences in the cost of living between the regions, relating to the costs of home ownership. However, one of the key problems with this and much other data is our relative lack of knowledge about the differences in price levels between regions and the differences in inflation rates.

Figure 6 suggests that disposable household income per head in the South East was 10 per cent above the UK average over 1997-99. Some work done for the Corporation of London (Gordon *et al*, 2002) suggested that taking into account differences in the cost of living might halve the apparent gap between London and the UK average, and a sensible rule of thumb might be that adjusting for differences in the cost of living might have a similar impact on the South East's relative position. However, this would still leave households in the South East with above average disposable income. The release of further data on both household income and regional price levels in late 2004 may allow us to say more on these issues.

Figure 6: Gross disposable household income £ per head, by region



Source: ONS

These problems in interpreting the data on disposable household income would also need to be taken into account when making any international comparisons. Unfortunately, it is not possible to make these comparisons anyway. The UK data in Figure 6 refers to 1997-99; data for the period up to 2002 is promised for later in 2004. Eurostat does not have reliable and up-to-date data from a number of countries including the UK and this data has not been updated using the most recent PPS estimates, so we have no reliable up-to-date comparisons of disposable household income per head across the EU regions.

The South East and London

(The South East's) economy exists within the context of the UK. It is in all probability one of the key drivers of growth and change in the UK, but as in all trading relationships it is also dependent on the specialisations of other UK regions. (Oxford Economic Forecasting (OEF), 2004)

The availability of GVA data on residence and workplace basis does of course allow us to put some numbers to the intimate economic relationship between the South East region and the world city it is next door to. About 6 per cent of the economic output of London is produced by commuters from the South East; 11 per cent of those in employment who live in the South East commute to work in London. It is pointless to debate whether it is the labour of the South East that helps drive the London economy or the buoyancy of the London economy that provides jobs for some of those that live in the South East. In economic and labour market terms there is no difference between someone who works in central London and happens to live in the London borough of Sutton and someone who works in London and lives over the administrative boundary in Surrey.

Some observers have gone further than this to argue that London and much of the South East and East of England regions and, indeed, parts of the South West region along the M4 corridor and the southern part of the East Midlands, constitute a Greater South East that is effectively one economic and labour market region for which policies need to be developed in an integrated way (LSE/Corporation of London, 2003). This Greater region might stretch from Swindon in the west to Cambridge and Northamptonshire in the north. Other attempts to measure London's Functional Urban Region would certainly encompass parts of the South East reaching out to Maidstone and Crawley in the south and Guildford and Reading in the west (GLA Economics, 2004b).

We have no inter-regional trade or regional input/output data for the UK economy that would allow us to trace precisely the pattern of linkages between those different regional economies. That is why it is best to be circumspect in claiming that any particular region drives the UK economy, or indeed acts as a black hole sucking vitality from the disadvantaged regions, which is the other story that is sometimes told. Cheekily, the quote above is drawn from a report on the London economy, but with the words 'the South East' switched for 'London' to make the point that the statements are inter-changeable.

We could conduct the artificial exercise of asking what the underlying rate of growth of GVA per head would be in the UK economy if the South East's contribution as the only region growing at an above average rate was removed. The national annual growth rate would fall from 2 per cent to about 1.85 per cent, but this is a truly artificial exercise, as if the South East did not exist the economic activity located on that region would be located somewhere else, although we can't say where.

The relative success of the South East casts little light on a question currently exercising policymakers about whether successful cities drive successful regional economies or vice-versa. The South East has an intimate economic relationship with a world city. It also contains six out of the 31 large settlements in England and Wales with populations above 200,000, with Portsmouth, Southampton, Brighton, the Medway towns, Aldershot and Reading all having their own economic pull to a greater or lesser extent (ONS, 2004).

Disparities within the South East

The South East is not uniformly prosperous. There are important intra-regional economic disparities, but, as with international comparisons, it is important to consider the appropriateness of using different data to map out those disparities, especially when the data is arranged by administrative boundaries. In particular, the importance of 'city' effects and the different spread of retired populations make using GVA per head below the level of the region potentially very unreliable. Some counsel against its use at sub-regional level at all (Rodriguez-Pose, 2001) while the European Commission has quite rightly argued that regional policy instruments should be targeted at only the one level down from the region (NUTS level 2 in the jargon) rather than at the level that equates to the English counties (NUTS level 3).

