Reversing London's productivity slump

London's continued success cannot be taken for granted. It will need focused investment and policy attention, says Jon Tabbush

The UK is in poor shape, economically. Since the financial crisis, falling productivity growth has led to stagnant wages and living conditions – one analysis predicted that if we'd continued becoming more productive at pre-crisis rates, the average worker would be £10,700 better off every year. But although this is increasingly well-known, much of the conversation around the UK's 'productivity puzzle' presumes that the capital is the one part of the country in relatively good health. As the region of the UK with the highest productivity and wages, there is a widespread assumption that London can be expected to chug along happily while we focus on revitalising left-behind regions.

The problem is that London has also experienced a distinct slowdown in productivity growth since the financial crisis – one that is key to the UK's woes. Before the financial crisis, London enjoyed the highest productivity growth rate of any UK region. Every year from 1998 to 2007, the capital became nearly 3 per cent more productive – meaning we needed to do less work for the same amount of output. But from 2007 onwards, productivity growth flatlined. Rates have averaged 0.1 per cent - the lowest of anywhere in the country. Some of the challenges it faces are national, but not all.

ONS, Annual regional labour productivity

If the capital had maintained its previous performance, it would have been a third more productive in 2021. Up to the start of the pandemic, continuing pre-financial crisis trends would have meant productivity in finance and insurance would have been over 50 per cent higher, in information and communication, over 40 per cent. The growth model with which London flourished before the financial crisis is no longer delivering the goods.

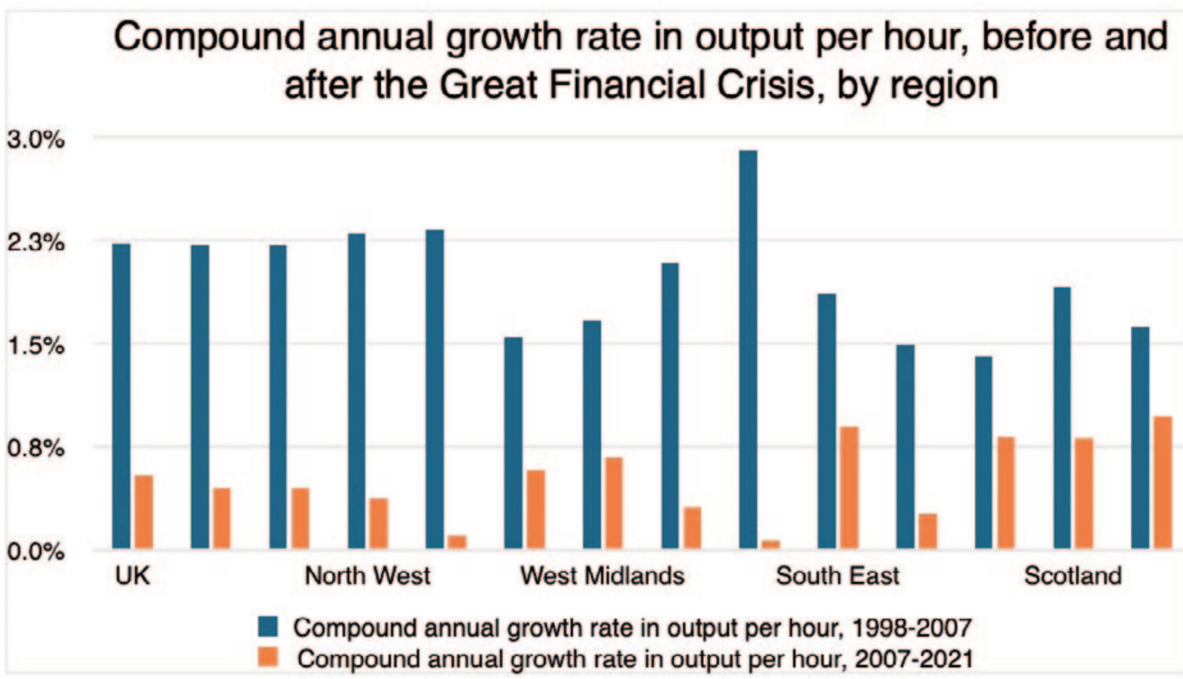
Productivity growth

It is hard to overstate how important productivity growth is to an economy. It is the key prerequisite for rising wages and, with them, buoyant tax returns to fund public services.

