



making business sense

Positive scenarios for the Northeast economy

**A report for One Northeast by centre for economics and business research ltd
23 September 2003**

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Our three 'positive scenarios' or targets

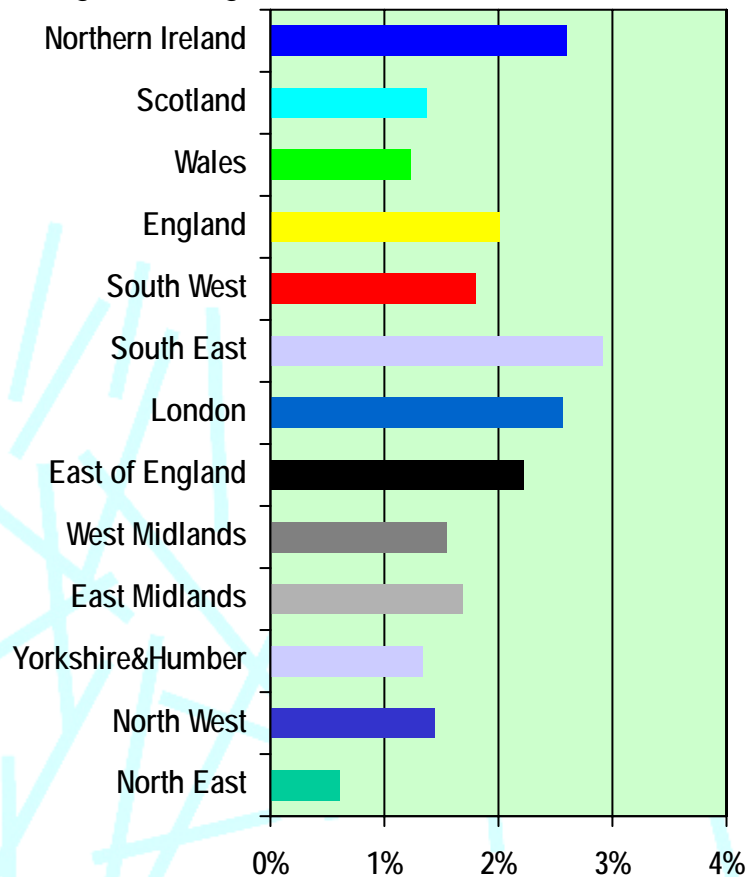
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The Northeast has suffered slow growth recently, and many commentators predict this to continue

Average annual growth in real GVA, 1989-2001



The Northeast was the slowest growing region of the UK over the past decade.

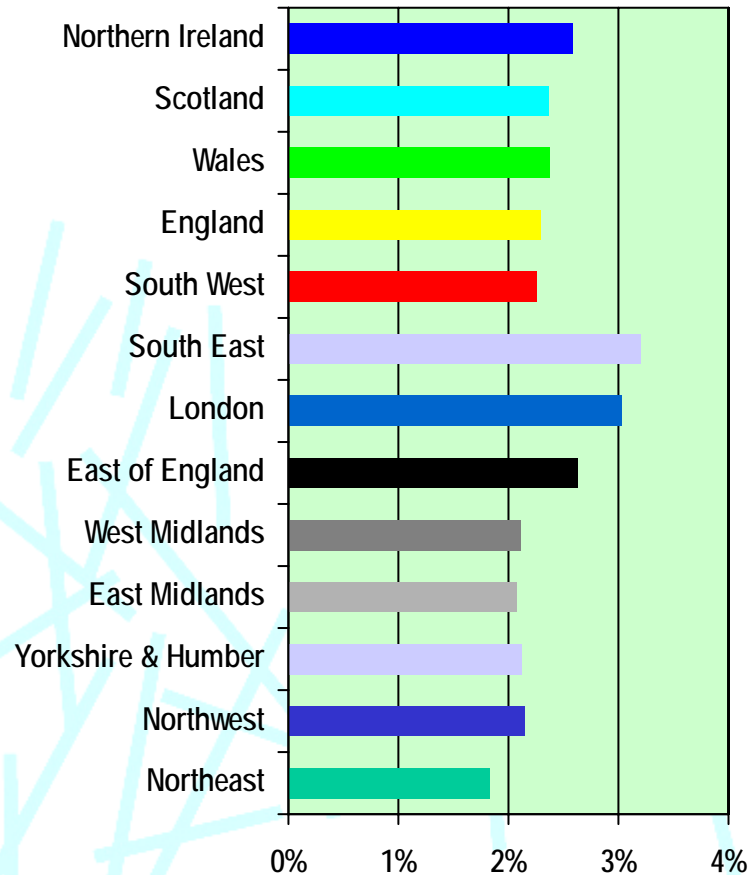
The region has been hampered by a bias towards manufacturing, and particularly sectors — like chemicals — which have performed poorly recently.

Most forecasts of future economic performance suggests this sluggishness will continue.

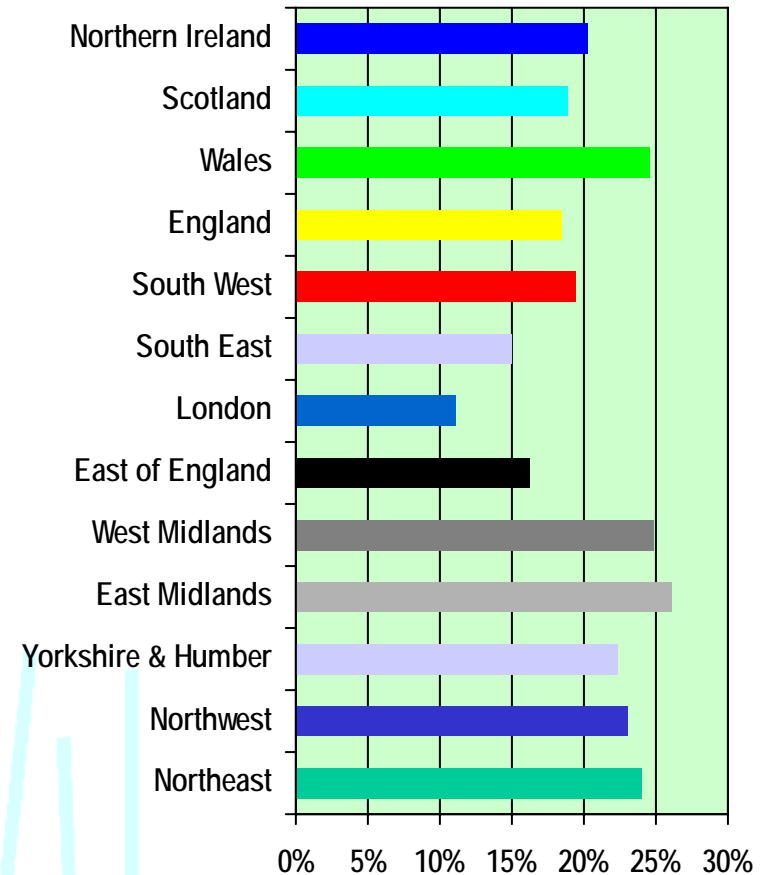
Indeed, our own baseline forecast for the region suggests average annual growth of 1.8 per cent up to 2016, compared to 2.3 per cent nationally.

With its manufacturing bias, it is all too easy to write-off the Northeast as a low growth region

Average annual growth in real GVA, 2001-2016



Manufacturing share of GVA, 2000



If past trends continue, the baseline forecast is for only 1.8 per cent annual growth

Our baseline forecast is, effectively, a “no change” prediction, with the region’s historic industrial mix continuing to detrimentally effect its future performance. This is, though, in line with similar predictions by other forecasters.

The baseline also assumes:

- population as per the Government Actuary’s Department predictions
- productivity in each sector in the Northeast grows in line with national growth in that sector
- participation rate — i.e. employed workers as a proportion of working age population — remains (broadly) constant

However, there are good reasons to test these assumptions, and review the underlying thesis that past trends must continue.

But recent news has been encouraging: so does the baseline understate the region's potential?

Recent economic data for the Northeast have been encouraging:

- Employment in the Northeast grew in 2001-2002 by 1.6 per cent, whereas the UK employment increased by 0.5 per cent
- Unemployment has fallen faster than in the UK: over the past 2 years, the Northeast claimant count fell by 15 per cent; at the same time, for the UK it was down by less than one per cent
- Business survival rates are improving, narrowing the gap between the Northeast survival rates and the UK average
- Recent business confidence surveys indicate more positive outlook in the region

This isn't what we'd expect from a region entering another decade of sluggishness.

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We've considered whether there's the potential for the Northeast to do better

We have considered three 'positive scenarios' or targets for the Northeast:



GOLD

Northeast achieves UK average GVA per head by 2016



SILVER

Northeast achieves an average of 3.4 per cent annual growth in real GVA in the period up to 2016



BRONZE

Northeast achieves an average annual rate of growth in GVA over the period up to 2016 equal to the UK average (2.3 per cent)

In addition, there is our **baseline** forecast (described above)

The positive scenarios push annual growth up from 1.8 per cent to 2.3, 3.4 and 4.9 per cent

These are equivalent to:



average annual growth in real GVA of 4.9 per cent



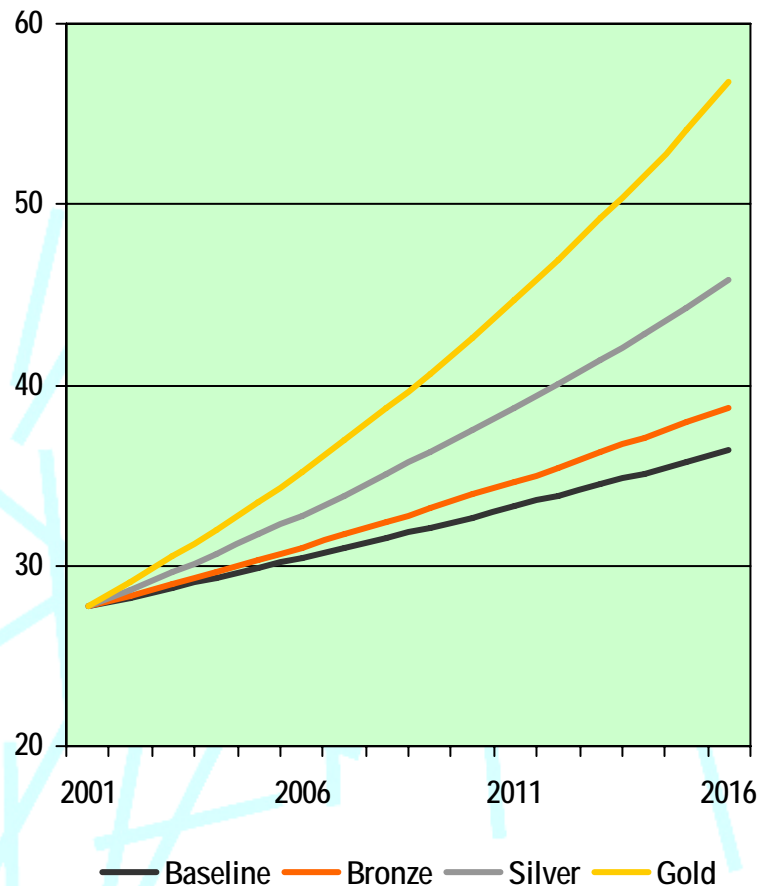
average annual growth in real GVA of 3.4 per cent



average annual growth in real GVA of 2.3 per cent

Our three positive scenarios put the Northeast's economy on very different trajectories

Northeast GVA, £ billions 2001 prices



The three targets put the Northeast's economy on very different trajectories.