Table 3: Measures of economic prosperity at the sub-regional level

Region (NUTS levels 2 and 3)	GVA per head (UK=100) workplace based, 1999	Gross disposable income per head (UK=100) 3-year average 1997-1999	Employment rate, 2002 (%16-59/64)
<i>Berkshire, Buckinghamshire and Oxfordshire</i>	140	115	
Berkshire	162	116	80.4
Milton Keynes	147	98	82.2
Buckinghamshire CC	122	120	78.3
Oxfordshire	124	114	84.0
<i>Surrey, East and West Sussex</i>	108	118	
Brighton and Hove	89	105	76.8
East Sussex CC	70	103	76.6
Surrey	132	131	81.3
West Sussex	105	114	79.4
<i>Hampshire and Isle of Wight</i>	98	101	
Portsmouth	111	87	79.7
Southampton	115	88	75.1
Hampshire CC	98	107	81.9
Isle of Wight	61	89	73.8
<i>Kent</i>	84	101	
Medway	70	99	77.7
Kent CC	86	101	75.9

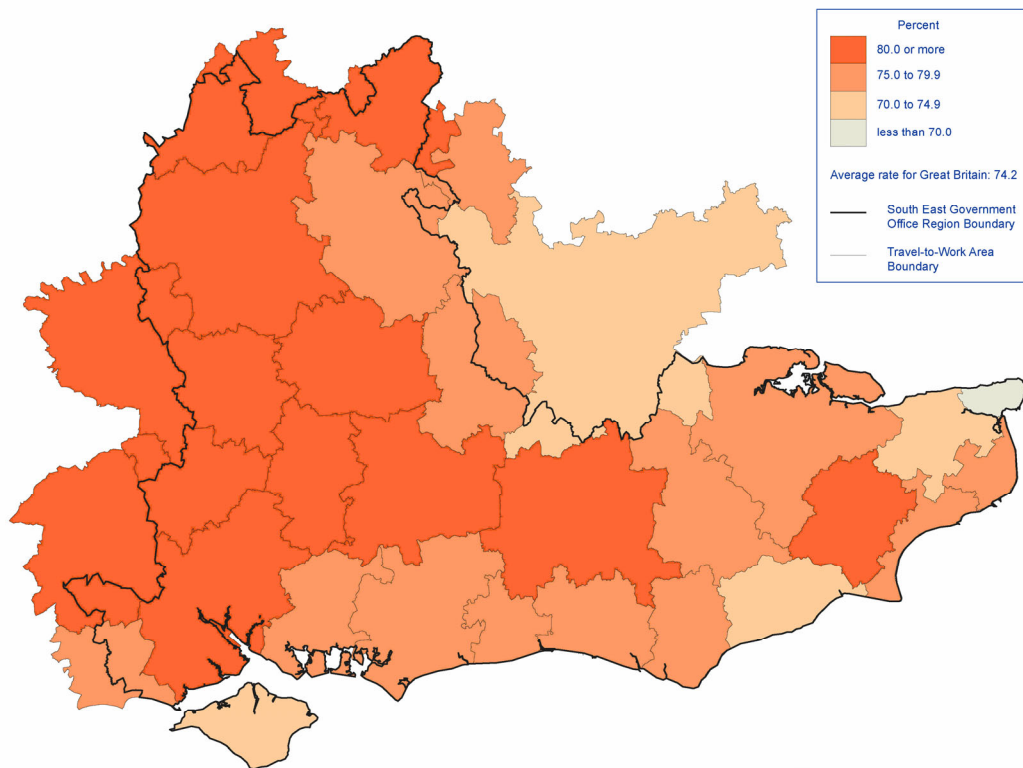
Note: The lower and upper confidence intervals for the employment rates range from plus or minus 1.5-3 percentage points. For example the employment rate for the Isle of Wight is between 71.2 % and 76.5 %.
Source: ONS and ONS/LFS

Table 3 shows GVA per head (workplace based), gross disposable household income per head and the employment rate for the sub-regions (NUTS level 2) and counties (NUTS level 3) that make up the South East. The different stories one can tell by reference to different data should

be obvious. According to the GVA data, Portsmouth and Southampton are relatively prosperous and the Isle of Wight is the least prosperous part of the region. But the GVA per head (workplace based) of Portsmouth and Southampton will be biased upwards because they are cities drawing in commuters from beyond the city administrative boundaries. The Isle of Wight has a large retired population whose pension income will not be counted as part of GVA but will make up a part of household income. On this latter measure there is little to choose between the two cities and the Isle of Wight. Indeed, with household income the city effect works in the other direction, because residence patterns and housing markets tend to work in a way that concentrates more of the less advantaged and lower income households in cities.

The employment data, analysed using administrative boundaries, tell a somewhat different story again, but then these boundaries do not constitute self-contained labour markets anyway. Moreover, the estimated employment rates in Table 3 are just that, estimates drawn from the sample Labour Force Survey, which allows us to say with some confidence that the employment rate for the Isle of Wight in 2002 was between 71.2% and 76.5% of the working age population. Figure 7 maps employment rates for the Travel-to-Work areas that make up the South East region.

