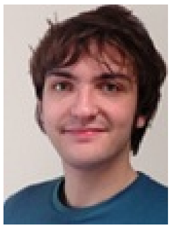
If the Chancellor is serious about ‘rebalancing’ the UK economy we need serious investment in regions outside of the greater South East

Mar 21 2012

Lewis Goodall *mulls over the impact of the 2012 budget on the UK's regions, arguing that it is a lack of investment in capital projects that will really hold back Northern economies and the UK economy overall.*



The Chancellor used a three word phrase that a few years ago would never have passed the lips of any British finance minister, of any party stripe. He described the package of measures unveiled in the first half of his budget today as a ‘modern industrial policy’ and that the UK would be ‘Europe's Technology Gateway.’ This partial embrace from the government of a semi-activist state is a welcome one and probably reflects Vince Cable's attempts to move the government from the stale and intellectually moribund impulses of laissez-faire economic thinking. However, the government must go much further in order to make the UK the economic powerhouse of the 21st century.

Over the last thirty years, both Labour and Conservative governments have been happy to allow British investment levels in its infrastructure, industrial base and economic assets to fall to the lowest in the G7 (as a percentage of GDP). The UK is a country with relatively low investment rates (17 per cent gross fixed rate capital formation over the last decade) compared with similar European countries such as Germay (19 per cent) and France (21 per cent). It is ranked 33rd out of 39 countries for overall infrastructure quality, behind most industrialised countries. These are major impediments to improving our long-term economic performance: if we are to ‘pay our way in the world’, they must be addressed.

These problems are especially acute in our regions, which have suffered from relative underinvestment to an even greater extent. If the Chancellor is serious about ‘rebalancing’ the UK economy we need serious investment in regions outside of the greater South East. As the OECD have recently pointed out in a major study, countries' so-called ‘lagging regions’ offer significant opportunities for growth. Indeed, in the UK, 57% of our net aggregate growth came from these regions. They could make an even greater contribution and, in the North of England (where all three regions are ‘lagging’ vis-à-vis the greater South East) we know that it is a lack of investment in capital projects that really holds back Northern economies and ergo, the UK economy overall.

As part of IPPR North's Northern Economic Futures Commission work (tasked with plotting a ten year strategy for growth in the North of England) we know that many good Northern businesses are desperate to expand and innovate, but simply cannot access the finance from commercial banks, especially when looking to produce highly innovative but risky new products and services. We also know that decades' worth of underinvestment in infrastructure deters business from investing in our regions.

In the North this is both a structural problem as well as one that got worse during the recession. Structural in the sense that, even in the good times, many businesses and innovators in the North struggled to access the finance they needed: 70 per cent of venture capital firms, for example, are located in London. Of the 176 public and private funds only 30 were based in the North. Pre-crash, 60 per cent of all investment activity was supported by the public sector, compared to only 16 per cent in the Greater South East. In these times of austerity, the North is doubtless paying the price.

Such a gap is not new. It was first openly identified by the MacMillan Committee on Finance and Industry, who published a report on the subject in 1931. The Committee gave birth to the term 'MacMillan Gap': that finance and industry in the UK lacked the symbiotic relationship that it Germany and the United States then enjoyed (something they both still enjoy, to some extent, to this day). Lest we forget, the industrial revolution was funded, not by the City of London (who were much more interested in investing money in British Empire Bengal than Bolton) but by strong regional investment institutions. 1911 the Economist pointed out that "London was more concerned with the course of events in Mexico than what happened in the West Midlands."

This historical inequality still exists despite the fact that today, the UK has the largest private equity market in Europe, with the greatest amount of venture capital per capita than any other European country. Unsurprisingly perhaps, companies in the Greater South East take the lion share of this investment. In 2007 businesses in the Greater South East attracted 41 per cent of all investment, despite only making up 32 per cent of the total number of businesses in the country as a whole. London alone attracted £5.7bn of investment for a mere 334 companies. By contrast, the North received 23 per cent of total investments, equating to 10 per cent of investment value. This is especially debilitating when one considers that the business base of the North is in fact around 25 per cent larger than that of the South East (excl. London).If British business could replicate the same rate activity nationally (relative to the business rate) in then British business in the regions could make use of an additional £4.4bn of investment, £1bn of which would come to the North.

Now in the 21st century, we must rekindle the radicalism of the first industrial revolution. A regional investment bank would help to fill this investment vacuum and unlock the significant economic potential in the North of England, providing capital investment and match funding in projects that could transform the Northern economic outlook. The German Landesbank, operating with a similar remit, have been an important part of Germany's continued industrial and economic vitality.

There are numerous capital reserves on which such a bank could draw: for example, local authority pension funds. A poll conducted recently indicated that many local authority finance officers would be interested in placing their reserves in such an investment vehicle: bearing this in mind and the stated levels of reserves and preferences for deposit levels we can estimate that local authorities would be willing on average to deposit between £1,167, 613 and £8,409,090, which would in total create a fund of between £389, 982, 742 and £2,808,636,060, a staggering figure would need to appropriate sufficient funds to inject the initial capital of the bank.

This is just one potential funding source but it ought to be remembered that the essence of banking is the ability to make loans up to a multiple of several times initial capital. As Lord Skidelsky has well argued elsewhere, any investment bank would be able to finance investment up to a sizable multiple of this initial capital by borrowing the extra dollars now languishing in the private capital market. Regional investment banks could also be part of a national investment bank structure, providing both the benefits of a national strategic network and a more local focus and remit.

To get the UK economy firing on all cylinders, every part of the country has to be achieving its potential. Despite their best efforts, many Northern and regional businesses in the UK cannot do this without real commitment to every part of the country: we need investment. The Chancellor has shown his willingness to invest- we now have a sustained and strategic view, with a new, commercially operated regional investment bank to invest in Britain's future and ensure the economic blunders of the 20th century are never repeated.

Please read our comments policy before posting.

Note: This article gives the views of the author, and not the position of the British Politics and Policy blog, nor of the London School of Economics.

About the author

Lewis Goodall *is a Researcher at IPPR North, IPPR's dedicated think tank for the North of*

England.

You may also be interested in the following posts (automatically generated):

1. The Chancellor had some good ideas, but rebalancing the economy looks as challenging now as it did yesterday morning
2. This was a Tory budget from a Tory Chancellor