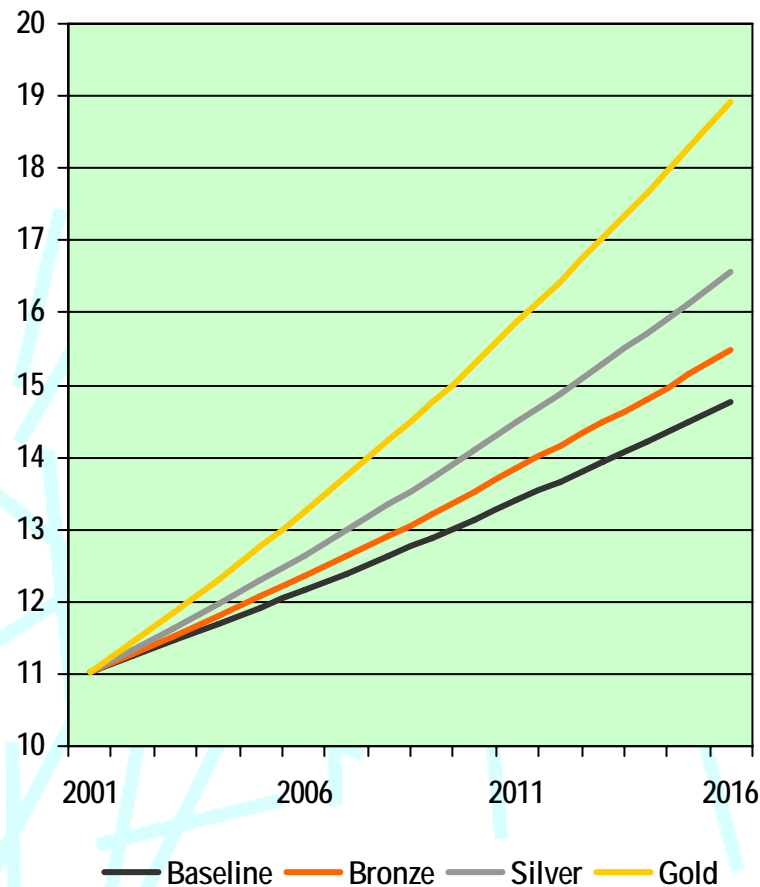
We have developed a simple computer model of the Northeast economy. This has allowed us to develop quantified scenarios — covering the key regional economic indicators — of how the region might look if the different targets were achieved.

For simplicity, we have started each of the scenarios in 2001 — the latest year for which there are official estimates of GVA.

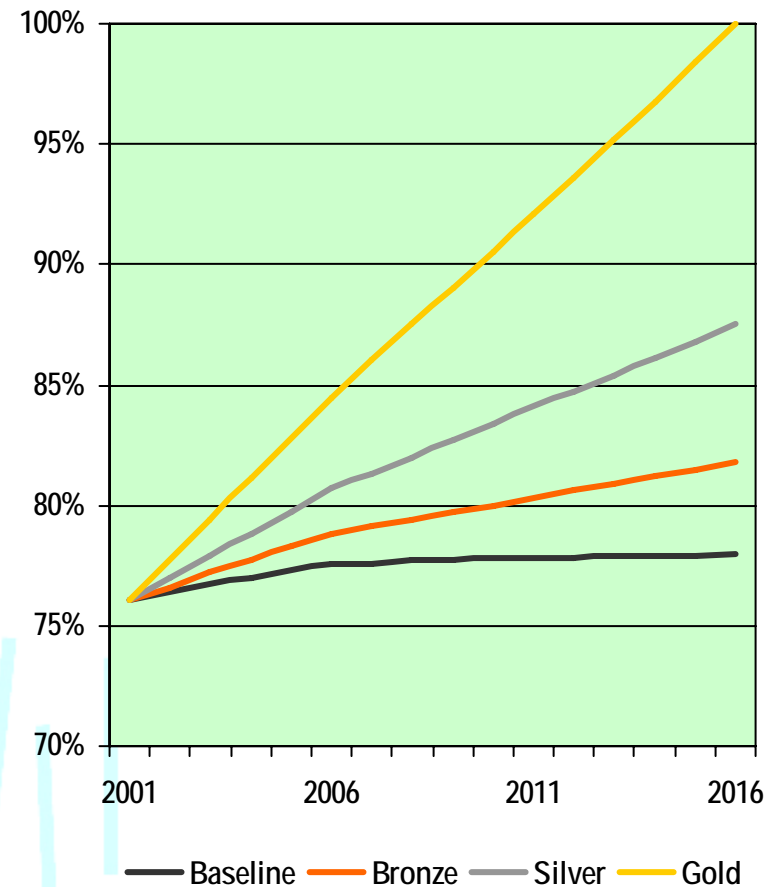
We have also assumed that most of the changes happen gradually and evenly over the period — but we all know the World isn't like that!

But none of the scenarios have the Northeast exceeding national average GVA per head

GVA per head, £ thousands 2001 prices



GVA per head, UK = 100%



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Getting more out of the labour force is crucial to pushing the region into the positive scenarios

The region's economy is blighted by low rates of participation and economic activity.

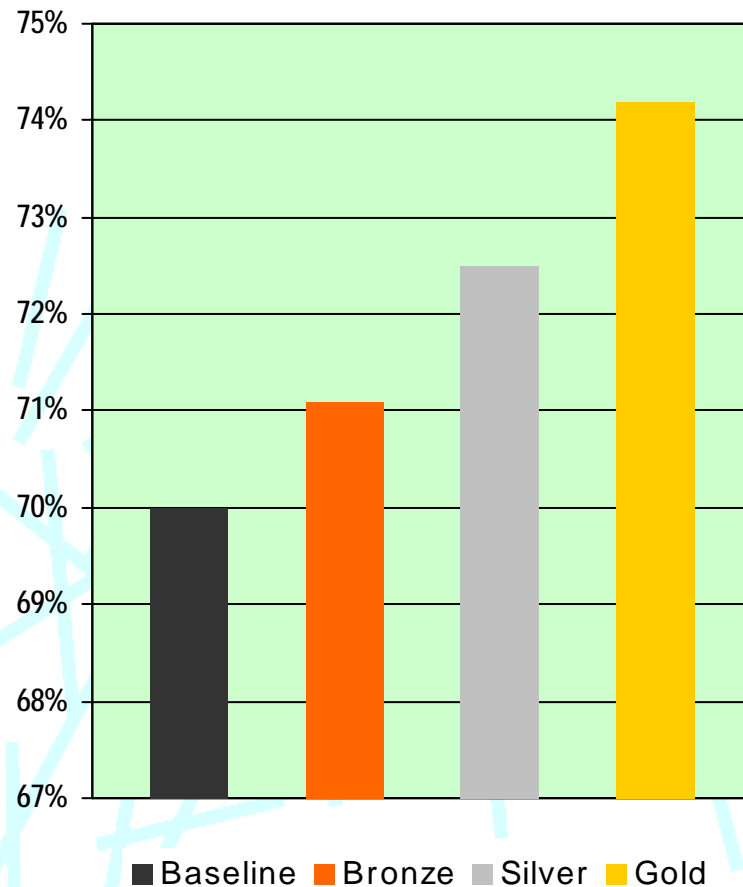
Much of the growth in the positive scenarios can be achieved by tempting more of the working age population into the labour market, and finding them any employment.

The baseline is for the number of jobs in the region to fall over the period to 2016 — but this is arrested in the Bronze scenario. The Gold and Silver scenarios require significant job creation to deliver their growth targets.

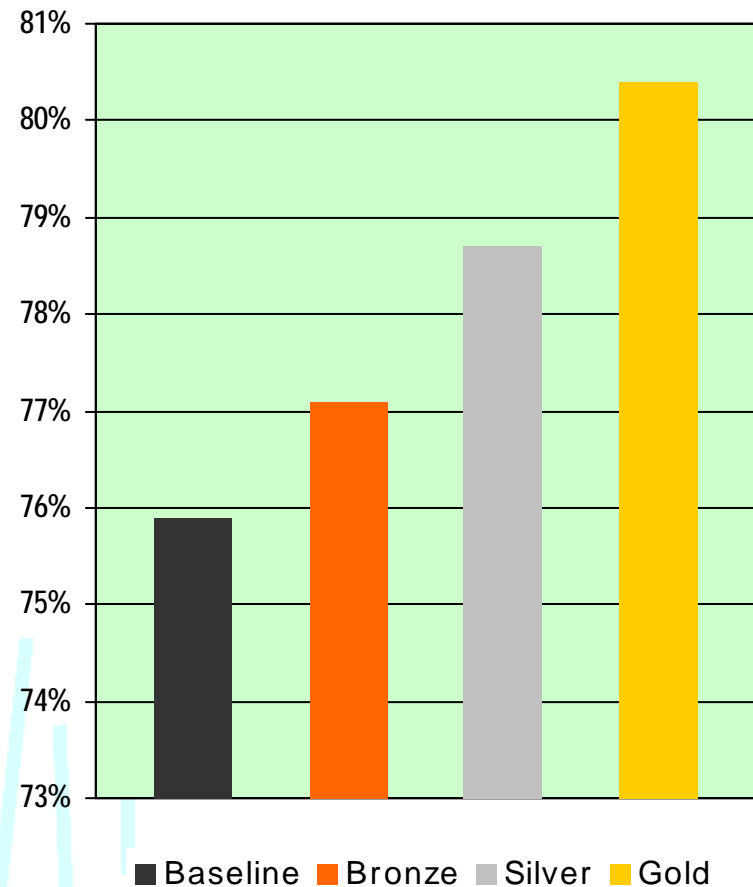
Increasing employment will not necessarily eliminate the problem of unemployment. Our forecasts for the Gold and Silver scenarios actually have the jobless number rising on the ILO definition. This is the result of population increases — as more younger people stay on and others move to the region attracted by the improving economic climate — and as a more buoyant economy attracts more marginal workers into 'economic activity'.

