Wales Institute of Social & Economic Research, Data & Methods

Sefydliad Ymchwil Gymdeithasol ac Economaidd, Data a Dulliau Cymru

WISERD WORKING PAPER SERIES

WISERD/WPS/002

Devolution and Supporting the Poorest He

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January 2011

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Abstract

A created community, a Nation State, is strengthened by a sense of fair and equitable treatment. Within Nation States the allocation of public funds through national budgets acts to contain regional inequality and to provide a positive response to structural decline. The UK Treasury accepts need as the correct guide to spending on public services in different parts of the UK. However, spending in London, Scotland and Northern Ireland is higher than measures of need would suggest. The division of public expenditure is too generous to Scotland, while unbalanced growth has contributed to expensive public services within the capital.

Key words: Need, Devolved spending, Regional inequality, Adam Smith

JEL classifications: R1, R5, H2, H7

Devolution and Supporting the Poorest He[i]

Introduction

"The poorest he that is in England has a life to live as the greatest he" (Thomas Rainsborough, Putney Debates 1647 [2007] p.69).

"The difference … between a philosopher and a common street porter … seems to arise not so much from nature, as from habit, custom, and education" (Adam Smith, 1776).

The Putney Debates (first quotation) introduce an Enlightenment theme: every citizen is important. The second quotation (from Adam Smith) poses a paradox. Natural talent and potential are fairly evenly distributed, but productivity and wealth are strongly concentrated. Market forces (prompted, Adam Smith claims, by a deep human need to barter, to trade and exchange) score high on growth, on invention, on innovation, on technical progress and also on response to consumer demand, but low on equity. The two quotations point to a problem. The promise of equal citizenship is central to democracy, but it conflicts with the inequality that is fundamental to capitalism.

'Economic progress in capitalist society, means turmoil' (Schumpeter, 1943) and the brutal displacement of the old is at the heart of economic advance. Pagano (2003) suggests that the institutions of the Nation State can ease the process of adjustment and Hirschman (1970, p.20) claims that the all-important policy instrument available to help poorer regions is 'the allocation of public funds through the national budget'. Public expenditure above tax is the standard pattern in the poorer parts of a free market economy such as the United States of America and also in the poorer parts of more collective economies such as Sweden and Norway. Public spending is above tax in 7 of the 12 UK regions, including 4 out of 9 English regions (see MacKay, 2001). Transfer flows from the attempt to ensure that payment of tax at the same rate in prosperous and less prosperous parts of the nation state results in comparable levels of service.

The nation is a civil society. People have rights and obligations of citizenship. Everybody is important and the key to valuable lives is that each citizen be given the opportunity to develop potential. Within the welfare state, the wellbeing of each citizen is weighted on a broadly equal basis. The Treasury accepts (see part 3 of this paper) that need is the fair and correct guide for devolved spending. Public spending is above tax receipts in Scotland, Wales and Northern Ireland. A financial settlement between Governments should be open and explicit, it should build from principle and be acceptable to all parts of the United Kingdom. However, recent research by the Institute for Public Policy Research suggests that this "subsidy" is increasingly being seen as unfair to the English taxpayer (McLean, Lodge and Schmuecker, 2008). This paper explores patterns of devolved expenditure in the UK. We argue that devolved expenditure should be based on one of the most widely accepted principles of fiscal equity: citizens in equal positions should be treated equally in poor and prosperous locations (Musgrave, 1959).

Devolved spending is the central theme of this article, but devolved spending connects to wider themes. These include fiscal transfer between regions, growing regional imbalance within the UK economy, nonmarket forces, automatic stabilisers, national unity and the nation as an imagined community. Part 2 of the paper explores the relationship between economic growth, structural change and the nation state. If devolved spending should be sensitive to the uneven geography of need, Part 3 of this paper claims that regional poverty is a better guide to need than regional income. Part 4 looks at the relationship between relative poverty and devolved spending in the twelve UK regions. Devolved spending is above expected levels in Scotland, Northern Ireland and London. Part 5 explores the mystery of the Barnett Formula, the mechanism used in the UK to allocate funds to devolved administrations. Part 5 considers the London problem. Part 6 concludes.

2. Economic Growth, Inequality and the Nation State

Smith explores the puzzle of evenly spread potential, but highly unequal reward in the context of a complex division of labour that provides opportunity for 'joint … and co-operative labour' (Smith, 1776, p.13-14). The division of labour builds from the division of labour is Alleyn Young's interpretation (Young, 1928) of collective learning and collective productivity that builds over time. In the Wealth of Nations division of labour, productivity, skill and dexterity come from experience in work and from extension of the market. Specialisation and market growth interact to provide the cumulative advantages that build from initial success. The competitive approach (the School of Natural Equality is Myrdal's phrase) is not helpful in understanding the more general aspects of increasing returns. Uneven development connects to the principle of 'circular and cumulative causation', where this is increasing returns interpreted in the widest possible manner to include skills, know-how, ideas, experience, specialist firms, differentiation of product and process, specific forms of private and public capital (Myrdal 1957, pp. 11-22). Division of labour and productivity develop not just in the individual plant, but in associations and linkages between plants and between plants and communities.

With Young, as with Myrdal, the cumulative chain extends in both directions. Decline implies capital and human obsolescence; new trades have to be learned, new habits to be acquired and a new set of internal and external economies of scale have to emerge. Experience shows how long it takes to prepare for useful investment, but it will be easier to check recession, if counter measures are available at the earliest possible stage. When allowed to emerge, cumulative forces of decline may evolve which prove extremely difficult to halt until they have run their course. Decline can be contagious, Keynes (Vol. 9, p.225) claims, while the Schumpeter emphasis is that every kind of unemployment generates further unemployment. As well as adding to unemployment, employment beyond the reach of the least effective may also encourage withdrawal from the labour force. The stern justice of each according to his (her) contribution excludes the vulnerable and accentuates their inefficiency.

