The UK economy

Martin Weale and Garry Young

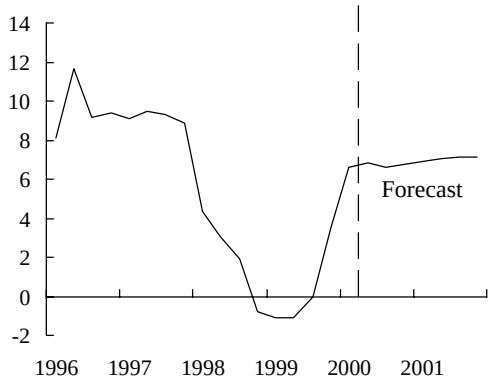
- The economy will grow by 1.8 per cent in 1999, accelerating to 2.9 per cent in 2000.
- The current account balance will swing into a deficit of £12bn in 1999.
- The base interest rate will rise to 6.5 per cent by the end of 2000.
- Inflation will rise to 3 per cent in the final quarter of 2001.
- There will be a public sector surplus of £7bn in 1999/00.

The outlook for the economy is now favourable. A strong expansion is under way, but inflationary pressures are likely to remain muted. The initial impetus to the recovery comes from strong domestic demand. In 2000 and 2001, more balanced growth occurs as exports and the manufacturing sector recover from the beating they have taken. With the labour market now fairly tight, the next two years will test the economy's ability to deliver higher productivity growth.

After flirting with recession at the turn of the year, the economy is bouncing back slightly faster than expected. The recovery is being driven by buoyant household and government consumption and strong capital outlays. Indeed final domestic demand will rise by more than 4 per cent in 1999. GDP growth is braked to a more measured 1.8 per cent by a swing in inventories and a further sharp deterioration in net trade.

Manufacturing a recovery

(Exports of manufactures, annual rate of change)



In 2000, the upswing gains momentum as GDP rises by 2.9 per cent. The pattern of growth over the next two years becomes more balanced. The increase in consumer spending slackens while exports recover after two years of virtual standstill. The squeeze on manufacturing eases and the sector returns to annual growth of just over 1.5 per cent, following this year's 0.5 per cent decline.

This rebalancing of the economy occurs as the effects of sterling's appreciation in 1997 and 1998 start to fade away. Real incomes are no longer boosted by falling import prices and this dampens down consumer expenditure. Now that the shock to trade has been essentially absorbed, exports can start to grow again.

With the exchange rate no longer a strong source of disinflation, inflation will be determined to a much greater extent by domestic influences. This means that productivity growth must pick up if the economy is to expand without an unacceptable rise in inflation. We anticipate a doubling in productivity growth to around 2 per cent p.a. in 2000–01.

The world economy

Paul Ashworth, Dawn Holland, Florence Hubert, Nigel Pain, and Véronique Genre

- World GDP will grow by 2.9 per cent in 1999, rising to 3.5 per cent in 2001.
- US consumer price inflation will rise to 3 per cent in 2000.
- The US economy will slow down in 2000 as short rates rise by half a point.
- GDP growth in the euro zone will pick up to 2.7 per cent in 2000.
- The ECB will raise interest rates by a percentage point over the next year.
- The Japanese recovery will grow by less than 1 per cent per annum in 1999 and 2000.

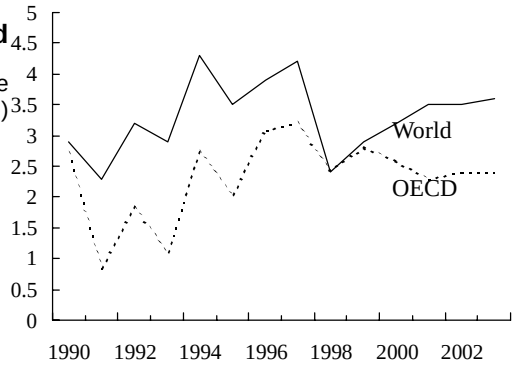
Last year's setback to the world economy has proved short-lived and a stronger than expected cyclical upturn has begun. This recovery in global GDP – now estimated for the first time in our model – is driven by growth outside the OECD. This marks a return to the pattern of the 1990s until the Asian crisis of 1997.

