Why do some parts of the country prosper while others don't – and what, if anything, should government policy try to do about it? **Henry Overman** discusses the regional distribution of prosperity and the potential policy responses.

Britain's regional divide

Last summer, the thinktank Policy Exchange caused controversy with a report on urban regeneration. In essence, the report suggested that some places in Britain (mostly in the North) have lost their raison d'etre, that regeneration efforts aren't making a difference and that we should build houses (in the South) so that people can move to places with better opportunities.

Conservative leader David Cameron, who was touring marginal Northern constituencies at the time, dismissed the report as insane. Government ministers agreed. The authors faced a barrage of criticism from offended individuals and local authorities.

The basic counter-argument goes like this: 'I am from [insert name of place]. It's a lovely place to live because [insert something nice about the place or mention the low cost of living]. If you want to see where [insert name of place] is heading, just look at the development of [insert name of nice new buildings].'

These reactions remind us that people and places are different and that amenities and cost of living matter as much as economic opportunities. But they miss a much more serious question: why do some regions, cities and communities prosper while others don't, and what, if anything, should government policy try to do about it?

There is no doubt that economic activity in Britain is very unevenly distributed. In 2004, the contribution to the economy of each individual (gross value added or GVA per person) in inner London and in Berkshire, Buckinghamshire and Oxfordshire was £24,500 and £23,700 respectively (adjusted for commuting) – about 40% above the national average of £17,100.

In the same year, Cornwall and the Isles of Scilly, West Wales and the Valleys and the Tees Valley and Durham had GVA per head of £11-13,000 – 24% or more below the national average. The differences would be even more striking if we considered particular cities or neighbourhoods within cities.

It is inconceivable that this unevenness can be explained purely by inherent differences in physical geography, such as natural resources. Instead, over time, the economic system amplifies initial differences to generate persistent disparities. This happens because there are self-reinforcing benefits from the concentration of activity.

These benefits arise in many different ways. As long ago as 1890, Alfred Marshall suggested that spatial proximity benefits firms and people because it helps the transfer of knowledge, allows people and firms to specialise and makes it easier to trade goods that are costly to transport. Economic geographers continue to try to quantify these benefits.

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A range of costs offsets the benefits:

as activity concentrates, the prices of scarce resources such as land increase, firms face more competition, roads get congested, and pollution worsens. The trade-off between these costs and benefits determines which areas are rich and which are poor, which grow fast and which grow slowly.

Factors like technological change and globalisation also affect the trade-off, with fundamental implications for Britain's spatial economy. Responses to these changes are not instantaneous, instead playing out over time as people and organisations slowly adjust. And, of course, government policies shape all these relationships.

Understanding spatial disparities, and identifying the appropriate policy responses, requires a much deeper understanding of the costs and benefits. What causes them? Are they changing? What are the implications? What policy interventions are effective? Are there trade-offs between spatial disparities and economic efficiency?

As the British government spends billions of pounds each year on policies for regional development and urban regeneration, answering these questions is of more than academic interest. Unfortunately, however, getting the right answers is difficult. There are many sources of costs and benefits and their importance differs across individuals, firms and locations, raising the possibility of 'sorting': different kinds of individuals and firms choosing to locate in different places.

Sorting is a key factor that makes spatial policy so difficult to get right. With sorting, many spatial disparities simply reflect inequalities in society that may not be directly or effectively reduced by spatial policy.

Differences between the North and South, between Manchester and Leeds, between Hackney and Westminster partly reflect decisions by different people and businesses about where is best for them to live, work or produce. The greater the difference between the fortunes of financial services and traditional manufacturing or between low- and high-skilled workers, the greater will be the likely spatial differences that result.

Personal inequality in Britain is high relative to many other European countries, as is the contrast between the performance of some of our manufacturing and financial services. So it is no surprise that spatial inequalities – such as 'postcode lotteries' in health or 'North-South divides' – partly reflect that.

Spatial policy may play a role in addressing these equity concerns. But other policies that directly affect the underlying personal inequalities are likely to be far more effective.

At the same time, because some economic outcomes depend on location, even for similar people or firms, there is also a role for policy in making the economy function more efficiently. The difficulty is determining when this is happening and what policy might do, particularly since sorting based on personal differences means that the existence of spatial inequalities *per se* tells us nothing about whether or not such effects are important.

We are a long way from a full understanding of all these issues and thus from knowing exactly what policy should do. Personally, I don't think that the existing evidence supports the conclusion that we 'should all move south' (the rather crude interpretation of Policy Exchange's message, which led to so much venom). But, for all the reasons outlined above, the existing evidence doesn't support the idea that we could, or should, eliminate all spatial disparities (an equally crude interpretation of government policy).

The answer, as usual, is somewhere between the two extremes. Of course, the crucial issue is where the balance lies. CEP research has already played a central role in advancing our thinking on this issue. Funding from government and the ESRC for the new Spatial Economics Research Centre based at LSE should help this to continue.

In the current economic climate, careful research to get the right answers to these questions and to help formulate the appropriate policy response matters much more than whether I think my town is better than yours.

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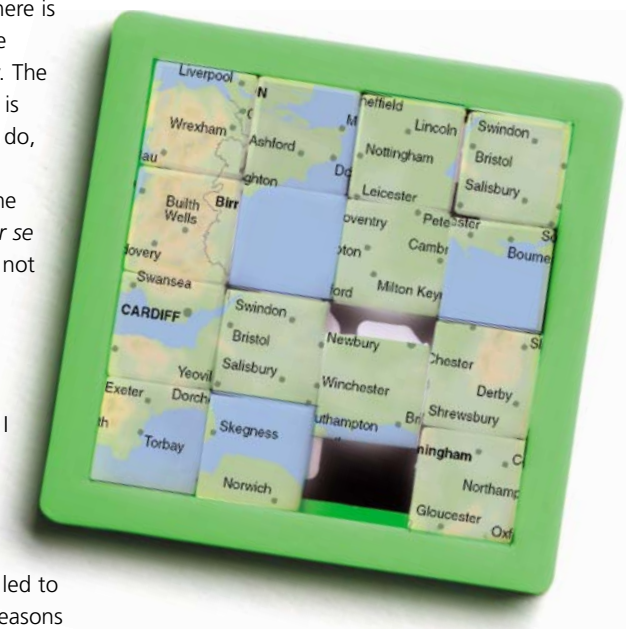

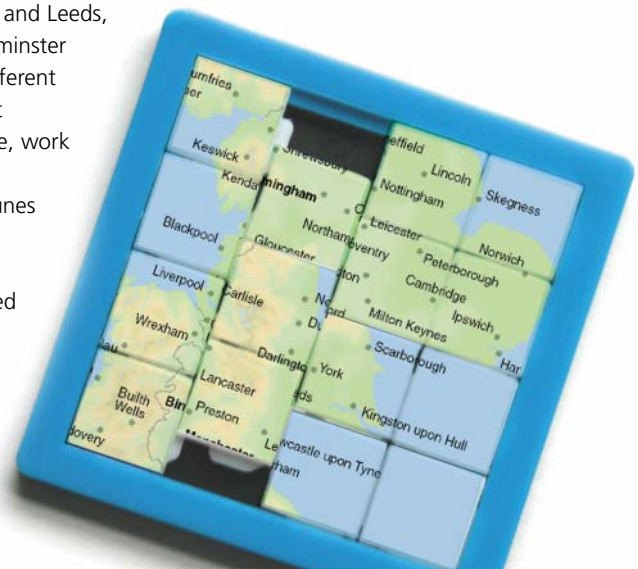

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