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Trade and the West Midlands Economy

By Andre Carrascal-Incera, Geoffrey Hewings and Raquel Ortega-Argiles

Summary

- This policy briefing outlines the trade relationships between the West Midlands economy, the rest of the UK, the rest of the EU and the rest of the World.
- The West Midlands runs a small trade deficit for international trade but a large trade surplus with domestic UK interregional trade.
- The West Midlands displays a relatively low export propensity to the EU but a relatively high import propensity from the EU.
- The risks associated with Brexit for the West Midlands economy are primarily in terms of the potential impacts on West Midlands supply-chains.

Introduction

This research is made possible through the use of the Socio Economic Impact Model of the UK (SEIM-UK) (<https://www.birmingham.ac.uk/schools/business/research/research-projects/city-redi/socio-economic-impact-model-for-the-uk.aspx>). In this policy briefing we are going to use the information contained in the interregional Input-Output database developed as part of the SEIM-UK wider project to show the main features of the West Midlands trade patterns.

The notion of trade

Most people associate the term “trade” with the notion of goods and services that are either exported or imported from **outside the country**. However, in many cases, trade between regions within a country can also be just as if not more important. In essence, any transaction – either import or export – outside a region’s boundaries can be considered trade.

In addition, in the last two decades, there have been two important developments in the structure of production that have made the assessment of the impact of trade more complicated. The first is the **process of fragmentation** whereby production is broken down into discrete segments – to exploit efficiencies especially in economies of scale – that are often spatially separated rather than being confined to one plant. The second development, closely allied with the first, has witnessed major changes in the nature of intra- and inter-regional dependence. This process has been termed “**hollowing-out**” whereby activities that were local are increasingly broken up into different tasks that have been re-distributed across regions and nations. Firms have been exploiting the advantages of fragmentation by changing the geographical sources of supplies and the destinations for markets.

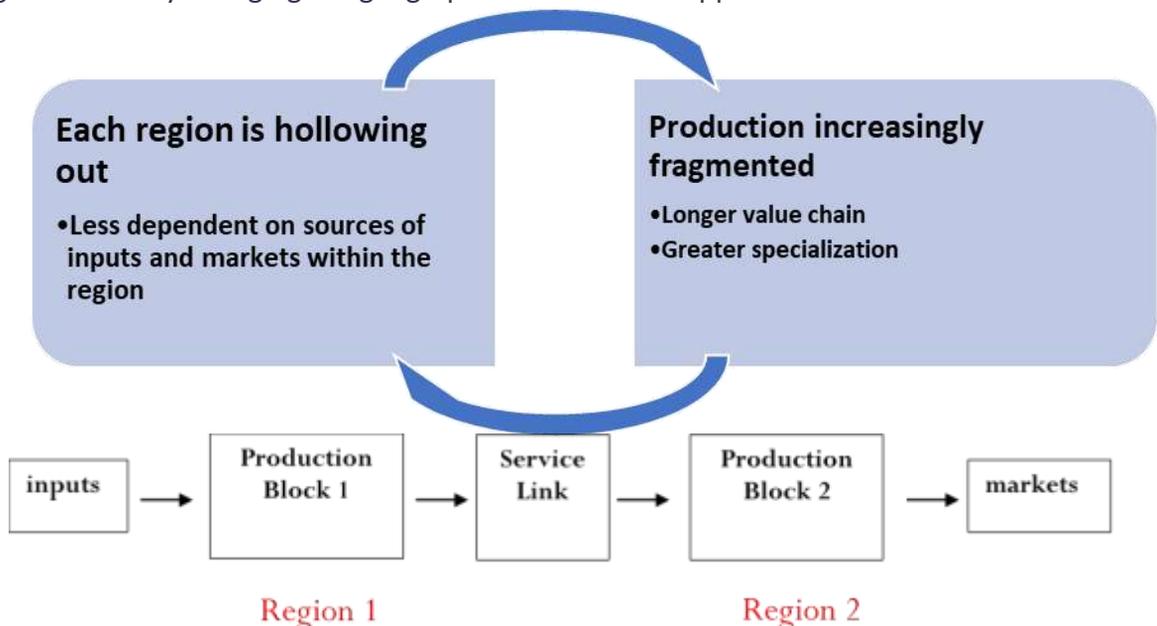


Figure 1: Hollowing-out and Production Fragmentation

Whereas in the 1970s and 1980s, with relatively high **transportation costs**, the geographical scope for out-sourcing was limited. Firms are now able to source inputs into their production processes from distant regions and countries and, at the same time, serve markets that may be similarly spatially scattered. Both within countries and between countries **interregional and international trade has been increasing** much faster than gross production (GDP) (Figure 2).

