

# Sustaining nationally-important economic success and tackling risks in South East England - an analysis of key data

May 2019



## Contributions from the South East are essential for Central Government spending and investment across the whole UK

- The South East economy contributed over £117.4bn to Central Government revenue in 2016/17.
- This is the 2<sup>nd</sup> highest contribution in the country and more than the Yorkshire & the Humber, East Midlands and North East regions combined.
- The net contribution (taxes minus Government investment) to Central Government finances from the South East was over £19.4bn in 2016/17.
- The South East is one of only three UK regions that makes a net contribution to UK public finances.

## A successful local economy is needed to safeguard future returns but the South East is becoming less competitive

- The South East saw no growth in labour productivity since 2010 and the region's competitiveness is slipping both in the UK and globally.
- The South East becoming less competitive is likely to have profound implications on the national competitiveness and growth and on the contribution that the South East makes to public finances.
- The South East receives the lowest public expenditure in the country and the lowest local government revenue settlements funding and grants from Central Government.

## The South East will need higher levels of investment to sustain competitiveness and to offset rising demand for local services

- Higher investment is needed to safeguard the South East's success and avoid a decline in the region's vital flow of tax return to Central Government finances
- More investment from Central Government is needed to help ease the pressure on the delivery of local services, especially for adult social care provision given demographic impacts from projected increases in the older population.
- To safeguard a successful economy it is necessary to invest in transport (a key physical enabler of growth) and the innovative capacity of the region. Investment will also have to be accompanied by an increase in skilled workforce.

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**‘Tax returns from the South East are essential for government spending and investment across the country’.**

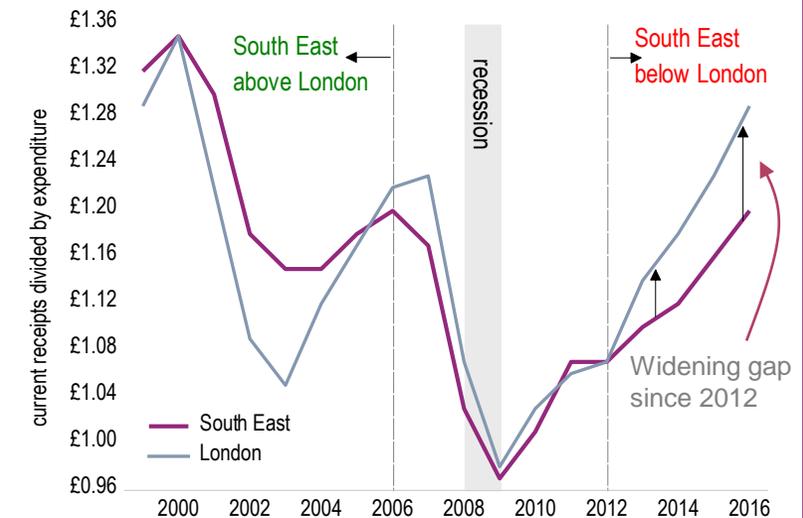
- **The South East is the 2<sup>nd</sup> largest net contributor to the Treasury in the country.** In 2016/17 the South East contributed almost £19.4bn more to the Exchequer in taxes than it received from Central Government spending. This is a return rate of £1.20 per £1 spent by Central Government in the South East.
- The South East's net contribution is 2<sup>nd</sup> only to London. The East of England is the only other net contributor whereas all other UK regions rely on receiving more than they give back.
- **The net contribution to public finances from the South East used to be the highest in the country.** In the eight years before the last recession (1999/00 – 2006/07) total net contribution to public finances from the South East was over £97bn or £12.2bn per annum, England's highest (slightly higher than London the only other significant net contributor with £92bn or almost £11.4bn per annum).
- **However, between 2007/08 and 2016/17 the South East net contribution slipped to 2<sup>nd</sup> place.** The region's net contribution totalled £81.2bn (£8.1bn per annum or 33% lower than before the recession), whilst London's net contribution totalled £135bn (£13.5bn per annum or 18% higher than before the recession).
- The return rate in the South East stood at of £1.35 per £1 spent by Government in the region in 2000/01 but by 2016/17 the rate had declined to £1.20, below London's £1.29.
- With the South East lagging behind, Treasury finances and Central Government spending and investment across the country are becoming increasingly reliant on London's economy alone.
- **The ongoing competitiveness of the South East is therefore of key importance to sustainability of UK public finances and it should not be taken for granted.**

