

## **The UK in the World Economy: Commentary on the Charts**

### **Ken Coutts and Robert Rowthorn**

#### **Economic Growth**

The performance of UK manufacturing industry has been poor by international standards, but services have done extremely well (Chart 1). As a result, per capita income in this country has grown slightly faster than in the USA (Table 1).

#### **Paying Our Way**

The UK has a balance of payments deficit equal to 3% of gross domestic product (GDP). This is much smaller than the US deficit and is not a cause for immediate alarm (Chart 2). The main items in the balance are as follows:

#### ***Deficit Items***

- *Manufactured goods* - a large and growing deficit (Chart 3).
- *Foreign holidays* – a large and growing deficit (Chart 4). This deficit is now equal to the entire UK surplus from insurance and financial services.
- *Energy* – roughly in balance at present, but moving into deficit with the decline of North Sea production and higher fuel prices (Charts 5 and 6).

#### ***Surplus Items***

- *Knowledge-based services*: insurance and finance, business services, education – a large and growing surplus on most items with virtually every country in the world, including the USA (Tables 2 to 4, Charts 7 and 8).
- *Income from overseas investments* (profits and dividends) – a large and variable surplus which has recently stopped growing (Chart 9).

There are also other items, such as food and raw materials, but they are no longer of such importance.

#### **Structural Change**

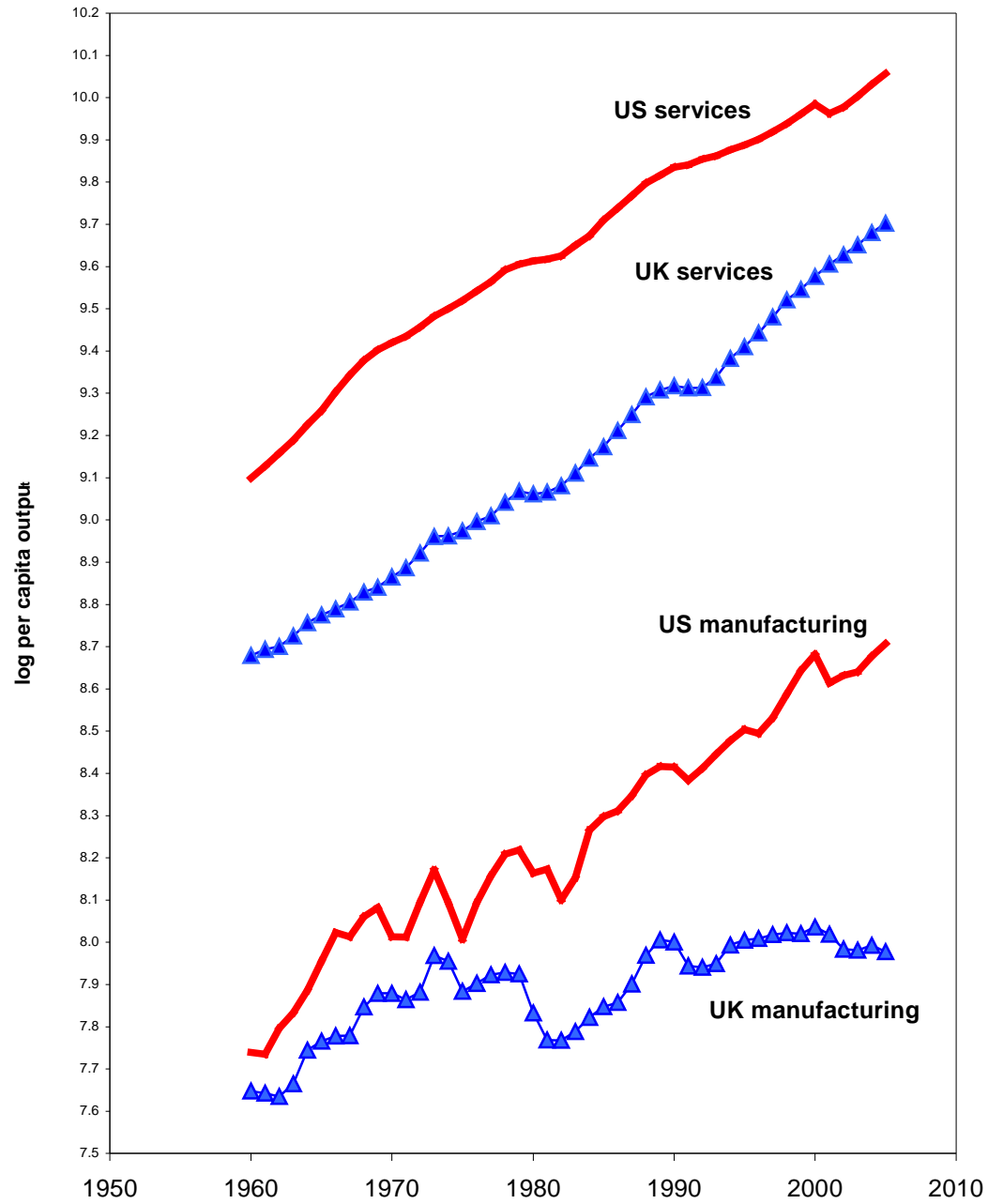
No other advanced economy has undergone such a dramatic transformation in the structure of output, employment and the balance of payments.

- *Manufacturing employment and output* – employment in this sector has fallen faster than in any other advanced economy (Charts 10 and 11). Output has risen much faster elsewhere.
- *Balance of Payments* – the UK is the only advanced economy to have experienced a major shift in the pattern of exports from manufacturing to knowledge-based services. In most advanced economies the balance of trade in manufactures has remained roughly constant as a share of GDP (Charts 12 and 13). As a share of GDP our knowledge based services are now many times larger than those of the USA (Chart 14a-b).

#### **No Room for Complacency.**

Growing deficits on energy and foreign holidays seem inevitable. To cover these deficits will require a larger surplus from knowledge-based services and overseas investment. We must also halt the slide in manufacturing. We cannot afford to neglect this sector, which still accounts for 60% of our exports. It is not a matter of choosing between services and manufacturing. We need both

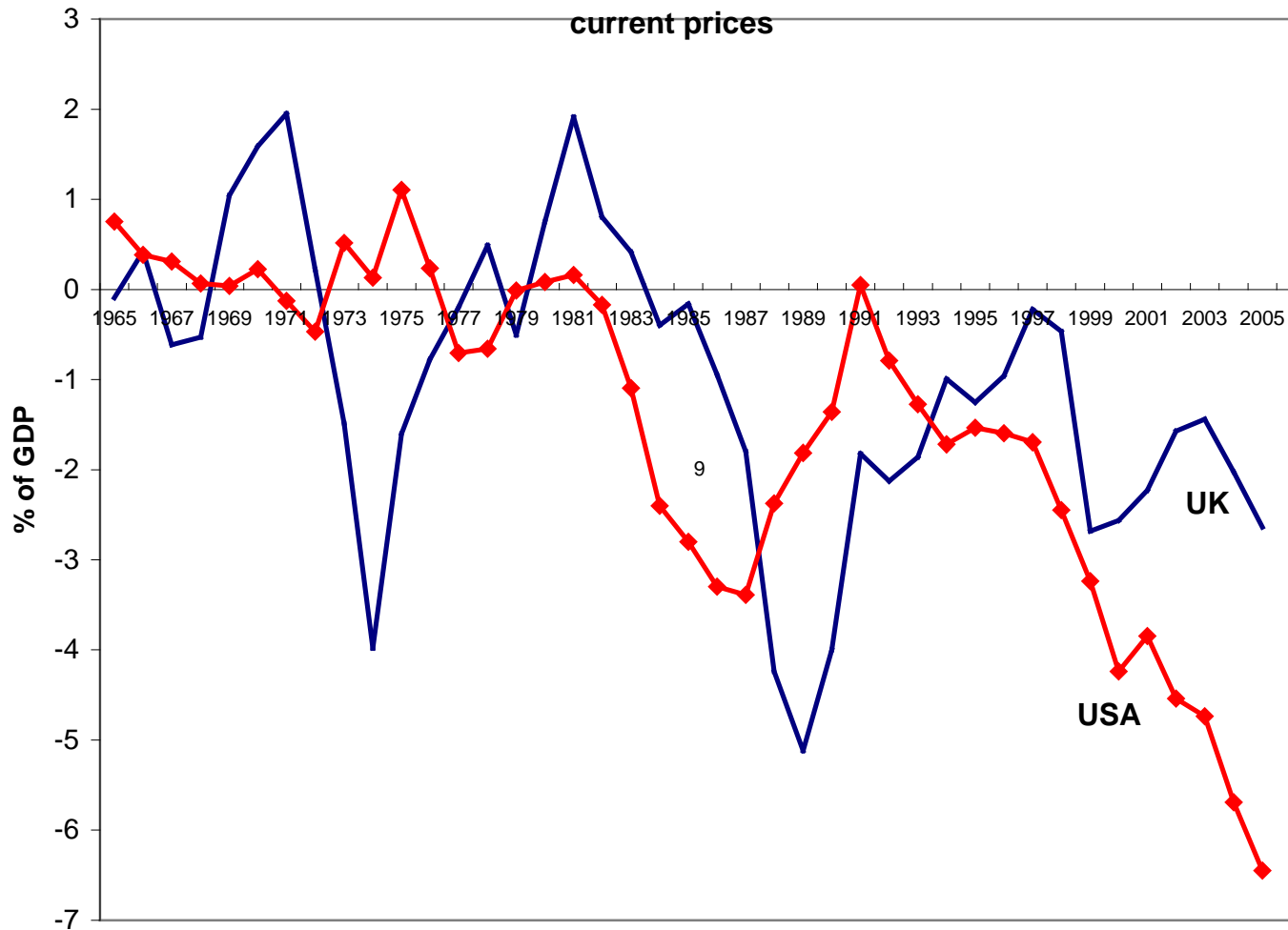
**Chart 1: Real Output per Head of Population  
(\$US 1995 at PPP)**



