



Why Place Matters and Implications for the Role of
Central, Regional and Local Government
Economic Paper 2



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Foreword

Economics is at the heart of what we do in the Department. We need to understand – and be capable of thinking rigorously about – the choices and trade-offs that people make in reaching decisions, what can incentivise behaviour, how markets operate and change and how people and firms operate in and across different places.

Our response to the Capability Review in December 2006 reaffirmed our commitment to base policymaking and delivery consistently on evidence, both through building our knowledge base and through accelerating our efforts to embed the use of evidence and analysis across the Department.

Against this backdrop, we will be publishing a series of economic papers, highlighting key pieces of analytical work undertaken within the Department. These papers will range across the broad policy spectrum for which the Department is responsible, including spatial policies, housing, planning, regeneration, cohesion, and local government.

This is the second paper in the series. It builds on the first paper which provided a framework for considering the rationale behind policy interventions, including an account of how this framework applies in a spatial context. This paper approaches the rationale for spatial policies from a different perspective – identifying four reasons why place matters – and explores the implication for the role of different government levels. This work was developed in the context of the Sub-National Review of Economic Development.

The Department will be publishing further economics papers in the coming months. I hope the papers will prove a useful resource for everyone, in the public sector and beyond, with an interest in the Department's policy responsibilities. We would be very happy to receive comments and reactions to this and subsequent papers in the series.

I am grateful to all those across government who have been involved in developing this paper and the underpinning analysis. Specifically, I would like to thank Michael Kell (former Chief Economist and Head of Analytical Services Directorate) for his support and guidance, Diana Cook who led on the development of the framework within the Department, David Wood who has brought this together and will be taking the Why Place Matters programme forward and Paul Cheshire (LSE), Henry Overman (LSE), Ivan Turok (University of Glasgow) and Patricia Rice (Oxford University) for their input at various stages of the process.



Grant Fitzner

Chief Economist and Head of Analytical Services Directorate, Communities and Local Government

Section 1

Introduction and background

1.1 Objectives of the paper

This is the second in a series of papers, highlighting key pieces of economic and analytical work undertaken within or on behalf of Communities and Local Government.

The first paper in the series (Communities and Local Government 2007a) provided a conceptual framework for analysing the rationale for Communities and Local Government's policy interventions, based on the three main rationales for government intervention known as the "three Es": efficiency; equity; and the environment. The paper was intended to be an introduction to the principles of public economics, and how these apply in a spatial context.

This paper is published alongside the *Prosperous Places: Taking Forward the Review of Sub-National Economic Development and Regeneration* (Communities and Local Government 2008). It highlights some of the underpinning Communities and Local Government analysis which fed into – and supported a number of recommendations of – the Review of Sub-National Economic Development and Regeneration (SNR HMT et al, 2007); including empowering local authorities to promote economic development and neighbourhood renewal, while recognising the benefits of supporting local authorities to work together at the sub-regional level.

This paper identifies the economic reasons why place matters, uses this as a rationale for spatial policies and highlights the policy implications, including the importance of intervening at the right spatial level. The paper goes on to explore the underlying principles for the allocation of responsibility for economic policies across different government levels and then applies these principles to six economic policy areas in the context of the SNR (HMT et al, 2007).

This paper is concerned with the economics of why place matters; it does not consider wider social, environmental and political reasons of why place matters eg political structures or cultural identity. It is aimed at those, in the public sector and beyond, with an interest in Communities and Local Government's policy responsibilities, including those who need to understand the spatial implications of policy.

1.2 Context

Communities and Local Government has wide-ranging responsibilities, as reflected in its Departmental Strategic Objectives (DSOs):

- To support local government that empowers individuals and communities and delivers high quality services efficiently.
- To improve the supply, environmental performance and quality of housing that is more responsive to the needs of individuals, communities and the economy.
- To build prosperous communities by improving the economic performance of cities, sub-regions and local areas, promoting regeneration and tackling deprivation.
- To develop communities that are cohesive, active and resilient to extremism.
- To provide a more efficient, effective and transparent planning system that supports and facilitates sustainable development, including the Government's objectives in relation to housing growth, infrastructure delivery, economic development and climate change.
- To ensure safer communities by providing the framework for the Fire and Rescue Service and other agencies to prevent and respond to emergencies.

In addition, linked to a number of these DSOs, Communities and Local Government has put place at the heart of what it does. This was reflected in the publication of *Place Matters* (Communities and Local Government 2006a). Within this context, Communities and Local Government aims to provide intellectual leadership on: the role of place; the case for spatial policies; and the spatial impact of other policies. This includes working with other government departments, local authorities and delivery partners to build our understanding and evidence on place, as well as building databases and software of spatial information, such as ARC GIS and the State of the Cities database.

The remainder of this paper is structured as follows:

- **Chapter 2** outlines when differences in places may not matter, how place does matter and explores the policy implications, including the importance of intervening at the right spatial level.
- **Chapter 3** discusses four broad principles for considering how responsibility for economic policies should be allocated across government levels (the levels of intervention principles).
- **Chapter 4** summarises the results from applying these principles to six economic policy areas (planning, transport, employment, skills, business support and neighbourhood renewal), as well as the intention to create a Single Regional Strategy for the nine English RDA regions, as suggested in the SNR Consultation Document.

Section 2

Why place matters

Chapter summary

In practice there are many different spatial levels from the national to the regional, sub-regional, local authority and neighbourhood level. This chapter uses place as a generic term to build a framework of why place matters. The application of the principles set out in this chapter will depend on the spatial level and policy in question.

This chapter uses economic analysis to explore when differences in place may not matter and how place does matter to support an understanding of where, when and how to intervene spatially. It recognises that **spatial disparities on their own do not necessarily justify spatial policies** as disparities in nominal GVA per capita may merely reflect differences in prices or differences in the mix of people who live in these places – in this case policies focused on people may be most effective at improving welfare. However, this chapter identifies four reasons why **place does matter**:

- **Drivers of productivity come together in places.** Places offer a combination of assets which can boost the productivity of firms and attract the skilled workers they need. Place is becoming increasingly important in a globalising world of mobile investment and people.
- **Place can and does impact on economic and social outcomes:** Market failures may impact differently in different places; government policies can have unintended spatial impacts; the way people interact once concentrated within specific places can undermine life chances; and the way place specific factors impact on individuals can impact on quality of life and undermine life chances.
- **There are limits to peoples' ability to move and commute.** The financial and social costs of mobility can act as a barrier to mobility. Where there are market failures that limit people's mobility, there is an efficiency rationale for policies to increase mobility. However, there will always be limits to mobility – especially for the low skilled, for those who have invested in location specific skills and for those who own geographically fixed assets – which can provide an equity justification for investing in places.

- **Place enables targeting of concentrated groups.** As vulnerable groups have tended to be concentrated in particular places, place can offer a way of targeting and tailoring services to these groups. There is also a need to co-ordinate the way in which policies come together in particular places.

These four reasons can be translated into a **rationale for spatial policies** in terms of the Government's over-arching objectives of efficiency, equity and environment; in applying the framework there will often be trade-offs between the Government's over-arching objectives. As with all Government policies, providing a rationale is not sufficient on its own to justify policies; all policies have to go through an Impact Assessment where the costs and benefits of the proposal are properly considered.

The rationale for spatial policies also highlights the importance of **identifying the right spatial level at which to intervene** and provides a **rationale for Communities and Local Government's focus on spatial issues**, working across government to build and disseminate an understanding of the importance of place and encouraging spatially sensitive policies.

The English economy and society are, in effect, the sum of what happens in different places. And places are the sum of the activities of people and businesses operating within them. The prosperity and cohesion of the nation therefore depends on how England functions as a series of places. The rationale for place-based policies should therefore reflect the holistic nature of place – where a whole range of actors, institutions and relationships come together to promote prosperity or compound poverty.

Depending on the circumstances, the term place can be used to describe specific locations at all spatial levels: pan-regional; regional; sub-regional; local authority; neighbourhood; or ward. This chapter uses place in the generic sense in establishing a framework for why place matters. When applying this framework to specific policies, it will be necessary to identify the appropriate spatial level.

Improving places is not however an end in itself; it is a mechanism for increasing the welfare of individuals. A major determinant of welfare is income, but it is not the only determinant. Other determinants of welfare include place specific factors such as local environmental quality, public services and connectivity.

