

# THE PROSPECTS FOR REGIONAL DISPARITIES IN THE UK IN TIMES OF BREXIT AND COVID-19

Arnab Bhattacharjee,\* David Nguyen,\*\* and Tony Venables\*\*\*

## Disparities come in many shapes and the forms are highly persistent

Regional or spatial inequalities are a concern in most (if not all) countries and with the current ‘levelling-up’ agenda they are also a priority of policymakers in the UK. Most often spatial inequalities are analysed as differences in GDP per capita or productivity at some subnational level of aggregation (e.g. regions, cities, local authorities). However, regional inequalities can have many dimensions, not all of which are apparent in standard macroeconomic measures of the economy. As well as regional differences in average income and wealth, there are differences in opportunity and job quality, health and wellbeing. Ultimately, while spatial denominations of places can sometimes feel arbitrary, there are systematic differences in the productivity and wellbeing of individuals across these spatial areas, and these merit the attention of policymakers.

At the same time policies affect spatial inequalities. For example, austerity-related cuts to local government budgets since 2010 have been unevenly distributed across the country and increased spatial inequalities (Gray and Barford, 2018), with cities in the North East hit the hardest. Moreover, the UK’s Industrial Strategy is heavily focussed on R&D and favouring specific sectors. This means that to some degree it is a spatial policy since sectors tend to be concentrated in a few places only. If supported sectors are located in places that are already better off, there is a concern that sector-based policies can actually increase regional disparities.

Based on a large number of empirical measures, spatial inequalities in the UK are higher than in other developed countries (McCann, 2020). The first article in this issue by Carrascal-Incera, McCann, Ortega-Argilés and Rodríguez-Pose (a team from Birmingham, Sheffield and LSE) explores the extent of inequalities

between regions and cities in the UK and compares them to other European and OECD countries. They find no relationship between spatial inequalities and economic growth and they suggest that spatial inequality has been a drag on the UK’s national economic growth. As an explanation they propose that low levels of investment in weaker regions means countries are leaving substantial untapped potential on the table. Moreover, in international comparisons the UK’s hyper-centralised governance structure means that public investment decisions are mainly taken in London. The article concludes that carefully designed devolution could be beneficial for national economic growth. Insights drawn from the German experience, however, show that the scale of necessary investments that are needed to tackle regional disparities is substantial. The latter point is echoed by Lord Kerslake (i.e. ‘go big or go home’) in the final report of the UK2070 Commission (2020).<sup>1</sup>

## Major economic shocks could worsen spatial inequalities further

With Brexit and Covid-19 the UK is facing two large economic disruptions that are clearly affecting some places more negatively than others. Hence – in the absence of adequate policy intervention – they will likely worsen spatial disparities in the UK even further. First, due to Covid-19, large groups of workers are required to work from home. However, evidence shows that this transition has been easier for workers with higher incomes and jobs in service sectors such as finance, insurance and professional services (Costa Dias *et al.*, 2020), both of which are likely to be found in richer regions. In terms of the overall share of jobs that could be done from home, London is leading (almost 60 per cent of jobs), followed by the South East and South West,

\*Heriot-Watt University. \*\*National Institute of Economic and Social Research. E-mail: d.nguyen@niesr.ac.uk. \*\*\*University of Oxford.

while the share is lowest for the North East (below 40 per cent), as well as Scotland, Wales and Northern Ireland (Costa Dias *et al.*, 2020). Overall, Covid-19 is expected to hit disadvantaged regions harder (Aitken and Overman, 2020; Bhattacharjee and Lissauskaite, this issue).

