

Average earnings vary widely across the regions of Britain, a fact that has prompted many decades of policies aimed at reducing regional disparities. But as **Henry Overman** and **Steve Gibbons** demonstrate, such variation reveals little, especially if we ignore regional differences in the cost of living and availability of local amenities.

# Unequal Britain:

## how real are regional disparities?

**R**egions, 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

Who you are is much more important than where you live in determining earnings

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





high wages.

Places with lower wages in Britain tend to be rural but as wages increase, house prices tend to fall not rise (so the relationship between house prices and wages is downward sloping). This suggests that places with high levels of consumer amenities tend to have few productive advantages for firms.

In these places, consumer demand for local amenities drives up land costs and house prices, but since these areas do not offer productive advantages, wages must also be lower to induce businesses to locate there. Households in the lowest wage places are willing to pay high house prices because they are compensated by higher local amenities.

When you look at the places we are talking about – for example, West and East Cornwall, Devon and Kendal – this clearly makes sense. These are places in which ‘underperformance’ and a lack of development has gone hand-in-hand with preservation of rich natural amenities that are highly valued by consumers, even though wages are low. This high valuation of natural and recreational resources, reflected in housing costs, is borne out in more detailed analysis we have done (Gibbons, Mourato and Resende, 2011).

In contrast, moving to higher wage areas – on the right-hand side of Figure 1 – we tend to see house prices increasing as wages rise (so the relationship between house prices and wages is positive). This suggests that local producer benefits tend to drive the relationship for higher wage areas. Firms drive up land costs in these labour markets, and workers must be

**The high valuation of natural amenities is reflected in high housing costs in relatively low wage places like Cornwall and the Lake District**



compensated with higher wages to induce them to live there, but with house prices higher to offset the benefits of higher wages.

Note though, that on the far right-hand side of Figure 1, in London and the South East, amenities for consumers and productive advantages for firms tend to be positively correlated across labour markets. Housing costs rise steeply, more than one-for-one with wages, indicating that consumers are willing to pay over and above the expected wage gain to live in these areas – though here the amenities are quite different from those they expect to find in places like the South West of England and the Lake District.

So across Britain, our research shows that increased living costs (particularly of housing) tend to offset completely increased wages for the average household. In the lowest wage areas, which are mostly rural, differences in amenities drive the trade-off between wages and the cost of living. In higher wage areas, which are mostly urban, differences in firm productivity drive the results.

What are the implications of this research for urban and regional policy in Britain? We highlight four:

**Area averages are not very useful indicators of wellbeing:** Differences in average incomes across neighbourhoods or regions reflect the interaction of area effects and the sorting of people. High wages tend to be offset by high house prices or low quality of life so income differences on their own are not very useful indicators of differences in wellbeing.

**Policy should be assessed by its impact on people not places:** People trade off wages, cost of living and amenities, and they can move in response to changes in any of these. As a result the impact on observed area differences offers a very poor guide to the overall effects of policy on individuals.

**In practice, policy has probably been too heavily focused on places:** Area effects mean that living in some places negatively affects individual outcomes. The usual response is to try to improve ‘bad’ areas. An alternative would be to focus on improving outcomes for people who live in bad areas.

The focus on area differences biases policy towards the first response. Unfortunately, evidence suggests this has not been successful as area effects are very

persistent. This argues for a greater focus on improving outcomes for individuals including, possibly, removing barriers that prevent people relocating to better areas.

**Policy has paid too little attention to house prices and amenities:** Planning decisions play a key role in generating area disparities because people and firms sort in response to both wages and local costs. Similarly, disparities in amenities matter because high quality of life compensates people if wages are low relative to the cost of living. Local policy-makers have policies that directly affect house prices and amenities and relatively few that affect wages and employment.

At a time of constrained finances and weak economic performance it is more important than ever that urban and regional economic policy focus on sensible objectives using cost effective policy levers. Reflecting these four key insights when considering how policy should be targeted and developed would be a useful step in the right direction.

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## Further reading

Steve Gibbons, Henry Overman and Panu Pelkonen (2010) ‘Wage Disparities in Britain: People or Place?’, SERC Discussion Paper No. 60 (<http://www spatialeconomics.ac.uk/textonly/SERC/publications/download/sercdp0060.pdf>).

Steve Gibbons, Henry Overman and Guilherme Resende (2011) ‘Real Earnings Disparities in Britain’, SERC Discussion Paper No. 65 (<http://www spatialeconomics.ac.uk/textonly/SERC/publications/download/sercdp0065.pdf>).

Steve Gibbons, Susana Mourato and Guilherme Resende (2011) ‘The Amenity Value of English Nature: A Hedonic Price Approach’, SERC Discussion Paper No. 74 (<http://www spatialeconomics.ac.uk/textonly/SERC/publications/download/sercdp0074.pdf>).