



# North and South

Joining the European Union had a big impact on the geography of UK trade and manufacturing. Henry Overman and Alan Winters trace the continuing effects of that decision on the North-South divide.

Concerns about the North-South divide in the UK are back on the political agenda. To many observers, the existence of such a divide is self-evident. For a whole range of indicators, people in the South score better than people in the North. People in the South are more likely to be employed. When they are employed, they earn more. They are healthier. They are probably happier. Worryingly, these observers argue, the gap between North and South may well be growing.

Dig a little deeper, however, and things become less clear. House prices in the South are booming. So people earn more but their real income (net of housing costs) may actually be lower. Also, people in the South are more educated. Shouldn't we expect more educated people to earn more and be more likely to have a job?

The problem is that these observers tend to list symptoms of the North-South divide rather than causes. But deciding whether a policy response is needed and what form that policy response should take requires information on causes not symptoms. Unfortunately, little is known about the

factors that actually drive differences in regional economic performance in the UK.

A good place to start looking for some of the causes may be the geography of the UK economy itself – this is the North-South divide after all. Firms based in northern regions are located far away from large markets in the south of the country and on the continent. Since distance still matters, surely being far from these large markets must explain part of the reason why firms in the North do less well than firms in the South?

But once again, things get slippery when trying to assess whether these kinds of factors matter. The basic problem is that this is a chicken and egg situation: firms in the South may do better because they are near to a bigger market, but the market is big because firms in the South do better. To assess the real significance of geography in explaining differing regional performances, something is needed to break this circular link.

Ideally, we want some 'shock' to the UK economy that might affect North-South geography but that is independent

## Joining the EEC shifted UK trade away from former trading partners and towards the six original members

of that geography. A very good candidate for such a 'natural experiment' is the UK's 1973 accession to the European Economic Community (EEC) as the European Union (EU) was then called. EEC accession had a large effect on trade patterns and would appear to advantage markets in the South over those in the North.

### The impact of EEC accession on the geography of UK trade

What happened to the geography of the UK economy in response to this trade shock? In other words, how did EEC accession affect the location of economic activity in the UK? The data that can help us answer this question are for the manufacturing sector from the early 1970s to the early 1990s. But despite the limitations of this sectoral and time coverage, lessons from studying this period of UK history can help us understand what drives UK regional differences more generally. Not only that, but it may also allow better predictions of the potential implications for the UK economy of the deepening integration implied by joining the euro.

Figure 1 shows four-year averages of the percentage of UK trade (the total of imports and exports) accounted for by the original six founders of the EEC (the EC6). The figure tells what is, by now, a familiar story: EEC accession shifted the direction of UK trade away from former trading partners and towards the countries in the EC6.

In the two decades leading up to EEC accession, the importance of UK trade with the EC6 was growing, but fairly slowly. In the 20-odd years before 1973, the percentage of UK trade with one of these six countries had grown from about 13% to 21%. In contrast, in the 20 years after accession, the percentage of trade with the EC6 more than doubled from 21% to 44%.

This post-accession reorientation of UK trade by source or destination is well known; the fact that it was associated with a geographical reorientation is not so well known.

Figures 2A and 2B show this geographical reorientation for imports and exports, respectively. To understand the figure, note that the underlying data give the share of UK imports and exports that enter or leave through particular UK ports (including airports). The figure then plots these shares for nine regional groups:

- Thames and Kent (THAKE);
- Haven and East Anglia (HAVEA);
- Sussex and Hampshire (SUHAM);
- South, South West and Cornwall (SSWCO);
- North East-Humber (NEHUM);
- East Scotland (ESCOT);
- Rest of sea ports (RESTP);
- London airports (AIRLO);
- and other airports (AIROT).