The secondary movements which support and amplify initial change involve increasing returns (including external economies), demonstration effects, and multiplier impacts (linkages). As value added declines in base and supporting firms, the initial and secondary impacts spread to the service sector. Division of labour and increasing returns imply organic interdependence and collective learning, the whole amounts to more than the sum of the parts. Pagano (2003, p.626) suggests that for a better understanding of the risks that attach to the ‘development of highly specialised skills’ which build over time, we need to connect division of labour to Schumpeter’s depiction of competition as innovation and structural change as Creative Destruction. Capitalism is, Schumpeter claimed, an organic, evolutionary process of change, where the economic structure is ‘constantly revolutionised from within’ (Schumpeter, 1943, p. 81-86) by innovations that annihilate important sources of value which sustained communities and local economies. Growth depends on innovation, but innovations destroy even as they create and creation and destruction are geographically separate. The destructive side of creative destruction is real and it hurts. The dislocations, upheavals and losses that flow from competition are not accidental by-products, they are a part of capitalist reality that every producer has to respond to or perish.

Within the Nation State there are common bonds and obligations that link people who will never meet. Myrdal (1957) and Hirschman (1958) claim that the nonmarket forces which help to contain regional divergence emerge naturally, almost inevitably within advanced nation states: they may be just as “automatic” as market forces. They are a response to weaknesses of capitalism and they address problems the market cannot reach. Regional tax and regional public expenditure are sensitive to regional income levels: they adjust to shifts in relative prosperity. Compensation systems (transfers from rich to poor regions) are both a product of national solidarity and a source of national identity (see Myrdal, 1957; Hirschman, 1958; MacKay, 1993; MacKay, 1994; MacKay, 2001).

Transfers are political since they keep the Kingdom United. They are also economic. Regional transfers can act like capital investments; they can improve opportunity and add to regional resource quality. An example that is relevant to Adam Smith's emphasis on division of labour is education expenditure. Investment in human capital adds to labour productivity and to entrepreneurial vitality. It is valuable in household production (including the care and nurture of the next generation) and it contributes to satisfactions and leisure pursuits that are critical to current and future consumption. In a Nation State that cares about the quality of its most important and most distinctive resource, its own people, the spread of knowledge and education expenditure cannot be left to the competitive forces that would concentrate resources. Education is a national public good and national and regional competitive advantage build from education and training that reach all parts and all groups within society. It is also true that a common culture allows people to retrain and adapt more easily to an unstable and shifting division of labour and that nonmarket forces (the Welfare State) can reduce the risks that attach to specialisation (see Pagano, 2003; Gellner, 1983).

Transfer is consistent with federal systems that grant substantially more power to states (or regions) than has been devolved to Scotland, Wales or Northern Ireland. The important distinction between Federal States and Unitary States is that transfers are likely to be clear, explicit, recognised in the former; but they are often a source of surprise in Unitary States. Wales, Scotland and Northern Ireland remain part of a Unitary State. No subnational tier of government has (as yet) constitutional status. It is unlike other Unitary States, as it does not have a uniform system of government below national level. Asymmetrical devolution ensures that the UK is also a Union State, where the Welsh and Scottish nations and the Northern Irish have special status within the framework of government. Special status includes responsibility for devolved (or Block Grant) expenditure. Devolution is designed to add to citizen choice. The Scottish Parliament and the Assemblies can select the spending patterns that are relevant to their populations. With devolution, the financial settlement between England, Wales, Scotland and Northern Ireland becomes a means of transferring money between governments, not a system internal to one government (Heald, 1998, p.76). Special status creates the need for clear, specific guidelines on relative spending levels.

2. Recognising Difference and Pointing to Need

'It is a long-established principle that all areas of the UK are entitled to the same level of public services and that *expenditure on them should be allocated according to relative need*'. (Treasury 1979. p.4 authors' italics)

"We find the argument that devolution funding should be based on relative need to be a compelling one….. [However] we are not in a position to reach a conclusion about precise relative needs in the four countries and regions." (Select Committee on the Barnett Formula, House of Lords, 2009, p9).

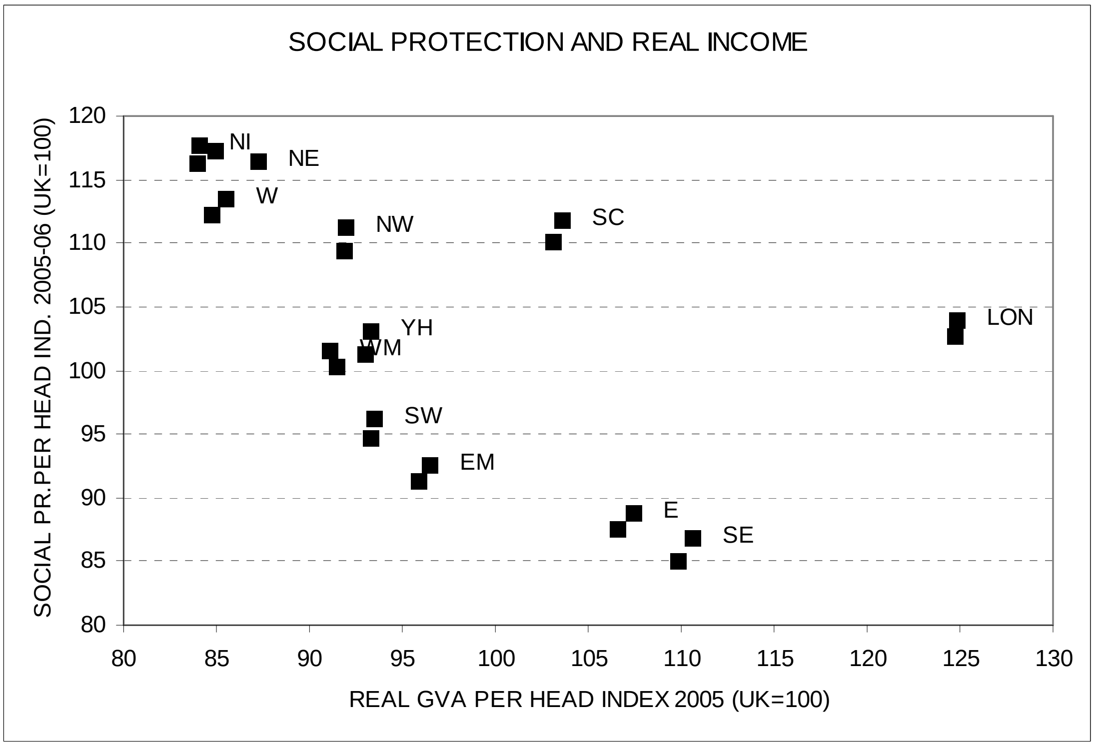
The Treasury claim that relative need is the true and proper guide for expenditure on the public services that are devolved to the Scottish Parliament and the Welsh and Northern Ireland Assemblies. This implies that expenditure per head should be above England, if an only if, need levels are higher for Scottish, Welsh, and; Northern Irish citizens. The problem with the Treasury's 'long-established principle' is that there is no accepted way to compare relative need in the four countries and the arrow of need provides no guide for devolved spending.

