Inequality

The IFS Deaton Review

Levelling-up economics

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An IFS initiative funded by the Nuffield Foundation

IFS Institute for Fiscal Studies

Nuffield Foundation

CPP ESRC CENTRE FOR THE MICROECONOMIC ANALYSIS OF PUBLIC POLICY

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Introduction

The UK interregional productivity inequalities are nowadays widely recognised as posing some of the greatest challenges to our economy, society, and governance systems. However, attention to, and concern about, these regional development issues is a very recent phenomenon in the UK. The nature and consequences of the UK's economic geography for its national economic performance were barely considered in mainstream economic thinking until very recently, reflecting the fact that as a polity, the UK and its institutions have, until just a few years ago, largely failed to consider the UK as having a serious regional problem. Even now, most economic policymakers and institutions at the very highest levels are belatedly struggling to comprehend the scale and complexities of the challenges ahead. Moreover, the role that UK-specific governance and institutional issues may have played in exacerbating the regional problem have also been largely outside of the narratives and debates in mainstream UK economics. Prior to the EU Referendum shocks of 2016, very few economists understood the scale of the problem (McCann, 2016), and it is only the political shocks associated with Brexit that have placed these issues centre-stage in UK policy and political debates. Unfortunately, in the meanwhile, this has allowed non-economic narratives, sometimes with little or no real substance, to flourish and drive the political economy of levelling up and devolution. For the sake of future good policy and institutions, UK economics must seriously engage with the regional question.

The rest of this commentary is organised as follows. The next section explains the nature and scale of the UK's regional economic inequality problem in the context of being a national growth problem. The third section explains how thinking about UK regional economic problems has, for a long time, been heavily shaped by various economic narratives emerging particularly from the United States (US), which have somewhat skewed UK policy-thinking away from the central challenges that the UK faces. This has left open the possibility for non-economic narratives to drive political debates in this arena – and, as the fourth section explains, this is precisely what has taken place in the UK. The fifth section focuses on the devolution-related governance reforms that the UK needs to undertake in order to begin to address the regional imbalances, while the sixth section briefly outlines the UK's inbuilt institutional pressures, which will aim to stymie any devolution-related governance changes.

The scale of the UK regional problem

When measured across a broad range of 28 indices (McCann, 2020)[2] or more (Raikes, Giovannini and Getzel, 2019; Carrascal-Incera et al., 2020; Zymek and Jones, 2020; Davenport and Zaranko,

[1] I would like to thank Angus Deaton, Robert Joyce and James Banks for their valuable comments and feedback on earlier drafts. The opinions contained here are my own and do not reflect those of either The Productivity Institute or the IFS.

[2] McCann (2020): Ratio top/bottom OECD TL2 regions in GDP per capita; Difference top/bottom OECD TL2 area in GDP per capita divided by national GDP per capita; Ratio top/bottom OECD TL3 regions in GDP per capita; Difference top/bottom OECD TL3 area in GDP per capita divided by national GDP per capita; Ratio top 10%/bottom 10% OECD TL2 regions in GDP per capita; Ratio top 20%/bottom 20% OECD TL2 regions in GDP per capita; Ratio top 10%/bottom 10% OECD TL3 regions in GDP per capita; Ratio top 20%/bottom 20% OECD TL3 regions in GDP per capita; Ratio top 10%/bottom 10% OECD TL2 regions in GVA per worker; Ratio top 20%/bottom 20% OECD TL2 regions in GVA per worker; Ratio top 10%/bottom 10% OECD TL3 regions in GVA per worker; Ratio top 20%/bottom 20% OECD TL3 regions GVA per worker; Ratio top 10%/bottom 10% OECD TL2 regions in Regional Disposable Income (RDI) per person; Ratio top 20%/bottom 20% OECD TL2 regions in RDI per person; Ratio top 10%/bottom 10% OECD TL3 regions in RDI per person; Ratio top 20%/bottom 20% OECD TL3 regions RDI per person; Gini index of regional GDP per capita OECD TL2 regions; Gini index of regional GDP per capita OECD TL3 regions; Gini index of regional RDI per capita OECD TL2 regions; Gini index of regional RDI per capita OECD TL3 regions; Difference top/bottom OECD metro urban area in GDP per capita divided by national GDP per capita; Ratio top/bottom OECD metro urban area in GDP per capita; Ratio top/bottom GDP per capita for EU NUTS-2 regions (including metro urban regions); Ratio top/bottom GDP per capita for EU NUTS-3 regions (including metro urban regions); Ratio top 10%/bottom 10% GDP per capita for EU NUTS-2 regions (including metro urban regions); Ratio top 10%/bottom 10% GDP per capita for EU NUTS-3 regions (including