Figure 7: Employment rate by travel to work area, 2002



Note: The lower and upper confidence intervals for the employment rates range from plus or minus 1.5-3 percentage points. For example the employment rate for the Isle of Wight is between 71.2 % and 76.5 %.
Source and ©: ONS

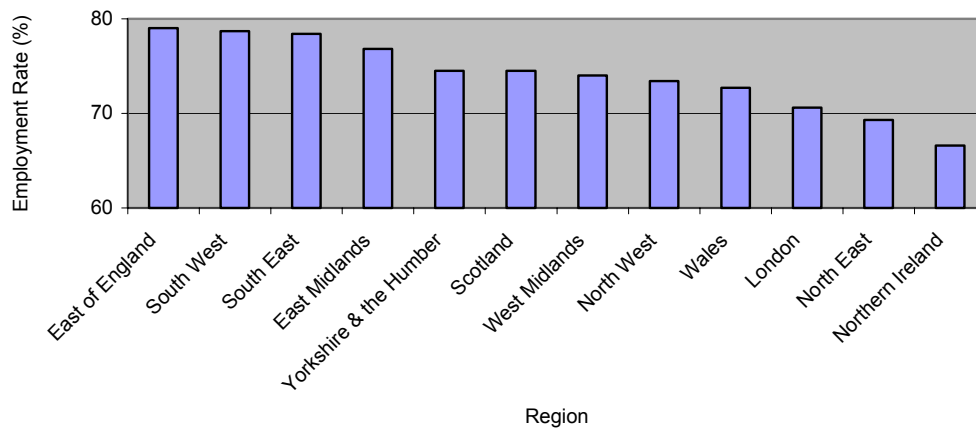
Even with the allowance that needs to be made for the wide confidence intervals for Labour Force Survey data, the relatively low employment rate for Thanet stands out – its employment rate is below 70 per cent, making it more comparable to the labour markets of the North East than the South East. This then is one of the key challenges facing the region, dealing with these

significant disparities in prosperity, with differential employment rates probably the best measure of the problem.

The labour market in the South East

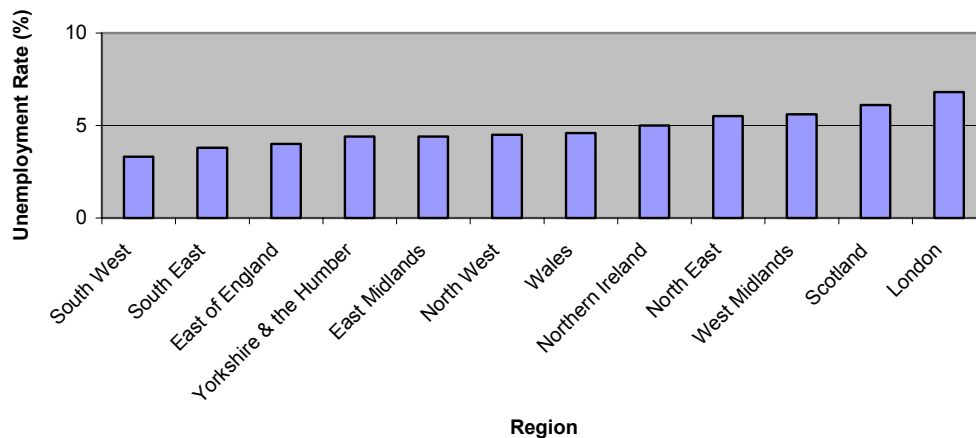
The South East is one of three English regions that in spring 2004 had employment rates approaching 80 per cent of the population aged from 16-59/64 (Figure 8). It also had one of the lowest unemployment rates, at around 4 per cent of the workforce, using the internationally agreed measure of unemployment (Figure 9). These figures are close to the benchmarks for full employment that ippr has identified in previous work (Burkitt and Robinson, 2001).

Figure 8: Employment Rate (%), March to May 2004



Note: The lower and upper confidence intervals for the employment rates range from plus or minus 0.9-1.9 percentage points. For example the employment rate for the South East is between 77.5% and 79.3%.
Source: ONS/LFS

Figure 9: Unemployment Rate (%) March to May 2004



Note: The upper and lower confidence intervals for the unemployment rate range from plus or minus 0.4%-0.9%. For example the unemployment rate for the South East is between 3.4% and 4.2%.
Source: ONS/LFS

It is, however, important not to over-emphasise the tightness of the South East labour market. Table 4 reports the proportion of the adult population that was claiming a key benefit in the

region in February 2004. Fully 9 per cent of the adult population was claiming a key benefit and of these three-fifths were claiming benefits relating to sickness and disability. This figure is well below the national average, but gives some indication of the level of labour market exclusion that does still exist in the region.

