

A series of background briefings on the policy  
issues in the May 2015 UK General Election

# The Economic Performance of UK Cities: Can Urban and Regional Policy Make a Difference to the North-South Divide

#ElectionEconomics

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## CEP ELECTION ANALYSIS

### **The Economic Performance of UK Cities: Can urban and regional policy make a difference to the North-South divide?**

- There are large variations in economic performance across UK cities and on some measures, they have widened since the global financial crisis. All main parties promise action to reduce them, but there is little difference between them in terms of the policies that they would pursue to meet this objective.
- The traditional policy mix – central government investments in local growth projects, transport and other infrastructure, funding for business support and access to finance, and a host of other interventions – is largely ineffective.
- Greater local control is needed to improve policy effectiveness. The coalition government has used ‘local enterprise partnerships’ (which have replaced regional development agencies) and city and local growth deals. It is too early to assess their effectiveness, although there have been problems with central government in allocating money and local government in spending it.
- There is disagreement about the methods of devolving power. It is important that policies that have wide scale impacts (such as transport and housing) are coordinated across local areas.
- Greater experimentation at the local level combined with effective evaluation would help improve policy, but this is highly unlikely given the short-term political focus on being seen to ‘do something’, which favours the announcement of new projects over the long-term development of policy effectiveness.
- London’s strong economic performance plays a large part in explaining widening disparities. Providing an effective counter-balance to London may require policy aimed at ‘rebalancing’ to be more spatially focused – for example, on Manchester.
- We ultimately care about the effect of policies on people more than on places. Efforts to rebalance the economy should be judged on the extent to which they improve opportunities for all, rather than whether they narrow the gap between particular places.

## Introduction

There are large variations in economic performance across the cities and regions of the UK. There is a broad North-South pattern to these disparities. But there is also substantial variation within those broad areas: some Northern cities (such as Manchester) are doing well and some Southern cities (such as Hastings) are doing relatively badly. Despite many policy initiatives by the current and previous governments, these disparities remain large and persistent. On some measures, they have widened since the global financial crisis.

Table 1 shows how these differences play out in terms of population growth for a selection of UK cities. The table highlights three important trends: first, the continued strength of London; second, the recent improvement in performance of some cities; and third, the variation in performance, which is apparent even for neighbouring cities.

**Table 1: Differences in population growth rates for a selection of UK cities**

Place	Region	Population growth (percentage)	
		1991-2001	2001-2011
Great Britain		4.1%	7.5%
London	London	7.2%	13.1%
Birmingham	West Midlands	0.5%	7.9%
Stoke	West Midlands	-0.1%	3.2%
Manchester	North West	-1.0%	9.3%
Liverpool	North West	-2.1%	1.4%
Newcastle	North East	-0.2%	4.4%
Sunderland	North East	-3.5%	-1.3%

*Source:* Cheshire et al (2014); authors' own calculations based on census data.

Cities Outlook<sup>1</sup> is the most useful source of detailed data on the economic performance of UK cities. The latest report shows that between 2004 and 2013, population growth in cities in the South was twice the rate of cities elsewhere. The growth in businesses was similarly unbalanced with over a 25% increase in cities in the South compared with an increase of nearly 14% elsewhere. The figures for jobs are even more dramatic: cities in the South had over 12% more jobs in 2013 than in 2004, while cities elsewhere saw only around a 1% increase.

<sup>1</sup> See [http://www.centreforcities.org/wp-content/uploads/2015/01/Cities\\_Outlook\\_2015.pdf](http://www.centreforcities.org/wp-content/uploads/2015/01/Cities_Outlook_2015.pdf) for the 2015 report and links to previous years.