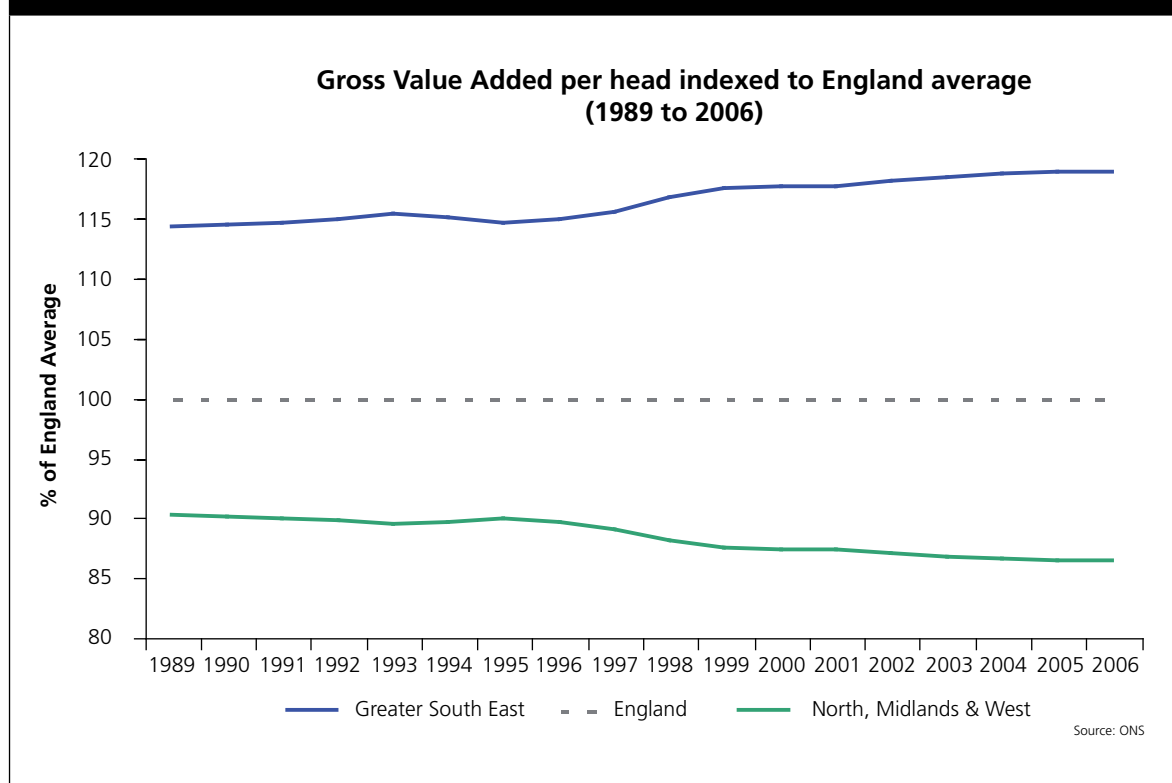
Paper 1 in this economic discussion paper series (Communities and Local Government 2007a) explored the rationale for spatially focused policies in terms of the three pillars of sustainable development: efficiency, equity, and environment.

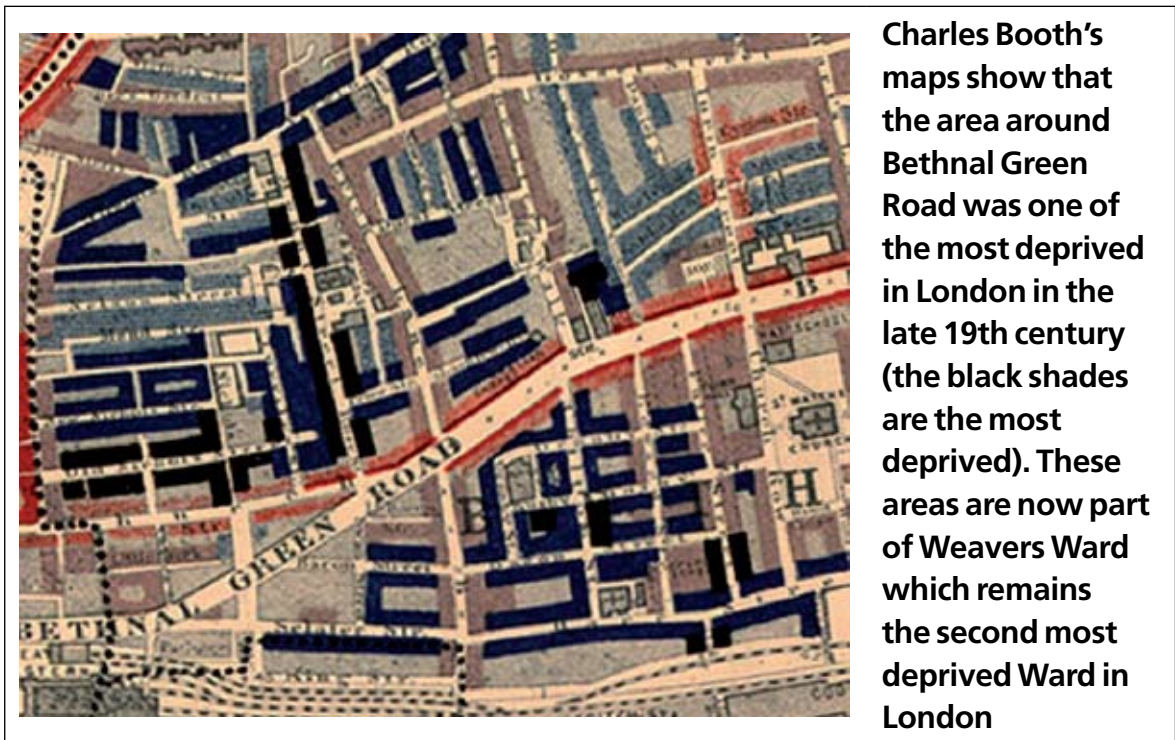
This second paper takes a different approach to thinking about why place matters. It identifies four reasons why place matters which are consistent with the analysis in Paper 1 and which cut across the three pillars of sustainable development. However, approaching the issue from a different perspective hopefully brings fresh insights and may be a more intuitive approach for some readers.

2.1 Why differences in place may not matter

The evidence that places are different is all around us. Differences are evident in a range of indicators across the three pillars of sustainable communities – economic, social and environmental outcomes. These outcomes differ radically between places at all spatial scales, from the regional to the neighbourhood level. While all areas have improved in absolute terms and the size of the relative differences between areas have changed, the differences themselves are roughly persistent (see Figure 1), with the regional divide in economic performance existing since at least the 1920s and patterns of deprivation in London changing little since the 19th century.

Figure 1 – Spatial disparities from the regional to the neighbourhood level





Charles Booth's maps show that the area around Bethnal Green Road was one of the most deprived in London in the late 19th century (the black shades are the most deprived). These areas are now part of Weavers Ward which remains the second most deprived Ward in London

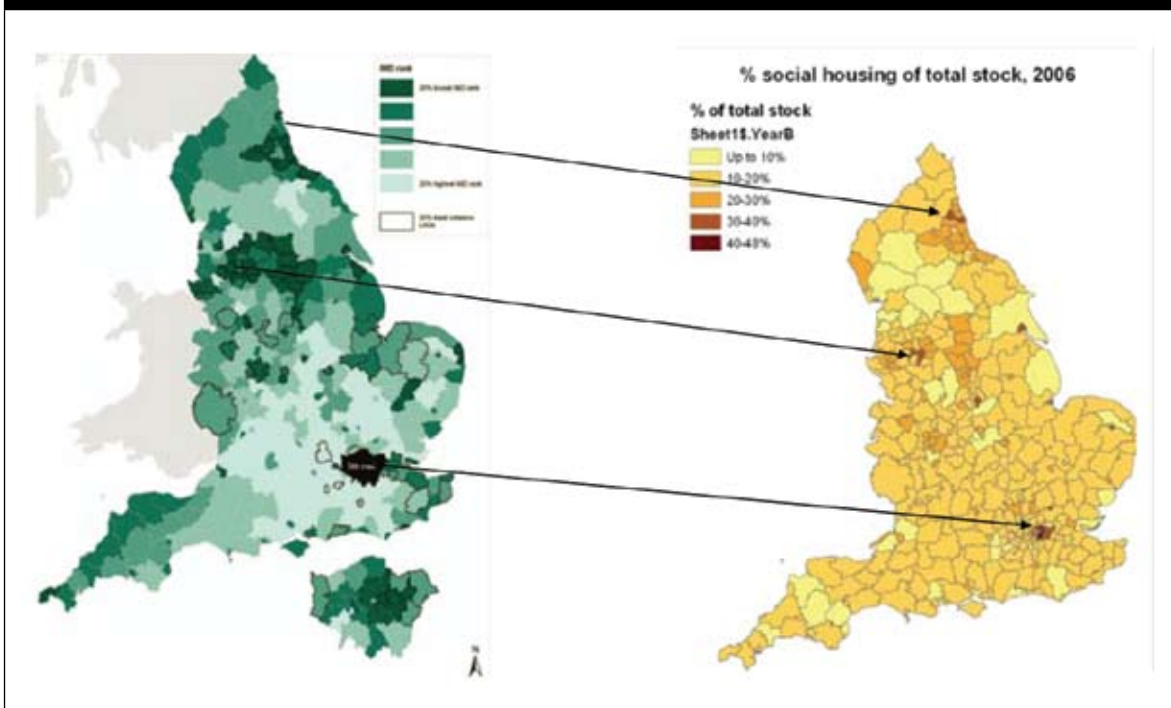
However, **these differences in headline indicators are not enough to justify spatial policies**. The first in this series of economic papers highlighted that much of the differences between places reflect differences in the costs of living and non-market factors between places (ie the benefits that individuals derive from living in specific places). Furthermore disparities in Gross Value Added (GVA) per capita often reflect differences in the characteristics of the people and firms located in that place – known as compositional effects – rather than the intrinsic characteristics of the places themselves:

- At higher spatial levels, such as the regional or sub-regional level, compositional differences may arise because of the agglomeration benefits firms derive from clustering together – either in large diverse cities or in smaller specialised clusters. This leads to concentrations of industries in particular places eg the finance sector in the City of London, the computer games industry in the North East of England (One NorthEast 2008) or the Formula One/ Indy Car cluster around Silverstone (The Economist 2002). The compositional differences lead to differences in GVA per head – as those sectors with high physical and human capital will be more productive and employ more skilled and experienced workers, who will earn higher wages. These 'compositional' factors may explain a significant proportion of the spatial disparities in GDP per capita.¹

¹ Venables and Rice (2004) found that differences in occupations accounted for at least one third of regional variations in wages. Duranton and Monastiriotis (2002) found that the majority of the divergence in regional average earnings over 1982-1997 was explained by differences in the education and skill levels across regions.

