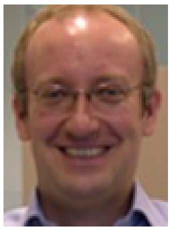
Investing in the UK's most successful cities is the surest recipe for national growth

Jan 26 2012

Wage inequalities between North and South in the UK and the dominance of the financial services sector over other industries have proven resistant to numerous policy interventions throughout the last few decades. **Henry Overman** *argues that prioritising growth in the UK's more successful cities may make the most economic sense.*



Yesterday's depressing economic growth figures, Tuesday's announcement by Greg Clark on **city mayors** and Monday's **City Outlook from Centre for Cities** have got me thinking again about urban economic policy and the role of cities in UK economic growth.

For some time now it has seemed to me that there is a fundamental, but unresolved, tension concerning the economic objectives for UK cities. On the one hand, government wants to maximise their economic potential. On the other government wants rebalancing both in terms of a shift away from financial services and geographically (from south to north). Of course, some will argue that these policy objectives are not in conflict. Most urban economists would disagree. If we do need to choose (at least in the sense of prioritising one over the other) what should we do? Overall, at least for the UK, I think the evidence points towards prioritising growth in our more successful cities even if this leads to more uneven spatial development. Let me explain why.

Disparities across local areas in Britain are pronounced and very persistent but much of these disparities are driven by 'people' rather than 'place'

Let's start with the underlying drivers of spatial disparities. In **recent SERC research** 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.

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 amenities

Such disparities between different cities and different labour markets concern policymakers because they seem to imply differences in standards of living and economic welfare. In fact, however, this is not the case. **Our research** shows that across Britain increased living costs (particularly of housing) tend to offset completely increased wages for the average household. In terms of real earnings (conditional on skill) it doesn't make that much difference where you live in Britain.

In short, looking at area differences greatly exaggerates the importance of place in determining individual wellbeing. Of course, the evidence says that place does play some role in determining wages so there is a question about whether or not we should try to address these area effects. If, say, Hull's economy is doing relatively badly because of the combination of lower skilled workers and bad area effects, shouldn't we try to address both?

It is very hard for policy to change area effects

Unfortunately, evaluation of specific policies suggests that it is very hard to change area effects. Details on that will have to wait for another day, but for the purposes of this post let me simply point to the fact that **our research** suggests that a decade of fairly significant intervention left underlying area effects essentially unchanged. It's asking a lot for the current government to achieve any bigger impact with much less money.

It is very easy for policy to drive up the cost of living

In contrast to the difficulties in reducing area effects it is very easy for government to do things that drive up the cost of living in our more successful places. The most obvious way in which we do this is through **constraints imposed by the land use planning system**. If you can't do much to tackle underlying area effects, then an alternative is to allow people to move to areas where they will do better. Of course, you might think that this is a second best option. But the evidence suggests that it is likely to be the first best *feasible* option.

The need to focus spending

But what should government do in terms of the limited amount of expenditure that it is able or willing to make? Given the difficulties in addressing area effects, as discussed above, there's a strong case for trying to build on success. Of course, success can be relative so this might call for focusing investment in, say, Birmingham, Leeds, London and Manchester. Again this is a matter of prioritising, rather than a call for *all* expenditure to go to a select set of places.

More uneven spatial development: good economics, bad politics?

Investing in more successful cities to either enhance the economy or reduce cost of living clearly exacerbates uneven spatial development. But I have tried to argue that this may make for good economic policy in a world where who you are matters more than where you are and the government can't do much to offset the market forces that make some places perform worse than others. Of course, adopting such a course, and prioritising growth over rebalancing makes for very difficult politics for constituency based politicians.

*Henry G. Overman will be speaking at the LSE on 30 January on 'What should urban economic policy do? Lessons for London'. Event information is **available online.***

This post originally appeared on the LSE's Spatial Economics Research Centre blog.

Please read our comments policy before posting

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

1. Without a greater focus on education, the government's strategy of transferring more power to cities may struggle to deliver growth.
2. The economic benefits of high speed rail in Europe can now be demonstrated beyond doubt. Now the UK should consider investing in HSR as well
3. Investing in a new High Speed line will provide a once in a generation chance to improve rail services
4. Book Review: Makeshift Metropolis: Ideas About Cities