

Prospects for Private Sector Jobs Growth in SW England

A report by the Economy Module of the SW Observatory,
October 2011

Summary

In the last couple of decades, SW England has generated most of its net increase in employment from activities related to the final expenditure of government and households.

The current downturn and the structural changes it is helping to invoke are expected to see future economic growth more driven by private investment and exports: so-called economic rebalancing. The evidence in this report suggests this will prove to be an uphill battle for SW England.

Faced with an aging population and differential gender effects, a hollowing out in middle upper occupations, technological changes favouring jobless manufacturing growth, less full-time working and low real wage growth, as well as elements of skill deficiencies (covered in our sister document), it is difficult to forecast significant structural shifts that favour private sector employment growth that will greatly exceed recent experience: offsetting public sector withdrawal on top of 'normal' trends.

With forecasts of a macro-economic background of weak growth and limited structural change, the prospects for private sector jobs growth in SW England are modest. From the viewpoint of 2011, it is difficult to be optimistic for effective, sustainable and significantly net positive employment gains in the near term.

We can be more sanguine, however, for the longer term. Private sector jobs growth, by occupation, sector or place, is inherently unpredictable the further out you look. There is still the hope that climate, demographic and technological changes as yet unforeseen in detail, as well as macroeconomic recovery and development based on market growth and market share acquisition beyond the region, will create the opportunity for significant jobs growth once the current imbalances in economic activity, at all spatial levels, is resolved.

Shane Vallance & Nigel Jump
October 2011

This paper complements its 'sister' paper produced by the Skills and Learning Module - "Private Sector Jobs Growth: Implications for Employment and Skills", October 2011. The two reports were presented to the SW intelligence and policy community at an event titled "Prospects for Private Sector Jobs Growth" which was held in Taunton on 2nd November 2011.

Summary	2
Index	3
Introduction	4
Historical Labour Market Trends.....	6
<i>Overall employment performance</i>	
<i>Structural shifts</i>	
<i>Long-term unemployment</i>	
<i>Regional unemployment performance</i>	
<i>Decline in hours worked</i>	
<i>Occupational composition</i>	
<i>Age profile</i>	
<i>Vacancy analysis</i>	
<i>Public sector employment</i>	
Current Labour Market Developments	23
<i>Local authority job loss announcements</i>	
<i>Wage adjustments</i>	
<i>Impact of public sector job losses</i>	
<i>Private sector employment</i>	
<i>Employment composition – loss of full-time jobs</i>	
<i>Employment composition – forced part-time/temporary working</i>	
Future Labour Market Factors.....	40
<i>Productivity improvements & sustainable employment gains</i>	
<i>High growth firms & employment growth</i>	
<i>Jobless manufacturing growth</i>	
<i>Short-term expectations</i>	
<i>Falling real earnings</i>	
Longer Term Projections.....	50
<i>Working Futures 2007-2017</i>	
<i>Regaining our balance</i>	
<i>South West growth scenarios</i>	
<i>Reconciling different projections</i>	
Turning Projections into Forecasts.....	59
<i>Introduction & context: the macroeconomics</i>	
<i>Rebalancing & funds flow</i>	
<i>Forecasting & forecasts</i>	
<i>Prospects for private employment growth: Conclusion</i>	
Other Perspectives.....	70
<i>The rest of Europe</i>	
<i>“The hourglass & the escalator”</i>	
<i>Job creation – evaluation findings</i>	
Conclusion.....	76

Introduction

It is now well documented that the favourable economic performance experienced over the last economic cycle, before the onset of the recession in 2008, was largely driven by consumer and government expenditure fuelled by high levels of secured (underpinned by significant house price rises) and unsecured debt. There was also significant expansion in public sector employment, driven by the high levels of government spending and accompanied by a continuing shift from production industries to services.

The financial crisis and the subsequent recession had related roots in these expansionary factors globally, as well as broader imbalances in the flow of funds. When the 'bubble' burst and inter-bank liquidity dried up, the high levels of wrongly valued assets on bank balance sheets exposed them to significant problems, leading to a credit crisis that was exacerbated by international contagion effects and required state bail-outs, making the public debt situation worse.

Since then, for individuals and households, the need to manage down debt levels has put downward pressure on aggregate consumer demand. As this debt adjustment proceeds, it is reasonable to suppose that consumption-led growth will not be a significant job creator for the foreseeable future. For the UK government, reductions in public expenditure caused by the need to reduce public debt has led to job losses in the public sector and a reduced role as a procurer of goods and services. Again, this has a dampening effect on final demand across the economy.

Addressing key imbalances, the main economic objective of the Coalition Government is to directly reduce the fiscal deficit by cutting public expenditure and raising taxes. This can only be achieved on the timescale the government assumes is necessary by reducing the size of the public sector workforce. As part of its desire for wider structural economic change, it expects and wants to encourage the private sector to more than replace some of the reduction in public sector expenditure and employment. This has become known as "economic rebalancing". The major elements of rebalancing include the following shifts in economic shares:

- Switching the national share of activity and employment from the public to the private sector
- Moving the share of national demand from domestic consumption to exports
- Increasing the share of national supply from manufacturing, with a reduced reliance on financial services
- Altering the geographical balance, with less reliance on London and the Greater South East (GSE)

The Coalition government has set out its fiscal plans for the current parliamentary period to 2015-16. It has two medium-term fiscal targets: to balance the cyclically-adjusted current budget by the end of a rolling, five-year period; and to see public sector net debt (PSND) falling in 2015-16. The latest forecasts are that public sector net borrowing will fall from 9.9% of GDP in 2010-11 to 1.5% in 2015 and PSND will decline from a peak of 70.9% in 2013-14 to 69.1% in 2015-16¹. This will be driven by a combination of lower expenditure and greater receipts as the economy recovers and the tax-take improves.

This fiscal retraction will lead to inevitable job losses in the public sector. According to the latest estimates from the Office of Budgetary Responsibility (OBR),² there will be a reduction of 310,000 general government jobs between 2010-11 and 2014-15, with a further 90,000 forecast for 2015-16. For the period 2010-14, this represents a further downward revision from the 330,000 in the OBR November 2010 forecasts and 400,000 in June 2010. These downward revisions have been made because the government feels more of its expenditure cuts will not necessarily have employment consequences.

Despite these downward revisions, the expectation is still for a substantial number of public sector job losses; and due to the high dependency of many areas within SW England on the public sector, our work shows that we expect a significant proportion of the English total public job losses to occur in the region.

Against this background, this paper discusses the likelihood that this reduction in public sector employment will be replaced by private sector job creation. It is based on our understanding of the SW economy: its underlying strengths, weaknesses and structures. As well as current analysis, it utilises work that has been previously published, much of it produced by both the Economy and Skills & Learning Modules of the SW Observatory.

¹ Emergency Budget – June 2010

² 'Economic & Fiscal Outlook' - Office of Budgetary Responsibility (OBR) – March 2011

Historical Labour Market Trends

Overall employment performance

SW England has enjoyed strong employment growth over much of the past decade, growing from 2.45mn in 2000 to just under 2.75mn jobs in 2008 (see Chart 1 below). Therefore, 300,000 jobs were added in eight years. Employment growth was particularly strong in the early part of the decade (2002-2004) when economic conditions were favourable and both public and private investment was high.

Chart 1: SW workforce jobs



Source: (Workforce Jobs – ONS)

This employment growth provides useful context for subsequent labour market performance. Over the recessionary period of 2008-09, the SW economy lost 85,000 jobs. Although it has since recovered a little, the labour market is looking fragile again. Moreover, the loss of employment during the recession took employment down to 2005 levels. Overall, whilst there was a labour market adjustment during the recession – which was relatively short and sharp – it did not undo all the employment increases seen during the period of economic growth.

On the other hand, employment and unemployment rates have experienced only marginal movements recently - for the past 12 months (albeit we are seeing signs of further deterioration with the latest data releases). In essence, the SW regional economy needs to create significant net new jobs merely to stand still as the population seeking work grows over time.

In this context, it is important to examine the potential link between the strong employment growth over the period 2004-07 and the subsequent rapid falls in employment since the 2008-09 recession. The growth in employment seen prior to the recession was driven by a cyclical economic boom, rather than reflecting a sustainable structural improvement in the labour market. The underlying structural problems such as skills mismatches, weak supply of technical skills, and poor basic skills in young people remained unaddressed. This suggests that employment policies need to concentrate on structural labour market issues rather than short-term schemes that may boost employment for a while but prove to be unsustainable. The six SW Local Enterprise Partnerships (LEPS) need to bear this in mind as they seek to improve economic performance in their local areas.

In more stable economic periods, such as 2004-07, the main driver of higher employment levels tends to be economic activity (i.e. more people make themselves available for work) and the flexibility of the labour market. For example, a higher proportion of part-time working has a positive effect on overall employment levels through increased participation.

The evidence³ suggests, however, that while economic activity is a driver of employment growth, it is a relatively unimportant factor in bringing down unemployment and inactivity during more stable periods in the economic cycle. Instead, the structural characteristics of the labour market are what matters. In particular, increased degree-level skills have a large and clearly statistically significant positive correlation with sustained, high employment rates. This is probably more important than, say, the share of public and private-sector employment in a given area.

Whilst the fact that the SW labour market has not had a significant downward adjustment - in an historical context - is to be welcomed, the key story for economic development of the labour market in both pre- and post-recessionary periods is as much, if not more, to do with the changing composition and continued structural shift of employment.

Structural shifts

Structural shifts are markedly illustrated by a comparison of the employment numbers for both the service and production (manufacturing and construction) sectors. As is well known, employment in the manufacturing sector has been in long-term decline over the past 30 years – this clear structural decline is shown in Chart 2 below. There were more than 92,000 fewer SW manufacturing FTE⁴ jobs in 2008 than there had been in 1998⁵.

In comparison, construction has been more adversely affected by the cyclical nature of the economy and has actually increased over the 30 year period. In

³ 'Mapping the route to growth – rebalancing employment' – CBI 2011

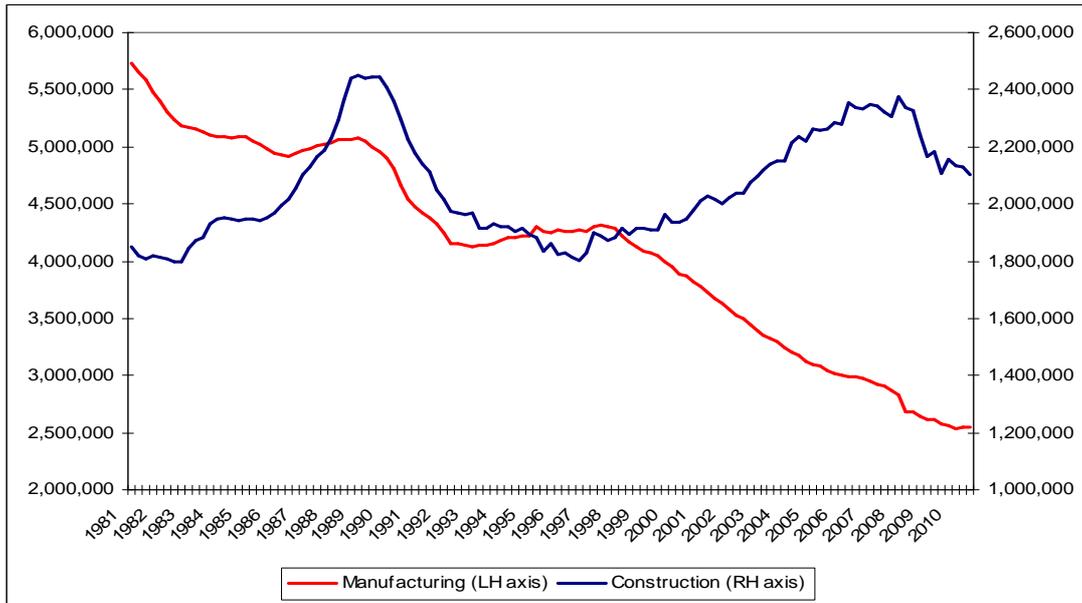
⁴ The chart details total workforce jobs rather than FTEs

⁵ 'Where will we work? Post recession futures for the South West' – SW Economy Module – 2009

the South West, it contributed 21% of total employment growth between 1998 and 2008, reflecting growth in the housing stock and public investment. However, it did experience a major contraction thereafter – illustrated by chart 2 - as construction demand quickly fell away in recession.

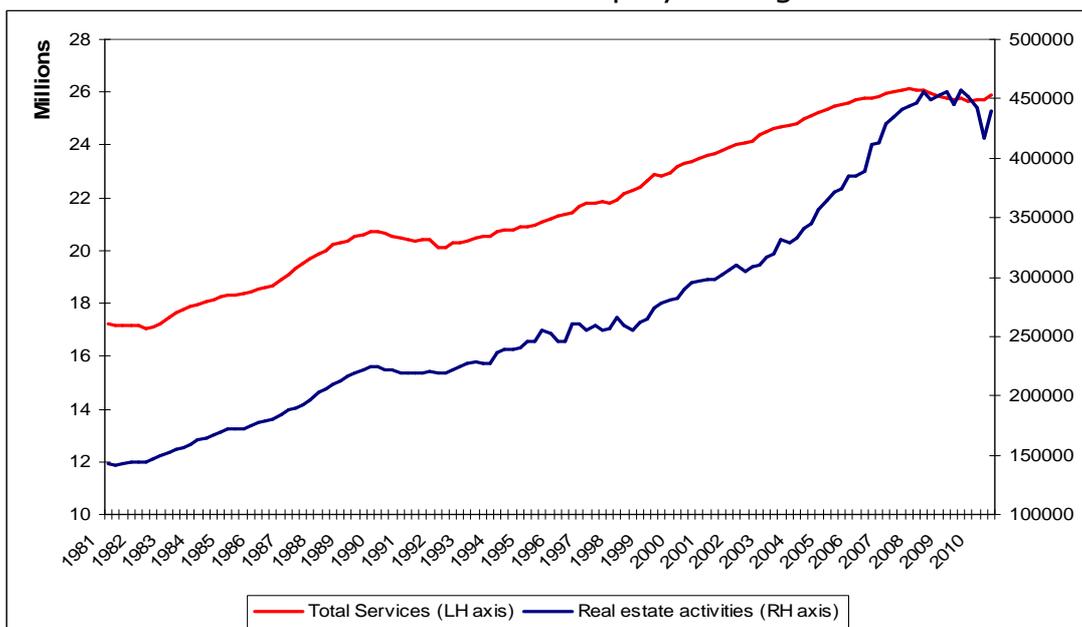
This illustrates our argument well; those sectors which are more driven by cyclical factors – such as construction – tend to suffer sharper adjustments when the cycle turns down. Sectors that are driven by longer-term structural change experience less marked fluctuations in output and employment growth.

Chart 2: UK employment in manufacturing and employment



Source: (Workforce Jobs – ONS)

Chart 3: UK services employment growth



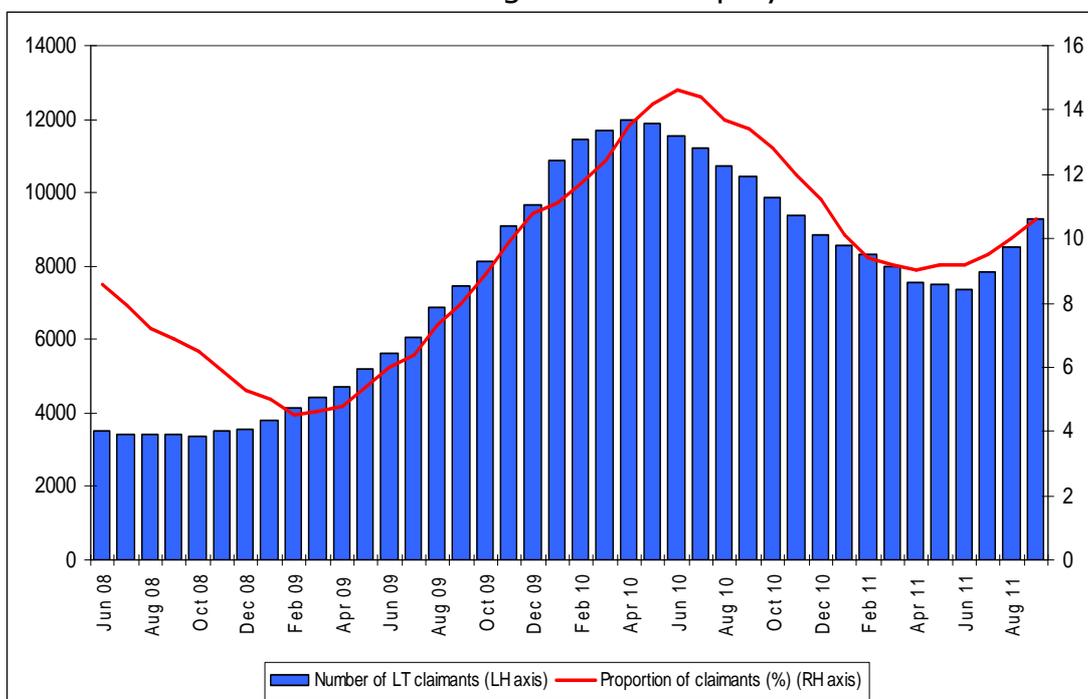
Source: (Workforce Jobs – ONS)

In comparison, service sector UK employment has consistently increased, growing from just over 17 million (mn) in 1981 to 26mn in 2010 (see Chart 3). The service sector covers a wide range of activities and sectors but, when broken down into specific sub-sectors, we can see specific marked employment increases which highlight the changing nature of certain aspects of the economy. As an example, the significant increase in real house prices and sales over the 15 years to 2008 led to a huge increase in those employed in real estate (a sub-sector of 'Total Services'). Over the past 30 years, the number employed in this area has increased by over 300%. This rate of employment growth could not be sustained and, to date, some correction has taken place. However, it serves as a useful illustration of the types of cyclical and structural shifts that have occurred and its impact upon the make-up of UK employment.

Long-term unemployment

One of the characteristics of any recession is that long-term unemployment tends to increase. The latest recession has been no exception. There has been a worrying increase in this measure, with the number of people out of work in the United Kingdom for more than two years having almost trebled over five years to reach 328,000 by 2010 Q3. Due to the problems of getting the long-term unemployed back into work (the problem of hysteresis⁶), it is likely that unemployment remains above pre-recession rates for a prolonged period.

Chart 4: SW long-term unemployment



Source: (Claimant Count – ONS)

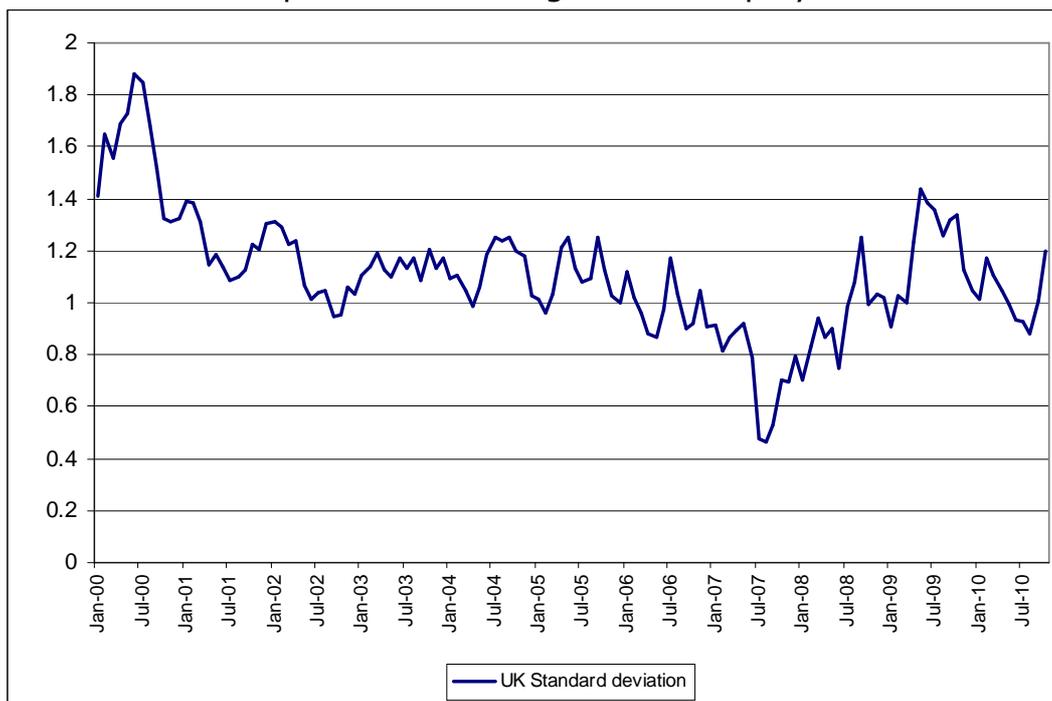
⁶ Those who are unemployed for long periods suffer from a deterioration of skills and aspirations, which, in turn, makes them less likely to be re-employed: a vicious circle of rejection and dejection can ensue.

This is borne out in almost all areas of the SW England. In terms of those unemployed and claiming benefits on the shorter measure of over 12 months, the proportion appears as though it first fell in the early stages of the recession. However, this was due to the diluting effect of a large influx of claimants; therefore the *proportion* of total claimants who were classified as long-term actually fell. However, as illustrated by chart 4, the *absolute* numbers began to rise by the end of 2008 and steeply through 2009. According to the latest figures (June 2011), there are 7,300 people claiming Jobseekers Allowance for over 12 months in the South West. This number is over double the pre-recession level.

Regional unemployment performance

Unemployment rates had been converging between UK regions in the decade prior to the recession. Chart 5 below shows the level of dispersion – as measured by standard deviation - between regional unemployment rates over the period 2000 and 2010. There was a long period between 2000 and 2007 when inter-regional unemployment rates converged quickly.

Chart 5: Dispersion of UK regional unemployment rates



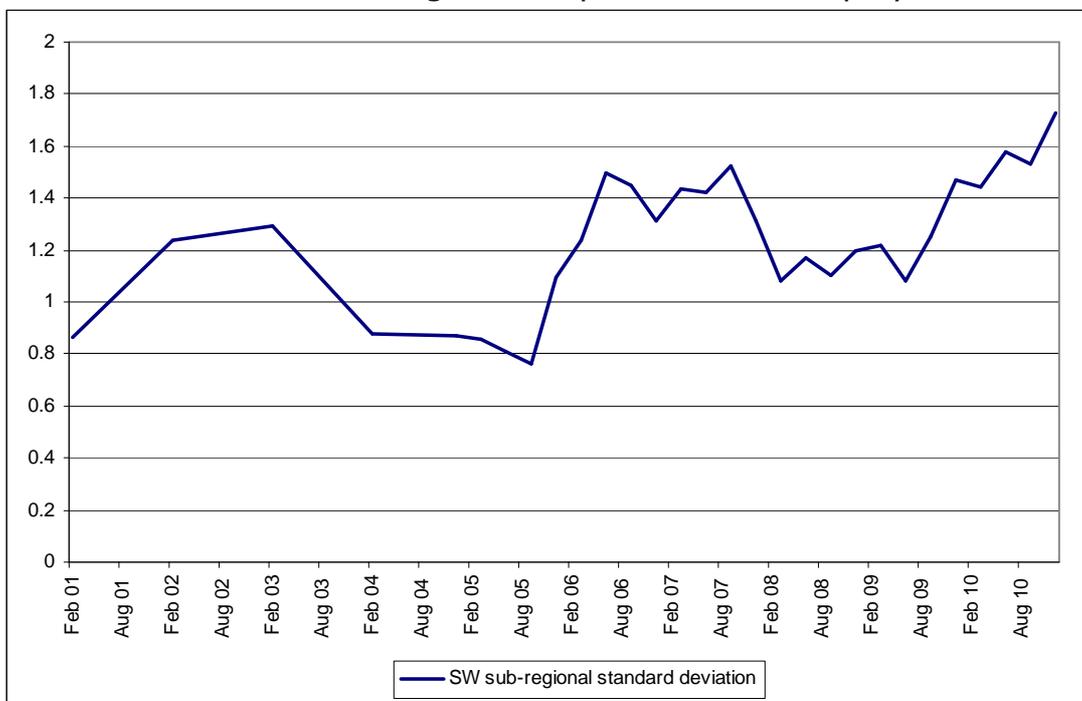
Source: (OCED Economic Outlook May 2011)

The early stages of the boom before the bust in 2007 saw the rates diverge once more as London and the Greater South East (GSE) experienced their 'last fling' and then we moved into crisis and recession. This suggests that, in more stable economic periods, labour markets – using unemployment rates as a proxy here – tend to converge. In troubled times, however, there are different levels of distress. This will be dependent upon a number of factors, not least the industrial structure in each area and how this relates to the causes and effects of the downturn. During the recession, areas with a greater

manufacturing presence such as the West Midlands & North East experienced sharper rises in unemployment than elsewhere. To some extent, this bias was also reflected in differential manufacturing impacts on local unemployment in this region, with Swindon, in particular, suffering the largest shift in employment.

In overall comparison, (using a marginally different time period due to data availability – see Chart 6), differences of unemployment rates between unitary and upper tier authorities in the South West did not change much over the whole period. The differential remained broadly consistent over the period 2001-2005 but has then increased – again, showing that unemployment rates have increased more quickly in some areas when compared to elsewhere. This measure shows there are greater differences between sub-regional unemployment rates than at a regional level, remembering though that the regional figures have a greater population and tend to be ‘smoothed’.

Chart 6: SW sub-regional dispersion of unemployment



Source: (Nomisweb – ONS)

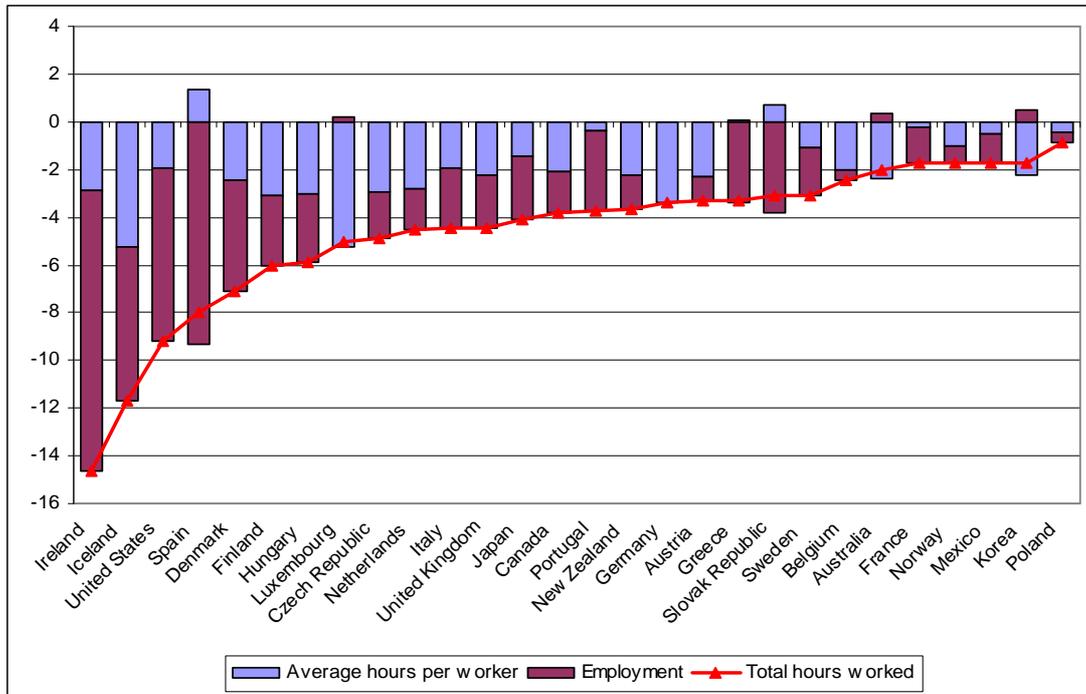
Decline in hours worked

Increased unemployment has been one reason why total hours worked has fallen significantly in most developed economies. This has been augmented by changing working practices during the recession – such as contracted hours, increase in part-time working etc. Chart 7 below highlights the percentage change in total hours from peak to trough in OECD countries.