Two indicators of regional need are show in Figure 1. McLean and Macmillan take inverse GDP as their measure of relative prosperity and regional need. Bell and Christie (2001) and MacKay and Williams (2005) prefer a poverty based approach. An income measure of need is on the horizontal axis and a poverty measure on the vertical. Gross value added (GVA) is a measure of income generated from the production of goods and services. Real GVA adjusts residence based regional income to allow for differences in regional cost of living. Economic Trends 2005 provides a regional cost of living index. London is exceedingly expensive and its two major commuting regions, South East and East, are high cost. Within Britain, the cost of living tends to fall as one moves away from the capital. Real income per head is almost 50% higher in London than in the 3 least prosperous regions – North East, Wales and Northern Ireland. Scotland's real per capita income is close to 20% above the level in the 3 least prosperous regions. Variations in real income are substantial.

Social protection [ii] (see Figure 1) is sensitive to unemployment, to incapacity benefit, to low and unreliable earnings, to concentrations of economic and social disadvantage. Regions with high levels of real income tend to have low levels of poverty but there are important and strong exceptions. Scotland has a high poverty rating, in spite of real income above the UK average. London has easily the highest real income, but poverty is above average.

Scotland and London are bi-polar, both high and low incomes are over represented. The richest part of the UK has vast wealth and acute poverty.

Figure 1



Dividing public money between the governments of England, Scotland, Wales and Northern Ireland requires a system that is fair, transparent, and reasonably acceptable to all. In considering whether relative income or relative poverty is the better guide to devolved spending it is appropriate to consider how need is used to guide spending levels in different parts of England. Let us take four examples:

1. School budgets take into account the levels of social and economic disadvantage in the community the school serves. Moreover, cash incentives to encourage young adults to remain in education are means tested, as are school meals.

2. In making provision for other forms of local authority expenditure, the Revenue Support Grant Formula is sensitive to social disadvantage, poor housing, employment deprivation and social exclusion.

3. Standardised mortality rates are used to represent health differentials and need for medical services. Standardised mortality rates are higher in regions of low incomes and particularly in locations with concentrations of poverty. The growing divergence in opportunity and income within the UK links to growing health inequality. The Department of Health objectives include containment of health inequality.

4. The Acheson Inquiry into Health Inequality argued for more generous levels of education expenditure in locations with high levels of socio-economic disadvantage. The report claimed that low education standards and poor health connect to poverty: "Logic and Equity argue that children in need should receive extra resources for their education" (Acheson, 1998, p.37-38).

It is poverty and severe economic and social disadvantage (rather than average income) that is used to guide spending and changes to relative spending within England. To be consistent with English example, devolved spending should reflect relative poverty rather than income. In the next section we will concentrate on poverty.

3. Relative Poverty and Regional Spending

"If we want to understand why a larger or smaller proportion of the vulnerable run into difficulties, we must understand how the economy and social structure damage more people in one society than another" (Wilkinson, 2005, p.64).

The economic and social environment is, Wilkinson (2005, p.64) claims, "the primary source of stress in modern societies". Causation runs, Wilkinson claims, from economic and social structure to variation in personal and family experience. Difficult economic and social environments (low levels of work, insecurity in work, low and unreliable earnings) add to personal harm: they link to low status, depression, family breakdown and to serious health problems and low life expectancy. Work, in particular, is one of the most important sources of wellbeing. We may not consistently delight in and enjoy work, but it is a strong tie to reality. Welfare payments may be partial compensation for income loss, but they cannot provide the discipline, growth and belonging that connect to reasonably secure jobs (see Jahoda, 1982; Freud, 1930). Relative poverty adds to the needs and difficulties that public services address.

The published data do not allow us to calculate Block Grant expenditure precisely but they can be used to provide estimates that are reasonably close. In the UK, and also in Scotland, Wales and Northern Ireland, health, education and law and order dominate devolved spending. These three account for more than three out of every four pounds of devolved spending in the UK. When considering need it is important to remember that health, education and law and order dominate devolved spending. Low incomes and particularly poverty connect to a range of ill-health conditions and to premature death. Low incomes and particularly poverty create education disadvantage and there are powerful inter-generation effects. Low incomes and particularly poverty add to crime and crime concentrates on poorer communities. Low incomes and poverty link to addiction, to antisocial behaviour and drug abuse. In sum, low incomes and poverty contribute to social exclusion and add to the need for extra expenditure on health care, education and law and order. In looking for indicators or pointers of need to guide devolved spending we can perhaps agree that the need to which we refer is sensitive to economic and social disadvantage.

In this paper, devolved spending is regionally identifiable spending[iii] (expenditure on behalf of those living in the region), less spending on social protection and agriculture. Devolved spending is not the responsibility of regional tiers of government within England, but it is possible to identify devolved spending levels in the 9 English Regions. Figure 2 provides information on the relationship between regional poverty (social protection per head) and regional spending on 1. Health; 2. Education; 3. Law and Order. The comparison is for 9 of the 12 UK regions – Wales and all of the English Regions apart from London. Spending on health, on education and on law and order climbs as we move from the prosperous regions (South East and East) to the poorer regions (North West, Wales and North East). Relative poverty links closely to regional spending on 1. health (r = 0.96); 2. education (r = 0.90); 3. law and order (r = 0.96). Law and order spending shows the greatest regional variation, but health spending per head in the North East is 23% above the South East level.