- At lower spatial scales, such as the local and neighbourhood level, the evidence suggests that personal and family characteristics have the biggest impact on educational and employment outcomes. This is manifested spatially through the 'sorting effect' of the residential housing market and means that people on lower incomes are constrained to live together in more affordable neighbourhoods.
- The sorting effect in residential housing markets is compounded by the unintended consequences of social housing policies, such as Right to Buy initiative which has resulted in the concentration of the less well-off in particular estates and neighbourhoods (Hills 2007 – see Figure 2).

Figure 2 – Index of Multiple Deprivation, social housing and spatial disparities



To the extent that spatial disparities are driven by differences in the mix of people, policies focused on people or businesses are likely to be more successful at improving outcomes and bridging the spatial divide than policies focused on place. Identifying a role for place means being very clear about the way in which the location of individuals and firms across space can influence outcomes. While more work is needed to measure their importance, it is possible to identify a number of ways in which place does matter.

2.2 How does place matter?

This section covers the four broad reasons why place matters from an economic perspective:

- Drivers of productivity come together in places
- Place can and does impact on economic, environmental and social outcomes
- There are limits to peoples' ability to move and commute; and
- Place enables targeting of concentrated groups.

Drivers of productivity come together in places

People and firms come together in specific places. The proximity and concentration of economic activity within specific places raises the productivity of firms and workers (HMT, Communities and Local Government and DTI 2006) because they:

- provide access to markets and to suppliers of goods and services (often referred to as forward and backward linkages)
- facilitate knowledge sharing, through the face-to-face contact of workers and entrepreneurs and from the movement of people between jobs. Firms in the same locality can also observe other firms' activities and developments, exchange ideas, and learn from and develop other firms' innovations; and
- offer large and concentrated labour markets, which provide more effective matching of vacancies and greater access to a range of skilled workers.

Therefore place offers a combination of assets which can boost the productivity (including innovation) of firms and help them attract the skilled workers they need (for example, see Cheshire and Gordon, 1998). This is partly about the agglomeration benefits which firms gain from clustering together – either in large diverse cities or in smaller specialised clusters – but also includes differences in the mix of natural, physical, social and human assets and economic history across places. In their location decisions, firms trade-off the agglomeration benefits of locating in different urban centres versus the higher rents and congestion that the demand for such places generates.

These differences provide places with an opportunity to maximise their potential by identifying where their competitive advantage lies – either in isolation or through complementary relationships with other places based on the linkages between their respective economies – and can provide a rationale for government to invest in places. As with all government policies, providing a rationale is not sufficient on its own to justify policies; all policies have to go through a Regulatory Impact Assessment (BERR 2007) where the costs and benefits of the proposal are properly considered.

Traditionally, the high costs of transporting goods meant that the primary force driving the location of businesses was proximity to transportation hubs and resources (such as coal). But improvements in transportation and the shift towards a service economy have reduced the need to locate near these factors. As a consequence, geography or location matters less for a number of mobile industries, while other attributes of places are becoming a substantially more important.

Two dimensions of globalisation accentuate the growing importance of the 'attributes' of places:

- The increased mobility of firms means that places need to offer a business environment which enhances their productivity, innovation and dynamism in order to attract and retain firms and enable them to grow. As many businesses benefit from locating in large diverse cities, or in specialised cities with other businesses in the same sector, places which gain the lead in enabling such agglomeration are likely to benefit from globalisation.
- Increasing competition from emerging economies is accelerating the UK's transition toward knowledge sectors, where it has a comparative advantage. This increases the role of skilled workers who also tend to be the most mobile in the workforce.
- The opening of markets combined with lower transportation costs increases the international mobility of goods, capital and people. The increased mobility of people means that housing plays a critical role in the economic performance of cities through its influence on the locational choices of the more highly skilled members of the labour force (Meen and Andrew 2004).
- As a consequence, businesses seek to locate in places which offer a residential environment that is attractive to skilled workers. (for example, see Glaeser et al (2001) and Cheshire and Magrini (2006)).

The location of firms and their activities and functions may reflect the compositional structure of an area or the manmade and natural capital of places. That is, there is a degree of sorting so that for example, HQs or R&D are disproportionately located in the wider London region, logistics in the Midlands and manufacturing in lower cost regions with less skilled workers. IBM provides an example which crosses national borders. IBM now has an active strategy of putting different business functions or activities where they can be done best – procurement in China, with R&D and call centres in Bangalore but its Headquarters still in America (The Economist, 2007).

However, as economic history has left places with different assets, it is important for the people, firms and institutions who come together in different places to identify – with the support of government – where they can add value in a globalising economy. Cheshire and Gordon (1998) emphasise that the pursuit of a standard set of 'locational attractors' (i.e. factors that firms consider when deciding where to locate business) maximises the bargaining power of mobile capital, whereas a policy of developing distinctive local strengths and specialisations both enhances the potential gains to areas, and promote a more efficient spatial distribution of economic activity.

Chicago provides a good example of a city which has identified where its competitive advantage lies, where a growing Futures business has evolved out of the financial services traditionally developed to serve its now shrinking agro-industrial economy (Sassen, 2007). As a UK example, the aerospace cluster in Lancashire developed from the base provided by engineering specialisms in late 19th century (eg manufacture of steam engines and looms).

Place can and does impact on economic and social outcomes

The second reason why place matters is that, while many differences between places reflect sorting or compositional effects, the characteristics of places and people often interact to impact on economic, social and environmental outcomes.

Firstly, the impact of market failures will vary across different places because of the mix of factors including geography, economic history and the assets of places or even the composition of people and firms and variations in incomes and / or preferences. While differences in composition in themselves do not necessarily justify spatial policies, they might if they reinforce or exacerbate market failures. As explored in Box 1, such spatial market failures may be compounded over time, while government policies can sometimes unintentionally undermine the flexibility of places to respond to changing economic circumstances.

While more evidence is needed to understand their relative importance, spatial market failures could operate at a variety of spatial scales:

- People and firms may not take into account the impact of their location decisions on others. For example, firms are unlikely to fully take into account the ‘knowledge spill over’ benefits of their innovation for nearby firms or the impact they have on congestion; this balance of positive and negative spillovers means that **cities** could be either too big or too small to maximise economic growth and welfare. The negative externality problems associated with spillovers, such as congestion or the environmental costs of the use of greenfield land for development, will also differ significantly between different **sub-regional** economies depending on factors like the geography and population density of the urban area.

Knowledge is crucial for the sustained growth of high-income economies; geographically limited knowledge diffusion can help to explain clusters of regions with persistently different levels of growth (Dorling, 2006). Characteristics of the incumbent firms and the absorptive capacity of a region can determine the extent of knowledge spillovers (Harris 2007).

- While to some extent differences in places are driven by compositional differences in the mix of people and firms, composition in itself becomes a place-specific factor that can drive differences in the impact of market and government failures across places. While the causes of deprivation may be more about personal rather than place factors, once concentrated in particular **neighbourhoods**, it may be reinforced through social networks (Lindbeck 1995 and Gustafsson 1999), access to the labour

market, access to public services, information failures and discrimination. Paper One (Communities and Local Government 2007a) highlighted that the evidence on these types of 'area effects' suggests that they are of marginal significance, in comparison to individual characteristics, as predictors of life outcomes. However, this may partly reflect measurement challenges, particularly if area affects impact dynamically over time by influencing personal characteristics.