There is another aspect as even those workers that can work from home face different levels of digital infrastructure. Aitken *et al.* (2019) show that the regional differences are stark, with the share of premises that have ultra-fast internet reaching 75 per cent in London but only 31 per cent in Wales. The increasing digitalisation of our economies (accelerated by Covid-19) means that digital skills are becoming more important. However, when looking at the distribution of various ‘online’ activities, we can see considerable differences across people living in different places (see table 1). For example, while around 90 per cent of Londoners use the internet to send and receive emails, the share in the West Midlands is only 78 per cent. Similarly, almost 60 per cent of people in London and the South West use the internet to use information for work or study purposes, while it is less than 40 per cent in Yorkshire & The Humber and below 50 per cent in the North East and North West. Similar regional differences can be seen for the use of online banking or the cloud services.

The other major economic disruption that the UK is currently facing is its departure as a member of the European Union. The direct impact on regions is twofold. First, due to varying degrees of economic relations with the EU it is likely that Brexit will hit some places harder than

others. One reason is that cities will switch from tradable to non-tradable activity, leading to a continued loss of real income in the absence of appropriate policy interventions (Venables, 2020). While studies show that those are more likely to be in the richer South of England these regions are also more likely to adapt in the long run due to higher levels of productivity and skill levels (Dhingra *et al.*, 2017). Second, by leaving the EU the UK is losing access to the EU’s structural funds, such as the European Regional Development Fund (ERDF). Funds from the ERDF are reserved for development projects in the poorest regions of a country, and for the period 2014–20 alone €17.2 billion were allocated to the UK (Aitken *et al.* 2020).

The term ‘regional resilience’ is often used to describe the way in which regions respond to economic shocks such as Brexit and Covid-19. Following Martin (2012), resilience can be divided into resistance, recovery, re-orientation, and renewal. The article by Sensier and Devine (Manchester) in this issue analyses the economic resilience of UK regions in light of the economic fallout from the global financial crisis in 2007/8. The authors use business cycle turning points in value-added, employment and productivity and develop a regional resilience scorecard. They develop empirical measures for the four dimensions described above. It is clear that a better understanding of regional resilience can help policymakers to understand what policies regions need in order to recover from economic shocks. Sensier and Devine find that the South East and South West are the most resilient regions in the UK, with Northern Ireland and the North East being the least resilient ones.

Table 1. Digital skills across regions in the UK

Region	Have internet access at home	Send/receive emails	Find info. online for work/study	Access files via cloud service	Use internet banking
England	86%	85%	50%	25%	65%
Scotland	82%	79%	42%	24%	64%
Wales	82%	81%	47%	20%	58%
Northern Ireland	84%	75%	32%	19%	68%
London	87%	90%	59%	24%	59%
South East	90%	89%	50%	26%	68%
South West	91%	90%	59%	28%	70%
East Midlands	83%	86%	46%	23%	64%
West Midlands	82%	78%	44%	24%	64%
East of England	87%	85%	53%	29%	72%
Yorkshire & The Humber	78%	76%	38%	19%	59%
North East	88%	88%	47%	32%	67%
North West	85%	80%	49%	22%	62%
Urban	85%	84%	49%	24%	64%
Rural	88%	87%	52%	29%	67%

Source: Ofcom Nations & Regions Technology Tracker – 2019. Percentages show share of people in the UK that are using the internet for a given category of online service.

## Better data is needed to show what is going on at the regional level

Productivity is the main source for long-term economic growth and regional economic disparities tend to arise when highly productive firms and workers cluster in some places. There are many factors that determine regional productivity, including spending on research and development, worker skills and education, and investments in infrastructure. In turn, the spatial concentration of highly productive firms and workers can turn into a self-reinforcing cycle due to knowledge spillovers, specialised labour pools, and backward- and forward linkages between buyers and suppliers (Fujita *et al.*, 1999).

Data for the UK show that spending on research and development, investments in infrastructure, and the education level of workers are all highly unevenly distributed and disproportionately high in the South East and London (Aitken *et al.*, 2019). Another key factor that economic theory associates with the economic performance of a firm or place is the amount of available capital (per worker). For countries in continental Europe, there is an existing literature on understanding regional productivity patterns in terms of capital stock and its vintage; see, for example, Bhattacharjee *et al.* (2009) for Denmark. However, regional data on capital stocks have been difficult to come by in the UK.

