

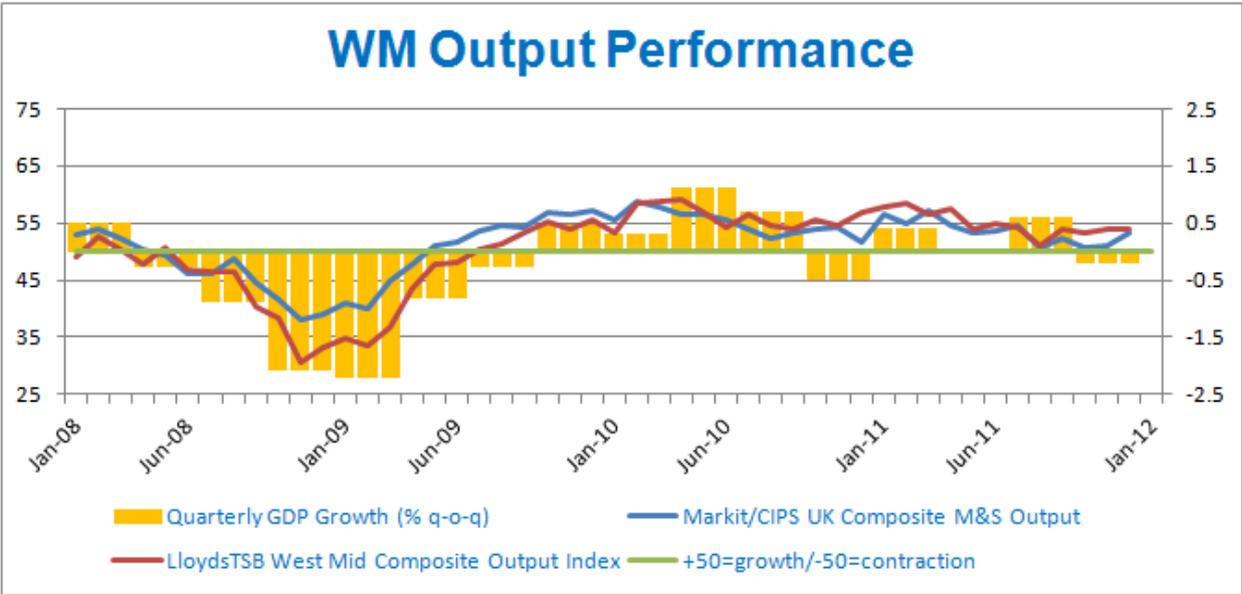


The West Midlands Economy: Perspectives and Potential

Introduction

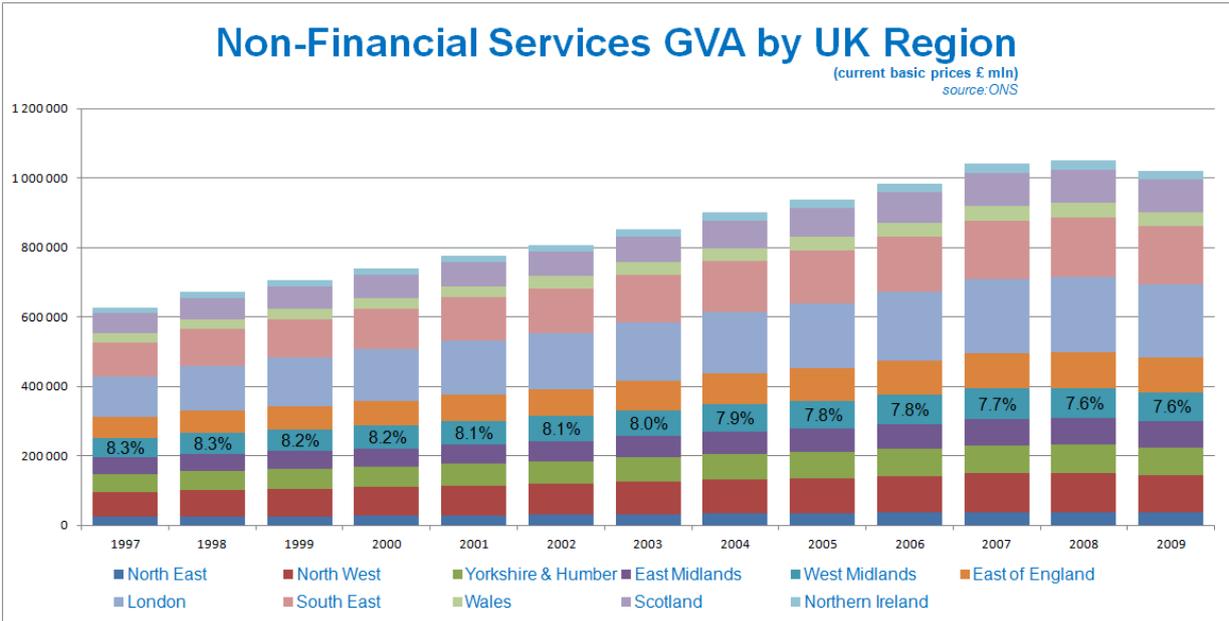
The West Midlands (WM) economy encompasses considerable diversity, in terms of population density, relative deprivation, prosperity, access to infrastructure, educational attainment, employment, productivity, produce and products.

