Jon Tabbush and Josh Cottell

Rebooting London's Economy

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Nonetheless, the findings, interpretations, and conclusions presented in this report are the result of independent research conducted by the authors. The views expressed are solely those of the authors, and all errors and omissions remain our own.

Summary

London's economy is key to the nation's prosperity. It is by far the most productive region in the UK and a key driver of economic growth. This results in a concentration of well-paying jobs, as well as a disproportionate contribution to the nation's tax revenues. However, after a long period of rising productivity in London, the amount of value produced per job and per hour worked in the capital has hardly grown since 2007. This slowdown in London's economy is a major factor behind the slowdown in the UK's economy. And even when productivity was growing, the benefits of that growth were often only accessible to a narrow a slice of the population. Meanwhile, London's economic activities must face up to the growing challenges of the climate crisis. This report explores how to reboot London's economy, so that it is more productive, while being more inclusive and sustainable.

Chapter 1 introduces the challenge and the opportunity, and in Chapter 2 we describe London's economy today and how it compares to other regions in the UK and globally. In Chapter 3, we explore in detail what needs to happen to make London a more competitive place to do business, how to attract workers and develop their skills, and how changes to tax and governance at the national and regional level can support economic growth. In Chapter 4, we conclude this report.

In this report we argue that rebooting London's economy will require a different model to the one that succeeded in the 1990s and early 2000s. This report aims to build on existing research and discussions with a range of experts to discern what that model could look like. Our discussion of public policy changes seek to reflect that economic productivity matters to living standards in London and the UK, and that how inclusive and sustainable London's economy is matters too. It is beyond the scope of this report to address fully how to achieve these three aims together. Instead, our recommendations seek to build on three key ambitions for a new local industrial strategy for London.

Rebooting London's economy will require investment, therefore several of our recommendations call for changes to Government spending, either at the national level or by granting the Mayor of London more powers to raise funds and direct investment to influence economic growth. But this investment will lead to returns. Recent history tells us that when London's economy grows, it boosts the UK's economy too, increasing the number of high productivity jobs and increasing total tax revenues.

Making London more attractive to productive businesses

- High housing and office space costs in London, driven by under-supply, are stifling investment in more productive assets and inflating the cost of living and doing business here. In October 2023, rent on new tenancies in London accounted for an average of nearly 39% of tenants' income, up from 35% a year earlier.[1] Insufficient funding for affordable housing, an under-resourced planning system, and restrictions on building on strategically identified areas of the Green Belt are limiting supply.
- The UK suffers from low levels of investment, particularly in research and development (R&D). This underinvestment limits economic growth and hinders innovation, particularly when R&D per job in London is lower than the median UK region.
- Our transport system has enabled London to become an economic powerhouse and helps millions of Londoners and visitors access the brilliant opportunities our city has to offer. However, London's public transport network isn't doing enough to connect the millions of people who live in Outer London to the capital's most productive jobs.

Attracting workers and developing their skills

- London has a well-educated workforce with the highest proportion of university graduates in the UK. However, London faces significant skills shortages, particularly in vocational areas. Fewer apprenticeships are completed in London compared to other English regions, impacting sectors like construction and various green industries, which have major skills shortages.
- Post-Brexit immigration policies have shifted the composition of London's migrant workforce, with an increase in non-EU migration. While this hasn't had the negative effect on skilled migration to London that was once feared, more can still be done to make London attractive to high-skilled workers.

Reforming governance and taxes to boost growth

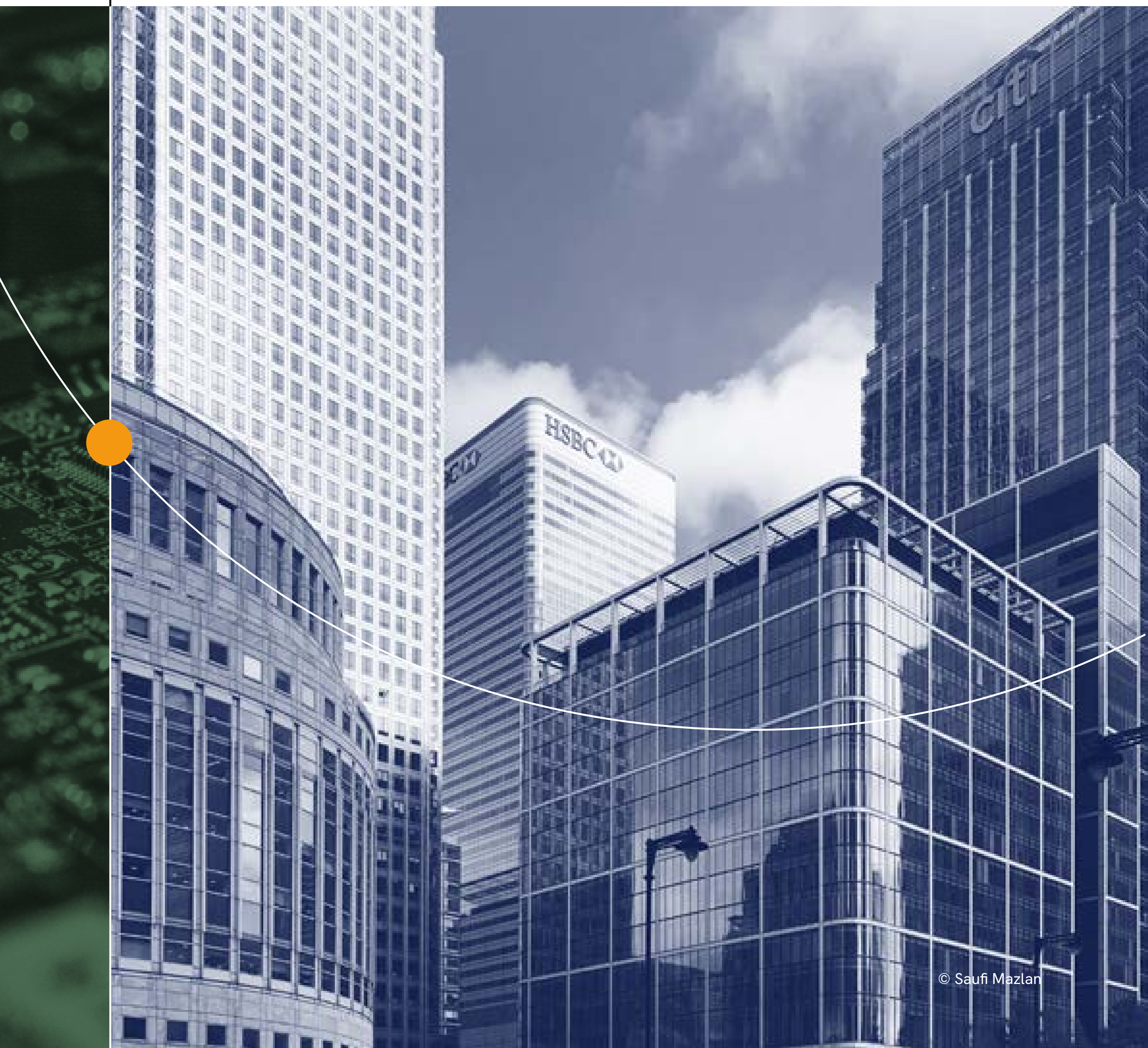
- The UK's relatively centralised system of government limits London's autonomy compared to other global cities and local government is not consistently empowered to permit growth. Greater fiscal power for local government, as seen in cities like New York and Paris, is associated with increased GDP per capita and productivity.
- Devolution could enhance strategic capacity for investments and planning in areas like public transport and skills development.
- Council tax and business rates are critical sources of funding for local government in England but both are in need of structural reform. Council tax is regressive, and charges are based on arbitrary property values, while business rates disincentivise investment.
- Reliance on short-term, competitive funding pots for grants to local government is time and resource-intensive and reduces strategic planning capacity. Devolved funding streams could be used to create locally specific, tailored programmes to address London's challenges over the long term.

The UK's economy is significantly underperforming comparable countries. For instance, typical households in the UK are almost 10% poorer than those in France, while those on low incomes are more than 25% poorer.[2] This is leading to missed opportunities to improve living standards. Whatever the story of how we get things moving again, the capital will be key to it. London and the UK must succeed together, and we hope that this report contributes to the conversation about how to reboot London's and the UK's economy.

Note on methods

We reviewed the existing literature on London's productivity and its historic drivers and analysed a range of publicly available data to describe the nature of the problem. We hosted two roundtables and conducted a series of interviews with experts on a variety of aspects of London's economy in which we explored what they would prioritise to improve London's productivity growth, while making the economy more inclusive and sustainable. However, the conclusions of this report and any errors are the authors' own.

Chapter 1
Introduction

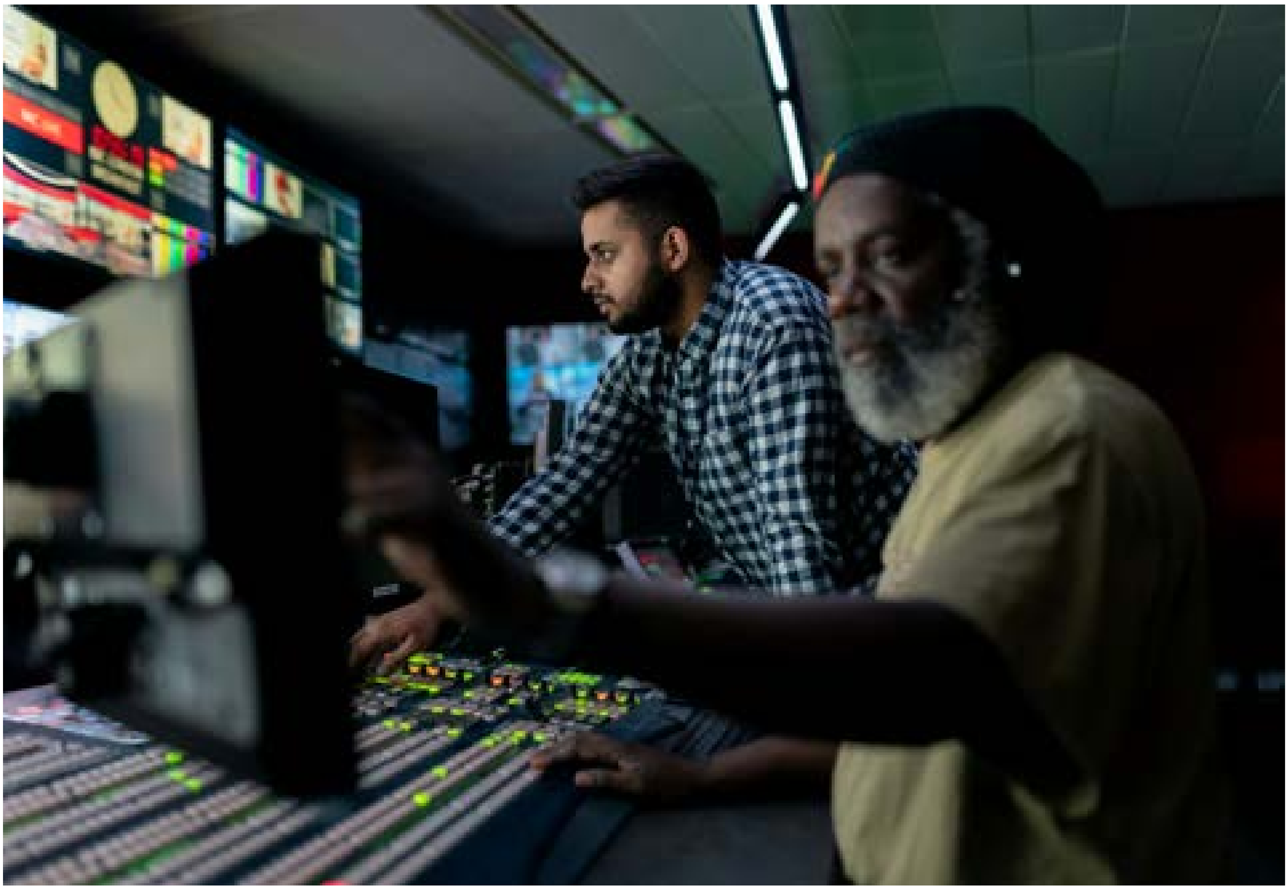


London's economy represents around 25% of the UK's output,[3] providing over 6.5 million jobs (18% of the UK total)[4] and contributing 21% of the UK's tax revenue.[5] It is more productive than any other English region, meaning that more is produced per job or per hour worked—rising productivity has helped to drive living standards, both inside and outside the M25. However, the evidence suggests that London's productivity growth has slowed from approximately 3% per year in the nine years up to 2007, to under 0.1% per year since. This report explores how to change that.

Growth in an economy's productivity is among the most reliable ways of boosting the average household's living standards. However, for it to lead to improvements in incomes for the average household, public policy needs to pay attention to the distribution of incomes too. The UK has higher levels of inequality than any large European country,[6] and London is considerably more unequal than the country as a whole.[7] High levels of inequality often lead to extra potential income disproportionately benefitting those already on high incomes.

Finally, while London's urban environment means that greenhouse gas emissions per person are lower here than any other UK region, and falling, the capital still contributes 10% of England's total CO_2 emissions.[8] The Mayor of London has set a target for London to be net zero carbon by 2030. Making London's economy more sustainable need not hinder economic growth; in fact, leading the way in the development of green industries could be a boost to London's economy, as demonstrated by the accelerating decoupling of emissions from growth across the UK in the last decade.

This report explores how to boost London's economic productivity, through a new local industrial strategy, while ensuring that more people benefit from that growth and ensuring that we continue to decouple economic growth from greenhouse gas emissions.



Chapter 2
London's productivity problem

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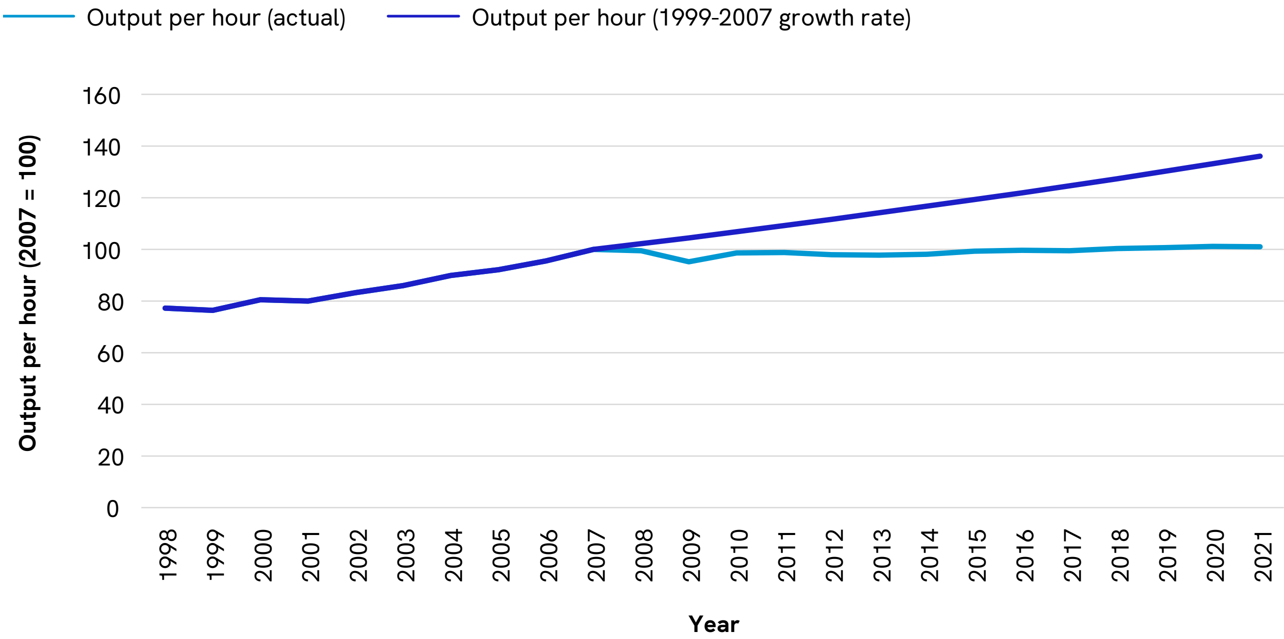
Productivity growth in London has flatlined since 2007

Before the 2007-2009 Financial Crisis, productivity growth, as measured by growth in economic output per hour worked, had averaged just under 3% per year since 1998. Since the crisis, it has slumped to just 0.1% until 2021, below the UK average.[i]

Productivity in London in 2021 was 35% lower than if pre-crisis trends had continued

Figure 1: Output per hour, actual and if it had grown at the compound annual growth rate of 1997-2007 from 2007-2021



Source: ONS, Annual regional labour productivity. Notes: Latest data available is for 2021.