For some countries, the fall in total hours worked has been significant. In Ireland, total hours worked fell by over 14% and in the United States by 9%. This was caused by a combination of a fall in employment and a reduction in

average hours worked. For some countries, the former was more significant, for example the reduction in Spain was totally driven by a fall in employment. Elsewhere, particularly in mainland northern Europe, a contraction in hours was the primary reason for the fall⁷. In the United Kingdom, the reduction in total hours (4.4%) was evenly split between a reduction in average hours (2.2%) and fall in employment (2.2%).

Chart 7: Falls in hours worked across the OECD



Source: (OCED Economic Outlook May 2011)

Occupational composition

In the past five years, some occupational changes (types of jobs) have continued longer-term structural trends, whilst others reflect short-term demand/cyclical changes (see Chart 8).

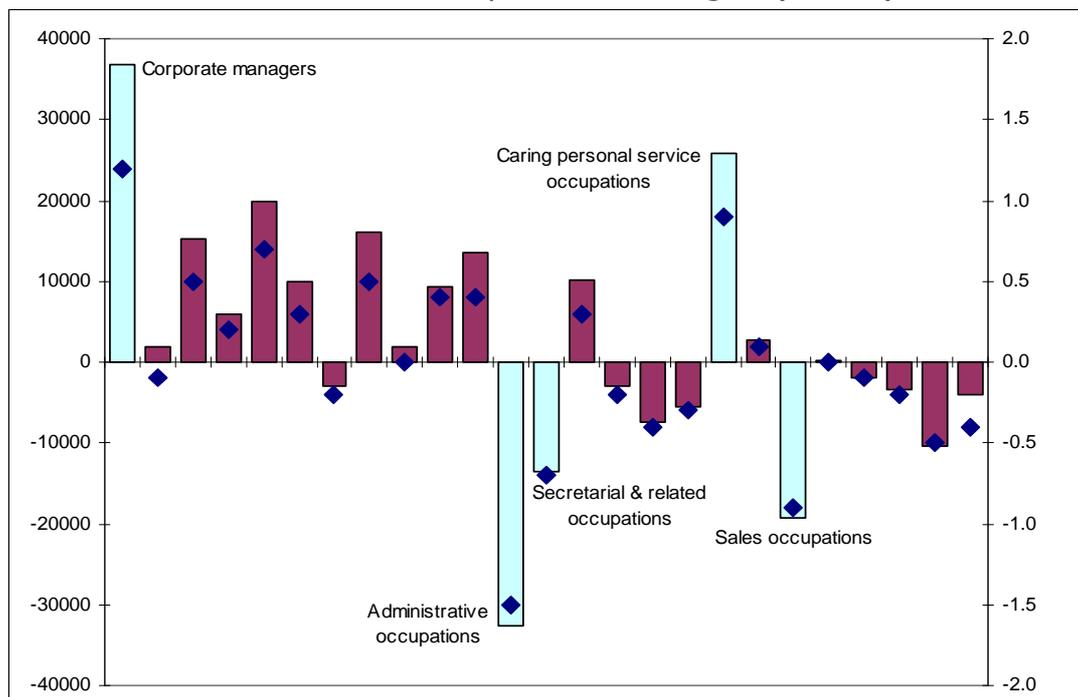
There are different economic and demographic reasons behind the longer-term changes. For example, between 2004 and 2010, there was an increase of approximately 37,000 corporate managers in the SW region, an increase of 1.2%. This increase would have been mostly connected to the structural shift to services already mentioned; sectors where comparatively more corporate managers are employed.

Another longer-term factor influencing occupational composition is ageing. An example of the impact of our ageing society is the increasing importance of the care and personal services sector, as highlighted by an increase of 26,000 in these occupations, 1% of the total.

⁷ In countries such as Germany, Denmark and Finland there were state-subsidised short-time work (STW) schemes in place.

One possible inference that we could also take from the employment figures – as illustrated in chart 8 – is the role of ICT on changing labour demand. The transformational impact of ICT on the workplace can possibly be seen by the decline of administrative, sales and secretarial occupations. Whilst ICT has a positive impact on improving productivity, it has dampened labour demand for some job types. It has reduced the labour intensity of certain administrative tasks and the increasing use of the internet as a direct sales and marketing tool has also reduced the need for sales staff. It should be noted, however, that administrative and sales posts are often the first to be lost in a downturn because they are relatively ‘cheap’ and discretionary. We need to track such changes over a longer period to see if it is a structural as well as cyclical effect.

Chart 8: SW occupational changes (04-10)



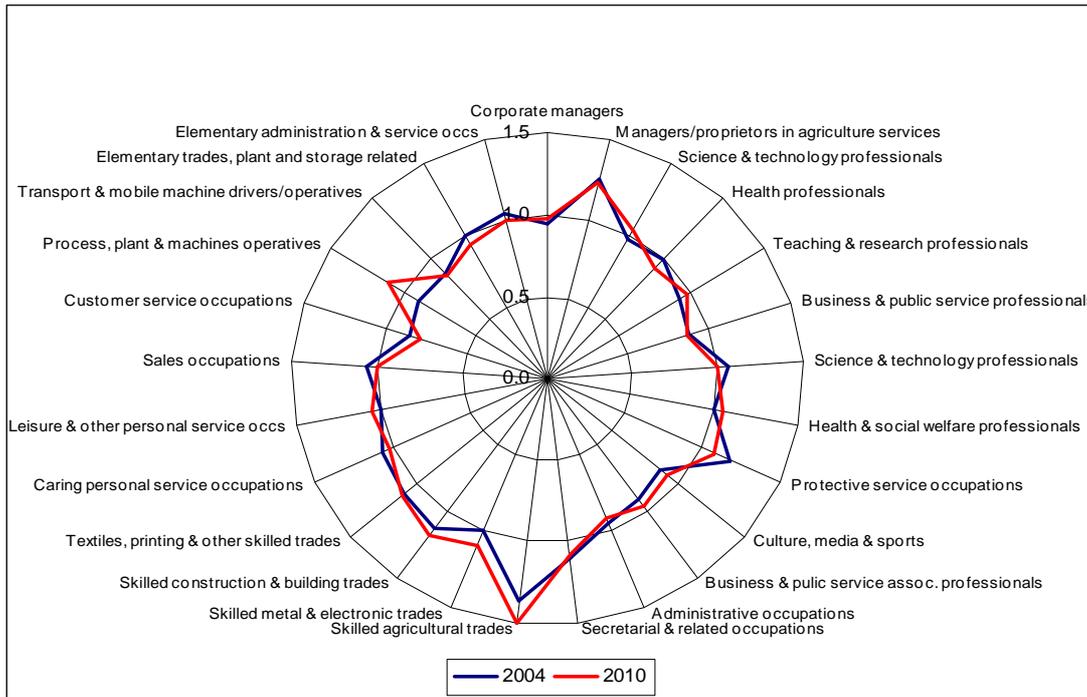
Source: (Workforce Jobs – ONS)

Our interpretation is that any occupation which has experienced a +/- 1% shift in employment during this five year period could represent some form of longer-term structural change. For those occupations that have experienced a smaller shift over this period, it is more likely to represent shorter-term changes associated with the economic cycle. The increase or declines experienced over the period could be reversed as and when economic conditions improve.

The period of economic growth and the subsequent recession has subtly changed the SW’s occupational composition compared to the wider United Kingdom. Chart 9 demonstrates this. It displays the proportion of the SW workforce in each of the respective broad occupations, compared to the proportion in the UK workforce. It also highlights changes that have occurred in the most recent five years, therefore capturing any recessionary impacts. Any score greater than one on the chart represents the SW having a greater relative employment share than the UK economy as a whole.

In terms of significant differences between the SW and UK occupational compositions, the chart shows that, as expected, the SW has a greater representation in agriculture – both in skilled trades as well as ownership. However, what is most noteworthy is that the occupational structure of the SW broadly matches that of the United Kingdom. There are variances around 'one' but most occupations are near to 'one' (and are probably within margins of error).

Chart 9: SW v UK in employment shares (2004 & 2010)

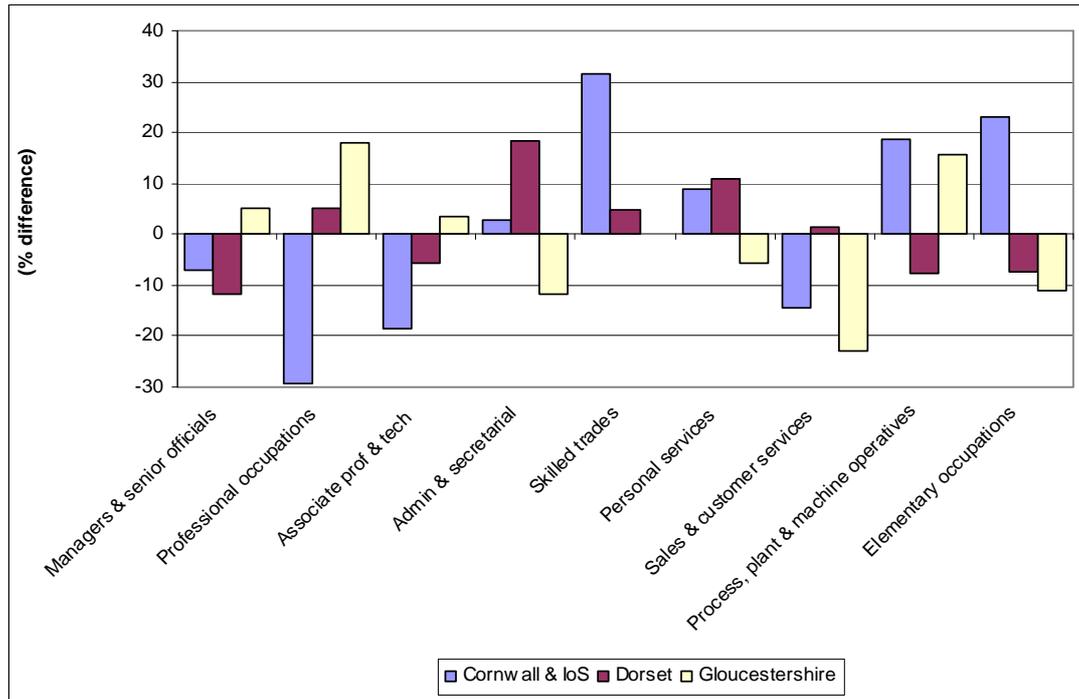


Source: (Workforce Jobs – ONS)

What is of interest is that for process, plant & machine operatives (largely manufacturing) and skilled construction and building trades (construction) the relative SW employment quotient increased between 2004 and 2010. This signifies that for those broad sectors, employment levels in the South West stood up more robustly than experienced elsewhere. This is confirmed by the overall manufacturing employment numbers – they have significantly declined in both the region and the United Kingdom as a whole (as we highlight later), but more slowly in this region than the average.

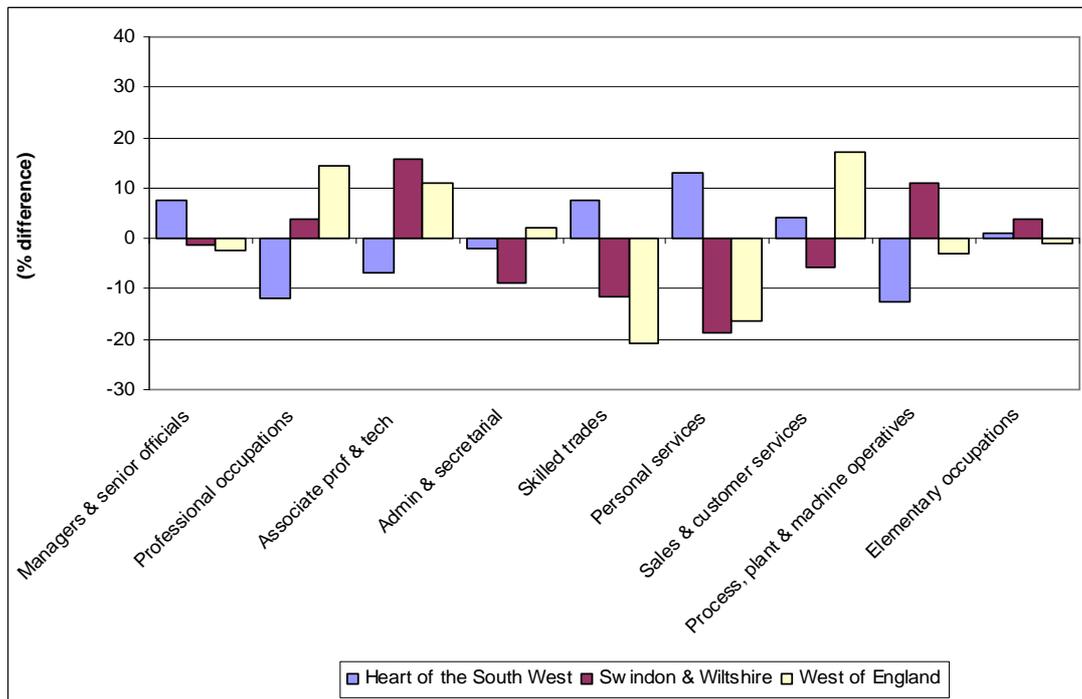
Again, for the construction sector, we know that employment has declined over the past 2-3 years. However, it has decreased at a marginally slower rate in SW England. This could be due to the region having a higher proportion of small and sole proprietors, making it more difficult to reduce employment levels compared with larger firms.

Chart 10: First three LEP area occupational shares (% difference SW = 0)



Source: (ONS – Workforce Jobs)

Chart 11: Second three LEP area occupational shares (% difference SW = 0)



Source: (ONS – Workforce Jobs)

We also present similar data for the LEP areas, showing where there is a relatively high or low presence of certain occupations in each area. The data in charts 10 and 11 shows employment when compared to the SW average. The first chart highlights that Cornwall has a relatively high proportion in skilled trades (30% above average), plant operatives and elementary occupations.

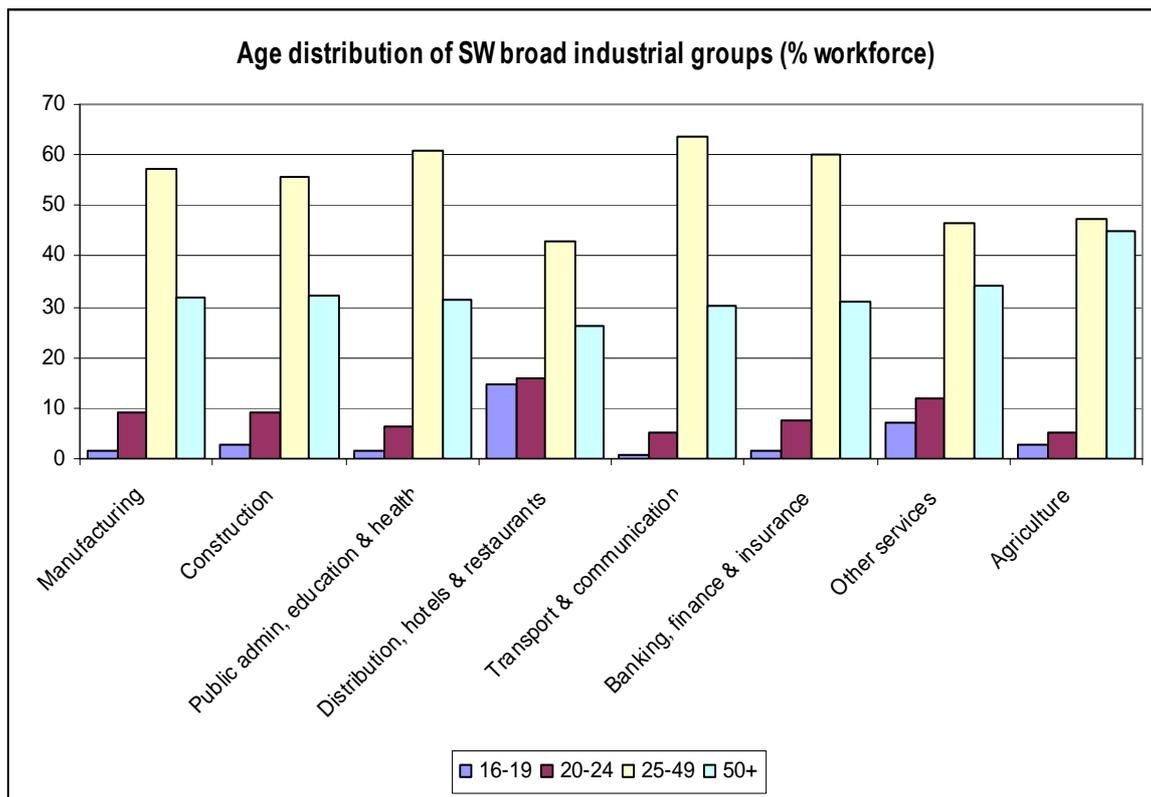
Conversely, it has a lower proportion of those employed in professional and technical services.

The West of England and Swindon has relatively higher proportions of people working in professional and sales & customer services, whilst lower in skilled trades and personal services. In contrast, the Heart of the South West LEP area has a greater proportion in these occupations.

Age profile

Data for industrial age profiles is not available for LEPs or Local Authorities. The data that is available at a regional level shows the age profile for broad SW industrial sectors are broadly similar to that at a national level. Generally, 50-60% of the workforce is aged between 25-49 years and 30% are aged 50+. Therefore, there will be 'replacement demand' issues in specific parts of the economy. For example, it is estimated that there are 80,000-95,000⁸ people working in the manufacturing sector within the SW region that are aged over 50. At some point, as they retire, many of these will need replacing. There are less than 30,000 people working in SW manufacturing aged under 25.

Chart 12: Age distribution of SW workers by sector



Source: (Annual Population Survey – ONS)

Agriculture is also an 'old industry': 90% of its workforce is aged over 25, with 45% aged over 50. Agriculture could face serious issues in the future with regards to sustaining activity in the face of this aged workforce (although

⁸ This include the +/- confidence interval at 95%

many farmers work far beyond the normal age of retirement and there continues to be a factor shift from labour to capital).

The age distribution in other sectors is younger. The distribution, hotels & restaurant sector has a distinctly young workforce – 30% of those working in the industry are aged under 24 (see chart 12).

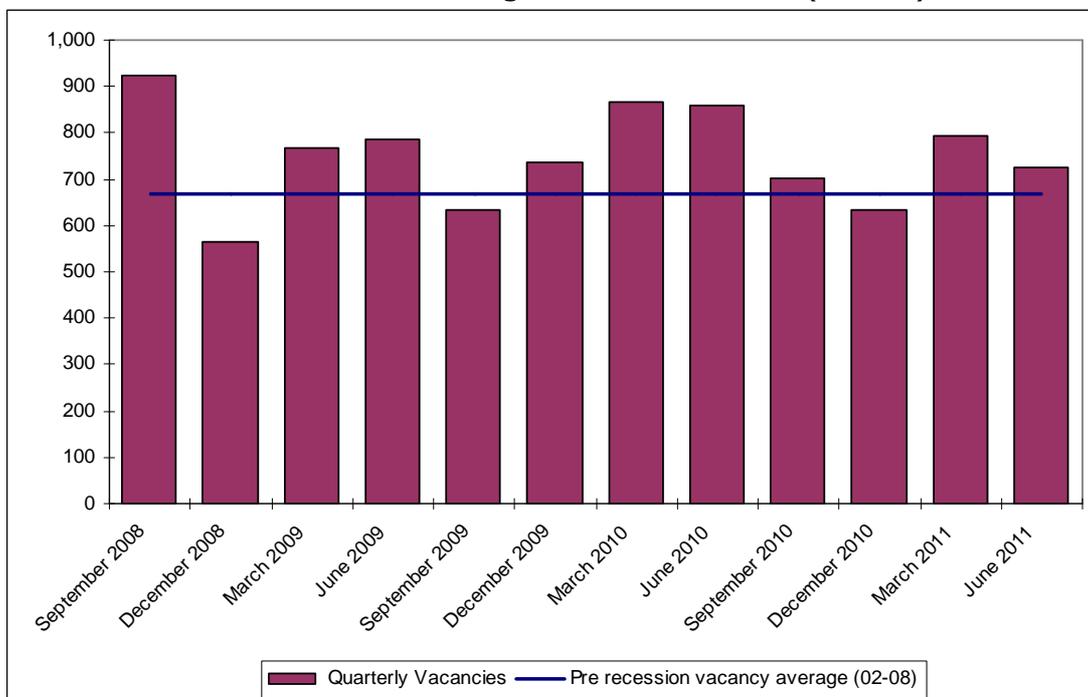
Vacancy analysis

Notified vacancies advertised through Jobcentre Plus are used as one of the indicators of demand for labour. It is far from a comprehensive measurement of labour demand – given that only a proportion of jobs are advertised through this route – but it does provide some use as a proxy.

As you would expect, analysis shows that the number of vacancies dropped off sharply when the recession began to take effect. For some of the main growth occupations – such as Corporate Managers (Chart 13) – the vacancy levels in the period following the start of the recession are significantly below the average in the pre-recessionary period.

If we take Corporate Managers as an example – remembering that longer-term projections indicate continued expansion – vacancies have, in fact, recovered well. Generally, quarterly vacancies are near the average during the period 2002-08.

Chart 13: SW management vacancies (08-11)



Source: (Jobcentre Plus vacancies)

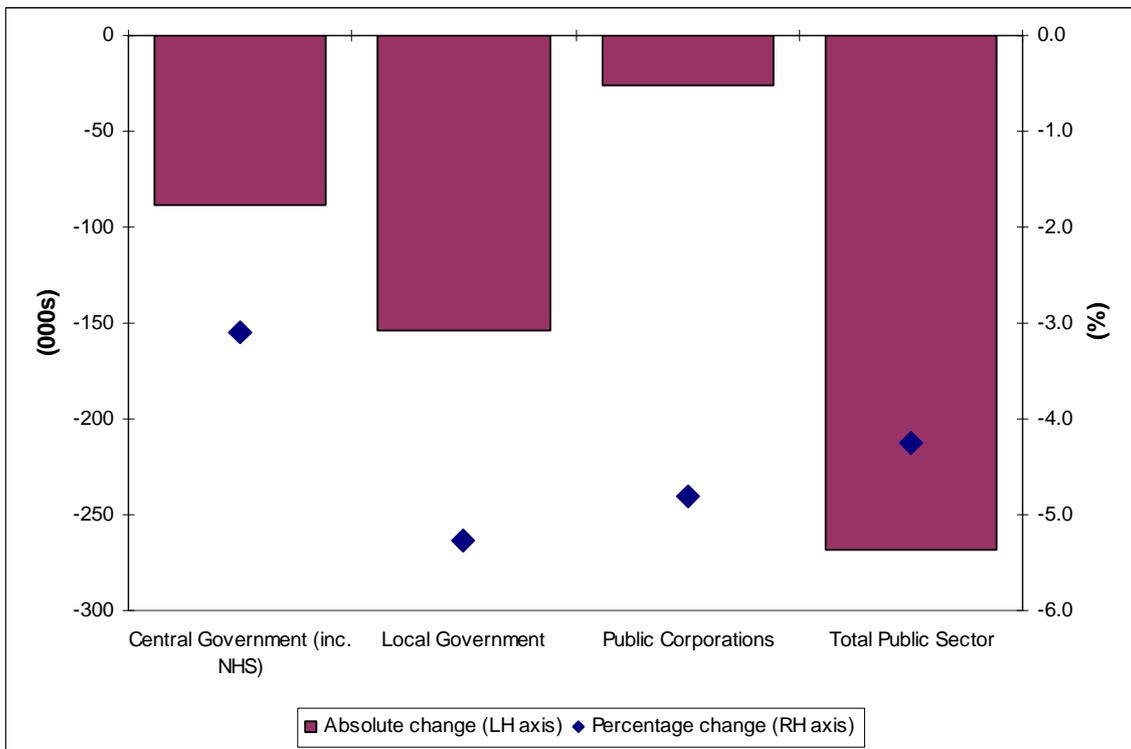
Public sector employment

Between 1999 and 2009, approximately 56% of all jobs that were added in the South West were in the public sector. These estimates are volatile, being subject to some reclassification through time, but the indications are that the public sector share of total full-time equivalent (FTE) employment increased by almost 2.5 percentage points during this decade⁹.

Excluding the temporary effects of the 2011 Census, estimates of total public sector employment for Q2 2011 was 6.037mn. The latest estimates show total public sector employment levels in the United Kingdom decreased by 268,000 between Q1 2010 and Q2 2011 (chart 14). The greatest proportion of these (154,000) was in Local Government, representing a 5% decline. There has been a decline of 88,000 in Central Government (3.1%) and 26,000 in Public Corporations (4.8%).

A proportion of the job losses in public corporations would have been in the partly nationalised banks. We would expect this figure to increase in the next 1-2 years as those banks accelerate their consolidation and reduce numbers further, as exhibited by recent announcements by HSBC, Lloyds Group and RBS. Latest estimates are that publicly owned financial corporations account for 210,000 jobs in the public sector counts. Of the total decline, 15,000 were classified as civil servants.