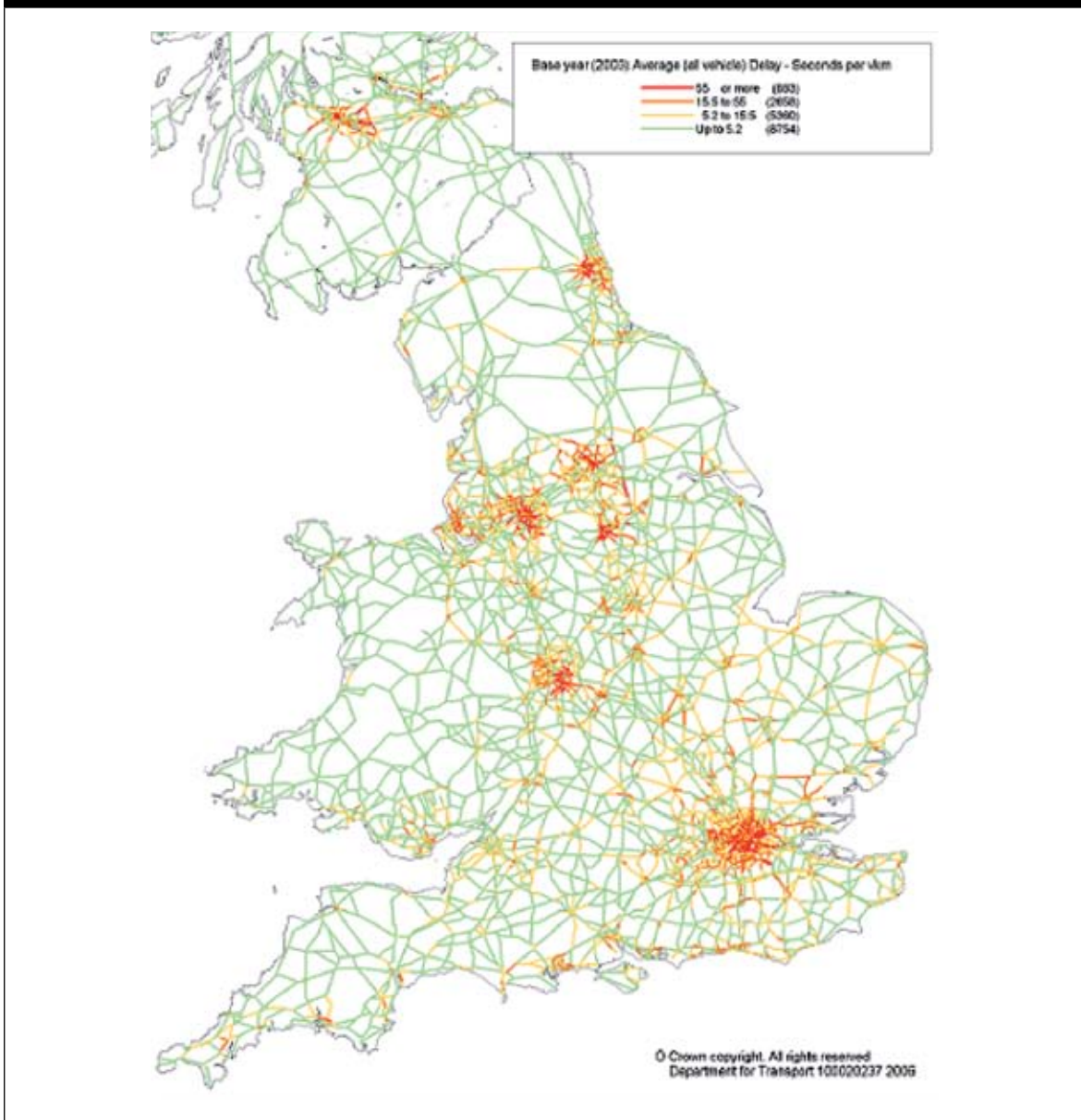
- Public sector activity may "crowd out" the private sector, reinforcing a dependency on the public sector and limiting the development of competitive industries; the high levels of public expenditure at 54 per cent of GVA in the North East, for example, compared to 29 per cent in the South East and 34 per cent in London, may be a signal of increasing dependence of the region on government (see Bosanquet et al 2006). Bosanquet et al (2006) assert that a vicious circle of economic activity could be created; as more and more people become dependent on the government for their jobs and incomes, there would be fewer opportunities for small businesses to start up and employ workers. This could be compounded if nationally-set wages do not show the same regional variation as private sector wages. Talented young people and modern industries – which are source of future economic progress – would move from outlying regions into London and the South East. Further government resources would be redistributed into the outlying regions, continuing the cycle.

The presence of spatial market failures – or the speed at which market forces are reversing spatial decline – is central to the regeneration challenge. The initial causes of decline are often stimulated by a change in the economic circumstances in an area, such as economic restructuring away from traditional industries. Some areas respond quickly to these challenges where as others can enter a cycle of decline; where economic and social problems interact and people become trapped as the more mobile move out to seek opportunities elsewhere. The result can be concentrations of deprivation, which can persist for generations, where the combination of market failures acts as a barrier to private enterprise and inward investment into the area.

There may also be environmental implications of spatial disparities or market and system failures. Poor integration of land-use and transport policy decisions could also lead to disproportionate carbon emissions, energy consumption and congestion through poorly located development and deficient transport investment.

For example, London and metropolitan counties account for just one quarter of all traffic in England but experience nearly two-thirds of all delay on the roads (that is total 'lost time' relative to 'free flow' conditions). In London the time lost per kilometre travelled by the average vehicle is around 50 seconds; this is more than twice as much as Metropolitan areas (21 seconds) and over four times that experienced in smaller urban areas (12 seconds). On average traffic in rural areas does not experience much delay – just 3threeseconds per vehicle km. However, this can vary considerably depending on time of day and specific location (see Figure 3).

Figure 3 – Average Delay on Major Roads (Eddington 2006)



Box 1: Path dependency

Over time spatial market and government failures can be reinforced through path-dependency – the interaction of current and past performance can reinforce and exacerbate differences in economic, social and environmental outcomes.

Past decisions, or accidents of history, can have important implications for the nature of subsequent economic development (HMT, 2004) and places can be trapped in cycles of under-performance. Government policy may sometimes unintentionally reinforce this type of path dependency if they undermine incentives for local and regional economies to respond to changing economic conditions.

Box 1: Path dependency (continued)

While path dependency may often be best tackled by 'people' policies, such as helping the long-term unemployed to return to work, sometimes it can be reinforced by place-specific factors, particularly as economic histories lead to differences in the levels and qualities of 'assets' across places. The durability of physical structures means that the history of government investment can have a significant impact on business and worker location decisions. In addition, the legacy of economic history on the physical environment could mean that market failures which led to too little private investment in public spaces are bigger in areas with a history of under-investment. They particularly suffer from problems of negative perception and co-ordination failures – as the lack of existing firm activity can limit the expected return on investment for the first mover to that area.

The importance of economic history means that places are on different paths and may need different policies to transform their economies in response to a changing economic environment. The English coalfields have presented one of the most significant regeneration challenges facing the country over the last two decades (Communities and Local Government 2007b). Some 170,000 people lost their jobs in coal mining between 1984 and 1997 – representing one quarter of total male employment in the coalfield areas as a whole.

This major structural shock disrupted and, at worst, destroyed traditional and dominant working patterns without, in many cases, there being alternative sources of demand for labour (because of accessibility, peripherality, and / or dereliction / contamination problems). Also, the labour force was ill prepared or not able to search for new jobs with very different skill requirements. These causal factors were reflected in the following wide range of problems (of more severity in some areas than others): poor education and skills attainment levels; low levels of entrepreneurship; out migration; high proportions of economic inactivity (especially long-term sickness); and increasingly localised deprivation, poor health, and high crime rates.

Secondly, government policies can have unintended spatial impacts, such as unintended differences in the quality of public services across places or challenges in flexing service delivery to meet the different needs of sub-regions, localities and neighbourhoods. For example, if public sector wages do not show the same regional variation as private sector wages it can present the public sector with recruitment and retention difficulties which can impact on the quality of service (Hall 2008). This could also cause crowding out in areas where the public sector is seen as a more attractive employer.

Thirdly, even if there is not an explicit market or government failure, there may be spatial outcomes that are undesirable for equity reasons. For example, the physical and natural environment is a key 'place-specific' factor which impacts on peoples lives. Paper 1 highlighted how environmental 'bads' are often spatially concentrated, while

environmental ‘goods’ tend to be regressively distributed; households living in the 10 per cent most deprived areas are over four times more likely to live in poor quality environments than those living in the 10 per cent least deprived areas (ODPM 2003). Poor quality environments can: directly impact on individuals health and quality of life; and there is also some evidence that this can impact on outcomes like mental health and crime perceptions².

Limits to peoples’ ability to move and commute

The third reason that place matters is simply that not everyone can move to maximise their utility; if all people were perfectly mobile, then they would simply move to places that optimise their welfare. Welfare will be dependent on the level of income an individual can earn as well as the wider benefits the individual derives from where they live eg social networks, leisure facilities, local environmental quality and level and quality of public services. Individuals will value different aspects of where they could live differently, which influences their decision of where to locate.

But we know there are limits to mobility and not everyone can be where they want to be all the time; financial and social costs of moving and informational failures act as drag on mobility. Empirical evidence suggests that, on average, people do move in response to wage differentials but people are not very mobile across regions (see left map in Figure 4). Each year about 10-11 per cent of the English population move house, but only about 1 per cent move to a different region; job related movements only constitutes about 12 per cent, whereas a large proportion of moves are related to housing or area characteristics (Dixon, 2003).