In the next paper of this issue, Gardiner, Fingleton and Martin (Cambridge) use a new dataset on regional capital stocks in the UK to show that both physical and human capital are in fact important determinants of labour productivity. In addition to the prominent role of capital deepening (i.e. increasing the amount of available capital per worker), their study also highlights an interaction effect between capital and labour. They show that as regions accumulate more human capital the importance of physical capital decreases and they speculate that this could be due to the increasing importance of intangible capital, which is currently not well-measured. The worrying implication is that, while the scale of regional disparities in productivity has already widened in recent decades, their finding suggests that richer regions (with higher levels of human capital) could pull further ahead. The authors conclude that raising the productivity levels of the UK is mainly a question of raising productivity outside of London and the South East.

The final article of this issue also focuses on improving the availability of regional data in the UK. More specifically, Koop, McIntyre, Mitchell and Poon (Strathclyde and WBS) produce more up-to-date data on quarterly

regional economic output and labour productivity, at a higher frequency and with much less delay. Their method allows for nowcasting quarterly regional GDP shortly after the national quarterly GDP figures for the UK are released. This is a considerable improvement over the existing Regional Short Term Indicators (RSTIs), which are released with a delay of six months and do not cover Scotland and Northern Ireland. In addition, while the official RSTIs are only available until 2012, their paper extends this series backwards until 1970. Their figures are largely in line with ONS estimates and show that between 1998 and 2018, Scotland and London have been the regions with the fastest average growth in productivity. The lowest average productivity growth was registered in Northern Ireland, South West and East of England. While substantial differences in productivity performance can be seen across different regions the authors highlight that this is partly driven by the number of hours worked, rather than by changes in output.

## NOTE

1 The Director of NIESR was a member of the Commission and our Landscape paper (Chadha, 2017) set the scene.

## REFERENCES

- Aitken, A., Boshoff, J., Nguyen, D., Rincon-Aznar, A. and Stochino, A. (2019), 'Places and spaces: mapping Britain's regional divides', *NIESR General Election Briefing*, December.
- Aitken, A. and Overman, H. (2020), 'How will the economic effects of coronavirus vary across areas of the UK?', *Economics Observatory*, July 2020.
- Bhattacharjee, A., Castro, E. and Jensen-Butler, C. (2009), 'Regional variation in productivity: a study of the Danish economy', *Journal of Productivity Analysis*, 31(3), pp. 195–212.
- Costa Dias, M., Farquharson, C., Griffith, R., Joyce, R. and Levell, P. (2020), 'Getting people back to work', IFS Briefing Note BN286, Institute for Fiscal Studies, May.
- Dhingra, S., Machin, S. and Overman, H. (2017), 'Local economic effects of Brexit', *National Institute Economic Review*, 242, pp. 24–36.
- Gray, M. and Barford, A. (2018), 'The depths of the cuts: the uneven geography of local government austerity', *Cambridge Journal of Regions, Economy and Society*, 11(3), pp. 541–63.
- Fujita, M., Krugman, P. and Venables, A.J. (1999), *The Spatial Economy: Cities, Regions and International Trade*, Cambridge, MA and London: The MIT Press.
- Martin, R. (2012), 'Regional economic resilience, hysteresis and recessionary shocks', *Journal of Economic Geography*, 12(1), pp. 1–32.
- McCann, P. (2020), 'Perceptions of regional inequality and the geography of discontent: insights from the UK', *Regional Studies*, 54(2), pp. 256–67.
- UK 2070 Commission (2020), *Make No Little Plans – Acting At Scale For A Fairer And Stronger Future*, UK 2070 Commission, February.
- Venables, A.J. (2020), 'Why some places are left-behind: urban adjustment to trade and policy shocks', Department of Economics Discussion Paper Series No. 903, University of Oxford, February.