As a result, in the decades up until 2007, some sectors expanded robustly, namely finance, legal, accounting services, real estate and retail (mirroring the national economy); whilst others contracted, most notably manufacturing industries, producing pockets of long-term structural unemployment. In part this was a result of policy and investment decisions reflecting a post-industrial consensus. Since the financial crisis commenced in 2007, the economy at national and local levels, has struggled to recover and growth has been anaemic at best. Sectors that had provided impetus for the past three decades have under-performed, suggesting the achievement of more robust trend growth will require increased output in other sectors, most notably manufacturing. Indeed, the export-orientated manufacturing industries of the West Midlands have been performing comparatively vigorously, primarily, but not exclusively, the result of the rapid and extended depreciation of Sterling.



This continued resilience of manufacturing is reflected in the PMI output indicator, which suggested that WM economic performance, through the second half of last year, was firmer than that of the UK overall. Indeed, since the second quarter of 2010, WM output growth has exceeded that of the UK, in marked contrast to the period prior when the WM significantly underperformed. PMI data up to December suggests a slight acceleration in local growth prospects, with the headline Business Activity Indicator edging up to 54 from 53.8 in the month previous. This increase in an already robust pace of expansion, was supported by increased incoming new orders and outstanding business grew for the first time in 11 months. Furthermore, private sector business activity in the WM continued to grow, extending the current period of expansion to 30 months, and was the strongest across all UK regions. Nevertheless, the lack of effective access to working capital continues to be reported as a major constraint to successfully tapping this latent potential, as is the erosion of skilled labour during the recession.