The low skilled in particular are less likely to migrate and they commute smaller distances to job opportunities (see right map in Figure 4). One reason why migration rates are lower among the low skilled is that low skilled wages show less spatial variation than wage rates for higher skilled occupations and hence the expected returns to migration tend to be lower. The same argument applies more strongly in the case of those who are inactive and receiving pensions or benefit incomes. Furthermore, it is possible that for a given expected income differential between two locations, the difference in house prices and/or the non-monetary costs to the individual of relocating are such that the expected return to moving is zero or negative.

In addition, while in theory unemployed workers should move to where jobs are available, the unemployed are only slightly more likely to migrate than the employed (HM Treasury, 2001).

² For example, unfit housing, overcrowding, and poor conditions are associated with poor health, an increased risk of disease, and can also have a very direct impact on mental health (see Platt et al. (1989), Martin et al. (1986), and Gabe and Williams (1993)). Evidence from the Neighbourhood Management Pathfinder Programme (Communities and Local Government 2007c) also suggests that improvements in the physical environment are linked with improved local perceptions of crime levels.

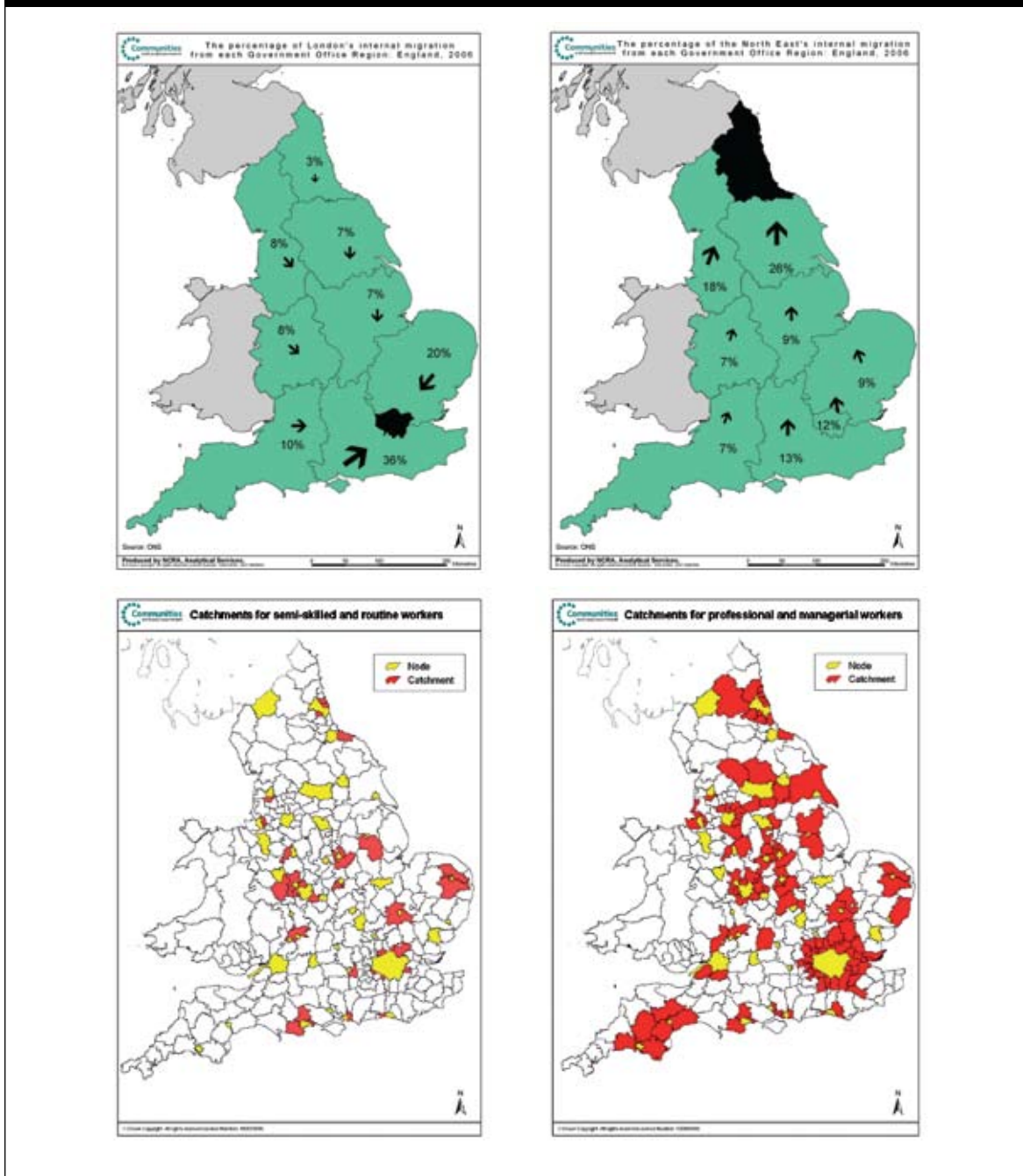
There may be market failures which limit mobility, and some government policies may unintentionally restrict mobility. For example, planning policies that restrict the supply of residential houses or the rationing system within social housing which makes it very hard to move home, but particularly between regions (Hills 2007).

As the movement of people is a key mechanism for the equalisation of welfare across places, this suggests there are significant limits to spatial adjustment in response to the changing economic fortunes of places. This reality opens up two broad types of policy responses:

- From an efficiency perspective, the answer lies in helping people become more mobile to enable them to access different opportunities, which in turn enables firms to realise agglomeration benefits by attracting individuals with the specific skill sets required. However, it must also be recognised that geographical mobility is complex: it can have social costs, like the erosion of social networks or communities and peoples identification with places; while the efficiency gains from mobility could be offset by reduced productivity and earning potential from the low-skilled who are left behind, as there may be positive externalities between the skilled and unskilled.
- From an equity perspective, there is a risk of some people becoming 'trapped' in declining places – especially the inactive or low skilled, those who have invested in location-specific skills or those who own geographically fixed assets. Spatial economic adjustment can be slow and traumatic for these groups; therefore constraints on mobility provide an equity justification for investing in places. However, there is a risk that trying to protect places from economic change may simply delay – and increase the cost of – adjustment. Any policy response on equity grounds will need to balance managing the social costs of economic decline with the need to encourage flexibility to changing economic circumstances.

There is a clear tension between these two policy responses as policies that increase mobility: may increase the mobility of high skilled individuals; which could further reduce the productivity and earning potential of the low-skilled who are left behind; increasing the need to respond on equity grounds.

Figure 4 – Migration and commuting flows



Place enables targeting

The fourth reason that place matters is its importance in policy delivery. As vulnerable groups have become concentrated in particular places, place can enable the efficient targeting and tailoring of policies to those groups (see Figure 5). For example, the Department for Work and Pension's Cities Consortium policy reflects recognition of the worklessness problems in cities and enables local partners to design, develop and deliver local initiatives.

Figure 5 – Concentration of deprivation in Church Street Ward, Westminster**IB Claimants**

The map shows the number of IB claimants by postcode.

Number of IB claimants



In addition, policies also come together in places, so there is a need to join up and coordinate delivery of different policies in particular places. For example, the area-based initiative of Housing Market Renewal provides an example of co-ordinating different policies in one place (eg housing, planning and regeneration). The Housing Market Renewal pathfinder program is focused on physical improvements to housing (including demolition and new build) and this is reflected in the high proportion of capital in pathfinder spending. It is therefore essential that the pathfinders (which comprise of local authorities) ensure that their activities fit with the economic development strategy of the surrounding area and region, as well as with regional housing strategies. Initial evidence from the on-going Housing Market Renewal pathfinder program evaluation suggests that progress is being made towards a stronger alignment of policy at the regional, sub-regional, district and neighbourhood level, but in no case is this process complete. Integration is more advanced in some areas than in others, so for example, Elevate East Lancashire has proposed to bring all economic development and housing activity under the control of one City Development Company.

2.3 Implications for policy

The first implication for policy is that it cannot be assumed that all spatial disparities are inefficient or inequitable. Clarity about the rationale for spatial policies requires identification of the way in which place is impacting on outcomes. The four reasons for why place matters have been translated into a rationale for spatial policies in terms of the ‘three Es’: efficiency; equity; and the environment (see Table 1). As with all government policies, providing a rationale is not sufficient on its own to justify policies; all policies have to go through a Regulatory Impact Assessment (BERR 2007) where the costs and benefits of the proposal are properly considered. Paper 1 (Communities and Local Government 2007a) provides more explanation of the rationale for spatial policies, but in summary:

- From an **efficiency perspective, justifying a focus on spatial disparities depends upon identifying spatial market and government failures**. If spatial disparities at least partly reflect market and government failures they represent a drag on economic performance and welfare. However, it cannot be assumed that all spatial market and government failures are reinforcing spatial disparities – some may actually be undermining efficient agglomeration. While policies could focus on those market and government failures which have led to undue concentration of economic activity, this would mean forsaking opportunities to enhance overall economic performance and standards of living. Instead, by focusing on market and government failures and enhancing understanding of their impact on people and place dimensions, government can help places achieve their potential.
- From an **equity perspective, focusing on disparities between people in specific places depends on identifying ways in which people and place factors interact to impact on life chances**. This is particularly important if there are constraints on mobility. Economic restructuring within the economy often means those who are low-skilled, immobile or own fixed assets, are unable to take advantage of better economic opportunities elsewhere.
- There are also **environmental market failures**. Spatial interventions may be justified if there are environmental implications of spatial disparities or market failures in the development and use of place-specific environmental assets.