Chart 14: UK public sector employment changes (2010 Q1-2011 Q2)



Source: (Public sector employment estimates – ONS)

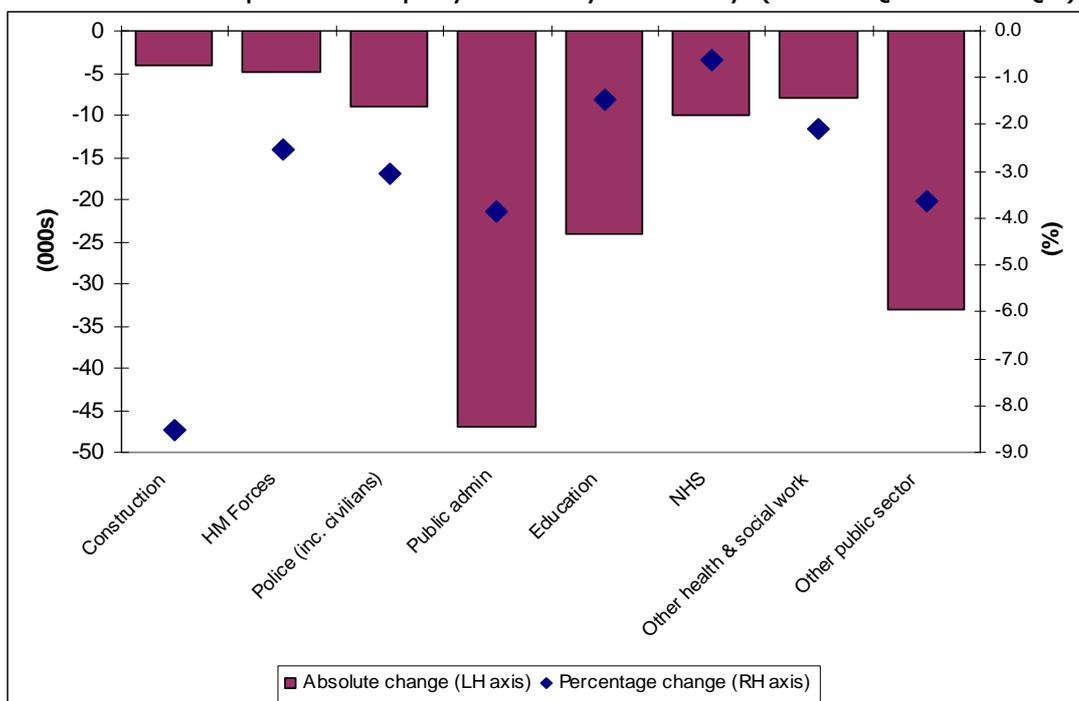
⁹ SW Regional Accounts

If we assume the largest proportion of the job losses in public corporations were at partly nationalised banks – and not, therefore, typical public employees – total employment declines equated to 242,000. If we compare this to the OBR forecasts (310,000 being the latest¹⁰) then it is perhaps surprising that nearly two-thirds of those forecast job losses have already taken place. The public spending cuts were forecast to be back-ended to the latter stages of the current parliamentary period¹¹ and the general consensus was that the greatest decline in public sector employment would take place then. It could be that public organisations have taken the opportunity to reduce staff numbers or that the spending cuts have been more front-ended than originally envisaged. Certainly, this appears the case in local government where budget cuts have been more front-ended, taking effect from 2011 onwards.

Analysis of the figures certainly shows that local government has incurred the greatest pain to date. If we look at the breakdown by industry – as classified by SIC codes (chart 15) – the largest decrease has occurred in public administration. This reflects the cut backs in local government. Smaller absolute and relative declines have occurred in the military, police, education, health and social work and NHS.

These figures will partly reflect an ‘outsourcing’ of jobs from public to private sectors, which is largely an accounting exercise for the overall economy – though it will mean a different process and mix of job development.

Chart 15: UK public employment by industry (2010 Q1-2011 Q1)



Source: (Public sector employment estimates – ONS)

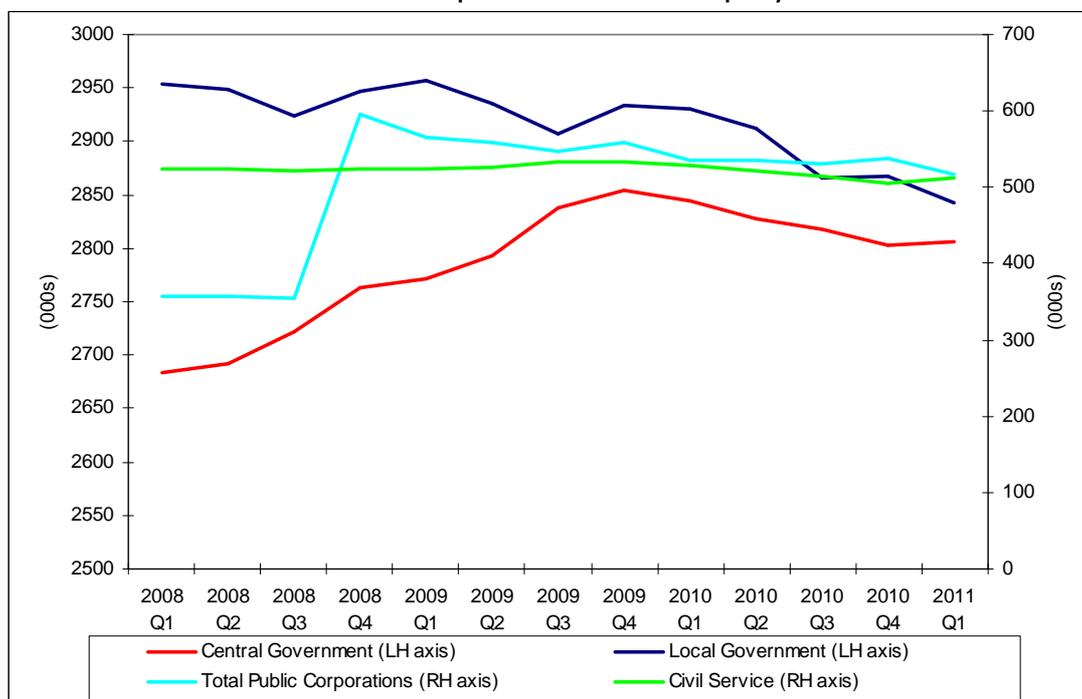
¹⁰ Oxford Economics modelling has suggests that given the size of the spending envelope set by HM Treasury, a decline of around 500,000 public sector jobs could be likely by 2015/16

¹¹ The spending cuts are cumulative, with each year going a step further than the year before, so that 70% of the total cuts in the first five years occur in years four and five.

These near term declines do also reflect trends over the medium-term. Chart 16 below highlights the fact that local government employment in the United Kingdom has actually fallen since 2008 (it reached a peak of 2.964mn in 2007).

In contrast, central government employment continued to increase to a peak in 2009. The chart highlights the large spike in employment in public corporations during the latter part of 2008 – reflecting the part-nationalisation of the banks during that turbulent period (again, more of an accounting exercise rather than a fundamental change). Its downward trend since that date reflects ongoing consolidation in that sector.

Chart 16: UK public sector employment



Source: (Public sector employment estimates – ONS)

Looking specifically at the South West (chart 17), public sector employment has been declining from a peak at the end of 2009. Since then, employment has fallen from 553,000 to 508,000. Moreover, the South West has experienced the largest absolute and relative declines in public sector employment of any region (exc. London). This probably reflects our higher reliance on public jobs in the first instance, (given the sharp rise in the preceding decade)¹². Between Q4 2009 and Q2 2011, public sector employment declined by 8.2% - significantly higher than the 4.6% national decline experienced over that period.

¹² The 162,500 additional jobs in public services was equivalent to 74% of the total growth in regional employment between 1998 and 2008.

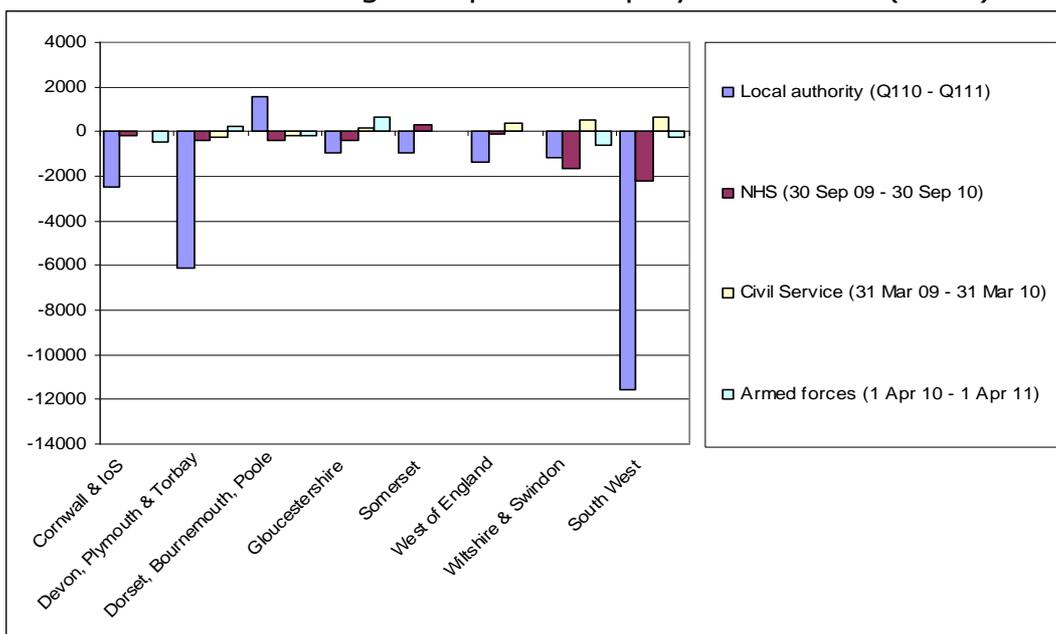
Chart 17: SW public employment



Source: (Public sector employment estimates – ONS)

Sub-regionally (chart 18 below), the majority of public sector jobs that have been lost over the past year have also been in local authorities with over half of these were lost in Devon, Plymouth & Torbay (6,000). Cornwall & Isles of Scilly (2,500) and the West of England (1,400) have also seen significant reductions in local authority employment between Q1 2010 and Q1 2011 (the former probably reflecting the ongoing impact of the move to unitary status).

Chart 18: Sub-regional public employment shifts (000s)



Source: (Public sector employment estimates – ONS)

Some of the data relating to other areas are somewhat lagged; the latest NHS data relates to the year ending Sept 2010 and civil service employment for the year ending March 2010. The NHS data does capture a reduction of 2,200 jobs – the majority of which (1,200) were in Wiltshire & Swindon.

There has been a small fall (260) in the number of armed personnel in the region in the year to 1st April 2011. However, recent announcements by the Ministry of Defence (MoD) of a further reduction in just army numbers of 19,000 by 2020 means we expect these SW figures to significantly rise over the coming years, particularly given the region's high armed force presence.

Current Labour Market Developments

Local authority job loss announcements

All local authorities in the region have announced potential job losses as a consequence of significant reductions in their grant funding over the next 2-3 years. As we see from the charts above, some of the job losses that have occurred are feeding through to reductions in the published figures, whilst a high proportion are still to take place. The reductions in headcount will be through a combination of factors; including redundancies, natural wastage and recruitment freezes.

It is also important to note that this information relates only to announcements made by the local authorities. They do not relate to actual job losses that have yet to take place. Therefore, the data needs to be interpreted correctly.

Chart 19 shows the falls in revenue grant – but including any transition grant¹³ – over 2011-12 & 2012-13, expressed in percentage terms. The largest proportional reductions in revenue will occur in Plymouth during 2011-12 and Bournemouth during 2012-13. Bournemouth is expected to suffer the largest cut over the 2 years (7.5%) with Dorset and the Isles of Scilly seeing the lowest reductions.

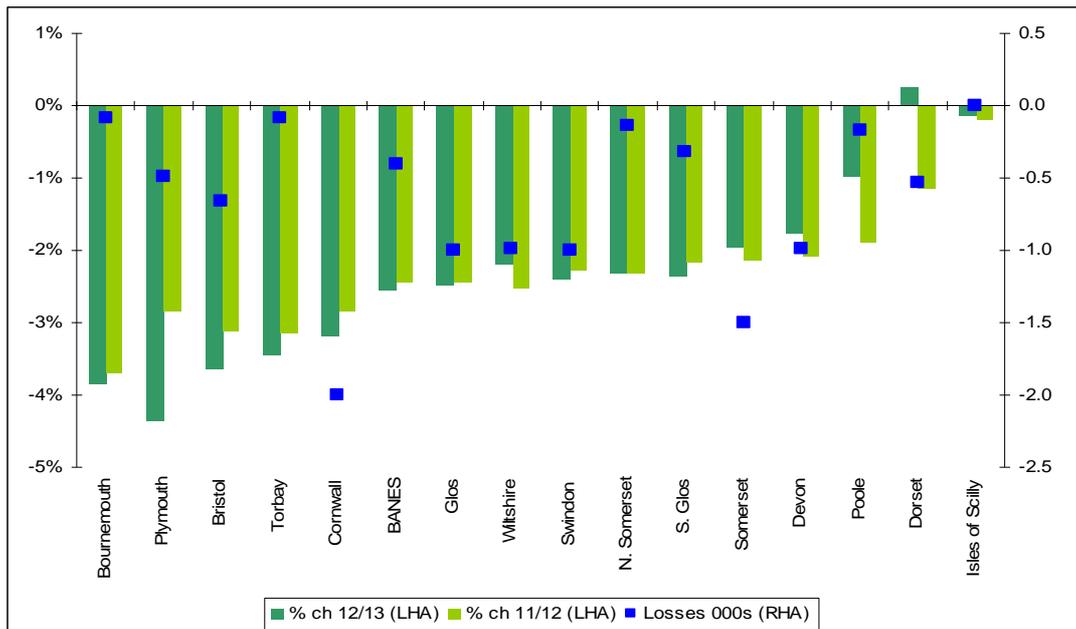
We now present a selection of charts, showing job loss announcement data in a variety of different ways. Chart 19 shows the cuts in revenue spending (expressed as a proportion of previous budget) set against the job loss announcements made by the local authorities so far. This illustrates that the largest announcements have been made to date in Cornwall (2,000), although it should be recognised that some of this will be driven by continued re-adjustment as a consequence of moving to single-tier local government in 2009.

It appears that authorities such as Bournemouth, Torbay and North Somerset have announced relatively small job losses in comparison to their projected budget cuts. Crucial, though, is that this analysis could indicate that some authorities have made their job loss announcements early – and may not have any further to make over the next few years – whilst others have further announcements still to make. For many authorities, the job loss announcements relate to a number of years and, therefore, the net impact locally will be staggered and smaller in any one year

Of course, this chart does not take into account the relative size of each authority and displays absolute numbers only (see later).

¹³ The Government have announced that it will pay a revenue grant ('transition grant') to local authorities in 2011-12 and 2012-13 who would otherwise see a reduction in 'revenue spending power' of more than 8.8% in either year, based on spending power set out in provisional 2011-12 settlement.

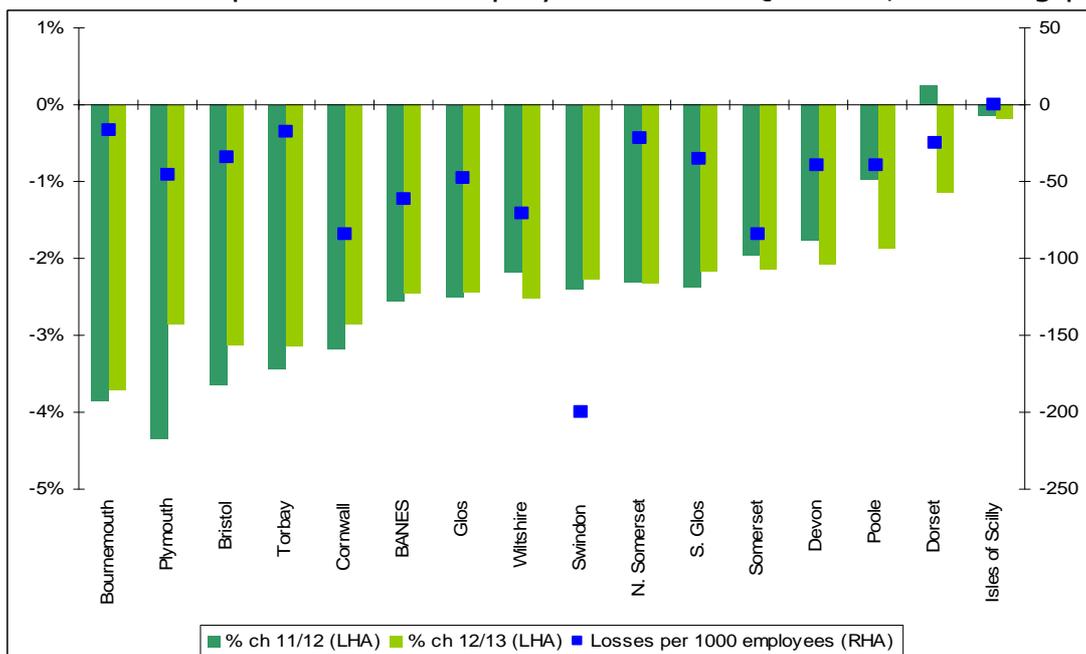
Chart 19: Local Authority budgets and jobs (% including transition grant & announced losses (000s))



Source: (Local authority budget details and media announcements)

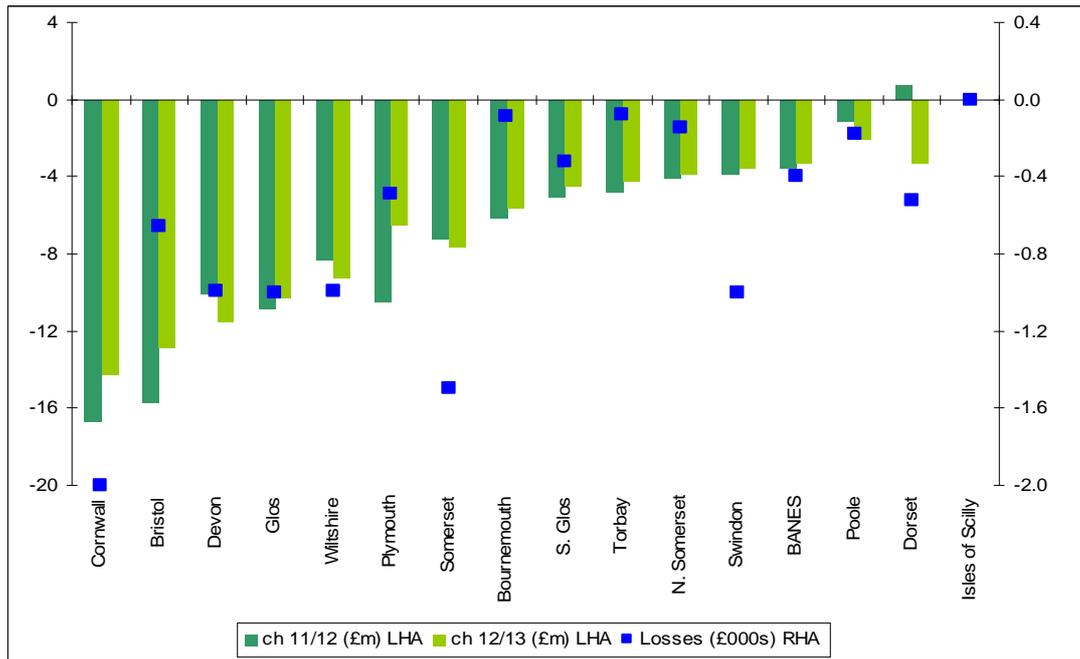
The second chart (20) displays the same revenue grant reductions, but now as a proportion of the existing workforce. Through this approach, we see that Swindon is now most marked in terms how large a proportion of its workforce it could potentially lose – it could be 200 per 1,000 employees. This does appear a particularly ‘aggressive’ stance. In comparison, on this measurement, other larger authorities such as Bournemouth (16), Plymouth (46) & Bristol (35) have made much smaller proportional announcements.

Chart 20: LA budgets & jobs by proportion (% inc. transition grant & announced losses per 1000 LA employees – as at Q3 2010, including police)



Source: (Local authority budget details and media announcements)

Chart 21: LA jobs and budgets absolutes (£m exc. transition grant) & announced losses (000s)



Source: (Local authority budget details and media announcements)

A further angle (Chart 21) shows the revenue grant reductions in absolute monetary figures. The largest falls in revenue grants over the 2-year budgetary period are for the large authorities - Cornwall (£31m) and Bristol (£29m). Set against the absolute announcements, this measurement suggests the announcements made by Somerset now become most marked.

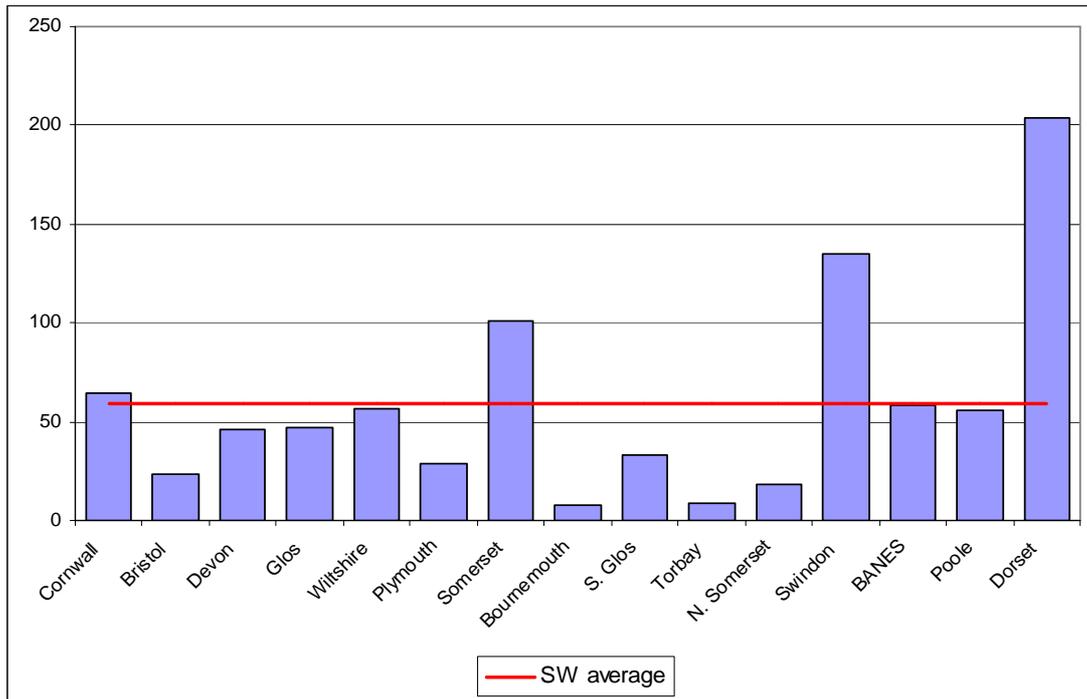
Finally, we try to 'normalise' the analysis (chart 22) by expressing the job loss announcements per £million of revenue grant reduction. On this basis, the job loss announcements made by Dorset now become most notable. In the previous charts, Dorset looked as though it was planning fewer job losses than elsewhere. However, this was principally due to a relatively small reduction to its revenue grant funding.

However, Dorset has announced 527 job losses set against a total revenue grant reduction of £2.6m, equating to 203 jobs per £million. This compares to a regional average of 59 jobs per £million revenue grant reduction¹⁴. Swindon (135) and Somerset (101) are also significantly above the average. Cornwall, which appeared noteworthy on other measurements, now broadly matches the regional average.

Bournemouth, South Gloucestershire, Torbay, Bristol and North Somerset are significantly lower than the regional average. This could indicate that, as previously stated, they may have further announcements to make. Alternatively, it could mean that they are meeting their grant reductions through means other than reducing staff.

¹⁴ This, interestingly, only equates to £17,000 per job.

Chart 22: LA job losses related to revenue (per £m reduction)



Source: (Local authority budget details and media announcements)

Wage adjustments

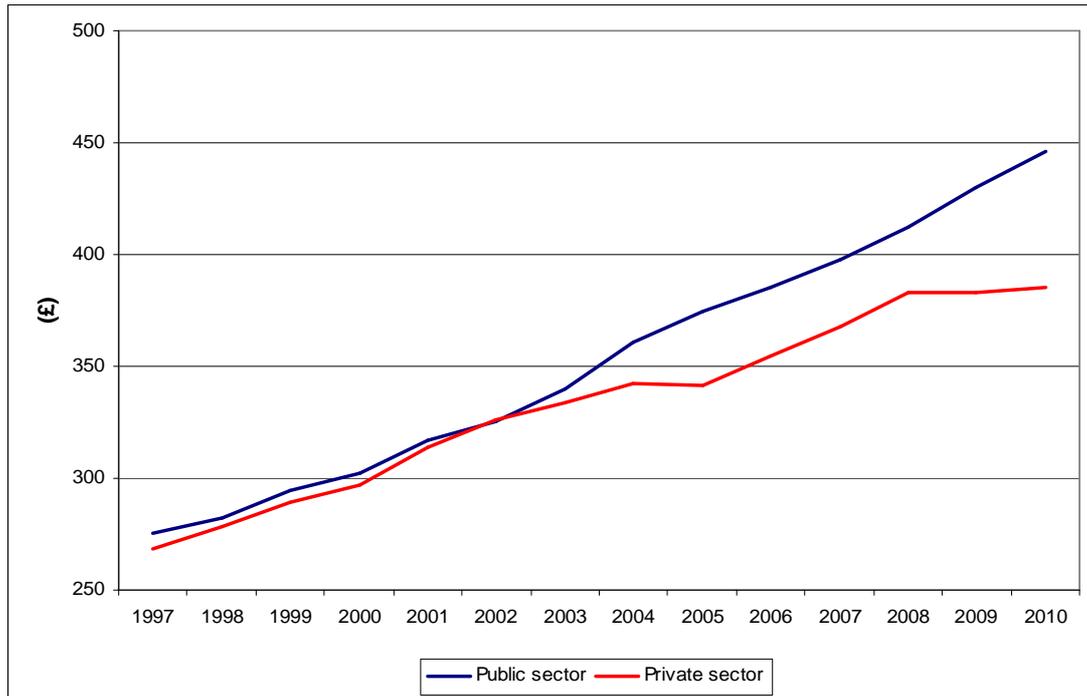
A major question for the SW economy and others is how easily the displaced public sector workers will find jobs in the private sector; this is a question of occupational mobility. One factor that will affect mobility will be wage differentials. If there is to be a switch from the public to the private sector, then there may be a need for an adjustment of total compensation expectations (this includes wages and other benefits).

A recent data paper by the ONS¹⁵ shows that a significant wage differential has been established between public and private sector workers. The earnings model used in the ONS estimates shows that the public sector, on average, earned 7.8% more per hour (excluding overtime) than the private sector in 2010 (after accounting for differences in qualifications). The earnings model accounted for gender, age, occupation, location and qualifications.

Chart 23 shows how public and private pay were broadly matched until 2002 and have then since diverged, particularly widening since 2008 when private sector pay came under pressure in the recession. We would expect this gap to narrow as the public sector pay freeze takes effect, but it does obviously present 'adjustment' questions for those needing to switch, especially at the higher age ranges.

¹⁵ 'Estimating differences in public and private sector pay' – ONS – July 2011

Chart 23: Median earnings by broad sector



Source: (Annual Survey Hours & Earnings – ONS)

The public sector generally consists of an older workforce than the private sector. Around 15% of employees in the private sector are aged 16 to 24 compared with around 5% of employees in the public sector, and around 45% of public sector workers are aged 35 to 49 compared with around 38% of private sector workers. This will explain much of the wage differentials, given that most of the public sector tends to have an annual incremental system of wage increase and public workers have tended to stay within the same employer spectrum for longer.

Around 65% of employees in the public sector are female, compared with around 41% of employees in the private sector. On average, employees in the private sector work more hours per week than employees in the public sector.

One conclusion that could be drawn from the difference in make-up of public sector workers compared to their private counterparts is that there could be a requirement to adjust expectations of terms and conditions on behalf of the former, particularly women, if they are to be assimilated into the private sector. Higher average earnings, shorter working hours and greater part-time working could mean that public sector workers need to revise expectations downwards in order to take advantage of private sector opportunities.