Figure 2

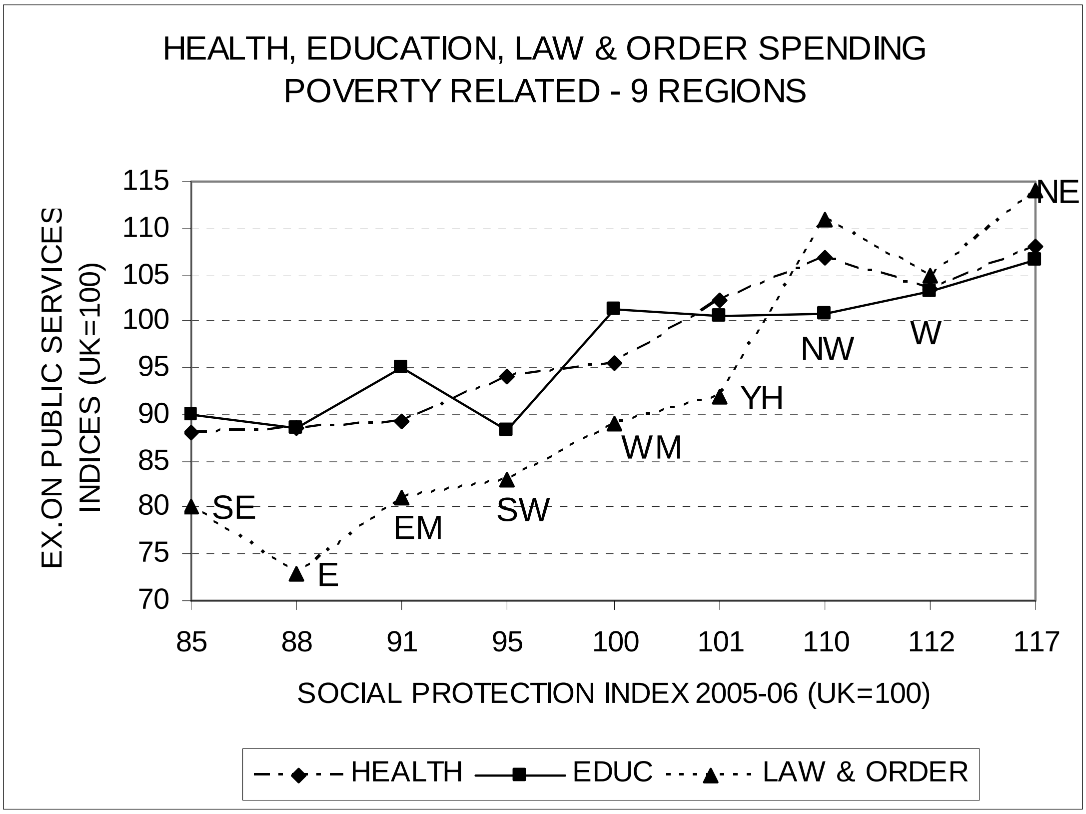
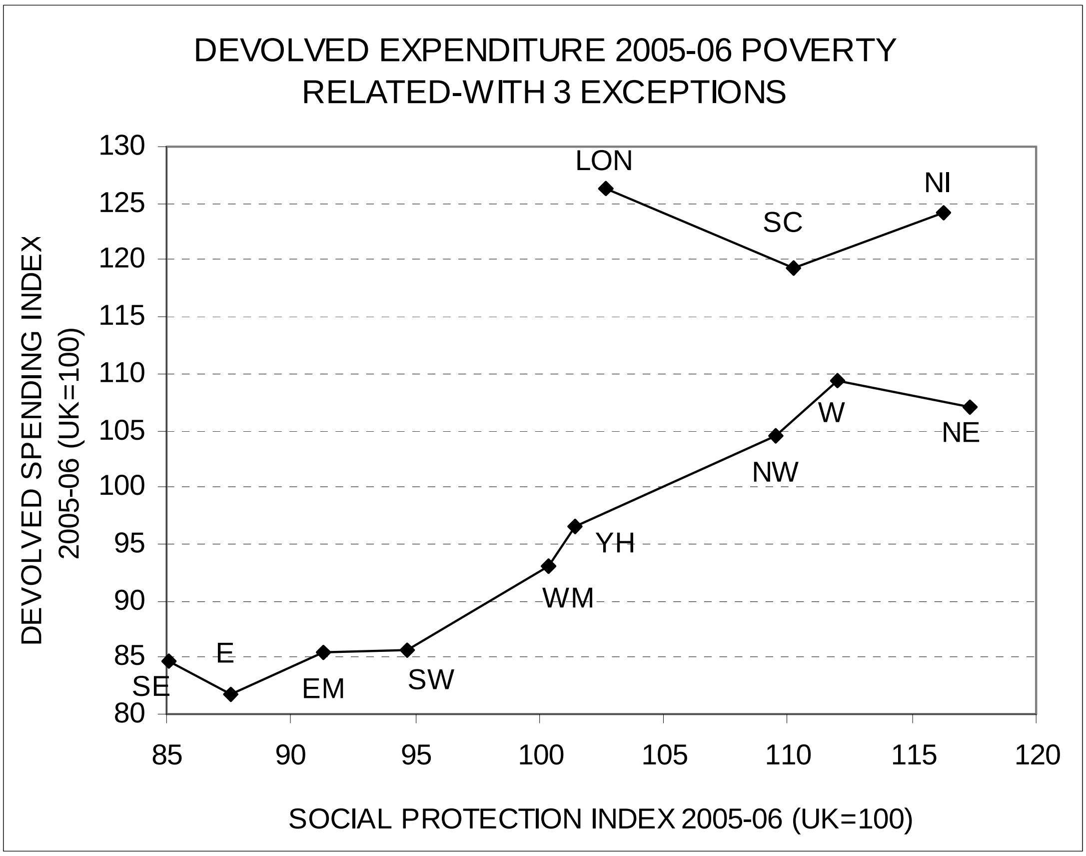


Figure 3 looks at devolved spending in relation to relative poverty in all 12 UK regions. For 9 of the 12 regions (Wales and 8 English regions) there is a close relationship between relative poverty and devolved spending (r = 0.96): devolved spending in Wales is 26% above the level in region East. But there are 3 clear and strong exceptions to the rough consistency between relative poverty and devolved spending. In London, Scotland and Northern Ireland, devolved spending is far higher than relative poverty levels would suggest. London, the most prosperous part of the UK, has the highest levels of spending on devolved services. In Scotland and Northern Ireland spending is much higher than relative poverty (economic and social disadvantage) would anticipate.