If growth rates before the crisis had continued, productivity would have been 35% higher than it was by 2021.[ii] The figures are even starker for some of London's key sectors, for which data is available up to 2019 – at which point productivity for London as a whole would have been 41% higher than it was had the trend up to 2007 continued. Productivity in finance and insurance would have been 53% higher. For information and communication, the figure is 43%.

It is difficult to estimate how much this slowdown in productivity growth has cost the London economy. Had productivity continued to grow at a similar rate, London might be different in any number of ways, from the number of jobs and hours worked to the capital's sectoral make-up, to the rate of technological change. Further, the events of the Global Financial Crisis revealed that at least some of London's economic activities up to 2007 were unsustainable, given that the measurement of financial sector performance interprets ballooning growth in balance sheets as growth in output.[9] However, we might look to comparable global cities to see how much productivity London has missed out on. A recent study did just that, comparing London to New York, Paris, Stockholm and Brussels. It found that if London had matched the average productivity growth of this set of capital cities from 2007 onwards, London would have generated an extra £54 billion in 2019, or over £6,000 per Londoner.[10]

i. Average growth rates are calculated using Compound Annual Growth Rates (CAGR) throughout.

ii. The slight disparity between 2019 and 2021 is due to slight improvements in productivity seen during the pandemic, resulting from a rise in unemployment and inactivity.

Productivity

Productivity is the ratio of how much labour, measured in hours worked or jobs filled, is needed to produce a set amount of economic output. If a worker takes two hours to make a widget by hand and another uses a machine to do it in one hour, the latter is twice as productive. As well as 'capital deepening' of this kind, productivity growth can be caused by workers' skills and firms' management practices, the use of ICT, or external factors, like the choice to export products or exploit 'agglomeration' effects by basing firms near other collaborators and competitors, among many other factors.

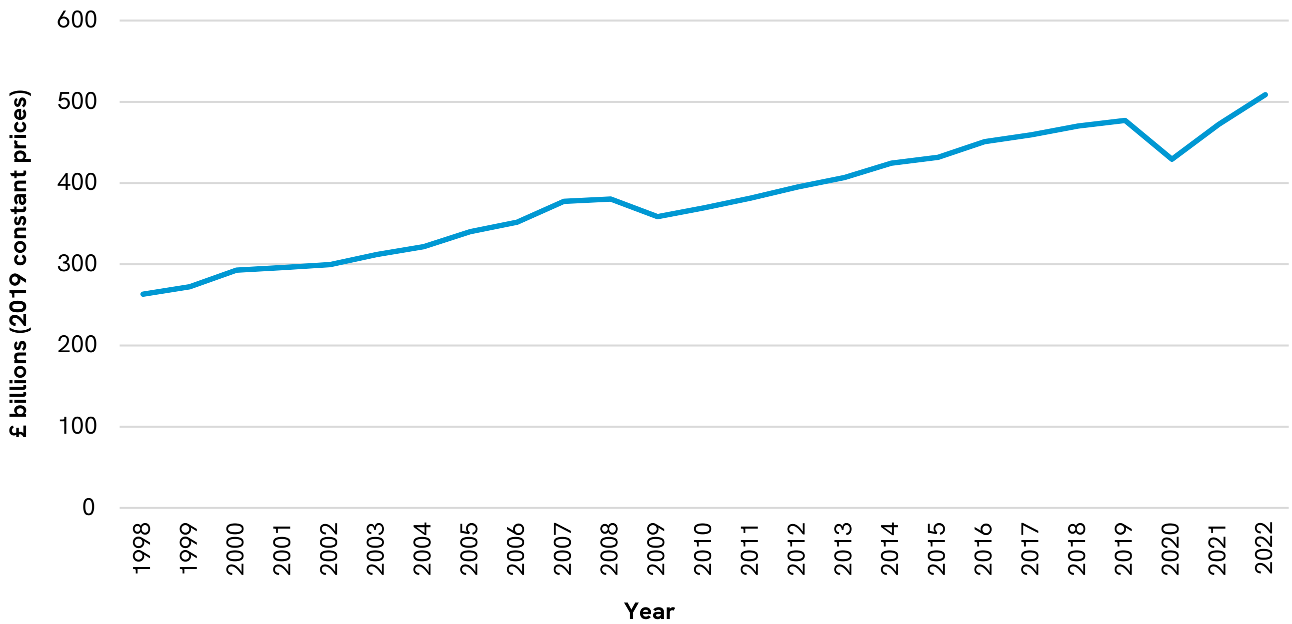
Productivity growth is the key determinant of a country's ability to raise incomes and living standards more broadly over the long run.

Rising employment has coincided with falling productivity

Although the Global Financial Crisis caused a nation-wide recession, output in London returned to growth relatively quickly.

Output in London recovered quickly from the Great Financial Crisis

Figure 2: GVA at basic prices, 2019 constant prices

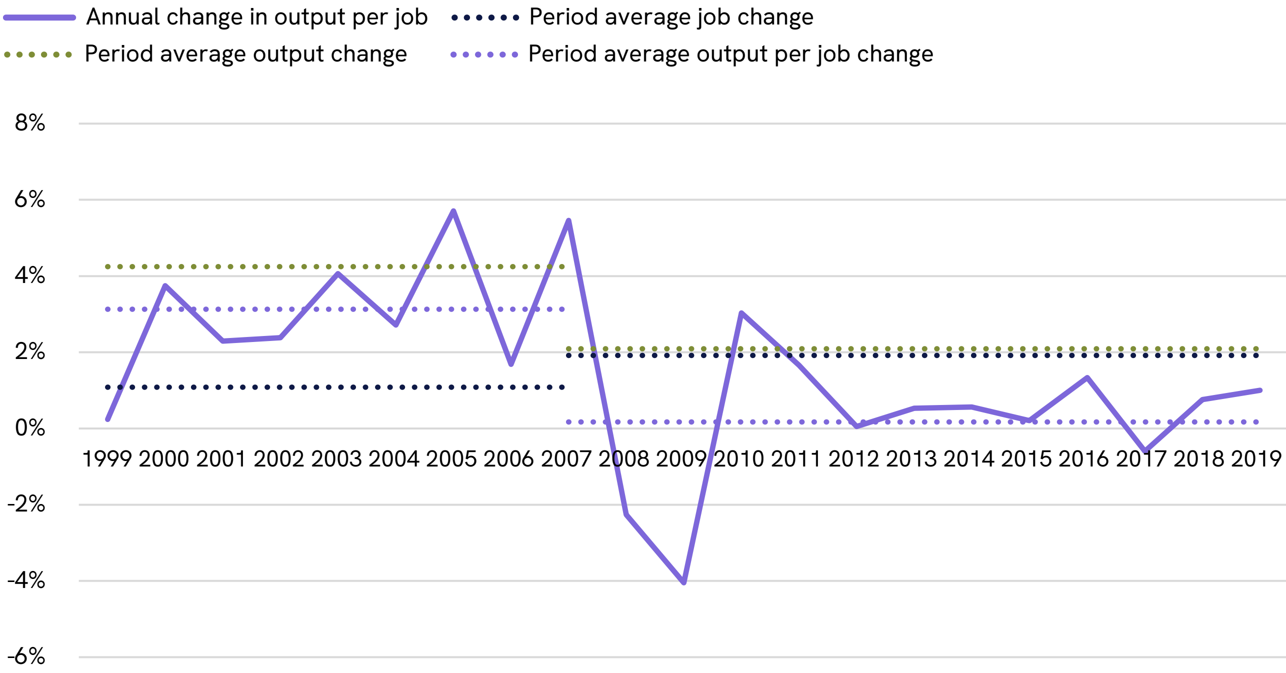


Source: GLA, Medium Term Economic Forecast

Since the Global Financial Crisis, London's economy has been one of high employment. After an initial drop in employment rates, job growth began to surpass the figures seen during the 2000s. The employment rate among people aged 16-64 stayed flat from 1998 to 2007 at 69%, but had risen to 75% by 2019.[11] Low output growth and relatively strong employment growth meant one thing – flat productivity growth. The same trend is visible when comparing output and productivity to the number of hours worked – meaning that the phenomenon was not caused by more workers each working fewer hours. This suggests that since the financial crisis, falling productivity growth has been disguised by increasing labour – we have been working harder, not smarter.

After the crisis, job growth overtook output growth, reducing productivity growth

Figure 3: Annual change and compound average growth in jobs, output, and output per hour, London



Source: ONS, Region by industry labour productivity

None of this is to say that productivity is all that matters or that employment growth is a bad thing. If London suddenly lost a large proportion of its jobs but maintained output, productivity would increase, but many people could be excluded from the labour market and suffer worse life outcomes as a result (barring redistribution). Similarly, if London successfully encouraged marginalised unemployed or inactive residents into work, productivity would likely fall—at least initially. Many important activities are unlikely to directly impact London's aggregate productivity – health and social care being a key example – but are nonetheless very important in their own right and because they create positive externalities that boost productivity in other sectors, making them vital to keeping the capital on its feet.[12] Meanwhile, many important activities like unpaid care aren't directly captured in measurements of economic output despite being of immense value.

However, as the economist Paul Krugman once argued 'productivity is not everything, but in the long run, it's almost everything'.[13] Higher productivity growth could help us to achieve the outcomes we want – growth in incomes and job quality and more money for public services – without simply increasing the number of hours we work or using more resources.

Productivity in London and the UK

Although London's productivity is the highest of any UK region, it is increasingly falling behind other equivalent international cities.[14]

London's feeble productivity growth does not just matter to Londoners. It is a major part of the UK's productivity puzzle – a problem which is agreed to be a central cause of the country's economic stagnation in recent years.[15] The Resolution Foundation's Economy 2030 Inquiry concluded that the UK's productivity gap with France, Germany, and the US cost £3,400 in lost output per person since 2008, leading to more than a decade of stagnant wages. Productivity growth across the country is below average among OECD countries and GDP growth has been dependent on more hours being worked.[16]

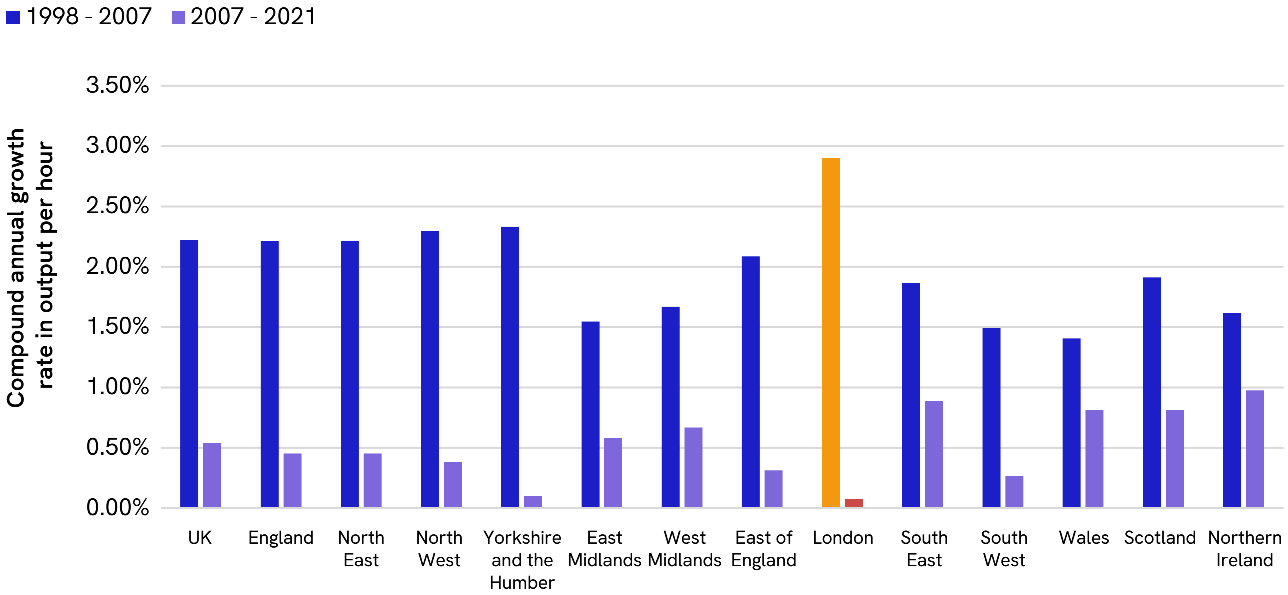
Leading explanations point to a lack of investment, both public and private, into the British economy. For decades, the UK has had the lowest investment rate, as a percentage of GDP, of the G7 and consistently one of the lowest rates in the OECD.[17] This is particularly the case with investments into 'intangible' capital – non-physical assets like intellectual property or software. Public investment has been remarkably weak, generally in the lowest third of OECD countries for the last two decades, and almost uniquely volatile, reducing its effectiveness.[18] This was driven by more than a decade of austerity, which some argue contributed to an overall decrease in aggregate demand and public infrastructure, in turn quashing the incentive for investment.[19]

Relatively low wage growth and growing employment are often argued to have facilitated this trend, allowing employers to maintain or grow output without investing capital into productivity-improving technologies or activities. Poor quality management and low take-up of technology (known as 'technological diffusion'), like the insufficient use of basic ICT in many businesses, are also widely blamed for sluggish performance.[20] And falling rates of employer-funded training support this picture – training spend per employee has fallen by 28% (in real terms) since 2005 and is now half the EU average.[21] Complementary explanations cite a 'long tail' of low-productivity firms in the British economy, below the elite of high-productivity innovators, that have slowed down progress.[22] However, there is evidence that focus on this long tail is unlikely to increase aggregate productivity significantly, due to their limited potential to export.[23]

London's story is a key part of the UK's poor productivity performance – one study calculated that it was responsible for 42% of the slowdown.[24] London went from having the strongest productivity growth of any region from 1998-2007 to having the weakest from 2007-2021.