Table 1 – Reconciling the four reasons why place matters with the ‘three Es’

Table 1 – Reconciling the four reasons why place matters with the ‘three Es’				
	Drivers of productivity come together in places	Place impacts on economic and social outcomes	Limits to mobility	Targeting of concentrated groups
Efficiency	Focusing on market and government failures can help places achieve their potential.	Market and government failures can interact with place-specific factors to create intensive deprivation.	Market and government failures may limit mobility, while the financial and social costs of mobility mean there will always be limits to spatial adjustment.	The concentration of vulnerable groups enables the more efficient targeting and tailoring of resources and effectiveness can be enhanced by co-ordinating policies in particular places.
Equity	Enhancing the understanding of the people and place dimensions to economic and social outcomes will help achieve equality of opportunity.	People and place factors can interact to drive inequitable economic and social outcomes.	Some people will always be left behind – particularly the low skilled, immobile and those who have geographically fixed assets. These groups particularly suffer from differences in economic opportunities between places.	Place can be used as a mechanism for helping to reach the most vulnerable groups.
Environment	Environmental assets can play an important role as a driver of productivity of places.	There may be environmental implications of spatial disparities while there may be market failures or equity issues in the development and use of place-specific environmental assets	The spatial distribution of environmental goods and services means that there are accessibility issues.	The concentration of deprived persons and environmental problems often go hand in hand – suggesting a particular focus on places.

The second implication is that identifying the ways in which market failures and government policies impact differently in different places, **may provide a rationale for tailoring policies to particular places and helps to identify the right spatial level at which to intervene.** If a market failure or government policy impacts in a similar way across the country then it makes sense to deal with them on a national scale. But if a market

failure is specific to a region or locality, or impacts differently across places, then there are benefits in enabling a local solution. Identifying the appropriate level of intervention, and role of different government levels, is explored further in section three.

The third implication is that the **increasing importance of place for economic, social and environmental outcomes highlights the need for a department which builds and disseminates an understanding of the importance of place and encourages spatially sensitive policies**. There are five broad roles:

- **Analytical leadership** leading the analytical debate to understand the role of place and the benefits of spatially sensitive policies – this will be informed by the Economic and Social Research Council (ESRC) Centre for Spatial Economic Research which Communities and Local Government are co-funding with BERR and the Welsh Assembly Government. As an example, in line with the recommendations of the SNR (HMT et al, 2007), Communities and Local Government is developing a ‘regeneration framework’ which seeks to provide guidance in developing regeneration strategies and appraising regeneration initiatives.
- **Policy leadership** raising awareness of the impacts of place and ensuring that Other government departments recognise the spatial impacts of their policies. This includes providing support to those agencies with delivery responsibility for spatial policies, such as Government Offices, Regional Development Agencies, local government and other partners; as well as investing in capacity building to strengthen local, city and regional leadership.
- **Co-ordination** of the way policies come together in particular places by co-ordinating Communities and Local Government’s policies, Other government department’s policies and between different levels of government.
- **Spatial policy** setting the national strategy and delivery framework for those policy functions with clear spatial implications and objectives (housing, planning, neighbourhood renewal, regeneration); and financial policies with spatial (re) distribution objectives, (such as the LG Finance system).
- **Promoting decentralisation across government.** The Local Government White Paper (Communities and Local Government, 2006) emphasised the importance of changing the way we work to: give citizens and communities a bigger say; to enable local partners to respond more flexibly to local needs; and to reduce the amount of top-down control from central government. The SNR (HMT et al 2007) also highlighted the Government’s commitment to devolving powers and emphasised the need for local government to take a greater role in economic development and neighbourhood renewal.

Section 3

Levels of intervention – an economic approach

Chapter Summary

The importance of place highlights the benefits of targeting policies at the right spatial level. This chapter identifies four key principles which help to demonstrate the relative strengths and limitations of different government levels:

- **Enabling local solutions**, or the tailoring of economic policies to reflect the different economic challenges facing different places. However, decentralising economic policies will only bring benefits if the residents of places have different preferences or if places face different challenges.
- **Ensuring that costs and benefits are considered across functional economic areas**. This is the areas' economic footprint (HMT 2006) – the area over which key economic markets operate, such as labour markets as measured by travel to work areas, housing markets and retail markets. A limit to decentralisation is the risk that lower levels of government may not consider: significant policy impacts on other jurisdictions, leading to policies which are not in the national interest; or policy opportunities that could make all places better off.
- **Exploiting economics of scale and scope**. Higher levels of government may enjoy cost savings from delivering large volumes of public goods and services or have better access to specialised staff or knowledge of best practice (economics of scale). While different levels of government may realise cost savings by expanding the number of activities where combining the activities reduces the overall cost (economics of scope).
- **Enabling effective co-ordination** reflects the need for co-ordination between policies to maximise their impact. While for some policy areas the need for co-ordination will drive centralisation, in other cases lower levels of government may be better placed to provide integrated solutions to the ways in which problems come together in particular places.

However, it is not possible to develop a definitive list of which level of government should do what, as different levels of government have different advantages and disadvantages which must be balanced against each other in drawing conclusions about the appropriate level of intervention for specific policies.

3.1 Levels of intervention principles

Section 2 argued that one of the implications of spatial market and government failures was that there are benefits from enabling the tailoring of policy to reflect the different opportunities and challenges facing different places. These potential benefits support an important role for sub-national levels of government in economic policy, as they will often be better placed to understand and address the problems of their area.

It is complex as market failures or policy interventions often impact at different levels, and different levels of government have different advantages and disadvantages which must be balanced against each other in drawing conclusions about the appropriate level of intervention. For most policy areas, interventions are needed at more than one level and the issue will be how to allocate responsibilities across government levels to maximise the impact on the delivery of policy objectives.

This section identifies four key principles which help to illuminate the relative strengths and limitations of government levels, which have been drawn from the fiscal federalism literature, which is discussed further in section 3.2. These principles have been used in the context of the SNR (HMT et al, 2007) to explore the appropriate allocation of responsibilities for six economic policy areas– Planning, Transport, Business Support, Skills, Employment and Neighbourhood Renewal and Regeneration – which are summarised in the next chapter. The four broad principles are:

- Enabling local solutions
- Ensuring that costs and benefits are considered across economic areas
- Exploiting economics of scale and scope; and
- Enabling effective co-ordination.

The following sections explore these principles and how they can be applied to analysing the appropriate level of intervention for economic policies. However, the application of these principles will not provide a silver bullet. Applying the principles to policy areas requires judgement and trade-offs to be made between the different advantages and disadvantages of different levels of government, in the context of economic and social conditions, as well as the capacity and capabilities of policy makers at each level and their lines of accountability. But the identification of these principles does help in ensuring the right questions are being asked and enables a consistent approach to be taken in considering the allocation of responsibility across policy areas (see Box 2 for a definition of levels of government).

Box 2: Levels of government

In the UK there are formal government structures at the national, regional and local levels. However, some policy areas and/or functions may sometimes fit between these formal government levels. While not formal structures, other spatial levels can also take a role in policy-making through:

- Co-ordination between jurisdictions; for example increasingly local authorities have been co-ordinating to develop economic strategies at the city-region level and pan-regional economic strategies. This is explored further in Box 3.
- Engagement mechanisms; for example local authorities can enable wards or neighbourhoods greater involvement in policy development or delivery. One example is the devolving of the local authority landlord function to 'Tenant Management Organisations' (TMOs) or the devolving of decision making on small budgets to residents groups to 'control' environmental improvements, such as street lighting.

3.2 Enabling local solutions

The Local Government White Paper (Communities and Local Government, 2006) emphasised the importance of changing the way we work to: give citizens and communities a bigger say; to enable local partners to respond more flexibly to local needs; and to reduce the amount of top-down control from central government. The SNR (HMT et al, 2007) also highlighted the Government's commitment to devolving powers and emphasised the need for local government to take a greater role in economic development and neighbourhood renewal.

While in theory central government may also be able to provide differentiated services across places³, sub-national governments may be better equipped to tailor services. The rationale for such decentralisation or devolving of decision-making is typically driven by the hope that regional and local governments, being closer to the people, will be more responsive to the preferences of their constituencies and will be able to find new and better ways to provide services (Oates, 1999). In particular, they are likely to be better able to tailor public goods and services to reflect differences in preferences or circumstances across places. This is because they may have better information on local preferences and needs (Oates, 1999 and Sharpe, 1970).