Growth must be driven by improvements in economic activity and participation rates

Share of working population employed, 2016

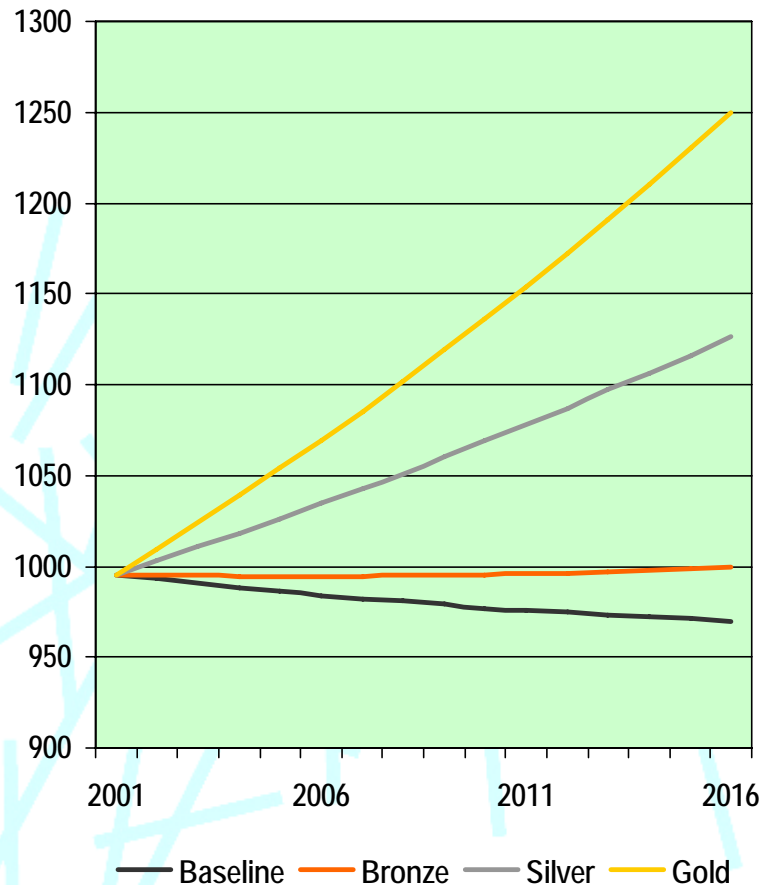


Share of working population economically active, 2016

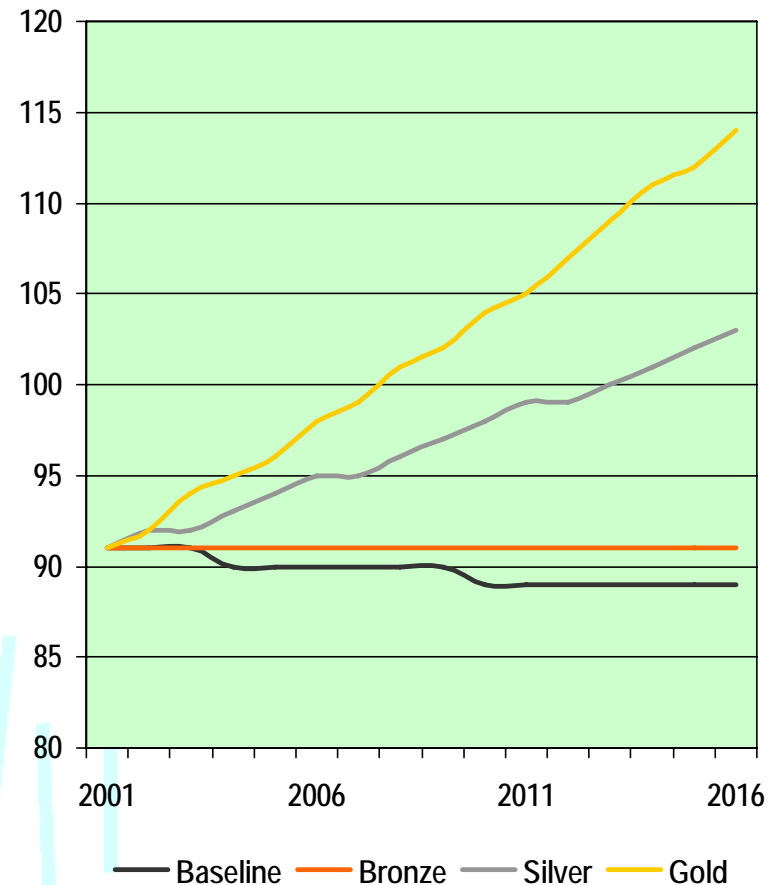


The buoyant climate of the positive scenarios generates more jobs but more unemployed

Northeast employee jobs, thousands

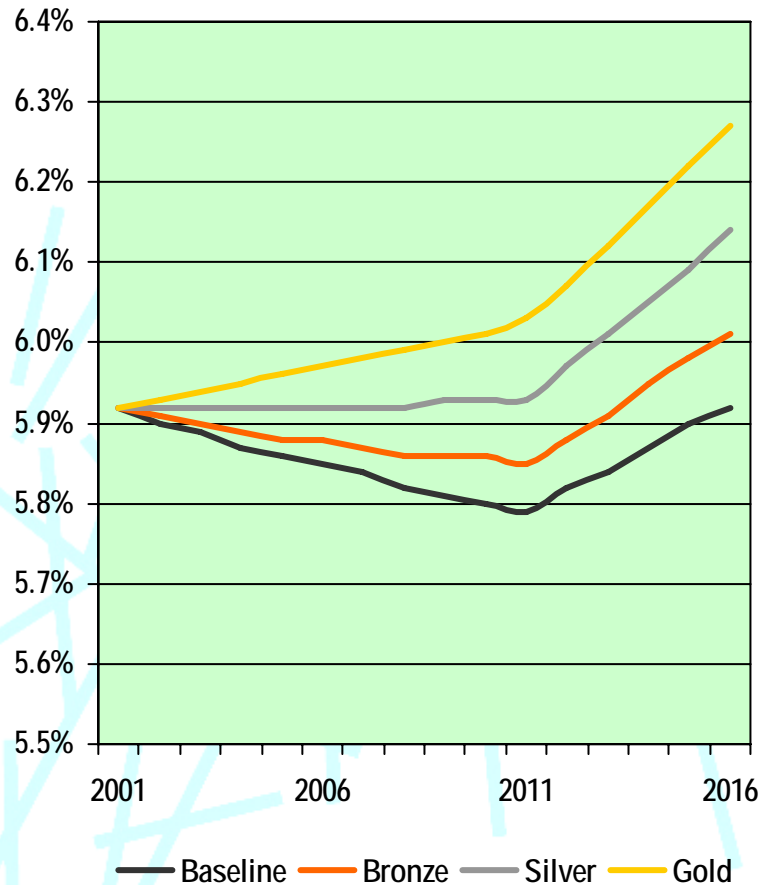


Unemployment on ILO measure, thousand



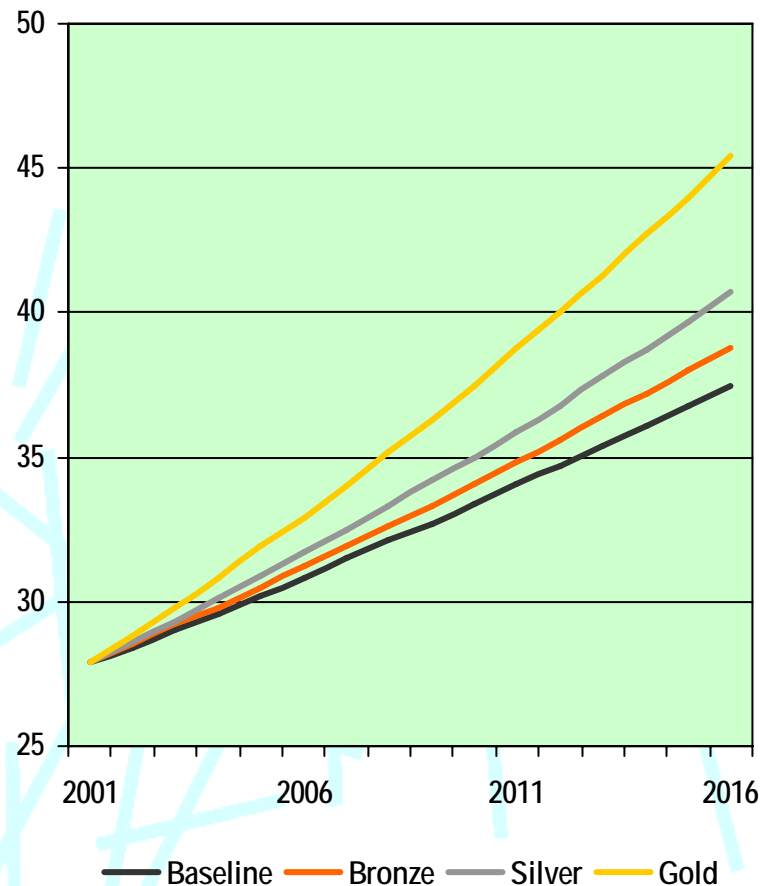
The buoyant climate of the positive scenarios generates more jobs but more unemployed

Unemployment rate: ILO unemployment as a share of working age population



Improving productivity is another key driver of growth in the positive scenarios

GVA per employee, £ thousands 2001 prices



Underlying every scenario is continual improvements in productivity across all the region's industries.

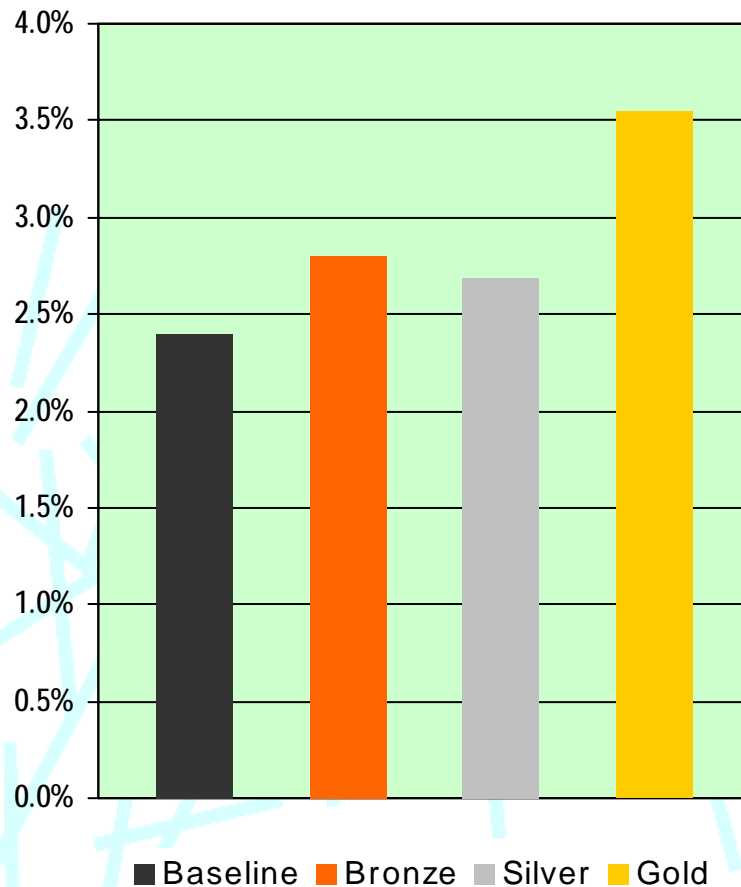
Our baseline assumes national rates of productivity improvement — including 2.4 per cent per annum for manufacturing and 2.5 for most services.

The positive scenarios require the region's businesses to perform better than the national average — but not by that much.

