

Core Cities – Enabling Sustainable Economic Growth

Interim Report



Summary

Cities are the key to the UK responding to the challenges of the decade ahead. They are the places in which most people live and work, in which future growth sectors will locate, and in which demand for skills, infrastructure and a shift to a low carbon economy will be greatest. Together, the Core Cities' urban areas alone deliver more than a quarter of England's economy.

For cities to realise their potential as drivers of sustainable economic growth over the next decade requires a range of activities:

- **Development of 'anchor institutions' and city innovation systems:** developing regional and local banks and innovation institutions (e.g. 'City Innovation Panels') and working closely with universities, cultural institutions and employers to provide the financial, intellectual and social capital to drive innovation and economic growth in cities;
- **Improvement in skills at all levels:** delivering skills provision at the level of the 'real' economy, working closely with employers and skills providers to respond to changing demand for skills at all levels and to help address worklessness;
- **Financial freedoms and flexibilities for cities:** Reducing ring-fencing of funds, taking an 'outcome' focused approach to performance monitoring and increasing capability to raise local revenue (for example through securitization of local assets) would enable cities to invest in a way that responds to their distinctive circumstances, whilst taking on the responsibilities and risks associated with financial flexibility;
- **Place-based approach to investment and improving the efficiency of public services:** Integrating strategy and delivery within economic areas, building on the 'Total Place' review and support local authorities to 'integrate' services at the local level in order to realize efficiency gains;
- **Innovative approaches to investment in low carbon infrastructure:** Cities are the site of most carbon emissions but also have the scale to lead the fight against climate change. This requires investment in low carbon infrastructure, local energy supply, climate change mitigation and adaption of housing and offices.

These are the conclusions of this interim report by The Work Foundation and Oxford Economics. Our analysis is based on an assessment that under any macroeconomic circumstances, the UK will face four key challenges:

1. **High unemployment.** It will take at least four years for economic output to return to 2008 levels and up to a decade to return to the levels of employment we had in 2007. And this will affect some groups more than others: 84% of jobs lost in the recession were administrative, manual or unskilled – and many will not return.
2. **Adapting to a 'knowledge' economy.** The recession has intensified the structural shift towards a service based, more knowledge intensive and skills-hungry economy and further exposed the gaps in the UK's skills and infrastructure.

3. **Climate change.** It is becoming increasingly urgent that the UK takes decisive action to move towards being a low carbon economy, reflected in national targets.
4. **Public expenditure constraints.** Recovery will take place during a period of significantly constrained public spending to reduce the public deficit.

Cities are the most effective way to respond to these challenges – but there is no guarantee that they will realise their potential. Under any circumstances, cities face a long road back to recovering pre-recession employment levels. In improved circumstances, cities are set to make a significant contribution to GVA and employment.

But if macroeconomic circumstances worsen, there is a real possibility of a decade of urban decline. The difference between the better and worse scenarios is significant: 752,500 jobs; 98,500 people unemployed; and £33.5bn GVA. This makes it even more important that cities act now to prepare the foundations for recovery. The policies implemented over the next twelve months have the potential to enable or constrain the prosperity of the UK, its cities, businesses and institutions over the next decade.

About this paper

As the UK moves slowly towards recovery, it is becoming increasingly urgent that policymakers address the challenges of unemployment at a time of constrained public expenditure. But as well as dealing with the immediate effects, our perspective on recession must now begin to question what will happen when recovery comes. How will the economic landscape have shifted, what sectors are likely to grow, what skills will be needed in local labour markets, and how will a transition to a low carbon, knowledge intensive economy impact on this?

To identify what the next phase of economic recovery and growth might look like, how cities can continue to show leadership in the way they respond, and what actions need to be taken, the Core Cities Group commissioned The Work Foundation and Oxford Economics to identify the drivers of sustainable growth in the future and the approaches to place-based investment that will best shape and gain competitive advantage for the long term.

This paper sets out the interim findings of the work, to be presented at the Core Cities Summit and consulted on with stakeholders. It assesses the key challenges, the role of cities in driving future growth and reviews three different possible scenarios for the future, highlighting both that cities can make significant contributions to growth and that an era of urban decline remains a real possibility. The paper then starts to set out the implications of our analysis for policymakers. A final paper, setting out detailed policy recommendations, will be published in December 2009 / January 2010.

1. Challenges facing the UK economy

The global recession has brought to a halt two decades of unprecedented prosperity. Fuelled by a boom in consumer credit, the UK economy grew for 16 consecutive years. High employment and low unemployment rates contributed to soaring disposable income. Between 1988 and 2008 household income went up by 60% and household wealth more than doubled.ⁱ UK cities experienced a renaissance, with many reversing periods of economic decline, supporting business growth and investing in their public realm, cultural amenities and infrastructureⁱⁱ.

The speed of the global downturn over the last eighteen months has hit the UK hard: GDP has declined much more rapidly than in previous recessions.ⁱⁱⁱ The collapse of the global financial markets that catalysed the recession has made credit much more difficult to obtain. Many businesses have gone bankrupt as a result and the property market has imploded. Unsurprisingly, the labour market has been badly hit: the employment rate has declined and unemployment in October 2009 was 2.47 million, up 677,000 in the year. There are now nearly 1 million young people who are unemployed and 7.97 million economically inactive people of working age.^{iv}

The recession has already lasted longer than any UK recession since the 1930s and, looking to the future, economic conditions are at best uncertain: there are a wide range of possible outcomes for the UK and its major cities. If the recent recession has taught forecasters anything it is to be alive to the possibilities that changing global and local conditions, and changing public policy, can bring to economic outcomes.

What is certain, however, is that, regardless of wider economic conditions, four main challenges face the UK on its road to recovery.

Challenge 1 - High unemployment

We know that high unemployment will be a significant challenge. Based on the experience of previous recessions, it will take at least 3-4 years for economic output to return to 2008 levels. The ongoing squeeze on public expenditure and continued restrictions on access to finance may even lengthen the time it takes the economy to recover from this recession. And, however long the economy takes to recover, the labour market takes longer. Despite some signs that employers have sought to retain staff in this recession, all cities are experiencing job losses and history suggests that they are unlikely to return to 2008 employment levels until 2015/16 (see Table 1 below).

Table 1: Employment change – a long road back

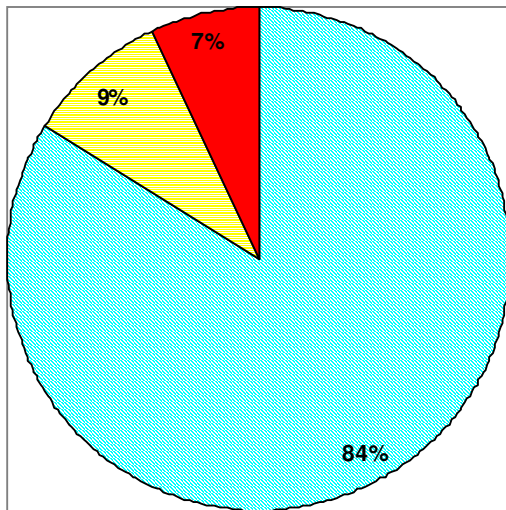
	Change 1998-2008 (000's)	Change 2008-2011 (000's)	Change 2011-2021 (000's)
Birmingham	7.8	-25.3	24.9
Bristol, City of	7.2	-9.0	28.4
Leeds	46.8	-18.1	29.1
Liverpool	24.7	-8.3	19.2
Manchester	44.1	-10.6	31.4
Newcastle upon Tyne	28.4	-6.4	14.5
Nottingham	4.6	-7.8	15.8
Sheffield	26.8	-12.2	17.7

Source: Oxford Economics

We can predict too that many of the jobs being lost now will not return. The recession is accelerating the structural change that was happening anyway. 84% of the jobs being lost are administrative, manual and unskilled – and many are unlikely to come back.^v By 2020, as shown in Figure 1, The Work Foundation’s analysis suggests that 52% of jobs will be ‘knowledge associated’: in other words, they will require higher level skills and cognitive abilities.

