FRONTIER CENTRE FOR PUBLIC POLICY
FRONTIER Backgrounder
BRIEF ANALYSIS

(FB041) AUGUST 2006

Whitehall's Last Colonies

Breaking the cycle of collectivisation in the UK regions

By Professor Nick Bosanquet, Seth Cumming and Andrew Haldenby
Reform, London, England

Executive Summary

- There is a profound economic imbalance between the UK regions, with wealth creation, enterprise and growth concentrated in London and the South East of England and high welfare dependency and large public sectors in the North-East, Wales and Northern Ireland in particular.
- The trends in economic performance are worrying for both South and North. The North faces further out-migration of young people and even slower business formation while the South faces greater congestion and rising living costs.
- The tax and spending imbalance – with London, the South East and the East paying half of personal income tax but receiving only a third of public spending – may create increasing political tensions.
- The South East increased its Gross Value Added (GVA) by 80 per cent between 1994 and 2004, while the North East has grown by just over a half in the same period.
- If all regions had grown at the same rate as the South East since 1994, UK output would be over £61 billion higher in 2004 (an increase of 6 per cent).
- Between 1991 and 2004, London's population grew by 8.8 per cent, more than twice the rate for the UK as a whole. Scotland, the North East and the North West actually shrank.

- London has a much higher percentage of young people (20-44 year-olds) than any other region. London also has three times the number of VAT registrations per head of population as the North East.
- The danger is that a vicious circle of economic activity will be created. As more and more people become dependent government for their jobs and incomes, there would be fewer opportunities for small businesses to start up and employ workers.
- Talented young people and modern industries – which are the lifeblood of future economic progress – would move from outlying regions into London and the South East.
- Further government resources would be redistributed into the outlying regions, continuing the cycle.

Population change

From 1991 to 2004, the UK population grew at a robust 4.2 per cent. However, there is substantial variation between regions. Most of this growth came from high population growth in the South of England (London, the fastest growing region, grew by 8.8 per cent). The populations of Scotland, the North East, and the North West actually shrank over the period. Yorkshire & Humberside and the West Midlands grew by only 2 per cent.

Age profile

London has a much higher proportion of younger working-age people than any other location in the UK. 44 per cent of Londoners are between 20 and 44 years old, in contrast with only 32 per cent of the Welsh and South Westerners. In fact, the combined South East and London regions have nearly a third of the UK's young workers (20-44 year-olds). London was also the only region which had more young workers in 2004 than it did in 1999.

Internal migrants

We focus on the 20 – 29 age bracket because it consists of young people seeking employment and other opportunities. All regions except London, the East, and the North West are net exporters of 20-29-year-olds. These young people are drawn predominantly into London but also into the East of England; around 12,000 young adults migrated to London from other regions in 2004.

Net internal migration within England & Wales, number of persons aged 20 - 29[1] 2001 - 2004			
Region	**2001/2002**	**2002/2003**	**2003/2004**
London	17,200	10,600	10,900
East	4,700	4,000	3,700
North West	-2,400	-400	700
South West	-100	400	400
South East	1,000	1,300	-1,400
Wales	-3,000	-1,500	-1,700
East Midlands	-2,300	-1,500	-2,000
North East	-3,400	-2,500	-2,400
Yorkshire & Humberside	-5,400	-4,200	-3,500
West Midlands	-3,700	-3,300	-3,600
Source: *ONS, Internal Migration 2001-2002, 2002-2003 & 2003-2004 Local Authority Flows by Quinary Age Group and Gender*			

The picture that emerges is relatively clear. Over the last decade-and-a-half, London and the South of England have seen expanding populations, while the populations of the Northern regions have remained constant or declined. Furthermore, London especially has a high concentration of younger workers, a trend confirmed by the high numbers of 20 – 29 year-olds migrating to London. This is in contrast with regions like Wales and the North East, which have older, ageing populations. This trend is worrying for two reasons. First, it puts greater pressure on the public services of the Northern regions, and for their state sectors to expand to accommodate an ageing population. Second, it places an increasing burden on the economies of London and the South, as their working populations face increased congestion and rising living costs.