Net contributions to UK public finances (£ billion, 2016/17)



Source: HM Treasury (2018)

Return rate to UK public finances, (per £1 spent)



Source: HM Treasury (2018)

**'Financial contribution that the South East makes to public finances depends on the success of its economy'.**

- **The South East is the 2nd largest economy in the UK but experienced sluggish economic growth.** With total economic output, Gross Value Added (GVA) of £267bn in 2017 the South East contributed over £117.4bn to Central Government revenue (mainly taxes and national insurance contributions), the largest in the country after London (£145.3bn).
- However, economic (GVA) growth in the 2<sup>nd</sup> largest economy was below the England average since 2010. Over this period economic growth in London (3.4% per annum) was on average close to double the growth rate in the South East (1.8% per annum).
- **Northern regions have received significant public sector investment since 2000 and most northern economies have performed relatively well compared to the South East and East of England** (the regions with the lowest Central Government spending per head).
- Between 2007/08 and 2016/17 the South East accounted for 15.7% of total Central Government revenue raised in the UK compared to London's 19%.
- However, London's share of Government revenue increased to 20% in 2016/17 compared to 16.2% in the South East. This again confirms the Treasury's increasing dependency on the performance of London's economy.

- Had the South East expanded at the same rate as England since 2010 its total GVA would have been £7.7bn larger in 2017, and had it grown at London's rate its GVA would have been £31bn larger. A larger economy would have made a significant net additional contribution to public finances, given that the South East gives more back to Central Government than it receives from it.
- **The South East is the 2nd most prosperous region in country in terms of GVA per head but with declining relative levels of economic prosperity.** With GVA per head of over £29,000 in 2017 the South East region was about 8% more prosperous than the UK average but the levels of economic prosperity in the region are well below London (over £20,000 per resident lower than in London).
- **Relative levels of GVA per head in the South East decreased from 14% above the UK average in 2000 to 8% above the UK average in 2017.**
- Economic output (GVA) is determined by how many people are in employment and their productivity. Total employment in the region increased by 300,000 since 2010, the 2<sup>nd</sup> largest absolute increase in the country but well below London's 844,000. However, **in relative terms (adjusted for the region's size) employment growth in the South East (0.9% per annum) was sluggish since 2010 compared to London (2.6% p.a.).**
- The region used to have 2<sup>nd</sup> highest job density in the country but it is now ranked 3<sup>rd</sup> in the UK with 0.87 jobs per resident of working age.

**‘A successful economy is needed to safeguard future returns to the Treasury but recent evidence suggests that South East is becoming less competitive’.**