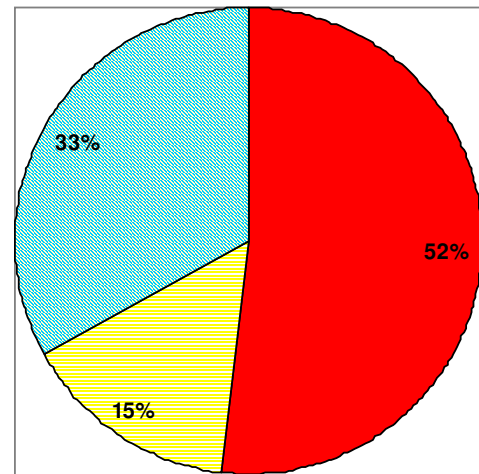
Figure 1: Recession speeds up structural change

Total employment change, April – June 08 – 09



Manual, unskilled, admin Care and sales Knowledge associated

Workforce in 2020



Knowledge associated jobs Care and sales Manual, admin, unskilled

Source: The Work Foundation

Any analysis of the future shape of the economy identifies skills as a critical component of future success, and therefore as having a significant impact on employment. It will become increasingly important for the UK to invest in intermediate and high level skills to respond to employer demand¹, remain competitive and support people into employment.^{vi} This means investment in ‘hard’ skills (qualifications) as well as ‘soft’ skills such as teamwork and problem solving. At the same time, a decade of low employment growth will reinforce the ongoing challenges for people and places with low skills – nearly 9 in 10 currently unemployed people in one Core City were unemployed *before* the recession and are likely to be in the same situation post-recession. Given that we face a decade of slow job growth, unemployment will create significant economic and social costs for the individuals involved, the places in which they live and for the state at a time of reduced public expenditure.

Challenge 2 – Adapting to a ‘knowledge’ economy

The recession has accelerated the structural shift already happening in the UK economy. The last twenty years saw the UK make a decisive shift towards becoming a more service based and knowledge intensive economy. Employment growth was predominantly in service-based sectors, fuelled by growing demand from more affluent consumer and businesses for high quality goods and services.

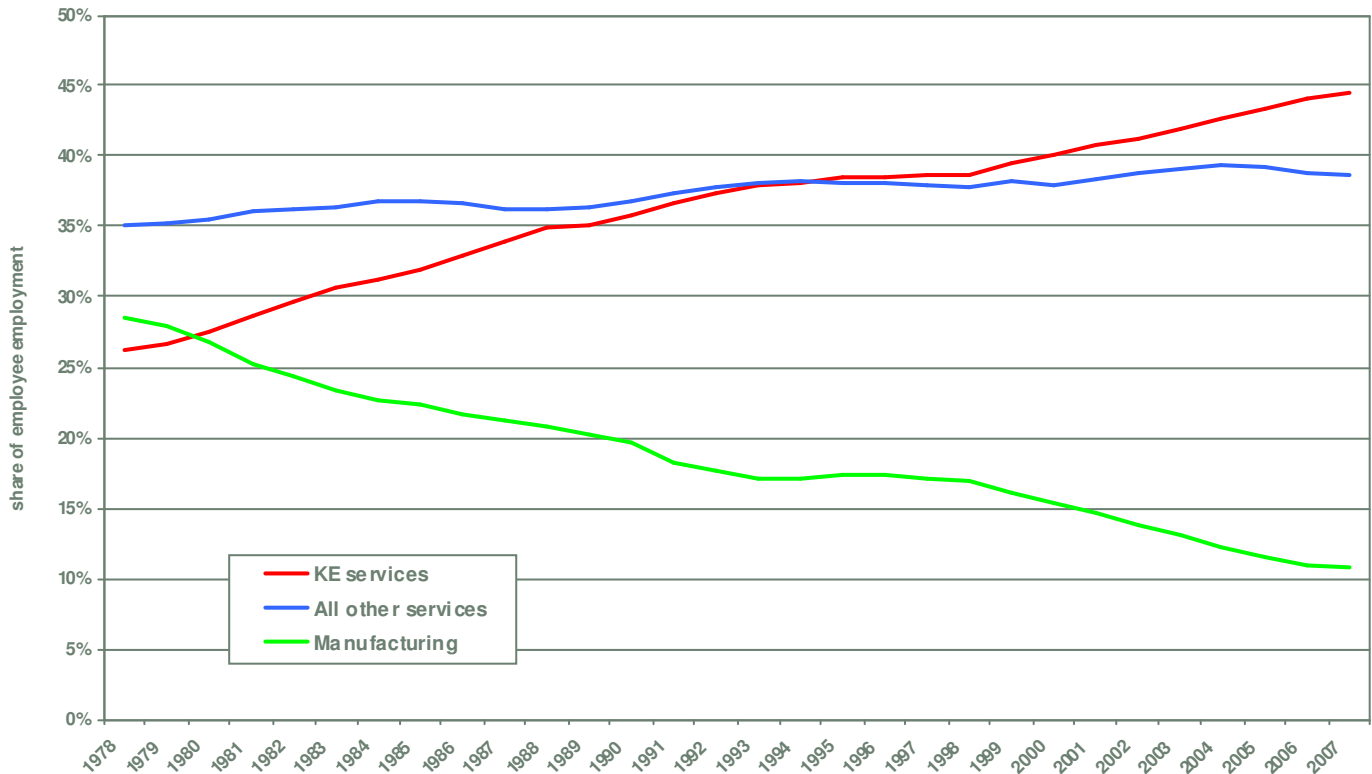
‘Knowledge intensive industries’² have been particularly significant sources of growth. Between 1995 and 2005, 12 new jobs were created in knowledge intensive industries for every one new job created in other industries. Over 40% of industrial value added and employment was accounted for by knowledge intensive services in 2007.^{vii}

¹ Between 1970 and 2004, business investment in ‘intangibles’ including R&D, human capital, organisational capital, software and brand equity more than tripled.

² Defined by Eurostat to include private industries - high to medium tech manufacturing, finance, business services, communications, cultural services, and air and sea travel – and public industries – health and education. Unless stated otherwise, this is the definition used.

Figure 2: Share of employees in employment, GB

Knowledge based services WF estimates from Office for National Statistics figures based on OECD definitions and includes communications, financial services, business services, education and health but excludes creative industries (part of Eurostat definition). All other services includes retail, hospitality, transport, public administration and other community, social and personal services. Manufacturing includes both knowledge based and other sectors.



Source: The Work Foundation

In this recession it is knowledge intensive industries that have been least affected.

Predictions of greatest impact being felt in highly skilled sectors during recession have been confounded by employment in knowledge-intensive services falling less than employment in other sectors. Manufacturing in particular has been hit by this recession. It is the places who were struggling to adapt to a changing economy before the recession: the cities with higher levels of employment in manufacturing and with lower levels of skills, mainly in the Midlands, Wales and Northern England - which have experienced the highest levels of unemployment.^{viii} This increases the pressure on these places to adapt to the changes in the wider economy and increase employment in knowledge intensive industries.

Challenge 3 – Climate change

Climate change is already having an impact on our lives. The last decade was the warmest recorded since records began in the 19th century^{ix} and the results of climate change are being seen now through direct and indirect impacts on human health. Already many cities have had to strengthen their flood barriers to protect against unpredictable weather and even the smallest rise in sea level could have major implications for the tourism industry in coastal cities. Water shortages will impact on daily lives and on tourism; fuel shortages could see flights becoming more and more expensive, perhaps preventing tourists from venturing as far from home. Whilst particular places will be affected more – those on the coast or near rivers, those undergoing rapid urbanization or with economies linked to climate-sensitive resources^x – everywhere will feel the impact of climate change.