³ Note that decentralisation of economic responsibility is only one approach to ensuring that spatial economic differences are captured. For example, it may be possible for nationally designed and delivered policies to take account of local differences eg while the UK has a national competition framework, spatial differences and the geographical reach of markets are taken into account when analysing competition complaints or merger requests. A significant role for sub-national governments in economic policy is appropriate if they have better information or incentives to designed spatially targeted policies.

Devolving functions to lower levels of government may also bring other benefits:

- It may provide opportunities for innovative policy solutions to be tried and tested. But it should be noted that decentralisation may not necessarily increase innovation – places may hope to ‘free-ride’ by learning from the experiences of others rather than taking risks themselves (Oates, 1999).
- As well as more tailored public goods and services, there may be wider political benefits from devolving policy decision-making – the greater scope for impact may encourage greater political participation and community engagement, which may be seen as a benefit in itself (Oates, 1999). The Government’s Devolving Decision-Making series (HMT et al 2004a & 2004b) also sees greater local autonomy as linked with greater local democratic oversight. HMT et al (2004a & 2004b) suggests that accountability could be enhanced with local and national performance indicators published and tracked, and – as pioneered in New York – the local community expecting their local managers to continuously monitor and learn from their performance. However, it is possible that decentralisation can just empower different types of interest groups which find it easier to organise political activity at the local level (Cremer, 1996).

While the spatial tailoring of public services and policies will bring welfare benefits, the magnitude of gains will depend upon the extent to which preferences and circumstances really do differ across jurisdictions.

In his famous model, Tiebout (1956) suggests areas should be enabled to provide differentiated packages of services and taxes/charges so that mobile households (and firms) “vote with their feet” and choose the jurisdiction that provides the fiscal package best suited to their tastes.

In some services, such as health and education, there may be concern about (excessive) variation in service standards between areas, eg because of fears that an unfair ‘post-code lottery’ will then drive the quality of service users receive. This may then require national government to set minimum service standards for the major public services. However, beyond these minima, there may still be a case for devolving some aspects of implementation to lower government levels (Prime Minister’s Strategy Unit, 2006).

In the same vein, decentralising economic policies will only bring benefits if places do face different economic conditions and challenges. More specifically, if market failures and government failures interact with place-based factors to impact differently across places, then there may be benefits from tailored regional or local solutions.

If a market failure has an international dimension where UK level representation or co-ordination is needed, then it makes sense to deal with them on a national scale. For example, competition and mergers that have a national dimension need to be dealt

with under national competition law – different competition rules in different localities would raise business costs and depress productivity as firms have to negotiate a variety of competition regimes. Similar arguments apply to other national legal frameworks, such as company law, employment legislation and health and safety and for national infrastructure such as airports

However, as we have seen, place does matter; market and government failures may interact with place-specific factors to impact differently across places (see section 2.2 for examples). If a market failure is specific to a region or locality, or impacts differently across places, then it is likely to be appropriate to address it at a lower spatial level.

In identifying spatial market and government failures it is important to distinguish between where the consequences of a market failure may manifest themselves, with where the cause of the problem is. For example, in some cases, the underlying problems or market failures that lead to concentrations of deprivation may actually operate at higher spatial levels. The existence of concentrated pockets of worklessness within economically successful cities may reflect the ‘sorting effect’ of the housing market resulting in the most vulnerable living in lower cost areas (see section 2.1). While individuals living in those areas may face significant constraints on the distance over which they can commute (see section 2.2), they are still operating within a wider spatial labour market where jobs within their area attract competition from contenders from outside the area. This highlights that tackling neighbourhood deprivation requires recognising the connections between neighbourhoods and a wider economy and understanding the factors that constrain people in disadvantaged areas from taking advantage of opportunities in the wider labour market (Communities and Local Government 2008).

However, even if the spatial level at which market failures are generated suggests policy development occurs at a relatively higher spatial scale, it may still be appropriate for policy implementation to be undertaken at lower spatial levels to enable more individualised service within strategic frameworks. This may enable efficient targeting of delivery, reflecting the spatial concentration of “client groups” in particular places and help to target people that may be beyond the reach of national policies. It may also help in co-ordinating the way policies “come together” in particular places (see section 3.5).

3.3 Ensuring that costs and benefits are considered across economic areas

An important constraint to devolving policy-making and implementation downwards is the need to ensure the significant benefits and costs of a policy are taken into account in decision-making. As lower levels of government may not take into account the impacts of its policies on other jurisdictions (spatial spillovers), it will tend to under-invest in the public good when there are benefits for other jurisdictions, and over-invest if there are costs

imposed on another jurisdiction (Oates, 1999). While it will never be possible to totally eliminate such spillovers, the allocation of policy responsibilities should be at a high enough spatial level to avoid significant spillovers or substantial impacts on other jurisdictions (McGregor and Swales, 2005).

The spatial spillover principle is particularly important for economic policies as they often impact over a wide geographical area. The dispersed impacts of economic policies suggest that decentralising policy responsibilities for them could cause significant spatial spillovers. This may lead to:

- **Policies that are in the interests of that place, but are not necessarily in the wider regional or national interest.** In particular, sub-national governments may have an incentive to develop policies that bring benefits to them at the expense of other places. Cheshire and Gordon (1998) warn that local policies designed to influence the location of mobile investment are likely to be wasteful. By focusing on relocations, it favours measures which are purely redistributive between areas, rather than adding to productive capacity, particularly where those policies would have benefits beyond the local area. Appraisal guidance highlights the issue of additionality and displacement when considering the net impact of government intervention (ODPM 2004 and English Partnerships 2004). For example, the competition for businesses in the US has resulted in large public subsidies to the private sector and local officials presenting escalating counter-offers to attract business investment from other localities (Federal Reserve Bank of Minneapolis, 1994)
- **The loss of policy opportunities that could make all places better off.** For example, many transport policies will impact across jurisdictions, creating the risk that too much decentralisation would create co-ordination challenges in developing and implementing transport schemes that might have positive benefits for the wider sub-region or region. In a similar vein, while enabling housing supply is critical to improving affordability, these benefits are widespread, while the costs are often concentrated. Achieving these affordability benefits may depend upon co-ordination at a higher spatial level.

If a policy impacts across a wide geographical area, the costs of spatial spillovers may offset any benefits from more tailored regional or local solutions. The challenge lies in striking the right balance between enabling the development of strategies that are specific enough to provide relevant solutions for a given place, but that are also coherent with national objectives (OECD, 2005). For many economic policies, this balance may lie at the **level at which the relevant economic market operates**, whether national, regional or sub-regional level, as this will minimise spatial spillovers (see Box 3).

Box 3: Sub-regional co-ordination

While it often makes sense for economic policies to be developed at the level at which the relevant economic market operates, there are a number of practical challenges. Most fundamentally, economic boundaries or markets will not always be well aligned with the current administrative structure. In particular, while uniform national or regional policies may not be sufficiently flexible to reflect intra-regional differences, many local authorities are ‘under-bounded’ in the sense that they cover too small a geographical area to encompass most economic markets and so are too small to effectively tackle many economic challenges.

Therefore, co-operation between local authorities across the wider area in which key economic markets operates increases the economic role they can play and enhances the scope to grasp the benefits of decentralisation. Empirical analysis by Cheshire and Magrini (2005) has highlighted that enhancing co-ordination across the city or sub-region can enhance economic performance. This evidence has underpinned the development of co-operative mechanisms to enable sub-regional working.

For example, much is already happening to encourage co-operation on planning across functional areas, with a number of local authorities already collaborating, particularly on housing, at this level. Last autumn the Secretary of State announced the 13 areas that are working towards a Multi Area Agreement – a number will sign agreements in June and a number of other sub-regions have come forward to discuss entering into an MAA in subsequent years – where funding will be devolved to a sub-regional level in return for partner local authorities meeting targets.

3.4 Exploiting economics of scale and scope

Another limit to decentralisation comes from economics of scale and scope:

- **Economics of scale** can occur when there is a reduction in average costs as the scale of output is increased. National government can enjoy lower average costs from delivering large volumes of public goods and services. Where economics of scale are significant, we have to balance the benefits of decentralising against the cost of doing so through the loss of those economics of scale (Cremer et al, 1996; McGregor and Swales, 2005 and Arzaghi and Henderson, 2002). There may be economics of scale in the delivery of large infrastructure projects or in economic development policies with large upfront costs. Policy development at a higher spatial level can also allow the profile of a particular policy or programme to be raised.

- **Economics of scope** can occur when different levels of government can realise cost savings by expanding the number of activities where combining the activities reduces the overall cost. This combination of staff and information may enable higher levels of government to undertake higher quality policy analysis and development (Cremer et al, 1996 and Anton, 1997). In some policy areas, there may also be significant risks that separate policies in each region or locality would create confusion or distort decision-making. Economics of scope can occur in information collection. While local officials will often have a much better understanding of local conditions, they may not match that with good understanding of the wider national framework and best practices.