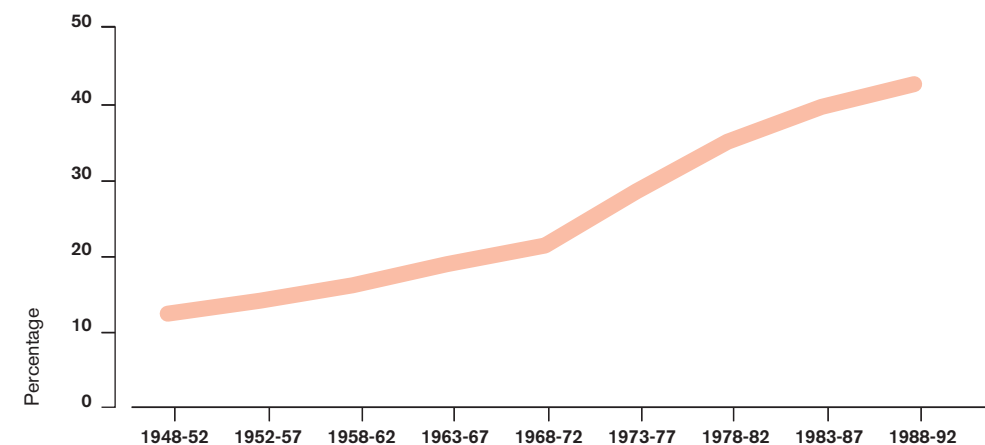
The figures illustrate two key characteristics of the changing geography of UK trade:

■ First, the growing share for the top two segments (AIROT and AIRLO), which clearly captures the growing importance of air transportation in the value of UK trade.

■ Second, the gradual reorientation of trade towards the South East port groups – roughly speaking, the lower the segment, the closer the port groups are to the South East corner of the UK. Between 1970 and 1992, the ports in the south of the country – THAKE, HAVEA, SUHAM and SSWCO – saw their share of manufactured imports increase by 20 percentage points – from 42% in 1970 to 62% in 1992. The reorientation of manufactured exports is in a similar direction but not as marked: the ports in the South saw their share of manufactured exports rise from 47% to 58%.

In summary, the general picture for both exports and imports is of a reorientation to ports in the southern part of the country.

Figure 1: Percentage of UK trade with the EC6



## Since 1973, there has been a reorientation of UK manufacturing trade to ports in the South

## Dover has become a major trading port and Liverpool has seen a corresponding decline

Figure 2a: Manufactured imports by port region

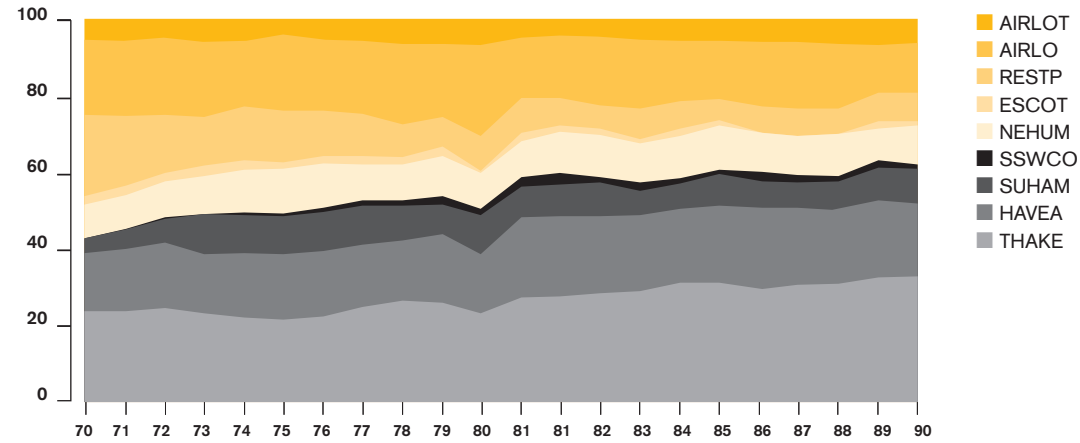
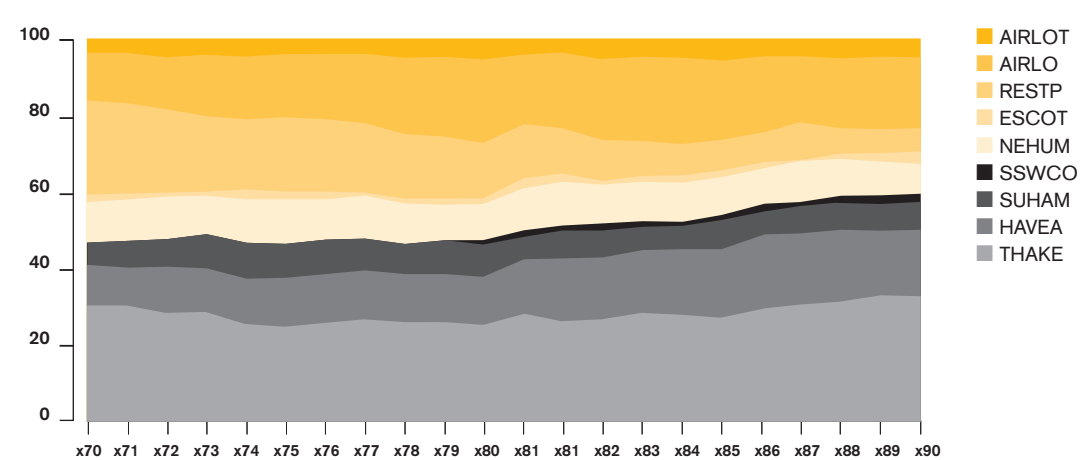