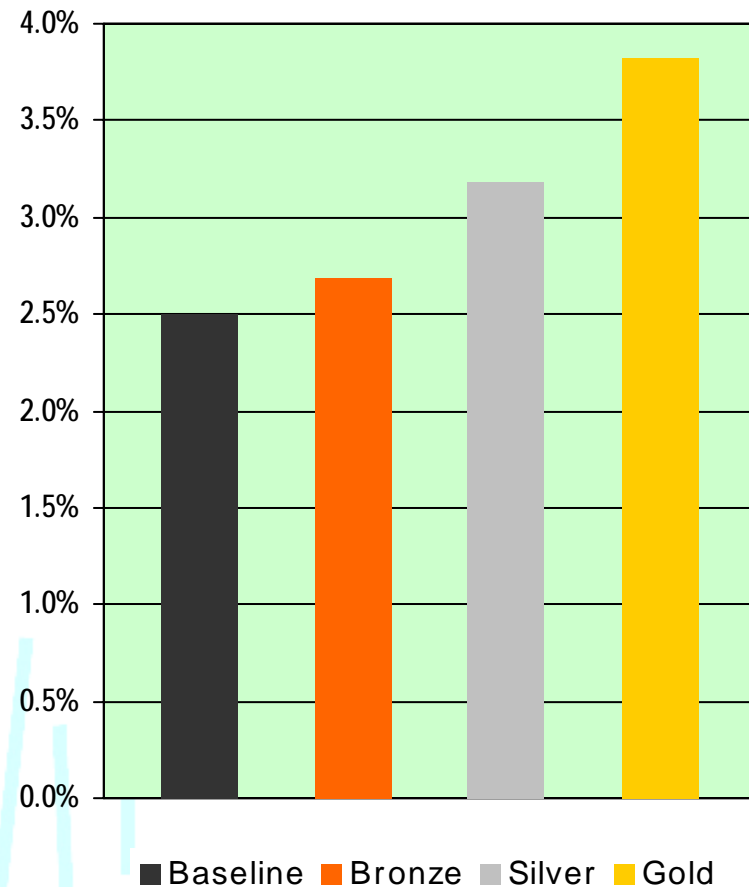
None of the scenarios demand much more than a one percentage point annual improvement in productivity growth rates. But these increments will make a big difference when compounded over 15 years.

The positive scenarios require businesses to improve productivity by more than the UK average

Average annual growth in manufacturing productivity

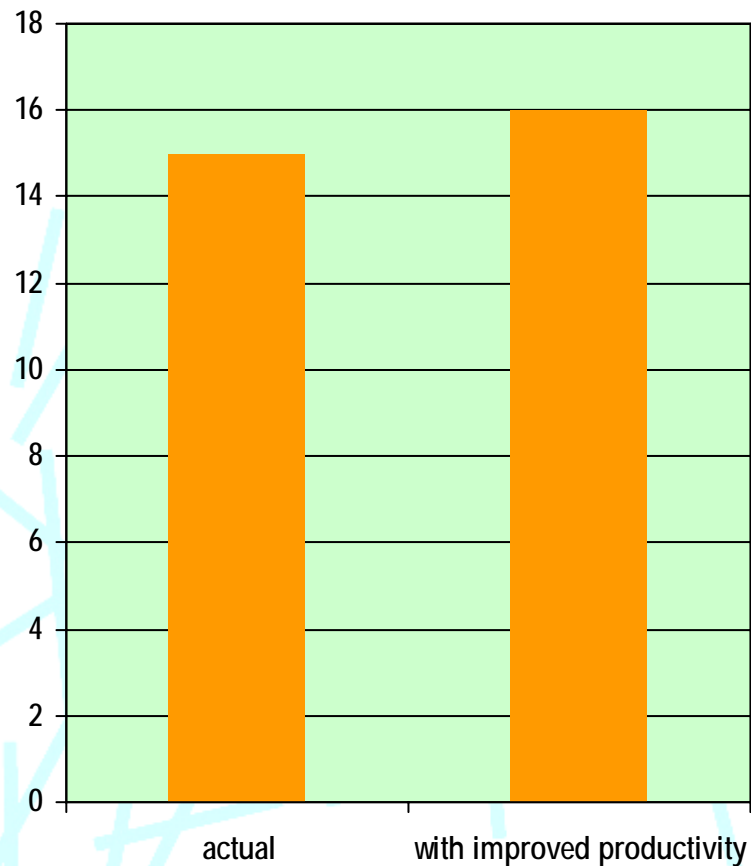


Average annual growth in services productivity



There's a lot to be gained from employing best practice in manufacturing

Northeast GVA, £ billion, 2000



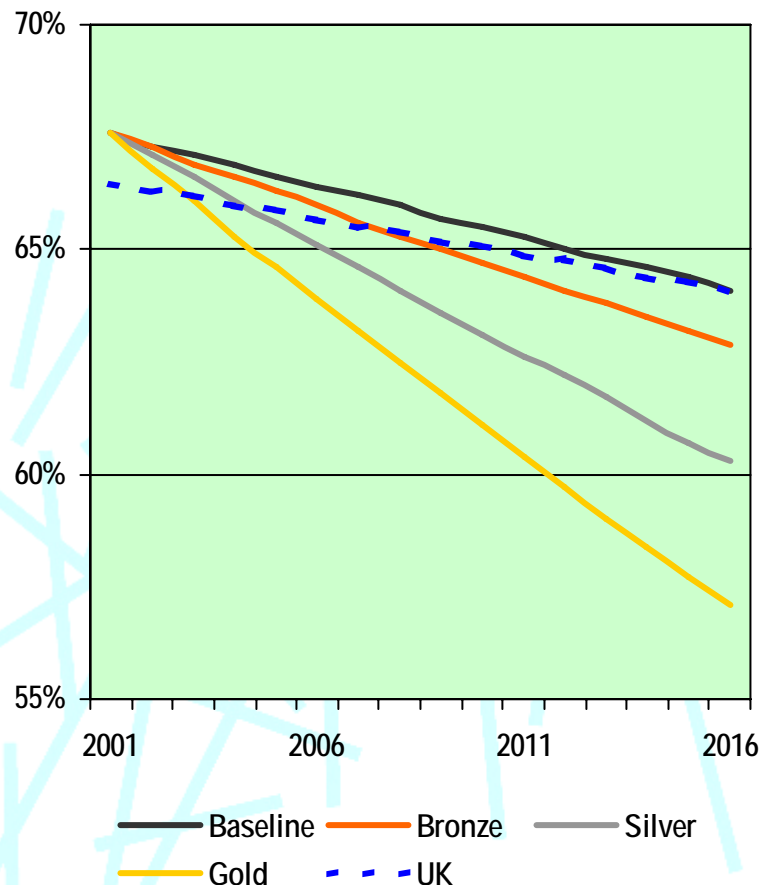
Some of the improvement in productivity can be achieved by bringing the region's lagging sectors up to national standards.

Over half of the region's manufacturing workers are in sectors that are performing at below national average rates of productivity.

If these workers were to achieve national average productivity rates — let alone best practice rates — it would add 9 per cent to productivity and 13 per cent to the regional GVA

Improved profitability will encourage business to the Northeast and help drive higher growth

Compensation of employees' share of GVA



Currently, the profitability of business in the Northeast falls behind the UK average.

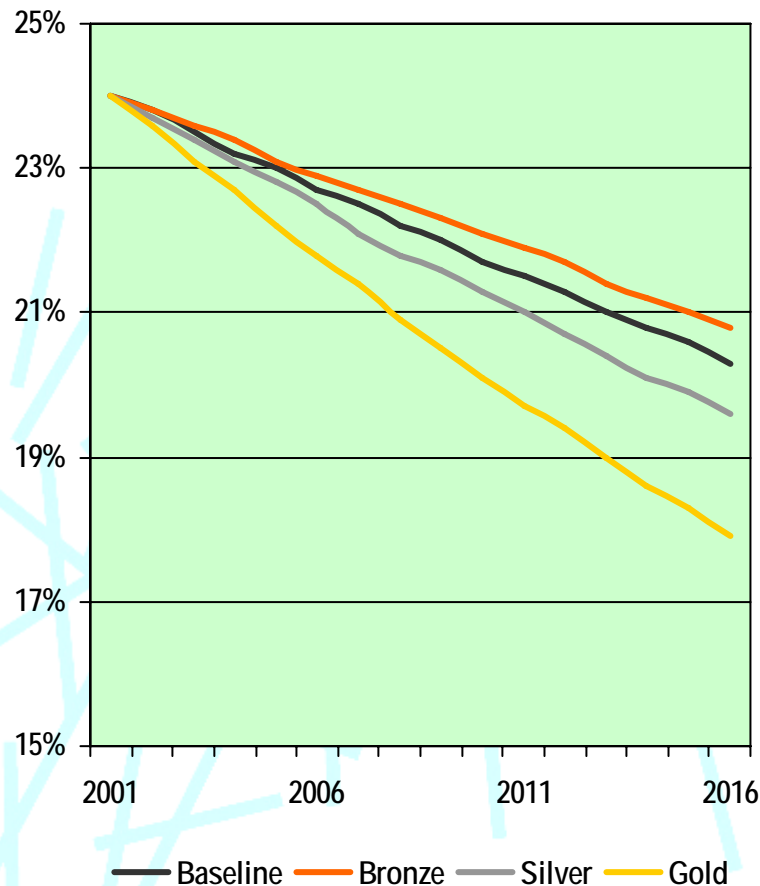
For 2001, 67.6 per cent of the region's GVA compensated employees for their efforts. This left only 32.4 per cent to fund taxes and operating surplus, and reward entrepreneurs — compared to 33.5 per cent nationally.

This has to change if the region is to encourage businesses to establish and develop.

In the baseline, we predict regional rates of profitability will have to at least converge with the national average by 2016. In the Gold scenario, we believe profits in the region will have to improve more sharply — to generate a positive and significant differential between the Northeast and the national average.

All scenarios point to manufacturing having a declining share of regional GVA

Manufacturing's share of Northeast GVA



All the scenarios point to a decline in the importance of manufacturing.

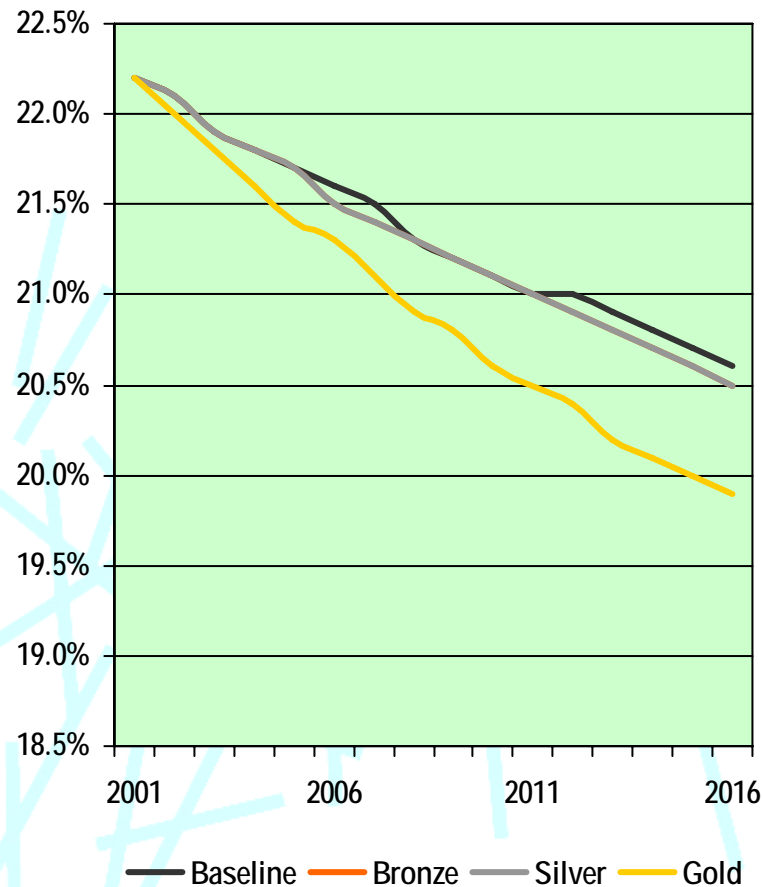
The baseline reflects ongoing lower rates of growth in manufacturing compared to services leading to a fall in manufacturing's share of GVA.