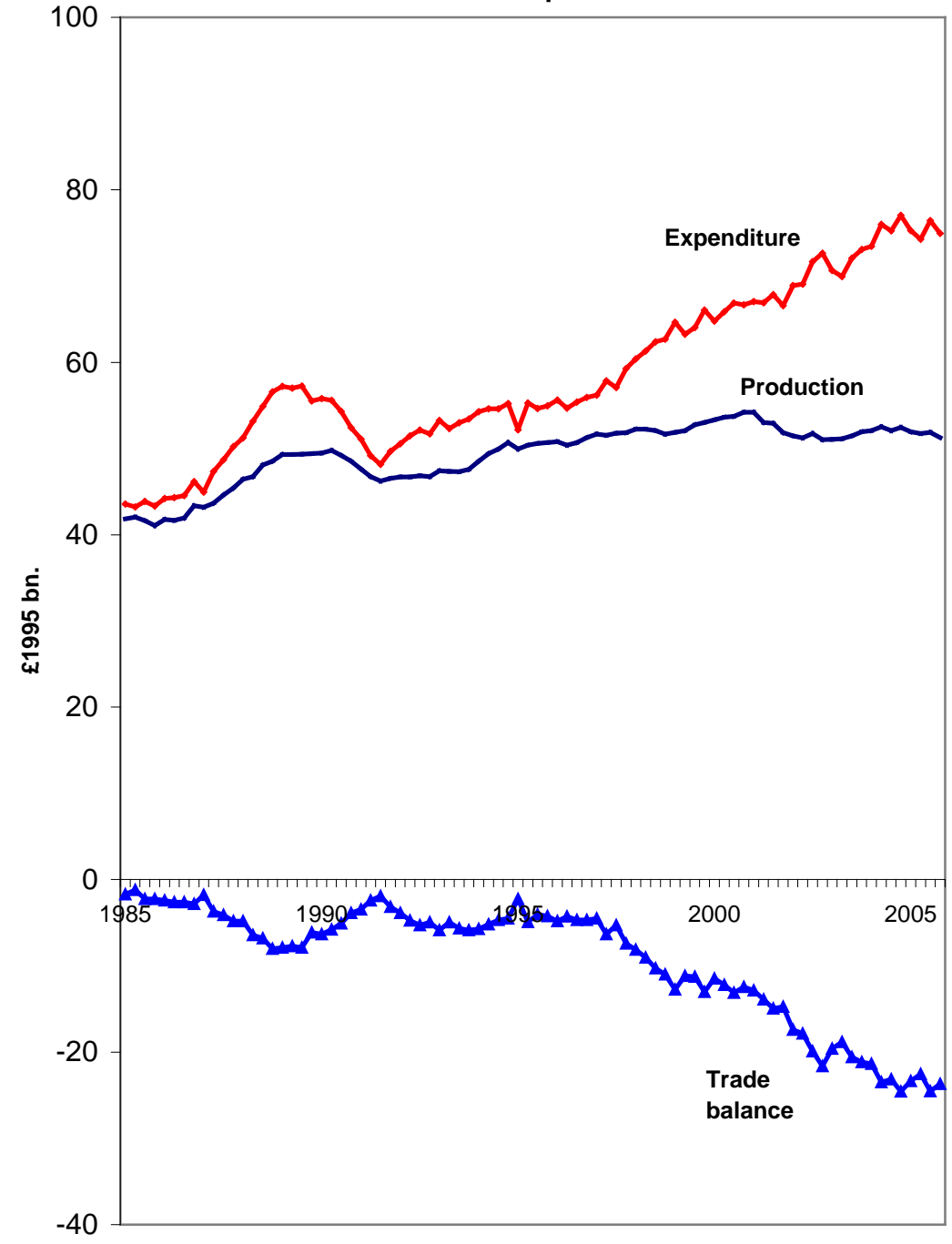
**Table 1**  
**USA and UK Compared: 1990-2005**

	percent change per annum	
	<b>USA</b>	<b>UK</b>
<b>Output</b>		
Goods and Services	3.0	2.4
Manufactures	3.4	0.3
<b>Population</b>	1.4	0.4
<b>Output per Head of Population</b>		
Whole economy	1.6	2.0
<b>Employment</b>		
Whole economy	1.3	0.5
Manufacturing	-1.4	-2.8
<b>Productivity (output per employed person)</b>		
Whole economy	1.7	1.9
Manufacturing	4.8	3.1

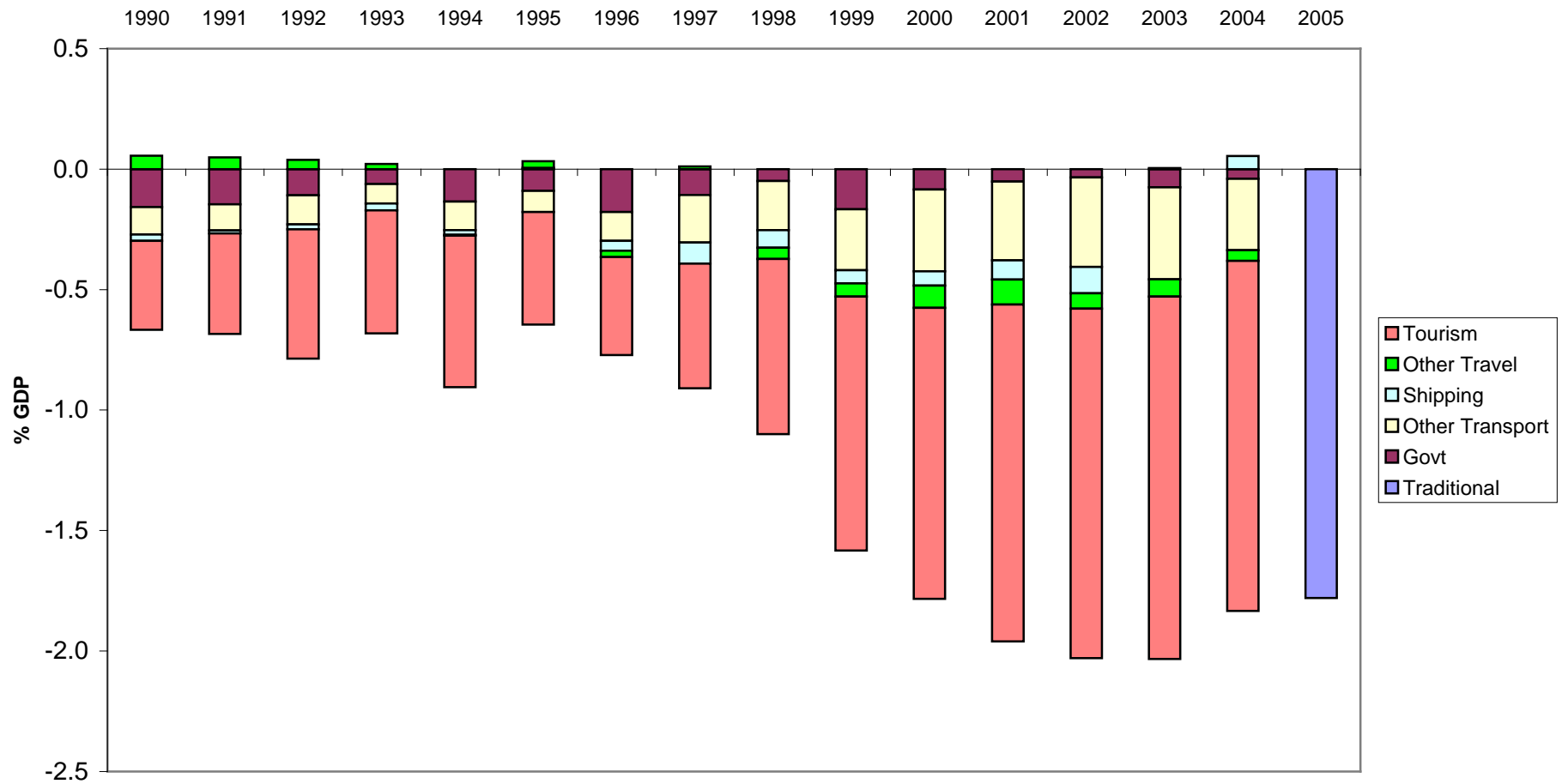
**Chart 2. Current account of the balance of payments  
USA and UK 1965 - 2005**



