MIDLANDS ENGINE
Economic Observatory

MIDLANDS ENGINE
STATE OF THE REGION EXECUTIVE SUMMARY

OCTOBER 2020

Executive Summary

Welcome to State of the Region 2020 – the first annual review of economic performance across the Midlands Engine.

Our State of the Region report has been produced for the Midlands Engine Partnership by our Observatory. It presents something of a stocktake of where our region stands - what we are doing well and where we need to work together to improve economic performance across the Midlands Engine. The report also highlights the far reaching impact of COVID-19 on our regional economy – a shock we are yet to fully understand but which we are already feeling the effects of.

The Midlands is home to almost 11 million people, is responsible for 22% of England's exports – the greatest share of any region; and generates £239 billion annually for the UK economy. That's an economy the size of Denmark's – and a geography serving a greater population than the devolved nations – Scotland, Wales and Northern Ireland, combined.

The region was one of the most prosperous areas of the UK until the 1970s and 1980s. Over the last 5 years it had been experiencing a resurgence of its economic potential, thanks to growth across a wide range of sectors. It is the Midlands which had been bucking the national trend on a host of economic indicators, such as enterprise and employment growth. Much of this was powered by a young, skilled workforce.

However, there are both long-term structural challenges and shorter-term shocks which are preventing us reaching our economic and community ambitions – ambitions which see every part of our region prosper and our communities strengthened.

Hard evidence within our Independent Economic Review, published in April 2020, shows there is a structural productivity challenge leading to a GVA output gap of £76bn. The barriers to achieving the levels of productivity required to close this gap have been identified in four main areas – skills, infrastructure, R&D investment and access to finance.

2020 sees the addition of two further external factors which are having an impact on our economy. Firstly, there is the forecast impact of **Brexit** on the Midlands economy, where research suggests our region will be hit hard. The high degree of specialisation in our manufacturing base, and high level of exporting to Europe present us with serious challenges as trading parameters shift.

In addition to this is the impact of **COVID-19**. Across the Midlands Engine, over 1.49m people were furloughed, nearly 33% of the eligible population, slightly above the UK average of 32%. The full effects on the economy are as yet unquantified, but the Midlands Engine Observatory's COVID-19 Monitors have analysed both early quantitative and qualitative data - analysis which is invaluable as we move forward in uncharted waters, helping us to target local changes and shape regional and national policy making, to support recovery. Our economic impact reporting through the pandemic has captured too the truly remarkable work undertaken by Midlands Engine partners as they work to mitigate the effects of the pandemic on our regions businesses and communities.

Whilst the challenges outlined above are real, and will require concerted effort in partnership to overcome, I am mindful too that we have a unique opportunity ahead of us. An opportunity to carefully assess the needs of our region, and to build back better, stronger and greener. The work of the Midlands Engine Observatory is crucial in understanding how we can do this together, in partnership, and how we achieve our shared ambition for a prosperous Midlands. For it is when the Midlands succeeds that the UK succeeds.

Sir John Peace, Chairman, Midlands Engine

Executive Summary

Independent Economic Review Findings

In April 2020 we published our **Independent Economic Review** which sets out the challenges facing the region. We know there is a productivity challenge with GVA per capita only 76% of the national average leading to a £76bn output gap. In order to fully close the productivity gap (match the UK productivity level by 2030), the Midlands' productivity performance would need to increase at a rate of 2.4% per annum, meaning the region would need to return to (and exceed) productivity growth rates previously seen in the 1980s and 1990s. This is extremely ambitious given how productivity growth has been subdued over the past decade (averaging 0.4% per annum.) and in current climate this will become even more challenging.

The barriers to this growth links to four main areas – skills, infrastructure, R&D investment and access to finance:

Skills

- To reach the national average of 40.2% in terms of higher level skills –requires an additional 390,000 people to gain an NVQ4 qualification. (currently 34%).
- Business highlights shortage of digital skills.
- Region struggles to retain graduates – losing a high percentage of our skilled workforce.