Impact of public sector job losses

In previous work undertaken by the SW Economy Module, forecasts were made for the total number of job losses that could occur in the SW region over the next five years. The paper '*Impact of public sector spending cuts*¹⁶' was based

¹⁶ '*Impact of public sector spending cuts – emerging evidence base for the South West*' – SW Economy Module - 2010

on the fiscal forecasts outlined by the Office of Budgetary Responsibility (OBR) in June 2010 and was conducted prior to the detail contained in the Comprehensive Spending Review (CSR) in October 2010. At that time, based on the Government's fiscal targets to the period to 2014-15, it forecast that there would be a reduction in general government employment of around 600,000.

The OBR has subsequently revised these forecasts down; in its November forecast to 330,000 and to 310,000 in its latest March 2011 forecasts¹⁷. These were revised downwards principally due to more optimistic forecasts of growth in the latter part of the period to 2014/15. It was the OBR's view that stronger economic growth in 2013/14 and 2014/15 would lead to a rise in tax revenues, resulting in lower spending cuts and, therefore, fewer job losses would be required.

However, since the March 2011 forecasts, the two subsequent quarterly real GDP estimates have been very weak. This means that the OBR's near-term growth forecasts are not likely to be met¹⁸, particularly given the turmoil in the financial markets and continued sovereign debt problems. There are expectations that the OBR will lower its immediate and longer-term growth forecasts this autumn.

As a consequence, we feel the forecast of a 310,000 reduction in government employment could now be seen as optimistic. If growth is weaker – and tax revenue lower – then the Coalition Government will need to reduce spending more than forecast to hit its overriding deficit targets. This will be politically unpalatable but may be required if a fiscal policy "u-turn" is not to be countenanced. As a consequence, the loss of 310,000 jobs could be seen at the lower end of estimates¹⁹.

Nevertheless, we felt it useful to revisit the earlier paper to understand how these revised figures could impact on the South West and to also estimate the wider impact.

The Comprehensive Spending Review outlined details of reducing both local and central government expenditure by 19% over a four year period to 2014-15, compared to the baseline of the 2010-11. It is likely this will affect parts of the country differently²⁰ but for the purposes of this exercise we assume the SW experiences this average decline of 19% public spending. It is recognised that, principally due to a greater presence of military personnel, the actual figures could be higher. We also recognise that local government will actually see a 27% cut in their revenue grant funding over the four year period.

¹⁷ 'Economic and fiscal outlook' – Office of Budgetary Responsibility – March 2011

¹⁸ 'OBR chief warns on UK growth targets' – Financial Times, August 4th 2011

¹⁹ Indeed, as we've highlighted, some commentators such as Oxford Economics forecast the figure likely to be nearer 500,000

²⁰ For example, those areas where more social security payments are made could see greater cuts in expenditure.

According to the latest figures²¹ there was an estimated £42.5bn of public expenditure in the South West during 2010-11. The SW Regional Accounts has an impact analysis tool that allows assessment of changes to industrial structure (say changes in employment) or to changes in demand (such as changes in spending). The table below shows an analysis of the effect of reducing government spending/demand by the 19% as outlined in the CSR. In total, an estimated 119,000 jobs and £4.4bn of GVA could be lost by reducing public expenditure by 19%. These estimates broadly match those made in September 2010²². The hardest hit sectors are to be the public sector itself (including public administration, health and education) and then the knock-on effects, through the public sector supply chain²³ and the general impact in sectors such as retailing as aggregate wages and consumption fall.

Note that this is an instructive but simplistic approach to measuring the impact of the rather complex public sector cuts, which combines cuts to public sector jobs and cuts to public sector contracts. Not all of the cuts will happen at once (which we have assumed in this approach). Furthermore, the private sector will hopefully exploit opportunities that open up ('crowding in') as the public sector retrenches.

Impact of reducing government spending by 19%				
	GVA (£m, 2008 prices)		FTEs	
	Initial	Total	Initial	Total
ALL INDUSTRY	2674	4450	75074	119587
Agriculture, forestry and fishing	0	9	22	516
Extraction	0	1	0	13
Manufacturing	0	62	0	1598
Energy and water	0	24	0	120
Construction	0	67	0	2205
Total Services	2674	4287	75052	115135
Distribution and retail	0	261	0	9605
Hotels and catering	0	78	0	3411
Transport and communication	0	123	0	3209
Financial services	0	113	0	945
Business services	7	619	267	8225
Public administration	1034	1054	24621	25110
Education	522	646	13580	16804
Health and social work	1037	1212	35007	42802
Other services	74	181	1577	5023

Source: (SW Regional Accounts)

²¹ Public Expenditure Statistical Analysis – HM Treasury 2011

²² In the September 2010 paper it estimates total (direct and indirect) job losses of 115,000

²³ The public sector obviously plays a vital role as a major procurer. Research previously undertaken on behalf of BIS (formerly BERR) suggests that private sector sales to the public sector were estimated to be £79.4bn in 2007/08. The largest area for procurement of services was health with an estimated £24.2bn spent in 2007/08. The next largest categories were social protection (£17.9bn), defence (£10.1bn) and education (£7.3bn).

The counter argument is that a 19% reduction in local government spending underplays the cuts in this region. The average revenue grant reduction could be 27% in local government. If we were to run this scenario, then the potential job losses are higher. Direct job losses in the public sector could reach 88,000, with a total loss of 140,000.

Overall, the question that arises is that the estimate of 75,000 public sector jobs being lost in the South West alone is high when set against the context of the latest OBR forecast of 310,000 jobs being lost over the four-year fiscal period. But, this reflects our doubts over the OBR estimate represented earlier. Given the fact that we have highlighted that the ONS public sector employment figures already show a national fall of 95,000 since 2010 (excluding public corporations) and 45,000 in the South West (since 2009) then we argue that the 310,000 estimate is conservative for the country and the 75,000 direct losses in the region are reasonable. Worryingly, given the Government's prime objective is to remove the structural deficit by 2015, the flatness of the recovery to date suggests further measures to tighten fiscal policy and cut public sector jobs will be necessary.

In summary, if the cuts in public expenditure are implemented in full - as outlined in the CSR - and the SW experiences its proportional share of them, then we estimate that between 70,000 and 90,000 public sector jobs could be lost directly in the region over the next four years. This estimate broadly matches the one in the original paper in September 2010, despite the fact that the OBR has significantly lowered its national forecast. Also, it does not reflect all the indirect and induced multiplier effects.

Of course, the Coalition Government could choose a different route and decide to address the fiscal deficit through greater levels of taxation rather than expenditure cuts. This would affect the estimates and geographical distribution²⁴.

Finally, it's important to again make the point that this will not physically result in up to 90,000 people leaving their jobs. The reduction in headcount will be through a range of measures – notably natural wastage. There are signs that flexible responses, including outsourcing, pay cuts and other measures may limit some of the net negative labour impacts. If these are successful then the employment adjustment, in terms of its broader economic impact, might be lower. It should be remembered that these are gross rather than net figures for the economy as a whole: the latter depending on how private sector substitution effects pan out (see next section).

²⁴ Previous work undertaken by Experian indicates that the South East would suffer more from a 'higher tax' scenario.

Private sector employment

Of course, much has been made of the need for the private sector to alleviate the public sector job losses by increasing its demand for labour - the focus of this paper. In some respects, the latest estimates show the private sector is taking up some of this employment slack (chart 24). Between Q4 2009 and Q1 2011, employment in the UK private sector increased by 562,000 to 23.1mn. This has far outweighed losses incurred in the public sector over this period. The majority of this excess of private sector job gains over public sector job losses were due to very strong job creation in Q2 2010. This gain of 560,000 jobs has partially off-set the significant decline experienced during the recession, where 1 million jobs were lost between Q2 2008 and Q2 2009.

Crucially, it is important to recognise that in a recovering or normal economy, it would be expected that private sector employment, representing the bulk of the workforce and most of the orientation to dynamic growth, would grow much faster than the public sector. Most of what we have observed to date is 'normal' behaviour rather than actual economic rebalancing: it is cyclical rather than structural.

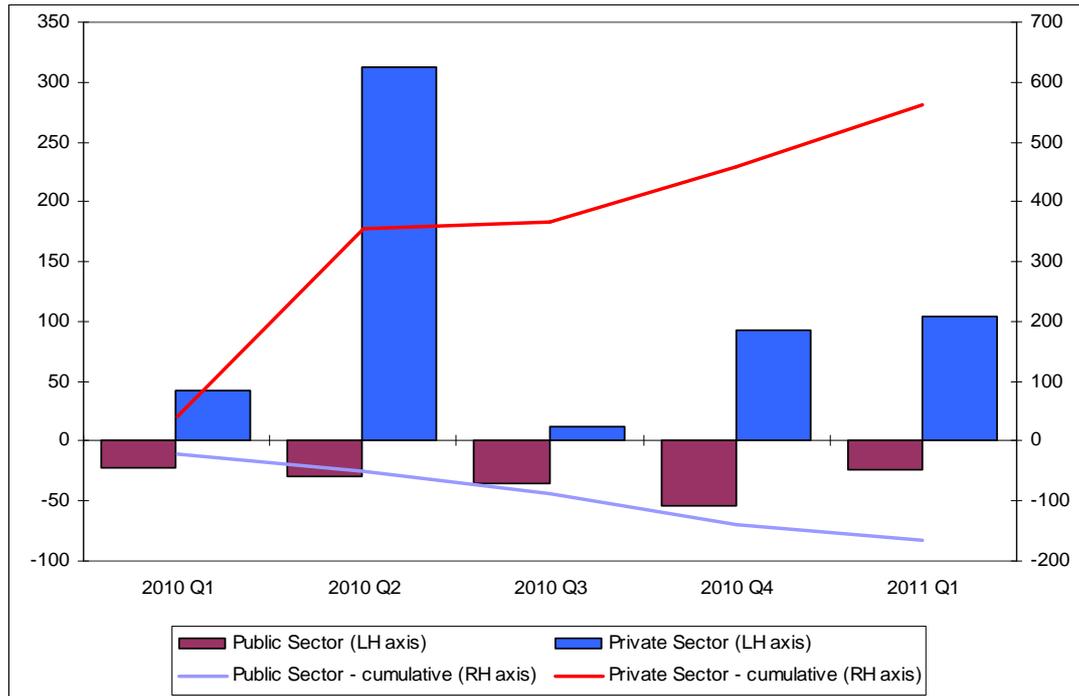
What we do not know, of course, is how many of the 143,000 employees who have left the public sector in this period have taken up employment in the private sector. Many will have left the labour market altogether through retirement, voluntary exit etc or switched to different models of employment, including self-employment.

The next quarterly estimate figures will be interesting; given that they will cover the first three months of the financial year, we might expect that public sector job losses to increase as public organisations move into the next budgetary period.

A gap in our understanding, due to a lack of available data, is the quality of those jobs being created in the private sector. Through monitoring of job creation announcements in the media, we understand that a large proportion of the jobs created have been in sectors that tend to have relatively low productivity and, therefore, lower pay and conditions i.e. retail and other distribution.

The loss of better-paid jobs in the public sector (as we demonstrate later in this analysis) may not be directly offset by the creation of similar jobs in the private sector. Not only does this have an impact upon the individuals concerned, but it also serves to weaken demand and productivity in the overall economy – as well-paid jobs are substituted for less well-paid jobs at an aggregate level, the national standard of living will drop.

Chart 24: Employment trends by broad sector (000s)



Source: (Public sector employment estimates – ONS)

The above figures also relate to headcount and do not take account of whether the jobs are full or part-time. We now analyse the data to understand what changes to the composition of employment are taking place.

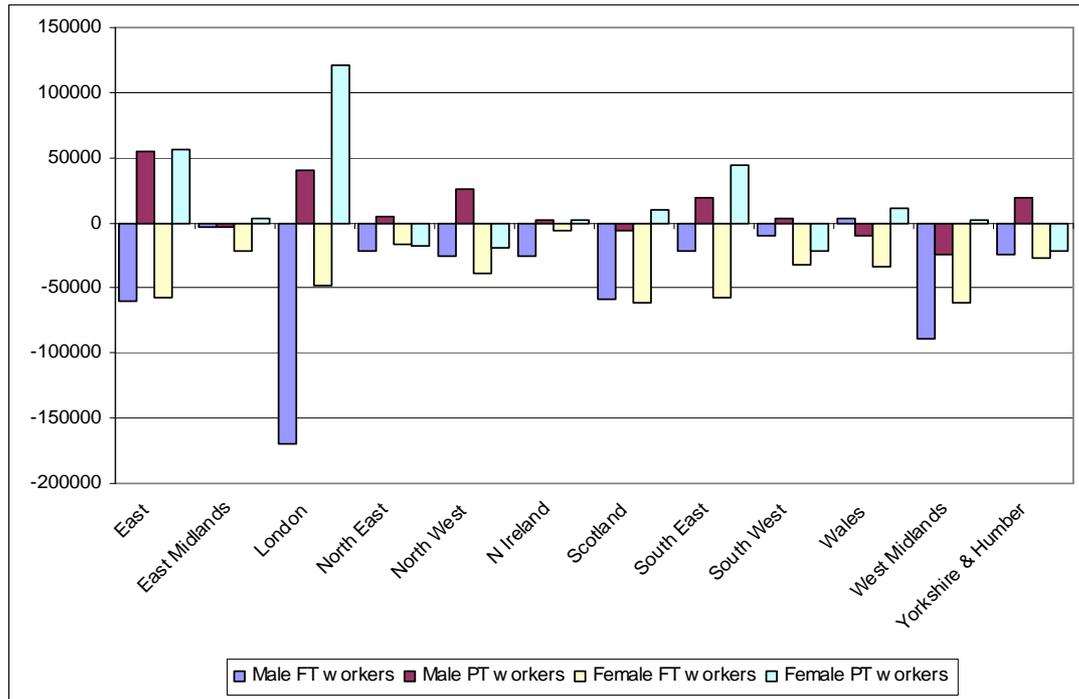
Employment composition – loss of full-time jobs

It is clear that at a national level, a notable aspect of the labour market over the past 2-3 years has been the decline in full-time (FT) workers and the increase in the number of part-time (PT) workers (chart 25). This decline in both male and female FT workers has taken place in each region and devolved administration of the United Kingdom, most notably in London where the number of male FT workers fell by 170,000 between March 2008 and March 2011 and females FT workers by a further 49,000.

At a national level, the ONS data suggests that 960,000 FT jobs were lost between 2008 & 2011. This was only partially offset by an increase of PT workers of approximately 300,000. Over 40% of the UK jobs created in the last year were PT. FT employment has yet to recover its pre-recession level whereas PT employment is well above its equivalent figure.

Closer analysis of the SW figures show that, rather contrary to the national picture, the decline of female FT workers actually exceeded that of male FT employees over the 3-year period. The number of female FT workers fell by 32,000, compared to 10,000 for males. This is also interesting because it indicates the South West lost a relatively small proportion of the overall reduction in UK FT workers (less than 5%).

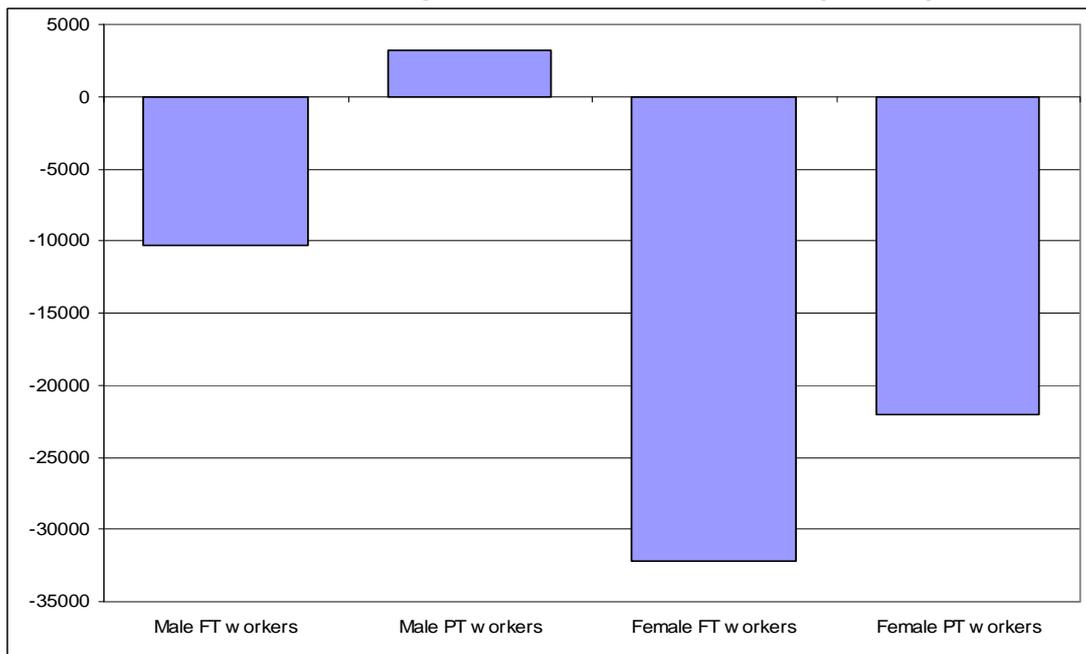
Chart 25: Changes in UK regions' employment time (08-11)



Source: (ONS – Workforce Jobs)

Whilst there was a small increase in the numbers of male PT workers, there was actually a decline in female PT workers – highlighting the particular difficulties experienced by females in the SW labour market. This may support the story that our region has a higher proportion than most of female workers with relatively low job “stickiness” that are comparatively easy to let go when the economy slows. It also suggests these functions are likely to be at the lower end of the job structure in terms of output productivity and wages.

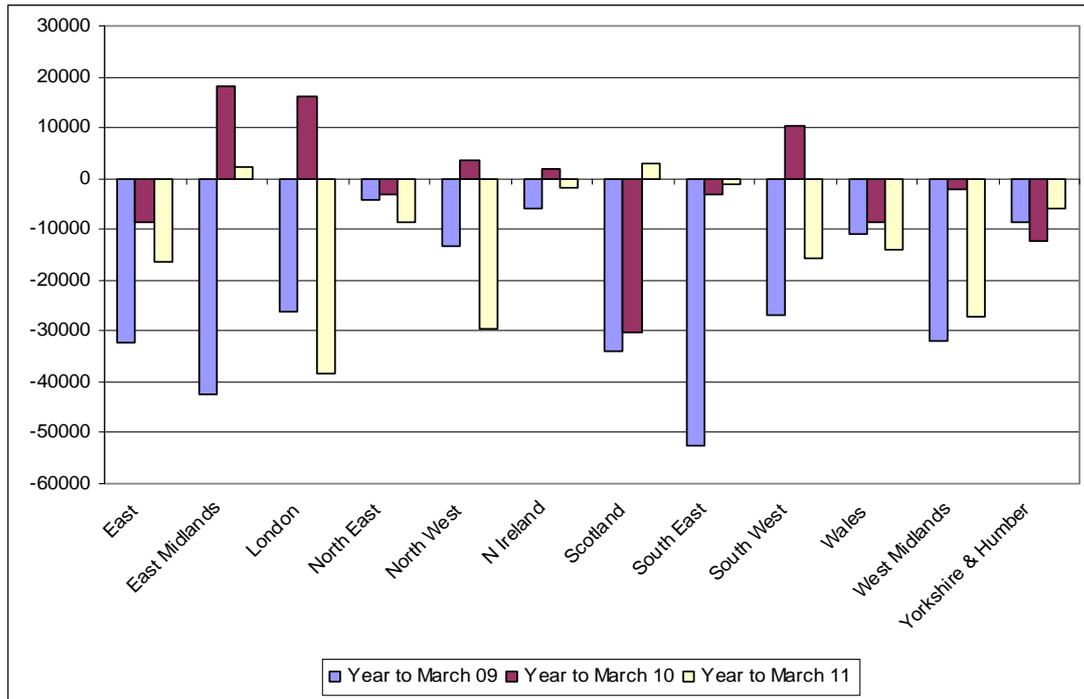
Chart 26: Changes in SW workers time (08-11)



Source: (ONS – Workforce Jobs)

If we break this 3-year period into individual years, we can see that the greatest initial 'shock' of the downturn that started in 2008 was that female FT employment fell sharply in most regions – including the South West. Levels recovered slightly throughout 2009 but have fallen again during 2010, highlighting the vulnerability of female FT employment. The reality is that many of those female FT workers leaving employment will have left the labour market completely, albeit perhaps temporarily²⁵.

Chart 27: Changes in female jobs by region



Source: (ONS – Workforce Jobs)

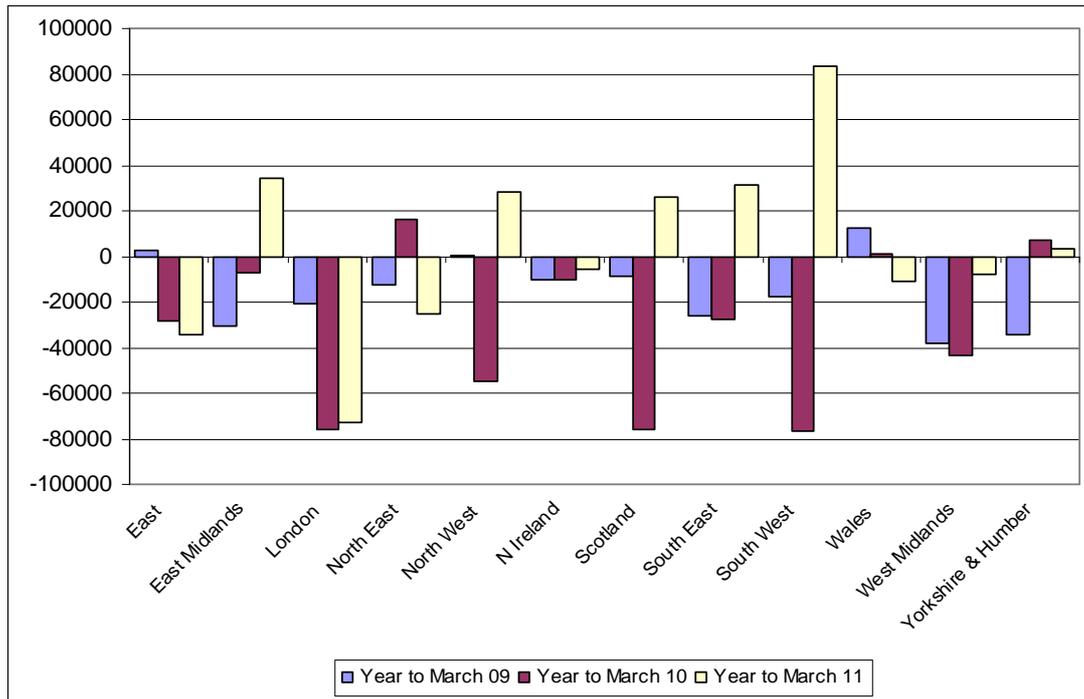
In contrast, the impact upon male FT workers appears to have been more delayed. The largest decline here was experienced throughout 2009 and the early part of 2010 when the global shrinkage in product production kicked in.

Thereafter, the data suggests that in the South West, male FT employment has made a robust recovery in the year to March 2011, probably reflecting the pronounced swing in value added exports – largely making back the 80,000 FT jobs lost during the previous year.

However, it is difficult to be sure that this is the only cause of this large swing and we suggest some caution in interpretation of this dataset. In particular, we see no obvious reason why the SW would add this scale of male FT jobs over the last year – far in excess of other regions. Whilst we know there have been swings in construction employment – which explains part of this switch – it is again difficult to understand why the magnitude would be greater here than elsewhere.

²⁵ Recent work by the Centre for Economic Performance confirms that there is a greater flow of females from employment into non-participation, particularly during recessions

Chart 28: changes in male jobs by region



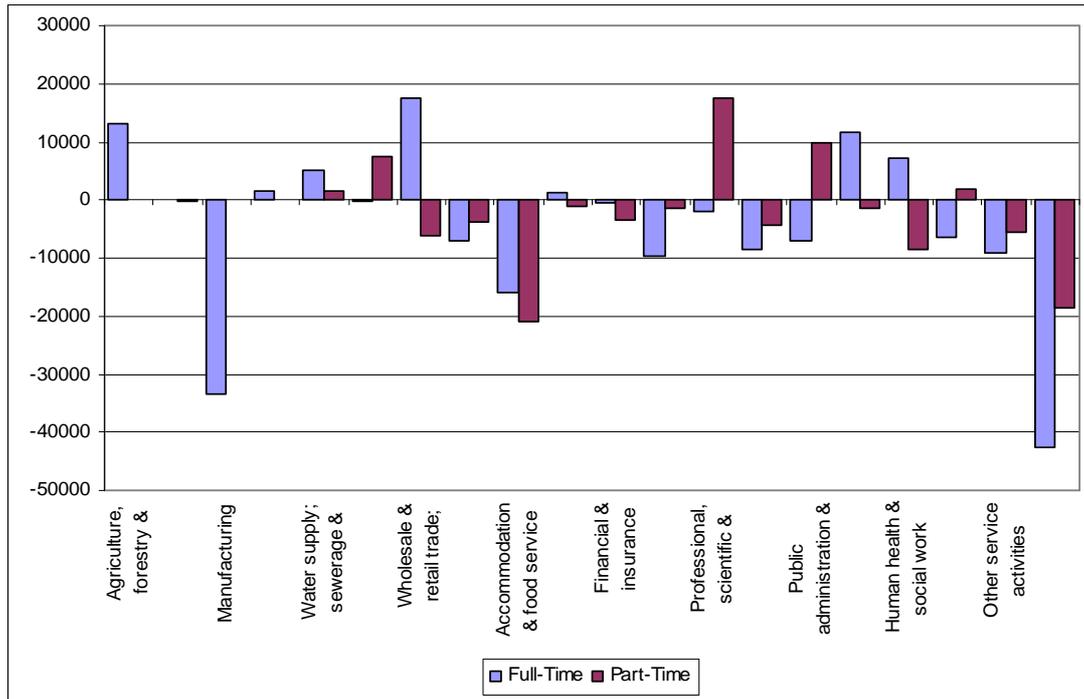
Source: (ONS – Workforce Jobs)

To help us understand the specific drivers of changes in FT employment in the region, it is useful to analyse the industry-specific numbers during this period. This data (chart 29) shows that, as expected, the largest declines in FT employment occurred in manufacturing industry and general services. Between March 2008 and March 2011, 33,500 FT jobs were lost in the manufacturing sector in the South West. A further 16,000 were lost in accommodation & food services and 9,600 in real estate activities – highlighting the particular difficulties associated with the housing market and any sector reliant on discretionary spending.

The retail, education and health sectors all experienced increases in the number of FT workers. In itself, this causes some concern for immediate prospects. Retail is currently experiencing difficulties as household real disposable incomes fall and consumer spending is reduced. As a consequence, we would expect there to be a reasonable amount of employment ‘churn’ (winners and losers) in retail and other sectors dependent on discretionary spending over the next 12 months.

Similarly, we have seen from earlier analysis that employment in the education and health sectors is already beginning to decline as a consequence of the public spending cuts. Therefore, we expect those sectors which have generated a large proportion of recent employment growth to experience more weakness; this has obvious implications for near-term employment growth.