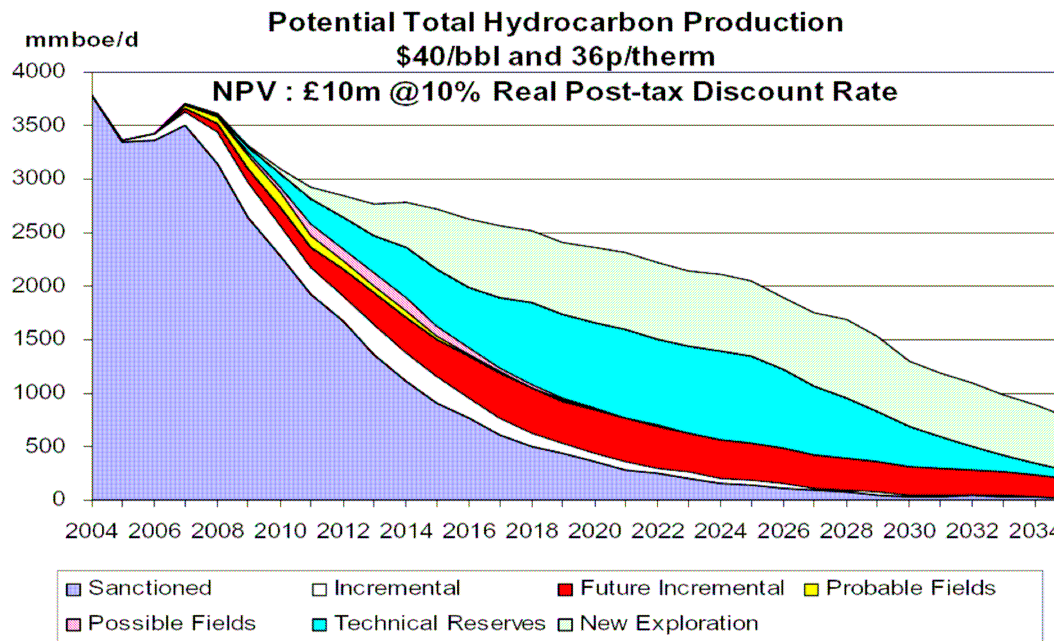
**Chart 3**  
**UK Manufacturing expenditure, output and trade balance**  
**1985 - 2005**  
**constant prices**



### Chart 4: UK Balance of Trade in Traditional Services

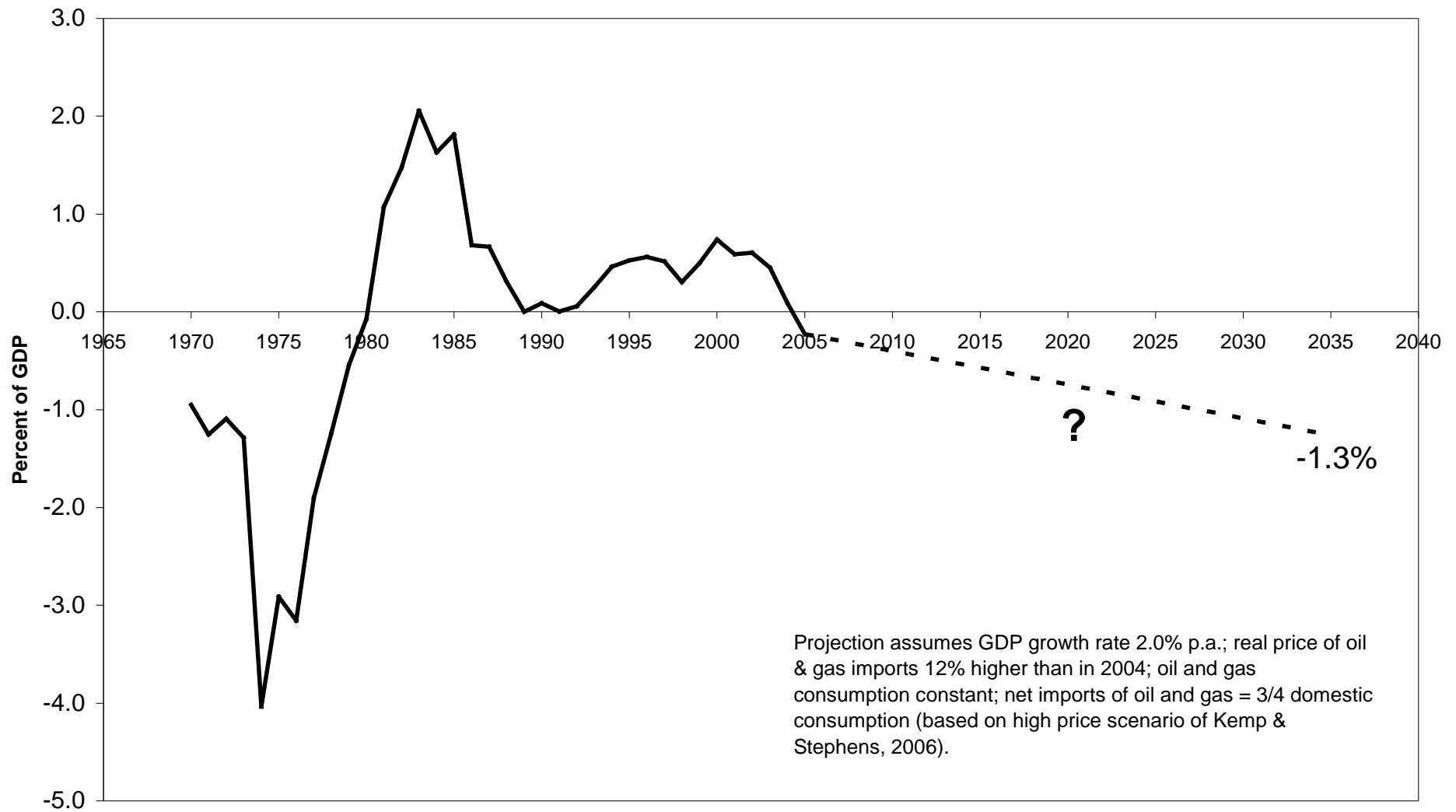


## Chart 5: Total Oil and Gas Production – High Price Case



Source: Alex Kemp and Linda Stephen, *Prospects for Activity Levels in the UKCS to 2035 after the 2006 Budget*, North Sea Study Occasional Paper 101, University of Aberdeen, 2006

Chart 6. UK Energy Balance of Payments 1970-2035





**Table 2**  
**Breakdown of Services and Property Income in UK Balance of Payments**

	Balances		% of GDP		Change
	1990	2005	1990	2005	
<b>Knowledge-based services</b>	<b>7397</b>	<b>37826</b>	<b>1.5</b>	<b>3.5</b>	<b>2.1</b>
<i>of which:</i>					
Insurance+	585	2350	0.1	0.2	0.1
Financial services	3333	13939	0.7	1.3	0.6
Other business services+	3520	13511	0.7	1.3	0.6
Computers & information+	301	3383	0.1	0.3	0.3
Other services+	-4	4643	0.0	0.4	0.4
<b>Traditional services and transfers</b>	<b>-7992</b>	<b>-31493</b>	<b>-1.6</b>	<b>-2.9</b>	<b>-1.3</b>
<i>of which:</i>					
Transport	-706	-2798	-0.1	-0.3	-0.1
Travel	-1565	-16036	-0.3	-1.5	-1.2
Government	-789	-258	-0.2	0.0	0.1
Transfers	-4932	-12401	-1.0	-1.2	-0.2
<b>Income++</b>	<b>-2979</b>	<b>26413</b>	<b>-0.6</b>	<b>2.5</b>	<b>3.1</b>
<i>of which:</i>					
Retained earnings++	6253	18148	1.2	1.7	0.4
Dividends & other income++	-9232	8265	-1.8	0.8	2.6