Infrastructure

- There has been decades of underinvestment in our **transport infrastructure** - In 2018/19 the East Midlands was the lowest region in the UK for spend per head on transport at £268. The West Midlands was the eighth lowest at £467. Both regions are below the UK average of £481.
- Poor connectivity – transport and digital especially in rural areas.
- Energy intensive sectors confirm energy capacity as a barrier to growth.

Access to Finance

- Firms regularly cite **Access to Finance** as key barriers to business growth. In particular, access to finance for business growth and innovation (especially the second valley of death and pathway to commercialisation) is commonly cited as one of the most significant challenges for businesses in the region.
- Poor supply side co-ordination, fragmented landscape.
- Lack of awareness of available finance, difficulties in navigating funds available, confusion in appropriate sources.

R&D

- A recent report by NESTA shows that West Midlands is the lowest region for public sector spend per head in **R&D** at £83, this is followed closely by the East Midlands at £89. Public sector investment in R&D across the region as a whole is below the England minus London average, although it has shown strong growth in recent years (relative to the benchmark). R&D spend is concentrated in a relatively small number of highly innovative firms/institutions, masking variable performance across the region).
- R&D spend too concentrated.
- Diffusion of knowledge across business base is too slow.

On top of these structural challenges, 2020 saw two additional impacts on the economy. Firstly there is the potential impact from **COVID-19.** Across the Midlands Engine area over 1.49m people were furloughed, which is an uptake rate of 33%, above the UK average of 32%.

There is also the potential impact of **Brexit** on the Midlands Economy with predicted high levels of exposure of GDP and Local Labour Income exposure high at an average of 13%. The manufacturing sector is most exposed to Brexit and the likelihood that Brexit would make inter-regional inequalities worse.

This report will now look in greater detail on the impact of COVID-19 across all areas of the economy.

Executive Summary

Impact from COVID-19:

- The speed and scale of this economic shock is unprecedented. It is likely that there will be strong sectoral / place / demographic differences on business survival, future growth and employment. KPMG have produced some GVA forecasts for 2020/2021 that show **West Midlands, East Midlands and East of England as being the top regions to be forecast to be hit the hardest.**
- Based on the number of workers furloughed as a percentage of eligible workers suggests that of the ten main Midlands Engine sectors that the **visitor economy (75.6%), construction (57.5%), advanced manufacturing and engineering (46.0%) and retail (42.0%)** will be the sectors most impacted from COVID-19. Analysis suggests that public sector including education (7.7%) and life sciences and healthcare (10%) sectors will be least impacted.
- Following the responses to the Bank of England's Decision Maker Panel (DMP) survey, analysis indicates that **employment across the Midlands Engine could fall by 8.1% in 2020 Q4**. The sectoral composition of each local authority is a key factor in determining local vulnerabilities to the crisis. **Sales in the Midlands Engine local authorities are expected to be decline by an average of 13% by 2020 Q4** – in line with the national estimate. **Investment is expected to decline by 20.2% in 2020 Q4** across the Midlands Engine – this is higher than the national estimate of 19.7%.
- Across the Midlands Engine there were over **1.49 million workers furloughed** which is an uptake rate of 33%, above the UK average of 32%.
- In September 2020, there were **428,515 claimants aged 16 years and over** in the Midlands Engine which is 216,975 (+102.6%, UK +113.6%) more claimants than March 2020. The number of claimants as a percentage of residents aged 16 years old over was 5.1% in September compared to 5.0% for the UK.