London went from having the highest to the lowest productivity growth rate of any region

Figure 4: Compound annual growth rate in output per hour, before and after the Great Financial Crisis, by region



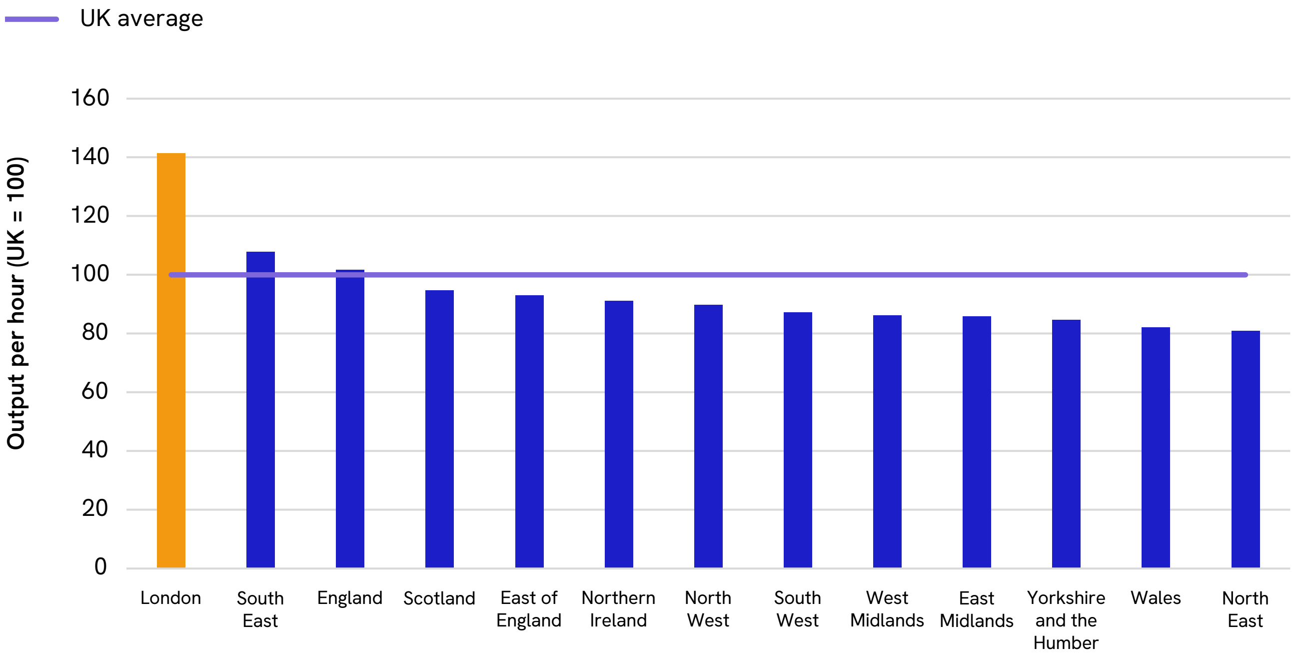
Source: ONS, Annual regional labour productivity

If London's productivity had even grown at the UK's relatively low 2007-2021 rate over the period, it would have been 6% higher by 2021.

But although London is critical to the UK's productivity problem, its story differs from much of the rest of the country. It remains by far the most productive region of the UK – in 2019, only London and the South East exceeded the UK average for productivity. Among city-regions, London is more than a quarter more productive than the second-best performer among the ten regions with the most jobs (Edinburgh and South East Scotland).[25]

London is by far the most productive region in the UK

Figure 5: Output per hour, 2021, by region (UK = 100)



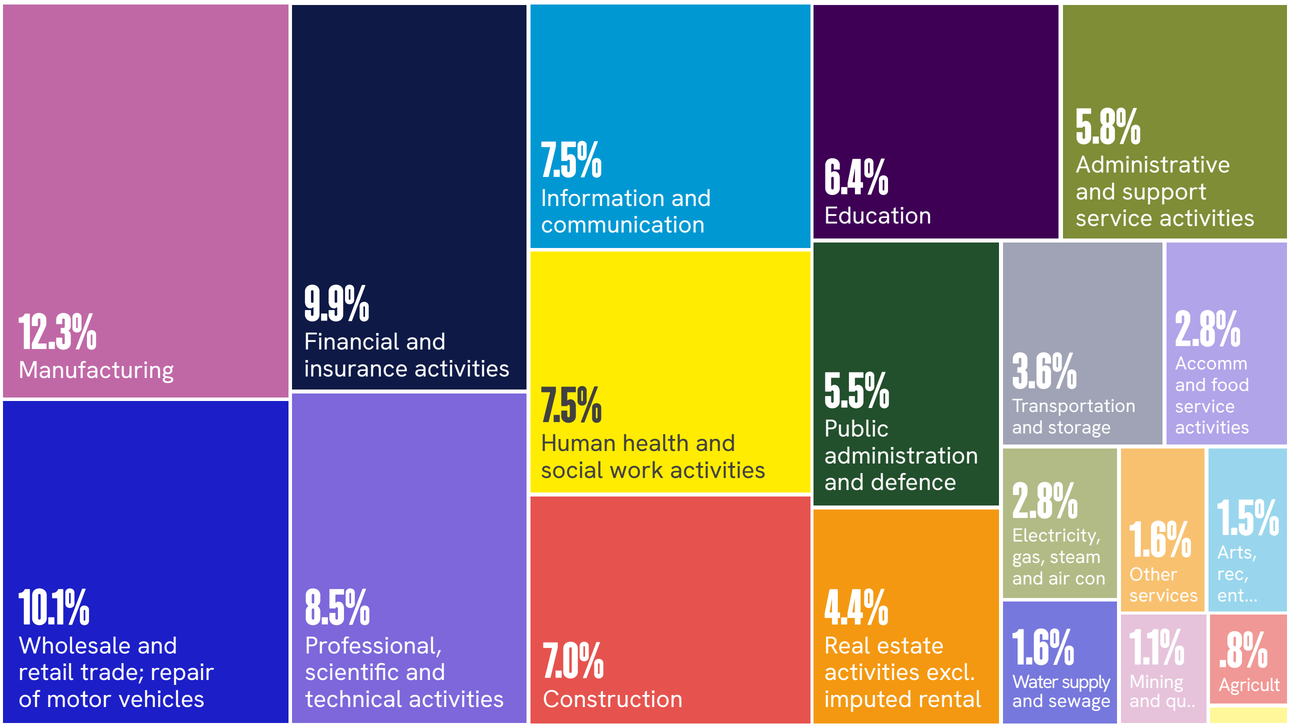
Source: ONS, Annual regional labour productivity. Notes: Latest data is for 2021.

The gap between London and the rest of the UK is both because London's firms are more productive across the board than elsewhere and because of London's specialisations in high-productivity sectors.[26] The former explanation is bound up with the capital's deep labour market, the 'agglomeration effects' of clustering many skilled workers and productive businesses in a dense urban area, and historic investments into public infrastructure and education in the capital.

The latter is that the capital's economy is compositionally different from much of the rest of the country. Across the UK, labour-intensive sectors like education, healthcare, and administrative and support services make up the largest proportion of output, along with productive but declining sectors, like mining and manufacturing. By contrast, London's three largest sectors in 2021 were financial and insurance activities, professional and scientific activities, and information and communication. These are all known as 'knowledge-intensive business services' – they are often 'tradable', meaning they can be sold to other places, and are characterised by high productivity, requiring relatively few labour-hours and jobs per pound of output. In 2021, London provided 46% of the UK's service exports, growing up 8 percentage points since 2016, with particularly strong growth in the information and communication and professional service sectors.[27]

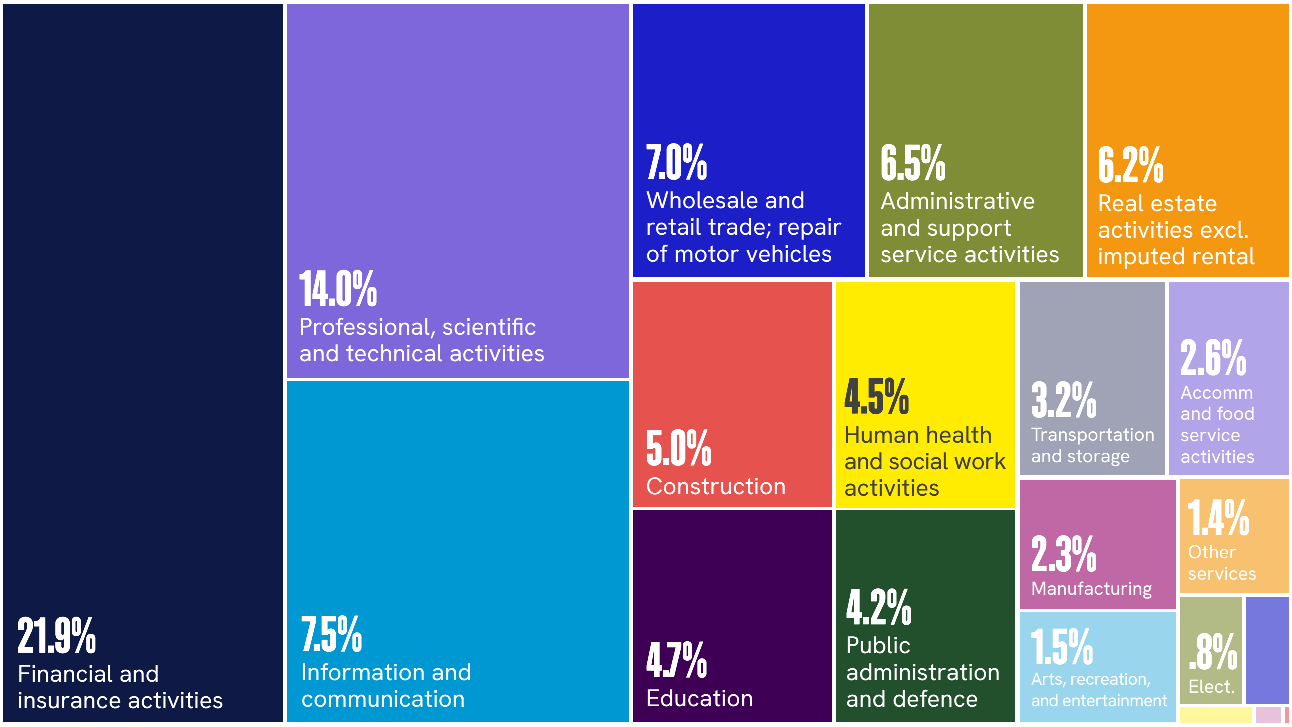
Manufacturing and the car industry are most prominent in UK output

Figure 6: Proportion of total output by sector, 2021, UK



London's output is dominated by high-value services

Figure 7: Proportion of total output by sector, 2021, London



Source: ONS, Regional gross value added (balanced) by industry. Note: Imputed rental is excluded from real estate activities.

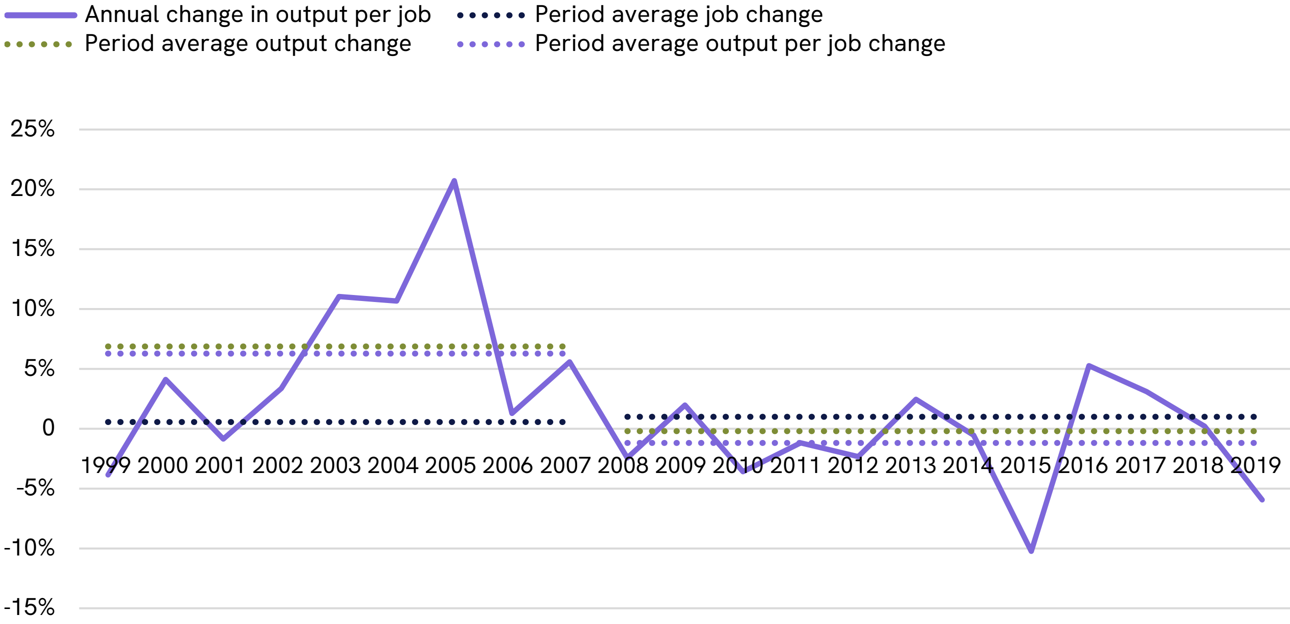
Deindustrialisation and the turn across the developed world towards the service sector and the knowledge economy created the widening gap between London and the rest of the UK, particularly compared to manufacturing-heavy areas.

However, this compositional difference was also at the root of the capital's productivity growth slowdown after the financial crisis. The capital was unusually exposed to the forces that have hit developed economies worldwide. Increased regulations after the crisis have seen a degree of deleveraging and increased risk aversion in the finance and insurance sector, a key productivity growth driver. And London's role in an increasingly globalised world economy also made it vulnerable. A decline in global trade volumes is also likely to have particularly impacted London, with its unusually high exposure to world export markets, particularly in its financial services industry.[28]

Industries like the finance and insurance sector, as seen in the chart below, saw negative compound annual growth rates in their productivity in the 2007-2019 period, with the average number of jobs increasing at a faster rate than the total amount of output from those jobs. Several other sectors that drove productivity growth in the capital before the crisis also saw declining figures, including professional services and information and technology, among others.

Finance saw negative productivity growth after the crisis

Figure 8: Annual change and compound average growth in jobs, output, and output per hour, finance and insurance activities, London



Source: ONS, Region by industry labour productivity. Notes: Latest sectoral data available with full job-output breakdowns is for 2019.

Why is London different?

But although much of the developed world was affected by productivity slowdowns, London's productivity growth is unusually low among other global cities – since 2007 it has underperformed New York, Paris, Stockholm, and Brussels.[29] The capital's poor performance must therefore also have been exacerbated by domestic factors. A report from Centre for Cities on London's productivity slowdown blamed the problem on falling investment into intangible assets due to rising real estate prices, along with the negative effects of high housing costs and restrictive immigration on the capital's ability to attract high-skilled workers.[30]

There were many fears that the UK's exit from the European Union would cripple London's high-productivity financial and business services sector, particularly due to the loss of the 'passporting rights' that allowed UK-registered firms automatic access to European markets.[31] Although the UK's exit from the European Union has harmed London's economy – one study estimated that Brexit cost the capital £30 billion in output and 290,000 jobs – most forecasts suggest that the capital has been more resilient to the shock than the rest of the country.[32] In fact, according to this forecast, Brexit caused a larger reduction in the number of new jobs than in output, meaning that the other productivity-reducing effects of the decision to leave have been offset.

There is significant uncertainty about the effect that the pandemic has had on productivity growth in London. Data from 2020 and 2021 suggests that productivity saw a mild improvement, likely due to temporary increases in unemployment and inactivity in less productive sectors, like hospitality, but we heard scepticism about the long-term reliability of data from these years. We do not yet know how hybrid working and the changes to commuting and office use it caused have affected the capital's productivity.[33]

What we do know is that the financial crisis saw London's productivity growth model falter. The capital's strengths – specialisations in high-value financial and business services and openness to globalisation – became vulnerabilities. And those sectors which had generated the lion's share of productivity growth before 2007 were no longer able to deliver sustained improvements. Since the crisis, the capital has not found a new model to replace the pre-2008 consensus, that assumed high and continuous productivity growth in financial and business services to fund sustainable growth.

Local Industrial Strategies, LEPs

The Government's industrial strategy in late 2017 required Mayoral Combined Authorities and Local Enterprise Partnerships (LEPs, public-private partnerships led by local government), to draft Local Industrial Strategies. These documents set out long-term plans to increase local productivity and were to guide funding allocations in the post-Brexit era as part of a national Industrial Strategy.

Led by the GLA, London completed a Local Industrial Strategy and published an evidence base for it. However, before it could be implemented (or even made public), government scrapped the programme in March 2021. This kind of inconsistent policy environment is widely considered to be a critical weakness in the UK economy.[34]

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London's future

Any programme to address the capital's productivity slowdown should make use of London's competitive strengths in high-value services, while improving productivity growth in other sectors. It should be tailored to the moment – a post-pandemic, post-financial crisis world in which previous certainties about Londoners' preferences with regard to leisure, work, and travel are no longer stable.