The differences are even more marked for private sector employment (because public sector employment is more evenly distributed). This has been disputed by the coalition government, who argue that 60% of the rise in employment since 2010 has taken place outside London and the South East. But their figures are misleading on two counts:

- First, they use a strange definition of private sector employment.<sup>2</sup>
- Second, they look at short-term recovery from recession rather than long-term performance. As areas outside the South were hit hardest by the recession, it is not surprising that they have shown stronger recoveries.<sup>3</sup>

In short, because the impact of recession was very uneven, recovery is not as uneven as suggested by City Outlook. But those figures do highlight the limited progress towards reducing long-run differences. This is unsurprising. The economic processes that drive spatial differences are poorly understood by policy-makers, and evidence plays little part in the formulation of policy. As a result, there is confusion about what urban and regional policy can do, a confusion that is shared by all political parties.

## **Understanding differences in performance: London versus the rest**

What are the economic forces polarising the UK? As the figures make clear, a big part of the story concerns the geographical concentration of economic activity in London (and the South East). Is this concentration good for those who live or work in London but bad for those who don't? Is the attraction of London creating an economy that is distinct from the rest of the UK? And what are the implications?

Neither finance nor the globally oriented part of the London economy are as important as suggested by popular discussion. Financial services are clearly important, but most of London's long-term job growth has come outside finance or those sectors closely linked to it. For example, London has strengths in a range of business and information services well beyond the financial sector.

London is a preferred location for the super-rich, but this is a tiny, if much publicised, minority. For example, while the fraction of foreign buyers in London residential properties worth over £2 million is a little over 50%, these transactions represent less than 0.5% of overall transactions. Even in terms of overall transactions, recent increases in foreign demand are swamped by increases in demand from first time buyers and other sources of domestic demand.<sup>4</sup> It is domestic sources of demand that drive the London housing market.

In fact, what is most distinctive about London's economy is its competitive strength and skill levels across a wide range of services. A large part of the superior economic performance of London (and the broader South East) comes from the concentration of skilled workers who would be paid relatively well wherever they lived. In turn, that

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<sup>2</sup> Figures are from the Public Sector Employment series and include, for example, sixth form colleges, general practitioners and universities.

<sup>3</sup> See 'How Did London Get Away With It?', *CentrePiece* (<http://cep.lse.ac.uk/pubs/download/cp333.pdf>).

<sup>4</sup> See <http://spatial-economics.blogspot.co.uk/2013/05/foreign-buyers-and-london-property.html>.

concentration is partly because London provides greater opportunities for such individuals to use and develop their talents.

All of this means that London has higher wages, more expensive housing and a greater general cost of living, with the gap in all of these rising as wage inequality has grown since the late 1970s. But at least for those who are young, able and willing to economise on housing costs, London offers opportunities that are simply not available elsewhere. And since many later move on to other areas of the country, London also acts as a source of highly skilled workers for local economies throughout the UK.

Whether this seems good or bad for the UK partly depends on how we tell the story about what is going on. If, as is popular, we talk about London sucking the talent from the rest of the UK, then this sounds like a pretty bad thing. But if we think of London's performance as the result of a large number of people responding to the opportunities that London offers, then this changes the debate:

- First, it becomes clear that we need to think about individual winners and losers. Some of the basic effects are described in the Annex.
- Second, it helps to focus attention on why London offers those opportunities and whether they could be created elsewhere. A large body of evidence suggests that both size and the concentration of skilled workers is key to generating these opportunities, which makes it harder to generate similar opportunities elsewhere.

On the implications for overall economic growth, the debate is polarised. For some, it is obvious that spreading growth across the UK would make use of underused resources. For others, London and the South East are key, and we should focus on making sure they continue to perform.

Since there is already a lot of redistribution away from London, the questions are first, whether there should be a lot more spatial redistribution than now, and second, whether we should put a high value on policies restraining London's growth (for example, tougher green belt policies; even lower London allowances for public sector workers, etc.). There is no evidence pointing to large benefits from spatial redistribution and much evidence that very restrictive planning in London and the South East has been harmful (see CEP's Election Analysis on housing and planning, 2015). Hence, artificially restraining London's growth does not seem like a desirable policy.