National Contribution

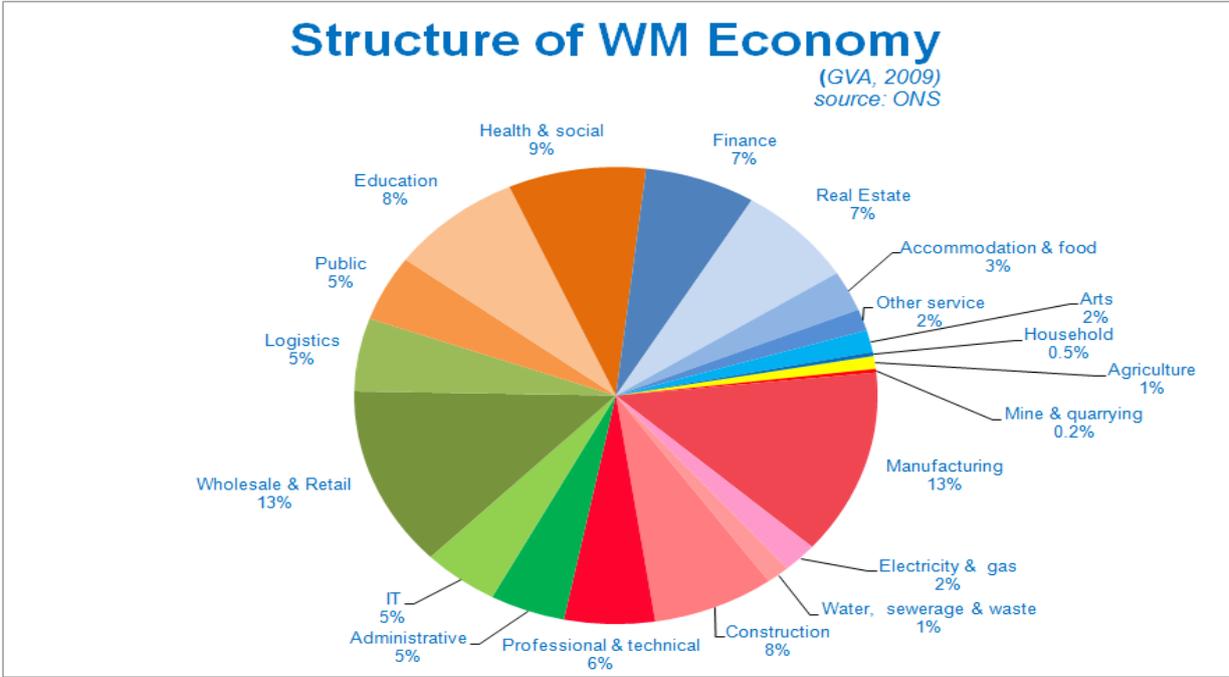


Since 1997, the WM has consistently provided an average of close to 8% of Non-Financial Services GVA produced in the UK, which given the statistical bias toward London & the South East (due to the predominance of the services sector and HQ location there), the real output contribution is probably understated. The WM economy has however a potential output gap, which is a structural feature that has been evident for three decades. Moreover, there was an 11 percentage point decline in manufacturing employment from 22% of the labour-force to 11% between 1996 and 2010. While the WM has the highest proportion of the working age population having no qualifications amongst the English regions, constrains the capacity for expansion.

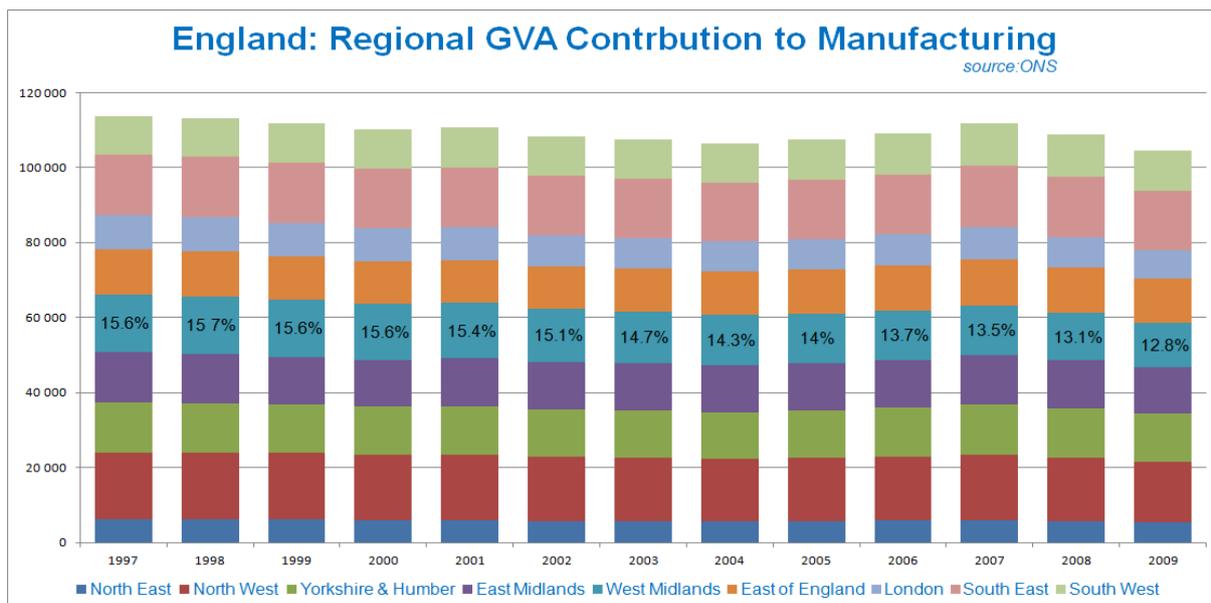
Parallel to the unfolding financial crises, there has been significant, perhaps trend-changing, interruptions to global supply chains (based on just-in-time management processes), due to unanticipated but regular natural disasters (such as volcanic eruptions and tsunamis), as well as concerns over transportation costs as peak oil approaches. This has contributed to manufacturing conglomerates re-focussing on proximity and sustainability of supply, to their main production units, rather than simply on the price competitiveness of assemblage. The repatriation of manufacturing is already evident in the WM, and accordingly a more nuanced approach in terms of sub-national and sectoral economic management is now required. Successful rebalancing