The strength of this upturn and the rise in oil prices means that the trough in global inflation is now behind us. Inflation in the OECD will pick up from the low of 1 per cent p.a. in 1998–9 to reach 1.7 per cent in 2000. Higher oil prices are expected to push up US inflation by half a percentage point and CPI inflation will rise to 3 per cent in 2000.

As US inflation rises, the economy will slow down. The current account deficit is currently running at an unsustainable 4 per cent of GDP. After growing for three years at almost 4 per cent p.a., output will rise by 2.7 per cent in 2000 and 2 per cent in 2001. Consumer spending and investment are expected to return to more normal rates of growth, as the US Fed raises interest rates and asset prices become less stretched.

Global rebound

(GDP, annual rate of change)



In contrast, the euro zone recovery will gather pace in 2000. GDP growth will rise from 2.1 per cent this year to 2.7 per cent. Germany and Italy will do better than in 1999, but both economies will still under-perform the euro area as a whole. The upswing will prompt the ECB to tighten monetary policy. The repo rate will rise from 2.5 to 3.5 per cent over the next year.

Japan's economic recovery remains fragile. Even with a further supplementary budget of Y5–6 trillion, the economy will grow by just 0.6 per cent in 2000. The recent appreciation of the yen has put the export sector under renewed pressure. The short-term impact of restructuring will be to reduce investment and employment, and this will restrain private sector demand.

Innovative clusters: global or local linkages?

James Simmie and James Sennett
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Regional policy has changed dramatically since the early 1980s. Instead of unsuccessfully attempting to prop up declining, old industries the emphasis has switched to encouraging endogenous local economic growth. Part of the intellectual inspiration for this shift has been academic based work around the concepts of flexible specialisation, new industrial districts and industrial clusters.

Industrial clusters are now seen by both the Treasury and the DTI as key vehicles enabling the growth of international competitiveness in some of the UK's key high-tech industries. The idea has spatial implications. The DTI, for example envisages encouraging a motor-sport cluster in the Midlands, aerospace in Bristol, engineering in the North-East, IT in the Thames Valley and biotechnology around Cambridge. As a result of the spatial implications of such developments, Lord Sainsbury published a report in August of this year urging the DETR, the new RDAs and local authorities "to take account of this concept through the planning system".

The concept of innovative clusters has therefore moved remarkably quickly from research to the policy communities. The research on which this paper is based forms part of the ESRC programme on "Cities: Competitiveness and Cohesion". The title of this particular project is "Innovative Clusters and Competitive Cities in the UK and Europe". It is concerned with comparing and contrasting innovation in five of Europe's most innovative cities. These are Amsterdam, London, Milan, Paris and Stuttgart. The main objectives of the research are to take a careful look at what is meant by the concept of clusters, to examine the different explanations for their formation and to follow what these difference mean for evidence based policy.

The interim findings so far are that the main reasons for the disproportionate clustering of innovations in core metropolitan regions like London include internal firm capacities, urbanization economies enabling the incubation of more radical and breakthrough innovations. This is combined with possibilities for regular sales to overseas clients and customers, the maintenance of linkages with them, and the openness of international trading nodes to new experience from around the world. The ability to seek out and transcode these experiences is also an important feature of the London region. This capacity is based on the presence of disproportionate numbers of highly qualified professional and technical workers in the region.

These kinds of advantages are more characteristic of core metropolitan areas than peripheral regions. The implications for policy are that because several different types of innovative clusters have already been identified empirically, different policy prescriptions will also be required. The relative success of endogenous local economic growth policies is likely to depend on tailoring interventions to the particular strengths of local regions. The new RDAs need to be aware that the uncritical general adoption of uniform industrial cluster policies is unlikely to achieve their desired objectives.

Housing and regeneration: the problem and the solution

Mark Kleinman and Christine Whitehead
(London School of Economics)

An important part of the current government's new agenda is the emphasis on pinpointing specific localities as a way forward in the implementation of "joined up" thinking. One result of this approach is that housing is being seen more as the means by which concentrations of poverty and exclusion have been built up rather than as in itself, a solution to these problems. This has important implications for the allocation of funding and the nature of required investment.