+ data for 1990 taken from 1991

++ data for 2005 taken from 2004

**Table 3**  
**Breakdown of Knowledge-Based Services**

**UK Balance of Trade**

	<i>£m</i>		<i>% of GDP</i>		<i>Change</i>
	1991	2004	1991	2004	
<b><i>Insurance</i></b>					
Life insurance, pension funds, freight	-228	-832	-0.04	-0.08	-0.04
Reinsurance & auxiliary insurance	981	4050	0.19	0.39	0.20
Other direct insurance	-168	2338	-0.03	0.23	0.26
<b><i>Financial services</i></b>					
Monetary financial institutions	1384	2332	0.26	0.23	-0.04
Fund managers	231	1418	0.04	0.14	0.09
Securities dealers	976	5122	0.19	0.50	0.31
Other brokerage & commissions	432	3370	0.08	0.33	0.24
<b><i>Other business services</i></b>					
Merchanting & other trade related	349	1750	0.07	0.17	0.10
<b><i>Consulting:</i></b>					
Legal	425	1564	0.08	0.15	0.07
Accounting	41	439	0.01	0.04	0.03
Business management	243	1018	0.05	0.10	0.05
Advertising & market research	159	1192	0.03	0.12	0.09
Research & development	248	2527	0.05	0.24	0.20
Architectural, engineering services	823	3717	0.16	0.36	0.20
Other miscellaneous	1232	1304	0.24	0.13	-0.11

*Note:* Detailed definitions are given in the appendix

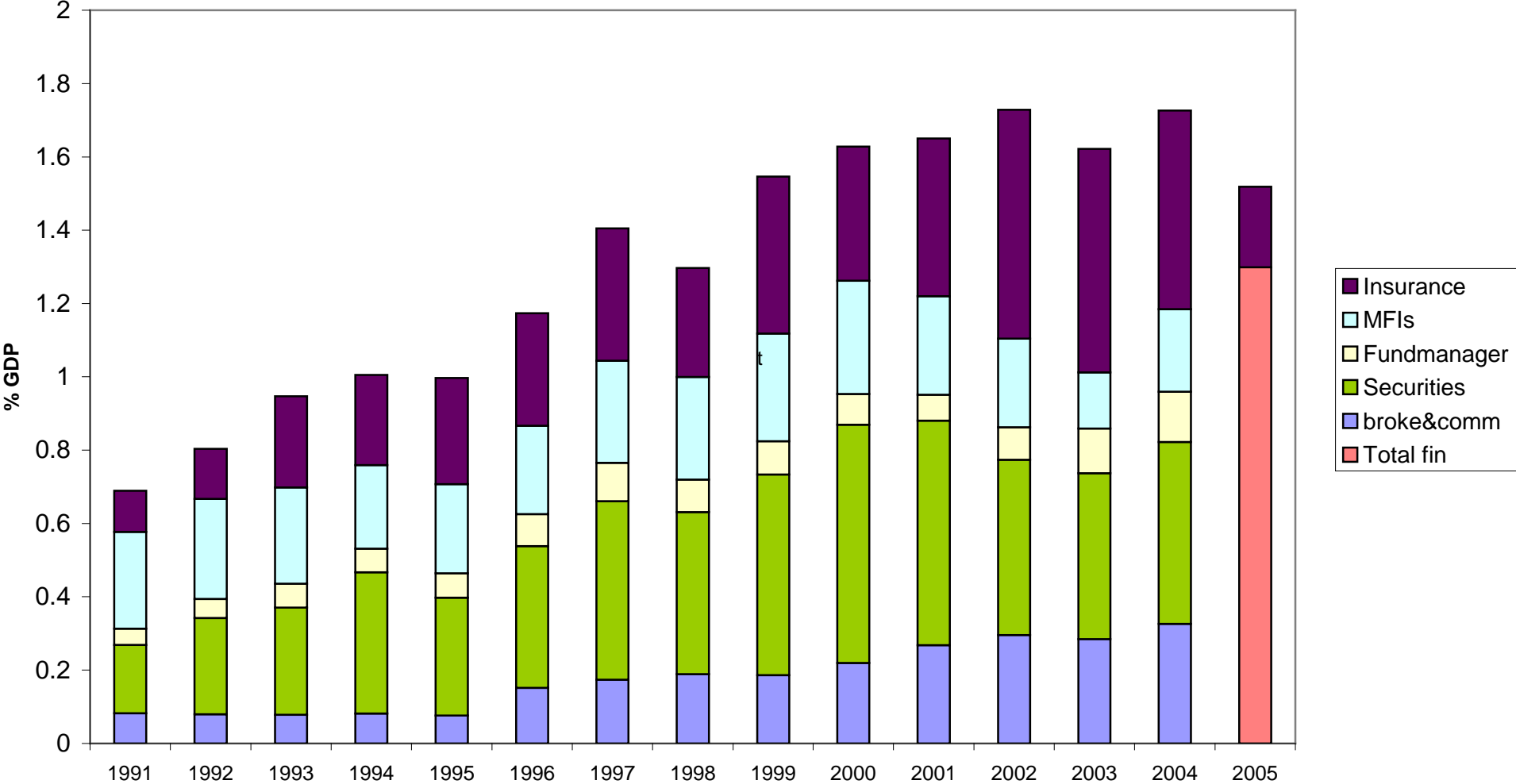
**Table 4**  
**International Students Studying at UK Universities: 2003 - 2020**

thousands

	2003	2020	Change
<b>Origin</b>			
Africa	19	44	25
Middle East	10	20	10
Asia	74	266	192
America	23	33	10
Europe	111	146	35
Oceania	2	3	1
<b>Total</b>	<b>238</b>	<b>511</b>	<b>273</b>
<b>Subject Area</b>			
Business Studies	51	132	81
Social Science	21	38	17
Computing Science	16	64	48
Engineering and Technology	30	59	29
Physics and Math. Sciences	23	39	16
Medical and Health Sciences	17	32	15
Architecture and Building	6	12	6
Law	12	21	9
Arts and Humanities	43	70	27
Education	10	18	8
Other	8	25	17
<b>Total</b>	<b>238</b>	<b>511</b>	<b>273</b>