A response is increasingly urgent – and it needs to be a long-term change in the way that we approach economic growth. The Stern Review argues that urgent action is required, noting that, “what we do in the next 10 or 20 years can have a profound effect on the climate in the second half of this century and in the next...policy must promote sound market signals, overcome market failures and have equity and risk mitigation at its core.”^{xi}

Challenge 4 – Constrained public expenditure

Public service cuts are already happening in some parts of the public sector, despite the stimulus package of last year, and look set to intensify. Politicians of all parties have committed to future public expenditure reductions to reduce the level of the public debt. Though it is not clear to what extent public finances will be rebalanced through tax rises as opposed to spending and direct employment cuts, it remains certain that some loss of jobs, or at least slowdown in the rate of growth, will shape the immediate economic future of the UK.

This is particularly significant because of the role that the public sector has played in the recent period of economic growth. For example, most cities benefited significantly from public sector investment in infrastructure, cultural amenities and quality of life. Public sector knowledge intensive jobs have helped to attract highly skilled professionals to cities, as well as created demand for other sectors that have driven city success such as retail, residential services, leisure and financial services.^{xii}

The role of public knowledge intensive employment has been more significant in some cities than others. Manchester and Leeds have relatively strong private knowledge intensive economies, whilst cities such as Sheffield or Newcastle have developed their private knowledge intensive sector by successfully building on their public sector assets. This means that, while all cities will need to face the challenge of reducing public expenditure, it will be more pressing for some cities than others.

2. Cities are integral to responding to these challenges

The UK must take steps now to address these challenges in order to secure a sustainable, prosperous economy for the medium and long term. And a key part of the solution is cities, as the places in which most people live and work and the places in which the industries that will drive future economic growth – knowledge intensive industries – overwhelmingly tend to locate.

Most future job growth will be in knowledge intensive industries...

Future economic growth will be driven by the expansion of the UK's private sector knowledge intensive economy. After the 1980s and 1990s recessions it was private sector knowledge intensive sectors which led recovery and this can be expected again. This growth will be fuelled by strong demand from both consumers and organizations.³ The next decade is likely to see particular demand for services for elderly baby-boomers and growing global competition in domestic markets for consumer goods and services. Risk management, regulation compliance and international demand for knowledge services will be important sources of demand from organizations.

Employment is most likely to increase in non-financial knowledge and technology based sectors, including high tech manufacturing, the creative and cultural services and ICT services, education and health, as well as emerging knowledge based sectors such as energy supply. SMEs will also play an important role in driving growth in these sectors: over the last fifteen years SMEs have grown rapidly in knowledge intensive sectors, whilst reducing in non-knowledge intensive sectors.

Education and healthcare – the public knowledge intensive industries – are an important part of this story and have potential for exports. Demand for education – both domestic and international - is set to increase in an increasingly skills-hungry environment and is a key opportunity for the UK. An ageing population and demographic pressures will also drive up demand for healthcare. These are also likely to be the areas in which public sector spending falls the least: even in previous periods of public spending austerity, spending on education and health only fell slightly.⁴ We would also expect additional funding in these areas to be sourced from individuals or corporations rather than the taxpayer.

Direct and indirect effects of climate change and energy availability will increasingly be felt in cities and will stimulate development of the low carbon economy. The direct impacts of climate change are already experienced by English cities. But there will increasingly be a number of indirect effects, for example through a drive to meet future national targets for carbon reduction and air quality through local contributions. In addition, energy pricing and energy security could have massive impacts. Peak oil and attendant price rises is predicted, and there are global

³ Organisational demand has historically played an important role in employment growth. For example, intermediate consumption of finance and business services by UK firms was worth £365bn, compared to £190bn of consumption by households.

⁴ Between 1992-1993 and 1999-2000 the share of GDP devoted to education and health fell only slightly from 10 per cent to 9.8 per cent of GDP. In contrast, spending on all services (excluding social protection) fell from 27 per cent of GDP to 25 per cent.

uncertainties over oil and gas supply from unstable regions. Reducing energy consumption, alternative energy sources and local supply will be key to addressing this. The public sector will have a major role to play: for example, a shift to a low carbon economy will impact on all types of capital spend in cities, including infrastructure, commercial property and housing. This will continue to shape the development of employment in the manufacturing and energy sectors.

And, during the upheaval of the recovery, it is likely that new sectors we have not yet considered will emerge. After the financial services driven recession in the 1930s, new industries were generated such as chemicals, consumer durables, automobiles and aerospace. Whilst knowledge intensive industries will undoubtedly dominate this recovery, the impact will be unpredictable and uneven. New sectors will develop, drawing on new technologies and 'intangibles' such as research and development to enable this to happen: for example 'manu-services', where advanced manufacturing companies increase value by selling services alongside products. Our economy may divide into leading edge sectors, specialist sectors and more 'pedestrian' sectors.

Some of these new sectors will be created through new technologies driving growth. Widespread use of computers and associated hardware as well as use of software and computerised databases have enabled businesses to respond quickly to demand from individuals and consumers. Moreover, new technologies – hard and soft – have enhanced the more cognitive and analytical roles associated with knowledge work. Over the next ten years we can expect at least one technological breakthrough or 'General Purpose Technology' (GPT) to emerge, with the potential to change the basis of our entire economy⁵, with bio-technology, nano-technology, alternative fuel and robotics all recent developments with this potential. However, in the short term it is the implementation and intensification of existing technologies will have a significant impact upon economic growth.

Globalisation will facilitate the emergence of new markets. UK exports of knowledge services increased by £34,000m between 2004 and 2007 and in a world with increasing demand for skills hungry services, the UK remains one of the few major suppliers (although competition is increasing). The UK is likely to continue to exploit its comparative advantage and the emergence of 'non-OECD' middle classes in countries such as China and India will create new markets for the UK and other countries.

⁵ Previous GPTs have included the three-masted sailing ship, the railroad, electricity and the internet.

Table 2 summarises the drivers of growth over the next decade.

Table 2: Drivers of growth to 2021

Drivers	Key factors	Examples	Possible changes to 2020
Demand	Consumer demand	Digital services, finance and insurance, cultural and recreational, private/co-financed education and health	“high demand” society for education, health, cultural and “green” services
	Organisational demand	Business and financial services, high tech, communications services, design, brand equity, human and organisational capital	High and growing demand for knowledge based intangibles
	Collective demand	Public education and health related spending, cultural services, environmental services	Public supply highly constrained Public sector efficiency drive
Supply	General purpose technologies	Computers, internet, lean production, networks	More intensive application of existing technologies
	Knowledge based intangibles	R&D, software, design, brand equity, human and organisational capital	Low carbon technologies and applications
Globalisation	High tech manufactures and knowledge intensive service exports High skilled labour	Bigger and more diverse markets Global production chains Ideas, best practices and technologies	Non-OECD “middle class” Migration to UK more constrained

...and these knowledge intensive industries which will drive economic growth tend to locate in cities

Whilst each city is different and will have different roles to play in helping the UK economy recover, cities as a group can provide the solutions to the challenges the UK faces.

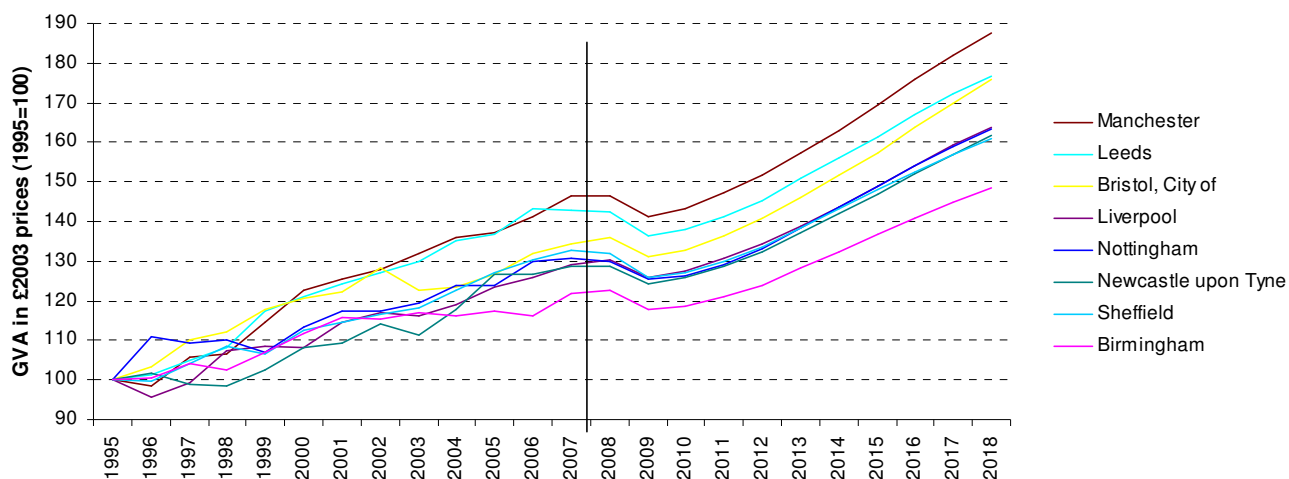
Cities will be vital places in which to adapt to the knowledge intensive economy and address the unemployment challenges because they are the places in which the knowledge intensive sectors that will drive future job growth tend to locate.