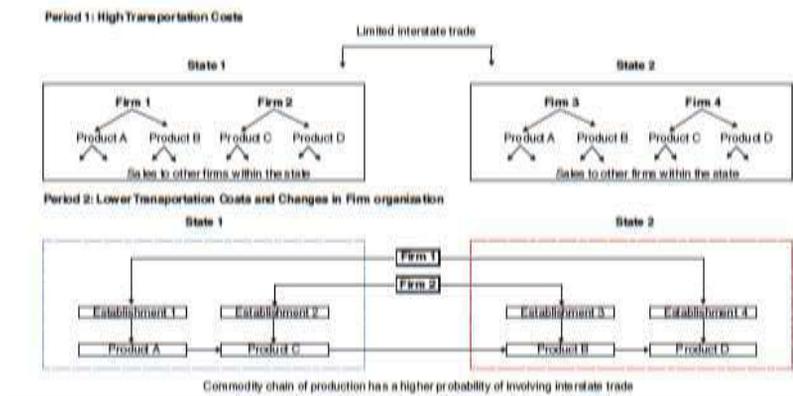


Figure 2: Periods in interregional and international trade

Regions like the **West Midlands are becoming more dependent** on other regions within the UK and the rest of the world. At the same time, they are directly competing with these regions to attract and retain components of supply chains and expand markets. Establishments in regions are often now producing and specialising in a smaller variety of products to serve geographically more extensive markets. One of the consequences of this change is that the **multipliers or ripple effects within regions have often decreased** – even though the **total volume of production may have increased**.

The concept of Direct and Indirect Trade flows

Analysis to date has focused on direct export and import relationships; however, as we see in Figure 3, many goods and services **may be exported to another region** in the UK and then, after further transformation, exported elsewhere in the UK or internationally. Similarly, a good or service imported from another region in the UK may have originated in another region or internationally.

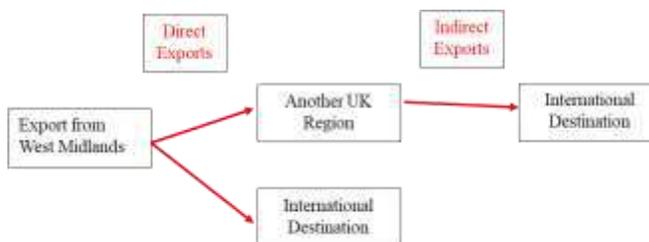


Figure 3: Direct and indirect trade flows (Exports)

Foreign trade and EU dependency

Figure 4a and 4b illustrate the importance of regional trade with the EU for regional imports (Fig. 4a) and regional exports (Fig. 4b). The orange lines in the pictures denote 50%. **West Midlands has a very high direct import dependency on the EU while a low direct export dependency on the EU.** Figure 5 shows that the West Midlands runs a trade deficit internationally but a trade surplus domestically within the UK.