Figure 2b: Manufactured exports by port region



### Which UK ports have benefited most?

The reorientation is associated with very significant changes for particular ports. Table 1 shows the top five UK ports in terms of manufactured exports for both the early 1970s and the early 1990s. The table highlights some important changes over the period. Most notably, there has been the rise of Dover as a major trading port and the corresponding decline of Liverpool. The former saw its share of both imports and exports increase more than threefold over the 20-year period, while Liverpool saw a decline of similar magnitude.

The southward reorientation shows up in the fact that all five of the UK's major ports in the early 1990s are based in the south of the country compared to only three in the early 1970s. Yet the contrast between the relative performance of London and Felixstowe urges caution in attributing the changes in port performance to port location alone. Felixstowe and London are both located in the South and both function as major specialist deep-sea ports. But while

Felixstowe saw its share of UK trade increase, London saw a marked decline.

Such contrasts suggest the importance of factors other than location in determining port outcomes. Among those explaining the different experiences of Felixstowe and London is that the former was outside the National Dock Labour Scheme. This was a highly restrictive labour agree-

Table 1: Top five ports for exports (percentage share of manufactured exports)

1970-2		1990-2	
Port	%	Port	%
Heathrow Airport	18.9	Dover	19.4
London	16.9	Heathrow Airport	14.6
Harwich	7.9	Felixstowe	12.4
Liverpool	6.9	Southampton	5.7
Dover	5.6	London	5.1

ment, which, until its abolition, reduced productivity and stifled innovation in member ports. The figures suggest that restrictive practices and a failure to innovate can spell problems for ports wherever they are located.

The evidence presented so far has been based on the shares of particular ports or groups of ports. Figure 3 attempts to capture the geographical pattern of trade more directly. It summarises the distance from Dover of an average £1 of exports over time. This figure eloquently captures the gravitation of UK manufacturing trade towards the ports of the South East. The average distance from Dover of an average £1 of exports fell by around 35% over the 20-year period. Figures for imports show a similar decline although the magnitude is slightly smaller than for exports.

So EEC accession resulted in a reorientation of the UK's trade towards the south of the country. What about the

impact on manufacturing activity itself? Figure 4 is the counterpart to Figure 3, but plotted to show the distance from Dover of the centre of gravity of UK manufacturing. Clearly, the southward movement for total manufacturing is much less pronounced than for exports.

Does this mean that EEC accession had no impact on the location of UK manufacturing industry and that market access plays no role in understanding regional economic performance? It turns out that the answer is no, but isolating the impact requires looking at individual manufacturing sectors and using economic theory to help structure the investigation.