Although in terms of raw output, London recovered relatively quickly from the financial crisis, this was achieved by growing the number of people in employment – in simple terms, we threw more labour at the problem. Before the crisis, output had grown significantly faster than jobs. Afterwards, the situation was reversed. This meant productivity hit rock bottom.

Although some of the causes of that slowdown are national – low investment rates and policy uncertainty are problems across the UK – London has its own set of problems. For one, the capital's economy is biased towards high-value services, like finance and IT, that have been particularly hard hit by the global downturn in trade and increasing risk aversion and deleveraging.

But crucially, London's success has begun to create its own problems. Real estate is unusually expensive in the city, particularly for residential use. The marginal young worker, moving to >>>



ONS, Annual regional labour productivity

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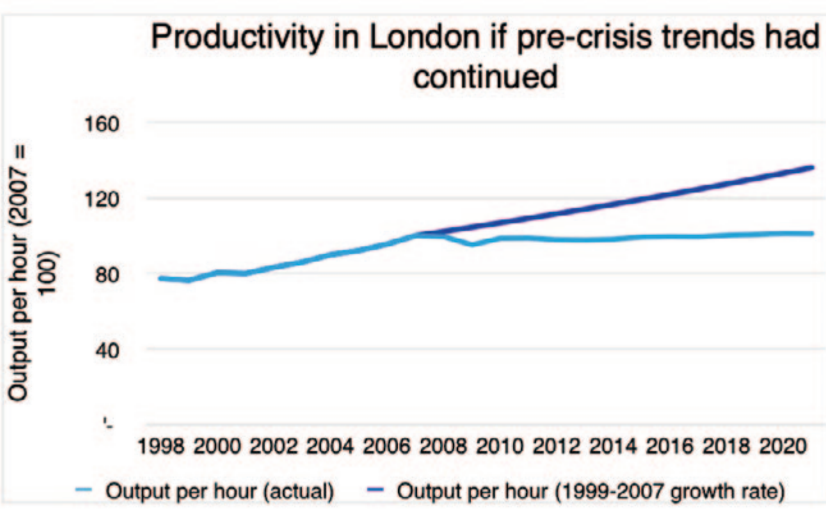
London, will rent privately – average rents now cost approximately 35 per cent of average incomes, the highest of any part of the UK. Those aspiring to own their own home face house prices 12.5 times the average salary – double the ratio seen 20 years ago.

Private rental affordability, England, Wales and Northern Ireland: 2022

Best estimates suggest that London would need to double the number of homes it builds every year for 15 years to fill the backlog of unbuilt homes and address our challenges with affordability and homelessness. If it doesn't, the housing crisis will continue to drag down our ability to innovate and grow. Median incomes in London are 17 per cent above the English average, but housing costs in the capital reduce this to 7 per cent. Talented workers won't be able to afford to live in the capital, and high-skilled migrants – the backbone of London's high-productivity economy – will be attracted by other cities with a lower cost of living.

Our failure to fulfil housing demand during London's boom years, as the population returned to growth and became more affluent, is one of the central causes of the rampant inequality generated over the 2000s and the poverty we are now plagued by, even after a vast expansion in employment. A fairer, more inclusive model of growth in the capital will have to address our housing shortage.

If we do not, it will eventually begin to affect London's deep, diverse labour market and its ability to benefit from agglomeration effects – the positive productivity impacts of highly skilled people working in close proximity to one another. More than two thirds of London businesses polled in 2022 reported shortages in key skills (rising from 58 per cent in 2021), of which 31