In the Bronze scenario, the region's manufacturers improve productivity and focus more tightly on growth areas, but still the share will fall from around 24 per cent now to 21 per in 2016.

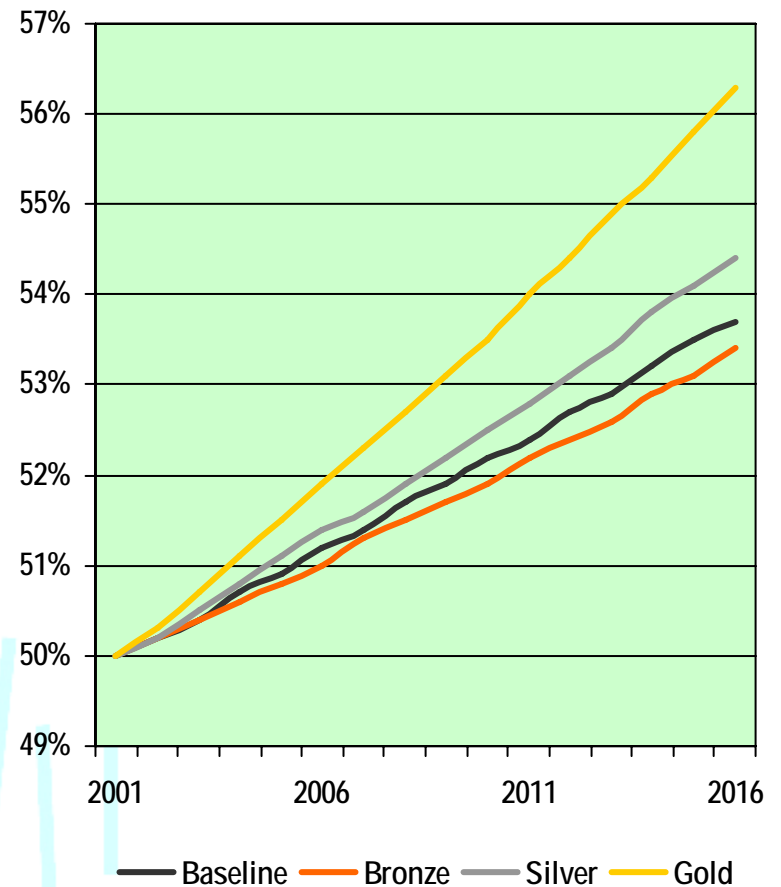
In the Gold and Silver scenarios, service businesses — encouraged by higher rates of profit and urban clusters of skilled workers — slowly crowding out an improving manufacturing sector.

Meanwhile, an increasingly constrained public sector is not the engine of growth for the Northeast

Public sector's share of Northeast GVA

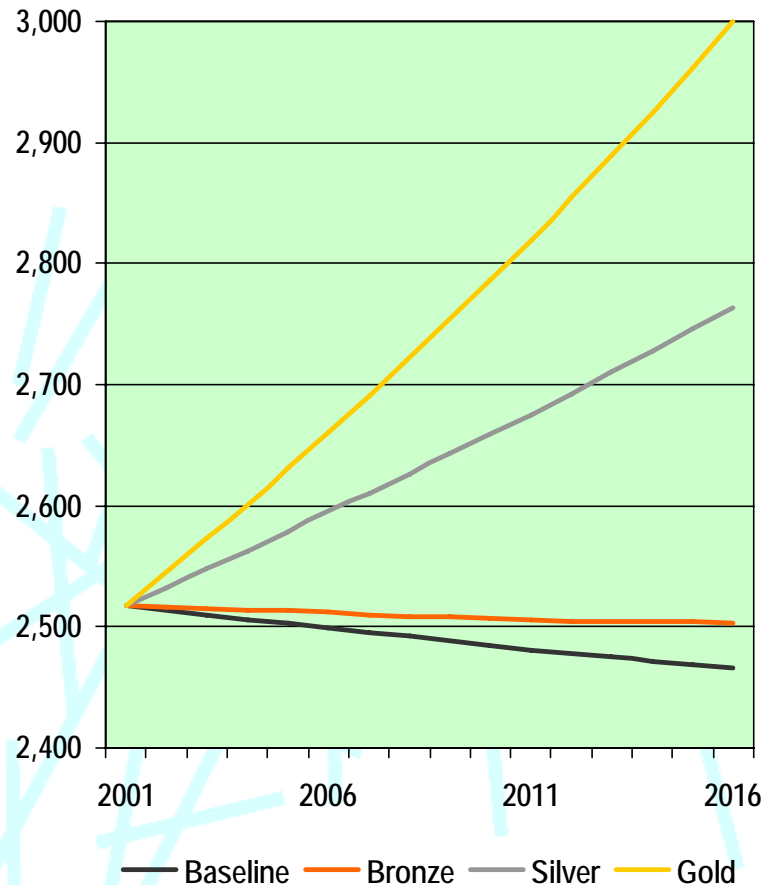


Services' share of Northeast GVA



The more positive scenarios show the Northeast's population growing

Northeast population, thousands



The different scenarios have very different implications for the population in the region.

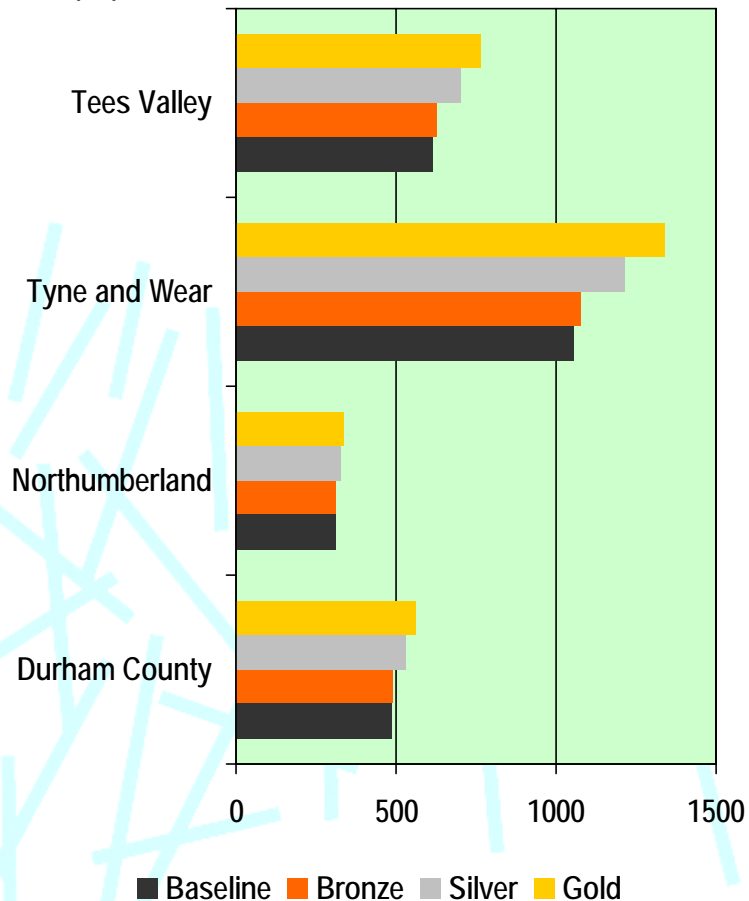
The higher growth scenarios both rely on and stimulate growth in the region's population. Higher rates of economic growth, and real incomes, will encourage migration into the region. Meanwhile, a larger workforce — and, hence, population — is needed to deliver some of the growth in the Gold and Silver scenarios.

In the Gold scenario, the Northeast's population could hit three million by 2016.

The Bronze scenario is achievable with some reduction in population, albeit a less marked decline than the Government Actuary's Department's projections (which we have used for our Baseline).

Economic growth will stimulate urban renaissance and a new era for the Tees Valley

Local population, thousands, 2016



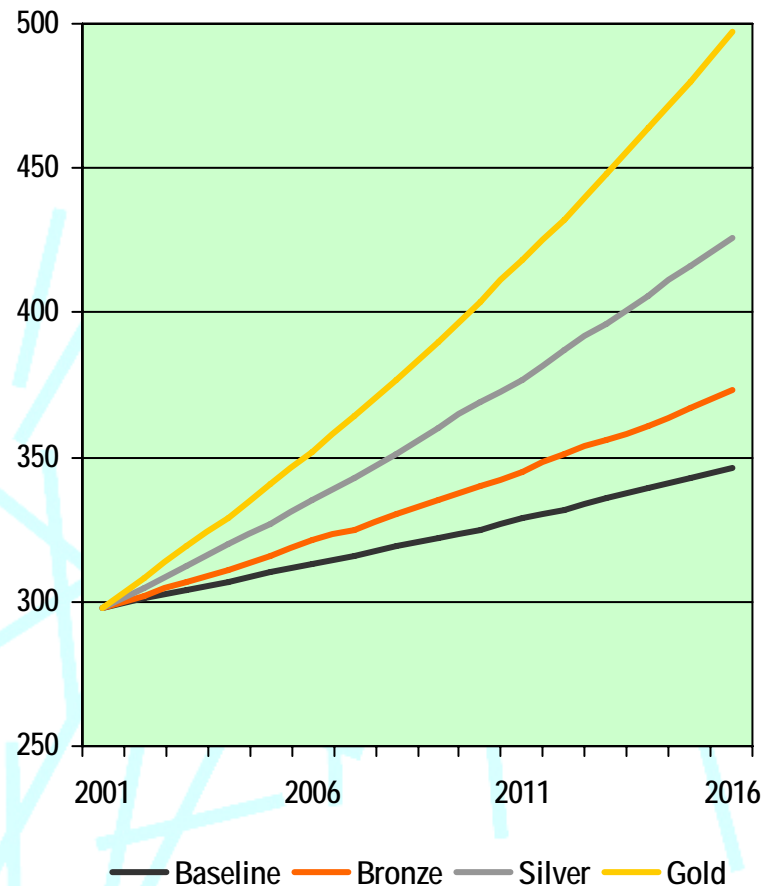
We do not expect the population growth in the positive scenarios to be distributed evenly over the region.

The Gold and Silver scenarios rely on a renaissance of the region's urban areas — especially the Tyne and Wear, and the Tees Valley — with business clusters able to make best use of a large and increasingly skilled pool of labour. This will, however, place further pressure on the more congested parts of the region's transport network.

The rural counties will also play their part — through leisure, tourism, agriculture and rural-urban commuting. But the more remote areas are unlikely to experience the same rate of growth as the urban centres.