This is because of the access that cities offer to consumers, specialist skills, specialisms in particular industries, cultural amenities, global connectivity and opportunities to exchange ideas^{xiii} – ‘agglomeration benefits’ that are particularly attractive for knowledge intensive industries. Cities also offer ‘consumption benefits’ and are becoming more and more attractive for young people and professionals who increasingly aspire to live and work in an urban environment. Throughout the economic boom cities were engines of economic growth.

Large cities are particularly likely to offer agglomeration benefits for knowledge intensive industries, as illustrated by the fact that, as the economy became more knowledge intensive between 1998 and 2007, the Core Cities increased their share of knowledge intensive employment.^{xiv}

Based on current economic and policy trends, Oxford Economics analysis of the future economy predicts that cities will be important sources of GVA growth in the medium to longer term. This is largely due to the unique offer of skills and sectoral specialisms discussed above. GVA growth is expected to return to strong positive growth in the post recession years.

Figure 3: GVA growth in Core Cities over medium-term



Source: Oxford Economics

Much of this employment growth is likely to be concentrated in knowledge intensive industries - Table 3 sets out Oxford Economics' baseline predictions for change in employment in the Core Cities between 2011 and 2021.

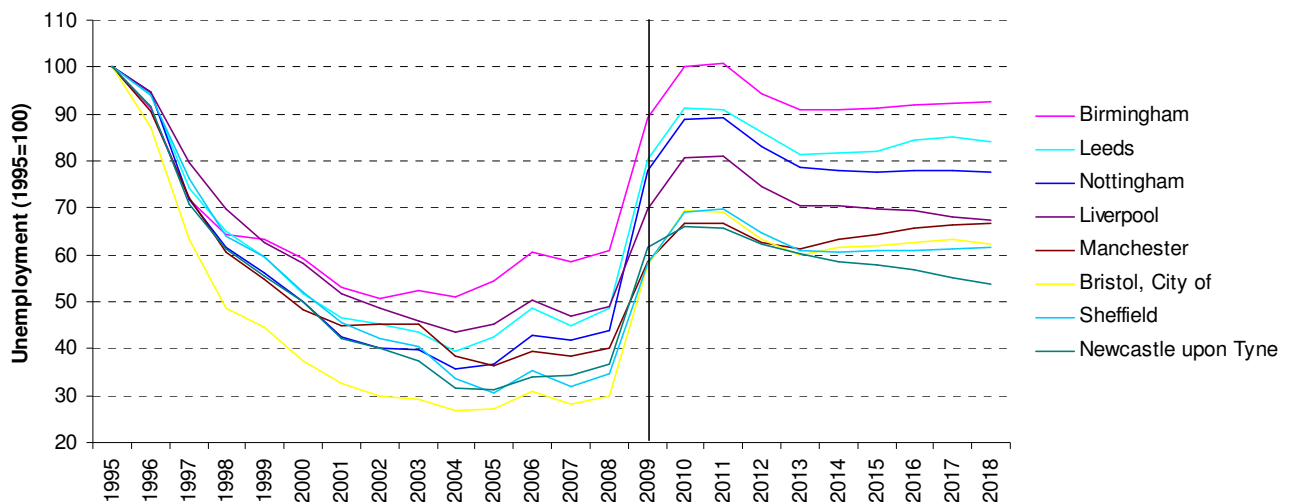
Table 3: Oxford Economics predicted employment change 2011 – 2021 in Core Cities

	Rest of production (000s)	Manufacturing (000s)	Retail & hotels (000s)	Financial & business (000s)	Public admin, education & health (000s)	Other services (trans / comms & leisure / voluntary) (000s)	Total (000s)
Birmingham	1.4	-15.3	6.5	16.6	12.6	3.0	24.9
Bristol, City of	1.5	-4.1	4.2	17.1	6.6	3.0	28.4
Leeds	2.7	-10.4	5.5	16.2	12.0	3.1	29.1
Liverpool	1.9	-3.0	3.6	12.4	3.1	1.3	19.2
Manchester	0.7	-4.5	5.7	13.8	12.1	3.6	31.4
Newcastle upon Tyne	0.7	-2.7	3.5	6.2	5.1	1.7	14.5
Nottingham	0.3	-3.4	2.4	10.5	5.0	1.0	15.8
Sheffield	2.1	-7.6	4.0	9.0	8.9	1.4	17.7
Total	11.3	-51.0	35.3	101.9	65.4	18.1	181.1

Source: Oxford Economics

However cities will have a long road back to the employment levels they have enjoyed recently. In the Core Cities, falling employment and rising unemployment, combined with high proportions of migrants staying (which remains an uncertainty in the forecasts), will force the resident employment rates across UK cities to fall. Unemployment is expected to remain higher than the recent lows enjoyed across the cities (see Figure 4) as UK growth is expected to be modestly lower in the medium term than pre recession, and the recent past begins to look artificially low through 'debt support'.

Figure 4: Unemployment forecasts



Source: Oxford Economics

This means that cities will continue to be the major centres of employment and drivers of growth under current economic circumstances – yet they will also face high concentrations of unemployment and worklessness for the medium to long term. This suggests that if measures can be taken that can help to increase employment and mitigate the impact of unemployment, this would reap significant benefits for the Government and the wider population.

And, as cities will be the places in which demand for skills and infrastructure will be concentrated, this suggests that they are the places in which investment needs to be focused. They are also the places in which long term unemployment and worklessness can be addressed. Cities can work with employers and individuals to link job growth and changing demand for skills with investment in skills at all levels (basic and intermediate to graduate) and measures to address barriers to employment (e.g. childcare, transport) that take into account the particular circumstances facing individuals and communities.

As the places in which most people live and work^{xv}, cities are also vital to tackling climate change and managing public expenditure

Cities have been identified as both the problem and the solution in the context of climate change. 78% of carbon emissions, 60% of residential water use and 76% of wood use for industrial purposes are attributed to cities^{xvi} - but cities also tend to have most resources to tackle climate change, as well as lower carbon footprints than other areas. The International Institute for Environment and Development found that city dwellers' reliance on public transport and denser housing contribute to them having lower carbon footprints than national averages.^{xvii} Cities have a critical role too in continued upgrading of physical infrastructure, from transport networks to building stock and housing. The combination of high population levels, resources to attract climate change and impact on infrastructure makes cities' role in addressing climate change and developing a low carbon economy critical.

And our analysis also suggests that cities will have an important role to play in public service reform and managing the impact of reduced public spending. Cities provide an opportunity to channel public spending into the 'real' economy – the area in which people live, work and consume – and can help to prevent duplication of funds (a 'Total Place' approach). Cities are important sources of employment for neighbouring areas and therefore considering issues such as skills, housing and transport at a city region level can help to respond to demand and ensure investment in the assets required for that particular city region with less duplication.^{xviii}

But cities face ongoing constraints to economic growth and to responding to these challenges

Even during the economic boom, cities faced constraints to sustainable growth. Against a backdrop of demographic change and climate change, lack of skills, long term worklessness, creaking infrastructure and the centralised nature of the UK leading to a lack of flexibility over funding, lack of devolved powers, and the lack of a place-based approach to investment, have all posed challenges even when growth was at its peak.

