8. Conclusions: growth patterns in the next 25 years, and the implications for the office stock and the infrastructure

Deep-seated international forces behind the City's growth

Chapter 3 argued that the deep-seated causes of the dynamism of international financial services, and so of the City of London, were trade and financial liberalisation in the post-war world economy, and the offshore revolution. Chapter 5 suggested that these forces remained intact and might even gather momentum over the next 10 or 20 years. The intellectual shift towards more liberal economic policies in the Third World during the 1980s and the fall of communism in 1990 have fundamentally altered the world economy. In particular, they have led to a huge increase in the number of countries whose domestic financial markets interact with international financial markets, including markets located in London.

The impact of these forces has varied from industry to industry. Offshore banking boomed in the late 1960s and 1970s, but in the 1980s its growth rate appears to have slowed to a speed closer to that of the world economy. More recently the growth of international banking may have accelerated once more. Foreign exchange trading has been a high- growth activity throughout the last 30 years, but suffered a cyclical reverse in late 1995 and 1996. The spectacular growth areas of the mid-1990s have instead been derivatives and corporate finance, particularly where these are global in scope. Only in one activity - insurance - has the City clearly lost ground to international competition in the last 25 years.

In the 1950s financial business in the City was predominantly expressed in sterling, and related to the UK domestic market and the Commonwealth; in the 1960s and 1970s it became increasingly international, but with a focus on dollar-denominated business and the leading industrial countries; in the 1980s and 1990s it has involved an ever-widening range of currencies and countries. As the growth of international financial services' output is likely to remain well above the growth of world output for the foreseeable future, the growth prospects of the City's industries remain excellent.

Prospects for City-type employment and incomes

In broad terms, the global output of international financial services could well run at over twice the rate of world output as a whole for the next 10 or 20 years. This would imply that their output might rise by 7% or more a year, well ahead of the trend increase in UK national output. The UK may find its share in world financial services undermined, at least to some degree, by the rise of offshore financial centres. But these offshore centres sometimes have a symbiotic relationship with London so that the growth of offshore centres (such as island-based tax havens) may proceed in tandem with the City's growth. An example is insurance, where business may be booked in Bermuda but only after much of the high-value-added work (brokerage, legal work and so on) has been done in London. A reasonable working assumption is that the City's real output will rise by at least 6% a year over the next 25 years, as it has done in the past.

The survey of large City employers (reported in Appendix 5) did not identify plans for heavy recruitment over the next few years. In fact, some employers (such as the UK clearing banks) are still thinking in terms of "down-sizing" and plan to switch employment to lower-cost locations in the UK. But they were exceptional. Most employers expect to increase numbers employed, if at a slower rate than in the past. Apparently, the correct forecast should be of slower growth in financial services' employment than the 1 1/2% annual average in the past 25 years. However, this is not necessarily right, because much of the growth in future - as in the past - will come from new entrants to the City. The City today is far more cosmopolitan than it was in the 1960s, because of successive waves of new foreign participation in its financial markets. Over the next 25 years the likelihood has to be of rising representation from such countries as China, India, Indonesia, Brazil and so on.

An assessment of the industrial composition of the City at present was given in Chapter 3. A projection of its future growth is given in Tables 6.1 to 6.4, reflecting the analysis in Chapters 5 and 6. The underlying thought has been that the future will be much like the past, with the most rapidly- growing industries in the last five years continuing to be the most rapidly-growing in next 10 or 20 years.

The difference between the 6%-a-year or 7%-a-year assumed trend growth rate of real output and employment growth of under 2 1/2% a year points to continued large increases in real output per head and personal incomes. This makes sense because of the globalisation of financial services activity, with consequent increases in the size of deals of all kinds (i.e., corporate finance deals, the average transaction size in bond and equity markets, currency trades and so on), advances in electronic technology and increasing skills. It is relevant that people working in the City are generally younger than the national average, implying scope for further skill enhancement and income gains. One consequence is that the income differential between the City and other kinds of employment seems likely to widen further. The income differential will act as a magnet, causing employment in international financial services to rise faster than in other activities.

Key points for planning policy

Two very important points need to be emphasized as background to public policy, particularly policy on planning consents and the financing of infrastructure. First, in the last 25 years the extra employment generated in the Square Mile by the dynamism of high-value-added international financial services has been offset by the contraction of lower-value-added non-financial-services activities (and also by a relative decline in UK-based financial services located within the Square Mile). A key finding of the study is that non-financial-services activities now account for such a small proportion of employment in the Square Mile that further significant displacement on these lines is no longer possible.

Unless there is a marked shift in the location of financial services from the Square Mile to the rest of London, it will be the Square Mile's *total employment* - as distinct from its *financial services employment* - which now starts to grow by between 1% and 2 1/2% a year. The latest Census data provides support for this conclusion. In contrast to the steady falls within the Square Mile seen since 1971 (1978 excepted), total employment rose by 20,000 in the last two years. The total number of employees has grown at an annual average rate of 4% in the last two years. The total for financial service sector employment rose at an average annual rate of over 6%. There is little or no room for non-financial employment to be squeezed out any more.

The implications for the size of the Square Mile office stock and London's transport infrastructure are obvious. As far as transport is concerned, pressure on existing facilities seems certain to increase. So far the increasing numbers of passengers working in financial services have been compensated by falling numbers of passengers working in other industries. This will not continue.

Secondly, the development of the City's office stock over the past 25 years - in terms of the relationships between employment, the total amount of space and the rent charged - demonstrates that, when the demand for and supply of space become unbalanced, the market clears by a change in rents. Financial services are long-term high-growth industries. If the necessary planning consents had been granted, if the office blocks had been built and if the requisite infrastructure had been put in place, employment in the Square Mile today could consist of both the original low-value-added activities well-represented in the early 1970s and the new high-value-added activities that have entered in the last 25 years. This may seem startling, but employment and population densities in the Square Mile (and in central London as a whole) are not particularly high compared with New York or Tokyo.

Instead the consents were not granted (or, at any rate, not granted soon enough) and the infrastructure was not put in place. As a result, the boom in international financial services in the early and mid-1980s drove up rents and labour costs. These soon reached levels unacceptable to the low-value-added industries, which were driven out. The change in policy towards planning consents in the mid-1980s was followed by a marked rise in space availability in the early 1990s. Rents fell sharply and employment growth resumed. To repeat, once space has been built, rents will fall (or stop rising) to fill it up. If necessary, space per head changes to help keep supply and demand in balance. (As construction costs rise over the medium term with general inflation, the residual beneficiaries of rising rents - and residual victims of falling rents - have been the City's landlords/landowners. Of course, the demand/supply balance in the Square Mile itself is also strongly conditioned by the attitude of neighbouring boroughs towards the granting of office planning consents.)

The argument of the last few paragraphs needs to be remembered when considering the projections of City-type employment and the associated demands for office space given at the end of Chapter 6. These tables reflect varying assumptions about employment growth (1% a year, 1 3/4% a year and 2 1/2% a year) and about space per head (static, and rising by 3/8% or 3/4% a year). But nothing has been said here about two important subjects,

- how the additions to the office stock are distributed between the Square Mile and the rest of London, and

- the much broader question of the distribution of financial services employment and office accommodation between London as a whole and the rest of the country.

Moreover, the projections are not cast in stone. In practice, there will always be a complex interplay between employment growth, planning policy and new office construction, with rents being the variable that changes to keep newly-built space more or less full. The central conclusion of the study is that the driving forces behind the City's growth in the last 25 years are still very much in place and will remain so for the next 25 years. This conclusion will stand, whatever planning policy is adopted by London's local authorities.