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Location matters

DEVELOPING EFFECTIVE REGIONAL POLICY

Governments have struggled for generations to reduce the disparities in economic performance between the different regions of England. Analysis has focused most recently on differences in levels of employment, education and skills, investment, innovation, enterprise and competition. Debate continues as to whether these are best tackled by generic policies to address “market failures” wherever they occur, or by specific policies targeted on individual regions. However, work carried out by Frontier Economics for a group of government departments suggests there is a missing link in this analysis: the role of place-based factors such as peer pressures, neighbourhood and intergenerational influences. As this bulletin discusses, failure to take such local factors into account may lead to the design of inappropriate or inadequate policies.

As is well known, there continue to be significant economic disparities between the nine English regions. In 2004, the economic output per person in the poorest region →

(the North East) was about 40% lower than in London, the most productive region in the UK¹.

There is a long history of government attempts to reduce these economic disparities. The latest version is enshrined in the 2002 Spending Review, which introduced a Public Service Agreement (PSA) target to make sustainable improvements in the economic performance of all English regions and, over the longer term, to reduce the persistent gap in growth rates between regions. The 2004 Spending Review re-affirmed this commitment².

However, closing the gap between the regions is not an easy task. In this bulletin we look at some of the key issues, drawing on work we have done for the Treasury, the Department of Trade and Industry (DTI) and the Office of the Deputy Prime Minister (ODPM). We focus on three questions:

- What is the extent of the performance gap between the regions?
- What are the best policies to reduce this gap, and to what extent are they regional rather than national?
- What are the key challenges facing policy-makers in the development of effective regional policy?

WHAT'S THE PROBLEM?

The Government's framework for the analysis of regional economic performance was laid out in *Productivity in the UK: 3 - The Regional Dimension* (Productivity 3), which identified six drivers of growth: employment, education and skills, investment, innovation, enterprise and competition. Frontier was commissioned by the ODPM, DTI and the Treasury to identify regional disparities in these and assess their potential causes.

Below we summarise our key findings.

Education and skills

There are substantial regional differences in the levels of education and skills attained. These are most apparent at GCSE level and above. In the northern regions, there are a large number of people with no qualifications at all, and relatively few people with higher-level qualifications. Participation in full-time education amongst over-16s is lower in the north than elsewhere in the country. In analysing the causes of these differences, we found evidence to suggest that place-based factors such as peer pressures, neighbourhood and intergenerational influences may play a significant part.

Innovation

Significantly less innovation activity occurs in the northern regions. The North East and Yorkshire, in particular, score consistently poorly across a range of indicators. For example, none of the top 100 R&D-intensive firms have their main R&D plants located in the North East or Yorkshire and the Humber. By contrast, about three quarters of these firms have their main R&D facility in the South East, the East of England or London. In analysing the causes of this persistent disparity, we found evidence to suggest that the exploitation of university research tends to take place in the same region as that academic institution: that is to say there is relatively little knowledge transfer between regions.

Enterprise

There are relatively few start-ups in high-value, high-skill, service sectors in the northern regions. The causes of this are not well understood: there is a range of possible explanations, but the available data is not sufficiently detailed to allow us to determine which is most plausible.

Employment

As is well known, there are significant regional differences in the levels and mix of employment. Across a range of indicators, London and the North East are the poorest

performing regions, whereas the East of England, the South East and the South West are the best performing. There clearly are many different causes of regional differences in unemployment. Evidence suggests that certain groups of people may face particular difficulties in finding work: for example, lone parents, disabled people and those on incapacity benefit, ethnic minorities and the very low skilled. However, the extent to which the different regions contain lower or higher concentrations of these groups can explain only part of these regional differences, and place-based factors (for example, intergenerational and peer group influences) may also be important.

Competition

There is a national framework in place to deal with competition issues in the UK. The two principal agencies – the Office of Fair Trading and the Competition Commission – deal with competition matters not just at a national level, but also at a regional and local level. It is unlikely therefore that regional disparities are being driven by a differential regional application of the competition regime.

THE POLICY CHOICE

Persistent failure to develop regional policies that narrow these differences caused policy-makers to change their tune in the 1980s. It was argued that developing generic policies focused on market failures would be more effective than directing subsidies to particular areas. Since these market failures would be most pronounced in the weakest regions, such policies would – it was hoped – provide most help where most needed without the need for specific decisions by central government to concentrate resources on one region rather than another.

However, such policies have failed to reduce regional differences in performance. As Figure 1 below shows, there has been very little change in the relative performance of regions in the past decade. The North East had the lowest gross value added (GVA) per head in 1991, and still had the lowest GVA per head in 2002, and if anything the gap has widened. Moreover, our analysis of the six key drivers of growth identified by the Government showed that regional differences in these indicators had persisted through the period. So while policies targeted at market failures have had a significant effect at the national level, they have had much less effect in reducing the differences between regions.