It should not purely aim to recreate the shape of the London economy before the Great Recession. It is generally agreed that some business practices in high-productivity sectors before the downturn involved excessive risk-taking among 'too-big-to-fail' businesses[35] and did not lead to broad-based wage growth.[36] Some analysts, like the Bank of England's Andy Haldane, have even argued that much of the 'productivity miracle' in banking was a mirage as the result of increased leverage and under-priced risk-taking – the same factors that sparked the financial crisis.[37] Expanding productivity in other sectors could also improve the inclusivity of London's labour market, by allowing for wage increases in low-productivity sectors that currently have low pay.

But neither should plans to improve productivity rely on an unrealistic dream of reorienting the economy towards sectors that London is unlikely to secure a comparative advantage in, such as manufacturing.

Instead, actions to boost London's economy should aim to create productivity and output growth that increases after-housing-costs incomes for working people, spreads opportunity, and helps the world respond and adapt to the climate crisis. To be effective, it will need to provide consistency and certainty – laying out a clear strategic framework for the capital's economic future for all levels of government, investors, and workers to buy in to.

That will require reforms and investments to achieve three goals – to make London a better place to do business, to attract workers and develop their skills, and to enhance our tax and governance systems.

This should be the goal of a local industrial strategy for the capital, crafted by the Mayor, in collaboration with London boroughs, and employers: creating a new productivity model for London. This report aims to start a conversation about what that model could look like.

Chapter 3
Solutions

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3.1 Make London more attractive to productive businesses

In addition to macroeconomic factors like high economic growth and low inflation that inform which countries productive businesses choose to base themselves in, a wide variety of factors that can be directly influenced by public policy also come into play. Infrastructure, in the form of a well-connected transport network, good quality and affordable housing, widely available high-speed internet, reliable and sustainable energy sources, and a network of effective public services all contribute to attracting businesses. A city also needs a favourable regulatory and tax environment, a rich ecosystem of investors into technology and R&D to support innovation, and a high quality of life to attract high-skilled workers. Strategic public-private partnerships can also play a role in boosting the attractiveness of a capital like London to businesses, while the mix of sectors signals who is likely to thrive here and adds to the agglomeration effect, where businesses and workers cluster together and make each other more productive.

In this chapter we explore the key challenges raised in a roundtable that we held on how to make London a competitive place to do business, and in subsequent interviews with experts:

- Investment, and in particular R&D investment, is too low, limiting future growth.
- The cost of living in London is high and increasing, risking a loss of talented workers.
- The planning system is under-resourced and failing to keep up with Londoners' and businesses' needs.
- London's public transport network isn't doing enough to connect those in Outer London to the capital's most productive jobs.

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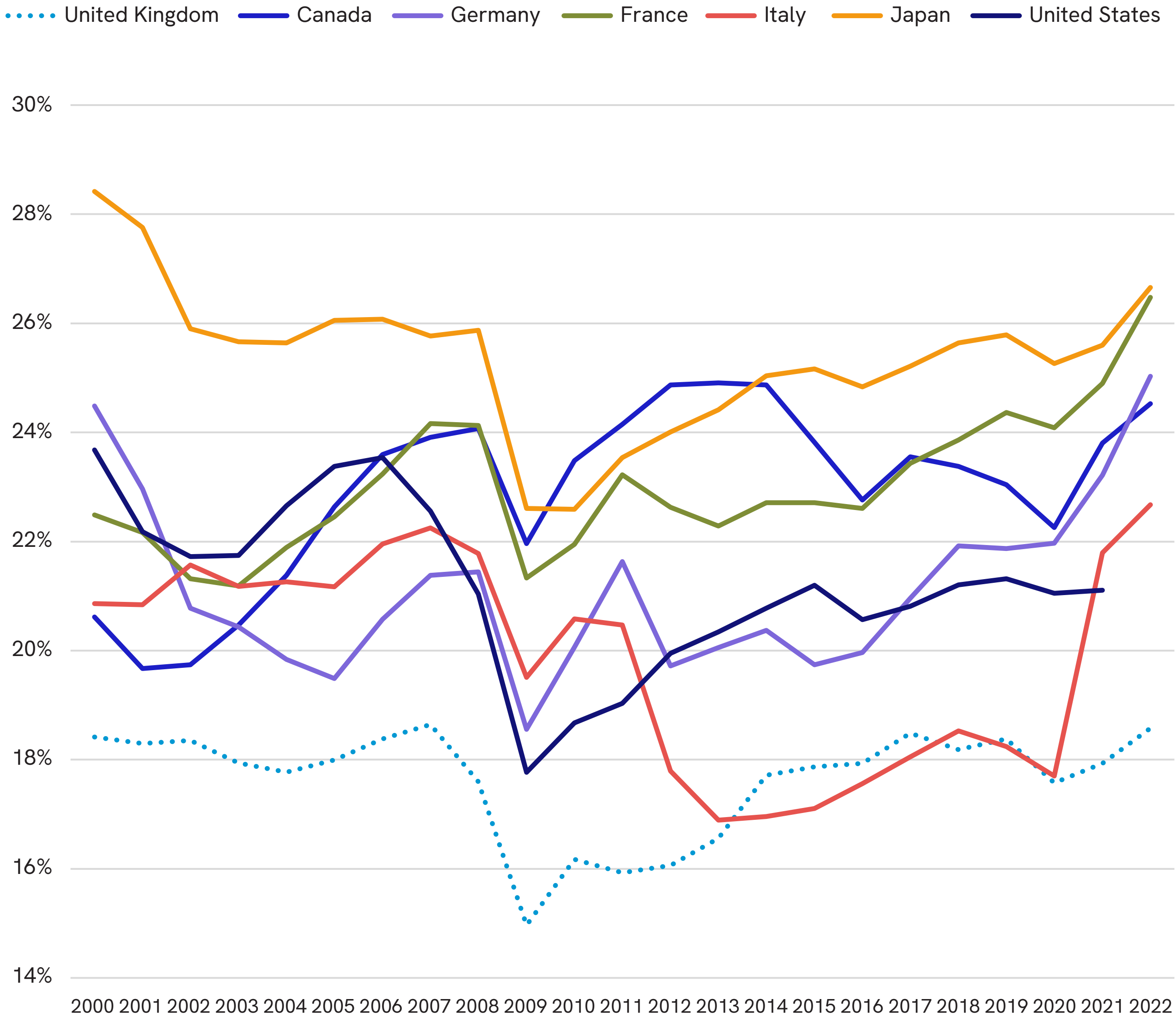
Investment is too low

High investment levels attract businesses by creating robust infrastructure, a skilled workforce supported by research initiatives, and a dynamic economic climate that fosters technological advancements and sustains long-term economic health. Investment – public and private – is much lower in the UK than in any other country in the G7, and has been for much of the last two decades.[38]

Investment in the UK lags G7 nations

Figure 9: Gross capital formation (% of GDP)



Source: World Bank, Gross capital formation (% of GDP). Notes: Data up to 2022 available at the time of writing, except for US (2021).

A recent review of investment in the UK by John Van Reenen and Xuyi Yang at the Centre for Economic Performance argues that "weak investment is partly due to 'a series of unfortunate events' such as the Brexit referendum and its aftermath, greater exposure to the financial crisis, a tough austerity programme, and enormous policy churn".[39] This lack of investment is likely to be part of the reason that, according to data from the OECD, investment in R&D in the UK was lower than the G7 average into the early 2010s. R&D investment drives innovation, creating new products and processes that—if adopted—enhance productivity and competitiveness.[40]

However, the ONS has recently changed how it measures R&D expenditure, leading to a substantial increase in estimates.[41] By this new measure, the UK invested the equivalent of 2.9% of GDP in R&D, above the OECD average of 2.7% but less than Germany (3.1%), Japan (3.3%) and the US (3.5%).[42] Nonetheless, the big picture of R&D investment in the UK over the past 40 years is one of "a significant drop in the 1980s and 1990s, a plateau through the 2000s and early 2010s, and then recent signs of some recovery," according to a report by the Productivity Institute.[43]

Of all investment in R&D in the UK, approximately half is performed in the 'Wider South East' region of London, the South East, and the East of England.[44] However, once we take into account the higher number of jobs in the region, the amount of R&D per job in London is actually less than the median UK region.[45]

Evidence suggests that low investment, particularly in capital and skills, is at the heart of the UK's economic slowdown, compared with the US, Germany, and France.[46] In addition, the US economy sees more investment in intangible assets, which plays a substantial role in how much more productive it is (28% more productive than the UK).

However, in London, investment is increasingly being directed towards less productive uses, with tangible assets like real estate crowding out intangible assets like software and R&D.[47] From 1997 to 2019, the total amount invested in intangible assets in London increased by 75%—below average for the UK, but not by much. However, over the same period investment in other types of assets in London grew by much more, meaning that the capital was the only UK region in which intangibles represented a lower share of total investment in 2019 than it had in 1997.[48] In particular, investments in buildings and structures went from representing 41% of investment in London in 1997 to 58% in 2019.

For London to become more productive, levels of investment need to increase, and there needs to be a shift towards investment in more productive assets. One way to address this is through changes to how we plan for and build new developments, so that rising investment in those assets can be redirected.

The planning system

Over the past two decades, housing costs have risen faster than wages in London, while office rents have remained higher than in global cities like New York and Paris, where productivity growth has been higher.[49] Inflated real estate prices may be contributing to a relative decline in investment in more productive assets, such as in R&D.

Relatively high real estate prices can be a sign of high demand to live or do business in an area. However, in London they are also a sign of under-supply of homes and some kinds of office space. We heard that while high quality office space remains in demand, secondary and tertiary office space continues to be in excess supply in London. One interviewee argued that London isn't only competing with other parts of the UK, but with global cities too; when it comes to providing enough space for fast growing sectors, such as life sciences, we need a planning system which is sufficiently responsive to changes in the market. This means, in part, planning authorities that can make decisions quickly.

Increasing the supply of homes is an established way of reducing prices.[50] As well as reducing housing costs in the long term, building new homes in the shorter-term can reduce the price of homes by creating chains in which someone moves out of a home and into a new home, freeing up space in theirs, and so on down the line. To build enough homes in London, the best estimates suggest that we need to double annual housebuilding from the 37,000 homes built in 2021/22 to approximately 74,000 a year for 15 years.[51]

The biggest gaps in housing supply at present are in social housing, with 300,000 households on the waiting list in London and a net decline in the number available over the past decade. Delivering more social housing would both reduce the rent burden of low-income Londoners and reduce strain on the private rented sector, increasing the availability of rented properties for middle-income residents. Over the long-term, there is good evidence that this investment would pay back higher returns than its costs, through savings on housing benefit, the NHS and temporary accommodation.

RECOMMENDATION

National government should increase its investment in the Affordable Homes Programme. The best estimates suggest that London needs more than 30,000 social homes a year for 15 years, and England as a whole needs 90,000—the cost of delivering these is high, at £15.1bn a year, but necessary to ensure that those on lower incomes can afford to live in London.

The planning system is often blamed for creating uncertainty for developers, both in terms of whether planning permission will be granted and how long the process will take. This uncertainty stems from several factors, including the discretionary nature of planning approvals and the political influence on decisions. Efforts to reduce uncertainty include mechanisms like outline planning permissions and permitted development rights, though the latter is associated with poorer housing quality. Some advocate for a shift to a zonal planning system to enhance certainty, as discussed in recent government proposals. Ongoing changes to the planning system exacerbate uncertainty, impacting housing associations and local authorities. Future changes to the planning system must be communicated and delivered in a way that minimises uncertainty for developers and local authorities.

Another source of uncertainty is the time that planning decisions take. In the decade from 2013/14 to 2022/23, the proportion of decisions on planning applications that were made within statutory time limits and without a performance agreement across England fell from 78% to 46%.[52] Local authorities have seen funding for planning departments cut by 60% since 2010, restricting their ability to carry out meaningful consultation and facilitate sustainable growth—over the same period, annual expenditure by planning teams fell by half.[53] [54] Increasing the supply of homes and making planning decisions responsive to changes in businesses' needs will require a substantial increase in their capacity.[55] Recently, there have been some welcome changes, such as increasing planning fees and tying them to inflation, as well as central government funding to put towards clearing planning backlogs. However, together these changes address less than half of the estimated shortfall in funding for planning departments of £225 million each year.[56]

RECOMMENDATION

National government should adequately resource local authority planning departments, through expanding grants. To make up for the relatively low supply of new homes in recent years, adequately resourcing them will entail increasing their funding at least to the levels seen in 2010, if not more to address the backlog of planning cases.

Restrictions on where homes can be built is contributing to the under supply and thus raising the cost of homes in London. Part of the solution to the problem will be building at high densities on remaining brownfield land and densifying existing settlements within London – higher density is linked to higher wages, innovation, and productivity through stronger agglomeration effects.[57] However, analysis from Lichfields, the planning consultancy, found that councils' brownfield registers of land only contained space for 29% of London's 15-year housing need.[58] And although suburban densification can certainly help to alleviate London's housing shortage, one study found that meeting London's housing targets by replacing single homes with three homes would require as many demolitions as there are sales of semi-detached houses in outer London, every single year.[59] Therefore, we believe that solving the crisis will also involve sustainable, strategically planned urban extensions into London's Metropolitan Green Belt.[60]

While there are good reasons to protect high-quality green spaces within London's Green Belt, there is a good case that unlocking a small fraction of poor quality land surrounding public transport stations could be well worth it, allowing for hundreds of thousands of new homes to be built within a relatively short (and sustainable) commute to central London.[61] As we argued in our recent report on solving London's housing crisis, this may require the introduction of a body for 'strategic planning' across the wider South East to create a shared vision of housing growth across the region.[62] The Mayor, national government, and representatives of non-London local authorities in the Metropolitan Green Belt, could work together to strategically identify areas for dense settlements, and ensure that they compensate for any loss of nature. In our recent report, Solving London's Housing Crisis, we laid out how this could be funded by abolishing 'hope value' on undeveloped land and capturing land value uplift from development.[63]

RECOMMENDATION

The Mayor of London should set up an expert commission to decide on 10 sites in London's Green Belt near rail stations for new development corporations. This should include representatives of any future strategic planning bodies for the Wider South East.

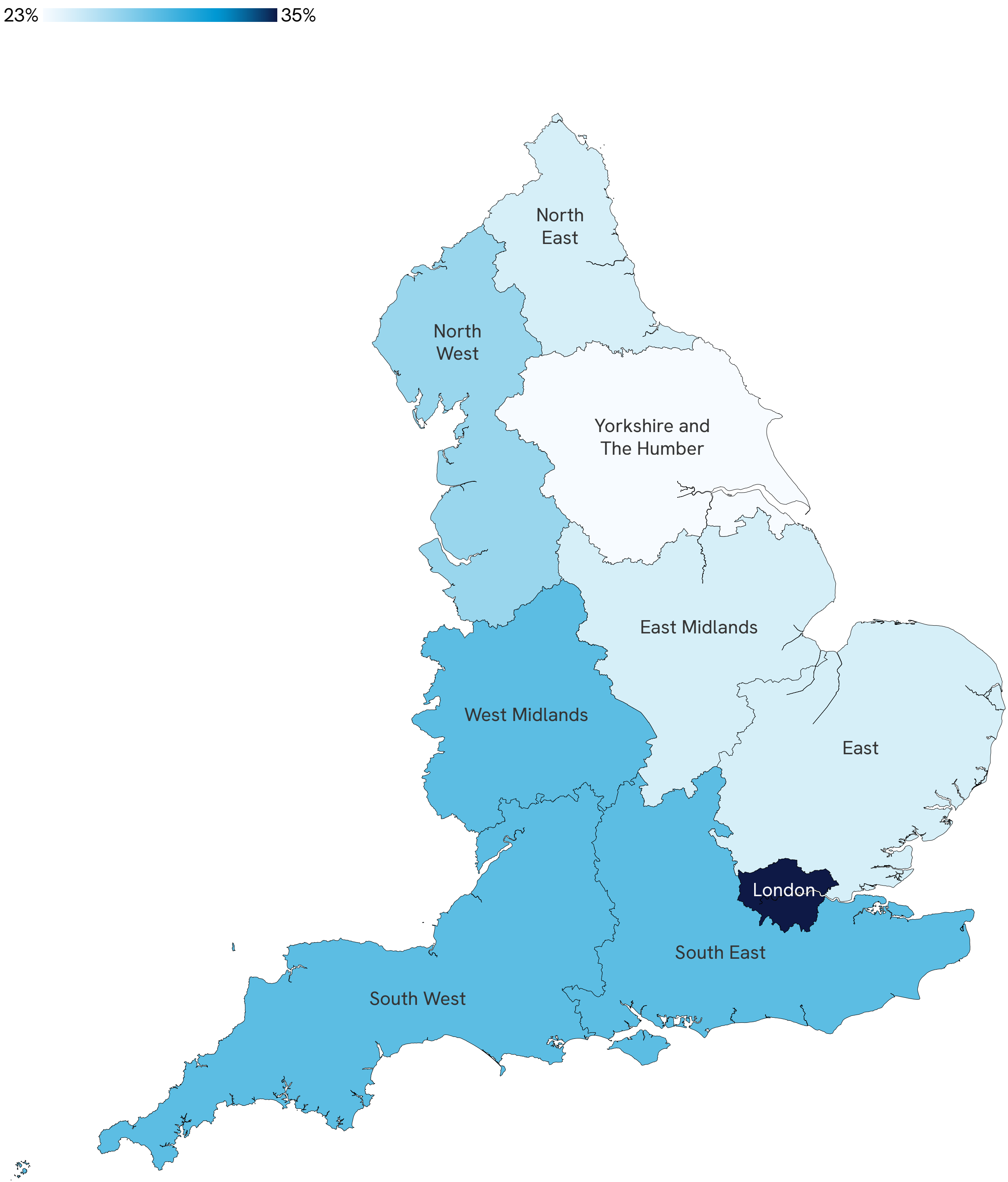
The high cost of living

In the next chapter we'll have more to say about how London can do more to attract workers and develop their skills. Here, while we're on the topic of the need to build more homes, we'll describe the high cost of living in London and how it could lead to London losing talent to competing cities, reducing the capital's attractiveness for productive businesses to operate here.