2020),[3] we see that the UK is more interregionally unbalanced than another 30 or so OECD countries. While London is a 'world city' success story, and much of its hinterland is also very prosperous on multiple dimensions, when measured at the level of the 12 large ITL1/OECD-TL2 regions based on purchasing power parity at 2016 standardised prices, half of the UK population today live in areas: which are poorer than the poorest US states of Mississippi and West Virginia; whose productivity is no better than the less prosperous parts of the former East Germany (McCann, 2016, 2020); whose quality and accessibility to healthcare is on a par with eastern Europe (GBD 2016 Healthcare Access and Quality Collaborators, 2018); with a thin and fraying social fabric (Tanner et al., 2021); and whose multi-dimensional living standards are akin to Alabama and Tennessee (Veneri and Murtin, 2019). Moreover, as well as interregional differences, the UK's inter-urban differences are also amongst the highest in the industrialised world (Carrascal-Incera et al., 2020). However, unlike countries with small regional productivity differences, the observed geographical variations in productivity within the UK are not primarily local variations. Some 60% of the UK's spatial productivity variations are due to productivity differences amongst the 12 large ITL1/OECD-TL2 regions, with some 40% of the UK's regional productivity variations due to local intra-regional imbalances (Arbabi, Mayfield and McCann, 2019; Zymek and Jones, 2020). Overall, the scale of the spatial inequalities is enormous by the standards of the industrialised world, and the falling productivity rankings of many UK regions alongside the consequent internal economic decoupling of whole swathes of the country from London and its hinterland (McCann 2016) represent longstanding shifts (McCann, 2016; Carrascal-Incera et al., 2020; Allen, 2021) since the late 1980s. Yet, in the UK, we have been largely blind to these issues for decades (McCann and Ortega-Argilés, 2021a).

As well as UK regional inequalities being very high by international standards, the governance system of the UK is also amongst the most centralised, top-down and space-blind in the industrialised world (McCann, 2016), something that has increased steadily since the early 1980s. Widespread evidence from across OECD countries (Carrascal-Incera et al., 2020; McCann, 2022a) demonstrates that devolved governance systems tend to lead to more interregionally balanced growth with no loss of overall national productivity growth, and many aspects of good governance also tend to be fostered in more devolved governance systems (McCann, 2022a,b). In contrast, not only does the UK have very high spatial inequalities, but the economic dominance of London is very high even by the standards of unitary countries. New internationally comparable evidence on devolved governance systems and structures (Hooghe and Marks, 2016, 2020; Hooghe et al., 2016; Ladner et al., 2019),[4] allied with evidence on the nature and scale of UK regional imbalances (Carrascal-Incera et al., 2020; McCann, 2020; McCann and Yuan, 2023), has led an increasing number of analysts to question whether governance and institutional questions are central to the emergence of the UK's regional imbalances. That is not to say that they are the only issues, in that the UK's particular economic geography and the asymmetric impacts over five decades of globalisation shocks, which are likely to be exacerbated by Brexit, are also critical (McCann, 2016). But the UK's highly centralised governance system is increasingly understood as being a major part of the problem. A growing range of observers and commentators nowadays suspect that the UK's governance centralisation has itself exacerbated the UK's regional inequalities over recent decades, by undermining the country's ability to develop policies aimed at adapting to localised shocks. The combination of high regional inequalities and governance centralisation has also contributed to the fact that today the UK also has one of the lowest levels

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metro urban regions); Coefficient of variation of GDP per capita for EU NUTS-2 regions (including metro urban regions); Coefficient of variation of GDP per capita for EU NUTS-3 regions (including metro urban regions).

3 Carrascal-Incera et al. (2020): Ratio of regional top 10% over bottom 75% in GDP per capita; Ratio of top 10% over bottom 10% of urban population; Ratio of top 20% over bottom 20% of urban population; Ratio of top 10% over bottom 75% of urban population; Gini index of inter-metropolitan inequality; Theil index of inter-metropolitan inequality.

Zymek and Jones (2020): Ratio of top/bottom NUTS2 regions by EU country.

Raikes et al. (2019): Coefficient of Variation in GVA per Worker for OECD-TL3 regions; Theil index of GVA per worker for OECD-TL3 regions; Gini index of GVA per worker for OECD-TL3 regions; 90th percentile/10th percentile in GVA per worker for OECD-TL3 regions; 80th percentile/20th percentile in GVA per worker for OECD-TL3 regions; Coefficient of Variation in Disposable Household Income for OECD-TL3 regions; Theil index of Disposable Household Income for OECD-TL3 regions; Gini index of Disposable Household Income for OECD-TL3 regions; 90th percentile/10th percentile in Disposable Household Income for OECD-TL3 regions; 80th percentile/20th percentile in Disposable Household Income for OECD-TL3 regions; Davenport and Zaranko (2020): GDP per capita in the 80th percentile/20th percentile for OECD-TL3 regions; GDP per capita in the 90th percentile/10th percentile for OECD-TL3 regions; Max-min ratio regional GDP per capita OECD-TL3; Coefficient of variation in GDP per capita.

Davenport and Zaranko (2020): Regional GDP per capita OECD-TL3 regions; 80/20 ratio rank; 90/10 ratio rank; Max/Min ratio rank; Coefficient of variation rank; Overall rank.