Growth

There is a large divergence in both levels and growth rates of output and productivity between regions. These gaps have generally been getting larger over the last 10 years:

- The South East has increased its Gross Value Added (GVA) by 80 per cent since 1994, while the North East has grown at just over 50 per cent over the same period.
- If all the UK regions had grown at the rate as the South East from 1994 to 2004, UK GVA would be £60.8 billion higher in 2004 than it actually was.
- The North East's economy was 25 per cent the size of the South East's in 1994. In 2004, it was 22 per cent.

Business formation

The lack of productive activity in certain regions also shows up in the business VAT registrations for each year. Over 61 new businesses per 10,000 adults were registered in London in 2003, while the figure for the North East is just over a third of that. It is clear that there is a relative lack of business activity in regions like Northern Ireland, Wales, the North East, and Scotland.

[1] Comparable figures for Northern Ireland and Scotland are not available.

Welfare dependence

A quarter of households in Northern Ireland and the North East are on incapacity benefits. Scotland, the North West, and Wales all have over 20 per cent of households containing one more member on incapacity benefits. But London and the South East have rates of only 10 per cent and 11 per cent, respectively.

The regional variations are quite striking: the North East has two-and-a-half times as many households on incapacity benefits as the South East. This underlines the impact of industrial decline in the North, as many workers have still not recovered jobs, and are forced to eke out a living on incapacity benefits. It may also indicate that many people, who are statistically considered as not being in the labour force, may in fact be in a state of long-term unemployment. When the incapacity figures are combined with the generally large public employment workforces in these regions, these statistics reveal the extent to which working populations are dependent on the State for most or part of their income.

Public spending

Public spending as a share of regional GVA varies widely across the UK.[2] The relative size of identifiable UK public spending in 2004 was 39 per cent of GVA (35 per cent in 2000).[3] In London, government is only 34 per cent of GVA, while in Northern Ireland, government spending is 61 per cent of output.

Scotland, London, the North East, and Wales all have an above-average level of public spending. In addition, Northern Ireland produces a relatively small level of output, only 2.3 per cent of total UK GVA, yet accounts for 4 per cent of public spending. This combination of relatively high public spending and low output produces extremely high public sector/GVA ratios.

Taxation and spending distribution between regions

Unsurprisingly, there is significant income distribution between regions. London pays 18 per cent of total UK personal taxation, but receives only 14 per cent of identifiable public spending. The South East also pays 18 per cent of personal tax, but receives only 11 per cent of public spending. This is in contrast with regions like Wales, which pays only 3 per cent of personal tax, but receives 5.5 per cent of identifiable government spending.

The impact of government on private sector activity

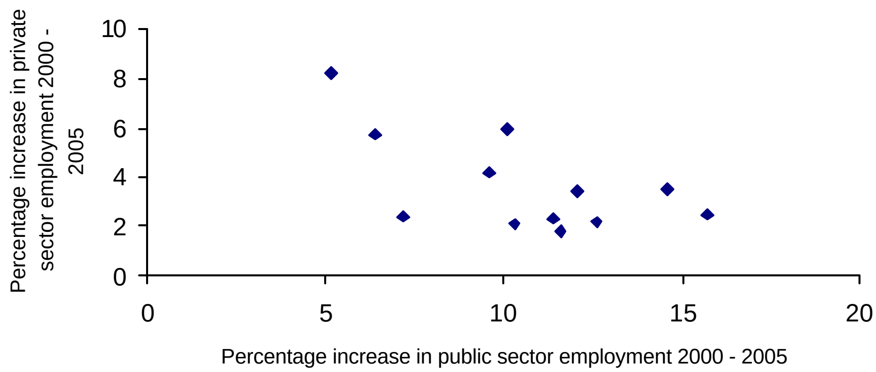
One potential problem with the high increases in public spending is that it "crowds out" private investment and private enterprise. The larger the role of the state sector in any modern economy, the more difficult it is for the productive private sector to establish and expand, and consequently, the economy is less productive than it would be with a smaller state. With slower growth in the private sector, the regions become less attractive to business start-ups which sell mainly to private buyers and other small firms, rather than to government or large corporations. As more and more people become dependent on the state for their jobs and incomes, there are fewer opportunities for small businesses to start up and employ workers.

---

[2] GVA is equivalent to GDP at basic prices (i.e. excluding taxes and subsidies).
[3] *Reform* calculation based on UK GVA in 1994, and projecting a growth rate equal to the South East's growth rate over 1994 – 2004.