Why have such policies had an impact on national economic performance but failed to correct regional imbalances? One explanation may lie in a key finding from our work, namely the role of place-based factors such as peer pressures, neighbourhood and intergenerational influences in perpetuating local differences. If nationwide generic policies fail to take account of such local differences, then gaps may persist even at the regional level. Clearly, more research is required to establish the nature of such effects. An important question is the size of the area to which they apply. But unless they are fully understood, it is likely that national or even regional policies may fail to have the impact policy-makers intend.

Empirical analysis of these place-based relationships is difficult. This is because many factors influence outcomes, and are difficult to identify. However, some research has begun in this area that suggests such factors are important³. For example, Dearden, Machin and Reed (1997) find strong evidence of intergenerational effects on the income and education of individuals. A one percentage point change in parental income or years of schooling leads to between a 0.4 and 0.7 percentage point change in the child's income or education.

Rice (2001) examines the factors that influence differential education participation rates across regions. The paper finds that individuals in the north are less likely on average to undertake further education than their counterparts in the south, irrespective of gender and attainment. Indeed, one quarter of the north-south gap in participation rates is the result of differences in the behaviour of observationally equivalent individuals. It may well be the case that the apparently unexplainable differences in behaviour are as a result of the effects of place-based factors.

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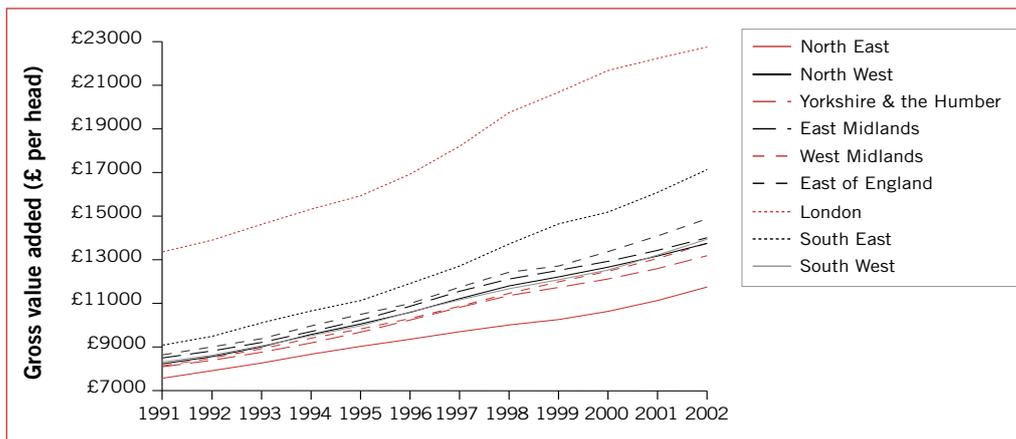


Figure 1: Regional GVA per head

Source: Regional accounts, ONS

THE REGIONAL CHALLENGE

Developing an effective regional policy is clearly not easy. The challenge can be split into two parts:

- arriving at a better understanding of the causes of disparity;
- developing the right institutions to design and implement effective response.

Improving understanding

Efforts to develop a better understanding of the causes of regional disparity have been impeded by the poor quality of information collected for the regions. Even at the headline level of the Government's six drivers of performance, official data provides too little detail at the regional, let alone sub-regional, level to permit rigorous causal analysis. In trying to test even the simplest hypothesis, we have been handicapped by

SOURCE	<ol style="list-style-type: none"> 1. HM Treasury, Department of Trade and Industry and Office of the Deputy Prime Minister, "Devolved decision making: 2 – Meeting the regional economic challenge: Increasing regional and local flexibility", March 2004. 2. HM Treasury, 2004 Spending Review - Stability, security and opportunity for all: investing for Britain's long-term future, summary leaflet, 2004, p.4. (available at: http://www.hm-treasury.gov.uk/Spending_Review/spend_sr04/spend_sr04_index.cfm) 3. References to the key papers examining these issues are provided at the end of this bulletin.
KEY REFERENCES	<p>Rice, P, <i>The Great Divide: Regional differences in education and training</i>, Department of Economics, University of Southampton, 2001;</p> <p>Gibbons, S. <i>Neighbourhood Effects on Educational Achievement: Evidence from the Census and National Child Development Study</i>, CEE Discussion Paper 18, January 2002;</p> <p>Dearden, L., Machin, S., and Reed, H., <i>Intergenerational mobility in Britain</i>, <i>The Economic Journal</i>, 107, January 1997, pp.47-66;</p> <p>Blanden, J., Goodman, A., Gregg, P., and Machin, S., <i>Changes in Intergenerational Mobility in Britain</i>, Forthcoming in Miles Cork (ed) <i>Generational Mobility</i>, Cambridge University Press;</p> <p>Borjas, G., <i>Ethnicity, Neighbourhoods and Human Capital Externalities</i>, <i>Journal of Economic Literature</i>, J24, 2001, pp. 365 - 390</p>
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