Housing is the biggest expense for the average household, representing 23% of household spending in London (compared to 16% across England).[64] However, this doesn't capture the high costs faced by many working-age Londoners. Average rents in London costs approximately 35% of the average household's income.[65] Renting in the private sector has become more prevalent in London over the past two decades, as the share of people living in social housing or homes they own has declined.[66] Meanwhile, the average price of a house in London is equivalent to 12.5 times an average salary—twice what it was 20 years ago.[67]

Private rent amounts to 35% of Londoners' earnings, on average

Figure 10: Percentage of total monthly household income spent on private rent



Source: ONS, Private rental affordability, England, Wales and Northern Ireland

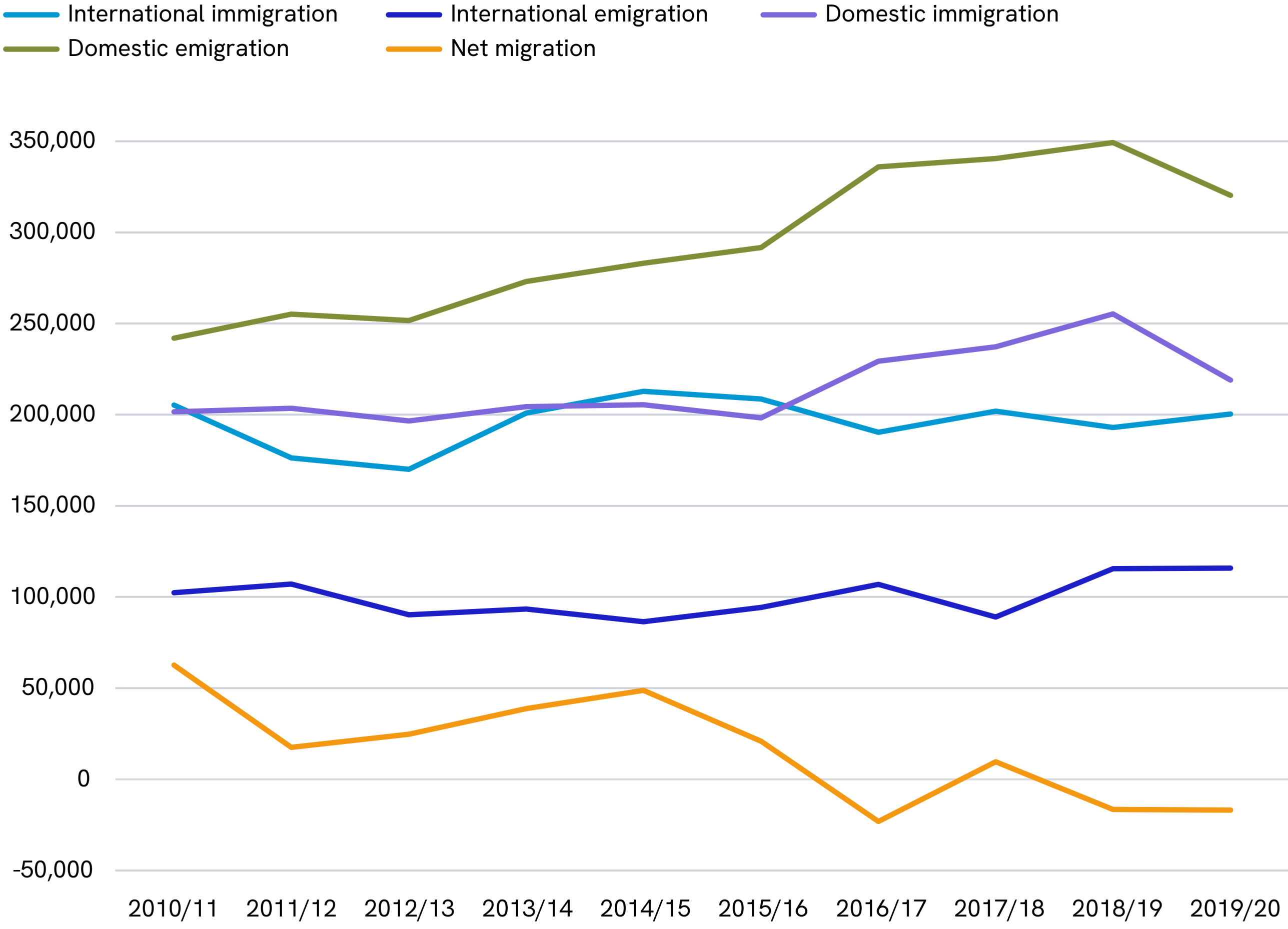
Among working age adults, the average (median) income in London is 17% higher than the English average.[68] However, after accounting for regional housing costs, this gap shrinks to 7%, and leaves the proportion of people in relative poverty higher in London than in most other English regions.

This has implications for the number of people who move into and out of London. Regional breakdowns of the number of people migrating to and from England are available until 2020. Every year in the decade to 2020, approximately 400,000 people moved into London from elsewhere, with about half coming from other areas of the UK and the other half coming from abroad.[69] At the beginning of the decade, more people moved to London than moved out each year, but by the end of the decade, this trend had reversed.

This was driven by an increase in people emigrating to other parts of the UK—this group represented about three quarters of all people leaving London in an average year. In recent years, surveys have reflected growing numbers of young people, in particular, planning to leave the capital due to the cost of living.[70] Migration to London has increased since 2020 (see next chapter), but we lack regional data on the number of people exiting London to understand net migration in this period.

Net migration to London fell over the 2010s

Figure 11: Number of people moving to and from London, 2010/11 to 2019/20



Source: ONS, Local area migration indicators, UK). Notes: Sub-national estimates of migration were discontinued after 2019/20.

The capital's attractiveness to international talent is an asset, rather than a liability, and one that should not be taken for granted. Policy should look to attract more highly skilled workers, not fewer. But for these aims to be achieved, London needs to reduce the cost of housing for residents old and new, by increasing the build-rate of market and affordable homes.

Public transport in London

For nearly 200 years, London has been at the forefront of innovation in transport. From the building of the London Underground to the adoption of the Oyster Card in 2003, ideas from London are in use across the world. Our transport system has helped us become an economic powerhouse and helps millions of Londoners and visitors access the brilliant opportunities the capital has to offer.

However, many parts of Outer London have relatively poor access to the public transport network. Additionally, the cost of housing has risen considerably in London over the past two decades, especially in Inner London. Partially as a result, population growth is slowing in inner London. This makes the importance of good connections to Outer London all the more important for making London a competitive place to do business, by increasing the size of the labour pool that businesses who locate here can tap into.

Expanding transport access increases efficiency in the labour market by enabling firms to access a wider larger pool of workers, creating 'agglomeration effects', while also widening access to London's most productive jobs to more people. Services operating on suburban rail in South London, outside of Transport for London's control, are not delivering their full potential, with fewer trains arriving on time or within 5-10 minutes than on London Overground lines.[71] 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% 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.[72]

Funding for this programme could be partly provided by the land value capture mechanisms discussed in Chapter 3.3, given the increases in land prices likely to be catalysed by metroisation.

RECOMMENDATION

The Department for Transport should work with Transport for London to improve the reliability, speed and frequency of services in outer London. This involves devolving suburban rail services terminating just outside the southern GLA boundary to Transport for London, as well as funding the necessary capital investments to improve the network. These will deliver a range of long-term benefits – including making it easier to travel into and around London, supporting economic growth and therefore increasing tax revenues from the Wider South East. Land value capture should be explored as a source of funding.

Supporting sustainable travel in Outer London

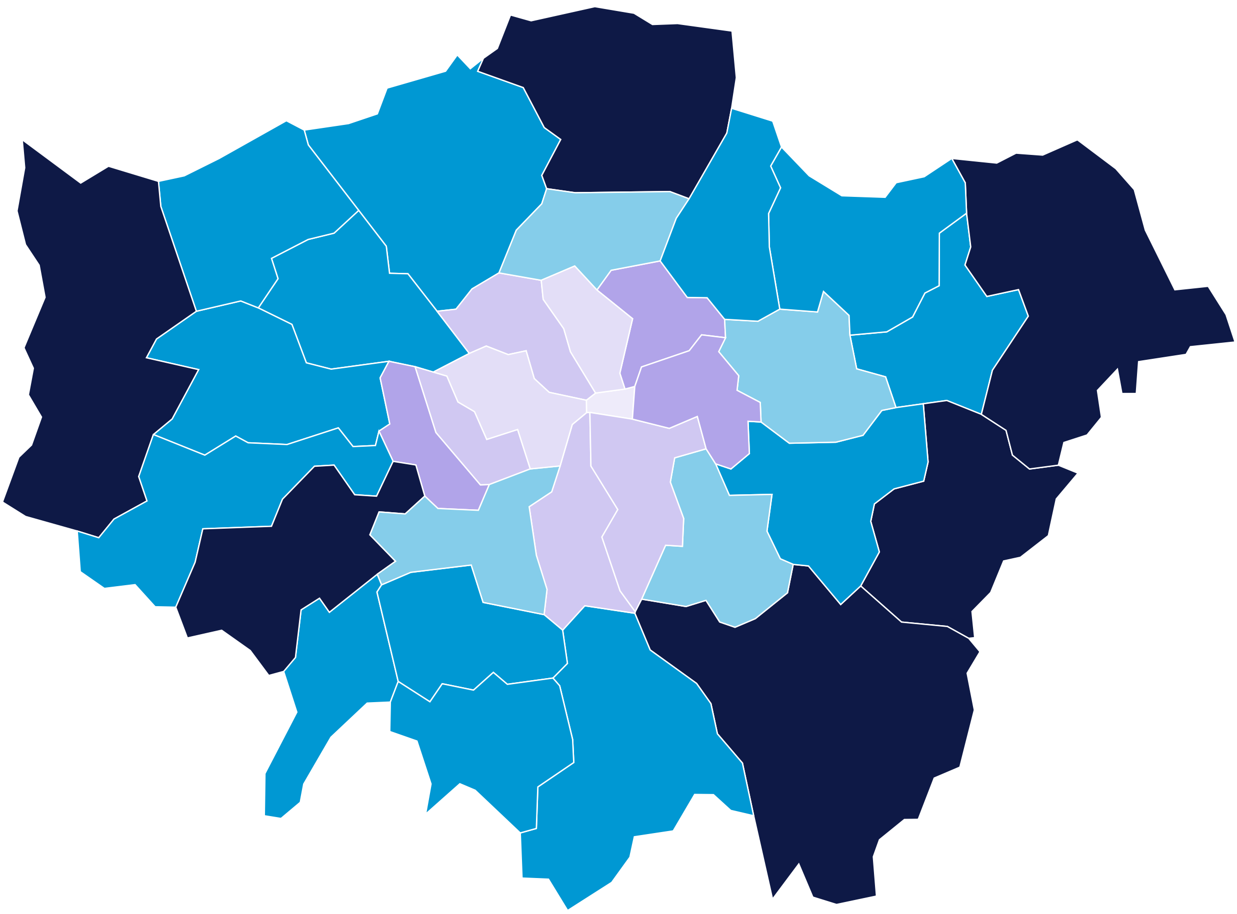
Centre for London published a report in 2023 exploring how to improve transport options for the millions of people living in Outer London. The report, Moving with the Times: Supporting sustainable travel in outer London, includes recommendations to make walking, cycling, car clubs and public transport better in Outer London for local trips as well as commuting in and out of central London.

As an example of its effect on businesses, the most influential element in the decisions made by international companies about where to locate their headquarter offices is access to talent.[73] Such jobs tend to be highly productive. With the cost of living in Inner London rising in recent years, and signs that young people are feeling pressure to move out of the capital,[74] connecting talent with London's productive centres becomes increasingly important.

Many areas in Outer London lack access to reliable and convenient public transport

Figure 12: Public Transport Access Level (PTAL) by borough, 2015

1b 2 3 4 5 6a 6b



Source: Office for National Statistics (Boundaries), Simple maps (Points), Transport for London Public Transport Accessibility Levels

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This is why it is concerning that the pipeline for new transport infrastructure projects in London is increasingly bare. The most significant projects to have broken ground were conceived of in the 2000s: HS2 and the Elizabeth Line and many others. Their intended successors, from the Bakerloo Line Extension to Crossrail 2, are unlikely to see the light of day without significant policy change.[75] However, there are some smaller scale outer London projects with the potential to be delivered within the next decade if funding is made available, including the West London Orbital and the DLR extension to Thamesmead, which could unlock tens of thousands of homes and jobs.[76]

Transport for London, which has historically relied more than the transport operators of other global cities on passenger fares to fund its services (70% of revenue came from fares before the pandemic),[77] has been severely impacted by the reduced ridership brought about by the pandemic. While passenger numbers have risen substantially since 2020, capital investments to improve the reliability, speed and frequency of services in Outer London are likely to require additional funding. This could be brought about by granting the Mayor of London the powers to raise additional revenue, or otherwise by direct funding from the UK Government. To be effective, funding deals should be long-term (ie. 5 years) to allow TfL to plan for maintenance and improvement to the network. The question of how to fund these projects is discussed in Chapter 3.3.