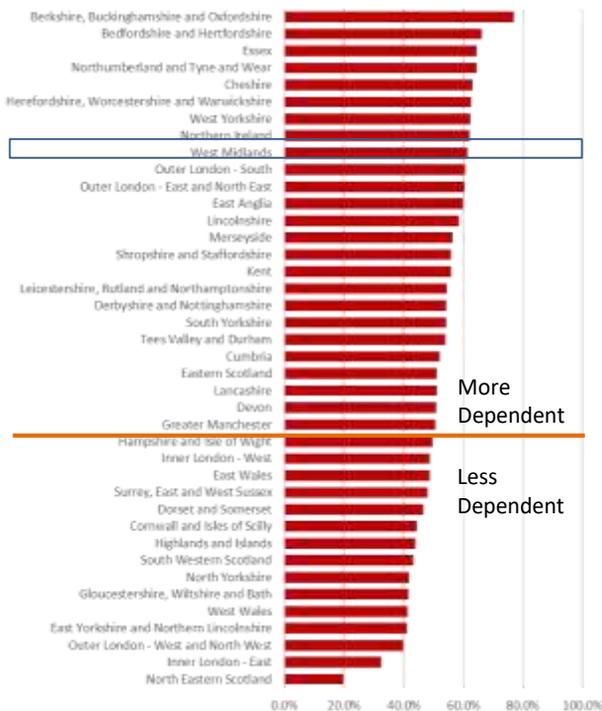


Figure 4a: Imports from EU as a share of total foreign imports

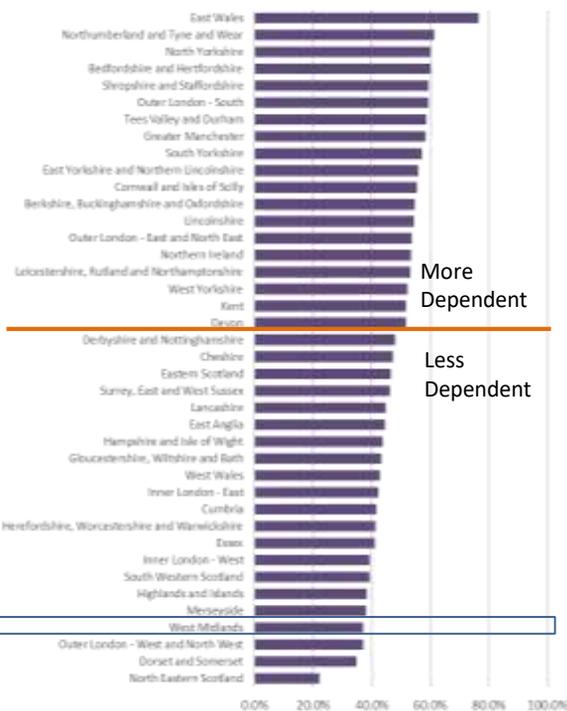


Figure 4b: Exports to EU as a share of total foreign exports

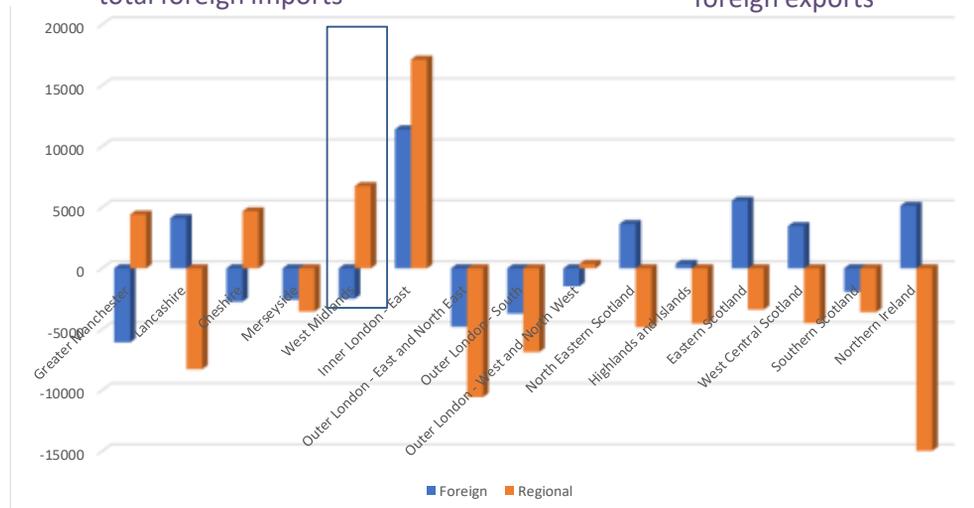


Figure 5: Trade balance (in millions of £) of selected NUTS2 regions 2016

Foreign trade and EU dependency (cont.)

Figure 6 shows the UK regional classification of direct exports vs. direct imports dependency from the EU.

The figure shows a clear UK regional heterogeneity in the cross between direct exports and imports dependency from the EU.