4 See http://garymarks.web.unc.edu/data/regional-authority/.

of trust in central government of any OECD country (OECD, 2020). The UK levels of trust in central government are currently ranked at 34th highest amongst the OECD countries,[5] and have been falling since 2007 (OECD, 2020). These combined observations raise serious concerns regarding our ability to govern the country, and in particular to design and deliver effective economic policy that works for all regions.

Centralised and top-down decision-making may work to some extent in countries that are internally and interregionally very equal on most socio-economic indicators, ranging from small countries, such as Finland, New Zealand and The Netherlands, through to very large countries, such as Japan. In these countries, any notion of a representative locality that is in the mind of a policymaker reflects the reality in most places and the policy impacts in each place are likely to be fairly similar, such that the expected national impact is simply the aggregate of all of the smaller scale but largely similar local impacts. In contrast, however, in countries with high interregional productivity and prosperity differences such as the UK, any top-down, nationally framed and centrally designed policymaking is likely to become largely ineffective in many parts of the country, simply by way of the sheer heterogeneity of places. Only a few places will conform to the notion of the type of representative place that is in the mind of a policymaker, with many places displaying fundamentally different characteristics; and in these very different places, the likelihood of generating similar local impacts to other places ranges from low to non-existent. As such, any national impacts of a policy are an aggregate of very different, and often unanticipated and unintended local impacts. This tends to undermine the efficacy of nationally designed policies in many parts of the country, and this lack of central government policy traction is itself likely to be exacerbated by the low trust in central government.

The UK's particular combination of high interregional productivity differences, high governance centralisation and low trust in central government has therefore given rise to a push for greater sub-central government devolution, with a view to both helping to improve the economic fortunes of regions and also to improve the quality and effectiveness of their governance. This culminated in the publication of the 2022 Levelling Up the United Kingdom White Paper, which aimed to foster more devolved decision-making in the service of generating more balanced interregional growth and better national and sub-central governance. The Levelling Up White Paper aimed to shift the narratives around UK regional development from being traditionally a view from the centre to being more of a view from the local. This shifting of narratives required facing head-on the headwinds arising from two different sets of policy framing, one of which is the longstanding Whitehall view of London as the 'motor' of the economy, and the second is the recent 'cities versus towns' narrative arising out of the geography of discontent. We will return shortly to the likely outcomes of the White Paper, but before we do this, it is important to explain the policy-framing headwinds emerging from these two narratives.

UK regional economic narratives and framing

From the 1980s onwards, a dominant political economy narrative emerged that, as a *national* priority, the London economy needed to be reinvigorated as a world-leading centre after many decades of decline. The rationale was that as the 'motor' of the UK economy, a reinvigorated London would act as both a generator and conduit for the national and global knowledge, technological and investment flows, which would diffuse throughout all UK regions and nations. According to this almost universally held narrative, the enhanced commercial dynamism in the core London economy would therefore disseminate and galvanise economic development in all other more peripheral parts of the UK economy. The international experience of the previous four decades suggested that this galvanising would take place in the context of interregional convergence processes (Borts and Stein, 1964; Barro and Sala-i-Martin, 1992) driven by capital and labour moving interregionally in opposite directions searching out locations with more favourable factor returns. To foster appropriate factor mobility, what was needed were well-designed regulatory systems ensuring robust competition in all areas of the economy, and this factor mobility itself would be expected to foster knowledge diffusion across all parts of the country. As such, this narrative also posited that greater shares (O'Brien and Miscampbell, 2020) of productivity-enhancing public investments in numerous major infrastructure, cultural and research-related assets in and around London's economy were regarded as a *national* priority. Note that there was no formal economic model underpinning this core-periphery argument in

5 See https://data.oecd.org/gga/trust-in-government.htm.

the specific UK context, beyond a very rudimentary notion of growth and diffusion, allied with optimism associated with the observation that interregional convergence was a widespread phenomenon throughout the industrialised world. Importantly, this narrative was both implicitly, and in some cases also explicitly, shared across numerous public, private and civil society institutions in key decision-making roles.

These core-periphery and agglomeration-diffusion narratives became even more embedded in UK national institutional thinking following the publication of two HM Treasury (2001, 2003) reports and a World Bank (2009) report. These were framed on the basis of the emerging narratives of North American urban economists, and posited that market-wide competitive processes allied with agglomeration economies would underpin national growth. The fact that there was a natural geographical efficiency-equity trade-off was not just assumed, it was asserted. On these arguments, policymakers should be primarily space-blind in thinking, eschewing any 'place-based' concerns for spatial inequalities, because eventually knowledge and technological diffusions will correct for any such core-periphery imbalances (McCann and Ortega-Argilés, 2021b). For many in Whitehall, Westminster and the London think-tank world, these reports bolstered the continuation of largely place-blind and sectoral narratives, which already dominated mainstream high-level UK policy-thinking and policy debates. Indeed, on the big scale, UK urban and regional economic policy interventions were only ever very marginal at best, only amounting to less than 0.4% of GDP during their mid-1970s high point, and subsequently to never much more than 0.2% of GDP, today standing at 0.1%–0.2% of GDP (McCann, 2016, 2022a; Martin et al., 2021). By comparison, Germany annually spends approximately some five times as much as the UK on regional economic development issues (Enenkel, 2021). As Lord Bob Kerslake remarked, in the UK these were only ever 'pea-shooter' policies. The UK has never taken regional imbalances seriously.