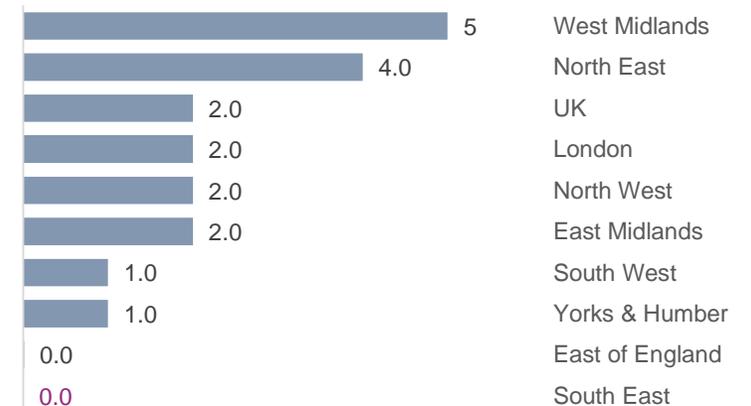
- **The South East was the second most competitive UK region after London in 2019 but is losing ground to other regions, based on a basket of indicators.**
- **Over the past four years the South East economy experienced the largest decline in competitiveness among all English regions.** The South East’s competitiveness decreased from 4.8 above the UK average (UK=100) in 2015 to 3.5 above the average in 2019.
- **Productivity is the main driver of economic growth and competitiveness over the long term but the South East is losing ground relative to other UK regions and its main European competitors.** The South East is the 2<sup>nd</sup> most productive UK region but it was one of only two regions that saw no growth in real labour productivity (output per hour worked) between 2010 and 2017. **Flat growth in labour productivity in the South East and the East of England explains subdued growth in productivity in the UK as a whole.**
- The South East is one of the most competitive regions in Europe but its productivity growth was not as strong as in several European competitors. The ratio of people in employment to population in the region is low and thanks to its less than favourable demographic outlook (the sharp increase in older population) it is expected to decrease sharply in the future.
- **The South East is becoming less productive and competitive and this may have profound implications on the UK’s competitiveness and also on the contribution that the South East makes to Central Government finances.**
- **Action is needed on key drivers of productivity including investment, enterprise, innovation, and skills.**

Change in Regional Competitiveness (percentage points 2015-2019)



Source: Cardiff University and Nottingham Business School (2019)

Real growth in labour productivity, 2010 to 2017 (%)

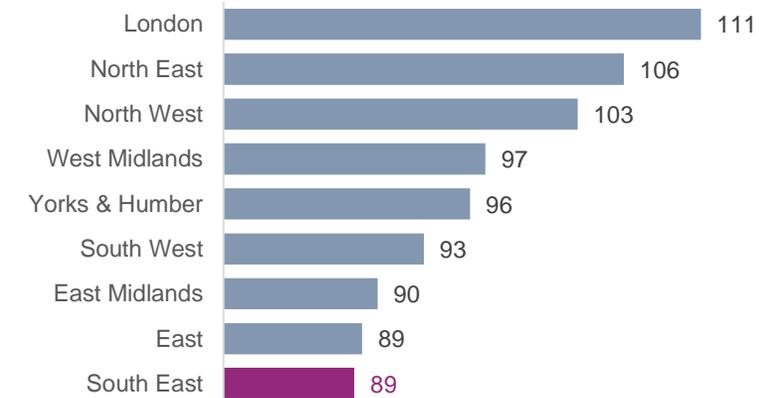


Source: ONS (2018)

## ‘Higher investment is needed to safeguard future competitiveness of the South East and the contribution it makes to public finances’.

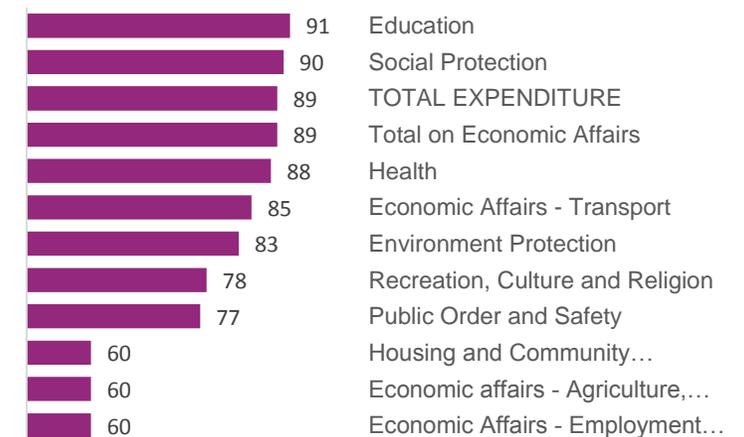
- **Public expenditure (central government plus local government and public agencies) on services and capital represents a major form of investment** which in turn is a key driver of productivity growth and regional and national competitiveness.
- **The South East receives the lowest public sector expenditure/investment per head of population in the country. This level of expenditure (capital and revenue) may affect the region’s competitiveness and future economic growth.** Total public sector expenditure (capital and revenue) in the South East was slightly over £8,100 per head in 2016/17, the lowest in the UK and, about 11.5% below the UK average. Expenditure in the North West was over £9,400 per head or 3% above the UK average. The North East received almost £9,700 per head or 6% above the UK average while London received almost £10,200 per head or 11% above the UK average.
- **The per head gap suggests that in 2016/17 the South East had a public expenditure (capital and revenue) deficit of over £9bn with the UK average and a deficit of over £18bn with London.** The South East has a large expenditure gap with the national average across most core expenditure functions, from housing and education to transport.
- Transport is a critical enabler of economic growth through movements of goods and people. **The region is the largest exporter of goods in the UK, home to critical national infrastructure (ports and airports) and a major national gateway to global markets but total public expenditure on transport in the South East is 15% below the UK average.**
- This **underinvestment in critical infrastructure could jeopardise growth in the South East and the Government’s aim to rebalance the UK economy towards exports and investment. Closing the region’s transport infrastructure deficit is crucial to securing the UK and the region’s competitiveness and future prosperity; and to the contribution that the South East makes to the Treasury both now and in the future.**