Increased research and development — but growth dampened by lower manufacturing share

Expenditure of R&D, £ millions 2001 prices



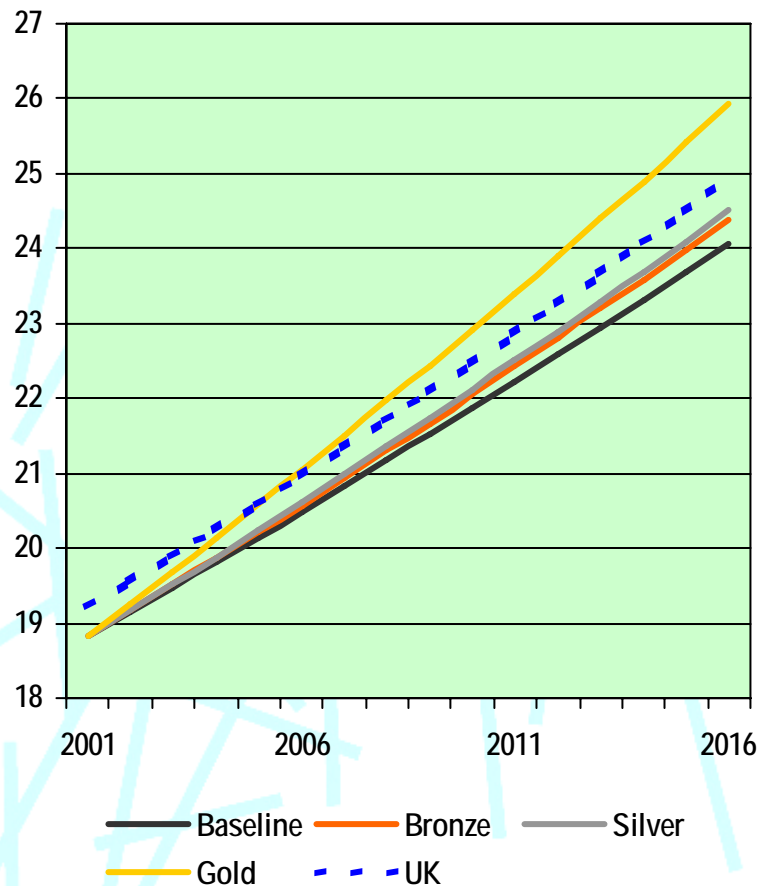
All the scenarios envisage increase in real expenditure on Research and Development, especially the Silver and Gold scenarios. In the Gold scenario, real R&D expenditure almost doubles by the end of our forecasting period.

This will result in higher productivity, but the effect on the output growth is likely to be dampened, since all scenarios assume a declining share of manufacturing sector, in which the R&D is more likely to improve productivity.

In the Gold and Silver scenarios, there is a more marked shift towards more productive manufacturing industries, which may partly compensate for the decline in the manufacturing sector's share as a whole.

Regional wage rates remain below national averages, except in the Gold scenario

Compensation, £ thousands per employee 2001 prices



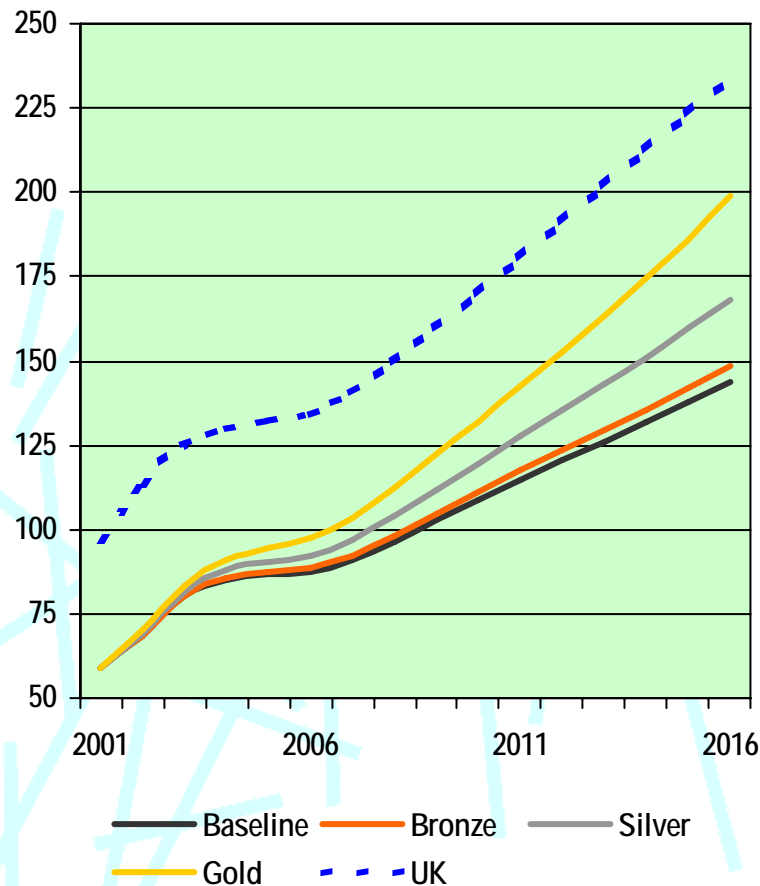
Only in the Gold scenario would we expect real incomes to accelerate substantially.

The predictions for employees' compensation are similar in the baseline, Bronze and Silver scenarios; average wages in the region grow from £19,000 to about £24,000 (in 2001 prices). In the baseline, the gap between Northeast and UK salaries widens slightly; in the Bronze and Silver scenarios the gap remains broadly constant.

In the Gold scenario, compensation per employee grows much quicker, and overtakes the UK rate in 2005. It goes on growing, exceeding the national average by more than £1,000 (in 2001 prices) by 2016.

House prices are put under pressure in the positive scenarios as population and incomes rise

Average house price, £ thousands current prices



All the scenarios show continuing house price inflation.

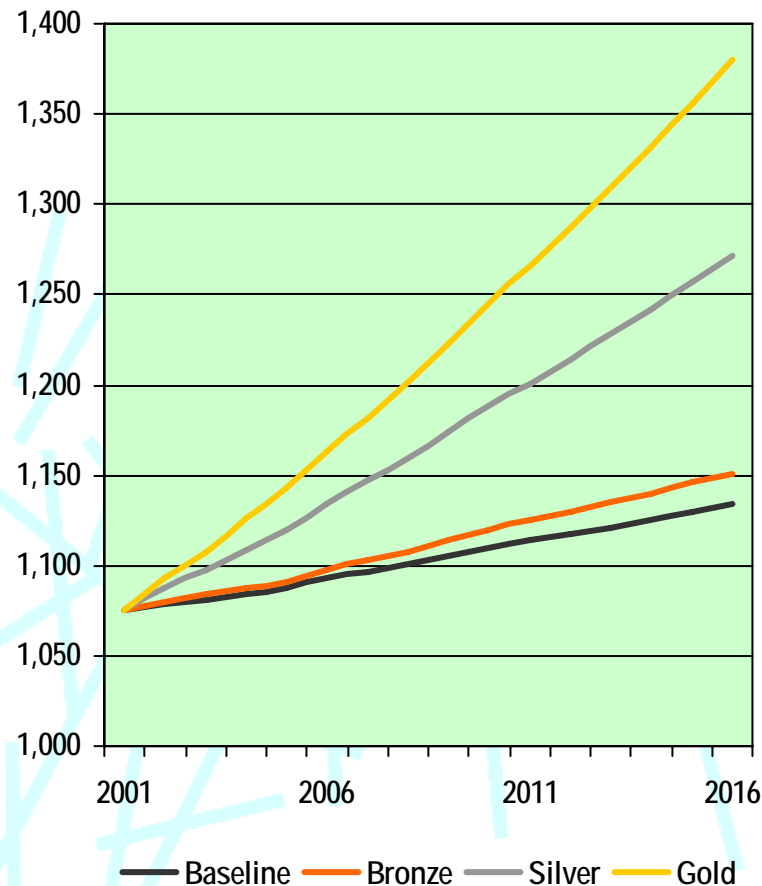
In the baseline and Bronze scenarios, the gap between UK and Northeast house prices increases as the region's population declines and incomes grow slowly.

The Silver and Gold scenarios assume that population starts to grow. This, and higher incomes, put pressure on the housing market in the region, and house prices start coming closer to the national average.

Nevertheless, even in the Gold scenario, the gap remains between the UK and the Northeast average house prices.

Even in the baseline, more homes are needed. The positive scenarios will require significant new build

Northeast's stock of dwellings, thousands



The trends towards smaller families, more one-person households and fewer children will lead to more homes being needed in all scenarios.

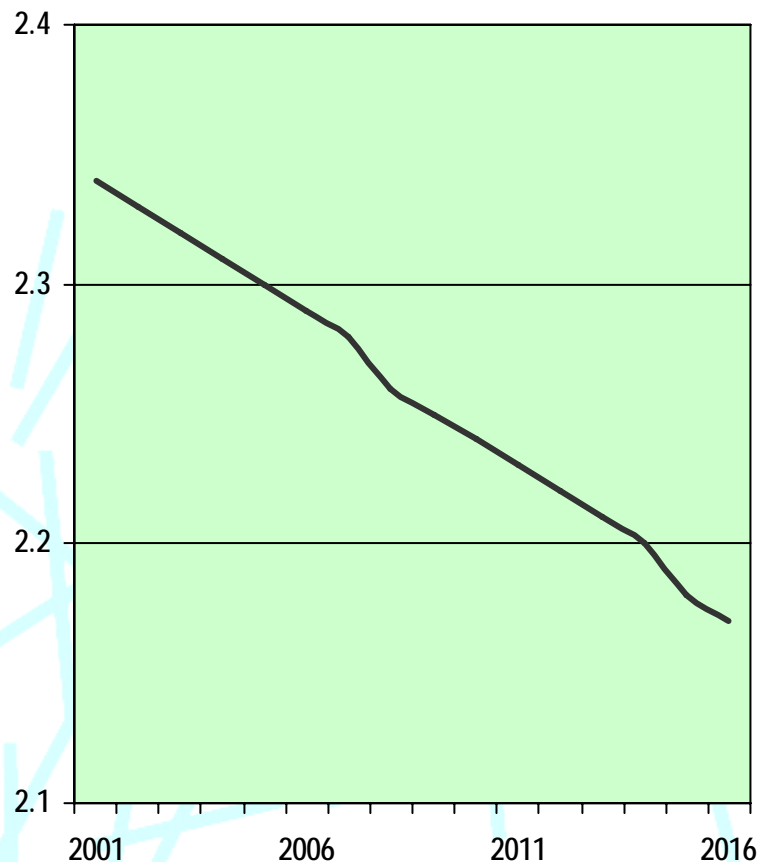
Even in the baseline and Bronze scenarios, which assume a declining population, we expect some increase in the number of dwellings in the region.

In the more positive scenarios, the region's housing market will be stretched — especially in areas with good commuting links to the urban centres.

The buoyant demand for housing construction output will provide additional boost for the economy of the Northeast in the positive scenarios.

More homes will be needed as the number of occupants per dwelling falls in all scenarios

Northeast's occupants per dwellings, number



The trends towards smaller families, more one-person households and fewer children is reflected in our forecast for the number of occupants per dwelling in the Northeast.

For simplicity, we have assumed the same ratio for all scenarios. However, it is not unreasonable to assume that, under the more positive scenarios, the ratio will fall even quicker — reflecting the impact of immigration and a more flexible workforce.