3.2 Attract workers and develop their skills

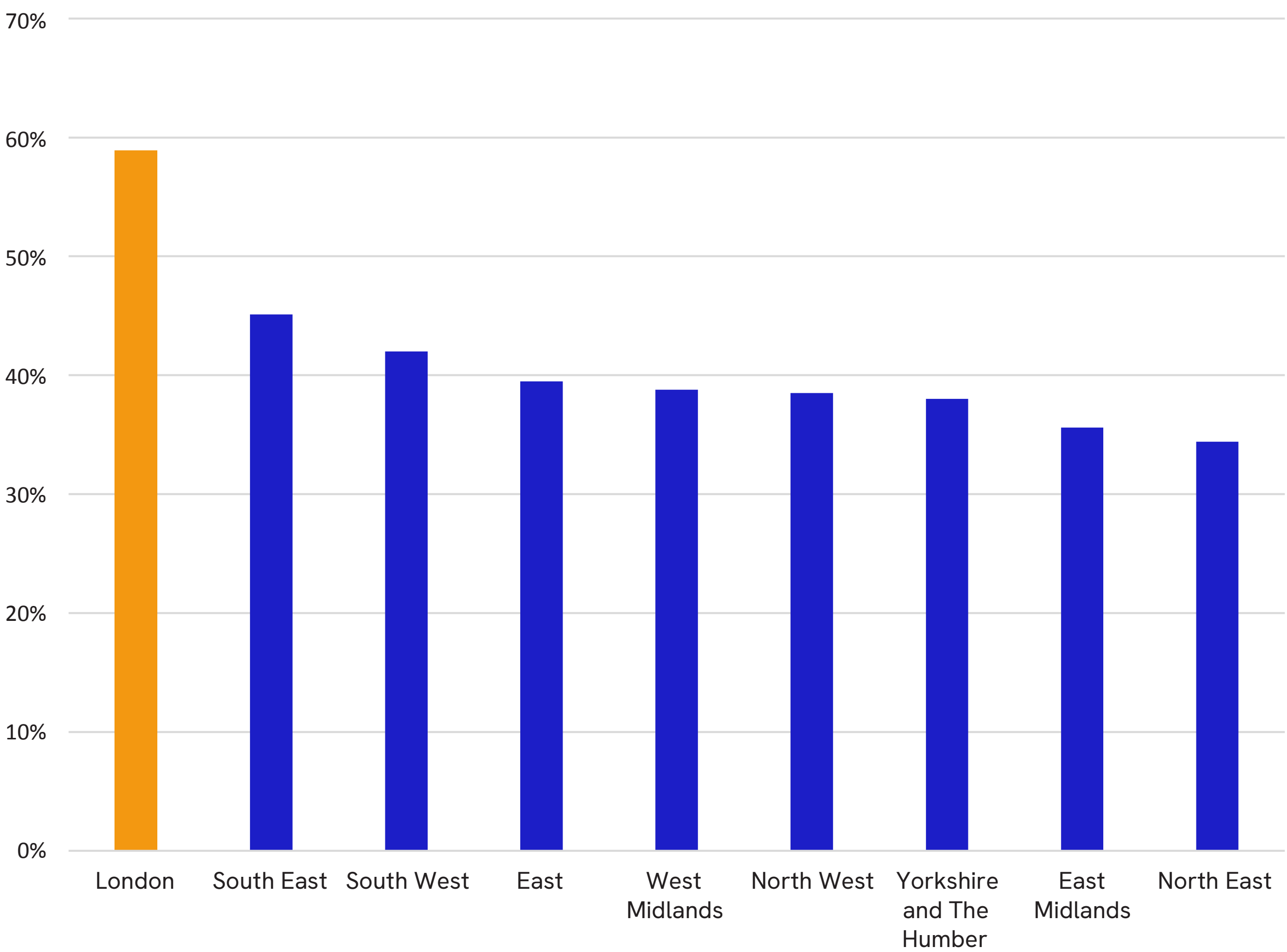
London's workforce is relatively high skilled

Alongside capital investments, raising productivity in London requires skilled workers. Education and training enables workers to perform complex tasks more efficiently and make use of advanced technologies and ideas. A 2015 government study found that improvements in workers' skills directly accounted for around a fifth of the annual growth in average UK labour productivity in the late 1990s and early 2000s.[78]

London's workforce is already very highly skilled. The capital has the highest proportion of university graduates of any UK region.[79] This is both due to high levels of in-migration of graduates from the rest of the UK and other countries, and the high propensity of graduates of London universities to stay in the capital. An underlying cause of this trend is the capital's 'graduate premium' – the economic reward workers gain from having a degree, compared to not having one – which has remained relatively high, while it has fallen elsewhere in the country.[80] As a result of relatively high wages, the City of London, with its concentration of financial and professional services sector workers, has an extremely high proportion of workers born outside the UK – 42% in 2021.[81]

London has the highest share of graduates of any region

Figure 13: Share of working-age (16-64) population with NVQ4+, by region, 2021

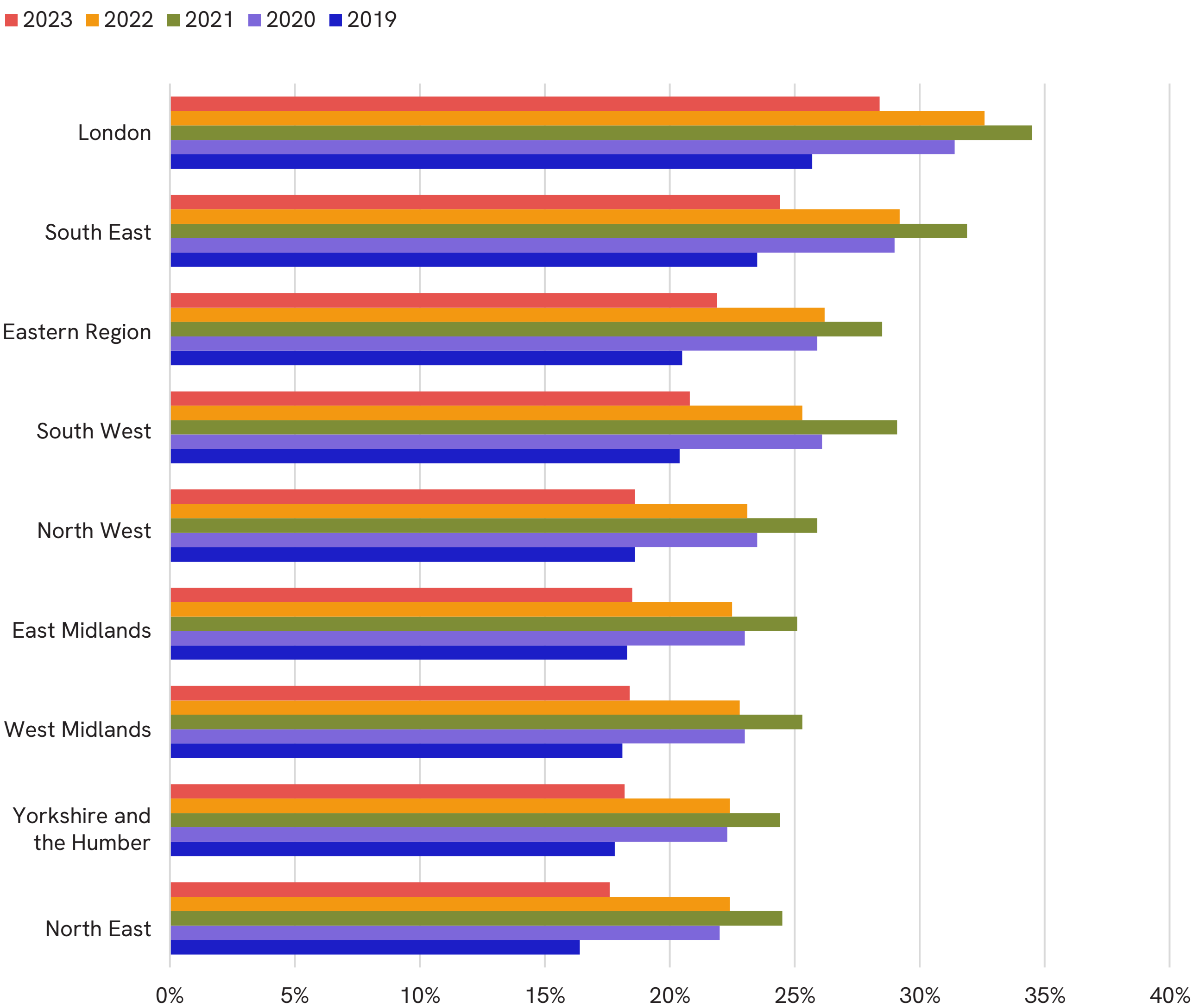


Source: ONS, Qualifications of Working Age Population (NVQ)

London also has the best outcomes of any region at GCSE level and the second-best outcome at A level, following a sharp turnaround in the capital's performance over the 1990s and 2000s.[82]

London is the highest performing region in GCSEs

Figure 14: GCSE grades 7/A and above, by region



Source: Department for Education, Statistics: GCSEs (key stage 4)

Gaps in London's skills

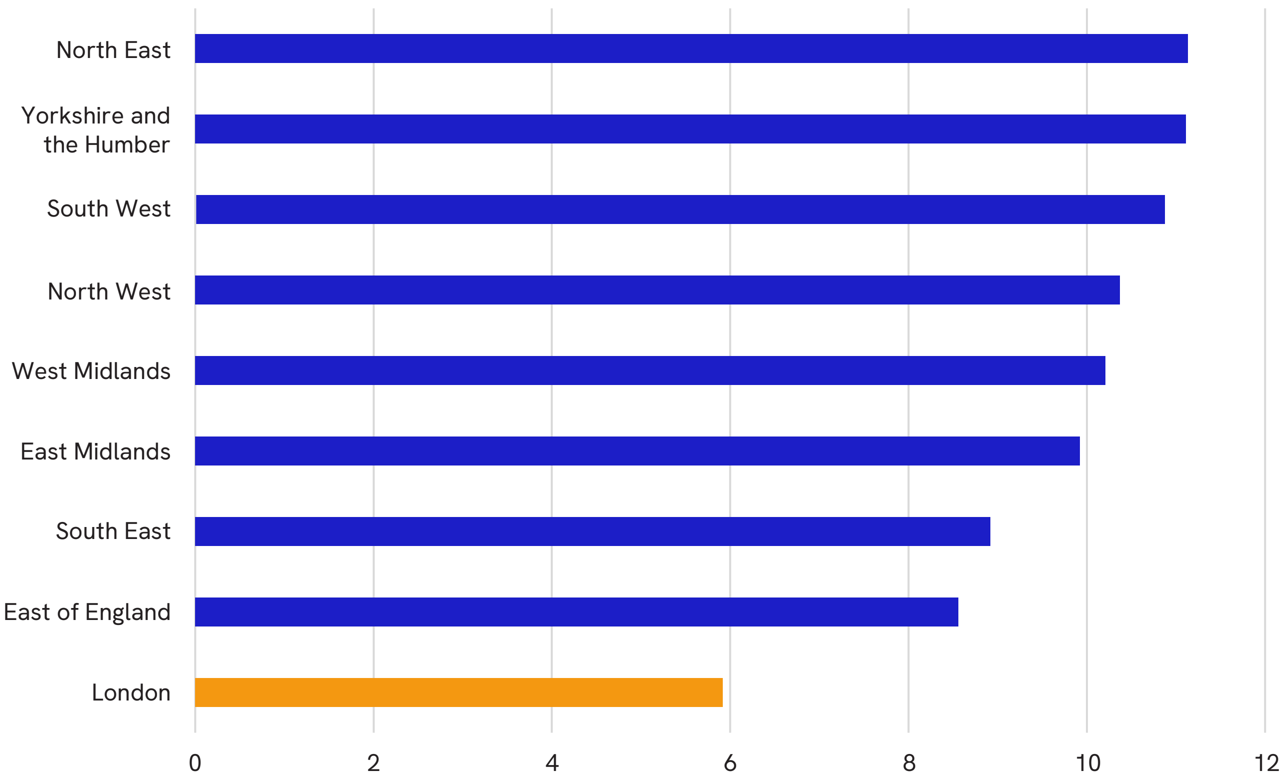
But despite London's high skill levels, the capital has significant skills shortages that are likely to impact productivity growth. Of a sample of businesses polled by Savanta for the London Chamber of Commerce in Q3 2022, 69% reported shortages in key skills, up from 58% in July 2021. 31% of these businesses claimed that skills shortages had lowered their productivity.[83] Among large businesses, more than three quarters said they experienced barriers in meeting the skills requirements of their organisation either all or most of the time.

Strong headline figures disguise the 13% of Londoners with no qualifications and the almost 20% with either none or only Level 1 qualifications (1-4 GCSE A*-C or other entry level qualifications), suggesting further progress can be made to increase the contribution of skills to London's productivity.[84]

Where the capital is weakest is in vocational education and skills. Per 1,000 residents, fewer apprenticeships are completed in London than in any other English region.[85] Evidence suggests that every £2 billion spent on apprenticeships returns £1 billion per year within a decade, while each degree level apprenticeship raises the productivity of an individual working in the private sector by 27%.[86] And Department for Education analysis found that among men, a Level 3 apprenticeship generates a lifetime productivity gain of £176,000, compared to those with lower level qualifications.[87]

London hosts fewer apprenticeships than any other region, as a proportion of the population

Figure 15: Apprenticeship starts per 1,000 16-64 population, 2022-23



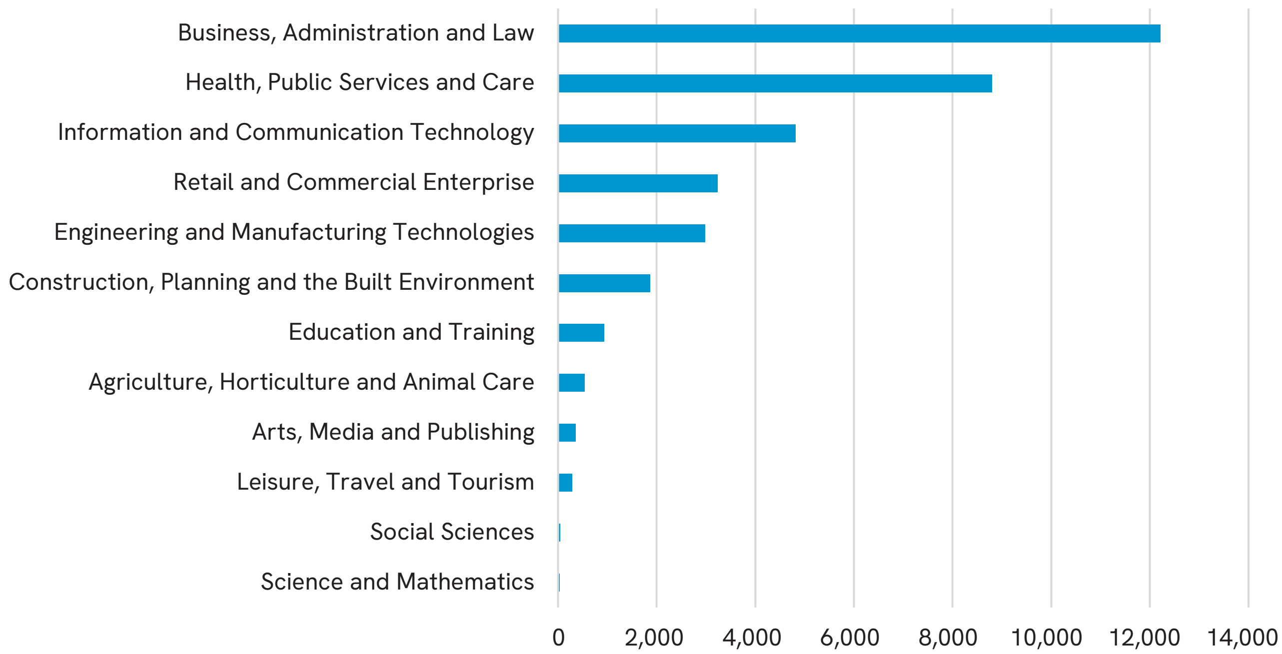
Source: GLA, Apprenticeship Statistics for London

Part of the gap between London and the rest of the country will be due to London's sectoral makeup – fewer Londoners work in sectors likely to hire apprentices than elsewhere, like in health and social work, which employs the most apprentices in England.[88] However, GLA analysis that weighted for these sectoral differences found that London still had a lower number of apprenticeship starts than elsewhere in many sectors, such as construction.[89] And too few apprenticeships are completed in industries suffering from major skills shortages, of which construction is a leading example.[90] Along with recent construction inflation and the rising cost of finance, this presents a critical barrier to ramping up housing production – addressing it would contribute to easing our housing affordability crisis.

