



# Spatial Economics Research Centre

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## Made in Britain II

I have just finished Evan Davis' 'Made in Britain'. The book's basic message is that, recession aside, the UK is doing OK, but that on some things we could do better. This sort of message is pretty appealing to an academic economist as opposed to the extremes often advocated by popular writers. The book is also full of fantastic examples which I shall be liberally plagiarising in the future.

I was particularly interested to read what the book had to say on the balance of manufacturing versus services - particularly as many people view such rebalancing as playing a part in dealing with the problems faced by some declining places. Davis identifies two macro issues that may adversely affect manufacturing. First, capital may be expensive because we don't save very much and capital (investment) is a big fixed cost for manufacturing. Second, excess business cycle volatility, possibly driven by the housing market, hits manufacturing harder (again, because of the big fixed costs involved).

As Davis acknowledges, the capital argument is complicated by the fact that in the recent past foreign investors have been free to invest in the UK. That if profitable investment opportunities in manufacturing exist, that are not being funded by domestic investors, why don't foreigners step in? Home market bias might form one part of a response, but a puzzle remains even if you could establish a causal link from savings rates to manufacturing shares. More fundamentally, I'd argue that Davis completely ignores an alternative source of distortion in terms of the fixed costs of manufacturing - the high price of land in the UK.

As my colleague [Paul Cheshire likes to point out](#) - when you first start studying economics you are told that firms need three things to produce: labour, capital and land. But a few weeks in and land is never mentioned again. This is unfortunate, because planning policy in the UK makes land very expensive. We have evidence that this causes big distortions in terms of rents for offices (see Cheshire and Hilber in the *Economic Journal*, 2008). I do know of equivalently robust evidence manufacturing. But, regardless, I wonder whether high land prices could be every bit as big a problem for manufacturing as relatively high capital costs (grateful for references, please if anyone has them).

On the second of Davis' arguments - that house market volatility matters - I certainly agree that this could be an issue. At least until this last recession, [average volatility in the UK housing market was higher than volatility in the most volatile market in the US \(LA\)](#). That said, I found it interesting that Davis makes no reference to supply constraints as one of the fundamental causes. Of course, when house prices fall, supply is fixed in both the UK and US (unless you destroy houses). However when, as in the UK, housing supply is very unresponsive to increased demand (whether rational or irrational) booms drive up prices rather than leading to more building. That means the UK sees more volatility on the up-side of the market. These supply issues interact with demand and are every bit as important.

A couple of further points. First, I have left the issue of the service industry untouched. The book has some further interesting points on this. Second, I should say that I am not entirely convinced that rebalancing towards [manufacturing helps declining places](#) - simply because they had manufacturing in the past. Indeed, one of my crucial concerns about the planning system in this country is how [incredibly backward looking it is](#). There are plenty of low cost brownfield manufacturing sites around. But perhaps brownfield sites of failed manufacturers are not the ideal sites for new, higher tech manufacturing? Who says new 'green tech' jobs are best placed in the same places as bad old manufacturing? Important questions for another day ...

Posted by [Prof Henry G. Overman](#) on [Wednesday, September 07, 2011](#)

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