Regions, cities and neighbourhoods across Britain seem to be very unequal. This is true if we look at average earnings, employment, education and almost any other socio-economic outcome.

Take ‘gross value added’ (GVA) per person, potentially a good indicator of living standards in different places. In 2005 (a point in time chosen to be sometime before the peak of the boom), the highest ranked regions in Britain were West Inner London and Berkshire with GVAs of £44,050 and £39,850 respectively. The lowest ranked were Liverpool and Blackpool with GVAs half those in the South East: £19,800 and £21,050.

These examples are representative of a broader trend: the top ranked 10% of regions have GVA at least 50% higher than the bottom ranked 10%.

Regional policy, urban policy, even neighbourhood policy are all largely based on concerns about these kinds of disparities. But these figures are simply aggregates of the outcomes for people who live and work in these places. Without further information, we do not know whether the outcomes for people currently living in Manchester would be any different if they lived and worked in London.

We also have no way of knowing if the productivity of London and Manchester would change if these movements of people actually took place. Similarly, we do not know whether replicating the economic, policy, institutional and environmental regime of London in Manchester would change anything without moving people. In short, it is hard to work out what these differences mean in terms of the economic advantages and disadvantages that a place offers to the people who live and work there.

It is also easy to assume from looking at these aggregated figures that disparities between places are big drivers of disparities between individuals. But this clearly need not be the case. For individuals, the disparities within local areas could far exceed those between different areas.

Our research offers new empirical evidence on the nature, scale and recent evolution of economic disparities in Britain (Gibbons, Overman and Pelkonen, 2010). We focus on disparities in individual wages, because wages are linked to productivity and they are an important cause of variation in living standards. We also have very good individual data on wages.

Using these ‘micro’ data, we assess the extent of and persistence in wage disparities across labour market areas in Britain. We examine to what extent these area differences arise because of differences in the characteristics of people who live in different places – ‘sorting’ – versus different outcomes for the same types of people living in different places – ‘area effects’. We also consider the extent to which these differences across areas contribute to overall individual wage disparities.

Our research finds that between 1998 and 2008 there were few changes in area
disparities, despite many policy interventions. It also turns out that who you are is much more important than where you live in determining earnings (and other outcomes). Area effects only play a small role in the overall wage dispersion.

We can tell this by looking at wage differences for individuals with similar skills living in different areas, and comparing them with wage differences for people with different skills living in the same area. The larger area wage disparities that appear at first sight, when taking a superficial look at the data, arise through sorting of individuals and the area-level aggregation of the individual skills.

So this research suggests that wage disparities across local areas in Britain are pronounced and very persistent but that much of these disparities are driven by ‘people’ rather than ‘place’. Regardless, such disparities between different cities and different labour markets concern policymakers because they seem to imply differences in standards of living and economic welfare. But spatial earnings disparities are uninformative about differences in people’s overall wellbeing unless we take account of differences in the cost of living and the availability of local amenities.

In further research, we consider the extent to which higher post-tax earnings are offset by higher housing costs (Gibbons, Overman and Resende, 2011). Figure 1 shows the results for a sub-set of 157 labour market areas. Both wages and housing costs are in £1,000s per year. The wage gaps between areas are estimated from the wage gains and losses for individuals who move between areas; and housing costs are measured from house prices, adjusting for differences in housing quality.

The solid upward-sloping line corresponds to the case where housing costs rise one-for-one with wages. Given that most people in Britain are free to choose where they live, higher wages should translate directly into higher house prices for places that are otherwise identical. That is, we should expect £1 higher wages to mean housing costs rise by £1 per person. In fact, on average the empirical relationship in Britain is close to this theoretical benchmark.

But as Figure 1 shows, there is also a great deal of variation around this general relationship. What drives this variation is the fact that other things are not equal. Places differ in the local amenities that they provide to households. These amenities include crime, weather, pollution, entertainment and natural beauty.

For example, places with high housing costs relative to wages must offer some kind of local amenity – better restaurants and entertainment perhaps, or lower crime and less pollution – which helps to offset the fact that real income is low in the area. Similarly, places that offer poor local amenities must ‘compensate’ people by offering low house prices relative to wages. This suggests that we can use cost-minus-earnings differentials as a measure of quality of life.

Rather than focusing on area rankings, it is more useful to consider what this approach tells us about the trade-off faced by people in Britain. The dashed line in Figure 1 does this by showing how the relationship between house prices and wages changes as we move from low to high net pay.
The high valuation of natural amenities is reflected in high housing costs in relatively low wage places like Cornwall and the Lake District.