of the economy will require an innovative approach to sustaining the successful sectors, whilst at the same facilitating the expansion of sectors that have underperformed over the past three decades.

Economic Structure

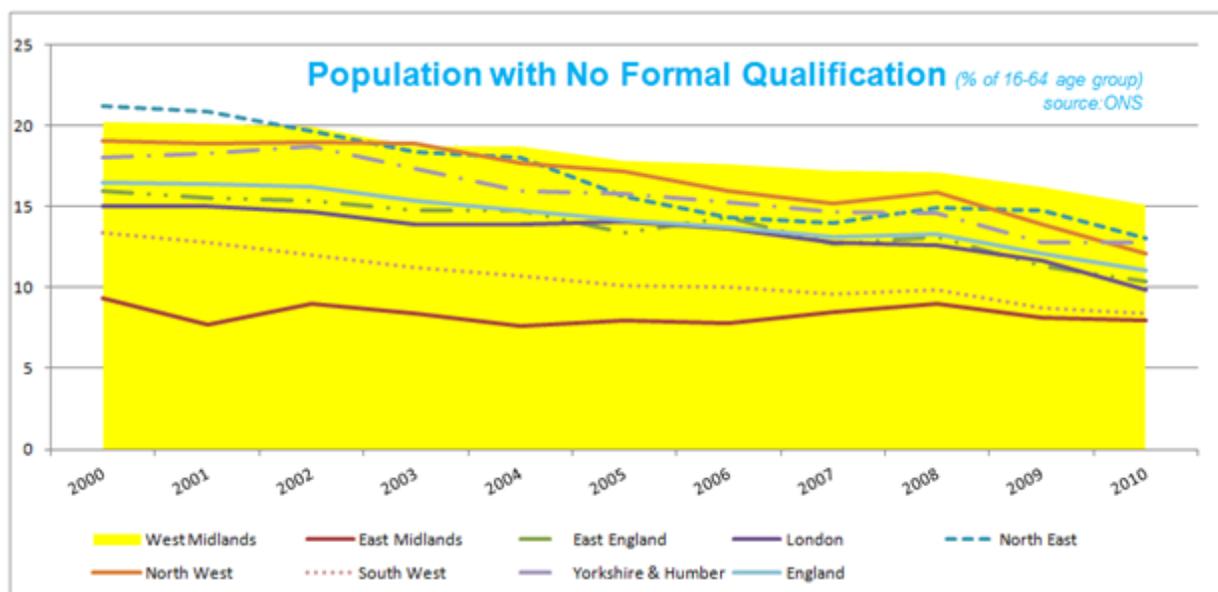


The latest data available for 2009, records that that the largest sectors are manufacturing (13%) and wholesale & retail (13%), followed by health & social (9%), education (8%) and construction (8%), with finance equivalent to 7% and real estate 7%. It has been calculated that output, as measured by GVA per head, has failed to keep pace with national output levels since the mid-1970s, and in real terms has probably contracted. Indeed, growth in workplace-based GVA per head was lowest in the country over last decade. This is exemplified by the steady erosion of WM manufacturing’s contribution to the overall manufacturing sector in England, falling from close to 16% of total GVA in 1997 to 13% in 2009, the latest for which data is available. There are a number of factors that contributed to this deterioration, including the real effective appreciation of Sterling.