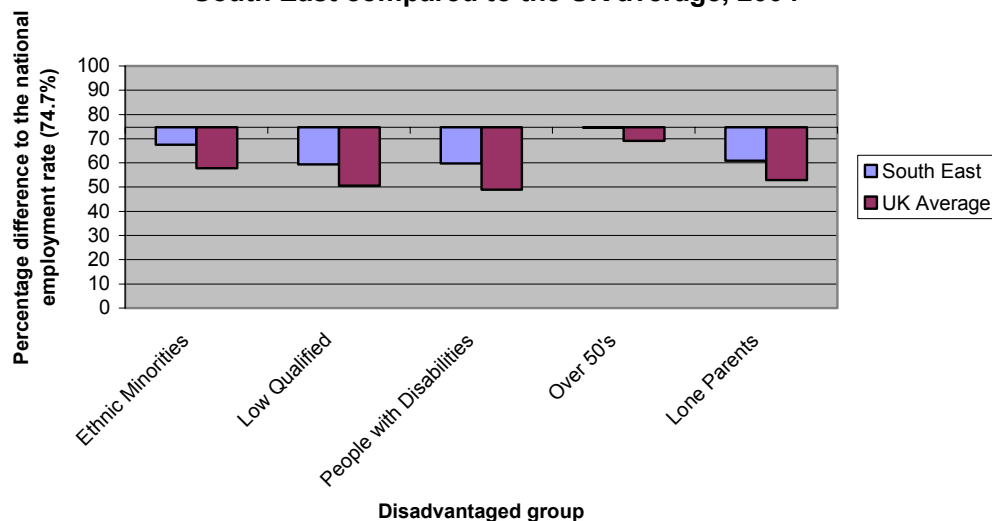
Table 4: Claimants of key benefits by statistical group, February 2004 (% of population aged 16-59/64)

Claimant group	South East	Great Britain
Unemployed	1.6	2.5
Sick/disabled	5.4	8.6
Lone parents	1.6	2.2
Other	0.3	0.5
Total	8.9	13.9

Source: DWP client group analysis

Figure 10 shows how the employment rates for a range of disadvantaged groups compare with the national average employment rate of around 75 per cent. In each case the employment rate for these groups in the South East compares well with the average rate for the UK for those disadvantaged groups. Indeed, the employment rate for the over-50s in the South East is similar to the national average employment rate of 75 per cent. However, in relative terms, the lowly qualified and people with disabilities have the lowest employment rates in the South East as they do nationally and in absolute terms make up the bulk of the non-employed adult population in the South East.

Figure 10: Employment of disadvantaged groups in the South East compared to the UK average, 2004



Source: DWP

There is another piece of evidence to bring to bear on the state of the South East labour market. Table 5 is drawn from the Employer Skills Survey (2003) that is used in England to gauge the extent of unfilled vacancies, hard-to-fill vacancies, skill shortage vacancies and skills gaps. This survey can only give a consistent time series since 1999, which is problematic as the utility of any such survey only really becomes apparent when you have a long enough run of data to be able to compare similar points in the economic cycle, for example today with the late 1980s when the UK economy was in the midst of an unsustainable (in the macroeconomic sense) boom. Over the last few years the results of the survey have not altered much. They do suggest, however, that the South East has only modestly higher levels of unfilled vacancies, hard-to-fill vacancies and especially skill shortage vacancies when compared with the average for England. The incidence of reported skills gaps is also very close to the national average. This is not consistent with a portrait of an overly tight labour market, though the aggregate picture covers a much more complex story of recruitment problems for certain types of labour in certain sub-regional labour markets (Brooks, 2004). Finally, data on the growth in average earnings drawn from the New Earnings Survey does not suggest that wage inflation is a problem in the South East, as would be the case if the labour market was over-tight.

Table 5: Incidence of vacancies, hard to fill and skill shortage vacancies and skills gaps, 2003 (% of total employment)

	South East	England
All vacancies	3.5	3.1
Hard to fill vacancies	1.5	1.2
Skill shortage vacancies	0.7	0.6
Skills gaps	10	11

Source: National Employer Skills Survey, 2003

The labour market in the South East then is relatively tight but it is *not* overheating and there are still uncomfortable levels of labour market exclusion for some groups. Skill shortages and skills gaps do not seem to be a bigger problem in the South East than in other English regions. Critically then the quantity and the quality of the labour force in the South East are not at the moment a serious constraint on growth in the region.

The quality of jobs - a knowledge-based economy?