The evidence supporting the argument that while London will drive the economy, it will also in time help to foster interregional convergence, was not forthcoming. In terms of labour mobility, flows of university graduates into the London economy became widely interpreted as evidence demonstrating factor mobility, and some observers interpreted this as an example of natural agglomeration-adjustment processes, which are economically efficient and should therefore not be discouraged or interrupted. The space-blind approach assumes that any emerging core-periphery inequalities will even out over time via competition-driven investment and knowledge diffusion effects (World Bank, 2009). In contrast, other commentators raised concerns regarding a so-called growing graduate 'brain drain' from economically weaker regions, arguing that such human capital flows would work against convergence. However, contrary to widespread public perceptions, there has not been either greatly increasing labour mobility or a widespread interregional brain drain to London. UK interregional migration flows today are little different from the 1970s (McCann, 2016; Champion and Shuttleworth, 2017; Stansbury, Turner and Balls, 2023), with gross interregional migration across the 12 UK ITL1 regions being of the order of 2%, while net interregional migration rates are typically of the order of 0.1%–0.2% (ONS, 2021).[6] Meanwhile, inflows of new university graduates into the London economy are stable and of the order of 50,000 per annum (McCann, 2016; Stansbury et al., 2023), an annual flow that is equivalent to some 0.5% of the London population and just 1% of the London workforce (McCann, 2016). To put these numbers into perspective, these annual flow figures are roughly equal in stock terms to just two-thirds of the workforce of London Heathrow airport. Indeed, movements of graduates into the London economy from outside London only account for less than 10% of all graduate employment movements (McCann, 2016; Britton et al., 2021; Stansbury et al., 2023), with typically 85% of graduates entering into employment either in their home or neighbouring regions (Higher Education Careers Services Unit, 2020). Indeed, the largest group of graduate migration flows are between non-London regions (McCann, 2016), at roughly double the flows into London. What is remarkable is how little interregional labour flows have changed over more than four decades, especially at a time when the numbers of university graduates have increased more than fivefold. Meanwhile, in terms of capital mobility, evidence from foreign direct investment (FDI) patterns suggest that investments in London and its hinterland were becoming qualitatively different to those in other regions and, in particular, were of a higher quality and of

[6] At the smaller county-level scale, migration flows are 3% of the population and at the even smaller ITL3 areas they are some 4% (McCann, 2016). For relatively high net inflow ITL1 regions, such as the East, the net annual inflows are 0.3%, while, for London, UK interregional net inflows are −1%, or something of the order of −100,000. Rather than UK interregional migration, over three decades international in-migration directly into London has been of the order of 200,000 and this has led to a net population growth of 100,000, and has sustained London's population growth along with higher local fertility rates due to a younger population in London (McCann, 2016).

newer forms of investment than what was taking place elsewhere (Dimitropoulou, McCann and Burke, 2013; McCann, 2016). There was no evidence of widespread movements of investment into the lower-cost regions of the UK. As such, there was no real evidence of interregional convergence, and while interregional divergence was taking place from the late 1980s onwards, the hoped-for ultimate self-correcting convergence process never materialised.

The longstanding UK government belief that any spatial market mechanisms would be both growth-enhancing and eventually also self-correcting started to fracture in the aftermath of the 2008 global financial crisis. Although London and its hinterland were initially in the eye of the storm, the economic recovery of the core regions was relatively rapid, whereas many parts of the periphery subsequently experienced a longstanding flatlining of productivity. Awareness of this started to emerge at exactly the same time that the OECD began to produce standardised estimates of the productivity performance of hundreds of cities and thousands of regions across some 35 countries. What became startlingly apparent was that although UK policy discussions often focus on the UK 'productivity puzzle', in reality there was no real productivity puzzle in the core regions of the UK. If we group London, the South East, the East, the South West and Scotland together, the productivity levels in this half of the country are comparable to those in Finland, Austria, Australia, Belgium and Canada, whereas the rest of the UK has productivity levels below the Slovenia and the Czech Republic, and only marginally greater than Slovakia. As such, the UK productivity puzzle is almost entirely a phenomenon of regions in the North, Midlands, Wales and Northern Ireland plus some parts of Eastern Scotland – and nor is this just a post-crisis phenomenon (McCann and Yuan, 2023). When compared against OECD-wide and EU-wide benchmarks, the longstanding productivity underperformance of half of the UK economy (McCann, 2016) is as dramatic as the productivity overperformance of the other half of the UK (*The Economist* 2020). The two halves of the economy have been progressively decoupling for almost four decades, with the result that aggregate UK productivity levels and growth rates are no more than pedestrian by OECD-wide and European-wide standards. It is now only recently becoming understood that the very average UK productivity performance has come at the cost of some of the highest interregional inequalities in the industrialised world (McCann, 2016, 2020). No country that is richer than the UK has higher interregional inequalities, and all more prosperous countries grow interregionally in a more balanced manner.