Figure 3



Spending on public services adjusts to change in economic and social prosperity, but change is slow. To understand present spending levels, we have to consider recent (and perhaps not so recent) history. The Troubles and the search for a peace settlement are important to our understanding of 2005-06 spending levels in Northern Ireland. Law and Order spending in Northern Ireland is 1.6x UK expenditure. Spending on housing and community amenities is 3x the UK level. If we extract Law and Order (Troubles related) and

Housing and Community (Peace Settlement related) from devolved spending, spending in Northern Ireland falls from 24% above the UK average to only 11% above the UK average. When we allow, crudely and roughly, for Troubles and Post-Troubles expenditure, spending per head in Northern Ireland and Wales are similar. When we adjust for the Troubles, Northern Ireland conforms to expectation.

In 2005-06, London devolved spending was 26% above the UK level. London is "jaw-droppingly expensive" (Lonely Planet, 2003, p.92). London is alarmingly expensive for consumer services and also for public services. Within the capital, the cost of providing consumer services is roughly 17% above the UK average (Economic Trends, 2005). With public services that are paid for by the National Exchequer, the gap between London and UK costs may be even more substantial, since public services are more land and labour intensive than consumer services.

Table 1 Service Expenditure and Service Levels
Selected Regions and England 2004-05

	Index of Education Spending	Class size		Pupils per Teacher		Index of Health Spending	GP List Size
		Primary	Secondary	Primary	Secondary		
London	116	26.8	21.8	22.8	16.5	114	1765
Scotland	109	23.8	…	17.6	12.7	116	142.1
North East	107	25	21.7	21.7	16.2	105	1533
Wales	105	24.2	20.7	20.7	16.6	105	1674
England	98	26.2	21.7	22.5	16.7	98	1666

Source: Regional Trends and HM Treasury 2007.

Table 1 compares levels of Spending and Service in London, Scotland, North East, Wales and England. London has high levels of spending on education and health, but low levels of service. Class size and pupils per teacher are high and London GPs have more patients than doctors in other parts of the country. Scotland's high spending, by contrast, translates into service levels that are notably more generous than in the rest of the UK. Wales and the North East are less prosperous than Scotland, but expenditure and service levels are lower.

The Treasury principle is that all areas are “entitled to the same level of public service” (Treasury, 1979, p.4). The expense and difficulty of providing public services in a congested, crowded capital is the reason London’s high levels of expenditure do not generate public services that the rest of the country envy and admire. Indeed, public services are under greater pressure and less satisfactory in the capital than in other parts of the country, in spite of spending levels higher than any other part of the UK.

4. Barnett – No Connection to Need

“We believe that Scotland now has markedly lower overall need than Wales and Northern Ireland in comparison to England. The current allocation of spending does not properly reflect this basic pattern across the devolved administration” (Select Committee on the Barnett Formula, House of Lords, 2009, p9).

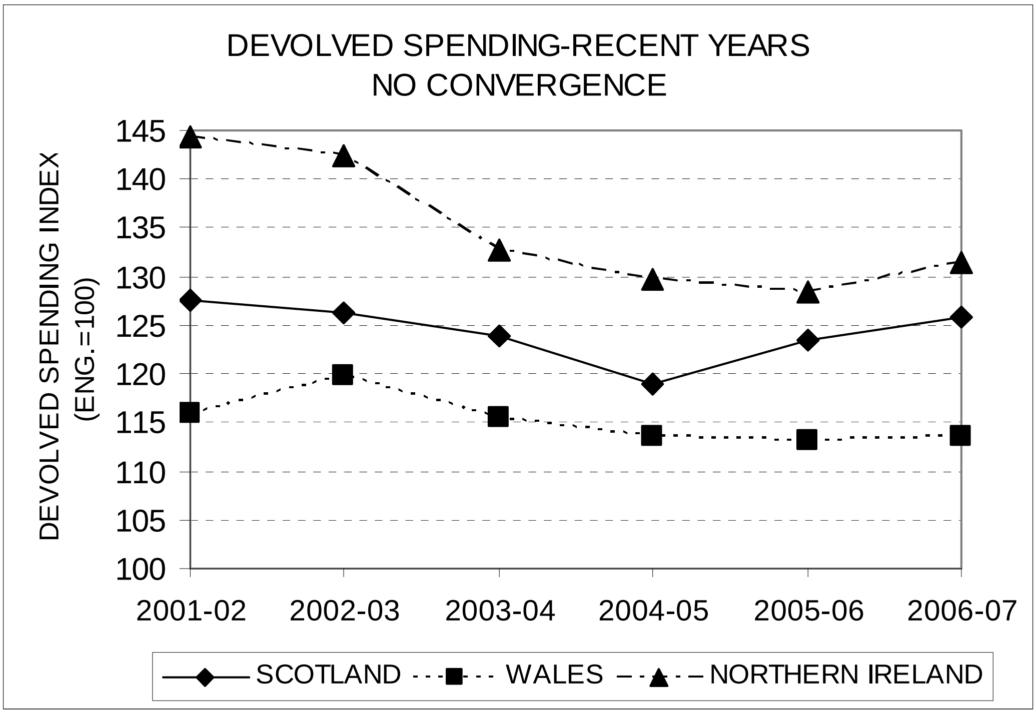
“Until such times as a proper assessment of relative spending need across the UK is carried out, the Barnett formula should continue to be used as the basis for calculating the proportionately reduced block grant”. (Commission on Scottish Devolution, 2009, p111).

The Barnett formula should, over time, produce convergence on English spending levels. Given the formula, there are two elements in deciding the Annual Block Grants for Scotland, Wales and Northern Ireland. First, in any one year, last year’s expenditure is accepted as a base and second, increments in spending are divided according to population. A population based formula for changes in spending has no connection to need and with inherited spending frozen, expenditure per head in Scotland, Wales and Northern Ireland will, over time, move closer to England. The pace of convergence will rely on the rate of growth of relevant public spending. Moreover, inflation as well as real expenditure increases, will reduce divergence.

