



# Spatial Economics Research Centre

Wednesday, 23 January 2013

## The Economic Future of British Cities: What should Urban Policy Do? (Part II)

A day later than planned, here's my write up of the second part of my LSE public lecture (you can read the first part [here](#))

I've made the case that it is very hard for policy to affect area level productivity. Policy can, however, have a very large effect on costs of living and doing business and this, in turn, can have a big impact on the economic performance of UK cities. Let me start with the evidence that we have that policy in the UK works to increase costs of living. A starting point for this is to note that in the period from 1970 to 2006 real house price growth in Britain averaged an incredible 4.5% *per annum*. This is the highest figure in the OECD. In contrast, the Netherlands experienced 3.5%, the USA a little over 2% and Germany saw house prices stay constant in real terms. Two things might explain this phenomenal increase. One is that we experienced a house price bubble as increases in supply were unable to keep up with speculative increases in demand. This is what happened in Spain and Ireland, for example, countries which saw similar increases in prices to Britain at the same time as building many more houses. Britain's story is fundamentally different, however, because most of the increase in prices is down to the fact that we built too few houses in areas where people wanted to live. The fact that we did so is down to the fact that the planning system in Britain strongly constrains the supply of land. My colleagues Christian Hilber and Wouter Vermeul have attempted to [quantify the role that the planning system explains in driving high house prices in Britain](#). By their estimates a Local Authority that moved from the average level of 'restrictiveness' to no restrictions would have houses that were about 35% cheaper than currently. That might seem extreme, but even moving from the average restrictiveness in the South East to that implemented by Local Authorities in the North East would see housing that was 25% cheaper. These are significant costs of the present planning regime.

These costs are not just limited to housing. Paul Cheshire and Christian Hilber have also looked at [the impact of supply restrictions on the cost of office space](#). To do this, they look at the cost of renting space relative to the cost of developing it (using the idea that large mark-ups of revenues over costs should be arbitrated away by commercial developers unless they are constrained by planning policy). This gives a rough and ready measure of the regulatory tax imposed by the planning system. In the West End of London this tax is around 800%. In Canary Wharf it's around 320%. Whenever people see these figures, they tend to argue that London is 'beautiful' and needs protecting. But central Paris is pretty attractive and there estimated regulatory tax is 305% (la-Defense is around 160%). London is already crowded is usually the other objection, but downtown Manhattan (very crowded) manages a tax rate that is somewhere between 0 and 50%. This isn't just a problem for London. Birmingham imposes a 250% tax rate. To put this in to perspective towards the end of the boom office rents in Birmingham were comparable to office rents in San Francisco. With rents like that, is it any wonder that Birmingham might struggle to attract private sector employers?

As a final 'bonus', SERC research suggests that [planning restrictions also reduce supermarket productivity by about 20%](#). In plain English, planning increases the price of our weekly shop.

Does any of this matter? I chose to highlight two implications in my lecture. First, these restrictions make our more successful cities very expensive. In fact, the productivity effect of living in our more successful cities is far outweighed by the cost of living effect. People who choose to live in those cities are compensated by those urban amenities that I discussed in part one of the lecture. But these amenities aren't sufficient to compensate many people who find themselves priced out of more successful urban areas. Posh restaurants are also cold comfort for the urban poor. What about the economic performance of British cities? Here too, I think there is a case to be made that planning restrictions are having a major impact on the urban system as a whole. In the lecture I made this point by appealing to something called Zipf's law. Applied to cities, Zipf's law suggests that the second largest city should be half the size of the largest, the third largest city a third the size etc. To a reasonable approximation, this law holds for the relative sizes of cities in many different countries in the world. But not in Britain where our second tier cities appear to be too small. Most people read this statement as suggesting that London is too big. It turns out, however, that London is about the right size when you look at our smaller cities (say those ranked about 25th onwards). The issue we have is that our urban population tends to be 'spread out' across a number of largish cities. To fit Zipf's law, what we would need is for some of those cities to become much larger and some to become much smaller.

What stops that from happening? Part of the problem is the supply restrictions that I have discussed in depth above. Take, for example, one of the recent city success stories - Manchester, which has seen the fastest growth in population outside London and the South East. As [documented in their independent economic review](#) supply constraints meant that this rise in population was accompanied by steep increases in house prices and office rents (at least in the more successful parts of the city). This, in turn, will have choked off further growth.

As I discussed in the lecture, planning constraints are not the only problem. Our larger cities struggle to provide good schools, accessible open space and safe streets. All of these things discourage more mobile households (particularly families) from living in our more successful cities. As discussed above, concentrations of higher skilled workers are important for cities, so if these families are 'forced' out of cities, this has implications for urban economic performance. More controversially, perhaps, I would argue that our relatively successful cities have also been hampered by the fact that 'place based' interventions tend to involve a lot of jam spreading. What I mean by this is that spending money in a city like Manchester on new transport links reclaiming land, improving parks etc is seen as 'unfair' if we don't pursue similar policies in less successful urban areas. As a result, what money we do spend, gets spread around rather than trying to build on success in cities like Manchester (I should disclose, that I sit on the Manchester LEP advisory board but one could make similar points about other relatively successful cities).

In short, I am arguing that the policy mix of supply constraints and jam spreading have led to cities like Manchester being smaller than they otherwise would have been. I think this has fundamental implications for the economic performance of those cities and the wider British economy and I'd like to see a serious debate about whether we should recognise this problem and try to do something about it. Focusing more on our relatively successful cities raises very difficult questions about what we should do for the places 'left behind'. I am not arguing that these places should be 'abandoned'. But I do think that the policy mix in these areas needs to be more realistic about the economic prospects of those areas. The balance of expenditure should be

strongly tilted towards ensuring better education and skills outcomes for households who live in those areas and away from the need for shiny building and expensive new transport infrastructure that will do little, if anything, to turn these places around.

Of course, this is a very difficult policy prescription for constituency based politicians. But the economic performance of Britain's cities is vitally important and improving that performance requires a serious debate about what urban policy can and should do better.

Posted by [Prof Henry G. Overman](#) on [Wednesday, January 23, 2013](#)

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### Anonymous said...

What is the role of urban design as a variable in the economic performance equation? For example, Birmingham has invested heavily in recent times in urban design. Urban design makes cities feel and look good. Does this help attract the types of businesses that constitute the new urban economy? Is investment in urban design a good policy option?

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