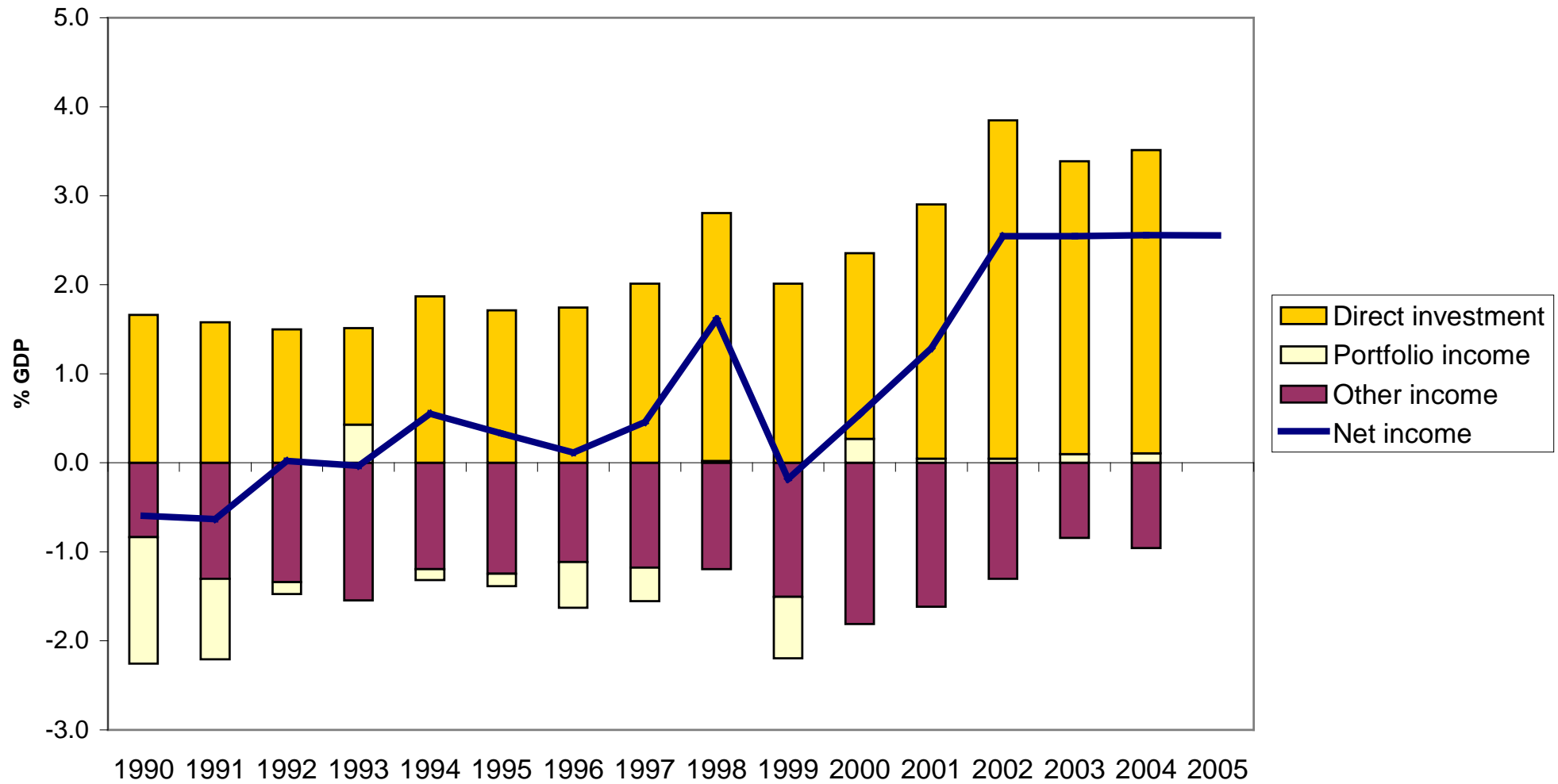
Note: This table is derived from the Base Projection in A. Böhm et al  
*Vision 2020: Forecasting international student mobility - A UK perspective*, British Council.