Skills Constraints

However, the most widely attributed factor to the decline in productivity is the low skills-base. The structure of the WM economy, with its high proportion of small and smaller-medium sized enterprises, ensured that in the past while there was an established core of a relatively skilled labour force, these skills were largely acquired during the production process, rather than through a formal process of qualification. The successive recessions since the 1970s, through enterprise failure, effectively halted on-the-job training of those made redundant. Without the ability to acquire such skills, pockets of long-term unemployment and deprivation build-up, compounded by a historic cultural attitude that has not recognised the value of formal qualifications.

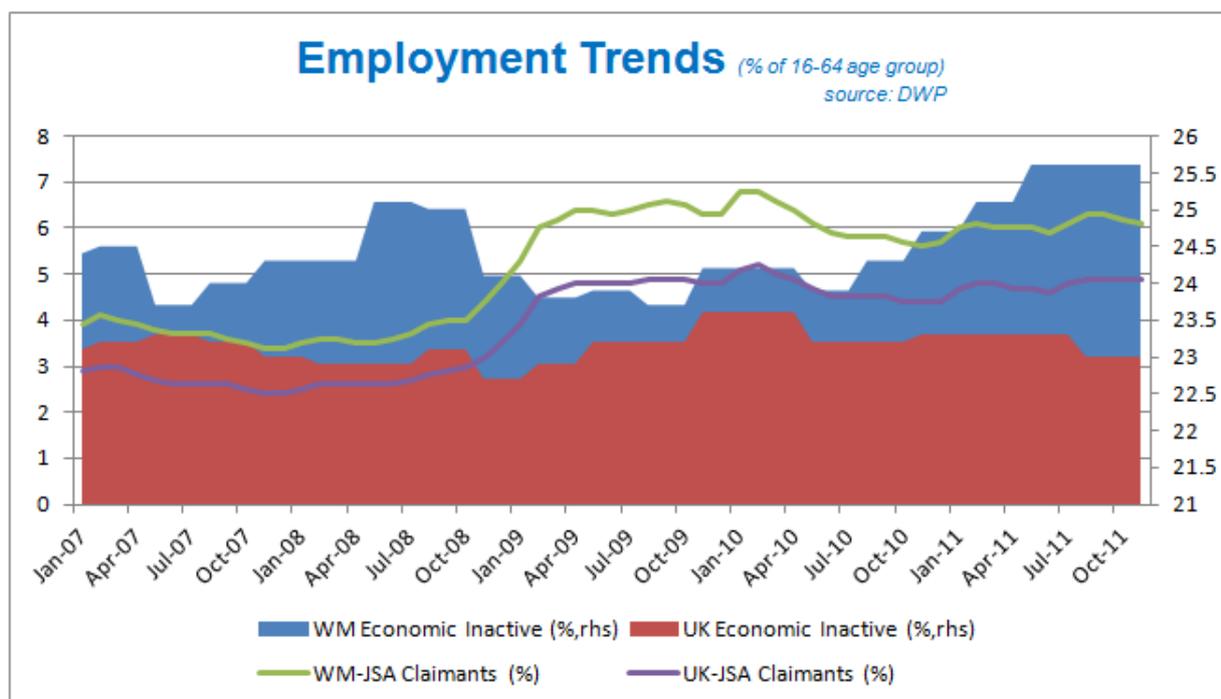


At the most basic level, there are too many people with poor literacy and numeracy skills, let alone qualifications, and too few with Level 2. There are 70,000 fewer people with high level skills compared to other regions and the second lowest proportion of managerial and professional jobs in England, although the proportion of people in the region qualified to at least GCSE, A Level and degree level has been increase. The WM Train to Gain service was the best in the country, helping over 24,000 employers and over 100,000 companies in the last year alone, ensuring that the WM has the highest proportion of young people and adults successfully completing Apprenticeships. As a City, Birmingham is one of lowest in terms of skills, with more than two in ten of the city's residents have low skills, compared to just over one in ten nationally. Greater London, by contrast, is now better than the national average in skills. Of Britain's major cities, only Leicester is worse placed than Birmingham in skills. Birmingham is behind even Liverpool, which has lost nearly half its population in the last 50 years.