The recession has sharpened the challenges for cities. The difficulties of 'twin-track cities' in which poverty and affluence co-exist are even more pronounced in recession. The long-term scars of protracted unemployment may have generational impacts upon particular places. Barriers to finding work for unskilled individuals and the implications of a growing and ageing population are even more evident in the context of a downturn. The implosion of the property market has created real challenges of empty housing and office space, with some city centre development sites sitting empty, waiting for investors to re-emerge and demand likely to be low for new sites for some time to come.

Not enough financial tools are available at a local level to enable city regions to effectively and creatively address the impacts of the recession, for example through providing capital to local firms, some of which could go on to be the 'gazelles' (fast-growing firms) that could drive the UK out of recession. Nor is there sufficient flexibility to allow cities to invest in 'enabling infrastructure'. The crisis and credit crunch has opened up a gap that could be best filled at local rather than national level, but this is difficult to do in the current regulatory and financial structures.

And there is growing need for stronger local ‘anchor’ institutions’ to support sustainable economic strategies. The institutions that helped to make cities great in the past were business associations, strong local government leaders, universities, museums and cultural institutions, large employers; all of whom provided the assets to attract, develop and retain skilled individuals; invest in the local area and create a vision of the future.^{xx} Local institutional capacity is increasingly important at a time when public expenditure will have to reduce and different cities are being affected in different ways by recession and recovery.

The cities that have been most successful have had high quality universities and strong cross-sector leadership enabling a place-based approach to investment in skills, transport, quality of place and infrastructure.^{xx} These cities have developed their institutional capacity, working with the wider city region through informal partnerships and, more recently, Multi Area Agreements and the two city region forerunners in Manchester and Leeds, to make and implement decisions at a local level. These decisions are made in a way which responds effectively to their distinctive circumstances and makes more efficient use of public funds. This has supported these cities to attract major multi-nationals to invest locally, as well as enabled a clear step change to be made in the quality of the physical environment to attract knowledge intensive industries and highly skilled individuals.

And there is a real possibility that, without action now, the challenges facing the UK could be even more serious

Cities are the only way that the UK can tackle its pressing challenges, but to do so requires both cities to take responsibility to drive growth and Government to implement policies supportive of a place-based approach to policy, economic development, regeneration and investment. Without cities and government taking a place-based approach to investment, more financial flexibilities and stronger local institutions, the potential for cities to drive economic growth will be lost. In a climate of severely constrained public expenditure the reliance of cities and city regions on external support is severely constraining. And this becomes even more concerning when different economic scenarios are considered in which cities will still be the key to tackling the four key challenges facing the UK – unemployment, adapting to the knowledge economy, climate change and reduced public expenditure – but wider economic circumstances raise the possibility of urban decline if Government and the Core Cities do not both rise to the challenge.

3. Potential Futures – Risk and Return

3.1 Understanding possible futures

Cities are the most effective way to address the four key challenges which will face the UK regardless of the wider macroeconomic environment. But given the different nature of this recession to previous recessions, it is important to consider scenario analysis and test ‘what if’s’ about how the wider macroeconomic environment might affect the economic outcomes facing cities in the decades ahead. How might cities drive economic growth? And are there possibilities that we return to urban decline if action is not taken now?

Even though long-run economic analysis and forecasting often assumes the economy will eventually revert to the same long-run equilibrium path in the face of short-term shocks, there is considerable uncertainty both over what that long-run path actually is and how long it might take the economy to get back on track. It is therefore helpful to consider not only how cities might contribute to getting the economy back on track but also how they might perform if the economy’s potential trend rate of growth differs from that underlying the baseline forecast.

As a result, Oxford Economics has modelled two scenarios that consider how different circumstances might change the scale of the four key challenges over the next decade. These models consider the impact of different levels of growth in knowledge intensive industries, different oil prices, different levels of public sector cuts and the impact of differential investment in skills. Whilst these scenarios cannot model specific policies, they do show the impact on employment of certain parameters changing, and suggest what could be done to ensure that the UK is on the right trajectory for sustainable economic growth.^{xxi}

3.2 Realistic ‘upper’ scenario

To test what might happen in a more positive economic future, Oxford Economics has developed a realistic ‘upper case’ scenario. This assesses the impact on employment and jobs of:

- Improved export performance as a result of improved global growth (equivalent to around 1% faster export growth each year than in the baseline)
- A rebound in consumer spending (equivalent to an additional 0.2%pp fall in the saving rate each year)
- An increased investment in UK universities (equivalent to perhaps a £2bn extra investment each year, likely to come from individuals / corporates)
- More modest Public Expenditure cuts (equivalent to approx £30bn less cuts in PE over 10 years)
- The upper scenario does not alter the Oxford Economics baseline forecasts for oil prices. As such oil prices are expected to fall to around \$56 per barrel in 2009 and rise gradually to around \$70 per barrel by 2012
- Improved business investment (allowing private sector companies to generate the equivalent of an additional 0.2% employment each year as a result of less restrictive financial conditions than in the baseline forecast)

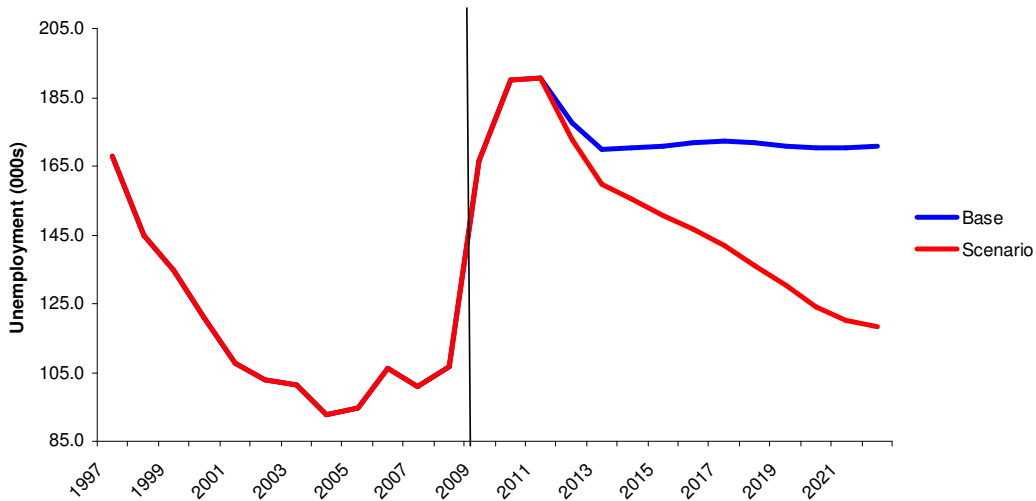
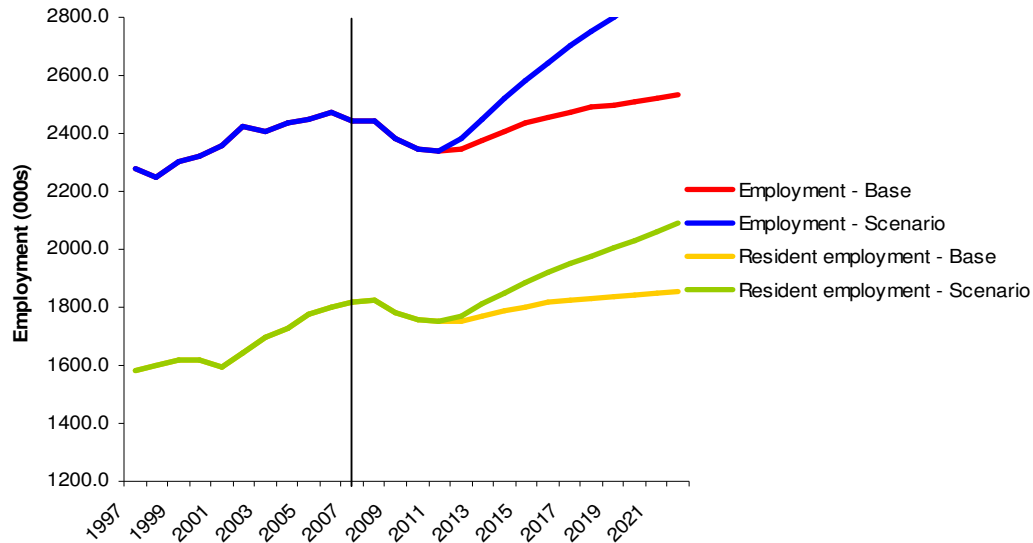
In the 'upper case' scenario, the impact by 2021 is:

58,500 additional population when compared to the baseline (an increase of 1.3%)

380,000 additional jobs when compared to the baseline (an increase of 15.1%);

A reduction in unemployment of 49,500 when compared to the baseline (the equivalent of -29.2%) – see Figure 5;

Figure 5: Impact of upper level scenario on unemployment in Core Cities



£16.8bn of additional GVA, again when compared to the baseline forecasts (an increase of 14.9%) – see Figure 6.