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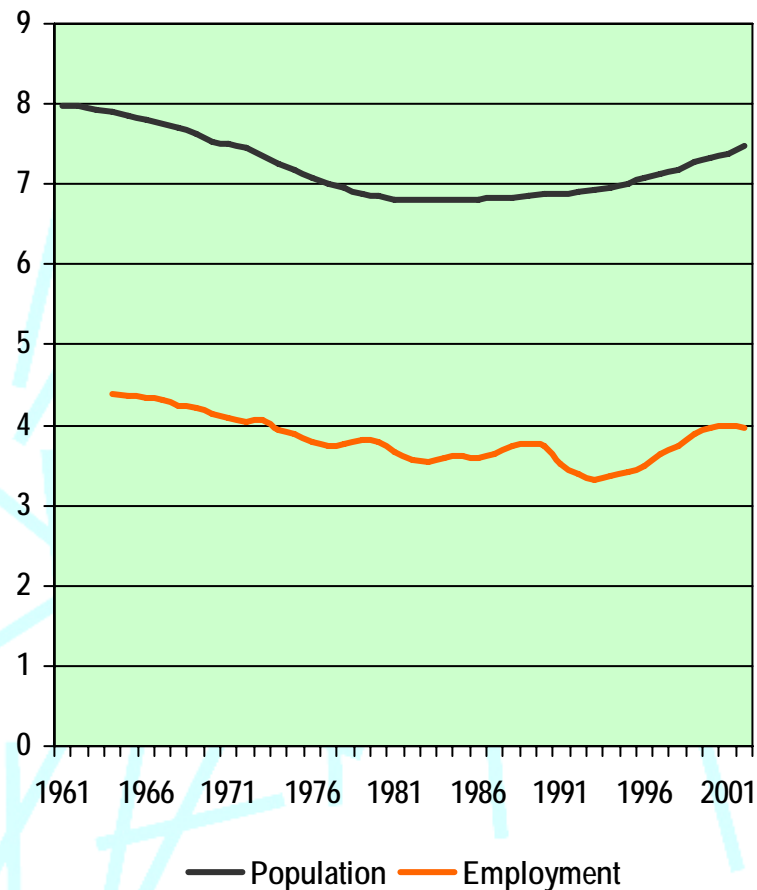
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Regions can reverse periods of slow growth; London turned 20 years of decline into success

London's population and employment, millions



Are the positive scenarios achievable?

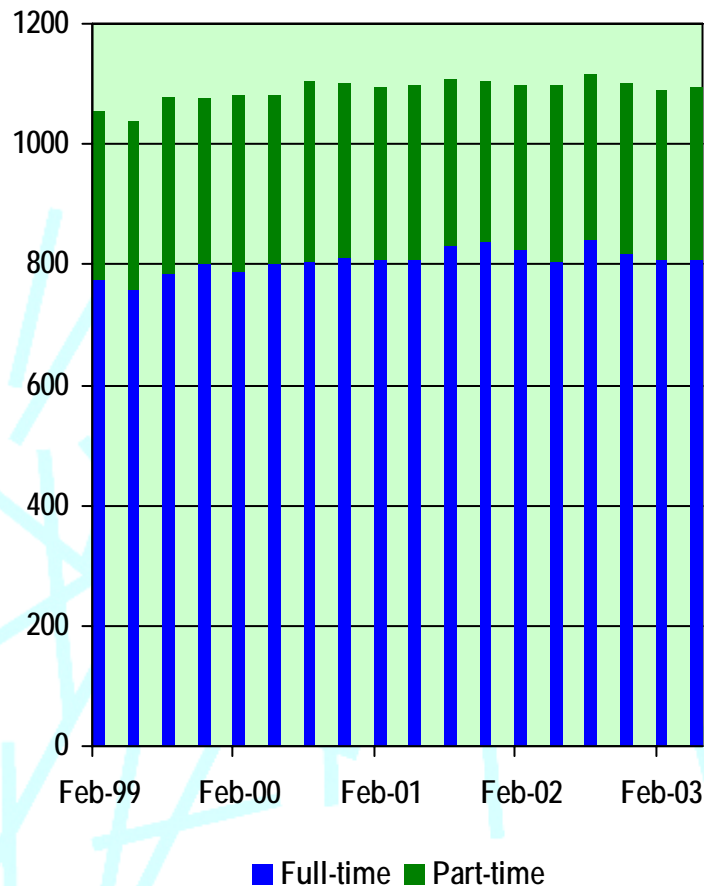
The approach we have taken does not allow us to quantify precisely the chances of the different scenarios happening. But there are good reasons to believe them to be possible.

It is all too easy to forget that even some of the UK's largest and wealthiest regions once suffered decline.

London had a prolonged period of decline, which was only arrested in the 1980s. Even now, London has a lower population and employs fewer workers than it did in the 1960s.

Past 3 years show that the Northeast can grow rapidly; now the growth needs to be maintained

Employment, thousands



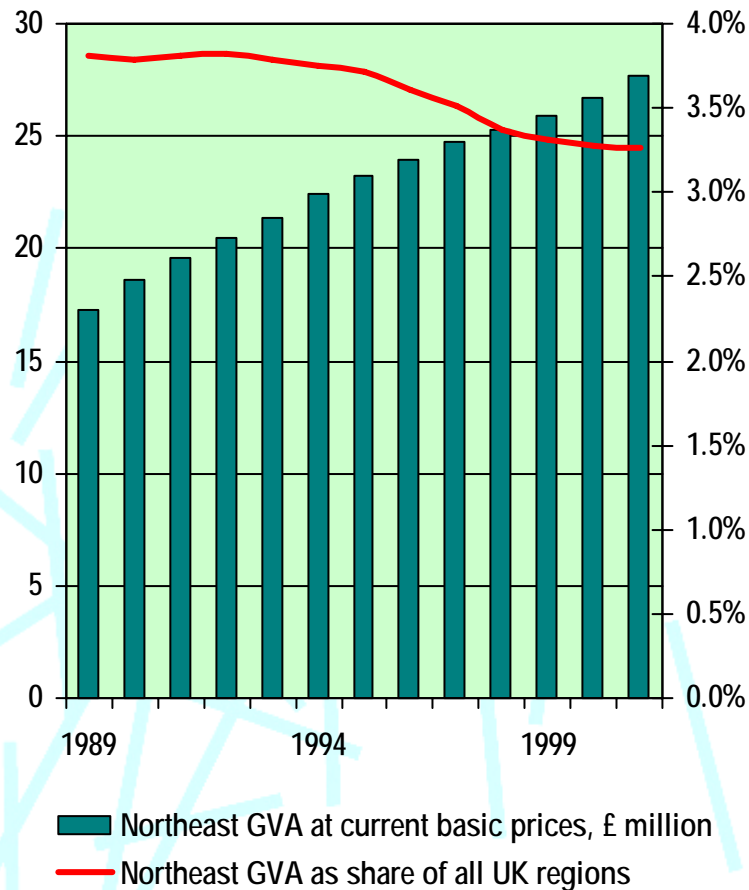
Recent economic data for the Northeast have been positive and hint that a higher growth path for the region is possible.

Since the recent low of May 1999, an additional net 56,000 jobs have been created in the region (of which 49,000 were full-time). Indeed, between May 1999 and August 2002 (the recent peak), employment grew by 84,000 full time jobs — although part-time jobs fell slightly.

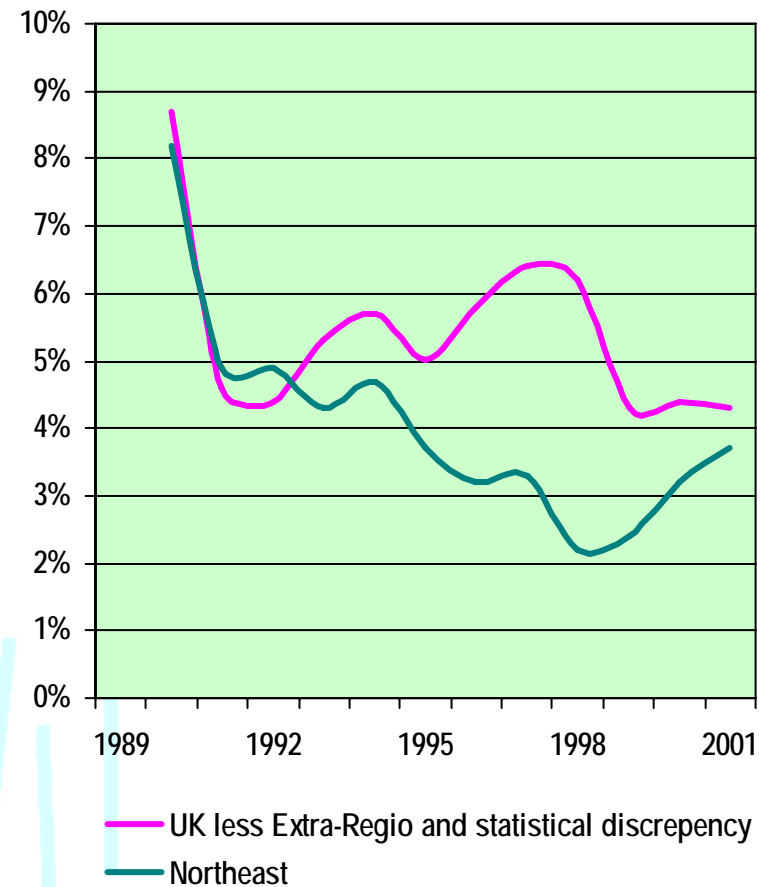
The latest revised regional gross value added statistics for 1989 to 2001 also provide some favourable news. After almost a decade of being slower than the national average, growth in the Northeast is again converging with UK rates.

Recent GVA figures suggest that the Northeast is closing the growth gap with the rest of the UK

Headline gross value added in the Northeast

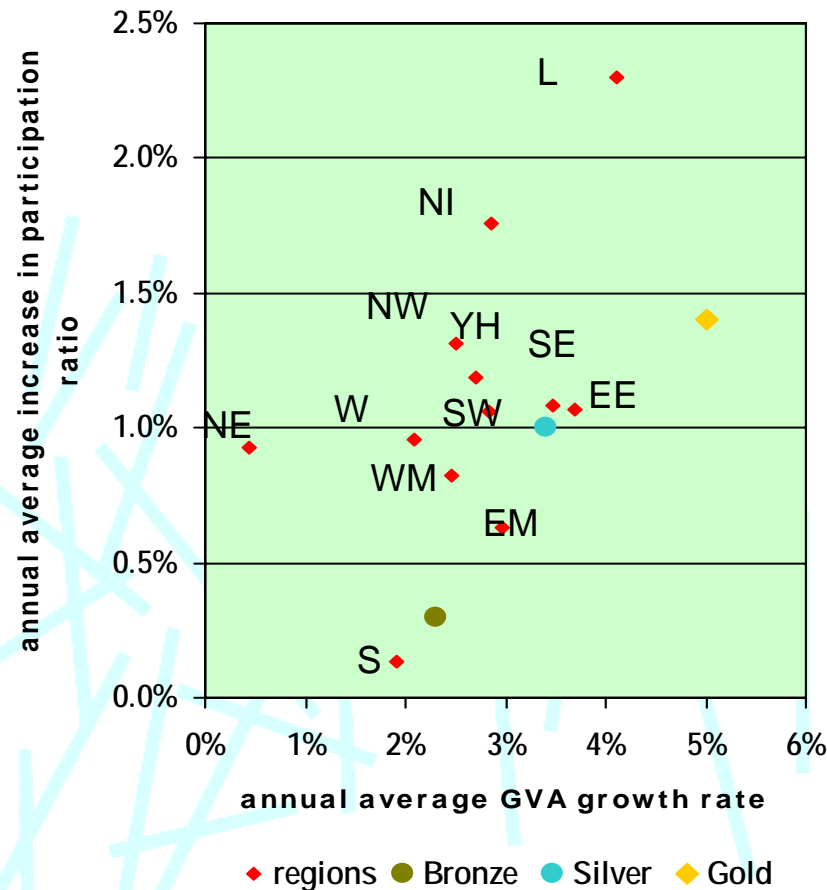


Annual growth in total GVA at current basic prices



The positive scenarios are tough, but other regions have achieved similar in recent years

Performance of UK regions, 1996-2000



Comparison with the recent performance of the other UK regions gives a flavour of the achievability of the positive scenarios.