Total (capital and revenue) ‘identifiable public expenditure’ per head relative to UK average, 2016/17 (UK=100)



Source: HM Treasury (2018)

Total (capital and revenue) identifiable public expenditure per head by function South East, 2016/17 (UK=100)

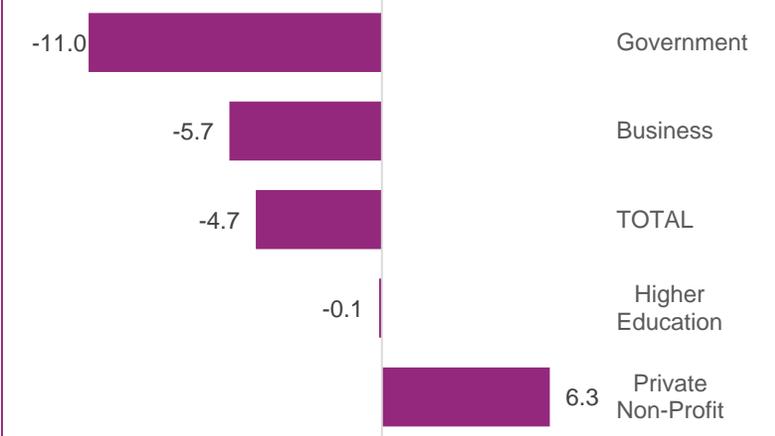


Source: HM Treasury (2018)

## ‘The South East is losing ground in enterprise and innovation, other drivers of productivity growth and competitiveness’.

- High-growth businesses (see Technical Box) only account for 6% of all businesses in the UK but account for half of all job creation. With 4,100 high-growth businesses in 2016 the South East has the second largest number of high-growth businesses in the country.
- The South East saw the second largest increase in the number of high-growth businesses between 2014 and 2016 but **in relative (adjusted for the size of region’s business population) term growth in high-growth businesses in the South East was sluggish.**
- The South East is home to over 80,000 businesses in high productivity sectors (professional, scientific & technical, information & communication and finance & insurance – see Technical Box). **Growth in number of businesses in these sectors was strong since 2010 but employment growth was the slowest in the country.**
- **The South East has been losing ground in terms of expenditure on R&D (a measure of innovation) relative to other UK regions since 2011.** Total public and private expenditure was less than 5% higher in 2017 than in 2011, the slowest increase in the country. The region saw a sharp decreases in its share of Government and business expenditure on R&D.
- **The South East benefits from significant foreign investment but there is intense global competition for private investment and there is no guarantee that the region will continue to receive the same level of investment in the future.** The region has over 8,800 foreign owned businesses, the 2<sup>nd</sup> largest number in the country and it received the 2<sup>nd</sup> largest number (1,082) of FDI (foreign direct investments) in the country since 2012/3.
- **By 2030 its infrastructure investment gap is projected to reach £15.4bn. However, the region has 2<sup>nd</sup> largest number of premises without the basic broadband connection.** Failure to invest in critical infrastructure will affect region’s competitiveness and may simply drive businesses overseas rather than to another part of the UK.