In order to understand the scale of the problem, it is useful to compare the UK with Germany, as these are two countries with similar scale populations, similar population densities, many similar sized cities and similar urban population densities. At the time of German reunification in 1990, unsurprisingly, the reunified Germany was more interregionally unequal than the UK. However, Germany has invested some €70 billion per annum for 30 years in what we now call 'levelling up', involving investments in infrastructure, land use, research and development, institutions, capacity building and governance reforms (Enenkel, 2021). As Carrascal-Incera et al. (2020) show, the result of these major and longstanding German levelling-up activities is that, over time, Germany has become less interregionally imbalanced than the UK. Indeed, on many indices, the UK today is more interregionally imbalanced than a reunified Germany was in 1990, while the reunified Germany today has a *national* productivity premium over the UK that is larger than that which West Germany had over the UK in 1990. Not only the comparison with Germany but also comparisons across all OECD countries demonstrate that there was no spatial equity-efficiency trade-off; indeed, it appears that there never was (Carrascal-Incera et al., 2020; Garcilazo, Moreno and Oliveira Martins, 2021). However, there is increasingly an international understanding that there is a trade-off between governance centralisation and balanced interregional growth. Centralised societies tend to exhibit more regionally unbalanced growth and a greater dominance by one major urban centre, but, as already mentioned, even on these criteria the UK imbalance is an outlier.[1] Indeed, the key feature of the UK economy over the last four decades is that while half of the country has outperformed both OECD and EU averages in terms of productivity, the other half of the country has underperformed these same averages by almost exactly the same extent (McCann, 2016).[7] Internally, the UK interregional economy has been decoupling for decades in terms of regional productivity, and consequently also other socio-economic features underpinned by productivity, including the quality of work,[8] social mobility, access to healthcare and life expectancy (McCann and Ortega-Argilés, 2021). The result is that, overall, UK national productivity growth has been no more than average over the last four

[7] See the article, 'Regional Inequality in Britain: Why Britain is More Geographically Unequal Than Any Other Rich Country: Other Countries Have Poor Bits. Britain has a Poor Half', in *The Economist*, 30 July 2020, https://www.economist.com/britain/2020/07/30/why-britain-is-more-geographically-unequal-than-any-other-rich-country.

[8] See https://www.ifow.org/resources/the-good-work-time-series-2023.

decades while at the same time the UK has become one of the most interregionally unequal countries in the industrialised world (McCann, 2020).

As such, the four-decade long narrative that London and its hinterland act as the 'motor' or 'engine' of the UK economy, and that growth in London would spur growth across the country, has largely broken down. A wide range of evidence suggests that the geographical coincidence of the seat of government, the national commercial centre and multiple modes of trade routes has meant that London and its hinterland have not acted as a 'motor' for the economy, but rather have been decoupling (McCann, 2016) from the rest of the country for more three decades, linked primarily to events in other global cities and largely (or even entirely) disconnected from many parts of the UK. The economy has morphed into a 'hub with no spokes' system (Haldane, 2018), in which there is little or no real knowledge diffusion or dissemination across regions from the London-centric core of the economy. These changes are also magnified by ongoing centralisation in the UK banking system away from longstanding banking–industry relationships (Mayer, McCann and Schumacher, 2021). Not surprisingly, there are now also serious conceptual as well as empirical doubts regarding whether many of the major infrastructure, cultural and research-related public investments in London are in reality national, or actually just primarily local and regional, in nature. Moreover, the effects of the COVID-19 pandemic are likely to further entrench the UK regional and governance inequalities (McCann and Ortega-Argilés, 2021b). Even without the pandemic, our understanding of regional imbalances is far behind where it needs to be, and now the likely scale of the required institutional, governance and policy changes to address the imbalances cannot be underestimated (UK2070 Commission, 2020).

The progressive internal decoupling of the UK's interregional economy into a highly unequal core-periphery structure is what makes the UK's hyper-centralised governance system also progressively less and less effective, and less able to address the challenges of the poorer half of the country (McCann, 2022a, b). The extreme decoupling means that any national 'one size fits all' policies emanating from Westminster and Whitehall have little or no traction in whole swathes of the country, while the more that government economic policy focuses on the behaviour of the London economy, the less able it is to address the needs of the rest of the country, precisely because of this decoupling.

Over the last four decades, the confrontation between the emerging evidence and the shifting growth and development perspectives framing UK policymaking means that the mainstream UK economic narratives about regional inequalities have gone through four phases.

(i) In the first phase during the 1980s–1990s, it was held that regional issues were not a problem, not an issue.

(ii) In the second phase from the late 1990s and the early 2000s onwards, regional inequalities were considered to be an issue, but not a problem, because the market system was expected to largely correct for these over time.

(iii) In the third phase, which was after the 2008 financial crisis, perceived regional inequalities were considered only a minor issue in comparison to other challenges, so there was no major policy prioritisation relevant to this, except on specific issues such as 'city deals'.[7]

(iv) The fourth phase commenced with the post-Brexit political shocks and the realisation that regional inequalities were a major economic and political issue and one that must be prioritised.