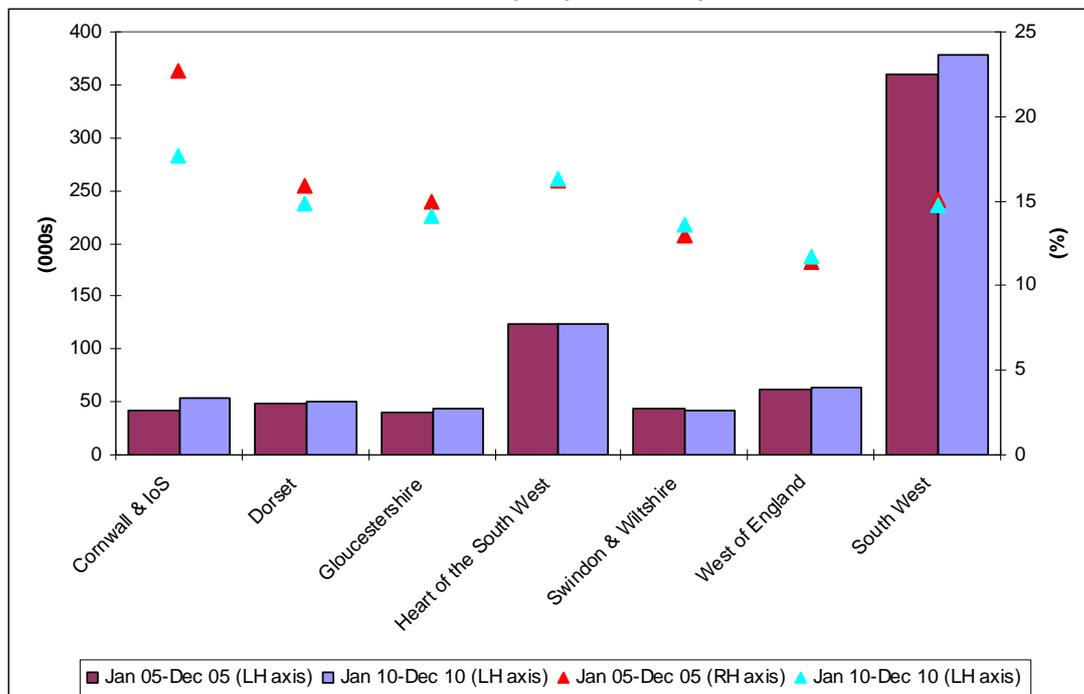
Chart 29: changes in SW employment by industry (08-11)



Source: (ONS – Workforce Jobs)

In terms of self employment, the data suggests that, at a LEP level (chart 30), there has not been a significant change for most areas in the South West. During the period between January 2005 and December 2010, only Cornwall experienced a marked increase in numbers and levels of self-employed.

Chart 30: self-employment by LEP areas

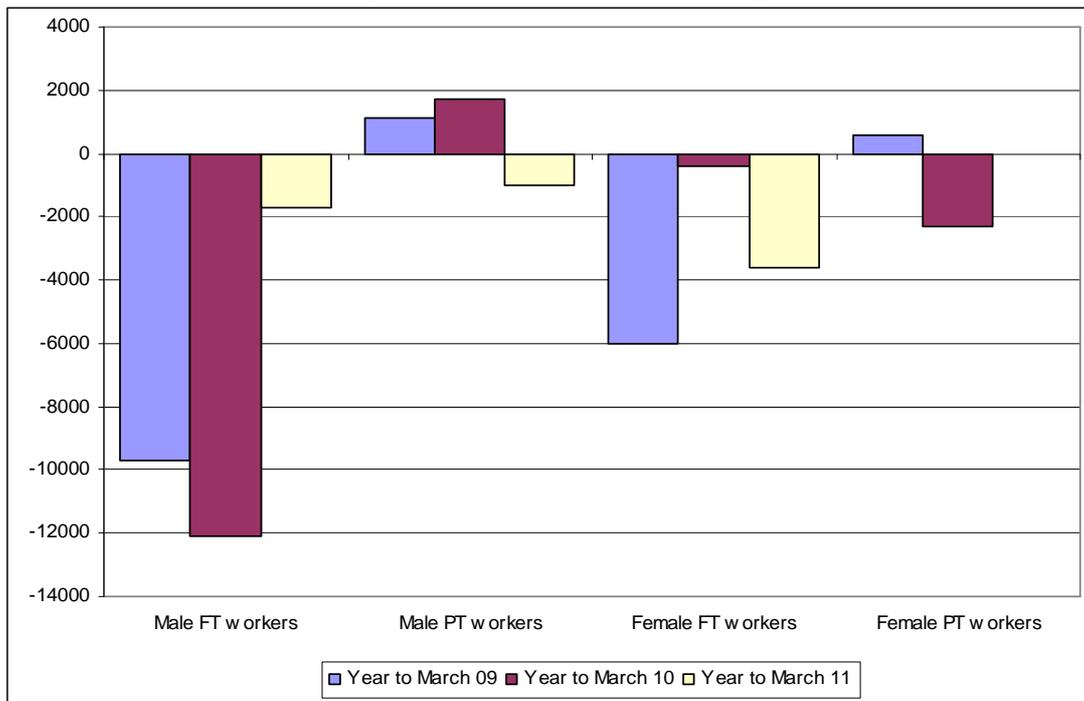


Source: (ONS – Annual Population Survey)

Of course, one of the core themes of ‘rebalancing’ is to increase the size and importance of manufacturing in the economy. As the measurements of manufacturing output shows (chart 31), the sector suffered its sharpest contraction in the early part of the recession and recovered somewhat in 2010 and early part of 2011. This is reflected in changes to the regional manufacturing employment base over the last three years. In terms of FT workers, both male and female numbers fell significantly during 2008 & 2009, with the pace of decline abating during 2010.

What is important is that, although manufacturing output has been rising for the past 12-18 months²⁶, manufacturing employment has not been similarly rising. This adds to the argument that a manufacturing recovery, or renaissance, may not necessarily lead to large-scale job creation. Rather, it may only lead to small-scale increases or even a slowdown in longer-term structural decline. We address this later in the paper.

Chart 31: changes in SW manufacturing jobs (08-11)

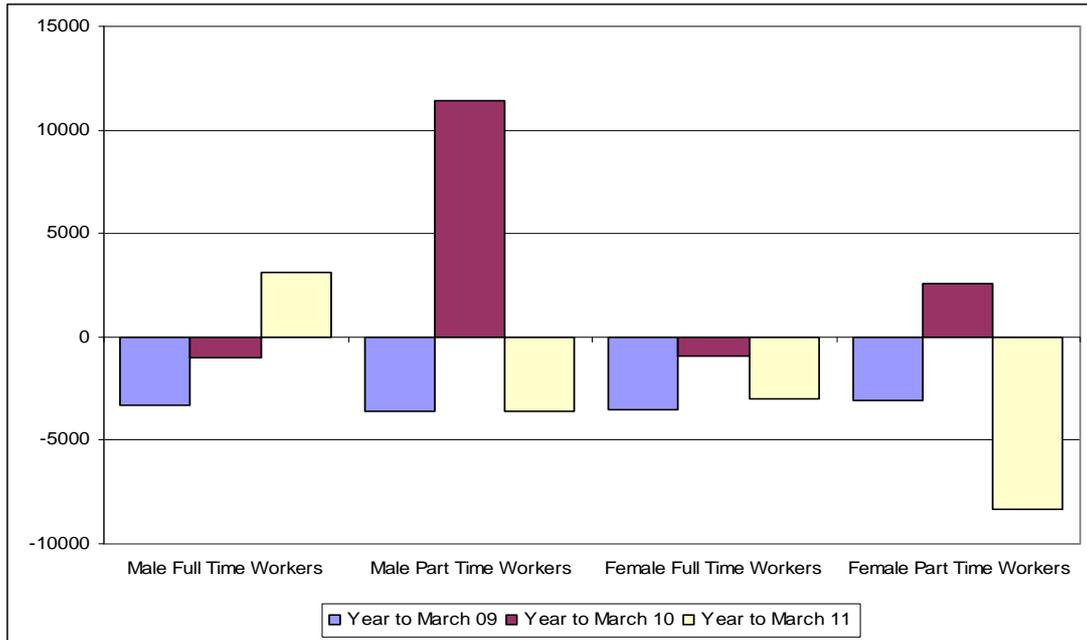


Source: (ONS – Workforce Jobs)

The picture for administrative services (chart 32) – the sector which experienced the largest decline in female FT workers – is more mixed. The decline in FT employment for both male and females is more evenly spread across the 3 years. The inference is that the administration sector did not experience an immediate and significant shock in the downturn, as happened in manufacturing. Rather, the recession and the weakness of the recovery continue to erode the FT employment base through ongoing organisational changes.

²⁶ Recent output data from the ONS suggests that the strength of the manufacturing recovery has recently weakened.

Chart 32: changes in administrative services (08-11)



Source: (ONS – Workforce Jobs)

Finally, we concentrate on changes to construction employment (chart 33). As stated above, this dataset does appear to have a large swing in male FT employment between the years 2010-2011 which is difficult to explain. First, there was a significant decline in male FT employment (>30,000) in the year to 2010, but most of this was regained in the year to 2011. Given the continuing weak demand conditions, it is difficult to understand why employment increased significantly during 2010. We suspect some statistical anomaly is at work in this series.

Chart 33: changes to construction jobs



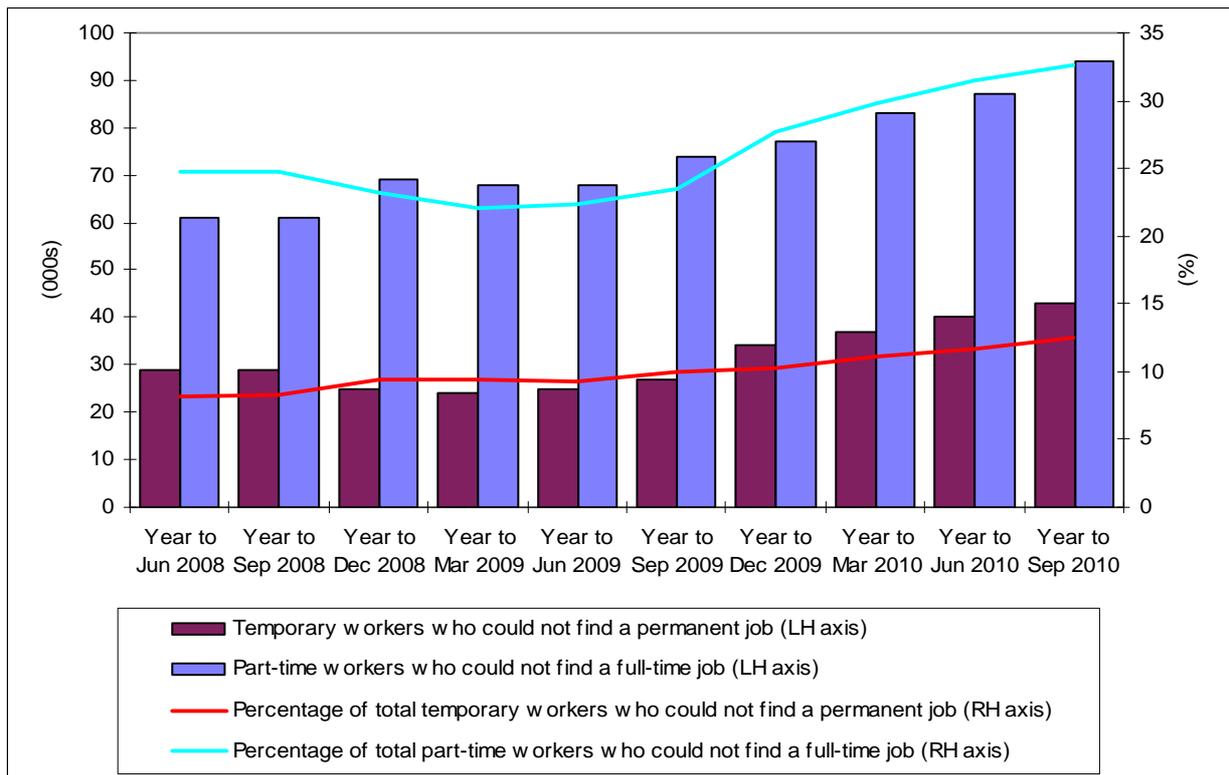
Source: (ONS – Workforce Jobs)

Employment composition – ‘forced’ part-time/temporary working

The shift from FT to PT employment, as well as working on temporary contracts, has not always been a ‘voluntary’ decision for people. It is clear that, for many, it is a necessity rather than a choice they would normally make. The lack of permanent or full-time opportunities has resulted in many working fewer hours or on a short-term basis. The number of people who now have temporary or part-time jobs has risen throughout the last three years, particularly since mid-2009.

The proportion of those temporary/part-time workers who have taken such jobs due to the lack of available FT opportunities has increased (see Chart 34). In 2008, only 8% of employees were ‘temporary due to a lack of permanent opportunities’. This ratio had risen to 12.5% by the end of 2010. Similarly, 25% of employees were PT in 2008 due to a lack of FT opportunities and this proportion increased to 32.5% by the end of 2010: one in three part-time workers would like to work full-time.

Chart 34: Forced Part-time working



Source: (ONS – Workforce Jobs)

The shift from full-time to ‘forced’ part-time working highlights the complexity of the labour market. Simple analysis of unemployment or employment rates does not tell the full story of deterioration in ‘value’. There are a significant proportion of people who are working in what they would consider ‘sub-optimal’ roles. This, of course, affects their income and overall well-being, weakening wider economic conditions.

Future Labour Market Factors

In this section, we look at the factors that will drive future labour demand.

Productivity improvements & sustainable employment gains

In the long run, improvements in productivity will underpin any lasting expansion of employment. It is important, therefore, to understand how changes in productivity levels and rates during the recession and subsequent recovery may affect the strength of employment growth over the next five years.

Generally the evidence suggests that productivity is pro-cyclical²⁷. The literature discusses three plausible explanations of this cyclicity:

- First, it is argued that, on the up-side, real GDP growth and productivity growth move together because they are both driven by positive technology shocks and skills acquisition that allow more output from a given labour stock.
- Second, on the down-side of the trend, pro-cyclicity is an outcome of labour hoarding. Firms do not downsize as rapidly as the decline in their output (or output growth) during periods of economic slowdown. Employees merely reduce their effort as the demand for output falls. This results in both lower labour productivity and total factor productivity (TFP – which encapsulates total input/resource use) during such periods. As the economy expands rapidly in recovery, the employees increase their effort to meet greater output demand, and productivity measurements rise once again.
- Third, it is suggested that the production process is subject to economies of scale, meaning that productivity would rise during upturns and decline during downturns. These economies can be intrinsic to firms, but they could also arise on account of spill-over effects in the wider industry/economy.

In terms of recent events, the widely held view is that productivity fell in the recession as a consequence of labour hoarding. UK businesses did not shed labour as quickly as the fall in output and, as a consequence, productivity measurements have fallen²⁸. If employees also shifted their effort downwards due to a lack of activity then this would accentuate that fall. The worrying sign is that after an initial bounce back after the worst of the recession, productivity has dropped again recently.

²⁷ Productivity and the Economic Cycle, BIS Economics Paper - March 2011

²⁸ There has been a difference in labour market reaction between the UK and the US, principally regarding labour hoarding. In the UK & US, total hours worked have fallen significantly – in the UK they remain 2.9% lower than the 2008Q1 peak. However, while US employers largely achieved this through reducing headcount, UK firms have achieved this by reducing average working hours. There is little evidence to suggest this has been through a wholesale reduction of hours for staff – average weekly hours for both full and part-time workers have barely changed since the beginning of the recession. Instead firms have substituted full-time workers for part-time staff (as seen elsewhere in the analysis).

Another useful area of analysis in the productivity literature is to understand how changes in the structure of an economy drive productivity at the aggregate level. A number of studies have decomposed productivity growth over time into its components:

- the impact of within firm changes i.e. changes between plants/sites with more productive sites replacing less productive
- the impact of reallocation of resources among firms
- the impact of net entry associated with creative destruction i.e. firms leaving and entering the marketplace with more productive firms replacing less productive

The evidence is somewhat mixed, with some studies attributing a high proportion of productivity growth to net entry while others attributing much less. However, two important conclusions can be drawn from the range of studies across developed economies: (a) both net entry and within firm strategies account for a significant proportion of productivity growth, (b) the relative importance of net entry is greater during downturns while that of within firm changes is greater during upturns.

Some studies, though, do suggest that the positive impact of net entry could be weaker in the United Kingdom. Scarpetta et al.²⁹ decomposed labour productivity growth across OECD countries into its various components. This study found that the UK impact of net entry on productivity growth was relatively small across a number of industries. A plausible explanation for this is that specific structural rigidities and institutional weaknesses prevent re-allocation of productive resources from exiting firms to (presumably more productive) incumbent firms or new entrants. The study confirms the negative impact of regulatory barriers to market entry and, therefore, productivity.

Another explanation is that the extent of contribution of net entry to productivity growth depends on the distribution of single-plant and multi-plant firms in an economy. A previous study³⁰ found that, historically, single-plant firms did not experience high levels of productivity growth. Multi-plant firms accounted for all the observed productivity gains, and the impact of net entry on productivity growth was due to the closure and opening of plants by these multi-plant firms. Therefore, reallocation of intra-firm resources is more effective than inter-firm reallocation.

The interpretation that could be drawn is that while net entry accounts for a significant proportion of productivity growth, especially during periods of economic downturn, within-firm changes – involving restructuring and investment in new capital, technology and human resources – generally account for a greater proportion of productivity growth. The relatively smaller contribution of net entry could be on account of institutional weaknesses that

²⁹ 'Regulation, Productivity & Growth: OECD Evidence' – Scarpetta & Nicoletti - 2003

³⁰ 'Entry, Exit, and Establishment Survival in UK Manufacturing' - Journal of Industrial Economics - Disney, Haskel, and Heden

prevent easy exit and entry of firms, as well as rigidities that prevent transfer of resources from incumbent firms to new entrants

The contribution of net entry to productivity growth may also be limited by the numerical dominance of single-plant firms in the firm population; much of the benefits of creative destruction accrue from entry and exit of plants owned by multi-plant firms. This may be a particular issue in SW England.

This has important policy implications. Rather controversially, it suggests the development of mechanisms that facilitate the exit of under-performing firms could be an important consideration for improving productivity, as long as this is part of a net positive churn. Equally, it is important to focus on policies that facilitate appropriate within firm changes i.e. to allow resources (be it capital or labour) to move more freely within firms.

Of course, both of these policies could be highly contentious. For a public body to facilitate the exit, or closure, of an underperforming business could be poorly received by public opinion. Similarly, helping businesses allocate resources – which could include employees – away from one site to another would also be difficult to justify publicly. These difficulties would be heightened if organisations shifted resources between different parts of the country or between countries. In essence, then, policy needs to focus on the regulatory, infrastructure and fiscal framework for structural business change rather than to incentivise particular business actions.

The literature suggests the policy focus should be upon ensuring the regulatory environment is conducive to the movement of firms into and out of the market, and to allow sufficient flexibility for multi-plant firms to re-allocate resources more freely. There is recognition, of course, that regulation that promotes improvements to productivity may well be in direct conflict to other social objectives, in particular to employment protection rights.

This highlights the difficulties in policy formulation. We argue that improvements to productivity need to underpin any longer-term expansion in employment. Previous studies show one of the most effective ways of boosting productivity is to free the movement of resources both within firms and within the wider market. Creating a regulatory environment that better facilitates this could be, therefore, a legitimate policy response to creating employment growth.

Other factors that could explain the pro-cyclicality of productivity include the evidence which suggests that R&D expenditure is generally pro-cyclical. However, there are theoretical arguments that suggest the counter; periods of economic downturn reduce the opportunity cost of a firm's resources and these resources could be used for R&D to better prepare the firm for subsequent recovery. There is some evidence to suggest that specific firms ('winners') may, indeed, reallocate resources to R&D during recessions. Overall, however, aggregate R&D expenditure is by and large pro-cyclical.

Wider business investment also tends to be pro-cyclical (with lags), and there is evidence that suggests this is due to the availability of credit and internal resources as well as the obvious factor of business confidence. While there is little specific evidence about the cyclical nature of investment in ICT capital, which may have contributed to as much as three-quarters of the growth in labour productivity during the 1995-2002 period, it is reasonable to infer that this type of business investment would be pro-cyclical.

The evidence about the cyclical nature of investment in human capital is more mixed. Enrolment in schools and universities tends to be countercyclical in developed countries, including the United Kingdom. This was exhibited during the recent recession, where applications to universities rose significantly as employment opportunities declined. On the other hand, recruitment of trainees and apprentices is generally pro-cyclical.

High growth firms & employment growth

One of the most interesting research areas in recent years has been the importance of a relatively small proportion of businesses to overall employment growth in the economy. Much of this work has been sponsored by the National Endowment for Science, Technology and the Arts (NESTA). These high growth firms will remain fundamentally important to employment growth in the future.

The work undertaken by Aston Business School on behalf of the NESTA has been very useful in highlighting the economic importance of relatively few firms to the majority of employment creation in most recent years. The 2009 research summary '*The Vital 6 Per Cent*³¹' analysed the records of all UK companies between 2002 and 2008 and showed that the 11,000 UK businesses that generated 20% or higher average annual employment growth³² over a three-year period i.e. experienced sustained growth, were responsible for creating 54% of new jobs.

This work has been recently revisited³³ to understand whether the recession had any impact upon the employment growth role of high-growth businesses. Analysis of newly released UK business records does show the continued importance that growth businesses play in aggregate employment creation.

An important initial finding of the work was that, despite the deepest recession in 80 years, many companies still experienced high growth even in the difficult economic climate. In the period 2007 to 2010, the number and share of UK businesses growing at over 20% remained broadly similar to that in the

³¹ '*The vital 6 per cent – How high-growth innovative business generate prosperity and growth*' – NESTA – October 2009

³² Surviving UK firms employing ten or more people at the beginning of the period accounted for 54% of all jobs created by established firms employing ten or more people at the beginning of the period. Therefore this excludes (a) jobs created by surviving microenterprises (e.g. businesses with fewer than ten employees); (b) jobs created by new firms; (c) jobs created by the public sector; (d) self-employed. Note that all job creation measures here include all jobs gained by surviving firms, regardless of whether they are the result of organic growth or are gained through the acquisitions of existing firms instead.

³³ '*Vital growth - the importance of high-growth businesses to the recovery*' – NESTA – March 2011

periods 2002-2005 and 2005-2008. The SW had approximately 6% of the UK high-growth firms in both the 2002-05 and 2005-08 periods.

What is more, the work found that high-growth firms still accounted for a disproportionate share of job creation, generating half of new jobs created by firms of ten or more employees between 2007 and 2010. This suggests a robust relationship that holds through good times and bad. The best companies continue to find routes to high growth, even during the recession.

A separate piece of research looked at high-growth businesses after their period of high growth during the recession. How did a track record of growth affect their performance in more difficult times? The analysis suggests that higher-growth firms were subsequently more resilient: they had markedly lower insolvency rates than their slower-growing counterparts during the recession. There is also some limited evidence that these firms are more likely to grow in the two years after the growth period than non high-growth firms, consolidating their growth by improving productivity. This is an unsurprising finding, given that previously successful firms may have characteristics such as greater cash balances, lower debt, loyal customer base, and liabilities etc. which allows them to withstand any weaker conditions.

What the NESTA analysis also shows is that high growth is not sector specific. The growth of companies in the period 2002 to 2010 shows that they are distributed across sectors, from mining to banking. Again, this touches upon the difficulties of a sector-focused policy. The idea of betting on growth sectors remains problematic.

Using past growth performance as an indicator of future growth is also unreliable: today's high-growth firms are unlikely to be tomorrow's high growth firms (although, as the above suggests, they may prove more robust). Looking at the 1998 cohort of start-ups, less than 40% that achieved growth above 20% in a single year had another episode of high-growth in that decade.

The other key finding is that growth should not just be associated with start-ups. Although young firms are more likely to be high-growth, the majority of high-growth firms (70%) are at least five-years old. The implication of this is that merely encouraging start-ups will not necessarily lead to dramatic employment growth.

This is a reminder that high growth is not an intrinsic characteristic of some businesses, but a stage that some companies will go through, and others will not, either because they do not aspire to it, as is the case for the majority of single-person enterprises, or because they don't achieve it. Therefore, the argument could be that Government's job is not to identify high-growth firms and then channel support to them, but to create the conditions where businesses that have the potential to grow can do so.

In many ways, this is the same argument as we exposed earlier regarding creating the right conditions to boost productivity (growth and productivity

improvements are obviously intrinsically linked). Both suggest that policy should focus on minimising obstacles rather than targeting specific companies.

From a geographical perspective – particularly at a sub or city region level, the research finds evidence of specific spill-over benefits and draws an interesting conclusion about the type of business mix required. If two city-regions have the same average level of firm growth, the one with a greater proportion of high growth companies (and by implication a greater proportion of lower growth or declining companies too) will generate more jobs. Specifically, a 5% rise in the share of employment accounted for by high growth firms typically leads to a 1% increase in employment rates in a city region, even assuming the same average firm growth.

Consequently, places with 'skewness' of growth – a mixture of faster and slower growing companies – have higher employment rates than local economies with a more even spread of growth among companies. That is, high-growth firms bring disproportionate benefits to local economies.

Therefore, overall the NESTA work shows the economic importance of high growth firms – not only have they created high levels of direct employment but they also drive wider spill-over effects and innovative activity.

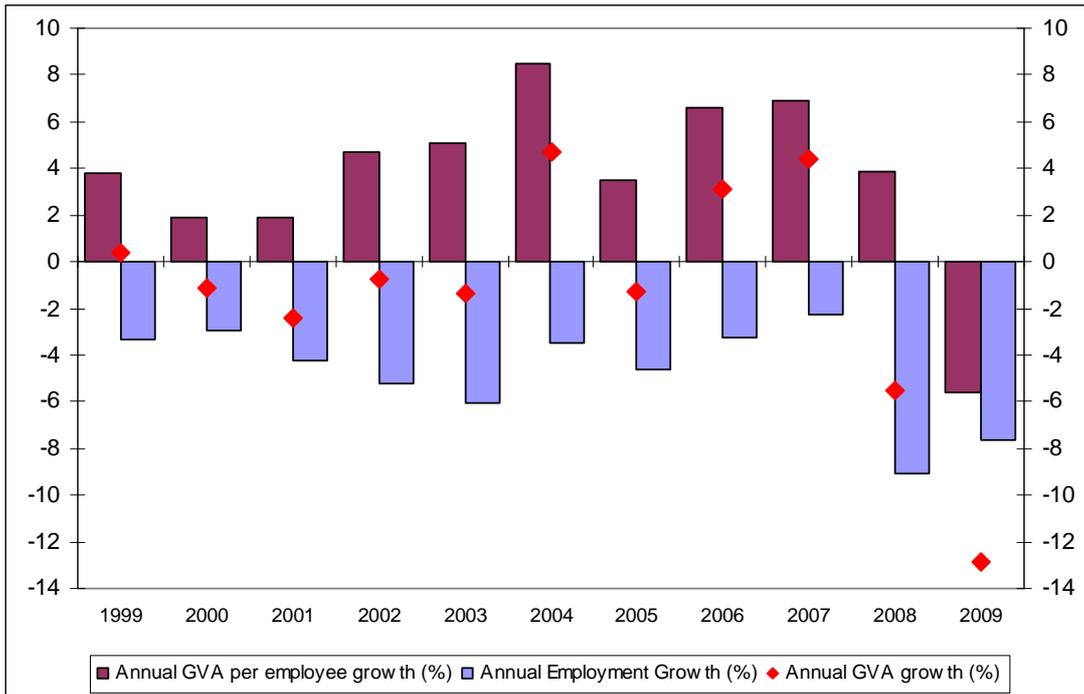
Jobless manufacturing growth

One of the difficulties implicit in the objective of increasing the role of manufacturing is that it may not create significant levels of new employment opportunities, certainly at a macro level. Over the past decade, when manufacturing output has increased, it has primarily been as a consequence of increases in productivity rather than employment growth. Chart 35 highlights that falls in employment have actually acted as a 'drag' on output growth.