Breaking this erosion of the skills-base, and hence productivity potential, will only be reversed via formal processes of training and qualification. Despite a general trend improvement in the proportion of the 16-64 year age group over the past decade across in England, the WM, not only started for a disadvantaged position, with only the North East in a weaker position, by 2010, the WM had the largest proportion of without

qualifications, and indeed the comparative distance with other localities had widened. Almost 15% of the effective labour force lack formal qualifications in the WM in 2010.

Employment Constraints

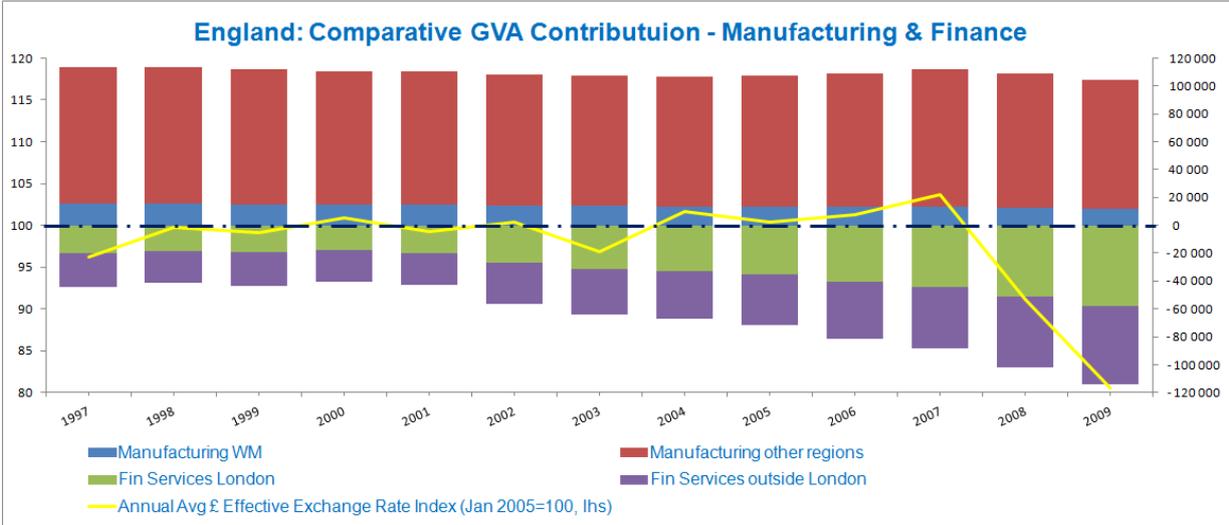


The increasing paucity of the skills base is reflected in employment trends. In terms of those in the economic active age range, close to 26% are deemed economically inactive in October 2011 in the WM, some 3 percentage points greater than the equivalent proportion for the UK as a whole. Similarly, on the narrower, and not directly comparable, Job Seekers Allowance claimants measure, the WM at 6% in 2010 performs worse than the UK as a whole at 5%. Overall, the unemployment rate in the West Midlands is now at 9.8% - the second-highest of any English region. Employment has also fallen rapidly and is now at 68%, lower than at any other time since December 1993. The number of people in employment fell by 48,000. This is a larger fall than in many other regions, with England overall experiencing a net loss of 111,000 people from employment. For example: Birmingham's unemployment rate is more than twice the national average, now at over 11 per cent, whereas London and Leeds are only marginally above the national average. Birmingham also has one of the lowest employment rates in the country, 61% against 70% nationally. London and Leeds, again, are at about the national average.