However, we now realise that regional inequalities are an enormous issue and we also realise that this issue is one that we do not really know how to address, such that competition for ideas in this arena becomes politically opportune. Unfortunately, the longstanding lack of any economic acknowledgement, understanding or engagement with these issues by Whitehall, Westminster and the London think-tank world means that the UK's macro- and micro-economics professions have had little of substance to say about these challenges, especially in comparison to other countries. This lack of engagement unwittingly has provided an ideal opening for non-economic narratives driven by the 'geography of discontent' (McCann, 2020). It has meant that political rather than economic considerations dominate the UK political economy framing of debates about the inequalities between regions and localities.

Cities versus towns, Brexit and the 'geography of discontent'

The geography of discontent (McCann, 2020) arises where people perceive that their communities have been largely undervalued, ignored and left behind by the modern economy. The political shocks associated with this discontent are a real and potent phenomenon. The ballot box 'mutiny' (Collier, 2018) is the only way that people are able to articulate their perceptions. In the UK, this was manifest in the geography of the Brexit vote and the fall of the so-called Red Wall parliamentary seats. Votes for Brexit tended to be dominated by smaller towns and rural areas, especially in the economically weaker regions and, indeed, the current levelling-up agenda was forged entirely out of the whole Brexit process. Yet, ironically, Brexit itself will almost certainly work directly against levelling up, primarily because the UK's weaker regions are far more economically dependent on EU markets than the more prosperous core regions of the UK. In particular, London is less adversely exposed to Brexit than other parts of the country. There is now a very large body of evidence on this, including the government's own analysis.[9] The scale of the regional economic Brexit problem is orders of magnitude beyond anything that a combination of Freeports, a Towns Fund, a Levelling Up Fund or a Shared Prosperity Fund can together address.

Unfortunately, from an economics perspective, the inherent contradiction between Brexit and levelling up has been almost entirely ignored by public narratives, and the long-run consequences of this are unknown and potentially socially destabilising. Importantly, in public and policy narratives where Brexit has been explicitly linked to economic geography, the linking has been fundamentally misguided in economic terms, driven as it is primarily by media and psephological considerations. The arenas populated by UK policymakers, media and think-tanks display notoriously poor capabilities in terms of other languages. The result of this is that policy experiences, comparisons and options tend to be immediately sought in other English-language speaking countries, such as Australia, Canada and the US. In the case of issues concerning urban and regional economics and economic geography, this is especially problematic, because these are all enormous countries in which cities tend to be far apart from each other with very extensive hinterlands, there are limited land-use planning constraints, and these countries have highly devolved governance systems. In other words, when considering local and regional issues, in terms of economic geography these countries could not be more different from the UK, which is a small, densely populated country, with small urban hinterlands and tight land-use planning constraints, operating in a highly centralised unitary state. Yet, it is to these countries that so many UK political and media debates immediately turn to for inspiration, and it is from these countries that the UK imported the notion of 'left-behind' towns. Smaller cities, towns and rural regions are indeed being outperformed on almost every socio-economic dimension by large cities in Australia, Canada and the US, but this is the opposite of the UK experience. An unfortunate borrowing of US 'cities versus towns' observations[10] and a mixing of these with claims about so-called 'metropolitan elites' (Goodhart, 2017) has meant that levelling up is now dominated by a 'cities versus towns' narrative, something that is important from a psephological perspective, but from an economic perspective is basically incorrect in the UK context. Obviously, there are 'left-behind' towns in the UK, especially in deindustrialised regions as well as in some coastal areas. However, across the country as a whole, the gaps between cities and towns,[11] between large urban areas and small urban areas, or between urban areas and rural regions, are almost non-existent (ONS, 2017), and amongst the lowest of any OECD country (ONS, 2017, 2019, 2020; Garcilazo and Oliveira Martins, 2020). Unfortunately, the borrowing of narratives from the US has meant that this has become something of a political mantra, although it is entirely untrue (Swinney, 2021).

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9 See Los et al. (2017), Clarke, Serwicka and Winters (2017), Chen et al. (2018), HM Government (2018), House of Commons Exiting the EU Committee (2018), Levell and Norris Keiller (2018), Borchert and Tamberi (2018a, b), Gasiorek, Serwicka and Smith (2018), Cambridge Econometrics (2018), Brewer, Quest and Gregory (2018), Thissen et al. (2020), Fetzer and Wang (2020), Fingleton et al. (2022) and Davenport and Levell (2022).

10 See the article, 'Left in the Lurch: Globalisation has Marginalised Many Regions in the Rich World', in *The Economist*, 21 October 2017, https://www.economist.com/briefing/2017/10/21/globalisation-has-marginalised-many-regions-in-the-rich-world.