Equally, London's role in the green economy of the future is threatened by skill shortages – London Councils reported high skill shortages for positions such as EV technicians and retrofit coordinators and installers.[91] Training workers in the green skills required to address and adapt to the climate crisis will require an expanded role for the apprenticeship system. Estimates of the 'green skills gap' vary, with one study citing 200,000 jobs in need of filling,[92] but there is a broad consensus that a reformed vocational education system will be key to successful delivery.[93]

Apprenticeship starts in London are concentrated in business, administration and law, rather than sectors like construction and engineering

Figure 16: Apprenticeship starts per 1,000 16-64 population, 2022-23



Source: GLA, Apprenticeship Statistics for London

The apprenticeship system

Overlaying these trends are fundamental problems with the apprenticeship system. The Apprenticeship Levy is a 0.5% tax on firms with payrolls over £3 million a year to fund training programmes. In cases that large firms are unable to use levy funds internally to hire apprentices, they can transfer 25% to small firms that don't pay the levy.

However, the levy system is widely agreed to be unnecessarily restrictive, causing it to be underutilised. Sector bodies across a variety of industries have called for greater capacity for the levy to be transferred between businesses, to allow SMEs to create more apprenticeships, benefitting both apprentices themselves and small businesses.[94] The Shared Apprenticeship Scheme (SAS) also offers a potentially more flexible model that could be expanded, guaranteeing learners a full 3-year Level 3 apprenticeship spread between different SMEs. The Scheme allows smaller employers which don't have the capacity to take on an apprentice full-time to benefit from the programme, and gives learners a varied set of employment experiences.[95] Given the significant administrative barriers faced by SMEs running apprenticeships, expanding the SAS could benefit both many prospective apprentices and many small businesses to improve their productivity.[96]

Levy funds must also be used within two years. In 2022, IPPR found that more than £3.3 billion of levy funds had been returned to the Treasury, unused since 2019,[97] while analysis from London Councils found that London boroughs spent just 26% of their levy funds between 2018 and 2020.[98] To take one London example, members of the University of London Federation contribute £10 million towards the levy every year, but £7.5m expires without being used – enough to fund more than 750 apprentices every year.[99]

RECOMMENDATION

The Apprenticeship Levy should be fully devolved to London and other Mayoral Combined Authorities and Combined Authorities. London government should then increase its flexibility, with longer time limits on spending.

RECOMMENDATION

National government (or London government, if devolved) should increase the portion of the levy that large firms can transfer to SMEs from 25% to 50%, to help address any 'long-tail' of low-productivity small firms in the capital.

Adult education and retraining

Adult education and retraining could play a role in increasing productivity among Londoners working in a variety of sectors, particularly given that employer spending on training has fallen by 27% across the UK since 2011.[100] Since 2019, the GLA has been delegated the administration of the Adult Education Budget (AEB) in London, which funds adult education at training providers and colleges. This flexibility has been used to fully fund courses for Londoners earning less than the London Living Wage, along with funding English classes for people who speak other languages, reflecting London's high cost of living and large proportion of jobseekers without English proficiency. An evaluation of the devolved programme showed that London performed well by comparison to other parts of the UK, both in terms of enrolments and in that providers were satisfied with GLA management of the budget.[101]

However, funding for the AEB has been cut by 45% from 2009 to 2019,[102] and across the UK, spending on adult further education has been cut by two thirds since 2003/4 (in real terms).[103] The adult education and skills system has been consistently criticised for being fragmented and difficult for learners to access.[104] As a result, alongside returning AEB funding levels to pre-austerity levels, the GLA has asked national government to expand the devolution of the AEB to include the apprenticeship system, 16-18 skills, and employment support services.[105] If it comes with the levers to raise funding for services within the capital, this could enable London to tailor a joined up vocational education and training system.

Adult education and apprenticeships fulfil different economic needs in different places – in areas with high youth unemployment, Level 2 apprenticeships for school-leavers will be a focus, while in areas with skills shortages in certain, high-skill professions, retraining and upskilling will be priorities, leaning on Level 4 and 5 apprenticeships. These decisions should be made by local policymakers, who work closely with employers in their areas and can design programmes to meet skill gaps.

Government projections forecast that professional, associate professional, and skilled trades occupations will see the most growth of any job type in London from 2020 to 2035.[106] Therefore, a new productivity model for London will need to produce more graduates and more high-skilled workers who have completed higher level apprenticeships in areas that are in-demand.

Business, administration and law is the most popular subject for apprenticeships in London, but this is likely to change as advances in technology replace some jobs in this sector. The same government study forecasts that jobs in administrative and secretarial occupations will shrink, in absolute terms, over the next two decades. In financial services, almost three quarters of all roles are now highly-skilled, rising from half in 2004, demonstrating the increasing marginalisation of lower skilled labour in high-value sectors.[107] Given that one in five Londoners are economically inactive, policy should aim to use the adult education and apprenticeship system to ensure that these people are supported into high-skilled jobs, rather than simply forced into low-productivity employment in sectors that may not have a long-term future.[108]

An approach aimed at building broad-based productivity growth will require a more flexible and tailored vocational and adult education system for the capital, built into a coherent local industrial strategy. This should build on existing, employer-led work, such as the London Local Skills Improvement Plan, which aimed to better match training to skills shortages.[109] Regional and local government need the powers and resources to direct investment into the subjects and industries that will drive high-productivity, high-wage employment.

RECOMMENDATION

National government should return the Adult Education Budget to its pre-austerity funding level.

RECOMMENDATION

National government should devolve the administration of the Apprenticeship Levy to London, so that the GLA, in partnership with boroughs, can tailor programme design and implementation to the capital's economic and social needs.

Immigration policy and attracting workers to London

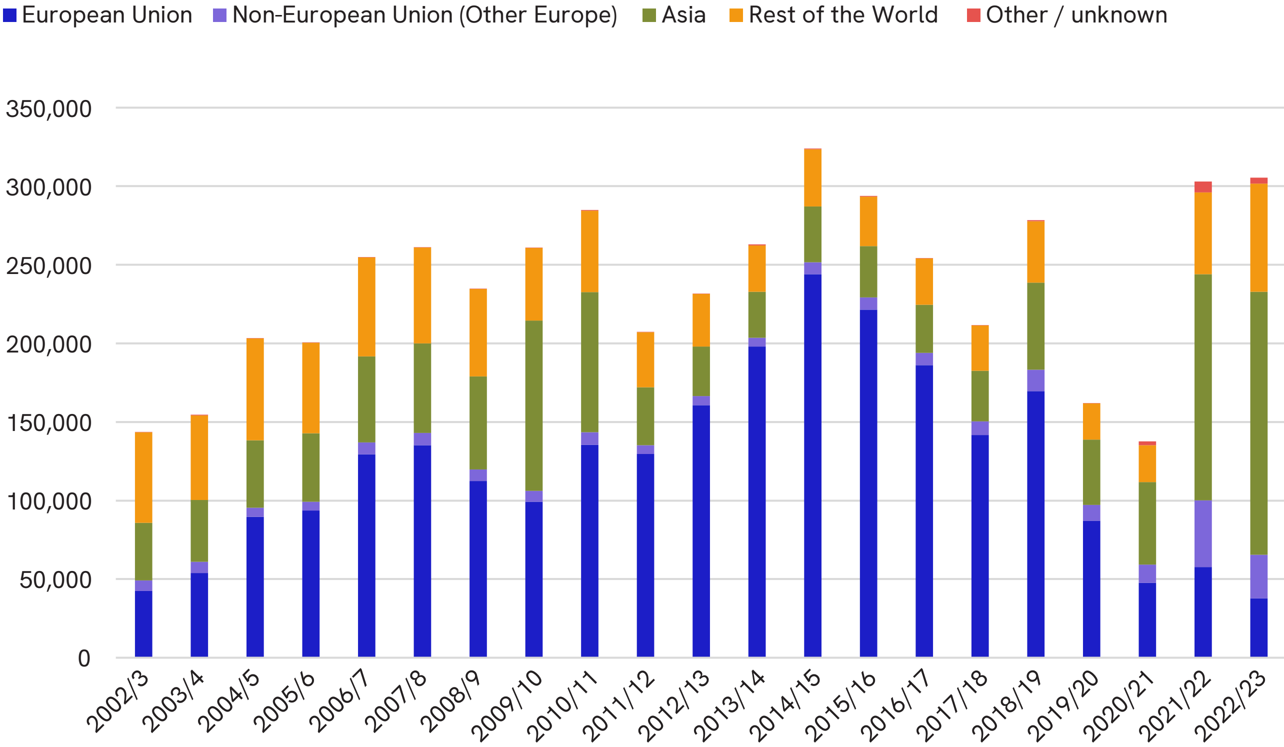
London's productivity growth relies on attracting workers from outside its borders – from the rest of the UK and the rest of the world.

Prior to and after the vote to leave the European Union, there were well-founded fears that a 'hard Brexit' would tighten restrictions on immigration and leave London – which was particularly dependent on migrant workers – in the lurch.[110] The reality has been very different.[111]

Immigration to London fell very sharply during the pandemic, as borders were closed, and potential migrants postponed their plans for work or study. But in the years since COVID, all evidence shows that the post-Brexit, skills-based immigration system has led to more migration to London, not less. The main shift appears to be compositional – European migration has fallen sharply, as freedom of movement for EU workers has been ended, but migration from the rest of the world, particularly Asia, has boomed. This comes alongside short-term increases in net migration from Ukraine and Hong Kong, amid humanitarian and political crises in both countries.

Falling European migration has been counterbalanced by rising migration from Asia

Figure 17: New National Insurance Number registrations to adult overseas nationals entering London, by area



Source: DWP, National Insurance numbers allocated to adult overseas nationals to September 2023

Many of these new migrants are international students. There is considerable evidence showing the benefits to London and the UK's economy and soft power of its status as a magnet for international students.[112] Universities UK claims that each cohort of international students contribute £42 billion a year to the UK economy.[113] The Graduate visa, introduced in July 2021, has also become key to London's post-Brexit migration settlement, along with the solvency of many universities, given insufficient tuition income from domestic students. The programme enables students to stay in the UK for work after their studies for at least two years, and across the UK, more than 100,000 were granted from September 2022-2023.[114]

There are concerns that the Graduate visa has enabled a degree of low-wage migration, alongside welcoming high-skill workers. A review by the Migration Advisory Committee is likely to address this by recommending restrictions on course and post-graduate employment choices, to ensure that the scheme is only used for graduate jobs.[115] However, the programme is critical to maintaining the competitiveness of London's labour market and should be retained and expanded. Not only should the length of the visa be extended, so that talented international students are not discouraged from working in the UK after graduation, but the system should aim to promote their choice to settle in the country in the longer term. We hear that this could potentially be achieved by counting time spent working on a Graduate visa as contributing towards the 5 years required to achieve 'settled status' for EU, EEA, and Swiss migrants.

RECOMMENDATION

The Graduate Visa should be retained and extended from two to five years, if restrictions on post-graduation work to ensure high-skill migration are put into place.

But those migrating for long-term work have tended towards higher wages and skills, due to post-Brexit salary minimums. Across the UK, the 2019 cohort of non-EU migrants has the highest income, relative to the overall workforce, of any – 6% higher than the UK average by 2022.[116] And in the high-wage sectors that have driven productivity growth in London in recent years, the Skilled Worker visa scheme has brought a large number of high-skilled workers to the capital. From 2016-2020, London received 44% of the total Skilled Worker Visa recipients in the UK, while representing only around 14% of the total resident population.[117]

Although we have relatively limited information about where new migrants settle, their working habits, and how long they remain, it is likely that these recent changes to immigration policy have tended to increase London's productivity.[118] This concurs with the existing economic consensus, that immigration tends towards increasing productivity – significantly due to migrants being, on average, relatively young and highly educated.[119]

One factor that might be holding back further increases is that the cost of applying for a visa, which is usually split between the worker and the employer, is one of the most expensive of any immigration system in the world.[120] The roughly 800% surplus made on many applications are taken by an Institute for Government analysis as intended to cross-subsidise other parts of the Home Office. This is because of a plan to make the immigration and borders system self-funding, which is unusual internationally.[121] High costs only worsens London's standing as a destination for skilled labour, particularly among young people.

These charges could also be made more effective. The Immigration Skills Charge (ISC), which raises £1,000 per sponsored worker per year from medium-to-large businesses, was intended to fund training of domestic workers. However, despite raising some £1.5 billion since 2017/18, there is a significant lack of clarity around how it is spent, with government admitting that it does not fund additional skills programmes.[122]i The GLA has called for London's share of the ISC to be devolved the city, to be spent on tailored skills provision to address shortages – these funds could contribute to a ring-fenced green skills fund.

RECOMMENDATION

National government should review the cost of applying for a Skilled Worker Visa and reduce charges for applying for indefinite leave to remain.

RECOMMENDATION

National government should devolve London's share of the Immigration Skills Charge to the city, to be spent on green skills provision.

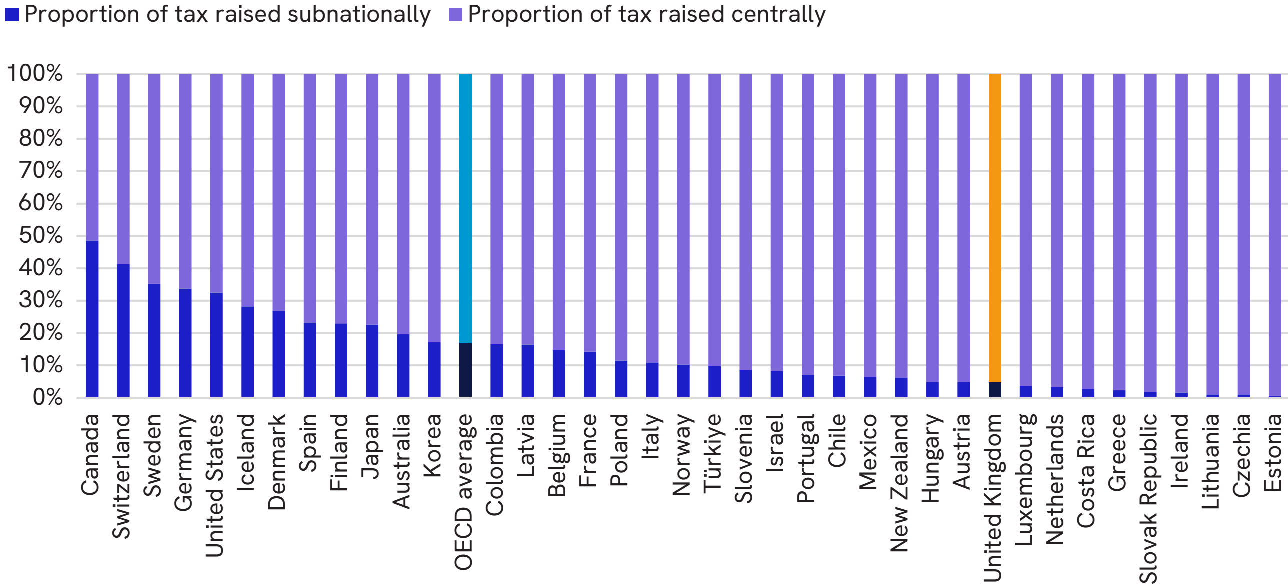
3.3 Reform governance and taxes to boost growth

The case for greater devolution

The UK is one of the most centralised countries in the developed world. While global cities like New York, Tokyo, and Paris are able to raise taxes from businesses, landowners, and residents, and direct spending towards productivity-enhancing investments, London government has very little autonomy. Sub-national government raises less than 5% of all tax revenue collected in the UK.[iii] As a result, it is not consistently incentivised to permit growth, as it does not sufficiently benefit from the gains created, and regional governments lack the strategic capacity to borrow, plan, and invest.[123]

Subnational government in the UK raises much less tax revenue than the OECD average

Figure 18: Proportion of overall tax revenue raised by subnational governments (2022)



Source: OECD, Fiscal Decentralisation Database. Data from Australia and Japan is from 2021, affecting OECD average

OECD analysis has shown that increasing the fiscal power of sub-national government is associated with meaningful increases in GDP per capita and productivity, along with levels of workforce education.[124] Devolution could, therefore, help to generate the increased economic activity that would fund many of the public investments we have called for in this report. It has, however, proved difficult to quantify the economic benefits of devolution, due to the many confounding factors affecting analyses.[125] Of course, the effect of further devolution on productivity would depend on what powers are devolved, and on what local administrations choose to do with their powers – what the Greater London Authority has called the 'quality of devolution'.[126] Investments into skills, public transport infrastructure, or research and development might have higher impacts than day-to-day spending on necessary services, like improved bin collections.

iii. This includes both local and city government in the UK. In many comparator countries, it includes local and state government.