### Lessons from the new economic geography

What does economic theory predict about the likely impact of EEC accession on the location of particular

Figure 3: Distance from Dover, manufactured exports

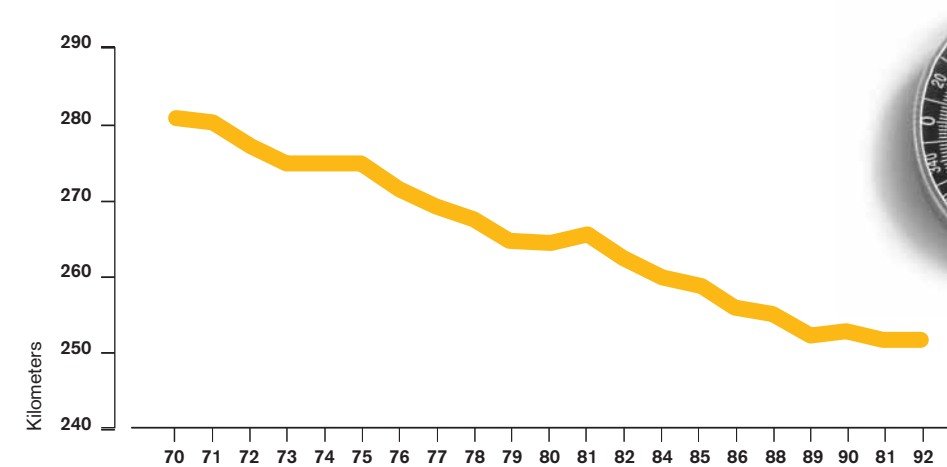
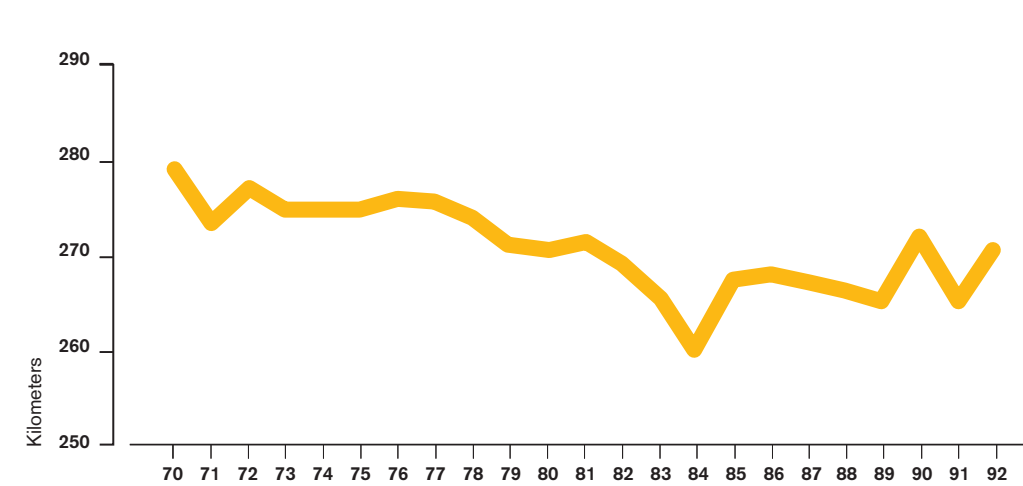


Figure 3: Distance from Dover, UK manufacturing



## Improved export market access has pulled employment in some manufacturing sectors towards the South

## Greater import competition has pushed employment in some manufacturing sectors away from the South



manufacturing sectors? Obviously, traditional theories of comparative advantage, which emphasise the fact that different EU countries have different endowments of labour and capital, help us understand the changing composition of manufacturing across sectors. This must play a part in understanding the overall decline in UK manufacturing during this period as production shifted to EU partners. It could also clearly help in understanding the shifts in the location of aggregate economic activity if particular regions specialise in sectors that do relatively better as the UK adjusts to its new trading conditions.