As a consequence, the projections for manufacturing (Chart 36) show that – despite relatively solid output growth beyond 2010 – UK employment levels will continue to fall. This expectation is based on output expanding on the basis of continued productivity improvements – facilitated by a deepening use of capital – rather than employment growth.

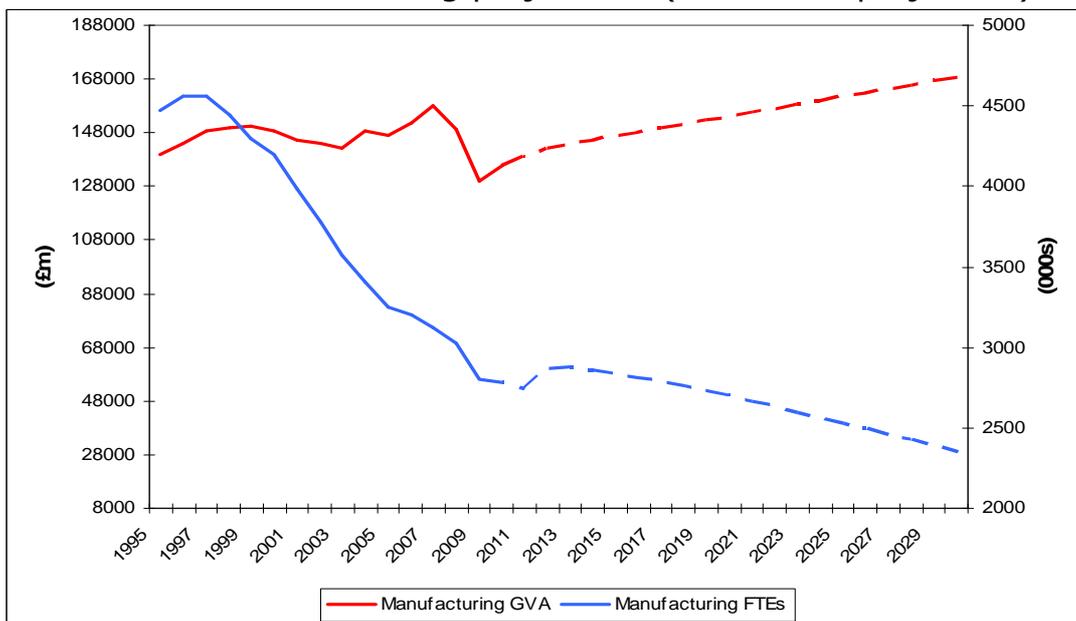
Therefore, the expectation is that manufacturing will not be the source of large-scale employment generation. Again, this highlights the natural conflicts that exist between the twin objectives of rebalancing and job creation.

Chart 35: Contributions to manufacturing growth (% per annum)



Source: (ONS – Annual Business Survey)

Chart 36: Manufacturing projections (actual and projection)



Source: (Experian Economics)

Short-term expectations

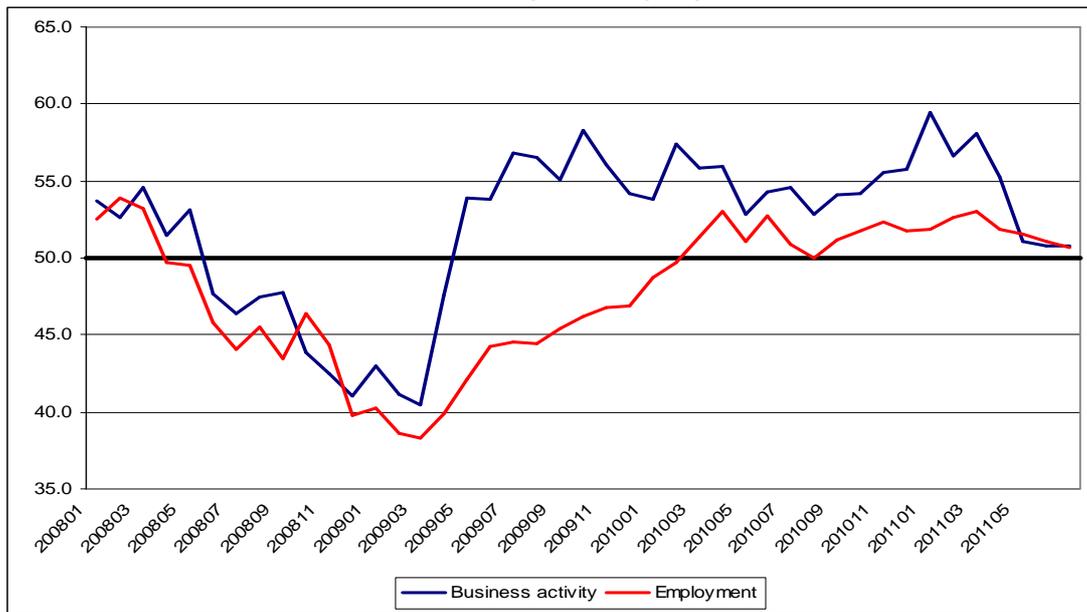
The Purchasing Managers Index is a useful forward indicator of economic conditions, it has been found to correlate with published measures of output³⁴. Among other measures, the survey captures the level of business activity and the immediate employment intentions of those businesses surveyed. The

³⁴ Office of National Statistics - Economic & Labour Market Review – Vol 4 – No 5 – May 2010

survey then provides a consensus balance – a score above 50 signifies expansion and below is a fall in output or employment.

These series showed the relative decline in both activity and employment through the latter part of 2008 and early part of 2009. As chart 37 shows, business activity then rebounded more strongly than employment from mid-2009 onwards. The employment series only reached a positive balance i.e. more businesses than not expected to increase their workforce, from March 2010 onwards. Overall, the employment series has been sluggish when compared to the recovery in business activity rates.

Chart 37: PMI activity & employment indices



Source: (Markit Economics)

This is important because it again highlights that employment levels have not recovered as quickly as many had hoped. The aspect which is of most concern is that, in recent months those employment intentions have again weakened, suggesting that hiring remain weak. Indeed, the series is now suggesting a further retraction in employment. The implication is that demand for labour will remain subdued in the near-term.

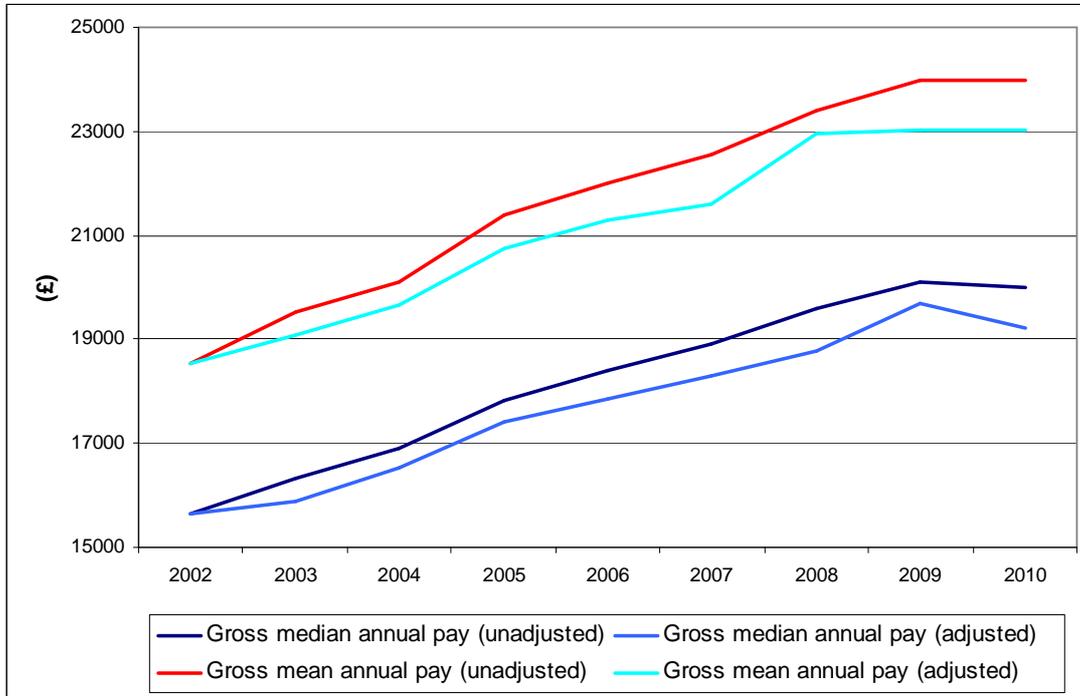
Falling real earnings

The considerable inflationary pressure on earnings and incomes is, and will continue to, dampen consumer demand. The slowdown in nominal wage growth – combined with high rates of inflation – has led to a widespread decline in real wages for the last 2-3 years. This follows a period of strong wage growth, a contributory factor in fuelling previously strong consumer demand.

As with elsewhere in the United Kingdom, SW earnings have grown steadily over the past decade. Chart 38 shows that nominal wages have increased since 2002, extending gains experienced before that. Indeed, when we adjust

for inflation³⁵, we can see that real wage levels also enjoyed relatively robust increases until 2008. Since 2008, however, average (as displayed through both the mean and median measurements) nominal wages have been broadly level.

Chart 38: Pay indicators



Source: (Annual Survey Hours & Earnings – ONS)

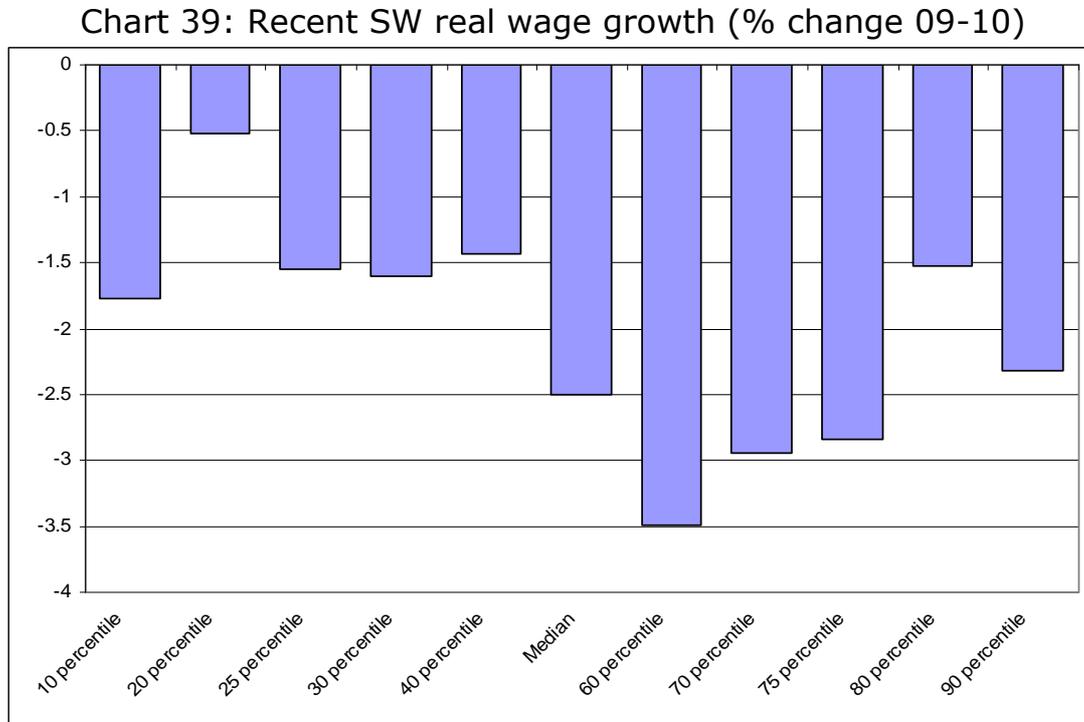
Real wages – which have been adjusted for price inflation – have fallen. Interestingly though, the two measurements show a slightly different story. In terms of the median average (the mid-point of the wage range), real wages have experienced a relatively sharp decline since 2009. The growing difference between the mean and median highlights the considerable pressure upon the majority of incomes that price rises cause at a time of relative economic and wage stagnation. Different sections of the income distribution are affected in different ways, exaggerating the relative market ‘power’ of different occupations.

This is demonstrated by highlighting real wage growth (or lack of) between 2009 & 2010³⁶, broken down in wage percentiles (chart 39). (The 10 percentile refers to the bottom 10% of wage earners, the 20 percentile refers to the element between 10% and 20% and so on.) This data shows us where the most severe real wage declines are occurring. In the most recent period, the mid-to-upper wage earners are actually experiencing the largest relative declines. Those wage earners between the median (50 percentile) and 75 percentile experienced the greatest relative decline – a real wage decline of 2.5% between 2009 and 2010.

³⁵ Here we have taken the average annual UK inflation rate, rather than any regional price deflator

³⁶ 2011 earnings data is not yet available.

In contrast – although still in real decline – the wages of those at the bottom of the wage distribution were less badly affected. This would suggest that there has been some narrowing – albeit it marginal - between the bottom and mid-range wage earners. Those at the top of the wage distribution have seen only relatively smaller declines than those in the mid-range.



Source: (Annual Survey Hours & Earnings – ONS)

The relevance of this analysis is that it builds on the picture of a 'hollowing out' in the labour market in recent years. We have already noted that the largest declines in employment numbers have occurred in those mid-range wage occupations. Now, we see that those mid-range SW occupations are also coming under the most downward pressure on wages. It is the upper middle income earners that are suffering in this 'recession & recovery' period.

Again, this could be a reflection of occupations that are typically middle income. Certainly, we may expect that a proportion would be those employed in the public sector where a pay freeze that has been in place.

Longer term projections

Predicting the longer-term is fraught with difficulty, understanding what jobs there will be in an economy in anything beyond the short term is a very inexact science. Therefore, in this section we concentrate upon the broad trends that could possibly influence future labour demand, concentrating on the near-to-medium term.

There has been a spread of work looking at future occupational demand (and supply) of labour but we concentrate on a few key pieces that relate specifically to UK and SW trends. We aim to pick up the broad principles that underpin each piece of work.

Working Futures 2007-2017

The *Working Futures* report³⁷ was a comprehensive review of the implications of technological change, changes in government policy and legislation, and changes in other economic and social drivers for the UK labour market. It is important to note that the research was undertaken before the recession: it is now less relevant as a set of short-term projections.

Changing patterns of employment by occupation, however, are largely driven by long term trends rather than the current cycle. The major factors driving occupational change over the longer-term will include technological change, productivity growth, international competition and globalisation, specialisation and sub-contracting, regulatory and legislative factors and changing patterns of final expenditure. All of this reflects the sustained strength and changing pattern of aggregate demand.

Employment is projected to continue to rise over the decade considered, principally driven by a significant increase in population levels. The long-term rate of employment growth (jobs) is expected to be just under 0.5% per annum. *Working Futures* projects that the majority of the additional jobs are expected to be taken by men, with an increasing share of employment in areas previously dominated by women – particularly in services.

In general, *Working Futures* projects there to be a much slower pace of change in occupational employment structure expected between 2007 and 2017 than was the case over the previous two decades. This is an important finding; the rapid pace of adjustment previously experienced is expected to slow as the historical shift from the production sector to services begins to mature. In particular, elementary occupations are now projected to see a much less rapid rate of job loss as the service sector generates more such jobs. Part of this

³⁷ *Working Futures 2007-17* – Institute for Employment Research & Cambridge Econometrics - Produced for the UK Commission for Employment and Skills - 2008

demand relates to services required for an ageing society. Working Futures does not attempt to forecast genuinely “new” occupational numbers.

The Working Futures report also notes a continued polarisation of demand for skills, with more growth at both top and bottom ends of the skills spectrum. As we have noted, this appears to be an increasingly common feature across developed economies (see the ‘*hourglass*’ effect below).

Employment projections tend to cover both expansion and replacement demand. Expansion demand refers to the net growth (or decline) in occupational employment as a result of general economic growth. Replacement demand relates to the need to replace those who leave the workforce due to retirement, sickness, movement between occupations etc.

For all occupations together, *Working Futures* projects that replacement demand will be about six times larger than the net changes projected between 2007 and 2017. Due to demographics, there is expected to be a net requirement of about 13.5million jobs. Retirements are the principal component in this estimate. This excludes job openings created by people transferring from one occupation to another (some of which will be filled by similar means) or other outflows.

Regaining our balance

An alternative focus was provided by previous work undertaken by us at the Economy Module. This specifically looked at a number of scenarios of how the economy might rebalance and how this might affect the SW region³⁸. The scenarios were specified in terms of changes in growth rates for the components of ‘final demand’ in the economy – household consumption, investment, government consumption, exports and imports. There were two scenarios, which were set against a baseline of continuation of the historical trend:

- Scenario 1 - Rebalancing of the household sector implies a rise in, and then a sustained higher rate of, household savings out of disposable income³⁹ – so that household consumption spending grows more slowly than income for some time before growing at the rate of growth of household disposable income.
- Scenario 2 - Rebalancing of the government sector involves higher taxes and lower public expenditure, leading to a sustained reduction in the government budget deficit as a share of GDP.
- This results in an external rebalancing involving a period when exports grow faster than imports to remove the structural current account deficit.

³⁸ ‘*Regaining our balance – implications for the South West economy*’- SW Economy Module – November 2010

³⁹ Spending grew faster than income in 11 out of 15 years between 1994 and 2008; average expenditure growth over that period was 3.0% a year compared to average income growth of 2.5% a year. This resulted in a large and sustained reduction in the household savings ratio (the share of savings in total household resources). The savings ratio fell from around 10% during 1990-1995 to just over 5% during 1995-2008. On average, UK households saved around 8.1% of their income during the 70s, 8.7% during the 80s, 9.2% during the 90s, but only 4.2% during the 2000s and 4.8% in 2010.

The two scenarios involve only marginal (and gradual) changes in the structure of UK demand, on a scale that has taken place in the past. Thus, under scenario 1 (scenario 2), the share of household consumption in total output declines by around 3% (4%) relative to the baseline over the entire 20 year period of the simulation, while the share of government spending falls by only 1% (2%) and the share of investment rises by 2% (3%).

Substantial changes in the current account are achieved under both scenarios through only modest changes to growth rates for exports relative to the baseline case. The share of UK total output exported to other economies increases by only around 1% under scenario 1 and by 2% under scenario 2, relative to the baseline case, over the period 2010-2030.

Even then, the reduction in the current account deficit compared to the recent past, in the scenarios as in the baseline, is primarily the result of slower growth in imports, rather than of a large surge in export growth. Import growth is assumed to slow from around 7% a year to around 4%. This is consistent with the rebalancing process that the United Kingdom has followed after previous peaks in the current account deficit, where both the deficit and the subsequent rebalancing have been more influenced by changes in imports than by changes in exports.

So, the rebalancing scenarios considered here do not envisage implausibly large or sudden shifts in the structure of demand within the UK economy. It is, however, worth bearing in mind that the UK's ability to achieve the assumed growth in exports (and, related to that, the assumed growth in investment and total output), is dependent on continued growth of demand in export markets. Given that the Euro zone is the largest UK export market, then current weakness in those economies will weaken demand for UK exports unless we can switch to alternative, more vibrant markets.

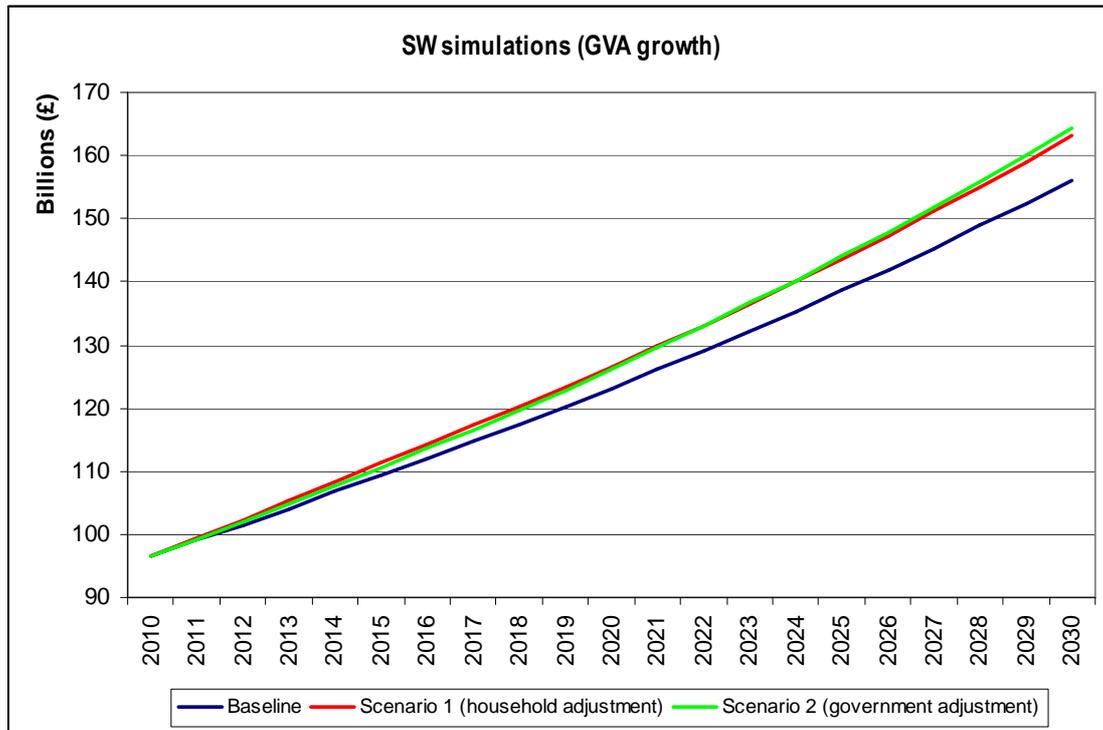
The two rebalancing scenarios result in production sectors (including manufacturing and construction) contributing a larger share of SW output than under the baseline case, but do not prevent the relative decline of these sectors over the 20-year period covered by the simulations.

The scenarios do alter the distribution of growth of output and employment across industries and regions, so that macroeconomic rebalancing is associated with some industrial and regional rebalancing. The aggregate impacts on the South West are similar to those for the United Kingdom as a whole.

Chart 40 below shows the projected growth of SW GVA in the baseline and the two rebalancing scenarios. This shows that, on overall GVA levels, scenario 1 & 2 broadly have similar impacts. By 2020, the baseline projections show a regional GVA of £123bn. Scenario 1 has a projection of £127bn and scenario 2 £126bn. Therefore, in the near-term, the benefits of adjustment are only just starting to work through.

These benefits do widen in the longer-term. In 2030, the baseline for the SW is £156bn and for scenarios 1 & 2 the projections are £163bn & £164bn respectively. Therefore the adjustments required for re-balancing the economy – away from a dependency upon household and government expenditure and into export-oriented growth - actually results in increased output in the SW economy over the medium to longer-term.

Chart 40: SW growth simulations



Source: (SW Economy Module)

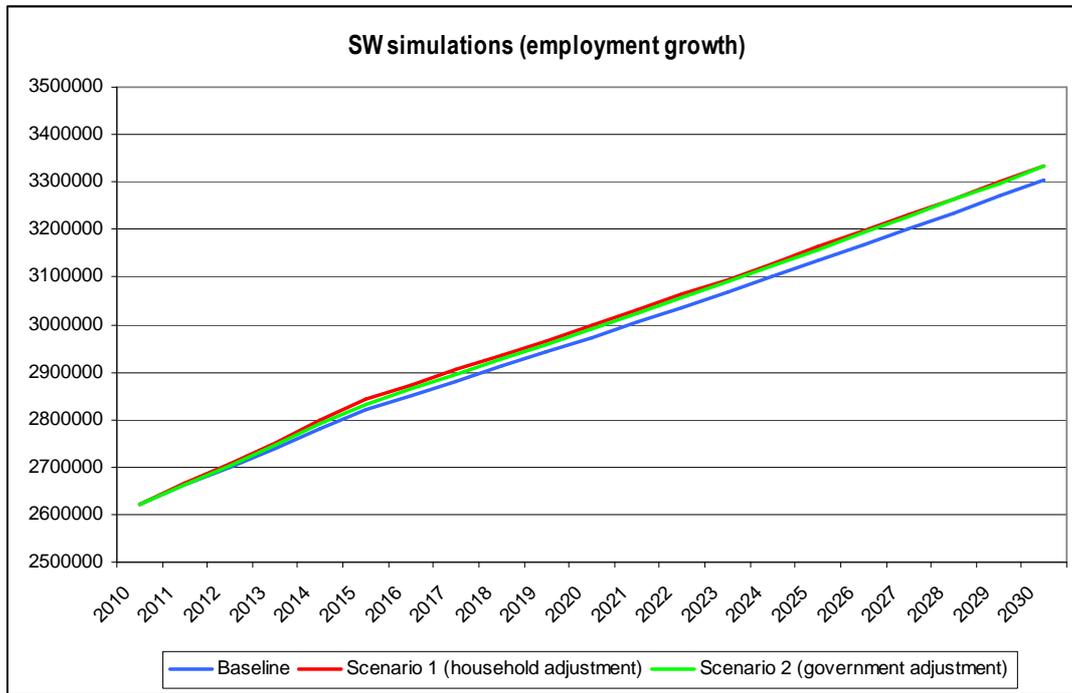
The impact that rebalancing has upon employment, however, is less marked. This again – as noted elsewhere in this paper - shows that any output expansion for the production/manufacturing sectors will not necessarily lead to a commensurate increase in employment. Consequently, there is a lower differential between the baseline employment projection and those for scenarios 1 & 2.

Using projections of output growth, the baseline shows an increase from the current 2.62mn jobs in the SW workforce, to 2.82mn in 2015 and 3.30mn in 2030 – an increase of 700,000 jobs over 20 years. In comparison, both scenarios 1 & 2 grow to approximately 3.33mn in 2030. Therefore, the rebalancing adjustments implicit in both scenarios are only projected to increase jobs by 30,000 over the baseline (chart 41). Clearly, any potential benefits are within the margins of error for this type of projections exercise.

Therefore, the overall message is that the small shift required from the services and government sectors towards manufacturing will have economic benefits for the South West but not necessarily large employment effects. Any increase in manufacturing employment will be partially offset by a slowdown,

or fall, in employment elsewhere. Indeed, most of the increase in manufacturing output will be as a result of productivity gains (as we highlight elsewhere), extending the long-term switch from labour to capital.