Innovation spending by government and business in the South East (change in the share of total UK R&D spending, 2011 to 2017, percentage points)



Source: ONS (2018)

The **fall in the share of R&D by business in the South East may indicate that the region is now perceived as being a less attractive location to undertake innovation.** However, if R&D is not undertaken in the South East then innovation expenditure by UK and foreign owned businesses may simply move abroad.

**Technical Box:** **high-growth business** is a business that achieves 20%+ turnover. A **high productivity sector** is one that on average sees high levels of economic output (GVA) per employee. A high growth business can be in any sector, whereas not all businesses in a high productivity sector will be high growth.

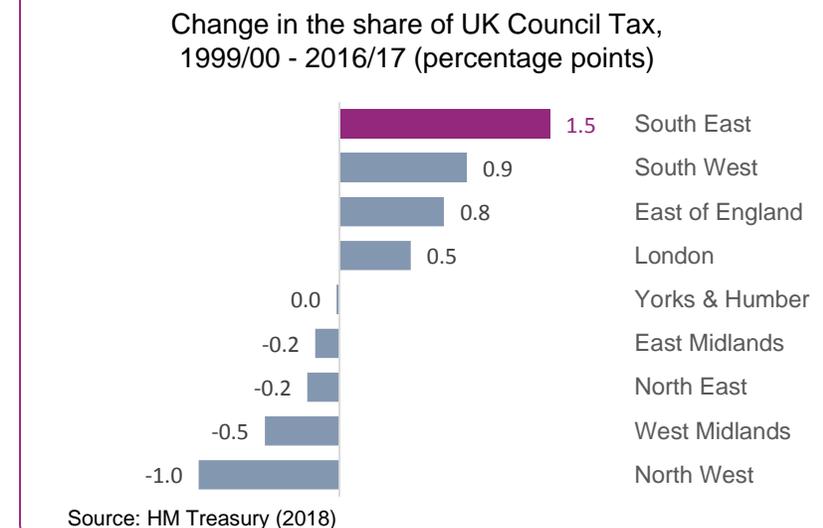
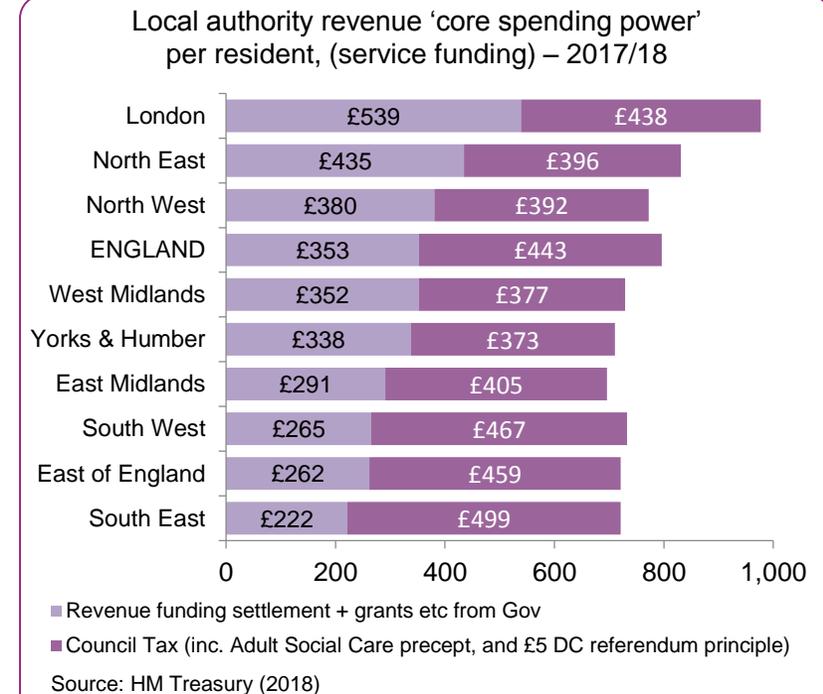
**‘Projected sluggish growth in South East’s workforce against the backdrop of untapped potential in large numbers of unskilled, low skilled and economically inactive people’.**

