

The Future of Rural Policy: Lessons from Spatial Economics

Policy Note

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This policy note spells out lessons for rural policy that emerge from recent SERC research. It summarises a SERC policy paper available at

<http://www.spataleconomics.ac.uk/textonly/SERC/publications/download/sercpp008.pdf>

The Future of Rural Policy: Lessons from Spatial Economics

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Urban and rural economies increasingly interlinked: The division between ‘rural’ and ‘urban’ is no longer as useful for thinking about the economic disparities and policy. Agricultural markets are internationalised, lower travel costs allow people to live further from where they work and rising incomes have increased the demand for rural amenities (environmental, ecological and recreational). This means that the economies of rural and urban areas have become interlinked – with important implications for policy. To understand interlinked economies, spatial economics focuses on how households and firms choose locations by trading-off economic opportunities, living costs and amenities.

Wage disparities: our research finds that **area disparities are highly persistent** from 1998 to 2008, despite many policy interventions to try to address them. However, **who you are is much more important than where you live in determining earnings** (and other outcomes). Small area effects can be reconciled with large area disparities by noting that people sort across areas so people with “bad” characteristics tend to live in “bad” places. Even so, area effects play a small role in overall wage dispersion.

Rural areas pay lower wages than urban areas: in Britain the **urban-rural premium is around 2.5%**. Sorting across rural areas is slightly less pronounced than for urban areas but the difference between “good” and “bad” rural places is less pronounced. As a result, on balance, place is no more important in explaining rural outcomes than it is in explaining urban outcomes. Regardless, individual characteristics matter far more.

Spatial Disparities in Cost of Living and Quality of Life: Spatial earnings disparities are uninformative about differences in wellbeing unless we take account of differences in the costs of living and the availability of local amenities. Across Britain, our research shows **increased living costs (particularly of housing) tend to completely offset increased wages** for the average household. In the lowest wage areas, which are mostly rural, differences in amenities drive the cost-of-living versus wage tradeoff. In (mostly urban) higher wage areas, differences in firm productivity drive the results.

Rural mainstreaming: The previous government used “rural mainstreaming” to ensure that the needs and interests of rural communities were addressed. DEFRA measured performance against these objectives by comparing indicators of outcomes (number of GCSEs, employment rates, etc) to UK averages. **This provides little information on whether policy is meeting the needs of rural communities.** When who you are is much more important than where you live, observing better educational outcomes for rural areas tells us little about whether policy is delivering for rural communities. In terms of the impact on rural communities, the crucial questions for central government concern the effective provision of

public goods (e.g. broadband, schools) and other policy interventions (e.g. employment policy) in low density areas.

Addressing “underperformance”: Rural areas pay lower wages than urban areas and some rural areas pay particularly low wages relative to house prices. **Should policy support economic growth in rural areas with the lowest performance? In light of the evidence this policy makes little sense.**

First, rural areas always tend to have lower wages than urban – why would firms pay city rents otherwise? Second, much of the reason why wages are lower in rural areas is because of lower skills employed in those areas. Policy may want to address these low skills (e.g. in tourism or agriculture). Third, many rural areas are attractive for non-economic reasons. Rural areas that pay low wages but have high house prices offer good local amenities. If anything, as these amenities are highly valued, policy that emphasises quality of life should protect them rather than worry about the “performance” of the local economy.

Fourth, tackling high house prices requires expanding supply – improving performance with fixed supply simply raises house prices further. Expanded housing supply may not be attractive when high amenity values reflect the fact that an area is not very developed. If the worry is about house prices relative to wages for particular workers then policy either needs to increase their relative wage (e.g. by targeted skills policy) or increase housing supply for those workers (e.g. through ‘key worker’ homes). Most economists argue it would be better to try to tackle the income problem directly. In the context of increased local powers this raises questions about fiscal incentives for development (supply) and local employment and skills policy (wages).

The wider impacts of rural policy: Environmental and farm policy have effects far beyond rural areas. In a mobile world, household and firm decisions link outcomes across areas, so this is true of “rural” policy more generally. **Thinking of households trading off wages, costs-of-living and amenities helps clarify the impacts of different policies.**

For example, rolling out rural broadband may have several effects. It provides a public good to rural communities. It may affect the productivity of firms in rural areas. It may allow people who live in urban areas to move to rural areas and keep working. For national government, concerned with rural communities, the first of these effects is far more important than the other two. The effect on existing firms is likely to be small and why should the government care about the composition of particular places? Of course if broadband makes rural areas more attractive, this will exacerbate local cost of living issues if housing supply is unresponsive.

The fact that places are linked also complicates questions around housing. **Local homes for local people may address concerns about social capital and apparent inequities but at the expense of being ‘unfair’ on other dimensions.** Such policies are good for people born in high amenity areas, bad for those who are not and would like to move in.

Conclusions: The way in which households and firms trade off economic opportunities (wages, income), living costs (housing) and amenities has profound implications for rural economic policy. Because area effects in earnings are small, not very much affected by policy, and offset by living costs, observed area disparities offer a poor guide to policy. **Instead of targeting disparities, rural policy should focus on effective provision of public goods and services in rural areas, and on the wider impacts of rural policy.**

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