The Barnett Formula was designed to avoid controversy and year by year bargaining. The system had two apparent attractions. First, it would provide gradual rather than abrupt and destabilising adjustments in relative spending. Second, it looked reasonably straightforward and it gave the impression of guarding against political influence and manipulation. But the Barnett approach has a basic design fault, a flaw that explains why the methods actually used to allocate funds have been unclear and open to political voice and manoeuvre. The defect goes to Barnett’s origins. The Treasury Needs Assessment Study (HM Treasury 1979) was set in motion because of the then expected devolution to Scotland and Wales and the desire to find a way of allocating devolved funds so that they reflect need. The Treasury Report proved unequal to the challenge, its measures of need were unconvincing and they were subsequently ignored (see MacKay and Williams 2005). In the absence of any rational and fair measure of need, or even an imperfect understanding of why need levels vary, a crude rule of thumb was introduced (see Heald, 1999). Spending was regarded as too generous in Scotland, Wales and Northern Ireland: movement towards English spending levels was progress in the right direction.

Barnett was introduced as a strictly temporary makeshift. In the early years, the formula did not even use correct population ratios and it was often ignored or bypassed. To the astonishment of many, including Lord Barnett, the formula was embedded in the post-1997 devolution settlement, in spite of its manifest faults. The Treasury consistently proclaims need, differences in need are important in determining expenditure within England, but a population based approach is not sensitive to the changes in opportunity and in economic and social advantage that adjust relative need. If Barnett were strictly applied, devolved expenditure would converge on English levels, even though Wales and Northern Ireland are notably poorer than England and Scotland is possibly at a disadvantage. From the late 1970s, the Barnett Formula has been the mechanism for formally determining Block Grant and devolved expenditure. In practice, the population based approach has not been decisive. The Scottish Office, it is claimed, has used Barnett as a safety net. The argument is made for special treatment of a particular devolved service, but if not successful the Barnett Formula provides a floor for Scottish spending (see MacKay 2001, and MacKay and Williams 2005).

Figure 4



Between the late 1970s and the turn of the century, Scottish, Welsh and Northern Irish devolved expenditure per head rose relative to England (see MacKay and Williams, 2005, p. 820). Divergence rather than convergence ruled. It has been claimed that Barnett was to be more strictly applied in the post-devolution years, but figure 4 shows that other influences remain important. Not only is there no clear tendency to convergence on English spending levels, but expenditure levels are consistently higher in Scotland than in Wales, even though the Scottish economy is more prosperous and Wales has more serious levels of economic and social deprivation. Expenditure levels depend on influence and voice and Scotland's voice is strong, clear and persuasive. A full explanation of differential spending in Scotland and Wales would depend on history, on geography and also on personalities, but a Bogdanor (1999) insight is important. In both Scotland and Wales there is a strong sense of national identity, but Scotland's distinctive institutional structure added to the bargaining power of the Scottish Office and remains important to the Scottish Parliament (MacKay, 2001).

If Barnett were followed strictly, Wales, Northern Ireland and Scotland would be harshly treated. If voice and influence are more decisive than Barnett, devolved spending depends on a political process that lacks clarity, transparency and principle. In sections 2 and 3 we argued for an approach based on need and provided a rough indicator of need. With the data resources available to government, it should be possible to move closer to a measure of need. There are two questions to be asked of a needs based approach. Would it be better than Barnett? The answer is yes. Would it be better than Barnett plus political voice and influence? The answer is probably yes.

Following devolution, more information on spending country by country (and region by region) has been made available. Barnett and expenditure outcomes have been the subject of continued controversy and sustained critique (see Bristow, 2009). An apparently clear, *but unjust,* population based approach produces results that confuse and confound. There is a lack of clarity, and an absence of principle. In Unitary States, funding mechanisms and forms of transfer are often unclear: in Federal States, funding and redistribution is more likely to be transparent. The House of Lords Select Committee on the Barnett Formula have recommended the establishment of an independent Commission modelled on the Australian Commonwealth Grants Committee which is ordered to calculate per capita relativities state by state. The approach is based on the fiscal equity principle of equal treatment of equal citizens, wherever located and the objective is to ensure that each state has "The capacity to provide services of the same standard" (Commonwealth Grants Commission, 1999, p.4). Equal treatment requires higher levels of per capita expenditure in poorer states.

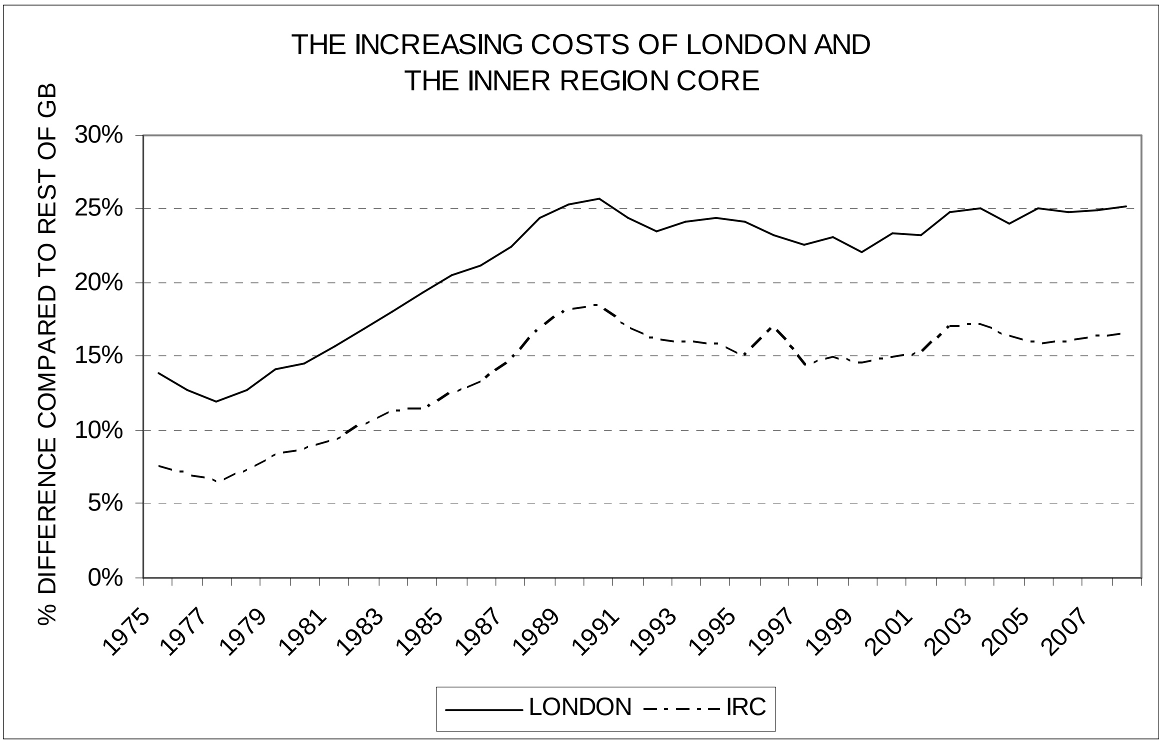
5. Regional Imbalance - The London Problem

"For some inexplicable reason economists have in recent years neglected the problems and implications of the location of industry" (Robinson, 1991, p.100).