### **Policy responses: who and where?**

Rather than focus on London's dominance, we should ask why other large UK cities do not offer similar economic opportunities and what can be done about it? Looked at this way, the evidence suggests that what we need is, paradoxically, the growth of one or two other large cities so that they provide similar opportunities. This is because overall population size helps generate more opportunities (as a result of what economists call 'agglomeration economies'). So too does the concentration of skilled workers and of certain types of knowledge-intensive industries (which employ those high-skilled workers).

### *City size*

If size matters, perhaps the issue is not that London is too big, but that some of our second cities are too small. International comparisons are suggestive. For example, applying Zipf's Law (which suggests that the second largest city tends to be half the size of the largest, the third city a third the size of the largest, and so on), the UK's larger cities after London all look too small.

Part of the reason for this is that population is quite spread out across a number of cities. Concentrating population in a smaller number of larger cities would bring us more in line with other countries. A powerful body of research points to the importance of agglomeration economies and the barriers to realising the benefits from those economies (in particular the UK planning system). In short, these international comparisons do raise questions about the relative size of our cities.

### *Local growth policies*

In principle, the coalition government's changes to the institutions and structures that deliver local growth policy allow for greater policy variation across areas. The move from 10 regional development agencies (RDAs) to 39 'local enterprise partnerships' (LEPs) in most cases moved strategic decision-making on economic development policies – particularly on transport – to a more appropriate scale: somewhere above local authorities (which are usually too small) but beneath regions (which are too big). The deal-making approach<sup>5</sup> – first through city deals for a limited number of cities, and subsequently through local growth deals for all enterprise partnerships – also allowed for greater policy variation.

In practice, however, decisions on deals are still ultimately made by central government. And this, combined with the centralised dispersion of funds from the Regional Growth Fund continues to constrain local decision-makers. The coalition government seems willing to go further – at least in areas with a good track record and credible governance arrangements. For example, recent announcements of 'Devo Manc' involve considerable devolution to Manchester (in line with recommendations from the City Growth Commission (2014) to increase devolution). But this 'earned autonomy' model is criticised by those who would like to see more systematic devolution to all local areas.

### *Policy variation across areas*

While in principle, the coalition government's reforms allow for greater policy variation across areas, the extent to which central government politicians can live with the consequences – in terms of variations in economic performance – remains to be seen. The Chancellor's 'Northern powerhouse' agenda – which aims to create a counterbalance to London by better integrating and empowering the collection of Northern cities – highlights these tensions. The evidence suggests that agglomeration economies work at smaller scales than the entire Northern economy, so more uneven development across Northern cities may be necessary if we want one of these cities to provide the kind of opportunities available in London.

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<sup>5</sup> <https://www.gov.uk/government/policies/giving-more-power-back-to-cities-through-city-deals>.

Labour, with their focus on inequality, find these issues even harder to address and have a tendency to focus on the objective of improving growth across all failing areas – regardless of whether this is achievable or the best way to help individuals.

To try to resolve this tension, it is always worth remembering that ultimately we care about the effect of policies on people more than on places. If growth for all requires us to provide opportunities for all, then it just may be that we have to put up with the fact that some places will always do better than others.

## **Policy responses: what?**

Discussion around the systems through which urban and regional economic policy is delivered often distracts attention from more fundamental questions about the effectiveness of particular policy interventions.

### *Transport infrastructure*

London's success depends on transport investment, but it is not driven by transport investment. Public sector transport investments are already quite evenly distributed, and evening out transport investment further will not be particularly effective in generating opportunities elsewhere.<sup>6</sup> It is also highly debatable whether HS2 will narrow disparities with the government's own analysis pointing to disproportionate benefits for cities on the line (including London).

### *Housing*

One major barrier to creating additional opportunities in London and other more successful places is that supply restrictions mean that house prices rise very fast in response to local demand growth. Relaxing planning restrictions and building on the green belt would help (see CEP's Election Analysis on housing and planning, 2015).

