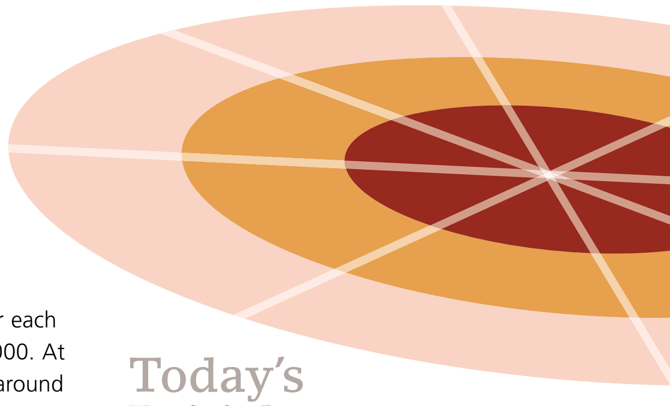
The fast-growing cities of the Victorian age made Britain the workshop of the world. **Tim Leunig** argues that there are important lessons for how we manage today's economy, notably the need to end the highly restrictive planning laws that constrain housing development in the South East and in cities associated with our top universities.

Where to build Britain's new houses



Nineteenth-century Britain resembled a textbook market economy in many ways. Taxes and regulations were low, and firms were able to respond to the opportunities and threats that they faced with very little 'red tape'. One aspect of that economic liberalism was that if you owned land, you were able to build houses or factories pretty much at will. Concepts such as the 'green belt' and planning permission had not yet been invented.

The result was a massive movement of population over the course of the nineteenth century, out of the countryside and into the towns. This reflected the 'agglomeration economies' that cities offered to manufacturing firms. Put simply, productivity was higher in cities than in the countryside, and therefore firms chose to locate in cities. That productivity in turn fed through to higher wages, and while the streets of London, Liverpool, Manchester and so on were not paved with gold, they did offer more opportunities than were available in smaller towns and villages.

At the start of the nineteenth century, Liverpool and Manchester each had a population of around 100,000. At the century's end, they each had around 600,000. Towns such as Preston grew tenfold, and Crewe, which was a hamlet of 46 houses in 1800, was home to 42,000 people in 1900. And London grew by a truly phenomenal five million people over the century.

Not that all cities grew dramatically: some, such as Bristol or Gloucester, important places in 1800, were not transformed by 1900: their share of the British population did not grow.

The nineteenth century shows us that

Today's British economy cannot respond to new opportunities in the way that it did in the nineteenth century

location, as well as size, matters. Lancashire was the home of the cotton textile industry for good reasons: the damp climate was well suited to cotton spinning and weaving, and the raw cotton was imported from America via Liverpool.

Once established there, agglomeration economies meant that productivity was higher not only because of the climate, but because of the levels of local knowledge. It would have been possible to open a cotton mill in Suffolk, but the costs of getting the raw material to Suffolk, combined with lower productivity away from the agglomeration economies, meant that such a firm would have to pay very low wages indeed to compete with Lancashire mills. People in Suffolk preferred to move to Lancashire and be paid well, than to stay in Suffolk, do the same job and be much less well paid.

By 1945, for perfectly understandable reasons, Britain's faith in the market economy was shaken. We had just won the war with a state-planned and directed economy. Furthermore, the free market period between the two wars was seen as a failure. Policy-makers looked to our own wartime experience, which, combined with the apparent success of Soviet Russia and, to an extent, Germany prior to 1939 gave them great confidence in the ability of state planning to deliver a successful economy.

The belief that 'the man in Whitehall really does know best' took many forms. One aspect was the rise of the planning system, originating in the 1947 Town and Country Planning Act. Today, green belts, 'areas of outstanding natural beauty', 'sites of special scientific interest' and so on dramatically constrain the places where development can take place.

Furthermore, even within land marked for development, planning laws heavily constrain what can be built. For example, land zoned for industrial use cannot be used for housing, and vice versa. The economy cannot respond to new opportunities in the way that it did in the nineteenth century: the location of Britain's population has been ossified, and in 2008 it bears a far greater similarity to 1945 than, say, the location of population of 1908 did to that of 1845.

This would not matter if economic opportunities could flow easily to the areas in which people lived half a century or more ago. Sadly, the evidence shows that this is not the case. Just as it would not have been possible to move parts of the Lancashire cotton industry out of Lancashire a century ago, so it is not feasible to move finance to Lancashire today.