The knowledge-based economy is an ill-defined concept. Work commissioned by SEEDA (Huggins, 2001 and 2003) defined it so narrowly as to include only a handful of hi-technology manufacturing and service activities, excluding vast swathes of economic activity, including business and financial services. This is a startling omission given that this is one of the obvious areas of comparative advantage of the UK economy and especially that of the Greater South East. Any set of international comparisons based on poor definitions will yield misleading results.²

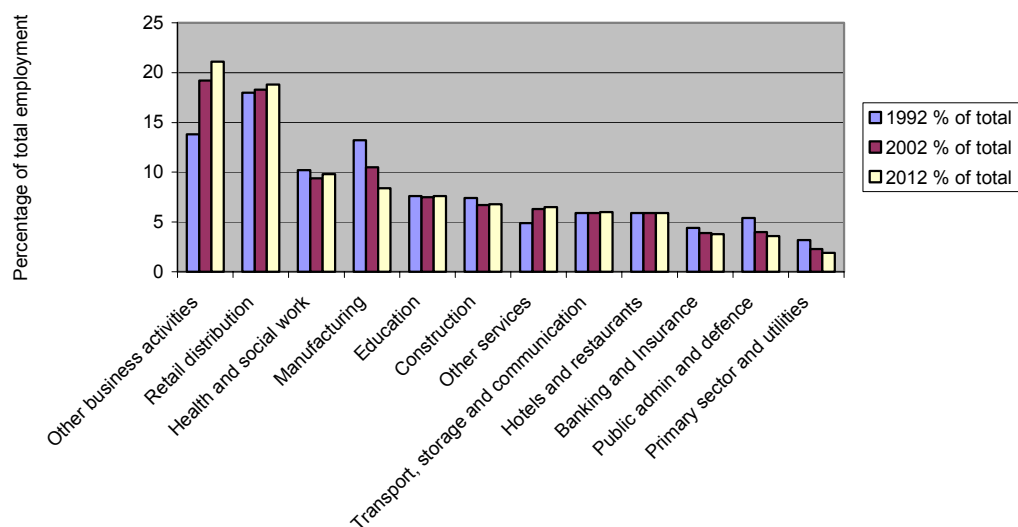
² On this definition neither a think-tank nor an accountancy firm would be regarded as being part of the knowledge economy.

The OECD uses a more inclusive definition of the knowledge economy, which includes hi-technology manufacturing and service activities, financial and business services and health and education (OECD 2003). These activities typically amount to around two-fifths of total employment in the advanced industrial economies. Other approaches use the proportion of graduates employed within sectors to define them as 'knowledge-intensive', though this leads to the obvious problem that as the supply of graduates increases more sectors will end up being defined as knowledge intensive even if their other characteristics have not changed.

The key question to ask is why would we want to define *sectors* that could be classified as knowledge intensive anyway? Presumably it is so we can target them for some kind of special attention from public policy, but in which case it sounds like the 21st century equivalent of an industrial policy based on 'picking winners', an approach that, by common agreement, had little success in the second half of the 20th century.

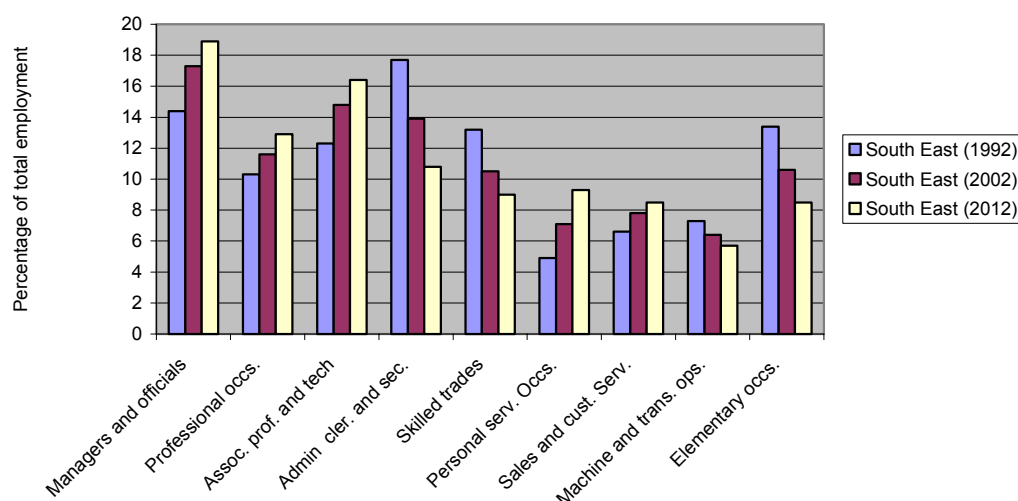
The most open thing to do is to look at the data that shows the overall trends in the structure of the economy and the labour market in the South East. Figure 11 shows the changes in the structure of employment by industry and Figure 12 the changes by occupational group over the period from 1992 to 2002 and, for what they are worth, forecast changes out to 2012, which unsurprisingly show the same patterns of change continuing. Analysing the data by industry, the largest category of employment in the South East is in 'other business activities', accounting for nearly a fifth of the workforce, and comprising all those business services outside of the financial sector, including advertising, legal services, design, consultancy and so on.