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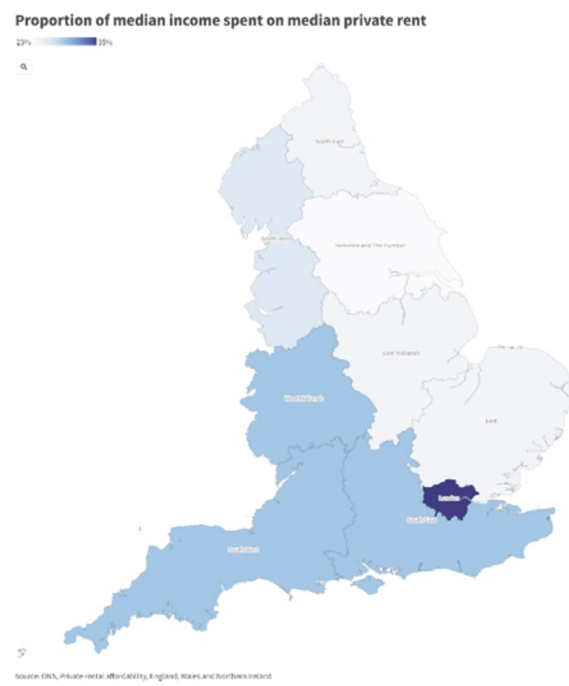


per cent reported that skills shortages had lowered their productivity, so the importance of this agenda can't be overstated. The staggering cost of real estate may have already attracted investment away from high-productivity uses – such as 'intangible' assets like intellectual property and software – to relatively low-utility uses.

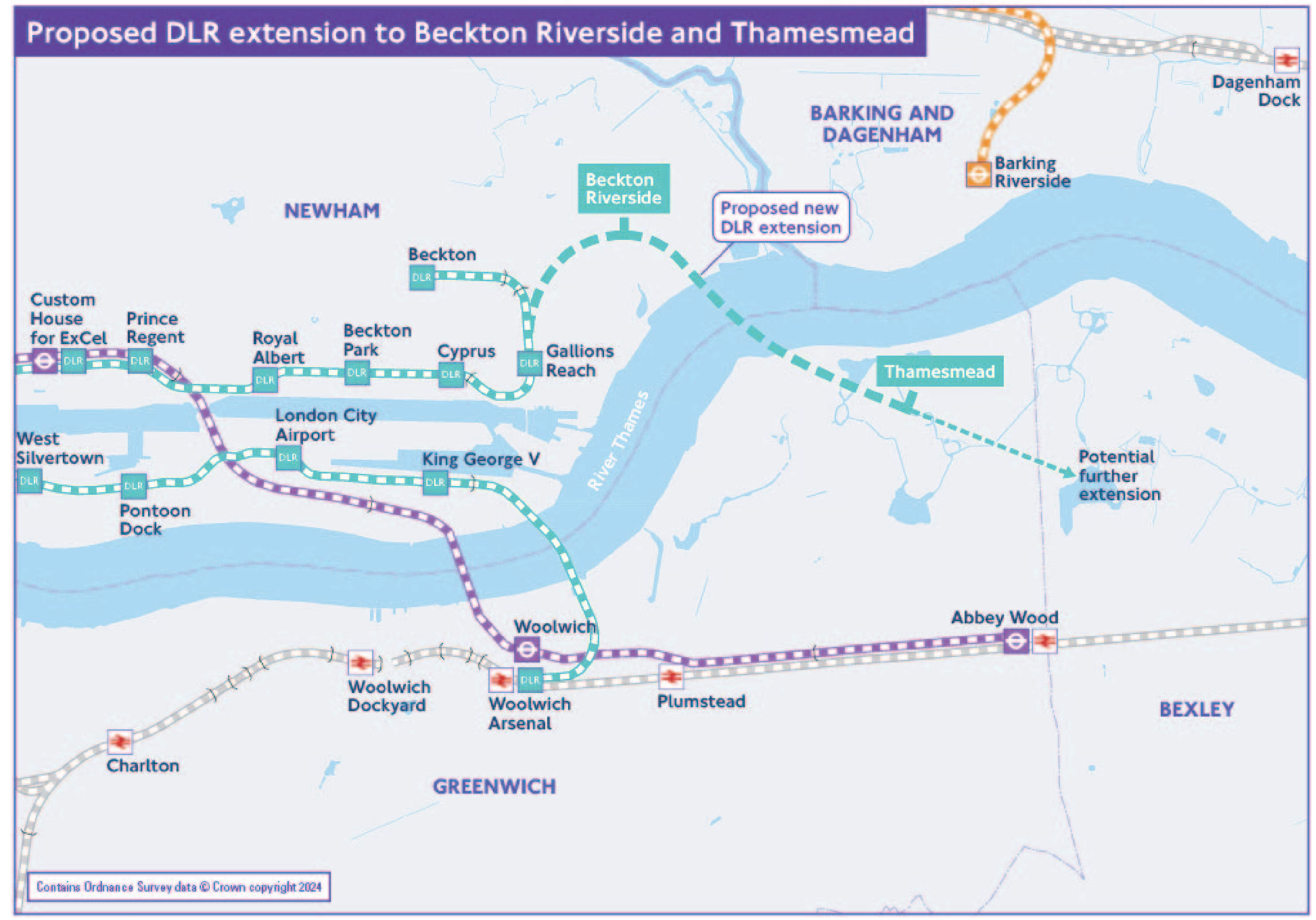
Our planning and land use systems slow growth and adaptation. In the decade after 2013, the proportion of residential planning application decisions that were made within statutory time limits (without a performance agreement) fell from 78 per cent to 46 per cent in England. This is perhaps unsurprising, given cuts of nearly 60 per cent to public funding for planning departments on a per capita basis since 2010, causing a 50 per cent fall in expenditure on planning.