### Chart 7: Insurance and Financial Services

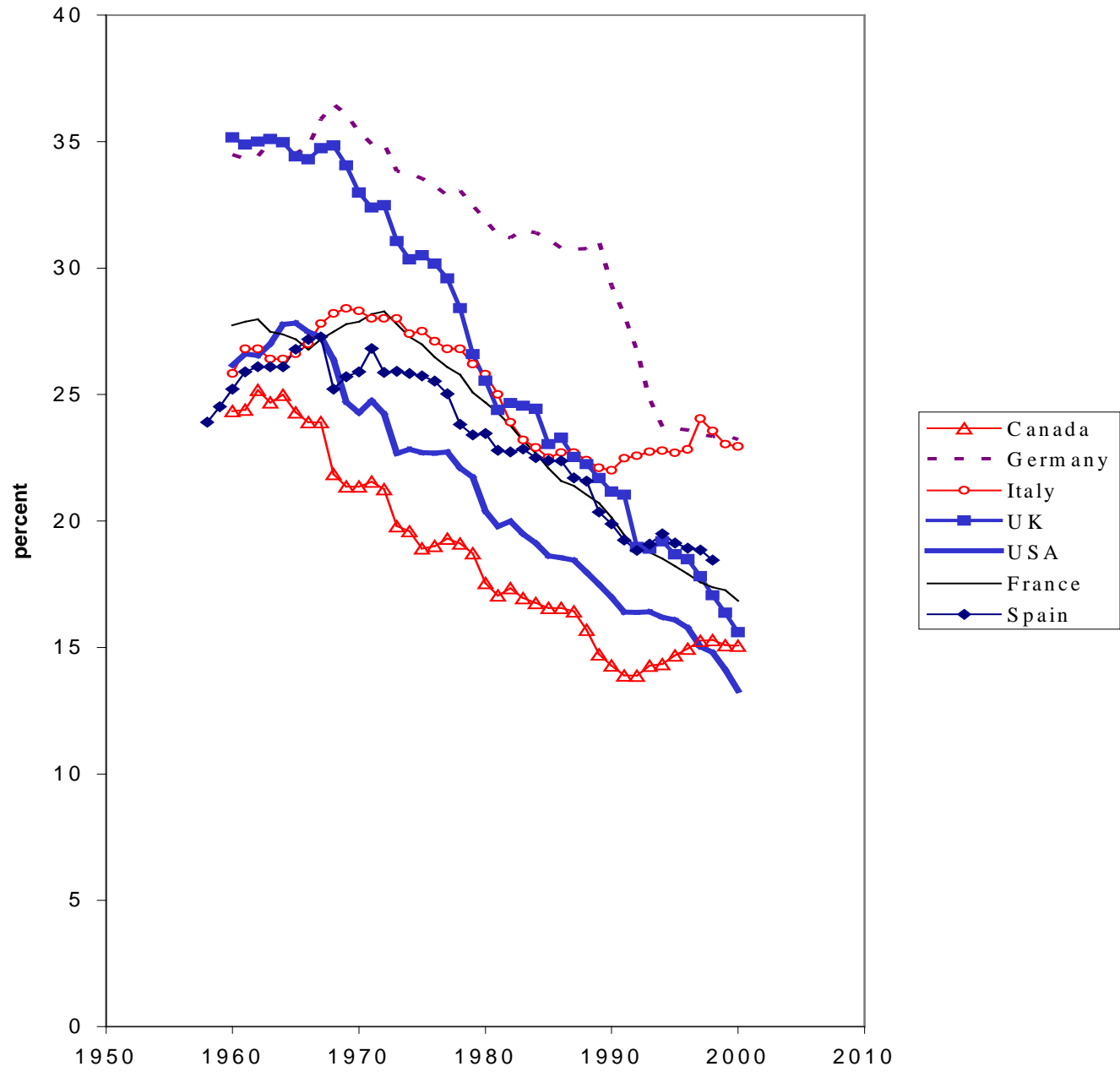




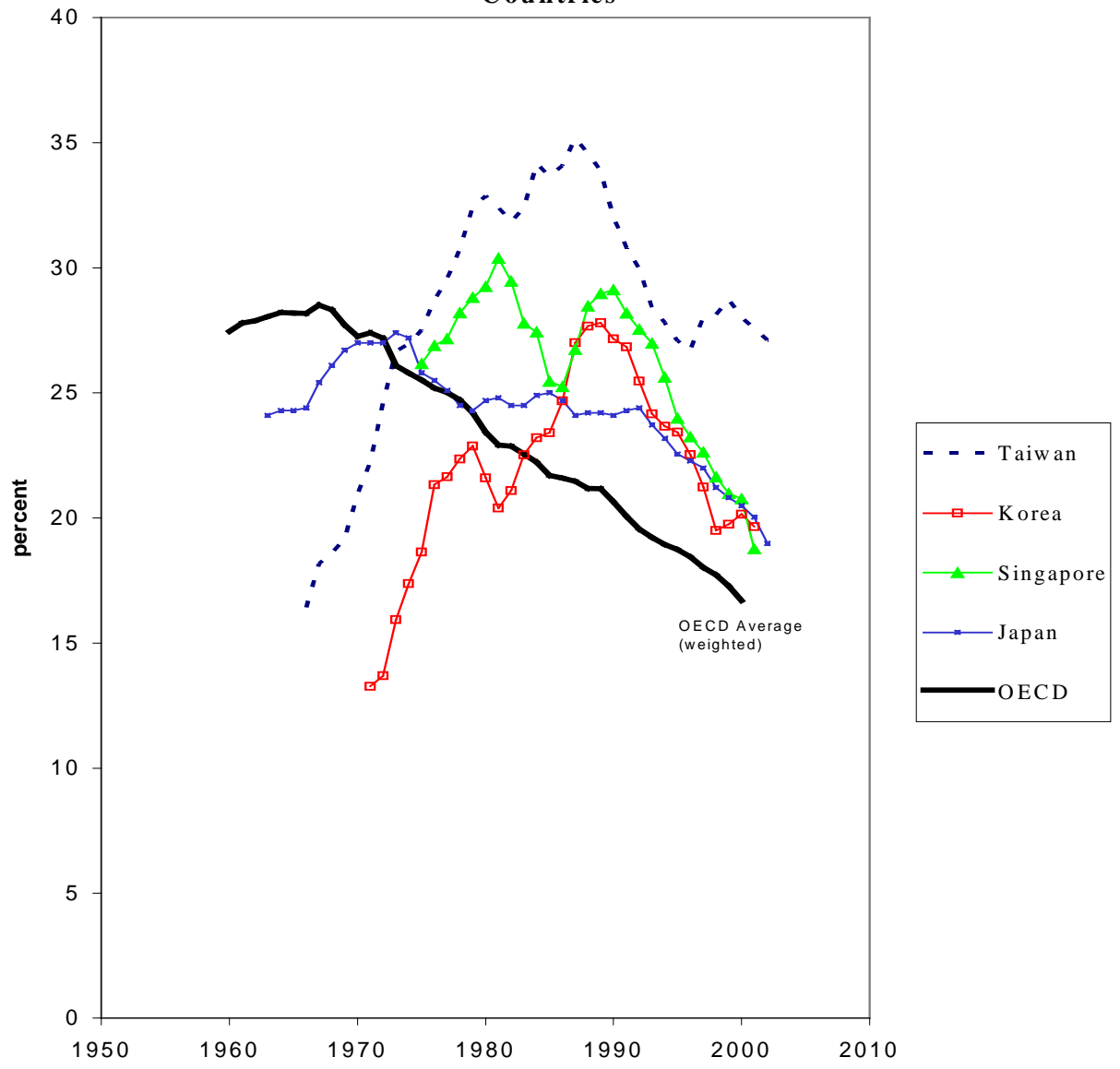
**Chart 9: Net Income**



**Chart 10**  
**Share of Manufacturing Employment in Europe and**  
**North America**

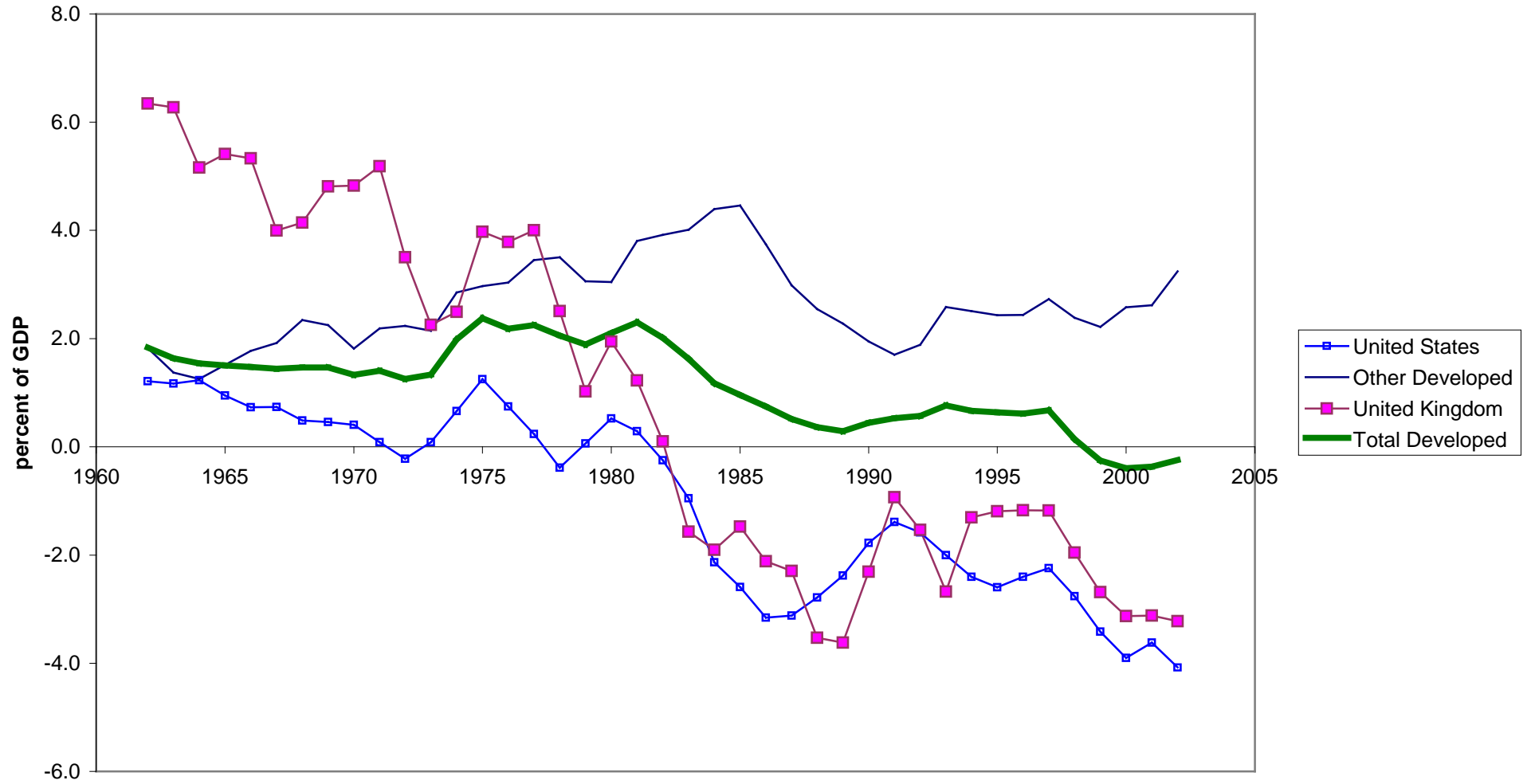


**Chart 11**  
**Share of Manufacturing Employment in Selected Asian Countries**

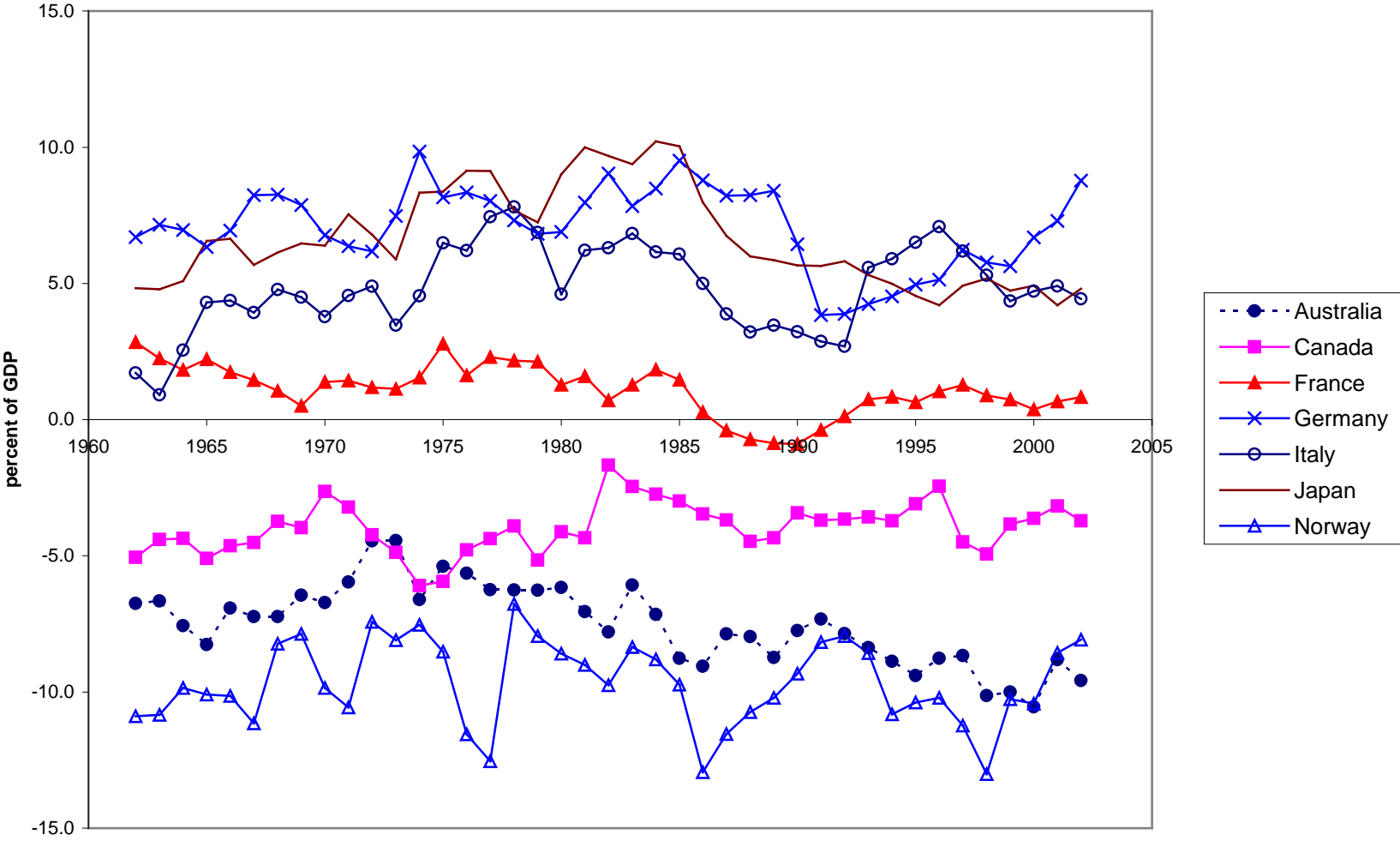




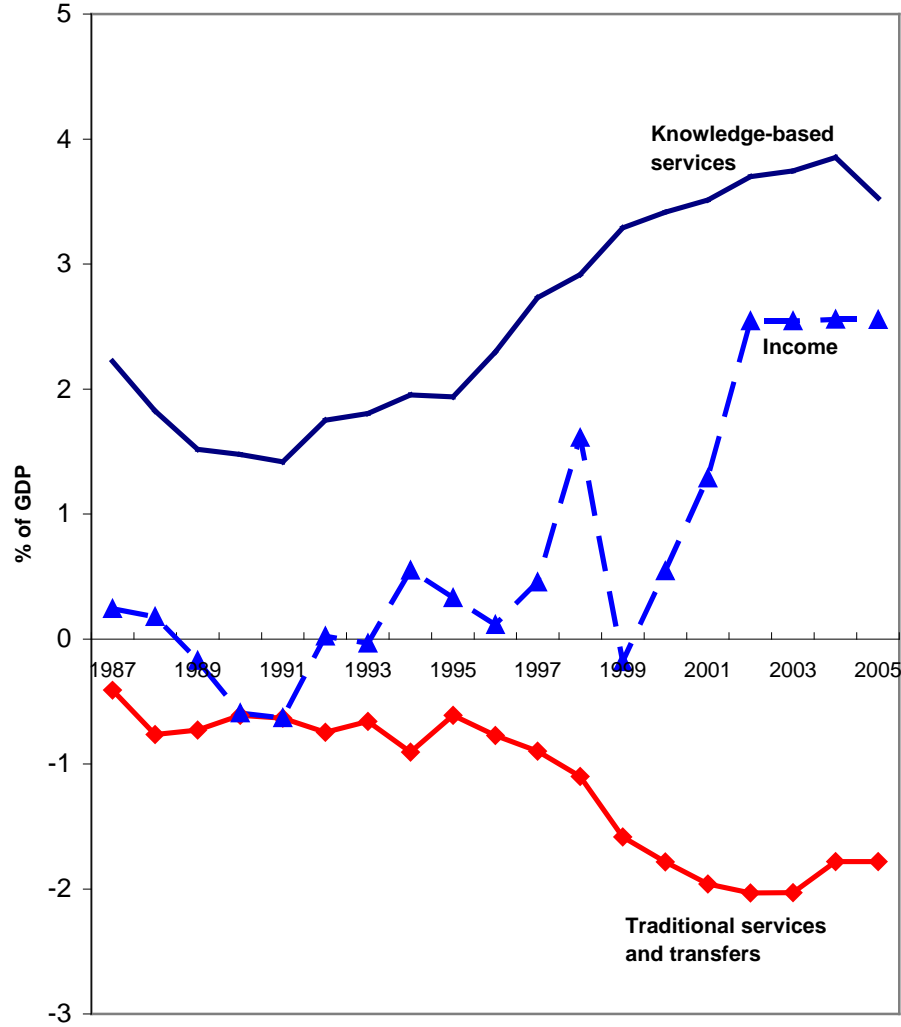
**Chart 12: Manufacturing Trade Balances of Developed Countries  
(percent of GDP)**



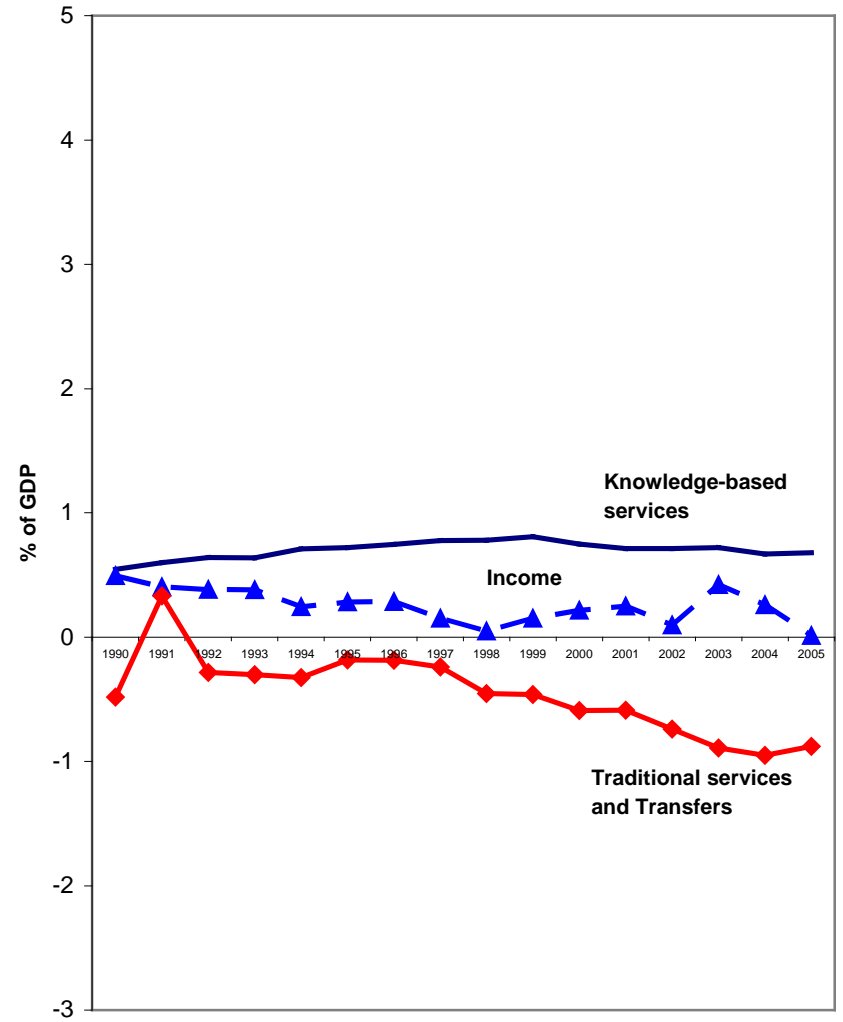
**Chart 13: Manufacturing Trade Balances of "Other Developed" Countries  
(percent of GDP)**



**Chart 14a**  
**Invisibles component of the UK Balance of Payments**  
**1987 - 2005**  
**current prices**



**Chart 14b**  
**Invisibles component of the US Balance of Payments**  
**1990-2005**  
**current prices**



## **Appendix: Definition of Service Exports (Extracts from The Pink Book 2005)<sup>1</sup>**

### **Introduction**

Trade in services covers the provision of services by UK residents to non-residents and vice versa. Trade in services is disaggregated into eleven broad categories of services, as follows:

- (a) Transportation (Sea, Air and Other) –Passenger, freight and other
- (b) Travel (Business and Personal)
- (c) Communications services
- (d) Construction services
- (e) Insurance services
- (f) Financial services
- (g) Computer and information services
- (h) Royalties and licence fees
- (i) Other business services (Merchanting and other trade-related services; operational leasing services; miscellaneous business, professional and technical services)
- (j) Personal, cultural and recreational services (Audio-visual and related services; other cultural and recreational services)
- (k) Government services

### **Transportation services**

The transportation account covers sea, air and other (i.e. rail, land, and pipeline) transport. It includes the movement of passengers and freight, and other related transport services, including chartering of ships or aircraft with crew, cargo handling, storage and warehousing, towing, pilotage and navigation, maintenance and cleaning, and commission and agents' fees associated with passenger/freight transportation.

### **Travel**

Travel covers goods and services provided to UK residents during trips of less than one year abroad (and provided to non-residents during similar trips in the UK). Transport to and from the UK is excluded and shown as passenger services under transportation (see above). Internal transport within the country being visited is included within travel.

A traveller is defined as an individual staying, for less than one year, in an economy of which he/she is not a resident. The exceptions are those military and diplomatic personnel, whose expenditure is recorded under government services. The one year rule does not apply to students and medical patients, who remain residents of their country of origin, even if the length of stay in another economy is more than a year.