Figure 11: Sectoral change in the South East, 1992-2012 (%of total employment)



Source: Working Futures Regional Report, 2003-04

Figure 12: Occupational change in the South East, 1992-2012 (% of total employment)



Source: Working Futures Regional Report, 2003-04

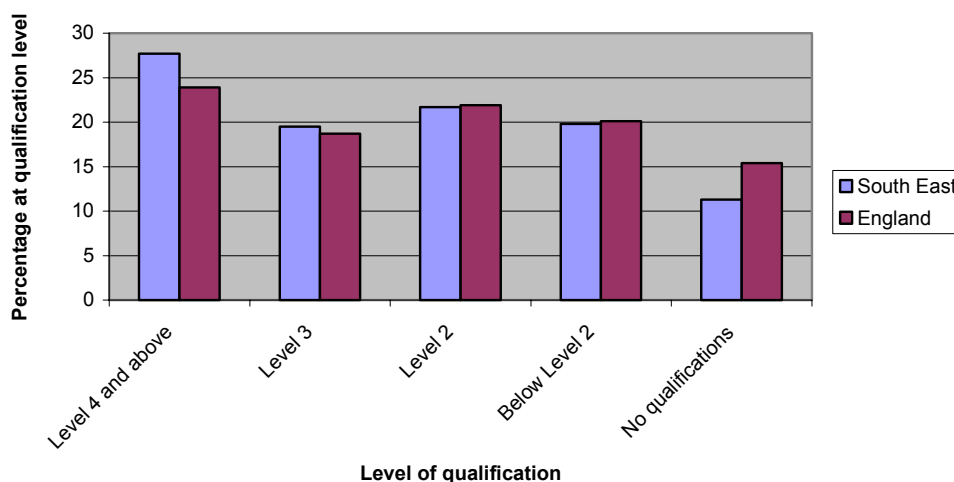
Analysing the data by occupation is actually more informative. The top three categories of the Standard Occupational Classification are designed to encompass those managerial, professional and technical jobs that demand high levels of qualifications, skills and/or experience and knowledge across all industrial sectors. A designer working in the high value fashion clothing industry or an engineer in an unfashionable but high value part of manufacturing is counted as having a 'knowledge-based' job though they may not work in a sector that usually makes the cut when that kind of job is defined. In 2002, 44 per cent of the workforce in the South East worked in these occupations, up from 37 per cent in 1992 and compared with 40 per cent across the UK as a whole in 2002.

This occupational data has been used to make a broad distinction between 'good' and 'bad' jobs, though of course this involves making some strong value judgements. Managerial, professional and technical jobs are 'good' jobs, defined in terms of their relative pay as well as their demands for education and experience. Jobs in the personal service and sales and customer service occupations might be defined as 'bad' jobs in terms of their relative pay. They have increased their share of total employment in the South East from 11.5 per cent to 15 per cent over the period 1992-2002. However, the elementary occupations are also 'bad' jobs on the same basis and their share has declined from around 16 per cent to nearly 13 per cent over the same period, leaving the overall share of 'bad' jobs up by only one percentage point over this period, compared with growth of seven percentage points in the proportion of 'good' jobs. The major declines in employment in the South East, as nationally, have occurred in the 'middle' of the labour market, amongst the administrative, clerical and secretarial occupations and the skilled trades, with their share of employment in the South East down from 31 per cent of the total in 1992 to 24 per cent in 2002. The 'middle' of the labour market has hollowed out to a certain extent but these jobs have primarily been replaced by jobs at the 'top' end of the labour market.

The relatively high incidence of such jobs in the South East economy also helps explain why an above average proportion of the South East labour force holds higher qualifications at level 4 and above – about 28 per cent of the working age population in 2002 compared with 24 per cent

for England as a whole (Figure 13). The reverse of this is that a much smaller proportion of workforce in the South East has no qualifications – just 12 per cent in 2002 compared with 15 per cent in England as a whole. The South East is also the region with the smallest proportion of its working age population lacking basic skills, with 12 per cent having significant problems with their literacy in 2002-03 compared with 16 per cent in England as a whole (Skills for Life Survey, 2003). This still amounts to around 600,000 people in the region, though very few people believe that their lack of basic skills has had any impact on their ability to obtain work or perform their jobs.

Figure 13: Level of highest qualification held by people of working age, 2002



Source: ONS/LFS

The labour market for the graduates and other highly skilled people who fill many of the managerial, professional and technical jobs in the South East is essentially a national, if not indeed an international, one. In other words if the South East offers a high and rising share of these jobs it will attract a high and rising share of well-qualified people from across the UK and to a certain extent from abroad. The region is not constrained by the supply of highly qualified people from within the region.