The largest group is the group of direct import and export dependency from the UK. The composition of this group is characterized by urban (Greater Manchester, Outer London, Oxfordshire, etc.) as well as rural areas (Northumberland; Devon).

		Direct exports dependency from the EU	
		<i>More dependent (higher than 50%)</i>	<i>Less dependent (lower than 50%)</i>
Direct imports dependency from the EU	<i>More dependent (higher than 50%)</i>	Greater Manchester, Devon, Tees Valley and Durham, South Yorkshire, <i>Leicestershire, Rutland and Northamptonshire</i> , Kent, Shropshire and Staffordshire , Lincolnshire, Outer London - East and North East, Outer London - South, Northern Ireland, West Yorkshire, Northumberland and Tyne and Wear, Bedfordshire and Hertfordshire, Berkshire, Buckinghamshire and Oxfordshire	West Midlands, Lancashire, Eastern Scotland, Cumbria, Derbyshire and Nottinghamshire, Merseyside, East Anglia, Herefordshire, Worcestershire and Warwickshire , Cheshire, Essex
	<i>Less dependent (lower than 50%)</i>	East Yorkshire and Northern Lincolnshire, North Yorkshire, Cornwall and Isles of Scilly, East Wales	North Eastern Scotland, Inner London - East, Outer London - West and North West, West Wales, Gloucestershire, Wiltshire and Bath, South Western Scotland, Highlands and Islands, Dorset and Somerset, Surrey, East and West Sussex, Inner London - West, Hampshire and Isle of Wight

Figure 6: Patterns of direct foreign trade dependency from EU

**West Midlands regions (UKG) in bold, East Midlands regions (UKF) in italics.*

There are few regions that present an unbalanced structure of direct export and import dependency from the EU. Areas such as West Midlands, Herefordshire, Worcestershire and Warwickshire are characterized by high direct import dependency and loss direct export dependency from the EU. While areas such as East Yorkshire and Northern Lincolnshire or Cornwall and Isles of Scilly are characterized by a combination of lower dependency in direct imports from the EU and higher dependency in direct exports from the EU.

Finally, other areas appear to be a lower dependency in direct imports and exports from the EU. These areas are more diversified or present economic structures more dependent from the UK market.

Who are the West Midlands Major Trading Partners?

Within the UK, the top trading partner providing imports to the West Midlands is Inner London (around 25%), followed by Berkshire Bucks and Oxfordshire (9.43%) and East Wales (5.80%). In the case of the exports, Welsh regions stand out as the main UK destination for more than 20% of the West Midlands products. Another important trading partners are Inner London and Gloucestershire, Wiltshire and North Somerset.