But the main focus here is on how trade shocks affected the location of particular sectors, a question on which traditional theories of comparative advantage are essentially silent. Studying this requires theoretical foundations that focus directly on the impact of opening up to trade on economic geography. These effects have been the focus of the recent boom in research on the 'new economic geography', predominantly associated with urban and international economists.

This research programme starts from the principle that the location of economic activity depends on a balance between forces of 'agglomeration' and 'dispersion' – in other words, a balance between forces that attract firms to large markets and those forces that repel them from those markets.

Firms that locate in big markets benefit from being close to both their customers and their suppliers. Offsetting these advantages is the fact that they operate in a more crowded market, which increases competition in product and factor markets and puts downward pressure on prices and upward pressure on wages.

The balance of these forces depends on the level of trade integration between different locations. When trade between regions or countries is difficult, the cost of serving distant customers is so large that it dominates the desire to be near customers in the large market and economic activity is dispersed. As trade becomes easier, the opposite is true and agglomeration can occur. If locations become very integrated and the cost of trade becomes very low, then congestion costs can emerge and industry can once again disperse.

### The impact of EEC accession on the geography of UK manufacturing

What does such analysis imply for the economic geography of the UK as it opened up to trade with Europe? One possibility is that border regions, in this case the South, benefited disproportionately from the improved market access that came with EEC accession – that is, firms located in regions closest to the continent benefited most. But this is not the only possibility when a country opens up to trade: allowing for increased product market

competition felt via imports, it is possible that border regions may suffer if firms relocate to regions in other parts of the country

Thinking about the specific case of the UK, this means that in some manufacturing sectors, increased import competition in the South may have outweighed better market access and the South might have lost out relative to the North. In other words, theory no longer predicts that EEC accession should necessarily have led to better economic performance of southern regions in all manufacturing sectors. Instead, we need to look at different manufacturing sectors in different regions and think about the balance between product market competition (which should be associated with lower employment) and increased market access (which implies the opposite).

To assess the strength of these two forces, our research has so far focused on how EEC accession explains changes in regional employment in particular sectors. Overall, the results seem to support the hypothesis that the reorientation of trade associated with EEC accession did have some significant effects on the economic geography of UK manufacturing. More than 40 manufacturing sectors out of 80 show a positive impact on employment of better export market access with most other sectors showing no effect. In these sectors, everything else equal, manufacturing employment shifted towards the South in response to better market access in those regions.

The results for import competition suggest that this too has a role in explaining changes in the location of UK manufacturing. 17 sectors out of 80 show negative employment effects associated with increased import competition. In these sectors, everything else equal, manufacturing employment shifted towards the North. Working out the overall impact of EEC accession means balancing out these two effects for different sectors. Doing that, we see, for example, that the centre of gravity of the pharmaceutical industry moved southward while that of textile production moved northward.

Clearly, these results are not the end of the story, but they are a start. For now, the evidence presented here suggests that cumulative causation and better access to EU markets may explain some of the difference between northern and southern regions. Of course, much more work needs to be done to understand how important these effects are relative to other theories in explaining the differing economic performance of the UK's regions. But it is only through careful examination of the underlying causes that we will truly be able to analyse the need for – and possible role of – regional policy.

This article summarises 'Trade Shocks and Industrial Location: the Impact of EEC Accession on the UK', CEP Discussion Paper No. 588 and 'The Geography of UK International Trade', CEP Discussion Paper No. 606, both by Henry G Overman and L Alan Winters.

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### Further reading

Combes PP and HG Overman (2004), 'The Spatial Distribution of Economic Activities in the European Union', CEP Discussion Paper No. 587 and forthcoming in V Henderson and JF Thisse (eds), *Handbook of Urban and Regional Economics*, volume 4, North Holland.

Midelfart, KH and HG Overman (2002), 'Delocation and European Integration: Is Structural Spending Justified?', *Economic Policy* 35, 321-59.

Overman, HG, SJ Redding and AJ Venables (2003), 'The Economic Geography of Trade, Production and Income: A Survey of Empirics', in J Harrigan and K Choi (eds), *The Handbook of International Trade*, Blackwell.