### *Area-based initiatives*

Policies that offer support for particular areas of cities or regions (such as enterprise zones) are unlikely to be effective in addressing broad disparities in opportunities. The evidence mostly suggests that these lead to displacement from other nearby areas rather than creating a large amount of new job growth. Similar problems limit the economic impact of other regeneration policies.

### *Business support*

There is a depressing paucity of high quality studies evaluating business support policies, but there is some evidence that job growth can be improved. For example, Criscuolo et al (2012) find job increases from European regional aid but only for small and medium-sized enterprises and there does not seem to be a sustainable increase in *productivity*. Evidence of how such interventions can be effective in the long run suggests that very large-scale investments are needed (for example Bloom et al, 2014; and Kline and Moretti, 2014). Overall, the current evidence on business support policies (such as improving access to finance, or offering advice and expertise) suggests that these types of policies are not very effective at generating employment growth. For more discussion, see CEP's Election Analysis on

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<sup>6</sup> <http://spatial-economics.blogspot.co.uk/2014/06/local-transport-expenditure.html>.

productivity and business policies (2015) and the What Works evidence review on business support.

### *Skills*

Local differences in the skill levels of workers play a large role in explaining disparities across cities. This suggests that education and training may have an important role to play in helping address these disparities. As with business support, policy needs to address similar concerns about cost-effectiveness although there does appear to be growing support for experimentation and evaluation aimed at improving the cost-effectiveness of policies. For more discussion, see CEP's Election Analysis on education policy (2015).

## **Conclusion**

There are large variations in economic performance across UK cities and on some measures, they have widened since the global financial crisis. All main parties promise action to reduce them, but there is little difference between them in terms of the policies that they would pursue to meet this objective.

The traditional policy mix – central government investments in local growth projects, transport and other infrastructure, funding for business support and access to finance, and a host of other interventions – is largely ineffective. There is a growing recognition that greater local control is needed to improve policy effectiveness, although there is disagreement about the form this devolution should take. Whatever happens, it is important that policies that have wide scale impacts (such as transport and housing) are coordinated across local areas.

London's strong economic performance plays a large part in explaining widening disparities. Providing an effective counter-balance to London may require policy aimed at 'rebalancing' to be more spatially focused – for example on Manchester. Concentrating resources in this way is controversial and difficult for constituency-based politicians (in both central and local government).

It is helpful to remember that we ultimately care about the effect of policies on people more than on places. Efforts to rebalance the economy should be judged on the extent to which they improve opportunities for all, rather than whether they narrow the gap between particular places.

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## **Annex: who gains and who loses from London's success?**

If we focus only on average outcomes, we see population, wages and house prices increasing in London and falling (at least in relative terms) in other cities. But from the perspective of people who live in these different places, the economic impact is much more nuanced. Indeed, as is the case for the majority of significant economic changes, the story is one of gainers and losers in all cities (including London).

In London, higher wages (and better amenities) tend to offset higher housing costs. If this were not the case, then people would not be moving to the city and it would not be growing so spectacularly. But not everyone in London is better off. Individuals outside the labour market may be worse off due to rising housing costs. This is one of the reasons why deprivation measures can be high in London.

Rising housing costs may also lead to worse outcomes for those workers whose wages are not very responsive to local economic conditions (such as the low skilled, and nurses and teachers whose wages are set nationally). This effect is partly responsible for the arguments about affordability issues for 'key' workers.

Similar patterns also play out in other UK cities (such as Bristol and Manchester) that have recently seen faster growth. In cities that are doing less well, this story of winners and loser is also repeated. Individuals who are able to move away do well. For those who stay, the balance of changing income and housing costs determines who gains and who loses.

## Further reading

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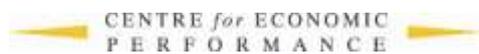
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