Agglomeration economies are growing. Information technology allows skilled white-collar 'HQ' service jobs to be detached from their associated manufacturing operations and located near to other skilled HQ jobs, allowing higher productivity driven by high skill service sector 'knowledge spillovers'. The rise of dual career households means that more couples want to work in places that are large enough to offer two careers rather than one career and one job.

The planning system prevents Oxford and Cambridge becoming the twenty-first century equivalents of Liverpool and Manchester in the nineteenth century

Today, the South East is the best location for business. It is obviously closer to European markets, but better air links make it closer to all parts of the world than the North of England, Wales or Scotland. And London has simply been lucky: finance has prospered in the last century; textiles have not.

The outcome is that wages in the South East, and particularly in London, are higher than those anywhere else in Britain, reflecting higher levels of productivity. In contrast, towns outside the South East have lower wages and higher unemployment.

So we would expect to see the

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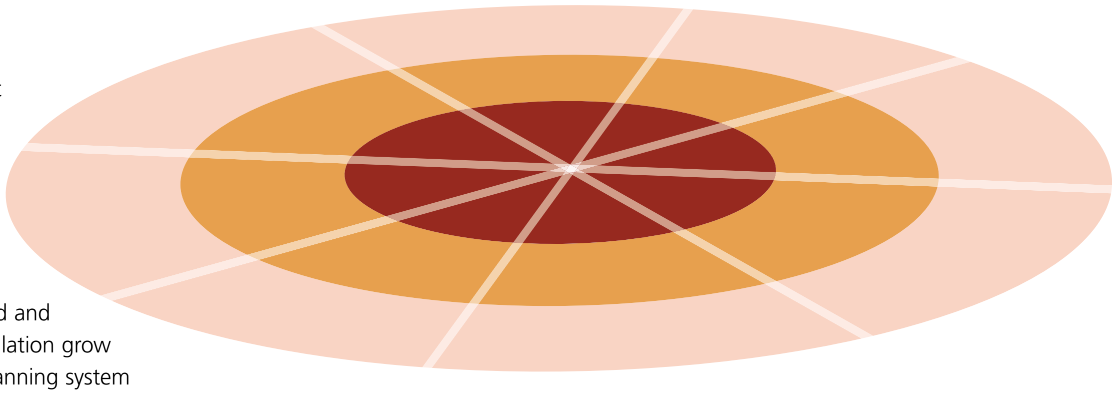

population of the South East boom as the population of the North West boomed a century ago. But this has not happened.

Two obvious places that should generate massive knowledge spillovers – Oxford and Cambridge – have seen population grow at just 0.5% per year. The planning system prevents them from becoming the Liverpool and Manchester of the twenty-first century, cities that grow beyond recognition within a generation, creating well paid, interesting jobs in abundance.

There is no doubt that Britain pays a high price for these restrictions. Had they been in place in 1850, Britain would not have become the workshop of the world and would have been markedly poorer. The same is true today.

The people who lose out are not primarily the well educated since they can afford to migrate and frequently do so after graduation. The people who lose out are those who cannot move to the South East because of housing costs: they end up in less well paid jobs and are more likely to be unemployed.

The planners were well meaning, and their confidence in planning over the market economy is easy to understand given the experience of 1939-45. They are still well meaning, but it is harder to understand ignoring market signals in 2008.

The market is very clear: land for housing and all other forms of development is worth far more in the South East than anywhere else in Britain. Land for flats or maisonettes is worth four times as much in Southwark as in Leeds, four times as much in Camden as in Manchester, and four times as much in Hackney as in Birmingham.

Indeed, housing land in the lowest cost part of London – Redbridge – is worth more than equivalent land in Manchester, which is the highest cost place outside the South East. Only Oxford, Cambridge and London's commuter towns come close to London's values.

Land is worth more in London and the South East because when people move to these places, they get better jobs and can afford to pay more for houses. Or to put it another way, if we build more houses in the South East, the jobs that emerge to take advantage of these new workers are better paid jobs than if we build them anywhere else in Britain.

For that reason, the government should make clear that all significant levels of new building will take place in housing hotspots: London and its commuter satellites as well as in high value-added cities, which are generally associated with top-notch universities. Land prices tell us where to allow development. If we follow those market signals, not only will the individual workers be better off but we will all be better off since tax revenues will be higher and benefit payments lower.

Of course, some land is worth preserving for its amenity value. But studies show that people place little value on relatively unattractive, industrialised agriculture that makes up so much of the green belt today. We have gone too far and it is those who are trapped in areas that are in decline, and will remain in decline, who are paying the price. It is a high price, and one that will increase, and not decrease, over time.

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