Figure 6: Impact on core cities' GVA

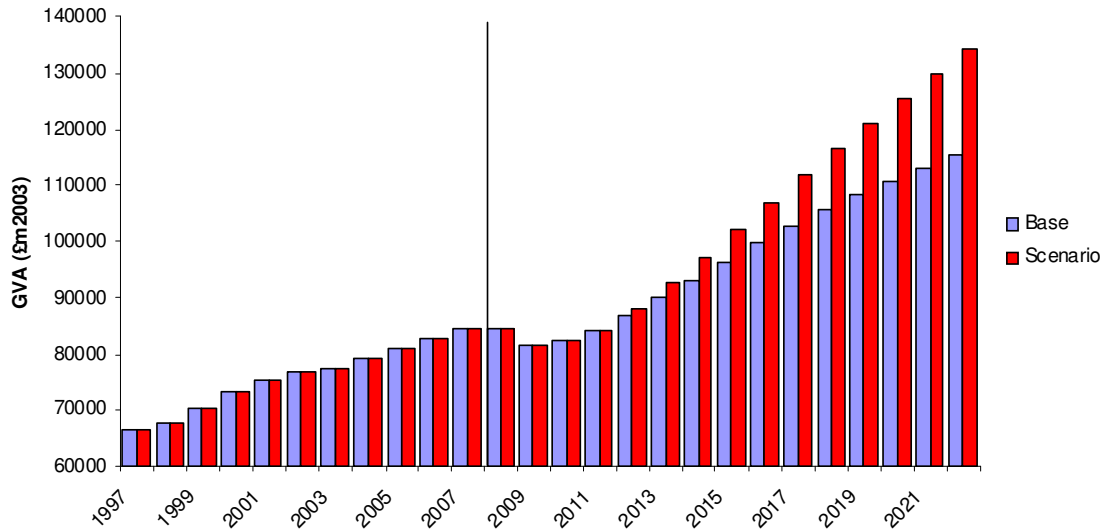


Figure 7 summarises the impact of an upper level scenario on the cities

	Birmingham	Bristol	Leeds	Liverpool	Manchester	Newcastle	Nottingham	Sheffield
Direct jobs	48.6	24.1	42.0	23.6	33.2	18.2	18.7	25.6
Direct and indirect jobs within the city	62.3	33.5	56.1	30.3	45.1	23.3	25.5	31.7
Direct, indirect and induced jobs within the city	74.1	41.0	56.2	36.6	53.1	27.7	30.2	39.2
Total jobs (includes additional public services jobs as a result of higher population)	77.1	41.7	70.0	37.2	55.4	28.4	31.2	39.7
Total resident jobs	48.1	26.0	49.7	21.1	19.4	15.0	12.9	30.0
Additional people	19.4	4.5	6.8	2.9	10.9	2.8	4.7	3.1
Change in residential employment rate	5%	7%	8%	6%	3%	7%	4%	7%
Resident employment rate (baseline)	59%	70%	69%	63%	57%	65%	61%	64%
Resident employment rate (scenario)	64%	76%	76%	70%	61%	71%	66%	71%
Change in unemployment	8.7	6.6	13.5	5.5	2.5	3.8	2.6	8.2
Unemployment (baseline)	55.3	12.0	23.8	20.9	19.6	8.3	14.3	16.3
Unemployment (scenario)	46.6	5.3	11.0	15.4	17.1	5.0	11.7	8.1

Figure 8 below attempts to decompose the upper scenario into its individual components. However this is difficult to estimate given interaction between the components. For example if one sector's growth were to be affected by the export led component, the investment in Higher Education and a rebound in consumer spending, the combined impact may be lower than a simple summation of individual impacts, given for example diseconomies of scale and rising costs pressures associated with faster growth. In addition, individual businesses may be limited in terms of export growth, as they lack knowledge of additional export markets.

Figure 8: decomposing the upper scenario impacts

Scenario components	Difference from baseline (2021)		
	Population (000s)	Employment (000s)	GVA (£m 2003)
Export led (1% faster export growth p.a.)	16	105	5,783
Rebound in consumer spending (additional 0.2pp fall in the savings rate p.a.)	7	46	1,691
Investment in HE (c.£2bn extra investment p.a.)	7	46	2,002
More modest PE cuts (c.£30bn less cuts in PE over 10 years)	20	140	5,053
Improved business investment (additional 0.2% employment p.a.)	15	100	4,104
Upper scenario	58	381	16,800

Source: Oxford Economics

Note: the individual scenario components do not add to the overall upper scenario due to the interaction of effects.

This means that under a more positive scenario, cities will continue to be the major centres of employment and drivers of growth. Whilst policymakers cannot exert a great deal of influence over the wider macro economy, there are clear opportunities to rise to the challenges that will exist even in the most positive scenario. Increased investment in universities and more modest reductions in public expenditure, for example, this has a significant impact upon unemployment and the costs (economic and social) associated.

3.3 Realistic 'lower' scenario

To test what might happen in a more challenging economic future, Oxford Economics has developed a realistic 'lower case' scenario. This assesses the impact on employment and jobs of:

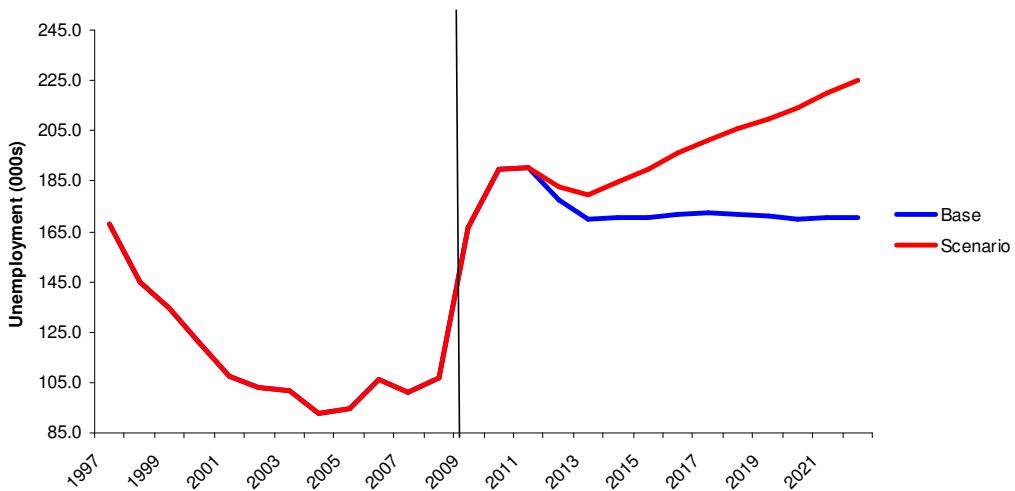
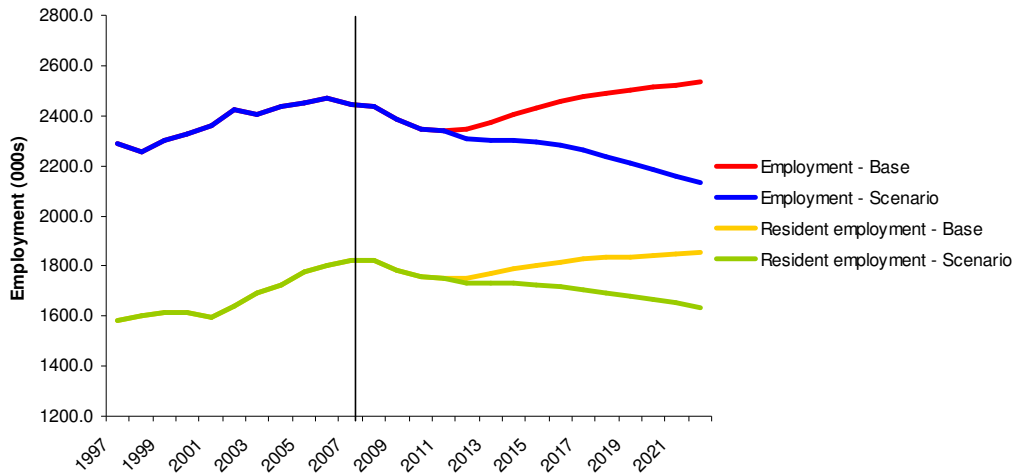
- More aggressive Public expenditure cuts (equivalent to approx £30bn additional cuts in PE over 10 years)
- A protracted contraction in consumer spending (equivalent to an additional 0.2%pp rise in the saving rate each year)
- A rapidly rising oil price (to perhaps \$175 a barrel by 2015)
- An unfavourable exchange rate for exporters (equivalent to approaching \$2/£ by 2015)
- A fall in FDI flows (equivalent to a loss of perhaps 50,000 jobs a year in the UK)