There is, Beveridge (1944) suggests, an ever present danger that the market will tend to settle demand and new growth on the wrong places. The realisation of potential and the growth of people depend not just on level of demand for labour, but also on direction. The outstanding UK regional problem is the growing gulf between the prosperous Inner Region Core (IRC) and the rest of the country. The IRC includes 3 government office regions, London, South East and East. London – the political, corporate and financial capital - provides work not only for its own residents, but also for an extensive and expanding commuter workforce[iv]. In the mid 1970s (at the end of the last period of active regional policy), the income per head gap (income generated from the production of goods and services) between the IRC and the rest of the country was about 15%; by 2005 it was 35%. A significant divide has become a major gulf. New capital has promoted the most prosperous, most congested, most expensive parts of the UK economy. Deindustrialisation, by contrast, has had an impact on all parts, but loss has concentrated on the less prosperous areas.

The evolution of inflationary pressure within London and the IRC is highlighted in Figure 5 which presents estimates of Standardised Spatial Wage Differentials (SSWDs) derived from regression analysis of repeated cross sections of the New Earnings Survey for the period 1975 to 2008[v]. These differentials are assumed to reflect the additional monetary and non-monetary costs associated with working within London and the IRC[vi]. In 1975, after controlling for observable job and personal characteristics, gross hourly earnings were 14% higher in London compared to the rest of the UK. Accompanying the increasing in population in the IRC, this differential increases to 26% by 1990. These increasing cost pressures were checked by the recession of the early 1990s that was heavily biased towards the more prosperous parts of the UK. This recession was the product of an unsustainable property boom during the 1980s, resulting in a collapse in housing values and weakened labour market conditions that had a major impact on relative earnings. Labour markets recover slowly from shocks. Increasing pressure within the London labour market returned in the late 1990s, with the London differential returning to its 1990 peak by 2008.

Figure 5



The service sector now dominates employment. With the decline of heavy industry (extraction and manufacturing) and the rise of the weightless economy (finance, information and services), the location of employment becomes more mobile in space, but less controllable (Harvey, 1996). The opportunity and pressure to be close to the dynamic centre of economic and political power increases. Mergers and take-overs have created London-based headquarters, sweeping away the command and control functions that once spread more evenly across the country. The altered balance of the economy adds to activities that concentrate on London and corporate power is drawn to the information hub of the national economy. Even within manufacturing there has been a shift in the balance of employment away from shop or factory floor employment and towards back office functions. That shift has added to income created in the corporate capital.

The parts of the service sector that cater for national and international markets have concentrated on the IRC. London and the IRC command the upper reaches of an increasingly uneven distribution of income and wealth. The growing imbalance in economic base has an impact on the many service activities that expand close to the consumer, to population growth and to housing development. As Young (1928, p.533) points out, growth and decline become "progressive and propagate themselves in a cumulative way": an expanding economy will provide opportunities, inside and outside the economic base, to add to employment and human capital and so further enhance prosperity.

There are strong links between economic and political centralisation. London is the political, administrative, corporate, financial, media and arts capital. The different sources of capital and power interact to provide a dynamic for expansion that is extremely powerful. The Treasury has recognised, albeit belatedly and reluctantly, that uneven development within the UK is a burden. It produces inflationary tendencies in some parts of the economy, while resources remain underdeveloped and unrecognised in others (HM Treasury 2001, p.29). Expansion has settled on locations where development is often strongly opposed. There are three reasons for concern. First, private sector location decisions consider only private costs. The social cost imposed on the community – inflation, congestion, expense of public services, lack of affordable housing – is not their responsibility. Second, the whole country pays for London's extremely expensive public services – cost per head is about one quarter above the UK average. The London Paradox is that subsidies are necessary if services in London are to be close to acceptable levels, but the more generous the support, the greater the domination of the economy by the capital. Finally, we might expect government to be sensitive to the high cost of London and the growing rift within the UK economy. But all too often, public location, funding and spending decisions have added to the domination of London and the IRC. Instead of acting as a counterweight, public spending has added to the concentration of capital and development. The Review of Public Sector Relocation admits that, until 2003, public sector expansion in London was nodded through without any regard for London's exceptionally high cost (Lyons, 2003). The IRC accounts for 35% of the UK population, but has over two-thirds of Ministry of Defence contracts and well over 50% of expenditure on public and private research and development. The science and research base is concentrated near London where most of the important decisions are made. Crowding close to political power is no accident. Government is a source of well-rewarded work and it acts as a magnet for other well-rewarded activities. The capital draws to its web much of the civil service, the establishment and the media. Career structures develop that demand location in or close to the capital.

There is, Wilkinson claims, a link between status and health and status and life expectancy. Status depends on relative position and positional competition is fierce in the capital city. The rich have the capacity to outbid the apparently comfortable in the competition for housing, schools, space and services. In response to the extremely high standards that London sets for staying properly housed and cared for, the workforce "has improvised a solution by a widespread adoption of commuting from home to work and back over longer and longer distances" (Robinson, 1991, p.100). Long-distance commuting adds to congestion, to absenteeism, to stress, to cost of living and to either shorter working days or reduced leisure. People are adaptable, they respond to opportunity, but at a cost. Indeed uneven geographic development (and London's combination of considerable wealth and high cost of living) has encouraged further improvisation. Large numbers of men, it is nearly always men, work in London and other parts of the IRC without moving house. They commute often for a week, or longer, often from considerable distance (see Green, 2004).