The authors bring together a range of research findings to examine the questions of the appropriateness of area targeting, the links between housing and employment and between satisfaction with housing and the desire and capacity to move and in particular whether success should be evaluated in terms of the impact on people or the impact on the area.

The evidence suggests that housing problems are not as concentrated as problems of multiple deprivation or unemployment - so restricting assistance particularly to those on social housing estates will exclude many of those in need of decent housing. It also shows that many of those helped by urban regeneration programmes will tend to leave the area and that dissatisfaction with the area and wishing to move tend to be concentrated among those with greater opportunities.

The authors conclude that many regeneration initiatives, even if they are successful, tend both to enable the people who benefit to move and to reduce the total quantity of affordable housing available in the area. These dynamics should be taken into account both when devising housing and urban regeneration strategies and when assessing their value for money.

Migration and British cities in the 1990s

Tony Champion
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Migration is a highly topical issue in the UK nowadays and a major force in population change at national as well as more local level. Net immigration from overseas has been running at a particularly high level in the 1990s, with especially large numbers of refugees and asylum seekers. The drift of population from the northern half of the country to southern England has been accelerating through the decade, reflecting the latter's earlier recovery from the post-1988 recession. The urban exodus has also accelerated since the early 1990s as the South East's problems of negative equity receded and housing markets became more buoyant across the country.

Britain's cities, and especially its largest ones, lie at the forefront of these population movements. By virtue of its 'cascading' nature, the urban exodus impinges most severely on the largest cities, as they lose residents to most other sizes and types of place. The North-South drift derives, in net terms, almost entirely from the main built-up areas of the northern half of the country that continue to experience the contraction of job opportunities in traditional industries and the shaking-out of some of their newer ones. Net immigration is very highly focused on the large conurbations that serve at the country's main entry points or are home to earlier immigrant communities, with London being by far the most important destination.

This article examines the scale and nature of the impact of 1990s migration on the populations of the eight largest conurbations in Britain, with particular reference to their labour markets. It shows that all these cities have been performing more strongly in demographic terms than in the 1980s, but London has seen by far the biggest upward shift in rate of population change. The article goes on to look—in as much detail as the available data allows—at the composition of both within-Britain and overseas migration, focusing especially on its industrial and occupational characteristics. The net exodus to the rest of the UK is found to be skewed towards the more skilled and generally wealthier sections of the population, especially in the case of the provincial conurbations. Similarly, the net gains from mainstream international movements are biased towards more qualified people, notably students but also professional and managerial workers, helping to some extent to offset the effects of the urban exodus. There is, however, no detailed information about the asylum seekers and 'visitor switchers' that are now contributing a significant share of overall net immigration, especially for London, and it is also extremely difficult to gauge the effects of emigration on cities.

Given the importance of migration for British cities in the 1990s and projected for the next two decades, there is an urgent need for the improvement of data sources on migrants' characteristics and for the more systematic analysis of the migration component of labour market change.

City size, diversification and income smoothing

Andrea Roberto Lamorgese
(Université Libre de Bruxelles)

This study looks at the link between earned incomes and disposable incomes in cities in the United States. There are a number of reasons why disposable incomes should be less volatile than earned incomes. The existence of other sources of income such as property and transfer incomes and incomes from the ownership of small businesses damp fluctuations in earned incomes. Volatility arising from earnings in particular cities is also damped by means of commuting. When job opportunities in one city decline some of its residents are able to find work in neighbouring cities. The study quantifies the effects of these different channels.

It is found that incomes in large cities are less volatile than in small cities but, surprisingly, after adjusting for the effects of size, industrially-diversified cities face more income volatility than do specialised cities. The difference is only marginal for large cities but is marked for small cities. The most-specialised small cities show the largest reduction in the volatility of disposable income as compared to wage income. In all cases the most important means of smoothing income volatility is offered by the social security system but the existence of investment income and commuting are also significant factors. In total about 25% of the volatility of wage incomes in the large cities is offset by these factors. In the smaller most specialised cities the proportion rises to over 30% but the residual, unsmoothed volatility remains higher than in the large cities.

This finding suggests that one of the benefits of large conurbations is that they offer more stable incomes than do smaller cities. It may be one of the factors behind the development of large cities.