11 The Office for National Statistics (ONS) uses 11 categories of urban settlements in order to classify cities and towns. These are: London; Major Conurbation; Minor Conurbation; City and Town Non-Sparse; City and Town Sparse; Town and Fringe Non-Sparse; Town and Fringe Sparse: Village Non-Sparse; Village Sparse; Hamlets and Isolated Dwellings Non-Spare; Hamlets and Isolated Dwelling Sparse (ONS, 2017). Meanwhile, the OECD uses five categories for its OECD TL3 small regions (equivalent to ONS ITL3 regions). These are: Large Metropolitan; Metropolitan; Non-Metro with Access to Metro Area: Non-Metro with Access to Small/Medium City; Remote (McCann and Yuan, 2023).

The reasons why there are no systematic 'cities versus towns' gaps in the UK are not only because many UK cities display low prosperity, heavily underperforming compared with their OECD and European competitors, but also because so many of the UK's most prosperous places are towns. Numerous towns, and especially in the south of England, are more prosperous than most of the UK's large urban areas, and some towns are actually the most prosperous places even in the UK's economically weaker regions. Across the OECD, we observe urban scale–productivity relationships as being the typical pattern within countries, whereas within the UK there are no scale–productivity relationships whatsoever amongst any types of places (McCann and Yuan, 2023), giving rise to almost no 'cities versus towns' productivity differences. Indeed, the lack of any 'cities versus towns' performance gap reflects the core productivity problem that the UK now faces, both nationally and regionally, which is the economic underperformance of its large cities in the economically weaker regions. In the South and South East of England, and Eastern Scotland, large cities do outperform smaller cities, and they in turn outperform large towns, which in turn outperform small towns and rural areas (ONS, 2017), as would be expected across the OECD. In contrast, the UK's large cities outside of the south of England and Eastern Scotland all underperform economically with respect to their size by both OECD-wide and European-wide comparisons. They also fail to display the scale-related productivity-driving features typical in other advanced economies. These cities consequently also fail to provide the economic 'motors' that their respective regional hinterlands – including towns and rural areas – need for their own prosperity. Obviously, there are areas of poverty in London and the South of England, but because cities in these regions 'do their job' in economic terms of generating higher productivity than their hinterlands, the lowest-income groups in these places also have much greater opportunities for upward social mobility and higher lifetime earnings (Social Mobility Commission, 2020), access to higher education (House of Commons Education Committee, 2021) and increased longevity (Institute of Health Equity, 2020) than people in other urban areas. As such, the very reason that the gaps between towns and cities and between urban and rural areas in the UK are so small is because so many UK cities do not punch economically even near their weight, let alone above their weight. Thus, a clear *national* productivity priority should be enhancing the productivity growth of the UK's cities in economically weaker regions. Overall, from an economic perspective, there is no 'cities versus towns' problem in the UK, but this narrative now dominates public debates and mainstream policy-thinking, and threatens to divert attention away from the core national productivity priority, which policy should be seeking to address.

The very real danger is that levelling up – in the sense of addressing the UK's profound core-periphery spatial inequalities – therefore becomes highjacked and diverted for political purposes into a primarily localism-based agenda, something that is politically persuasive, but largely unrelated to the nature of the problem. Further evidence for this comes from the fact that many people and institutions are currently making up their own definitions of what levelling up is or should be (House of Commons Business, Energy and Industrial Strategy Committee, 2021). These narratives now prosper when discussing regional inequalities because the UK economics profession has for decades largely departed the regional field, thereby allowing other narratives to prosper. The geography of discontent thrives in a sea of no alternative narratives.

The governance reform challenge

As already mentioned, there is now a growing awareness that the hyper-centralised structure of the UK governance system is likely to have played a part in fostering the UK's high interregional inequalities as well as the very low trust in central government. However, the key institutional feature that distinguishes the UK from other OECD countries, and particularly those that are interregionally much more equal than the UK, is the lack of any sub-central meso-level within the national governance system. This is the key reform that the UK must find a way to implement.

The UK governance system can be characterised as a pyramid, or as a Λ-shape or an inverted V-shape governance system, in which local governance at the lowest local levels has very limited real power, autonomy or authority, and almost all power comes top-down from the centre. In contrast, all other large, advanced economies, including unitary countries, display an A-shaped governance system, with a strong meso-level of institutions, which facilitate more localised governance and decision-making (McCann, 2022a, b). In terms of fostering economic development, the UK's Λ-shaped governance system has two pernicious features. First, it maximises the degrees of separation between local citizens and governance decision-makers, making the sharing of local knowledge with the decision-making centre as difficult as possible. Second, it automatically builds in systemic congestion problems for influence at the top of the pyramid, with only key institutions, firms and organisation located in London and its hinterland receiving regular hearings. This combination of features automatically disincentivises local citizens' engagement in helping to shape government policymaking in a bottom-up manner, and it inherently militates against place-based thinking (McCann, 2022a, b). Furthermore, these problems are exacerbated by the logic and structure of the UK central–sub-central fiscal system, which directly pushes against devolved decision-making (McCann, 2022a). In addition, in the case of England, the current trajectory towards limited devolution is one of devolving to areas whose scale is appropriate for countries that are a quarter of the size of the UK. These areas are far too small by OECD standards to provide the scale required for meso-level institutions to effectively facilitate economic development (McCann, 2022a, b; Pope, Dalton and Coggins, 2022). This devolved fragmentation is largely a result of conceptual confusion in UK governance circles regarding the distinction between the 'citizen-facing' roles of sub-central government, which are suitable for delivery at very local levels and which dominate local political voting patterns, and the 'market-facing' role of sub-central government aimed at fostering economic development. The market-facing role of sub-central government often requires much larger spatial and population scale units to be meaningful than is the case for the citizen-facing roles. However, UK political debates have tended to conflate these issues, leading in many cases to more of a localism agenda than is helpful in terms of trying to address the UK's regional productivity inequalities. The agenda set in train by the 2022 Levelling Up White Paper – aimed at introducing county mayors into the UK meso-level governance system – is an example of this. Meso-level institutions across the OECD typically cover population areas of the order of three to five million people, whereas county mayors and one-third of the UK's existing combined authority areas are only of the order of one million, or fewer. The lack of any effective economic scale–productivity relationships in UK areas (McCann and Yuan, 2023) is absolutely central to the UK regional productivity problems. Institutions of effective scale are required in order to begin to address these economic development challenges. At present, such institutions either do not exist, or where they do exist, they are far too small. This is exactly why the Industrial Strategy Council (2021), the UK2070 Commission (2020) and the One Powerhouse Consortium (2020) all recommended that economic development issues be handled at the scale of the 12 ILT1 regions, or at even greater spatial scales (One Powerhouse Consortium, 2020).