But there is a strong theoretical case that devolution can lead to better governance outcomes. Local policymakers are more likely to possess detailed knowledge of their area's economy and its policy needs than national policymakers, are more directly accountable to the local electorate, and are certain to prioritise its success, relative to other places. Devolution also allows for greater policy experimentation, enabling regions to learn from other places' innovations.[127] The devil is, of course, in the detail. Weak governing capacity and institutions, alongside the potential risk for local cronyism, can handicap local administrations. However, London (and, arguably, the Mayoral Combined Authorities) benefits from relatively mature devolved institutions, with competent administrators with experience implementing major reforms – one need only point to London's introduction of the innovative Congestion Charge in 2003.

And in practice, London, like the rest of the country, has suffered in recent decades from the volatile policy environment created by central government. This is made clear by HS2, the promised high-speed rail line originally designed to link the capital to Birmingham, Manchester, and Leeds. Central government prevarication has contributed to ballooning costs and, at the time of writing, to an impractical plan to only guarantee funding for the railway to Old Oak Common, a station outside central London without the capacity for a large increase in passengers, putting the Elizabeth Line under unfeasible strain. This would significantly reduce the line's utility to Londoners and will damage myriad investment cases for projects that relied on HS2's boosts to connectivity.

Large, multi-city infrastructure projects are going to continue to require national coordination. But greater fiscal devolution should allow for more stable transport and spatial planning, by creating a source of funding independent of national government that can only be spent in a single city or region. Devolving tax-raising powers can better align the incentives of those who have raised the funds with outcomes that would lead to better local growth (which in turn contribute to higher local tax revenues). One need only point to France, where cities are able to use local pay-roll taxes to fund transport infrastructure – French cities have built twenty one tram systems since 2000, while Leeds has been denied a single tram line for decades.[128]

Fiscal devolution would enable public policies that boost growth

The London Finance Commission (LFC) was a group of experts and policymakers, brought together by the Mayor and London local authorities, to make the case for deeper devolution to London.

In 2017, the LFC called for the full devolution of property taxes to London, including council tax, business rates, stamp duty, and several others. This was to be accompanied by the devolution of a small percentage of London's income tax yield, along with several other fiscal mechanisms, like the apprenticeship levy and a share of London's contribution to Vehicle Excise Duty. Each of these would be accompanied by an equivalent reduction in the grant provided by national government, making the changes fiscally neutral 'on day one'. After this point, local government would be considerably more incentivised to grow their tax base.

We believe that implementing policies that meaningfully boost London's economy will require a gearshift in the distribution of power and fiscal capacity. There is an increasingly widespread recognition that the present degree of centralisation is unsustainable. Perhaps the most prominent recent example is Labour's Commission on the UK's Future, led by former Prime Minister Gordon Brown, which called for a legal requirement for decisions to be taken as close as possible to the people affected by them, alongside the devolution of policy programmes regarding skills, infrastructure, and research and development.[129]

London's taxes

Devolution of key policy areas is most successful when it is combined with funding, ideally controlled at the local level. Decentralising services using 'unfunded mandates', where devolution isn't matched by adequate funding, often leads to poor outcomes and has been shown to have negative impacts on economic growth. And the current 'begging bowl' system of competitive funding pots for many major grant programmes is widely acknowledged as wasting local authority resources and time, while reducing local government's ability to plan strategically for the long-term.[130] In a more devolved system, existing funding streams could be brought together and directed towards a set of shared local priorities, aligning the aims of public spending.[131]

Property taxes

However, the problem with devolving key services without more fundamental reform is that many of the local taxes that could fund them are not fit for purpose. Across England, council tax funded 52% of local authority spending in 2019/20, the last pre-pandemic year.[132] Properties are placed into bands, determined by their values in 1991, which then determine how much households pay. This is despite high (and uneven) house price inflation since that year, so that council tax rates don't come close to matching the variation in property values.

The failure to update property values, alongside the design of the tax, has made this key source of revenue for local authorities extremely regressive. In 2019, a study found that households in the lowest value band pay 5 times more as a proportion of their property value on average than those in the highest band.[133] And local authorities have very little control over council tax – rates have to be set within a range given by Whitehall, unless councils decide to put the matter to a local referendum. Although stamp duty land tax is far more progressive – being charged at the point of sale according to the value of each property – it is widely thought to reduce residential mobility, reducing the incentive for people living in homes with more rooms than they occupy to downsize to smaller properties.[134] According to one estimate, an annual proportional property tax of 0.49% could replace both taxes (along with the 'bedroom tax' on social tenants) at a fiscally neutral rate, while contributing towards addressing the unaffordability of house prices in London.[135]

Business rates are also a critical source of tax revenue for local and regional authorities, charged on the rateable value of property occupied by businesses. However, irregular property revaluations and an unpredictable appeals process have led to large swings in the tax owed by businesses. Meanwhile revenue is slowly decreasing, as online retail rises in prominence. Given the effects of the pandemic on in-person retail and the commercial office market, the tax's future viability is unclear.[136]

Currently, London retains 75% of its business rate revenue, after a pilot from 2018/19-2019/20 when the capital was able to retain 100%. There is a strong case for business rates, in the long run, to be replaced by a land value tax (LVT), which charges based on land prices, rather than property value. Levied on landlords (though certainly capitalised into rents), a land value tax is designed to not discourage occupiers from investing in their properties, which currently increases their business rates liability.[137] It also aims to encourage efficient uses of land, encouraging development of under-occupied space. However, any proposals to introduce an LVT will require significant further study, given, among other factors, the lack of available data on land values, separate from property values.

Two taxes on development operating in London are somewhat more successful. The Mayoral Community Infrastructure Levy and boroughs' Community Infrastructure Levy are both charged on new developments to fund infrastructure and placemaking projects. Together, they unlocked over £2 billion in funding for the Elizabeth Line, providing more than 10% of its total cost, enabling an investment aimed at increasing London's agglomeration benefits.[138] This was combined with a Business Rate Supplement on firms, which raised over £4 billion. Widening the scope for raising funds from these kinds of devolved development and business taxes should be a critical part of any strategy to increase productivity-enhancing public investment in the capital.

Although this report reaffirms the London Finance Commission's recommendations, any devolution of property taxes to London should be accompanied by immediate moves to reform them. The values underlying council tax should be updated and the bands made more proportional, as the LFC recommended, but over the longer term, the system should move towards a fully proportional and progressive property tax, with appropriate mitigations for asset-rich, cash-poor households in London.[139]

Together, devolving property taxes to London would create a stable, immoveable tax base for the city, enabling the productivity-enhancing investments recommended throughout this report. This would still leave the vast majority of tax raised in London under national control, but build incentives for local policymakers to grow the city's tax base.

RECOMMENDATION

The UK government should devolve control over property taxes to London government, allowing the Mayor and London local authorities to update the values underlying council tax bands and add extra bands, to account for house price increases over the last 30 years. This would prepare the ground for a national proportional property tax.

RECOMMENDATION

National government should replace council tax and stamp duty land tax with a devolved proportional property tax, with mitigation for those pushed into unaffordability and the possibility of deferral. London government should gain control over rate-setting and any reliefs and deferrals.

RECOMMENDATION

The Mayor and local authorities should set up a commission to explore long-term alternatives to business rates.

Income tax

Devolving a share of local income tax generated would be complementary to these efforts. It would give local and regional government more of a stake in generating higher wages and enable them to tailor their investment programmes more specifically to their place. This is all while keeping the tax paid by individuals at the same level, to avoid tax competition (a 'race to the bottom').[140] This system would have to be accompanied by a continuously assessed arrangement to redistribute revenues to poorer parts of the country. A study by the Institute for Fiscal Studies, however, argued that devolving a portion of VAT to local areas, as the LFC recommends, may raise issues around judging where value-add is created.[141]

RECOMMENDATION

National government should trial allocating a portion of income tax to local and regional government in London, along with other Mayoral Combined Authorities and Combined Authorities.

Other taxes

Alongside devolution and reforms to existing taxes, there are strong cases for several other taxes, designed both to raise revenue for London government and to affect payees' behaviour. A smart, pay-per-mile road user charging system, based on the model Centre for London proposed in 2019, has the potential to cut emissions and air pollution by up to a fifth, while raising significant revenue for transport investment.[142] It would also, at the margin, encourage dense settlement patterns by discouraging avoidable car use, potentially contributing to agglomeration gains. The Mayor has ruled out introducing such a system following controversy surrounding the extension of the Ultra-Low Emission Zone. However, we believe that the need for additional investment into transport infrastructure, the continued need to account for the societal costs of driving, and the rise of electric vehicles which do not pay Fuel Duty mean that there remains a case for further change. The priority is for any future system to be smart, fair, and provide the right incentives for road-users.

Equally, a small, nightly tax, charged through hotels on visiting tourists was projected to be able to raise between £77 million and £240 million a year in London by the GLA – though this analysis was conducted in 2017 and estimates would likely be higher now.[143] This could build an additional source of revenue for local government, diversifying its reliance on council tax, business rates, and government grant. Equally, it could be invested into the infrastructure strained by tourism, particularly public transport.

On a far larger scale, there is a strong case for London to capture more of the land value uplift created by public investment, particularly into transport infrastructure. One study showed that Crossrail 2, which would link Surrey to Hertfordshire and create a North-South route across London, would create an uplift in land values equal to 221% of the total cost of the project among new and existing properties.[144] Existing taxes, like CIL, MCIL, and Section 106, only capture a small portion of value uplift.

Just as Hong Kong funded its MTR public transit system by selling development rights around train tracks, London could fund new strategic rail and bus projects using land value capture. In Northumbria, 25-30% of a project to re-open the Northumberland Line to passengers was funded via land value capture after years of insufficient financing.[145] This approach, based on obtaining agreements from neighbouring landowners, rather than using a method like a statutory transport premium charge, may not work in London, where landownership is more fragmented and space more contested. However, it is a rare success and worthy of study by TfL.

New local taxes, along with the devolution of funding and spending control recommended by the LFC, are essential for London government to implement many of the changes that would be most impactful in boosting the capital's economy.

RECOMMENDATION

The Mayor of London should introduce a smart, pay-per-mile road user charging system.

RECOMMENDATION

National government should allow local and regional government to design and implement 'tourist taxes'.

RECOMMENDATION

The Mayor should trial the use of land value capture mechanisms on undeveloped land in the capital, to tax uplifts in value due to public investment.

Accountability

It is arguable that placing a greater degree of tax revenue, spending capacity, and responsibility under the aegis of London government may require additional mechanisms for accountability. This has been debated in the national context of the 'trailblazer' devolution deals agreed with the Greater Manchester and West Midlands Combined Authorities, with committees of local MPs created to ensure accountability.[146]

Although the GLA model, based on scrutiny of the Mayor of London by elected London Assembly Members, is more advanced than arrangements in the rest of England, it requires an unrealistically large supermajority vote of two thirds of Assembly Members to make any meaningful impact on mayoral policy. Turnout for Assembly elections and name recognition of members are low.[147] In its place, one model that has been proposed is a local public accounts committee, made up of local authority and parliamentary representatives, to ensure adequate scrutiny, but little progress has been made.[148] In many international cities, like Paris (or London under the Greater London Council), city councils coexist with mayors – the mayor has significant personal power, but the elected council has a degree of parliamentary-style power and oversight, allowing greater democratic input and scrutiny. Regardless of the model, there is a strong case for combining a new wave of fiscal devolution with improved mechanisms for accountability.

However, we might expect that a more powerful role for regional government should increase public scrutiny and interest in its workings – voter turnout for local elections, for example, is seen to be significantly higher in some more devolved systems than in our own.[149] If London is to turn around its fortunes and return to productivity growth, the capital needs both a strategy and the institutions to execute it.

Chapter 4
Conclusion

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London’s economy has become stuck, underperforming compared to its past and to global peers. However, the evidence reviewed for this report, including discussions with a number of experts, suggest a path forward.

We have explored the drivers of London’s productivity to explore what a new model of growth in the capital could look like. Our proposed model centres on three core ambitions: make London more attractive to productive businesses, attract workers and develop their skills, and devolve powers to the Mayor of London to deliver meaningful change. Our recommendations cut across a number of sectors, from housing to transport to migration. Together, they aim to ensure that London’s economy tomorrow isn’t only more productive than in the past decade, but also that its benefits are more widely shared.

As London stands at a pivotal moment in its economic history, the execution of these recommendations could very well determine its future as a competitive, innovative, and equitable global city. We hope this report contributes to a discussion about how to steer London towards a prosperous, dynamic future.

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Appendix

Throughout this report we make recommendations for government at the national and regional level to reboot London's economy. These are listed below.

Making London more attractive to productive businesses

1. National government should increase its investment in the Affordable Homes Programme. The best estimates suggest that London needs more than 30,000 social homes a year for 15 years, and England as a whole needs 90,000—the cost of delivering these is high, at £15.1bn a year, but necessary to ensure that those on lower incomes can afford to live in London.
2. National government should adequately resource local authority planning departments, through expanding grants. To make up for the relatively low supply of new homes in recent years, adequately resourcing them will entail increasing their funding at least to the levels seen in 2010, if not more to address the backlog of planning cases.
3. The Mayor of London should set up an expert commission to decide on 10 sites in London's Green Belt near rail stations for new development corporations. This should include representatives of any future strategic planning bodies for the Wider South East.
4. The Department for Transport should work with Transport for London to improve the reliability, speed and frequency of services in outer London. This involves devolving suburban rail services terminating just outside the southern GLA boundary to Transport for London, as well as funding the necessary capital investments to improve the network. These will deliver a range of long-term benefits – including making it easier to travel into and around London, supporting economic growth and therefore increasing tax revenues from the Wider South East. Land value capture should be explored as a source of funding.

Attracting workers and developing their skills

1. The Apprenticeship Levy should be fully devolved to London and other Mayoral Combined Authorities and Combined Authorities. London government should then increase its flexibility, with longer time limits on spending.
2. National government (or London government, if devolved) should increase the portion of the levy that large firms can transfer to SMEs from 25% to 50%, to help address any 'long-tail' of low-productivity small firms in the capital.
3. National government should return the Adult Education Budget to its pre-austerity funding level.
4. National government should devolve the administration of the Apprenticeship Levy to London, so that the GLA, in partnership with boroughs, can tailor programme design and implementation to the capital's economic and social needs.

5. The Graduate Visa should be retained and extended from two to five years, if restrictions on post-graduation work to ensure high-skill migration are put into place.
6. National government should review the cost of applying for a Skilled Worker Visa and reduce charges for applying for indefinite leave to remain.

Reforming governance and taxes to boost growth

1. National government should devolve London's share of the Immigration Skills Charge to the city, to be spent on green skills provision.
2. The UK government should devolve control over property taxes to London government, allowing the Mayor and London local authorities to update the values underlying council tax bands and add extra bands, to account for house price increases over the last 30 years. This would prepare the ground for a national proportional property tax.
3. National government should replace council tax and stamp duty land tax with a devolved proportional property tax, with mitigation for those pushed into unaffordability and the possibility of deferral. London government should gain control over rate-setting and any reliefs and deferrals.
4. The Mayor and local authorities should set up a commission to explore long-term alternatives to business rates.
5. National government should trial allocating a portion of income tax to local and regional government in London, along with other Mayoral Combined Authorities and Combined Authorities.
6. The Mayor of London should introduce a smart, pay-per-mile road user charging system.
7. National government should allow local and regional government to design and implement 'tourist taxes'.
8. The Mayor should trial the use of land value capture mechanisms on undeveloped land in the capital, to tax uplifts in value due to public investment.

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