Chart 41: SW employment simulations



Source: (SW Economy Module)

This simulation work shows the conflict between the objective to rebalance the economy away from the government and service sector whilst creating more jobs. This conflict is based on the majority of new jobs created over the past 20-30 years being in the service and public sector. If the act of rebalancing weakens or reverses some of the previous job gains, the scenarios suggest that manufacturing will not take up the 'slack'. If manufacturing grows through greater export performance, there will be some job creation but it will not be significant in terms of the overall regional labour market.

This raises difficult policy questions and the question of how achievable large-scale job creation will be in the absence of strong growth in the service sector. If the service sector continues to grow strongly then, of course, the relative contribution of manufacturing will continue to shrink further and rebalancing may not occur at all.

South West growth scenarios

Next, we look at more specific macro-level projections – both for the United Kingdom and the South West – to understand the key issues determining the strength of economic growth over the coming decade. Importantly, it provides the context for future employment demand.

Fundamentally, the key determinants of historical growth, such as increased supply of labour and capital, seem likely to weaken in the coming decade and, therefore, suppress growth.

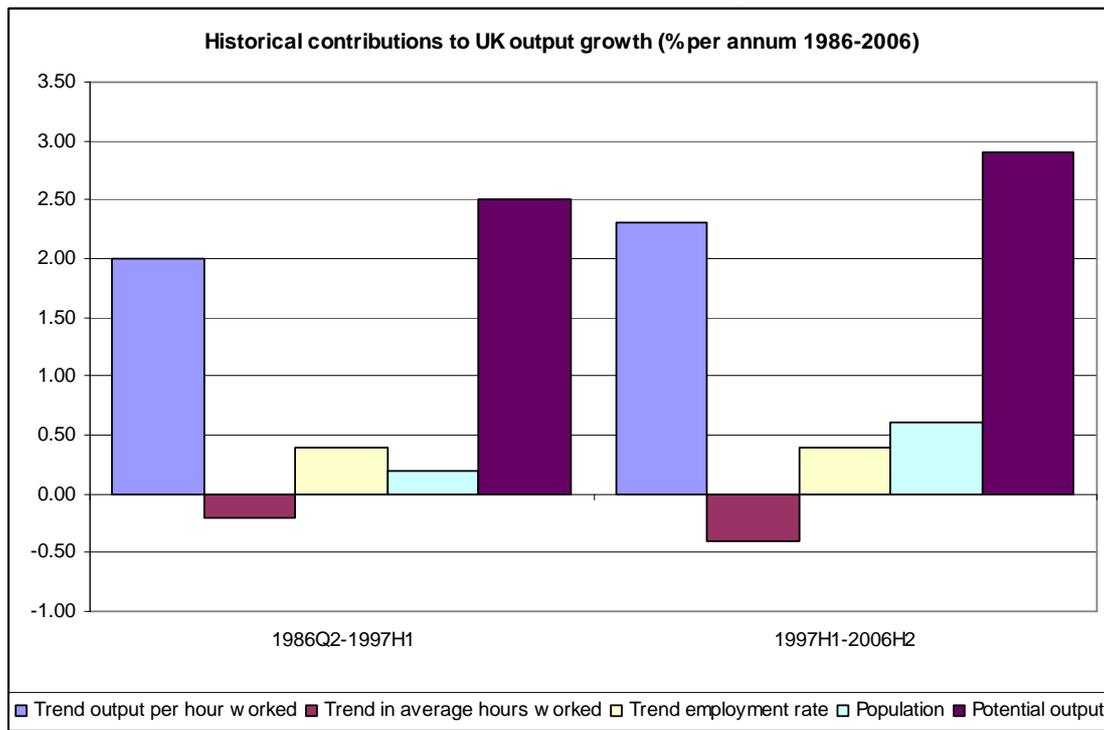
In 2010, the South West RDA commissioned Oxford Economics⁴⁰ to project a range of economic growth rates in the region around three growth scenarios – a low, central and strong forecast. We focus upon the central forecast in this commentary.

One of the key influencing factors this work was the reduction in labour supply caused by an ageing population. This, in turn, will slow the pace of output and employment growth, particularly from 2018 onwards.

Looking at the components of historical growth, the last economic cycle was characterised by an increased contribution to growth from the expansion of the capital stock, with business investment growing at a rate of close to 5% a year between 1997H1 and 2006H2. Given difficulties with supply of funds in the capital markets, (although the cost of capital is very affordable by historical standards,) it is unlikely this level of growth in capital investment will be replicated in the near term.

Chart 42 shows that during the period 1986-2006 the biggest driver of UK output growth was output per worker i.e. productivity. A contributing factor to this would have been the increased use of capital, such as ICT. There were smaller contributions from increased employment rate and population growth, whilst a reduction in hours worked negatively contributed to growth.

Chart 42: Contributions to growth



Source: (Oxford Economics)

⁴⁰ 'South West Growth Scenarios: Final Report' – Oxford Economics – June 2010

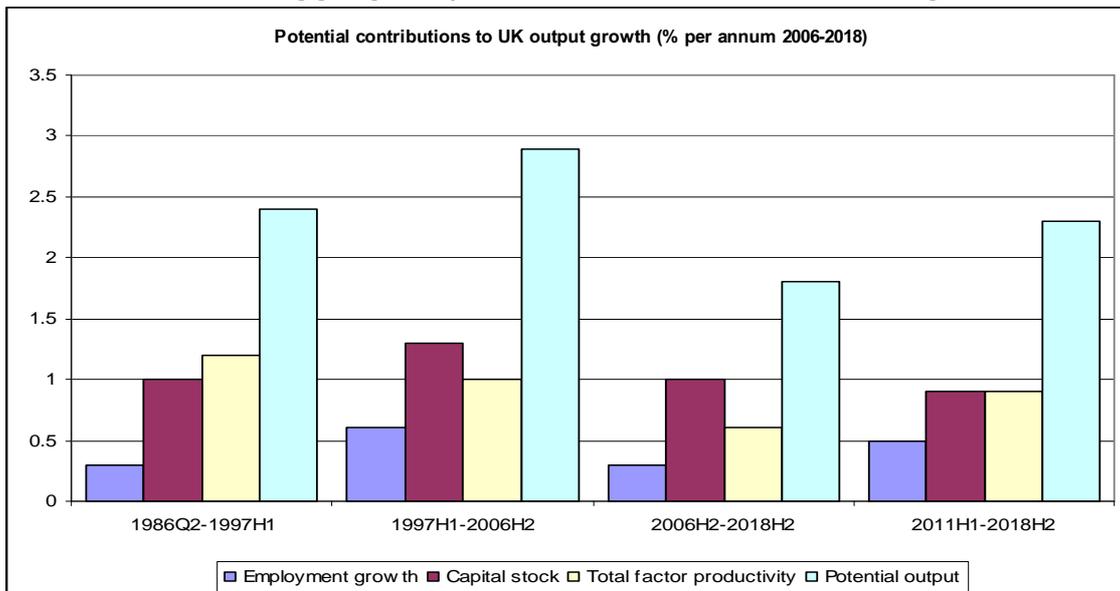
In terms of the contributory factors to potential growth, the projections unsurprisingly match the broad profile of growth implicit in most macro forecasts. That is, that average annual growth will be lower over the next five year as a consequence of the recession and its repercussions. Thereafter, growth will strengthen, but is not projected to reach pre-recessionary trend rates anytime soon.

The two left-hand periods in chart 43 replicate information shown previously in order to provide context to the projections. What this shows is that overall growth is expected to be weaker than that previously experienced. For the whole 2006-2018 period, average annual growth is expected to be 1.8% per annum – compared to 2.9% between 1997 & 2006. Naturally, given the 2008/9 recession, real growth strengthens in the latter part of the period; between 2011 & 2018 the projections average 2.3% per annum.

An explanation of the relative near-term weakness is lower employment growth and thereby consumption (as labour demand weakens and in-migration slows), decreasing capital investment and significantly lowering productivity growth. The weakness in productivity improvements are partly as a consequence of labour hoarding during the recession (discussed earlier).

In the medium-term, productivity is expected to recover slightly and employment engagement is also projected to improve marginally. Nevertheless, the macro projections are for growth to be below the long-term trend.

Chart 43: Aggregate potential contributions to UK growth

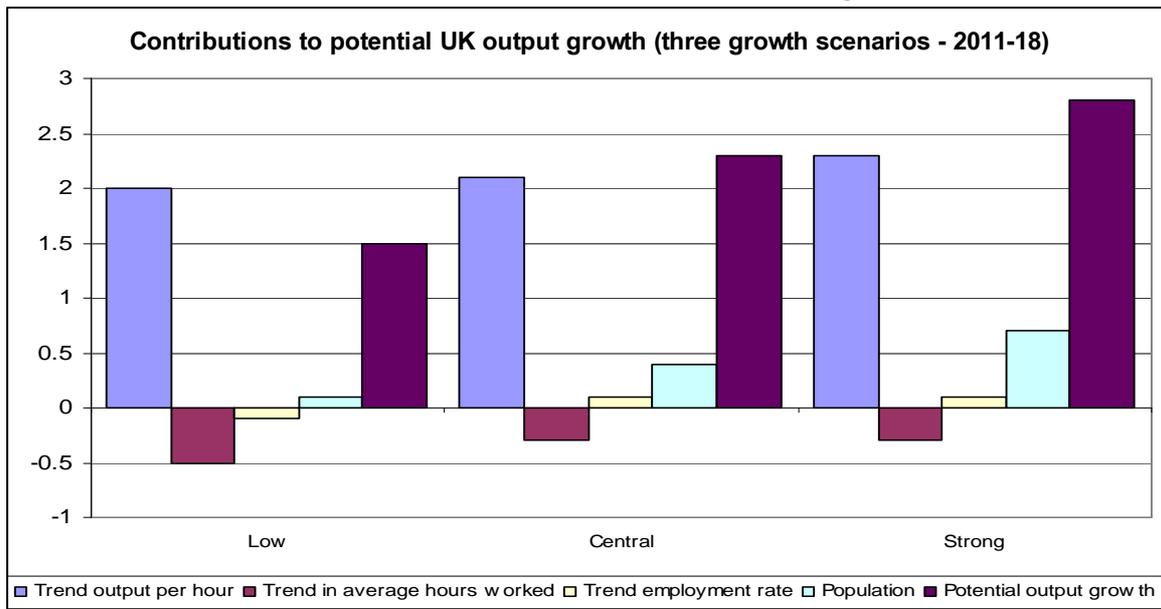


Source: (Oxford Economics)

Beyond this central scenario, it is useful to understand what may drive either weaker or stronger growth. In these projections, the main factor is the strength of population growth (Chart 44). Population growth expands labour

supply and overall demand and has been a major contributor of recent growth. The low and central projections are based on this population growth weakening somewhat over the next decade. However, if we were to assume that population growth would remain strong (in the high scenario) – then it could drive stronger output and employment growth. The majority of this population growth would be inward-migration rather than natural growth, nationally and regionally.

Chart 44: Labour contributions to UK growth



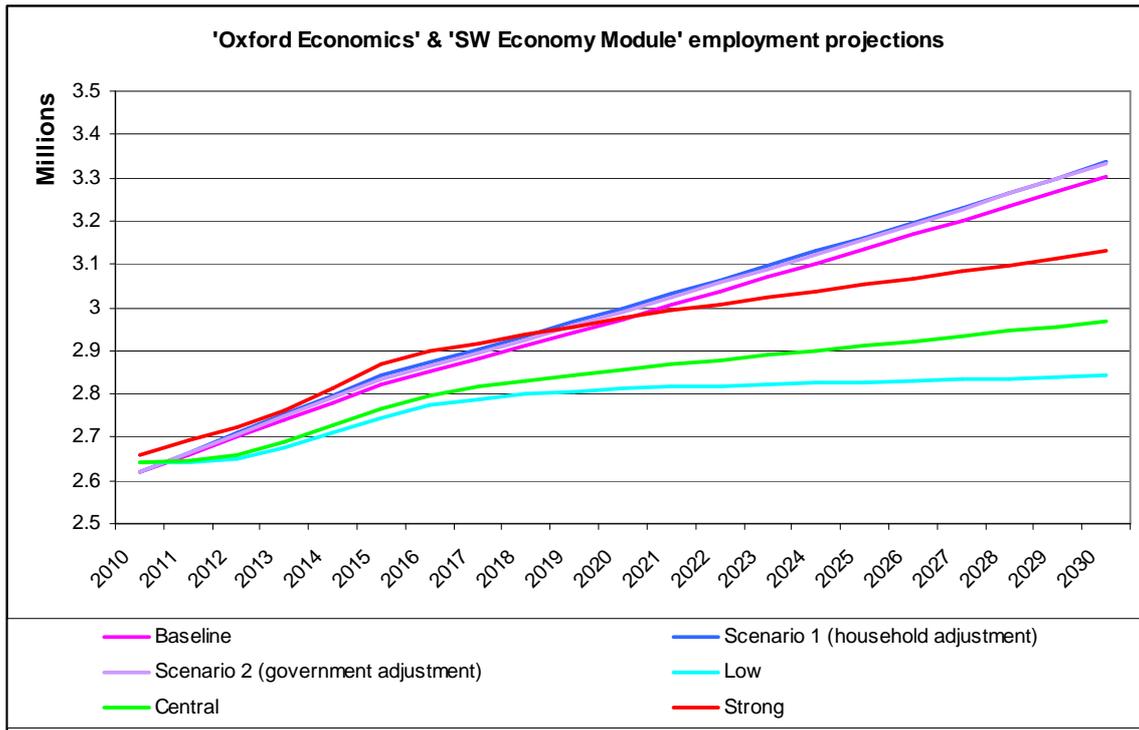
Source: (Oxford Economics)

Reconciling different projections

So far, this paper has looked at two differing set of projections. The scenarios in the 'Rebalancing the Economy' looked at structural adjustments that could be made, having beneficial impacts on future growth. In that sense, it is more of an 'output' based approach. In contrast, the 'South West Growth Scenarios' looked at wider socioeconomic factors including demographics that may affect growth – it has more of an 'input' focus. The Oxford Economics work does not make any further adjustment with regards to industrial structure.

Chart 45 below displays all six scenarios contained in these projections. It shows the projections in 'Rebalancing the Economy' to be more optimistic in terms of employment creation in the region. Broadly, all three scenarios in 'Rebalancing the Economy' match the 'strong' scenario in 'South West Growth Scenarios' until 2015-2016 but then accelerates beyond the Oxford Economics strong scenario as the benefits of structural adjustment begins to play out. This reflects the projection that, in the shorter, an adjustment to higher savings to finance investment means lower annual growth. In return, it should mean a higher trend rate of growth once more competitive capacity is in place.

Chart 45: Combined projections



Source: (Oxford Economics & SW Economy Module)

Given the two differing approaches in these projections, comparing the two is fraught with difficulties. Ideally, both would contain an element of the other. *'Rebalancing the Economy'* would make assumptions about changes to inputs such as productivity, labour supply etc. and *'South West Growth Scenarios'* would assume some small-scale shifts from public and private services into production.

Despite these difficulties, an inference that could be made is that the projected strength of change in inputs (through such factors as slowing in-migration, capital constraints and an ageing population) will not lead to relatively strong growth without the required structural adjustment.

Turning Projections into Forecasts

Introduction & context: the macroeconomics

Past: The long period of economic expansion from 1993 to 2008 fuelled significant employment growth in SW England. In total, the employment stock grew by 439,000 or over 20% to 2.56 million in this 15 year period.

Many “new” jobs were added in the public sector or parts of the private sector dependent on public procurement and services, especially from the late 1990s onwards. Between 1999 and 2009, 162,000 jobs were added in the South West and, officially, about 90,000 (56%) of the addition were in the public sector. These estimates are volatile, however, being subject to some reclassification through time. For example, between 1999 and 2008, the relative figures were 220,000 and 59,000 (only 27%). Given that 2009 was the main recession year and this affected manufacturing most, the public sector effect may be exaggerated in the former comparison. Nevertheless, our SW Regional Accounts suggest the public sector share of total full-time equivalent (FTE) employment increased by almost 2.5 percentage points in this decade.

A significant part of the rest of employment growth was in private jobs related to household consumption, particularly in business services driven by a buoyant housing market. For example, between 1999 and 2009, the number of jobs in UK real estate almost doubled (from 262,000 to 454,000). Over the same period, SW FTE jobs in real estate related services grew from about 26,000 to over 46,000. (Note, the SW share is about 10% of the UK total—higher than its overall economic share of just under 8%, suggesting the greater importance of housing to growth in this region during this period).

The “Great Recession” of 2008/9 and its aftermath brought these upward trends in public and property jobs to a halt as measures to address the financial crisis, labelled the “credit crunch”, expanded the public sector deficit. At the same time, the housing market froze.

Present: Adopting policies to address the government’s debt burden has reversed the trend towards public job destruction rather than creation. Our study of these effects about a year ago, estimated that between 75,000 and 115,000 public jobs could be lost in SW England over the 2011 to 2016 period, depending on precisely how you define public jobs and whether you invoke multiplier effects on the base numbers.

Although many of these job losses have still to occur, nothing has emerged in the last year to cause us to reject these estimates. There are signs that flexible responses, including outsourcing, pay cuts and other measures may limit some of the net negative labour impacts but this is not yet clear in any

numbers. Indeed, some public employers have been quicker off the mark than expected in terms of letting staff go. Worryingly, given the government's prime target to remove the structural deficit by 2015, the flatness of the recovery to date suggests further measures to tighten fiscal policy and cut public sector jobs will be necessary.

Also, the housing market remains very subdued and household incomes are under real downward pressure for the first time for many years. Average weekly earnings grew by an annualised 2.6% in the three months to June 2011 whereas inflation was 4.4% (CPI) and 5% (RPI) respectively in the same period. With many workers subject to current pay freezes and reductions, this trend of falling real incomes is not expected to reverse soon. It seems reasonable to suppose, therefore, that consumption-led growth will not be a significant job creator in the foreseeable future.

Future: With UK real growth currently estimated to remain below historical trends in 2011 and 2012, net job creation in the economy will be difficult. It is only likely to be in 2013-15 that the tide of employment growth may turn more positive.

Based on current Treasury (HMT) "Budgets", and accounting for the Business Department's (BIS) "Plans for Growth", the Office of Budget Responsibility (OBR) forecasts UK real GDP growth of 1.7% in 2011, rising to a peak rate of 2.9% in 2013. Thereafter, growth drops back to a more subdued long term trend. Business investment is expected to contribute 1.1 percentage points to the 2013 overall growth rate, growing by 10.6% that year. Exports are expected to grow by 6.2%.

After the immediate recovery, however, driven by demographic trends, the OBR sees overall trend growth declining to just 2.1% per annum. Historically, this is too low a rate of annual growth to prevent unemployment rising. The OBR suggests the employment growth trend will be -0.2% per annum after 2013, while population growth will be +0.5% per annum. Average hours are predicted to fall at -0.2% per annum and productivity to increase by 2% per annum. This is a relatively low growth future.

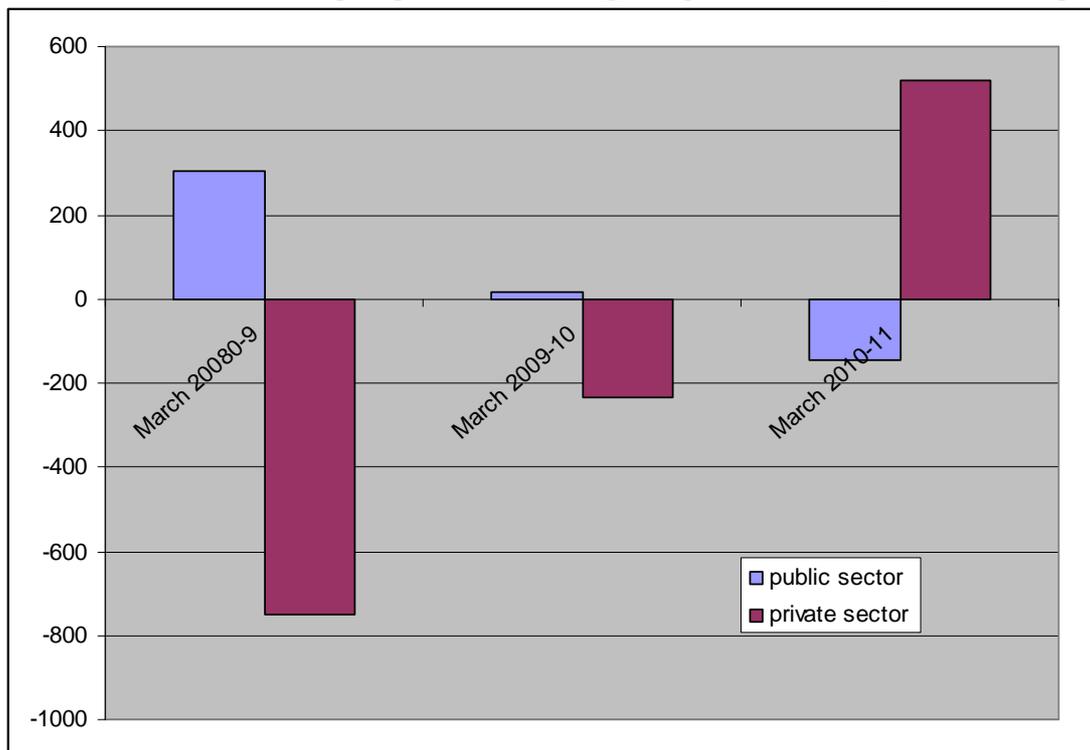
Other recent forecasts from the OECD, the IMF and private forecasters show a similar pattern of growth recovering in the 2012-14 period before settling at growth rates below those we experienced before the "Great Recession". All forecasters expect government and household spending to remain more subdued than we were used to before 2009 for some considerable time. Furthermore, very recent events in the stock markets and in the latest economic statistics suggest the starting point is slipping.

Rebalancing & funds flow

Rebalancing: Given this negative background for consumer and government spending, it is unsurprising that policy makers are hoping for a “rebalancing” of economic activity towards investment and exports with manufacturing playing a greater role than it has more recently. It is not clear exactly how this “game shift” will occur, but some main forecasters assume a recovery in private sector job creation will more than fill the gap of public sector retrenchment. In the period June 2010 to May 2011, for example, the UK public sector lost 144,000 jobs and the private sector created 208,000.

Partly, this reflects an ‘outsourcing’ of jobs from public to private, which is largely an accounting exercise – though it will mean a different process and mix of job development. There is also some debate as to the relative quality of current employment creation with a higher number of part-time jobs being added. (Over 40% of the 320,000 UK jobs created in the last year were part time and a higher proportion of those taking these jobs said it was because they could not find full-time work – 16% now compared with 14% a year earlier.) Full-time employment has yet to recover its pre-recession level whereas part-time employment is well above its equivalent figure.

Chart 46: UK employment changes (thousands, 2008-11)



Source: ONS

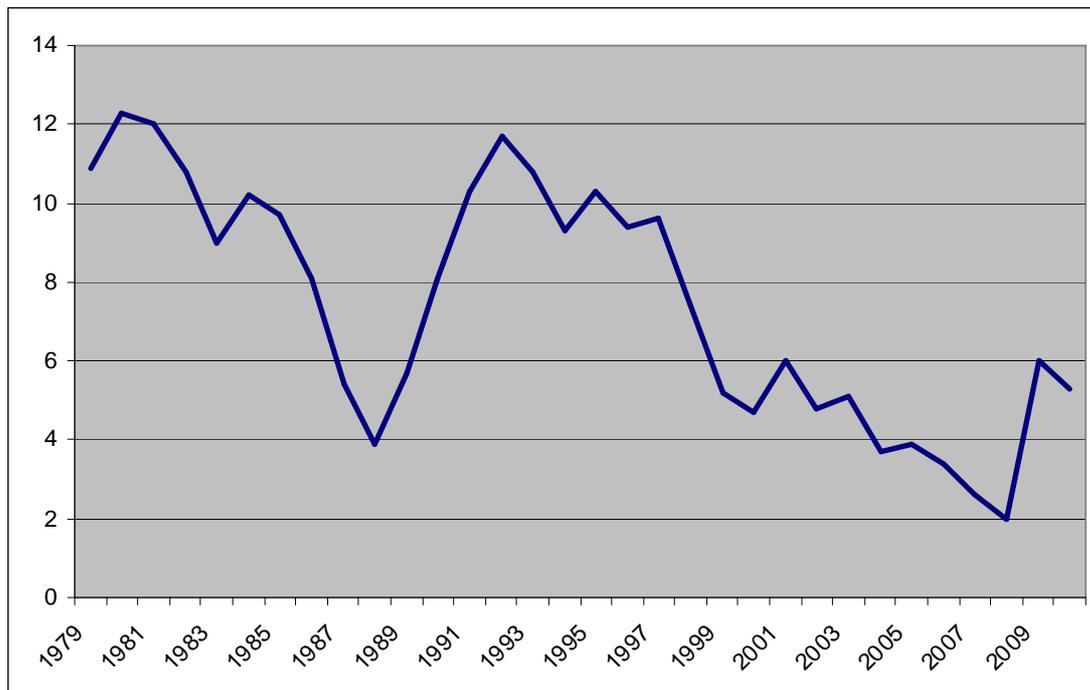
In the last couple of years, public sector employment – (now about 21% of the total) has fallen whereas private sector employment has grown. To an extent, this is the normal lagged response to recession (see chart 46 above), with public sector effects coming later than in the private sphere. In scale terms, of

course, the loss of private employment in the downturn remains the largest feature to date.

If private sector momentum is to grow genuinely new, value added jobs that spur productivity-led growth, boost employment growth and raise living standards, it suggests a market-driven economy that, in detail, will be largely unpredictable. We may be able to identify sectors, activities and occupations that might be the source of employment opportunities in broad terms and we can relate these to the relative strengths and weaknesses of the different parts of SW England. No one, however, can predict accurately in detail exactly where, in terms of industry, employers or geography those jobs will occur.

Rebalancing implies a reduction in the scale of the government in the UK economy (output and employment) in proportionate terms and a smaller current account deficit. If future growth is to be driven more by investment and exports than it has been in the recent past, this requires a change in savings behaviour by the UK population (households and government). The UK savings ratio has been low, compared with many of its external competitors, and has tended to fall over recent cycles (see chart 47 below). Going forward, this cyclical trend is not compatible with effective economic rebalancing.

Chart 47: UK savings ratio (%) 1979-2010



Source: ONS

In the short term, an adjustment to higher savings to finance investment means even lower annual growth in current output and expenditure. In return, it might mean a higher trend rate of growth once more competitive capacity is in place. Rebalancing, therefore, implies several new distributions over a range of facets of the economy: public and private sectors, goods and services,

exports and imports, savings, investment and consumption, financial credit and debt, and current and future output and incomes. These re-distributions suggest a period of adjustment that is not good for short term jobs creation, even if it boosts potential further out.

Funds Flow: The extent of the macro problem for employment growth can be shown by relating the flows of net lending and borrowing in the economy

In 2008, when the pressures of the crisis were building, UK households spent more than they earned to the tune of £41 billion. The government also spent more than it took in by nearly £67 billion. This required “borrowing” from the other parts of the economy, with £87 billion coming from the business sector (including banks) and almost £21 billion coming from the rest of the world.