In the 'worse case' scenario, the impact by 2021 is:

A loss of 53,800 people when compared to the baseline (a fall of 1.2%)

362,500 jobs lost when compared to the baseline (a fall of 14.4% in total employment) – see Figure 9:

Figure 9: Impact on employment in Core Cities of lower level scenario



An increase in unemployment of 49,000 when compared to the baseline (an increase of 29%);

£16.5bn of lost GVA, again when compared to the baseline forecasts (a loss of 14.6%) – see Figure 10:

Figure 10: Impact on Core Cities' GVA of lower level scenario

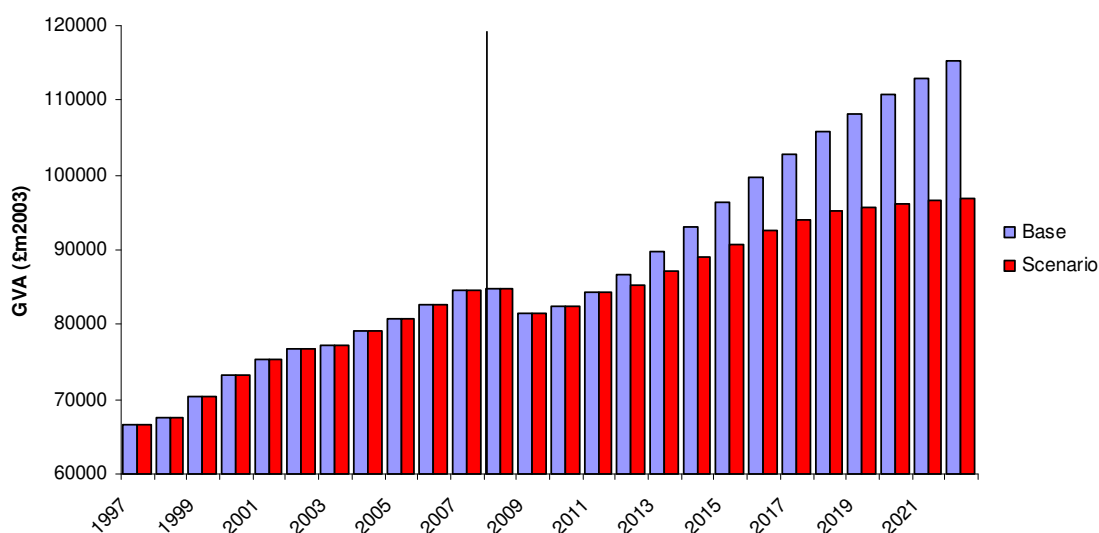


Figure 11 summarises the impact of a lower level scenario on the Core Cities

	Birmingham	Bristol	Leeds	Liverpool	Manchester	Newcastle	Nottingham	Sheffield
Direct jobs	-50.0	-25.1	-43.9	-24.2	-35.2	-18.9	-20.1	-26.5
Direct and indirect jobs within the city	-59.5	-31.1	-53.3	-28.7	-43.7	-22.6	-24.4	-30.8
Direct, indirect and induced jobs within the city	-70.8	-38.2	-53.3	-34.7	-51.4	-26.8	-28.9	-38.2
Total jobs (includes additional public services jobs as a result of higher population)	-73.7	-38.9	-66.4	-35.3	-53.6	-27.3	-29.8	-38.6
Total resident jobs	-45.5	-24.0	-46.8	-19.7	-18.2	-14.3	-12.3	-28.9
Additional people	-18.6	-4.2	-5.8	-2.7	-10.5	-2.2	-4.4	-2.9
Change in residential employment rate	-5%	-6%	-7%	-6%	-3%	-7%	-4%	-7%
Resident employment rate (baseline)	59%	70%	69%	63%	57%	65%	61%	64%
Resident employment rate (scenario)	54%	63%	61%	57%	54%	58%	57%	57%
Change in unemployment	-8.3	-6.2	-12.9	-5.2	-2.3	-3.7	-2.5	-8.1
Unemployment (baseline)	55.3	12.0	23.8	20.9	19.6	8.3	14.3	16.3
Unemployment (scenario)	63.6	18.1	36.7	26.1	21.9	12.0	16.8	24.4

Figure 12 below attempts to decompose the lower scenario into its individual components. However, as discussed above, identifying individual impacts of a lower scenario are difficult given the interaction between the components.

Figure 12: decomposing the lower scenario impacts

Scenario components	Difference from baseline (2021)		
	Population (000s)	Employment (000s)	GVA (£m 2003)
Aggressive PE cuts (c.£30bn additional cuts in PE over 10 years)	-19	-128	-4,635
Contraction in consumer spending (additional 0.2pp rise in savings rate p.a.)	-7	-45	-1,632
Rising oil prices (rising to \$175 a barrel by 2015)	-7	-43	-1,697
Unfavourable exchange rates (equivalent to approaching \$2/£ by 2015)	-11	-76	-4,608
Fall in FDI (equivalent to a loss of c.50,000 jobs p.a. in the UK)	-11	-81	-4,504
Lower scenario	-54	-364	-16,521

Source: Oxford Economics

Note: the individual scenario components do not add to the overall lower scenario due to the interaction of effects.

This means that under a more challenging scenario, an era of urban decline is possible. The challenges that the UK will face anyway will be worsened. Cities will struggle to kick-start the economy – with a £16.5bn price tag associated - and will face significant challenges in the labour market with rising unemployment and a continuation of the employment falls experienced during the recession. Measures need to be taken now to help cities to manage the impact of macroeconomic change and to mitigate the impact of public expenditure cuts.

4. Implications and Next Steps

Regardless of macroeconomic circumstances, the UK will face the challenges of a decade of slow job growth, structural shift to a knowledge intensive economy, and tackling climate change and rising energy costs in the context of constrained public expenditure.

Cities are the key to responding to these challenges and driving sustainable economic growth in the future. They are the places in which the future growth sectors will locate and the places in which most people live and work. They are the places in which demand for skills, infrastructure and a shift to a low carbon economy will be greatest. This suggests that cities need to develop the institutional capacity and financial flexibilities that will enable them to invest in knowledge intensive industries, skills, and climate change, and so drive sustainable economic growth over the next decade.