- The South East is the most populous region in the UK. The population is projected to increase from 9.2 million in 2019 to 10.2 million by 2041. **The region is projected sluggish growth in the working age population and this is likely to have economic consequences in terms of workforce availability.**
- The South East **could therefore have to look to fill gaps in the workforce with workers moving to the area** from elsewhere in the UK or abroad, but the **availability of affordable housing is likely to be a major factor that could impact on the ability of workers to afford to live in the area.** Alternatively, the region might have to rely on in-commuters.
- Commuting is already on the increase and **further increases in commuting that is not accompanied by investment will place additional strain on already congested roads and rail networks.**
- **Business productivity and investment, and the future demand for a skilled workforce** in the most populous region in the UK **could be impacted by congested transport networks.** As a result, **future business and workforce investments in the South East**, a region that currently receives the 2nd highest FDI (foreign direct investment) in the country, **could be diminished by congested networks prompting some businesses to consider relocating outside the UK.**

- **Skills is another driver of productivity (competitiveness) and the main determinant of wages and individual prosperity.** The South East has the 2<sup>nd</sup> highest concentration of highly skilled people (those with a degree or higher qualification) in the country but the region also has almost 883,000 people of working age with low skills or no formal qualification. Such a large number of low skilled and unskilled may undermine the South East’s success and impede its ability to compete in the global economy.
- **The South East has over one million economically inactive people of working age, second only to London, and 160,000 unemployed residents of which 67,000 are young people out of work. The large number of inactive and unemployed residents represents a large untapped source of potential labour.** However, since 2010 economic inactivity in the South East decreased by just 52,000, one of the slowest decreases in absolute numbers in England and less than half the number in the North West.
- Sluggish economic growth provided fewer opportunities since 2010 but **many unemployed and inactive people do not have the skills needed to compete in the labour market and require active support to find employment.** However, **public expenditure per head on employment based policies in the South East stands at just 60% of the UK average.** Higher investment in this area could boost employment and government revenue and reduce the need for Central Government expenditure on certain functions such as social protection.

**‘Higher government spending is needed to help ease the South East’s demographic pressures and especially adult social care provision driven by the fastest increase in older people in the country’.**

- **Sluggish growth of its workforce is not the only demographic challenge facing the South East.** The South East is the region with the largest number of residents aged 75+, 847,000 in 2019. The South East already has over 200,000 more older residents than the North West, the next largest region. **The population in the region aged 75+ increased by 86,000 since 2010 or by 25,000 more than in the next largest region.**
- On current population projections **the region will have 1.5 million residents aged 75+ by 2041, an increase of 657,000. This will be by far the largest population aged 75yrs+ in England and the largest growth in the number of older people in England.** The South East, like elsewhere in the UK will have seen strong growth in unpaid care provided by the family and friends but a system that increasingly relies on unpaid informal care is not sustainable in the long-term.
- **The South East has the lowest per head revenue settlement (funding and grants) from Central Government (part of the ‘core spending power’) in England.** In 2017/18 this stood at £222 per head, over 30% below the England average and well below the other regions.
- **The lowest local revenue settlement from Central Government means more of the South East’s overall council service spending comes from Council Tax.** The South East accounts for around 17% of UK Council Tax but even with Council Tax the region has the 3<sup>rd</sup> lowest average ‘core spending power’ at £732 per head or £256 below London.
- **Since 1999/00 the South East’s share of UK’s Council Tax increased by 1.5 percentage points, or close to double the increase in the share of the next highest region. Northern regions receive a much higher spending per head from Central Government and have seen decreases in their share of UK Council Tax.**





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