By 2010, when the financial crisis and recession had occurred, the latest official figures suggest government was spending almost £148 billion more than it took in. To pay for that, the business contribution was about £83 billion (with about half the previous level of bank lending) and the rest of the world contributed £43 billion – twice as much as before. Furthermore, with the correction in housing debt, the household sector had shifted into surplus to the tune of nearly £13 billion. (Notice, this leaves a gap of up to £9 billion yet to be explained, which is why there will be further revisions to all these 2010 numbers – though the broad pattern of adjustment is clear).

By 2014/15, the OBR expects a very different balance of funds flow. Having eliminated the structural deficit, the residual cyclical deficit is forecast to be down to about £29bn with the rest of the world provision down to £15bn and a net £14bn to be sourced from private households & business. (The balance between these is not itemised). These numbers imply a successful rebalancing with a smaller role for government, a smaller external deficit and a private sector in overall surplus.

This rebalancing can only be achieved through higher savings and stronger investment growth and this implies semi-permanent constraints on domestic demand growth. If achieved, this may be extremely positive for the long run,

There are many ways for this to go wrong, however; not least the risk that it is achieved by overall shrinkage in the UK economy and leakage of investment to more buoyant economies overseas and, thereby, to higher unemployment and little net new employment growth at home.

Also, there is a stark message here for many parts of SW England. Most of the sub-regions in the South West have low investment ratios and export engagement. In the previous long expansion, we were a region that was driven by household (property, distribution, tourism et al) and government consumption. With the exception of a few export-orientated sectors, led by transport equipment around Bristol, Swindon and a few other centres, we start, therefore, from a less advantageous base in terms of employment and skills, infrastructure and access, and engagement and agglomeration (see our

range of analyses of the SW Economy over the years, as recently explained in “The Economics Story” released as part of the South West of England RDA’s legacy series this last summer).

If we seek a competitive future in which parts of the region improve their relative economic performance and generate high value jobs, our need for economic rebalancing is greater than in many other parts of the United Kingdom.

It is against this background of threat and opportunity that we explore the potential for private job creation in the different parts of SW England.

Forecasting & forecasts

In “The Economics Story”, we explain the approach to forecasting in terms of a performance framework, growth scenarios and influencing trends. That is the analytical approach adopted here.

First, then, we take as given the performance framework revealed by the long and deep understanding, gained over many years of our analysis, of the historical trends and structures in the different parts of the SW economy.

Second, we consider the four aspects of setting growth scenarios:

- the current capacity of an economy to develop;
- historical performance and projection of that performance forward;
- forecasts based on some idea of the theoretical or econometrically established relationships between key variables through time; and
- target deviations, from both history, projection and forecast, on the basis of foreseeable change, investment plans and aspiration.

Third, we consider other “less economic” influences that may affect private sector job creation going forward: demographics, environment, technological change and the process of rebalancing itself.

We reproduce the latest projections and forecasts for the region and its parts in the following tables and charts.

The first table shows the results from the first two sections above for SW real growth:

- The first column reflects a projection based on recent performance both before and during the current downturn. In line with the overall views for the UK economy expressed earlier, this suggests a below trend performance in the near term and a return to historical norms (but lower than during the 2000s) thereafter.
- The second column takes into account a range of aspects (positive and negative) of the future that are reasonable to assume, such as global economic forecasts, private and public sector productivity and employment changes, demographic changes, crowding out and crowding

in, sector differentials, exchange rates and other variables. In net terms, these tend to boost growth across the range in the near term but not shift the long term average significantly.

- The third column then considers the possibilities if policy and other aspirations were to transform underlying performance. For example, if the government coalition is successful in removing the structural fiscal deficit and encouraging private sector growth, this could boost growth in the long run. Similarly, if rebalancing from domestic consumption to investment and exports were achieved sustainably, it would boost longer term growth capacity too, perhaps returning us to the growth rates experienced in the late 2000s but on a sounder basis.

Table 1: SW real growth forecasts

Average % change	Projection	Forecast	Target
2010-2015	+2.0	+2.2	+2.3
2015-2020	+2.3	+2.6	+2.7
2020-2030	+2.4	+2.4	+2.9

Source: SW RDA Economics – Economy Module

Against this background, we consider our latest projections in detail. Summarising the overall prospects for GVA, employment and productivity, over the long term, the projections suggest a continuing moderation of growth prospects compared with the period before the downturn, once a shallow recovery from recession has occurred.

The next table shows the employment prospects for each part of the region (by LEP areas). Again, the key message is that, after the expected recovery in the short term, longer run job prospects are moderate in many areas, with only Swindon and Wiltshire projected to have FTE growth averaging higher after 2016 than in the 1995-2005 benchmark period.

Table 2: SW sub-regional employment projections (FTEs)

Average % change	2011-2016	2016-2030	1995-2005
Cornwall & Scillies	1.6	1.4	2.6
Dorset	1.5	0.4	2.0
Gloucestershire	1.8	0.8	1.1
Heart of SW	1.7	1.1	1.9
Swindon & Wiltshire	1.9	1.2	0.9
West of England	1.9	1.4	1.9

Source: SW Economic Projections for SWRDA, autumn 2011

Turning to the industry breakdown (Table 3), the overall pattern is the same – modest recovery followed by prolonged comparative sloth, except in sectors where ongoing structural changes still have some momentum.

It is notable that most long term growth in employment remains concentrated in services, particularly business and financial services, rather than production. This highlights the problem that manufacturing-led growth will not be easy and, even if achieved, may not mean a lot more manufacturing employment.

The key question from these projections is whether there can be enough other structural changes, induced by market forces and/or public intervention, to reflect a major rebalancing of investment and overall demand in a way that leads to significant net new job creation in more high value added and tradable sectors.

Table 3: SW sector employment projections (FTEs)

Average % change	2011-2016	2016-2030	1995-2005
Agriculture	0.3	-0.5	-1.4
Extraction	7.7	1.4	-3.8
Manufacturing	1.4	-1.1	-2.1
Utilities	-1.9	-3.1	-5.6
Construction	1.2	-1.0	4.7
Distribution	1.2	0.8	2.0
Hotels & catering	2.6	1.3	3.6
Transport & comms	2.1	2.0	2.5
Financial services	4.0	2.8	-0.9
Business services	3.5	2.9	4.4
Public admin & defence	-0.7	-0.1	0.8
Education	0.7	0.3	3.5
Health & social	2.2	1.6	2.3
Other services	0.5	0.2	2.1

Source: SW Economic Projections for SWRDA, autumn 2011

Finally, by occupation (Table 4), we bring out the best and worst job prospects for the region in the table below. This suggests more growth in the professions and skilled technical “high value” occupations than in the relatively unskilled occupations although, reflecting demographic trends, personal services is also seen as a growth area. Again, overall lower growth prospects

mean lower occupational growth than in the benchmark period with the upturn slowing down in the long run in all occupational segments

Breaking down the projections into the new LEP areas does not change the overall ranking significantly. It does indicate a bit more buoyancy in the north and east of the region than in the south and west, mirroring the historical pattern of relative economic performance across the SW region.

Again, the issue is whether this pattern can change markedly as the downturn fades. Is the previous trend broken or merely suspended? Will the future be the same or different from the past?

Table 4: SW occupational employment projections (FTEs)

Average % change	2011-2016	2016-2030	1995-2005
2 Professions	3.7	2.7	4.1
3 Associate / technicals	3.1	2.4	4.9
6 Personal services	3.0	2.3	-0.7
1 Managers / seniors	2.4	1.7	1.5
5 Skilled trades	1.2	0.6	1.2
9 Elementary	0.9	-1.1	0.1
7 Sales & customer service	0.2	-0.5	-0.6
8 Process / operators	0.1	-0.6	-1.1
4 Admin / secretarial	-1.9	-3.5	-1.7

Source: SW Economic Projections for SWRDA, autumn 2011

The final element in the forecasting jigsaw is to consider those factors, such as demographic, climate and technological change that will influence the extent and pattern of employment growth in the future. Here, we can be no more than general in our assumptions and how these might influence trend growth by place, by sector or by occupation.

Demographic change is likely to mean more aging of the SW population. This may affect the structure of demand and employment towards services rather than products and within each category from “youngness” to “oldness”. Key will be the effects of public withdrawal on net benefit (including pensions) flows and work patterns between the generations: a field which is itself under great pressure to change and largely unpredictable.

Another demographic factor will be immigration. This is notoriously difficult to predict because it requires a multi-factor matrix model of income, wealth,

exchange rate and political trends in all parts of the United Kingdom and many countries overseas. The substitution effects here could be profound. Overall, however, SW England tends to be a net importer of migrants of both working and non-working age in times of growth in output and wealth. The low growth outlook suggests less of this in the years ahead but it is vital to remember that these net flows reflect relative changes not absolutes.

With respect to climate change, actions to mitigate and abate its effects suggest a move from carbon-heavy jobs and occupations to more carbon-free alternatives. This means an evolution of the skills set towards environmental and new energy technologies, offering opportunities for private sector employment growth even as other skills become redundant. Again, the net effect is unclear, in advance, but should offer scope for employment growth in the years ahead.

This leads us to technological change. As well as direct “green” technologies, we are likely to see further development in the areas of materials and fuels across all sectors with an emphasis on light and robust techniques, further development of digital delivery and communications systems. As with previous technical revolutions, this will bring private sector jobs growth in unforeseeable ways but there is no reason, a priori, why this might not be a net additional benefit to job prospects.

Prospects for private employment growth: Conclusion

Taking our detailed projections and overlaying them with our growth scenarios and views about some of the “futures” issues that are apparent, we can state the following broad expectations:

1. if the SW economy returns to previous form, the private sector will not generate a significantly different amount of new jobs – the businesses in the region and most of its parts will still be highly dependent on domestic discretionary spending and that spending is likely to be relatively subdued;
2. if employment prospects are to be increased significantly, this will be because private efforts to rebalance the economy towards investment and exports will have been successful – the businesses in the region and most of its parts starts behind the pack on this level and will need to improve its game sharply if it is to move up a league;
3. if rebalancing is achieved, however, it is likely to take some time – the businesses in the region and most of its parts may find it very hard to do anything other than produce minimal compensation for public losses in the short term;
4. if demographic, climate and technological factors play out as currently envisaged, there is the possibility of private jobs growth in new sectors/occupations related to aging, low carbon and digital change – the

businesses in the region and its parts need to focus on appropriate innovation and skills development to capture the opportunities across existing and new industries;

5. if private enterprise is to more than compensate for the withdrawal of public sector jobs, it needs to be more growth orientated – the businesses in the region and its parts need to reduce grant dependency, become more entrepreneurial, invest more and trade more, building new horizons for access and aspiration.

Other Perspectives

The rest of Europe:

It is useful to understand how the labour market is performing in Europe and the implications of this for the United Kingdom. The report '*Shifts in the job structure in Europe during the Great Recession*⁴¹' focuses on how the recession has changed the structure of the European labour market. Importantly, it highlights that the role of the public sector in holding up the level of well-paid jobs extended beyond the United Kingdom.

As in the United Kingdom, most European countries found that the recession accentuated the long-run shift in employment away from primary and manufacturing activities towards service activities. The shift has also been markedly skills-biased, sparing in large part higher-skilled, white-collar workers.

Employment change during the recession in the EU27 can be characterised as polarised, with some element of upgrading. This followed the pre-recessionary period which clearly demonstrated an upgrading of employment: growth in employment in the top two quintiles⁴² i.e. the top 40%, accounted for over two thirds of overall employment growth, but with some degree of polarisation (in that growth was lowest in the middle and somewhat higher in low-paid jobs).

The recession has bought a slowdown/reversal of higher quality job creation. The Eurofound report argues that the recession has negatively impacted employment in two ways: by destroying low-to-medium paid jobs and by stemming the net creation of new higher-paid employment. The report finds that the recession has 'hollowed out' the labour market in several European countries, disproportionately affecting those jobs in the middle of the wage distribution. This is a common finding of previous US and UK analyses that used a similar methodology and applied job-wage or occupation-wage rankings. What is interesting is these trends, previously observed during the growth period, should also be evident during the downturn.

These declines are attributable in large part to the plight of the construction industry in those countries where construction booms collapsed from 2007 onwards, particularly in Ireland and Spain. In this work, construction jobs were generally classified as 'middle wage' occupations. Remarkably, between 1995 & 2006, Spain accounted for over one in three net new jobs in the EU15. Much of the growth was in an overheated construction sector. Subsequently, the collapse has been even more dramatic than what preceded it. Spain alone shed a million construction jobs between the beginning of 2008 and 2010.

⁴¹ '*Shifts in the job structure in Europe during the Great Recession*' - Eurofound - 2011

⁴² The report used a methodology of combining 88 sectors with 27 occupation types and then using mean hourly wage rates to allocate the jobs into rankings. This was broadly termed a job-wage rank.

Other than having broadly similar workforce demographics, construction and manufacturing have been notably dissimilar in terms of their movements over time. Construction is amongst the most cyclical of all sectors whereas manufacturing is one of the most 'structural': it involves substantial fixed capital investment and much longer time horizons to reap the benefit of those investments. As previously commented, therefore, any decline in employment during a recession in manufacturing is more likely to be permanent, whilst in construction it is more likely to be temporary.

Earlier we showed the marked cyclicity of UK construction employment since the early 1980s – with two major employment peaks during the late 1980s and late 2000s. In comparison, UK manufacturing employment has generally been on a long-term decline.

Similar structural and cyclical movements have been observed in Europe. Between them, the construction and manufacturing sectors accounted for net job destruction of over 1.9 million jobs in the EU – over 35% of total net decline during the recession.

Given that over 70% of the working population is employed in the services sector, it might be expected that services would have a sizeable influence on the shape of current and future EU employment growth. This was certainly the case in the growth decade when services accounted for virtually all growth at both the top and the bottom of the job-wage distribution. However, the recent slowdown in growth in services means that the ongoing polarisation tendencies are, to a larger extent than before, accounted for by the collapse of middle-wage ranking jobs in manufacturing and construction.

Across the EU, retail was the sector that contributed most to employment decline during the recession – while losses were also notable in postal services (in the concluding phase of deregulation in the EU), in warehousing and transport and personal services.

During the decade prior to the recession, the EU gender employment gap continued to close, growth in female employment being greater in both relative and absolute terms than growth in male employment. The recession has accelerated this convergence. Before the crisis in 2007, the ratio of male to female workers was 55:45, having narrowed from 62:38 in 1987 (in the EU15). Because of the greater impact of the crisis on sectors that are male dominated, the gap has narrowed a further percentage point.

Across the EU, female employment has had a comparatively soft landing during the recession both in qualitative and quantitative terms. Almost all employment growth at the top of the job-wage distribution in the EU27 has gone to women (this runs slightly counter to the loss of female FT employment in the United Kingdom). This has resulted largely from continued expansion of professional-grade jobs in the health and education sectors. Meanwhile, net female job losses have been exclusively in middle and low-paid jobs including

retail salespersons, blue-collar workers in textiles/clothing manufacture and in agriculture. In fact, a clear contrast is visible between the patterns of employment decline for men and women: there is an upgrading pattern evident for women and a stark polarisation pattern for men – a partial reverse of the patterns observed during the pre-crisis period.

In terms of the age impact, the recession especially impacted unfavourably on the employment levels of younger workers in the EU while employment of older workers increased across the board, but with a skew towards higher-paid jobs. The consequence of this, of course, is that the age profile of the EU workforce grew older while that of the growing ranks of the unemployed grew younger. Of course, some of the workforce ageing simply reflects wider demographic trends.

As in United Kingdom, PT employment has increased quite sharply (and this is not solely due to the increased employment of women relative to men). The report summarises that some replacement of FT by PT work may be another manifestation of labour hoarding and could possibly be temporary in nature rather than permanent. On the other hand, the proportion of fixed-term employment fell – especially in the 2008–2009 phase of recession – as non-renewal of fixed-term contracts was often the path of least resistance when dismissals were considered inevitable.

"The hourglass & the escalator"

It is useful to extend our earlier commentary on the concept of the 'hourglass'. This has recently been succinctly summarised by the Work Foundation⁴³. Their findings – many of which we have discussed elsewhere - were:

- There appears to be an ongoing process of the gradual hollowing-out of middle-wage occupations, creating increased polarisation in the labour market. During the recession, and the period before it, occupations which have lost the largest number of jobs tend to be in middle-wage routine manual and non-manual occupations. For men, this has meant the loss of a significant numbers of jobs in process, plant and machine operative occupations; for women it has meant large-scale reductions in the numbers working in administrative and clerical occupations.
- There have been quite different patterns in labour market change observed between men and women. For men, the pattern of labour market change and polarisation is more clearly defined. Growth in employment share has been concentrated solely among the top three and bottom three occupations (when ranked by wage). For women, on the other hand, there has been strong growth at the top-end in professional occupations. Women, in particular, have benefitted significantly from public sector growth. Public sector employment accounted for more than 40% of the jobs growth which occurred in the

⁴³ 'The Hourglass and the Escalator – labour market change and mobility' The Work Foundation - 2011

top three occupational groups for women (totalling more than 375,000 jobs).

- During the recession employment in high-wage occupations for both men and women continued to grow. High-skilled occupations also appear to be doing better in the recovery, although managerial occupations have started to decline, professional, and associate professional and technical jobs continue to grow in number. In contrast, shares in administrative and clerical and plant and process occupations continued to decline rapidly in both the recession and early recovery; the recession speeded-up this structural change in the labour market. This is important because, although the economy has begun creating jobs, a significant number of these are in the low-wage occupations, meaning that those who lose jobs in relatively better paid and more skilled occupations may be excluded or have to take work at a lower wage and skill level. This has implications for the under-utilisation of their skills and hysteresis.
- The low-skilled have suffered in the recession as people with more skills are 'bumped-down' in the labour market. The employment rate for the unskilled fell markedly during the recession and it is likely that this, in part, reflects the nature of increasing competition in the labour market for lower wage occupations.
- Over the past decade, wage inequality has not grown as rapidly as it did in the 1980s and much of the 1990s. Indeed, wage inequality among women was stable throughout the decade. For men, there was a rise in overall inequality (between top and bottom) and this was driven by the faster rising wages among the top 10% of earners.
- One of the potentially damaging aspects of a more polarised labour market is that it may create additional barriers to earnings mobility. Evidence from the British Household Panel suggests that relatively large proportions of low-wage earners are not moving up from the bottom of the pay distribution even over relatively long periods of time, with a third remaining rooted in the bottom decile (and 60% remaining in the bottom three deciles). Those who are more likely to become trapped in low-wage work include individuals with no qualifications, women, and people working part-time.

Job creation – evaluation findings

The English Regional Development Agencies have undertaken an extensive evaluation exercise across their investments made during the last decade. This has provided a rich source of material to help us understand what types of investments could support greater levels of job creation.

First, it is important to understand that, throughout much of the decade, especially in the South West, the primary policy focus was upon improving business performance and to increase productivity, particularly in high-value

businesses. As we have seen, the labour market had generally been performing well with high levels of engagement and low levels of unemployment. Therefore, many economic development investments did not have job creation as the primary focus, although it would still have been a consideration.

In terms of the key evaluation learning points with regards to job creation, the main findings can be summarised as:

- In the South West, the largest employment impacts tended to have been created when investments were made in support of single organisations. This is in comparison to investment into more 'programme' level activities where the support is more dissipated and job creation is weaker. For example, the evaluations of Coral Reef⁴⁴ - a centre to develop composite materials led by Airbus UK - and the Eden Project⁴⁵ found that job creation was strong. In the case of Coral Reef, most of the job impacts were connected with safeguarding jobs rather than creating new opportunities.

In both cases, the investments were strategic, large-scale and highly important in making the overall project happen. Significantly, both organisations – Airbus UK and Eden – were able to substantiate the importance of the public support and to demonstrate the link between the investment and locating in that particular location. For Coral Reef SW, the alternative would have been to go elsewhere in Europe.

This type and level of employment impact was confirmed by the evaluation of inward investment support activities⁴⁶. Again, this was focused support (often not necessarily involving large amounts of financial assistance) but that support was strategically important to the decision-making of those businesses. This evaluation found that inward investment activities supported 5,600 new and 12,000 safeguarded jobs over the project period. Much of this would have been connected to a relatively small number of large employment impacts: larger employment impacts tend to occur when investment is encouraged by larger businesses.

The mechanism that sits behind businesses finding it more difficult to create rather than safeguard jobs was succinctly noted in the inward investment evaluation – *"stimulating a company to employ a new person(s) must entail them being pushed beyond their normal capacity for a sustained period of time. In a recession, many have substantial spare capacity and so are highly unlikely to take on new staff"*.

One conclusion that could be drawn from these evaluations is that the level of public investment needs to be focused on a specific objective

⁴⁴ 'Evaluation of Composite Research Alliance Regional Engineering Facilities South West' - 2008

⁴⁵ 'Evaluation of the Eden Project and SWRDA's role' - 2009

⁴⁶ 'Inward investment and international trade projects interim evaluation (2004-2009)' - 2010

and, sometimes, a single organisation with an engendered supply chain. The level of support needs to be a 'game changer', at a level that influences businesses' decision-making about location of future activity.

- By comparison, in terms of job creation, the evaluation findings for wider business support type programmes were weak. This form of support – which tends to have had less intensive financial support, but spread across a wider number of beneficiaries (businesses and individuals) – has a 'diluted' employment effect. Because the support was less intensive, the businesses themselves struggle with understanding the direct link between the support and any subsequent job creation or, not least, safeguarding. As a consequence, the evaluation findings were weaker in finding large-scale job creation. For example, only 55 businesses out of the 510 that were surveyed in the SW Business Links evaluation⁴⁷ stated that the support had resulted in an increased number of staff.

The other factor at play is that – because the links between support and employment effects were difficult for businesses to identify – there was a tendency to attribute any success to their own actions rather than the support. That is, the level of deadweight⁴⁸ was high and the net impact consequently lower.

- Evidence of strong job creation is also weaker in those projects where the investment support is 'one step removed' from job creation. Examples of this have been investments in physical regeneration/public realm improvements, where any positive impact would be spread amongst a range of businesses and, again, the causal link is not clear to businesses. Other examples have included projects aimed at improving the environmental efficiency of businesses, businesses again claimed this had a relatively weak employment impact even if beneficial to their performance.

The conclusions that we draw from the SW evaluation findings are that it tends to be easier for public investment to safeguard jobs rather than create new opportunities. For new jobs to be created, businesses need to feel that the benefits of the support will be sustained for a long period. Again, it is impact on development environment and capacity rather than direct business support that matters.

Additionally, the evidence seems to suggest that focused - often larger - levels of public support lead to stronger employment effects. This is particularly the case where that support relates to a specific objective – opportunity or market failure - whether it is for location or product development reasons, rather than less-focused business support for generic growth.

⁴⁷ 'Interim evaluation of Business Link services in the South West' - 2009

⁴⁸ The economic impact that would have occurred anyway in the absence of the public support

Conclusion

It is clear that the significant growth in employment over the decade prior to 2008 was largely driven by an expansion in public sector employment – over half of all new jobs in the region were in the public sector. However, since the end of 2009 that economic prop has been taken away and the regional economy will need to find alternative strength elsewhere.

This paper has shown that SW local authorities – under considerable financial distress – have announced job losses at varying speeds and levels. The make-up of the public sector means that older and female workers will tend to be affected most and we expect the greatest economic consequence will be in those smaller towns whose economies are not sufficiently diversified to withstand any localised shock.

Of course, at a macro level, the loss of public sector jobs would not necessarily be a problem if they were compensated by private sector job creation. However, the evidence suggests that whilst there was expansion in the private sector in 2010, much of this was concentrated in lower paid, temporary and part-time occupations. Hence, one of the most notable aspects of the last few years has been the switch from full-time to part-time and temporary employment, with over 40% of the 320,000 UK jobs created in the last year being part time – not necessarily a voluntary decision for many people. A reduction of full-time employment acts as a dampener on demand.

The other worrying aspect is that private sector job creation has recently slowed, whilst public sector job losses have continued unabated. This has resulted in unemployment once again increasing.

We expect public sector job losses to continue, given the financial pressures at an organisational and national level. We have argued that, given the economic slowdown in 2011, it is unlikely that the Office of Budget Responsibilities (OBR) growth projections will be met. The consequence of a greater fiscal deficit could be that its latest forecast of a 310,000 reduction in government employment is optimistic.

Perhaps it is surprising that nearly one-third of OBR forecast job losses have already taken place – given the assumption that losses were to be back-ended to the latter stages of the current parliamentary period. On the contrary, it appears that local government cuts have been front-ended, taking effect from 2011 onwards. The consequence of this is that our original forecasts of direct and indirect job losses of approximately 120,000 in the region still holds despite the OBR's UK forecasts being revised downwards.

All of this adds to the importance and urgency to rebalance the economy. The difficulty that faces this objective of shifting the economy away from services and building production industry base is that it is not necessarily a complementary to the further objective of large-scale job creation. Recent

evidence suggests that a manufacturing recovery, or renaissance, may not lead to large-scale employment expansion. We expect that most of any increase in manufacturing output will be as a result of productivity gains and not additional employment, extending the switch from labour to capital.

The service sector will remain important to the national and regional economies. Recent research has shown that a relatively small cohort of firms has created the majority of recent new private sector jobs and many of these remain in the service sector. It will be difficult to reverse the changing pattern of the labour market, which are largely driven by long term trends rather than the current cycle (although the majority of job losses in the past 2 years have been as a result of cyclical weakness in construction and manufacturing).

As a consequence, we argue that job creation will be, at best, weak in the short-to-medium term, particularly if individuals' savings ratio needs to rise to fund higher investment levels – compressing short-term demand further.

Whether this accentuates the 'hourglass effect' – the hollowing out of middle-income jobs in the labour market – is difficult to determine at this stage. Indications are that the recession has not slowed this longer-term process and we may expect this to continue.

The consequence for those at the bottom of the occupational structure is marked. Indications are that the low-skilled have suffered in the recession as people with more skills are 'bumped-down' in the labour market. The employment rate for the unskilled has fallen markedly and this, in part, reflects the nature of increasing competition. This is leading to problems of reduced earnings mobility with evidence suggesting that relatively few people are moving up from the bottom of the pay distribution. This clearly has substantial socioeconomic implications.

Therefore the picture we present in this paper is of a difficult labour market; one which is experiencing large-scale reductions in public sector employment without the commensurate increase in high value private sector opportunities. Short-term cyclical weakness has quickened longer-term structural shifts. One of the main consequences appears to be the loss of significant numbers of middle-income jobs.

The difficulty will be to stimulate job creation as well as instigating a structural rebalance in the economy. This will not be easy – there are contradictory issues at play - and policy makers will need to be informed by evidence, such as previous evaluations, to understand how best to invest limited resources. For the SW labour market, the next few years will remain difficult and considerable adjustment will continue to take place.

The overriding conclusion that we draw is there will not be a simple switch from public to private sector employment for all. The economy will remain below the strength seen in the preceding decade and for many individuals, expectations will need to be managed.

The content of this report, and all the output of the Economy Module of the South West Observatory, is written and produced by the **Economics and Evidence Team of the South West RDA**.

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