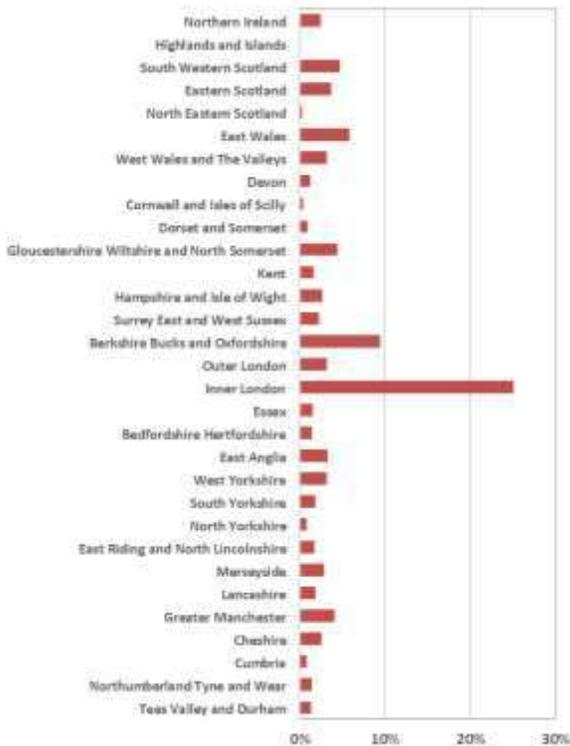


Figure 7a: Imports from other UK regions

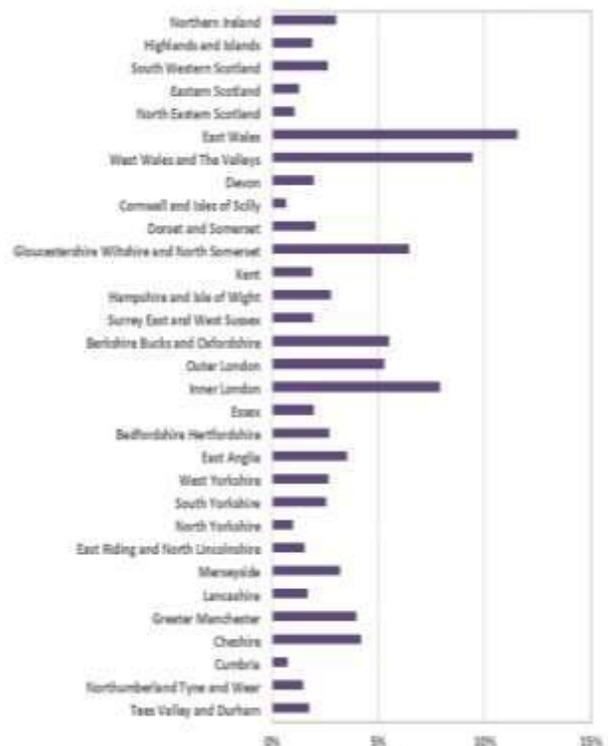


Figure 7b: Exports to other UK regions

As we see in figure 7a and 7b, the West Midlands exports more goods and services to almost all UK regions than it imports from those same regions. The obvious exception here is Inner London. The West Midlands purchases more (primarily services) imports from Inner London than the goods and services it sells to Inner London.