This is not to say that policy makers should not worry about whether the skills and qualifications of those adults at risk of exclusion from the labour market may help in part to explain that exclusion or worry about the attainment of young people in the education and training system. Policy makers will also be rightly concerned with securing adequate recruitment and retention in the public service occupations.

However, if the ‘knowledge economy’ is to have any relevance to public policy, it will be by helping us to think further about what is going on the labour market and what that might mean for policies in relation to employment and education and training, and not by resurrecting a sectoral approach to industrial policy given spurious credibility by the use of 21st century language.

Policy conclusions

This paper started with the question as to whether it makes sense for a region that already has the highest growth rate of any UK region and is one of the most prosperous regions in the EU to have as its main economic objective further increasing the current rate of economic growth.

We could think of there being three broad 'choices' facing policy makers:

1. We could continue to make increasing the trend rate of growth of GDP/GVA per head in the region the over-riding priority, as it currently is for the Government. This might make the 'problems of success' in the region somewhat more difficult to deal with.
2. We could accept the current rate of growth in GDP/GVA per head, recognising that this rate looks very healthy compared with other regions and would easily maintain the South East's position as one of the most prosperous regions in Europe. Even at the current rate of growth we would still need to deal with the 'problems of success'.
3. We could accept a modest deceleration in the rate of growth of GDP/GVA per head in the South East, which would probably still mean that the region's growth compared well with other regions and it maintained its relative position. This would modestly alleviate dealing with some of the 'problems of success'.

Of course, the word 'choices' in this context is fairly misleading. In practice it is 2) that will come to pass. This is because we do not really have the policy instruments that would allow policy makers to significantly alter the underlying rate of economic growth in the region.

What seems most interesting is that some agencies in the South East pragmatically recognise this to be the case and that any formal objective to increase economic growth in the region is essentially 'aspirational'. That is to say, lip-service is paid to the objective set out in the Government's PSA target to increase economic growth in all the regions, including the South East, but in practice it is not what is driving the policy agenda in the South East. The challenge here is for the Government – it has to recognise that achieving its target does not appear to be high on the agenda in the South East.

What is high on the agenda is addressing the issue of disparities *within* the region. There is clearly an important agenda to follow in relation to employment in the region, to raise employment rates in less advantaged areas (for example, Thanet) and amongst less advantaged groups (for example, people with disabilities). This would have implications for the allocation of scarce resources across different policy areas and across different agencies, giving prominence for example to the activities of Jobcentre Plus within the region and support for measures to help people with poor skills and qualifications. It would mean *not* using resources to support 'knowledge-intensive' sectors in the region's most prosperous areas, a strategy which anyway seems doomed to repeat past policy errors.

Most importantly for the analysis presented here, such an approach does *not* require a faster rate of economic growth in the region. If measures to boost *employment* rates were successful, this would raise the *level* of GDP/GVA in the region modestly, but would not alter the *growth* rate. Where the evidence base and indeed the basic data are lacking, is over the *productivity* agenda – we do not know how to raise the underlying rate of growth of productivity in the region; we do not even know how to measure it, never mind having a clear understanding of what explains different productivity growth rates in different regions. This too poses a big challenge to Government policy.

If GDP/GVA per head in the South East continued to grow at an underlying rate of around 2.75 per cent a year and overall levels of GDP/GVA by around 3 per cent a year, reflecting population growth, the South East would continue to pull away from the rest of the UK in terms of output per head, and regional disparities would continue to worsen. The South East

would also certainly maintain its position as one of the EU's most prosperous regions. Indeed, a look at the Appendix would suggest that this rate of economic growth would see the South East slowly improve its relative economic position compared with most of the other prosperous regions of the EU, with which the region already compares well.

Further increasing the rate of economic growth in the South East does not seem a high priority relative to dealing with disparities in prosperity within the region and coping with the problems that current levels of relative economic success pose, particularly in terms of traffic congestion, the lack of affordable housing, the use of natural resources and the quality of the environment. This is not the same as arguing for 'no growth' or even 'lower growth'. At the very least it is merely suggesting that the current rate of growth is acceptable as an economic objective, although this will pose challenges for achieving environmental objectives in the region.