Assuming nothing else changes, the outlook for the UK is challenging, with a fragile UK recovery held back by restrictive fiscal policy. A plausible upper level scenario suggests potential for rises in employment and GVA and lower unemployment. An equally plausible lower scenario suggests that an era of urban decline is at least a possibility. The difference between the upper and lower scenarios is £33.3bn GVA, 752,500 fewer jobs and 98,500 more unemployed individuals.

Emerging implications of this study

To ensure that cities are the drivers of sustainable economic growth, and can tackle the challenges the UK faces, requires Government and cities to work together. Our analysis so far suggests implications for both – implications which will be developed in the next phase of work (with an expert group) into detailed policy recommendations.

The emerging conclusions of this work suggest that both Government and Core Cities have key roles to play in:

Building ‘anchor institutions’ at a local level. The crisis has exposed the gap in institutions at a local level. There is an urgent need for institutions that can provide capital for local firms, investment in infrastructure and can provide the cross-sector leadership capacity required for cities to be engines of growth as they were in the 19th century. Regional and local banks, strong universities incentivised to work with the cities in which they are located as well as look internationally and cultural assets all have the potential to be ‘anchor institutions’ driving growth and making the most of public sector assets. This means giving local authorities in cities the backing they need to deliver leadership for change.

Developing innovative ways of investing in low carbon infrastructure to stimulate recovery. Recent studies have shown that it is the combination of economic development with investment in physical infrastructure and the urban environment that inspires confidence and a critical mass of economic activity.^{xxii} However, in a more challenging property market, this also means recognising where lack of demand will require a different approach to office blocks and housing from that adopted in the boom.

Underpinning these challenges is the need to develop in a way that meets carbon and energy reduction targets.

Improving skills at all levels. The changing economy will create more demand for higher level and intermediate level skills, as well as making basic skills more important. This is demand that Government can respond to through investment and changing incentives for education institutions and cities can respond to by working closely with employers and skills providers.

For Government in particular, the implications are that:

Giving cities greater financial flexibilities and freedoms, with access to innovative financing tools, would support more effective investment in economic development and regeneration. Cities do not have the financial tools, freedoms and flexibilities available to their European counterparts, making it more challenging to undertake innovative schemes that enable investment in physical infrastructure and new firms. This suggests there should be both less ring-fencing of funds, a more 'outcome focused' approach to performance monitoring and increased capability to raise local revenue (e.g. through Accelerated Development Zones and Tax Increment Financing proposals now being considered by Government).

Investment in city-based innovation systems enabling new ideas and new businesses to flourish at a national, regional and local level would reap significant benefits: This requires investment at a national level in appropriate infrastructure and skills but also the creation of regional or city-based 'Innovation Panels' that can provide capital to potential 'gazelles' and invest in enabling infrastructure.

Taking a more 'place based' approach to investment in cities and city regions, concentrating investment to increase values, would generate efficiencies as well as be more effective. Integrating strategy and delivery across Whitehall within functional economic areas provides opportunities to realise efficiencies, improve the quality of public services, work more effectively with businesses to enable growth, respond to climate change and generate higher levels of economic activity. This would build on the Total Place review and support the role of local authorities as 'integrators' at the local level. Investment in infrastructure, housing, new institutions or other major initiatives should, wherever possible, be focused on those places that can derive most added value from them, economically, socially and environmentally. This is likely, in the main, to be our large cities.

For Core Cities, the implications are:

The eight Core Cities have the potential to work as a group to lead economic recovery and help to rebalance the economy after the financial crisis: Activities they could undertake as a group include: lobbying for innovation institutions to be located in each of the 8 Core Cities; lobbying for branches of the National Investment Corporation in all 8 Core Cities; and sharing labour market information across all 8 Cities, enabling skilled workers to search for jobs in multiple locations.

There is a need to take on the responsibilities and risks of greater financial flexibility and to invest in their asset base to drive up values. This will enable cities to invest in a way that enables growth of the knowledge intensive economy, as well as addressing the significant challenges of worklessness they will face under any macroeconomic environment post recession. However, this is closely linked to the ability to generate revenue, for example to undertake further prudential borrowing, issue bonds or use other financial instruments to capture value. For this to happen, cities need to be able to operate in a much less restrictive way than is currently possible.

Investment in skills and infrastructure to respond to the demands of the knowledge intensive economy and recognize the realities of a post recession world is vital: This requires significant investment in skills at all levels, addressing worklessness and demand for higher level skills, reflecting the different skills profile and employer demand in different cities. Delivery should occur at the level of the functioning labour market and better communication between commissioning bodies and local authority partnerships is vital to align supply with demand. A greater recognition of the additional barriers that some workless people face – personal support arrangements, language, childcare – will ultimately achieve better long term results. This means that commissioners and providers need to think through the jigsaw of provision with local partners.

Cities also need to invest in appropriate low carbon infrastructure, local energy supply, climate change mitigation and adaptation and housing in a way that responds to demand from businesses and individuals. This should be undertaken in a way that recognises the challenging realities created by the recession – for example, demand over the next decade for office space will be relatively muted and may be met by existing buildings, and housing targets will need some revision in the short to medium term.

Should strengthen their international trade links with old and emerging economies, capitalising upon their universities and building on their strengths as high quality environments to work, live and visit. Cities have a critical role to play in working with universities and businesses to enhance the UK's role as a magnet economy for the world's best and brightest, attracting more overseas students to come to our cities by choice (this is a knowledge service export) as well as enabling more of our education and healthcare institutions to sell their services overseas. Increasingly, they are also tourist destinations and this opens up further opportunities for international dialogue. Being internationally competitive means creating high quality local environments, the tolerant, open, diverse and inclusive places that highly skilled workers and businesses tend to locate. The Core Cities already possess many of the assets and infrastructure they need to play this role, and this should be capitalised upon.

This remains a draft and we would value your comments and feedback – please send any comments to Sarah Barnett at The Work Foundation on sbarnett@theworkfoundation.com.

Endnotes

- ⁱ Social Trends 2008
- ⁱⁱ Parkinson, M. et al (2006) *State of the English Cities*: ODPM
- ⁱⁱⁱ Ian Brinkley presentation to Knowledge Economy Steering Group, September 2009
- ^{iv} Work Foundation analysis of Labour Market Statistics, September 2009
- ^v Work Foundation analysis of UK Commission for Employment and Skills figures, August 2009
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- ^{xiii} Harding, A. Marven, S. and Robson, B. (2006) *A Framework for City-Regions*, ODPM: London
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- ^{xvii} See www.iied.org
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- ^{xix} Hunt, T. (2005) *Building Jerusalem: The Rise and Fall of the Victorian City*: Phoenix, CEOs for cities
- ^{xx} Jones, A et al. (2006) *Ideopolis Knowledge City Regions*: The Work Foundation
- ^{xxi} The model developed for this exercise could be developed further to add more precision and consider more fully the implications on city regions, displacement of jobs from other locations & the long term UK economic position consistent with the scenarios.
- ^{xxii} Anne Power presentation to Regeneration and Renewal's Northern Regeneration Summit, 20-21 October 2009

The Core Cities Group is a network of England's major regional cities: Birmingham, Bristol, Leeds, Liverpool, Manchester, Newcastle, Nottingham and Sheffield. They form the economic and urban cores of wider surrounding territories, the city regions. The Core Cities work in partnership to enable each City to enhance their economic performance and make real advances within a highly competitive international market, increasing their comparative standing and - in different ways - securing positive identities as places to live, work, visit and do business.

The Core Cities Group is a strong cross-city and cross-party collaboration with a track record of more than 10 years. Leadership across the Cities takes in all three major political parties.



The Work Foundation is the leading independent authority on work and its future in recession and recovery. Our programmes of policy, research and consultancy on the Knowledge Economy and Ideopolis Knowledge Cities investigate the drivers of economic recovery and what this means for places in the UK and internationally. Our relevant and accessible insights are the basis of our work with businesses and policymakers at the national, regional and local level: we equip them with evidence, advice, new thinking and networks.



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