Sector specific analysis

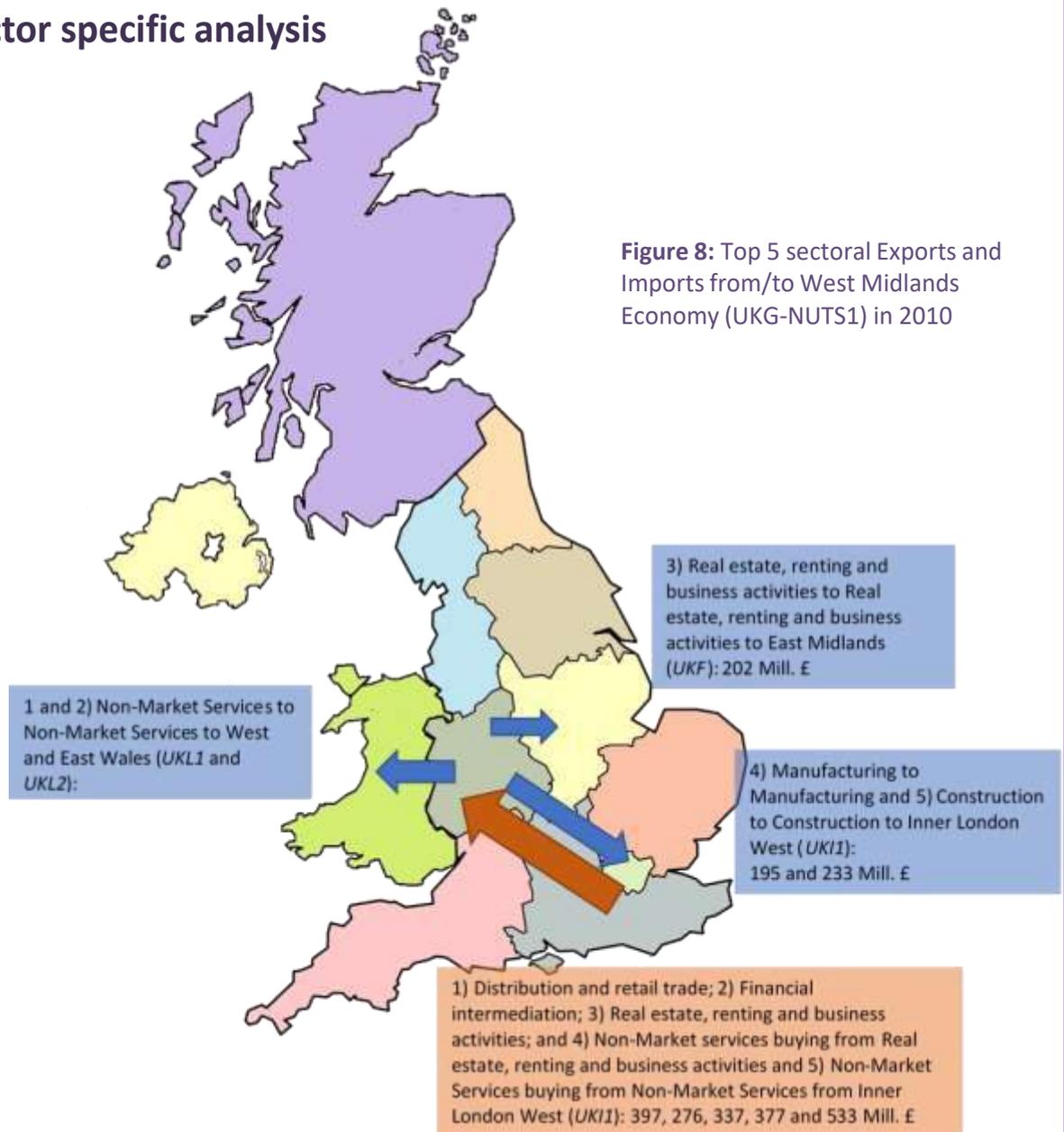


Figure 8 illustrates the complexity and variety of the types of regional trade flows to and from the West Midlands. For example, the West Midlands exports non-market services to similar sectors in different parts of Wales. The West Midlands also sells real estate renting and business services to the same sector in the East Midlands. The West Midlands also sells manufactured goods and construction services to manufacturing and construction activities in Inner London. Finally, the West Midlands buys regional imports from Inner London relating to distribution and retail, financial services, real estate and business services and non-market services. These imports from other UK regions are largely 'paid for' by the exports of the West Midlands economy to the rest of the UK.

Discussion

This is the second of a series of policy briefings linked to [the Socio Economic Impact Model for the UK \(SEIM-UK\) project](#). In this policy briefing, we describe the trade relationships between the West Midlands Economy (WME) and the rest of the UK and the EU.

In the last decades, WME has become more dependent on other economies due to the processes of the geographical fragmentation of production. Our UK interregional trade data allows us to analyse in depth the direct and indirect manufacturing as well as services trade flows relationships between WME and the rest of the world. In this policy briefing we focus on the direct effects.

The West Midlands economy is directly linked with the EU economy in terms of its value chains. Our analysis shows that WME has a very high direct import dependency on trade with the EU while a low direct export dependency on trade with the EU, in comparison with other UK regions and the UK average. This has important implications for the WME which are linked to the final outcome of the Brexit negotiations. Leaving the Single Market will imply higher costs of imports that will be translated into higher prices of products produced in West Midlands, leading therefore to a potential competitiveness loss (Thissen et al., 2019).

Our analysis illustrates the complexity and variety of the types of regional trade flows to and from the WME and the rest of the UK. Inner London, Berkshire Bucks and Oxfordshire and East Wales are the major providers while Welsh regions are the major receivers of products and services from WME. It is important to consider that services products also have an important role in explaining trade linkages of WME and the rest of the UK.

Glossary

GDP – Gross Domestic Product

NUTS – Nomenclature of Territorial Units for Statistics

References

Thissen, M.; van Oort, F.; McCann, P.; Ortega-Argilés, R. and Husby, T., The Implications of Brexit for UK and EU Regional Competitiveness (August 18, 2019). Tinbergen Institute Discussion Paper 2019-061/VIII. Available at SSRN: <https://ssrn.com/abstract=3440574>

Andre Carrascal-Incera is a Research Fellow in Economic Modelling at City-REDI Institute, University of Birmingham, UK.

Geoffrey Hewings is Emeritus Director of the Regional Economics Applications Laboratory (REAL), and Professor Emeritus, at the University of Illinois, USA.

Raquel Ortega-Argiles is Professor of Regional Economic Development at City-REDI Institute, University of Birmingham, UK.