Pre COVID-19 Performance - Headline Statistics for the Region

- Total GVA of £238.6bn in 2018 for the Midlands Engine. This has increased by 3.5% (nearly +£8bn) since 2017 compared to an increase of 3.4% for the UK.
- GVA per head was £23,190 in the Midlands Engine in 2018. This has increased by 2.8% (£627) since 2017 compared to an increase of 2.7% for the UK. Shortfall of £5,539 compared to the UK average of £28,729.
- The number of enterprises in the Midlands Engine increased by 1.1% (+4,480) since 2017, to reach 397,960 in 2018. Over the same period, the equivalent UK increased by 0.5% (+13,920).
- 49,775 enterprise births in the Midlands Engine in 2018, an increase of 430 (+0.9%) compared to a decrease of 0.3% for the UK.
- 4,414,000 jobs in the Midlands Engine in 2018, a decrease of 9,000 (-0.2%) since 2017. Overall, UK jobs increased by 0.6% over the same period.
- Across the Midlands Engine geography, 34.0% of the working age population were educated to NVQ level 4 and above in 2019, compared to the UK average of 40.2%. NVQ4 qualifications have increased by 3.8% from 2018, compared to the UK growth of 2.9%. 9.1% of the working age population in the Midlands Engine had no qualifications which is above the UK average of 7.9%. Since 2018, there was a 3.5% decrease compared to a 1.3% decrease for the UK.
- In 2018/19 there were a total of 78,700 apprenticeship starts in the Midlands Engine, this is an increase of 5.8% (+4,290) apprenticeships from 2017/18, which is above the national increase of 4.7% increase. However, levels are still significantly below 2016/17 where apprenticeship starts stood at 104,080 in the Midlands Engine area.
- The average unemployment rate across the Midlands Engine was 4.5% (222,700), compared to 3.9% for the UK in the year ending March 2020. The Midlands Engine area has decreased by 0.4pp and the UK by 0.3pp. The average employment rate across the Midlands Engine was 74.7% (4.7m), compared to 75.9% for the UK in the 2019. The employment rate has increased by 0.8pp, with the UK growth rate at 0.7pp.
- Resident earnings in the Midlands Engine was £28,783 in 2019. This has increased by 2.3% (+£644) since 2018 compared to 2.7% for the UK. Shortfall of £1,570 compared to the UK average of £30,535.

Policy Considerations From COVID-19

Table 1: Policy Consideration by Theme from COVID-19:

THEME	KEY CONCERNS
Access to Finance & Cashflow	• Financial support enquiries remain common. There is a real appetite for funding with many businesses calling their local growth hub to identify funding streams they can tap into. • There continues to be requests for funding for capital equipment and diversification. • There is a desire from businesses of all sizes to reconfigure their businesses and invest in capital. • Some businesses who had shelved growth plans, including inward investment opportunities, are revisiting these projects and are looking for grants and other investment.
Redundancies & Furlough	• There are increasing concerns about the impact of winding down of the Coronavirus Job Retention Scheme and the resulting job losses. • Furlough numbers are on the rise – might be down to flexible furlough – there is need to monitor dynamics and interdependencies occurring in the economy and across sectors to inform recovery planning.
New Business Models	• Remote working to some degree is now widely accepted as a permanent way of life for many businesses. • Increase in requests for property searches across the region suggests hope for the commercial property market which will already have been impacted by the inevitable increase of available space, particularly offices, post COVID-19.
Recruitment	• Starting to see some companies considering recruitment campaigns & planning to employ staff from potentially October, but still concerns about future. • Some companies are bringing employees back into the office, and some more thinking about how to interview candidates & plan recruitment campaigns.
Consumer Behaviour & Sales	• Sales in some sectors seem to be recovering strongly both in terms of business to business and business to consumer. • Retail sales benefitted in July from a full month of non-essential retailers being allowed to open (having been allowed to open from mid-June after being closed from 23 March).
Supply Chains	• Businesses are being disrupted by delays from suppliers. • Anecdotal evidence suggests some degree of supply chain disruption has begun, with businesses citing parts of their supply chain going into administration as well as the impact of local lockdowns as key reasons for this friction.
Overseas Investment	• A string of international companies moving to the West Midlands has put the region top of the UK's overseas investment chart for five years running. New data from the Department for International Trade has revealed that the West Midlands has again been hailed as the UK's leading location for Foreign Direct Investment (FDI) outside of London and the South East.
Brexit	• There has been a noticeable absence of businesses reporting any planning for Brexit. Anecdotally this is due to a combination of time to digest and plan, lack of capital and impacts relating to COVID-19 which have impacted on supply chains and warehousing. • Larger businesses appear to be preparing plans from last year whilst smaller businesses do not feel prepared locally.