The scatter plot shows how each UK region grew participation rates and GVA over the period 1996 to 2000 inclusive.

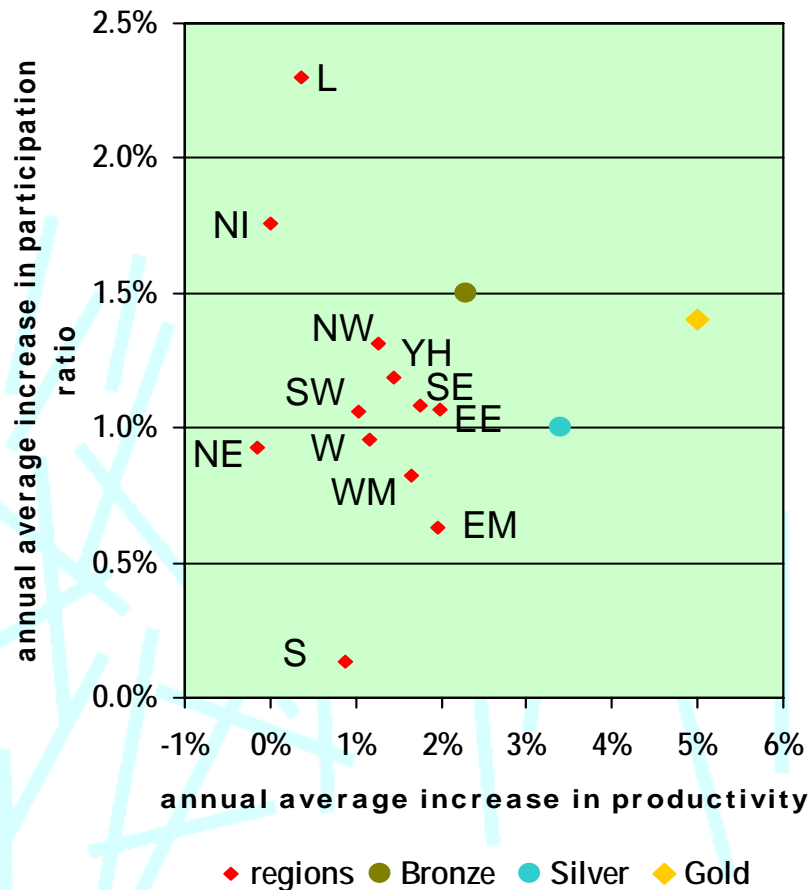
The scenarios are all largely within the recent range of achievements of other UK regions.

The Gold scenario demands annual GVA growth higher than any region achieved — but the increase in participation is still well within the range achieved by others.

The Silver and Bronze scenarios demand rates of growth in participation and in GVA that are easily within the range achieved by other UK regions.

The positive scenarios do, though, demand improvements in productivity that are stretching

Performance of UK regions, 1996-2000



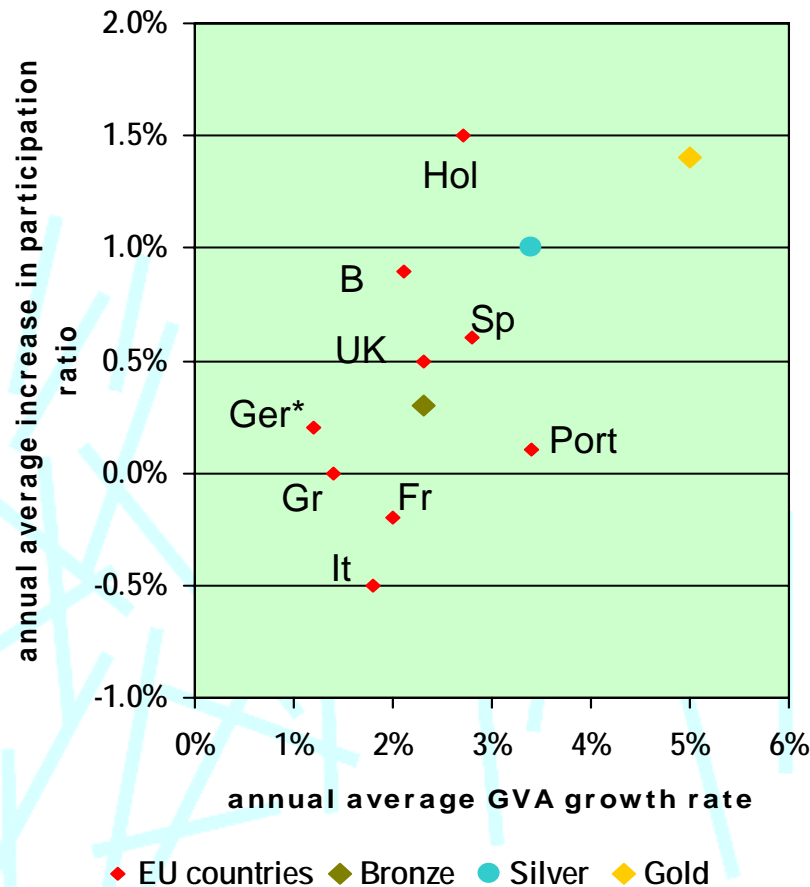
This scatter plot shows how each UK region grew participation rates and productivity over the period 1996 to 2000 inclusive.

The Bronze scenario requires increases in productivity just within the range of the recent performances of UK regions.

The Silver and Gold scenarios require stretching improvements in productivity.

The Silver and Gold scenarios would require the Northeast to perform better than most EU states

Performance of EU member states, 1987-1997



As a further comparison, this scatter plot illustrates the performance of European Union member states.

The Bronze scenario is well within the range of GVA and participation growth rates that were recently achieved by European national economies.

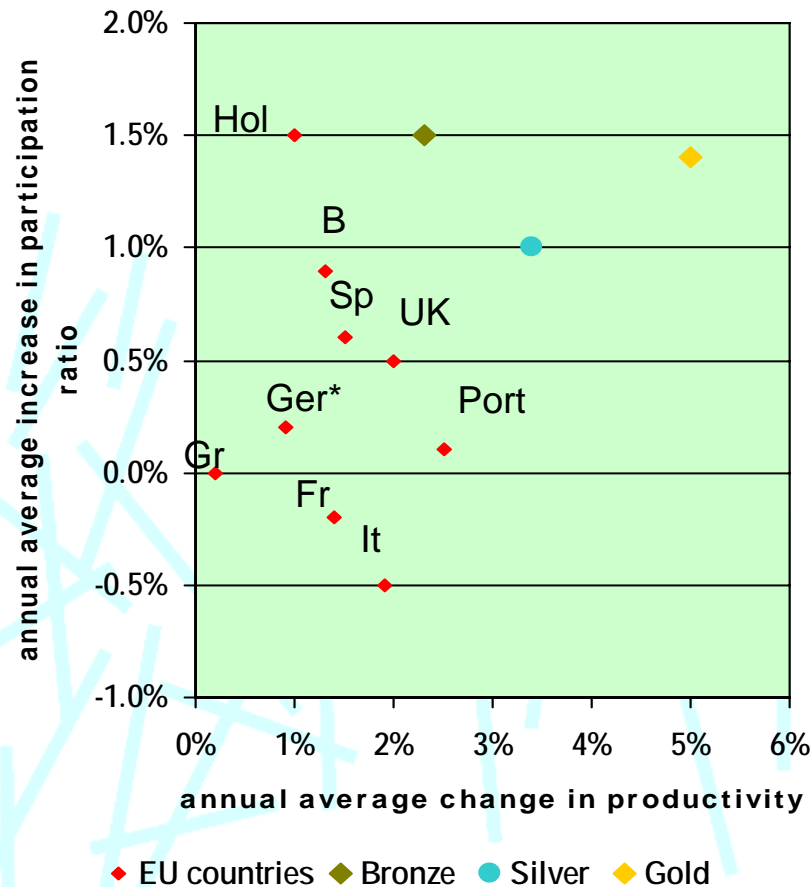
The Silver scenario is just within the range of rates achieved elsewhere in Europe.

The Gold scenario demands a rate of GVA growth not matched by the EU states in recent years.

*Note: Germany's rate of economic growth is for the period 1992-1997.

The Silver and Gold scenarios would require the Northeast to perform better than most EU states

Performance of EU member states, 1987-1997



This final comparison suggests that the productivity enhancements demanded by the positive scenarios are towards the upper end and beyond what has been achieved recently by the EU member states.

*Note: Germany's rate of economic growth is for the period 1992-1997.

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- The Northeast has suffered slow growth recently, and many commentators predict this to continue. With its manufacturing bias, it is all too easy to write-off the Northeast as a low growth region. Our baseline forecast is for 1.8 per cent growth, but this is based on assumptions that can be changed.
- There is a potential for the Northeast to do better. Our positive scenarios push annual growth up from 1.8 per cent to 2.3, 3.4 and 4.9 per cent.
- Our three positive scenarios put the Northeast economy on very different trajectories, but none of the scenarios have the Northeast exceeding national average GVA per head.
- Getting more out of the labour force is crucial to pushing the region into the positive scenarios. Growth needs to be driven by improvements in economic activity and participation rates.
- Improving productivity is another key driver of growth in the positive scenarios. The positive scenarios require businesses to improve productivity by more than the UK average.
- Improved profitability will encourage businesses to the Northeast and help drive higher growth, while increased research and development will help productivity.

Conclusions (continued)

- All scenarios point to manufacturing having a declining share of GVA.
- The more positive scenarios show the Northeast population growing. Economic growth will stimulate urban renaissance and a new era for the Tees Valley.
- Regional wage rates remain below national averages, except in Gold scenario.
- House prices are put under pressure in the positive scenarios as population and income rise. Even in the baseline scenario, more homes are needed. The positive scenarios will require a significant increase in new build houses.
- Are the positive scenarios achievable?
- Other regions — notably London — have moved from prolonged periods of decline through to economic success in relatively short periods.
- Recent data for the Northeast suggests fast growth is possible, although it remains to be seen if it can be maintained.
- Comparison with the recent performance of other UK regions shows that the growth in GVA and participation rates demanded by the positive scenarios are achievable, although the required growth in productivity is more ambitious. Comparison with the recent performance of the EU member states highlights that the positive scenarios are stretching.



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