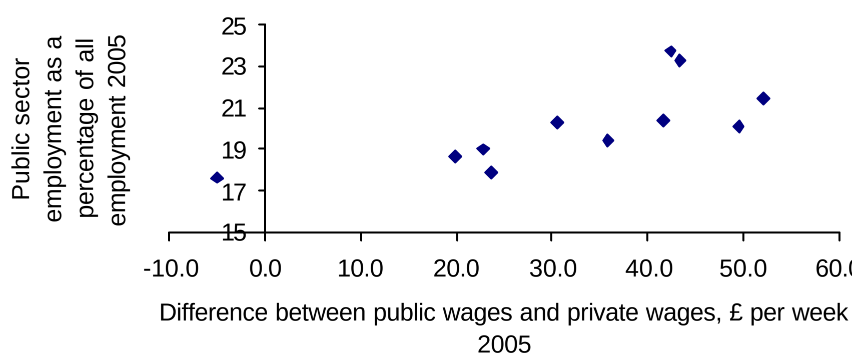
In order to test the thesis of crowding out further, we map the changes in public employment against the changes in private employment. The graph below shows that public sector employment may have crowded out private sector employment. Those regions with the largest percentage growth in public sector employment experienced the lowest percentage growth in private sector employment. This negative correlation can be seen clearly in the following graph:

Growth in public sector employment vs growth in private sector employment



While private sector wages are more likely to vary with local conditions, centrally-determined public sector wages are not. This induces a larger public/private wage differential in more challenged regions. Hence, public sector work would be more popular than private sector work, because of higher wages. In fact, with the exception of the South East, median public sector wages are higher than median private sector wages in all regions. Private employers may find it difficult to compete with relatively high public wages, and they are "crowded out" by high public employment. As graph below shows, the regions with the highest public/private wage differentials have the highest proportions of public employment.

Public sector employment vs public/private wage differentials



Conclusion

This report has presented consistent and clear evidence of a number of region-specific trends:

- Ageing and/or shrinking populations in the North; growing populations in the South; growing youthful populations in London.
- London and the South East are the productive economic hubs of the UK; the Northern regions still suffer from a lack of productivity, graduates and new businesses.
- High rates of welfare dependency in Wales, Northern Ireland and the North East, with one in four households having one or more members on incapacity benefits.
- Extremely high public spending in Wales, Northern Ireland and the Northern regions. The relative size of the state in these regions is nearly double that of the state in the South East.

Furthermore, the productive Southern regions of England generally pay for the large state sectors in the North East, Wales and Northern Ireland. As taxpayers become more resistant to further tax transfers, political pressures will prevent additional redistribution from taking place. Since local spending is increasingly divorced from revenue raising, there is little incentive for local politicians to control and manage spending effectively. Further political moves towards localism are blocked.

This regional imbalance is not only a political problem, it will increasingly become a major economic issue as more and more educated young people are drawn to the South. This puts an increasing burden on the transport infrastructure of London and the South East as these regions become more congested. Living costs in these regions will continue rise at a rapid rate. The economies of the outlying regions will become increasingly dependent on central state aid.

High public spending seems to have had little to no positive impact on the regional economies. It is likely that any recent growth of the challenged regional economies is due largely to public sector growth, with little sign of revived private sector activity In fact, it is possible that increased public spending will exacerbate regional differences. Private sector employment and business creation demonstrate a negative relationship with government spending. This is consistent with the hypothesis that raising public spending "crowds out" business activity and private employment.

The general answer is to allow the growth of a stronger private economy by slowing down the growth of public spending and lowering taxation. A low tax economy is the route towards regional revival in the UK.

About the Authors:

Nick Bosanquet is Professor of Health Policy at Imperial College, London. He is a health economist who first carried out research on NHS funding in the 1980s for the York Reports sponsored by the British Medical Association, the Royal College of Nursing and the Institute of Healthcare Management. He has been Special Advisor on public expenditure to the House of Commons Health Select Committee since 2000. He is a Non-Executive Director of a Primary Car Trust in London.

Seth Cumming has been Reform's Economics Researcher since June, 2006. He completed an MSc (Economics) at the London School of Economics in 2006.

Andrew Haldenby has been Director of Reform since 2005.