Robinson (1991, p. 100) believed that "the better location of growing activities [was] likely to become the predominant problem of the economy". His warning has been ignored. Recent British governments have not been concerned with uneven economic development, or extended travel to work. Their indifference has been based on the assumption that the free market maximises growth and welfare. They claim that the social and environmental problems of London and its commuters are curable only to the extent that market forces are liberated from planning constraints and regulations. Uneven growth has added to the intense pressure on land and transport within the IRC. The reality is that location decisions that make sense from the point of view of the individual firm can produce results that are collectively damaging. The risk of over development of the capital city is increased because we all pay for London's extremely expensive public services. It is compounded when the Government is careless with regard to the spatial implications of its own location and spending decisions. Unbalanced growth, and over the last 30 years it has been remarkably unbalanced, is contrary "to the wellbeing of the population of London" and the IRC (Barlow Commission, 1940, p.141).

6. Conclusion – The State we are all in

"The love of our country seems … to involve … an earnest desire to render the conditions of our fellow-citizens as safe, respectable and happy as we can." (Adam Smith, 1759, p.231).

Exchange based on self-interest may deliver our daily bread (Smith, *Wealth of Nations*), but there are limits to markets and self-love (Smith, *Moral Sentiments*). Our hard-wired default setting is self-centred, but some goods and services cannot be provided effectively by the market and to make us yet more selfish is no proper objective for economic systems or economists. 'Every man is certainly, in every respect, fitter and abler to take care of himself than of any other person' (Smith, 1759, p.219), but this does not mean that we are independent, isolated individuals fully in control of our own lives. Self-interest is consistent with regard for others and our ability to see beyond the lens of self creates bonds of sympathy and compassion. The ability "to see oursels as ithers see us!" (Robert Burns, 2008, p.162) connects us to society and provides the motivation to do right.

The impartial spectator, "the man within the breast" (Smith, 1759, p.130), seeks the approval of others and measures his behaviour against the standards of others. In *Moral Sentiments* Smith shows how the desire for the regard and sympathy of others transforms self-love into character and respectability and so generates the self-command, sensibility and shared social standards held by responsible citizens. Standards and guidelines make ordinary life possible: rules and social institutions emerge and survive, if they are effective in providing security, comfort and decency (Mueller, 1993, chs.8 and 9). Each individual "naturally prefers himself to all mankind" (Smith, 1759, P.83), but civil society depends on social bonds and empathy, as well as obsession with self.

A country, a nation, can engender a sense of belonging to and concern for a wider group than one can possibly know. "People in equal positions should be treated equally" is the Musgrave (1959, p.160) guide to tax and spending within the Nation State. Equal treatment develops from the basic democratic principles of equality before the law and equal concern for all citizens. An imaginary community, a created community, a "deep, horizontal comradeship" (Anderson, 1991, p.7) is encouraged by a sense of fair treatment. Horizontal equity, equal treatment of equal people wherever located, implies public service expenditures that are sensitive to the variable geography of need. Adam Smith's practical advice (1759, p. 235) is that, while there may be no boundary to "our good-will … our effectual good offices can very seldom be extended to any wider society than that of our own country" [vii].

Automatic stabilisers and transfers from richer to poorer regions draw strength from social protection and progressive taxation. However, if devolved expenditure is also to contribute to this process, then some attempt must be made to distribute devolved expenditure according to the uneven geography of need.[viii] The Barnett Formula is not acceptable: its longevity is mainly due to the fact that the formula has never been fully applied in practice. Poverty and low incomes add to the problems faced by medical services, education and law and order. A true measure of need should be sensitive to downturn or expansion in the economies of Wales, Northern Ireland and Scotland. Convergence on English spending levels would depend on improvement in the Welsh, Scottish and Northern Irish economies.

The maintenance of horizontal equity also goes beyond devolved expenditure. The London paradox demonstrates that market driven capitalism can produce deep regional divisions. Strong regional policies prior to the oil price shocks of 1973 and 1974 encouraged the relocation of innovative growth industries to less prosperous areas through a combination of financial inducements and location controls (Hennessey, 1993, pp.208-211). The reduced commitment to regional policy in the face of de-industrialisation within less prosperous areas combined with the concentration of both the service sector *and* public sector within London have contributed to increasing regional inequality. This is detrimental to the populations of all regions and we all pay for the increased costs of associated with the provision of public services in the Inner Region Core.

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[i] This research received no specific grant from any funding agency in the public, commercial, or not-for-profit sectors

[ii] Social protection includes social security and housing benefit and also government support for council tax benefits. Expenditure reflects need rather than tax capacity and is a rough indicator of relative poverty.

[iii] Regional identifiable spending is expenditure on behalf of the citizens of a region. It does not include expenditure on national public goods. This paper is primarily concerned with Government expenditure for a region. The uneven distribution of expenditure on national public goods contributes to regional imbalance. Much of the expenditure on national public goods (defence, overseas aid, national broadcasting, central administration) is concentrated on London and its surrounding regions. Political centralisation contributes to economic centralisation. 'Some might see [defence expenditure] as a hidden form of regional policy' (Gripaios, 2002, p.688) that consistently favours the South West, London and the South East.

[iv] The Inner Region Core (IRC) share of population hardly changes between 1961 and 1981, but increases from 33.5% of UK population in 1981 to 35.3% in 2007. The increase in share adds 1.1 million to the IRC population and accounts for 42% of IRC population growth in the years 1981 to 2007.

[vi] Based on Smiths (1776) idea of compensating wage differentials, Standardised Spatial Wage Differentials (SSWDs) are assumed to reflect the relative net advantages of working within an area. A summary of this approach is provided by Green (1998). The relative merits of different data sources for the estimation of SSWDs are discussed in Ma et al (2006). Regressions of hourly earnings are estimated for full time private sector employees whose pay was unaffected by absence. Models include control variables for age, gender, hours worked, industry and occupation. Estimates covering the period 1975-2000 are presented in Bell et al (2007).

[vii] Bauman (2000, p. 173) describes the Nation State as “the only ‘success story’ of community in modern times, or, rather the sole entity which made the bid to community status with any degree of conviction and effect”. The Nation State and the Welfare State lose some of their power when capital is less homespun and with easier movement of goods, ideas, people and finance. They remain important. There are underlying tensions that warn against pure market solutions. Given flexible, insecure labour markets, with weak ties between employers and employees, there are problems in relying on the market for pension provision, or even for reasonable security in the working age years.

[viii] Harvey argues (1996, p.432) that globalisation – the death of distance – adds to the process of communal dispossession as “the violence and creative destruction of uneven geographic development … [is] widely felt in the traditional heartlands of capitalism”.

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