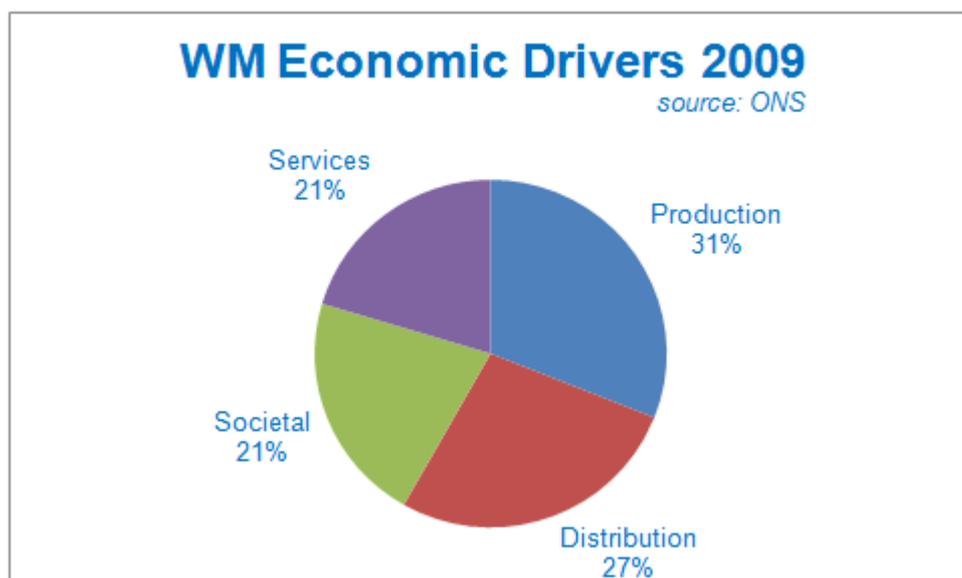
Moreover, the lack of employment is a structural feature of many of the LEP areas. Real levels of unemployment in Stoke are estimated to be close to 15%, in Wolverhampton 17% and of a similar magnitude in Sandwell. Adoption of kurzarbeit-style counter-cyclical re-skilling programme, prevalent in Germany, would have limited redundancies and given the manufacturing sector a more robust capacity base with which to respond to reviving global demand.

Significantly, the WM has an above average proportion of public sector jobs and above average proportion of jobs in low or slow growth industries. Notably, Birmingham has very low productivity and is excessively dependent on public sector jobs. In Birmingham’s shift from manufacturing to services over the last 35 years, public services have predominated. One in three jobs in the city are now in public services, compared to one in five in financial and business services. Only one in ten jobs are now in manufacturing. According to economic projections prepared for the city council, Birmingham’s employment is forecast to be 4% lower in 2020 than in 2008. The West Midlands is the only region where private sector investment declined over the last decade. In the five years to 2008 the city gained 10,000 public sector jobs but lost 3,000 private sector jobs. As public spending cuts bite, areas that are overly-dependent on public sector employment will be hit the hardest.

Potential



The manufacturing structure largely comprises small-scale precision-based component manufacturers coupled with traditional craft-based industries feeding into globally-ranked prestige producers including JLR, Rolls-Royce and JCB. This structure is not dissimilar from that which has provided the basis for sustained vibrant expansion in Northern Italy and Catalonia. Hosting one of the largest concentrations of manufacturing units in the EU, the WM has significant potential to enable the overall economy to be restored to growth. The strength of this potential is perhaps most amply demonstrated by the contribution of manufacturing since 1997, to the wider economy, which up until the depreciation of Sterling (which has probably inflated asset value) continually outstripped the contribution of finance and insurance services, and from London in particular. Balanced and equitable policy concentration on the real value generating economic sectors, would be a valuable first step.



Furthermore, instead of framing policy in terms of specific sectors and enterprises, policy development should focus on the key inter-relationships between sectors of the economy and the real economic drivers. Outsourcing of a number activities previously located in the manufacturing sector, such design, accountancy and IT, has rightly seen these categorised as services. However, without the manufacturing sector these would not exist, and indeed the performance of the manufacturing sector would be constrained without access to these services. Therefore balancing the economy should look to promote these linkages and developing clusters where innovative processes and qualitative methods can be accessed across the wider economy. An

example of this is the shift by many successful global manufacturers to the delivery of maintenance services, providing close to 50% of turnover.

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