#### *Business travel*

Business travel is divided into expenditure by seasonal and border workers (individuals who work some or all of the time in economic territories that differ from their resident households) and other business travel.

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<sup>1</sup> *United Kingdom Balance of Payments: the Pink Book 2005*, National Statistics, Palgrave Macmillan 2005.

### *Personal travel*

Personal travel covers holidays, visits to friends and relatives, the expenditures of people visiting for education and health reasons and miscellaneous purposes. Visits for more than one purpose, where none is distinguished as the main purpose, are classified as other. Education related travel exports covers the tuition fees and other expenditure of students who are funded from abroad and studying in the UK (imports covers the expenditure of UK students studying abroad). The figures also include the fees and other expenditure of pupils in UK private schools and students at other colleges and language schools. Income received direct from abroad by examining bodies and correspondence course colleges is included within personal, cultural and recreational services. Health related travel covers the cost of medical and other expenses of those travelling abroad for medical treatment.

### **Communication services**

Communication services covers two main categories of international transactions: telecommunications (telephone, telex, fax, email, satellite, cable and business network services) and postal and courier services.

### **Construction services**

Construction services cover work done on construction projects and installations by employees of an enterprise in locations outside their resident economic territory. For construction services, where a permanent base is established which is intended to operate for over a year, the enterprise becomes part of the host economy and its *transactions are excluded from the trade in services account*. Transactions where a permanent base is established are recorded under direct investment, within investment income.

### **Insurance services**

Insurance services cover the provision of various types of insurance to non-residents by resident insurance enterprises and vice versa. Insurance services include freight insurance on goods being imported or exported, direct insurance (life, accident, fire, marine, aviation etc.) and reinsurance. The amounts recorded in the accounts reflect the service charge earned on the provision of insurance services. This is equal to net premiums from abroad (premiums less claims), plus property income attributed to policy holders, less the change in the reserves for foreign business, less foreign expenses.

### *Life insurance and pension funds*

Life insurance covers underwriting services associated with long term policies. Pension fund services include service charges relating to occupational and other pension schemes, but not compulsory social security services.

### *Freight*

Treatment of freight insurance is consistent with the f.o.b. valuation of trade in goods (see "freight and the valuation of trade in goods" above). That is, non-resident importers pay for freight and insurance on journeys outside the UK. Where such services are provided by UK residents, this gives rise to a credit entry.

#### *Other direct insurance*

Other direct insurance covers accident and health insurance; marine, aviation and other transport insurance; fire and property insurance; pecuniary loss insurance; general liability insurance, and other (such as travel insurance and insurance related to loans and credit cards).

#### *Reinsurance*

Reinsurance represents subcontracting parts of risks, often to specialised operators, in return for a proportionate share of the premium income. Reinsurance may relate to package which mix several types of risks. Exports of services are estimated as the balance of flows between resident reinsurers and non-resident insurers.

#### *Auxiliary insurance services*

This covers insurance broking and agency services, insurance and pension consultancy services, evaluation and adjustment services, actuarial services, salvage administration services, regulatory and monitoring services on indemnities and recovery services.

#### **Financial services**

Financial services cover financial intermediary and auxiliary services other than those of insurance companies and pension funds. They include intermediary service fees associated with letters of credit, bankers' acceptances, lines of credit, financial leasing and foreign exchange transactions. Also included are commissions and other fees related to transactions in securities; e.g. brokerage, underwriting, arrangements of swaps, options and other hedging instruments etc.; commissions of commodity futures traders; and services related to asset management, financial market operational and regulatory services, security custody services etc.

#### *Monetary financial institutions (banks and building societies)*

This covers UK banking services giving rise to:

- (i) commissions for credit and bill transactions such as advising, opening and confirming documentary credits, collection of bills, etc.;
- (ii) spread earnings (dealing profits less holding gains) on foreign exchange transactions;
- (iii) net receipts on foreign exchange dealing;
- (iv) commission on new issues of securities, investment management and securities transactions;
- (v) commission on derivatives transactions; and
- (vi) banking charges, income arising from lending activities, fees and commissions in respect of current account operations, overdraft facilities, executor and trustee services, guarantees, securities transactions and similar services.

#### *Baltic Exchange*

This covers the brokerage and other service earnings of members of the Exchange for chartering, sales and purchases of ships and aircraft and other associated activities.

*Other*

This component also includes those financial services not included elsewhere.

### **Computer and information services**

Computer and information services cover computer data and news related service transactions including databases, such as development, storage and on-line time series; data processing; hardware consultancy; software implementation; maintenance and repair of computers and peripheral equipment; news agency services; and direct, non-bulk subscriptions to newspapers and periodicals. Information is obtained from the ITIS survey.

### **Royalties and license fees**

Royalties and licence fees cover the exchange of payments and receipts for the authorised use of intangible, non-produced, non-financial assets and proprietary rights (such as patents, copyrights, trademarks, industrial processes, franchises etc.) and with the use, through licensing agreements, of produced originals or prototypes (such as manuscripts and films). The heading includes royalties, licenses to use patents, trade marks, designs, copyrights, etc.; manufacturing rights and the use of technical “know-how”; amounts payable or receivable in respect of mineral royalties; and royalties on printed matter, sound recordings and performing rights. Data are obtained through the ITIS survey.

### **Other business services**

Other business services cover a range of services including merchanting and other trade-related services, operational leasing (rental) without operators and miscellaneous business, professional and technical services.

#### *Merchanting and other trade related services*

Merchanting is defined as the purchase of a good by a resident from a non-resident and the subsequent resale of the good to another nonresident, without the good entering the compiling economy. The difference between the purchase and sale price is recorded as the value of merchanting services provided.

#### *Operational leasing*

Operational leasing covers leasing (other than financial leasing) and charters of ships, aircraft and other transportation equipment without crews.

#### *Miscellaneous business, professional and technical services*

Miscellaneous services include legal, accounting, management consulting, recruitment and training and public relations; advertising and market research and development; architectural, engineering and other technical services; agricultural, mining and on-site processing services associated with agricultural crops (protection against disease or insects), forestry, mining (analysis of ores) etc.; and other services such as placement of personnel, security and investigative services, translation, photographic etc.



## **Personal, cultural and recreational services**

Personal, cultural and recreational services are divided into audio-visual and related services and other. The first category covers services and associated fees relating to the production of motion pictures (on film or video tape), radio and television programmes (live or on tape), and musical recordings. It includes rentals, fees received by actors, directors, producers etc. The second category covers all other personal, cultural and recreational services including those associated with museums, libraries, archives, provision of correspondence courses by teachers or doctors etc. Income received direct from abroad by examining bodies and correspondence course colleges is also included.

## **Government services**

Government services include all transactions by embassies, consulates, military units and defence agencies with residents of staff, military personnel etc. in the economies in which they are located. Other services included are transactions by other official entities such as aid missions and services, government tourist information and promotion offices, and the provision of joint military arrangements and peacekeeping forces (e.g. United Nations).

## **Exports**

*Expenditure by foreign embassies/consulates in*

*the UK:* this comprises the cost of operating and maintaining Commonwealth High Commission offices, foreign embassies and consulates in the UK, including the personal expenditure of diplomatic staff, but excluding the salaries of locally engaged staff which are included within income; and similar expenditure by the UK offices of non-territorial organisations.

*Military units and agencies:* this includes expenditure by the United States Air Force (USAF) in the UK (excluding the pay of locally engaged staff which is included within compensation of employees), together with receipts for services provided in the UK and elsewhere to non-residents, such as military training schemes.

*European Union institutions exports:* these are services of the UK government in collecting the UK contributions to the EU Budget, and services provided at the site of the EU's Joint European Torus project in Oxfordshire.

*Other:* this comprises goods and services which the government provides to non-residents under its economic aid programmes (these are offset under "Bilateral aid" transfer debits) and miscellaneous goods and services supplied by the UK government to foreign countries, including the reimbursement from other member states of the EU for treatment given by the National Health Service to their nationals.

## **Imports**

*Expenditure abroad by UK embassies and consulates:* goods and services provided by local residents to UK embassies, High Commission offices, Consulates and the British Council account for most of this heading. It also includes the goods and services

provided by local residents to UK diplomatic and other nonmilitary personnel stationed abroad, excluding the salaries of locally engaged staff.

*Expenditure abroad by UK military units and agencies:* this includes expenditure on food, equipment, fuel and services purchased locally.

*Other:* this includes goods and services provided by local residents to the UK Government, excluding military and diplomatic expenditure. It covers expenditure abroad of the British Council and the reimbursement to other member states of the EU for medical treatment given to UK nationals.