But the problem is not just resourcing. Restrictions on where homes are permitted in the first place are a significant part of our housing shortage. As the government has recently argued, encouraging development on brownfield sites can contribute to addressing this – Michael Gove's recently announced 'presumption in favour of development' on such sites has been forecast to unlock over 11,000 homes a year. But such an approach has natural limits.

Only 29 per cent of London's 15-year housing need could theoretically be met using land on local authorities' brownfield registers, much of which, in practice, is unviable for development. And in many cases, unlocking brownfield sites will not just require relaxing planning regulations, but investing into infrastructure. One need only look at TfL's proposal to build 25,000-30,000 homes in and around Thamesmead – an excellent opportunity that will require a relatively small investment to extend the Docklands Light Railway over the river. Investigating how land value capture could fund further expansions in the network must also be on the table. Planning is important, but it isn't everything.

The final piece of the puzzle

We believe that the final piece of the puzzle is to be found in London's Green Belt. Although the Metropolitan Green Belt contains some areas of natural and ecological value, unlocking a small fraction of land outside these high-quality areas surrounding public transport stations could enable hundreds of thousands of new homes.



In partnership with representatives of local authorities of the Wider South East, through a revitalised system of strategic planning, the Mayor and national government could set up an expert commission to choose 10 sites in the Metropolitan Green Belt for development. New development corporations could purchase and assemble land, and masterplan urban extensions across these sites. They could use land value uplift from development to fund affordable housing, improvements to infrastructure, and investment into high-quality green space in other parts of the Green Belt.

But agglomeration isn't just about housing. Transport allows workers living far from the city centre for commute in, deepening the capital's labour market. And although London's public transport system is by far the best in the UK, due to years of sustained investment and competent, integrated management by Transport for London, it is far from comprehensive. TfL's data from 2019 showed that suburban rail in South London is a particular weak point – from 2010/11-2017/18, the London Overground saw 80 per cent of trains arrive on time, Southeastern only saw 62 per cent on its mainline and metro services, and Southern only 53 per cent. This leads to many South Londoners using slower bus services to reach Tube stations.

The creation of the London Overground in 2007, which replaced suburban rail services in North and East London, improved service reliability and frequency, leading to a boom in passenger numbers and enabling significant growth in housing around the network. A 2016 Centre for London study estimated that a similar programme in South London (known as 'metroisation') could provide an 130 per cent increase in capacity on the suburban rail network and accelerate the development of approximately 13,000 additional homes in south Central London, alongside enabling the creation of 3,000 extra homes through higher densities.

Investments like these will tackle the housing shortage, reducing the crushing burden of rent and house prices on Londoners, while enabling London's labour market to keep growing in depth and complexity. It will allow the city to stay competitive in the international market for highly skilled talent, an essential requirement for succeeding in growth industries. And beyond its benefits to productivity, it will make the city fairer and more liveable.

London's continued success cannot be taken for granted. It will need focused investment and policy attention, despite its political unpopularity. But it is a prize worth having.

In our recent report, Rebooting London's Economy, we laid out the components of a new local industrial strategy to increase productivity growth in the capital – from the investments into housing and transport described above, to devolving power and finances to enable a new, locally designed skills and apprenticeship system. ■