Where are we going now?

The UK has some of the highest interregional productivity and prosperity inequalities by international standards. Over recent years, the evidence increasingly points the finger at institutional questions as being central to the emergence of the UK's regional imbalances. That is not to say that these are the only issues. The UK's particular economic geography and the asymmetric impacts over five decades of globalisation shocks, which are likely to be exacerbated by Brexit, are also critical (McCann, 2016). But the UK's highly centralised governance system is clearly a major part of the problem. Yet, correcting for these problems is extremely difficult in the UK case for three main institutional reasons: perceptions, political power and precedent.

(a) **Perceptions**. As already explained, the UK has built up very little conceptual capacity for thinking about these issues, having largely ignored them for decades. Our knowledge regarding international comparators in this arena is very limited. Where we do look for economic policy lessons from other countries, for primarily cultural and linguistic reasons (i.e., we are generally poor with other languages), both the UK media and think-tank worlds immediately jump to comparisons from countries such as Australia, Canada and the US. However, as far as regional economic and institutional issues are concerned, these countries often provide poor and even misleading comparators. These are countries that are enormous, with entirely different economic geographies, with separate commercial and government centres, and all are federal governance systems. In terms of the interactions between economic geography and institutional issues, they are less like the UK as it is possible to be. Often the challenges that the UK faces are fundamentally different to the challenges these countries face.

Our most instructive comparators are almost all in Europe, and for much of the UK the realistic regional productivity comparators are actually in southern and eastern Europe. However, we are largely unable to decipher the governance and legal frameworks of

European countries, primarily for language reasons, as well as for reasons of cultural resistance, issues that again are likely to be exacerbated by Brexit. As such, this limits our ability to learn relevant lessons from more appropriate comparators. Where we do look at European comparators, the fact that almost 90% of UK OECD TL3/ITL3 regions exhibit productivity levels that are below the OECD and European *averages* ought to give further serious pause for thought on the part of London-based policymakers as to whether policy-related comparisons with primarily the northern European countries have any meaning whatsoever for the challenges that the UK faces when it comes to regional issues.

(b) **Political power**. The UK's over-centralised Westminster–Whitehall governance system is itself likely to offer major resistance to further sub-national or sub-state devolution, precisely because monopolies and monopsonies will never self-reform. In order to stymie genuine devolution, the centralised institutions will deploy diverse narratives as to why limiting devolution is in the *national* interest, thereby preferring to frame devolution, where it is allowed to proceed, primarily in terms of ad hoc local issues.

(c) **Precedent**. Notwithstanding the legal, political and constitutional issues involved in devolving power, although the fiscal federalism literature provides us with a great deal of analysis as to how a more devolved governance system might be constructed, in reality designing and implementing the economics of a devolved governance system on a 'playing field' that is already adversely and severely tilted against the weakest regions have never been done in the modern era. There is no precedent amongst the advanced industrialised economies for widespread devolution to be undertaken on such an unbalanced and unequal interregional landscape, except for post-reunification Germany (Carrascal-Incera et al., 2020), and this experience underlines the scale of what is required. In the UK, this lack of precedence is exacerbated by the fact that the design of the UK central–sub-central fiscal system is so heavily tilted against devolution.

Moreover, these three institutional reasons for stymieing devolution – perceptions, political power, and a lack of any precedents for devolving in a highly unbalanced regional economic landscape – are further enhanced by the lack of any serious longstanding UK economics contribution to these sub-national governance debates. Taken together, these four pressures tend naturally to inhibit devolution-related governance changes. In the UK, the current severe lack of trust in central government, allied with a deep-seated geography of discontent, therefore nowadays leaves the wider political economy field of devolution open to being driven primarily by other non-economic narratives, as is already largely happening.

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