Appendix: The South East's Economic Performance compared with other EU regions

Region NUTS level 1	GDP/Head (PPS) 2001, EU15 = 100	GDP growth annual % change (1995-2001)	Employment rate % of population aged 15-64 (2002)	Population 1000 inhabitants (2001)
Regions significantly above the South East				
Reg. Bruxelles-Cap (BE)	217	2.6	54.5	971
Luxembourg (LU)	194	6.1	63.6	442
Hamburg (DE)	171	1.8	64.9	1721
London (UK)	165	4.6	68.7	7188
Île de France (FR)	165	2.8	66.4	11055
<i>London (UK)*</i>	142	4.6	68.7	7188
Bremen (DE)	136	1.5	60.7	660
Regions not significantly different from the South East				
Lombardia (IT)	131	1.9	63.2	9150
Emilia-Romagna (IT)	126	1.9	67.5	4023
<i>South East (UK)*</i>	126	4.1	77.0	8007
West-Nederland (NL)	126	3.4	74.9	7473
Hessen (DE)	124	2.0	67.5	6073
Ostösterreich (AT)	119	2.2	68.4	3395
Ireland (IE)	118	9.2	65.0	3853
Nord Est (IT)	118	1.9	63.4	6692
Bayern (DE)	117	2.5	70.7	12280
<i>Eastern (UK)*</i>	116	3.3	76.1	5395
South East (UK)	116	4.1	77.0	8007
Danmark (DK)	115	2.5	75.9	5357
Baden-Württemberg (DE)	114	2.2	69.9	10561
Nord Ovest (IT)	113	1.5	61.1	6030
Westösterreich (AT)	113	2.6	70.6	2893

Comunidad de Madrid (ES)	112	4.2	62.8	5218
Lazio (IT)	111	1.8	55.0	5322
Regions significantly below the South East				
Zuid-Nederland (NL)	107	3.3	74.4	3525
Centro (IT)	107	2.2	61.5	5870
Sverige (SV)	106	2.9	73.6	8896
Noord-Nederland (NL)	106	2.8	72.1	1678
Vlaams Gewest (BE)	106	2.5	63.5	5960
Finland (FI)	104	4.1	68.1	5188
Centre-Est (FR)	103	2.8	64.8	7055
Nordrhein-Westfalen (DE)	102	1.2	63.2	18027
Eastern (UK)	101	3.3	76.1	5395
Noreste (ES)	101	3.6	61.8	4044
Scotland (UK)	100	1.5	70.3	5064
East Midlands (UK)	97	2.5	73.5	4175
Südösterreich (AT)	96	2.6	67.5	1744
Oost-Nederland (NL)	96	3.2	74.5	3367
West Midlands (UK)	95	2.3	71.2	5267
North West (UK)	95	2.6	69.4	6732
Est (FR)	94	1.8	64.8	5202
Este (ES)	94	3.7	63.3	11123
South West (UK)	94	2.7	76.2	4934
Saarland (DE)	93	0.8	61.9	1067
Bassin Parisien (FR)	92	1.9	63.2	10486
Sud-Ouest (FR)	92	2.8	62.9	6267
Schleswig-Holstein (DE)	92	1.3	65.8	2796
Yorkshire & the Humber (UK)	91	2.1	70.5	4967
Niedersachsen (DE)	91	1.6	64.6	7940
Ouest (FR)	91	3.0	64.9	7884
Rheinland-Pfalz (DE)	90	1.3	67.0	4041
Méditerranée (FR)	90	2.9	56.5	7226
Berlin (DE)	90	-1.0	60.1	3386
Nord Pas-de-Calais (FR)	83	2.2	54.1	4014

Wales (UK)	83	1.8	66.3	2903
Abruzzo-Molise (IT)	83	1.7	54.8	1609
Northern Ireland (UK)	82	2.7	64.8	1689
North East (UK)	80	0.8	65.6	2517
Canarias (ES)	79	4.8	57.6	1737
Madeira (PT)	78	5.0	65.1	244
Région Wallonne (BE)	77	1.9	54.8	3351
Sardegna (IT)	76	2.2	46.7	1646
Attiki (GR)	71	3.4	57.0	3904
Continente (PT)	71	3.5	68.5	9811
Noroeste (ES)	70	2.9	55.7	4307
Centro (ES)	69	2.8	56.1	5265
Sachsen (DE)	67	1.0	61.0	4405
Brandenburg (DE)	67	2.2	61.9	2597
Thüringen (DE)	66	2.1	62.5	2421
Kentriki Ellada (GR)	66	3.2	57.7	2425
Mecklenburg-Vorpommern (DE)	66	1.2	58.9	1768
Sachsen-Anhalt (DE)	65	1.6	59.5	2598
Sicilia (IT)	65	2.1	41.9	5071
Campania (IT)	65	2.3	41.9	5783
Sud (IT)	65	2.0	44.4	6731
Sur (ES)	64	4.0	50.7	8573
Voreia Ellada (GR)	63	3.8	55.2	3516
Départements d'Outre-Mer (FR)	58	3.5	44.3	1724
Açores (PT)	56	3.9	61.5	238

Note: GDP per head is workplace based except for the second entries, in italics, for London, the South East and the Eastern region, which are residence based.

Source: Eurostat

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