However, some of these benefits from economics of scale and scope may be possible to exploit without full centralisation, through splitting the allocation of functions within a policy area across levels of government. For example, the new Homes and Communities Agency may enjoy economics of scale and scope in procurement or in developing strategies for leveraging in private sector finance. However, the aim is for it to work closely with RDAs and local authorities in agreeing the regeneration strategy for regions and areas/sub-regions which will additionally allow it to pass these lessons onto key delivery partners.

3.5 Enabling effective co-ordination

Tackling many policy problems will require co-ordination across a number of policies. Policy coherence may be hard to achieve when decisions are taken at different spatial levels, creating a need for policies to be ‘joined-up’ across government levels. However, local government can also be prone to ‘silo’ public services, highlighting the importance of partnership working at the local level. This highlights the importance of identifying synergies, or co-ordination issues, within and between policy areas in identifying the most appropriate level of intervention for a particular policy or set of policies. However, the most appropriate level of government will depend on the level at which these synergies impact.

However, despite these co-ordination needs, the design and implementation of economic development strategies must take place at all spatial levels, as no geographical area, let alone any institutional arrangements, can possibly fully capture the complex economic patterns. This highlights the importance of flexibility and co-operation to ensure economic strategies for different levels complement each other. This is true with respect to both vertical linkages (between lower and higher levels of government) and horizontal linkages (between agencies or levels of government at the same spatial scale). Given the complexity of multi-level governance mechanisms, it is important to identify organisational or institutional mechanisms which promote co-ordination within and between policy areas (OECD, 2005).

The SNR (HMT et al, 2007) highlighted the importance of greater clarity in objectives to enable more effective co-ordination and prevent duplication of activity. For example, it recognised the need for better alignment of local authority objectives and targets for neighbourhood renewal with those for central government delivery agencies to enable the co-ordination of interventions and strategies.

3.6 Implications for policy development and implementation

The principles, and the approach to applying them to economic policies, are summarised in Table 2. This recognises that responsibility for policy will often be split across government levels. While the distribution of responsibility across government levels will be more sophisticated than this simple distinction between policy development and delivery, it is an initial simplification to identify the level of government that will take the lead or the largest role in these broad dimensions of the policy process, after which the scope for further divisions of responsibilities can be explored.

Table 2 – Principles for policy development – economic policies

Principles	Possible implication	Example
<p>Enabling local solutions:</p> <p>Do market failures interact with place-specific factors or do government policies have unintended spatial impacts?</p> <p>Are there differences in the spatial impact of market or government failures which could be responded to by flexible policy implementation?</p>	<p>If market or government failures interact with place-specific factors to impact differently in different places, then there are potential benefits from decentralisation which enables the development of place-specific economic policies.</p> <p>Sometimes the impacts of market and government failures may be concentrated in particular places, even if they are caused at higher spatial scales. Therefore, there may be benefits in decentralising policy implementation to reach specific groups or for some flexibility in the implementation of policies to deal with the specific challenges facing different places.</p>	<p>For example, the legacy of economic history on the physical environment could mean that market failures which led to too little private investment in public spaces are different in nature across places and are bigger in areas with a history of under-investment.</p>

Table 2 – Principles for policy development – economic policies (*continued*)

Principles	Possible implication	Example
<p>Ensuring that costs and benefits are considered across economic areas:</p> <p>Does the economic policy have wide geographical impacts so that there is likely to be significant ‘spatial spillovers’ at the national/regional/sub-regional/local/neighbourhood level?</p>	<p>The greater the alignment between the policy-making area and the relevant economic market, the more likely that economic policies will support national, as well as sub-national, economic performance.</p> <p>There is a risk that even some flexibility in implementation will lead to decisions that impact on other jurisdictions – this risk must be balanced against any benefits from operational independence.</p>	<p>For example, as people commute over administrative boundaries and move to other places, individual local authorities will not capture all of the benefit of any investment they make in skills. This may lead a local authorities to under-invest in skills or invest in the wrong types of skills.</p>
<p>Economics of scale and scope:</p> <p>Is there a need for specialised knowledge in policy design?</p> <p>Is it cost-effective to deliver services at national, regional, local or neighbourhood level?</p>	<p>National government may have better access to specialised staff and centralisation may avoid the duplication of these resources.</p> <p>If there are significant economics of scale in the implementation of economic policies, there may be a case for all or some of policy implementation to be managed at a higher spatial government level. While if there are significant economics of scope in the implementation of economic policies there may be a case for all or some of policy implementation to be managed at a lower spatial government level.</p>	<p>For example, in many areas of business support, such as support for innovation, mobile investment, access to finance and trade development, a significant body of specialist skills is required to develop and implement policy and replicating this expertise would be very inefficient.</p> <p>In addition, a higher proportion of the available resources are used in the fixed cost of delivery for smaller programmes.</p>
<p>Are there synergies or co-ordination challenges within the policy area or with other policies at each spatial level?</p>	<p>Given that economic policies will need to be spilt across government levels, it is important to identify mechanisms to enable vertical and horizontal co-ordination</p>	<p>The need to integrate skills and employment policies is an example – to provide links between moving into work and ongoing skill investment to help job retention and progression.</p>

Section 4

Applying the levels of intervention principles

Chapter Summary

Building on the work of the Devolved Decision Making review (HMT 2006, 2004), the levels of intervention principles, outlined in Chapter 3, were applied to six economic policy areas in the context of the Sub-National Review of Economic Development and Regeneration. The chapter summarises the broad lessons from this analysis, as well as providing summaries of the application of the principles:

While there is **scope for greater decentralisation** of economic policies, this would be enhanced by **local authority co-operation across functional economic areas**. It is also important to distinguish between the spatial level at which a problem manifest and where it is ultimately caused. In addition, the **regional and national levels remain important** for many policies and in some policy areas responsibility may need to move up. However, even when there are limits to decentralisation of policy development, there can be benefits in enabling some **local flexibility in implementation** to provide integrated and tailored solutions to the ways in which problems interact at local and neighbourhood levels.

- **Planning.** The levels of intervention analysis chimes closely with the Barker Review (2006) which has highlighted the benefits of a clearer national framework for strategic infrastructure, as well as co-ordination across functional economic areas.
- **Transport.** In line with the recommendations of the Eddington Review (2006), the levels of intervention analysis suggests a need for better alignment of powers and funding, and a better match between decision-makers' administrative boundaries and economic activity.
- **Employment.** While employment outcomes differ significantly across places, more analysis is needed to draw conclusions about the scope for greater decentralisation of employment polices. However, there is scope for greater local flexibility in delivery of services.

- **Skills.** The analysis points to a continued important national and regional role in setting broad curriculum and standards as a framework within which sub-regional or local governments could tailor policy implementation.
- **Business support.** The significance of economics of scale for innovation and finance policies, and of spatial spillovers for mobile investment and trade development policy, means that there are no strong drivers for further decentralisation of business support.
- **Neighbourhood Regeneration and Renewal.** The initial analysis has highlighted the need to better integrate neighbourhood renewal with wider economic strategies, as well as the benefits of enabling flexibility in the implementation of worklessness policies to provide integrated local solutions.

4.1 Introduction

Chapter 3 outlined a series of principles for identifying the appropriate allocation of responsibility for economic development at the sub-national level which were developed to help inform policy formation. These principles were used to inform the thinking behind the SNR (HMT et al, 2007) – as part of this, Communities and Local Government worked with different government departments and independent reviews (such as Barker (2006) and Eddington (2006)) to provide an early application of the principles to six economic policy areas: planning, transport, skills, employment, business support and neighbourhood renewal. External experts were commissioned to review this initial work and a workshop was held on each of the policy areas, with a joint skills and employment workshop.

This chapter provides an overview of this analysis and the summary examples of the application of the framework to the policy areas, drawing on the department’s analysis, comments by the external experts and cross-cutting analysis undertaken with Other Government Departments. However, given the broad scope of this issue, the summaries do not outline the precise role of each government level but instead focus on areas where there was scope for reform.

4.2 Broad themes

This section explores some broad themes that emerge from considering the allocation of economic responsibilities in the English context.

There is scope for greater decentralisation of economic policies...

The diverse economic performance of places, from the regional to the neighbourhood level, highlights the potential benefits from enabling the tailoring of economic policy and its delivery to reflect regional and local opportunities, challenges and preferences.

These spatial disparities do not necessarily reflect market failures. An individual's economic prospects are largely determined more by their personal characteristics than by the place that they live while much of the disparities between places can be explained by compositional differences in the mix of people and businesses across places, differences in the cost of living and non-market factors between places (see section 2.1).

But place does matter. Market failures often do interact with place-specific factors to have diverse spatial impacts. One example is the costs of congestion which varies significantly across cities and regions. At lower spatial levels, while personal characteristics are more important than place for skills and employment outcomes, place-based factors may play a role through neighbourhood effects, productivity spillovers and intergenerational effects. In addition, most, if not all, government policies will have profound, and often unintended, spatial impacts.

Even when spatial disparities are compositional, these differences in themselves can stimulate a divergence in the scale of economic challenges and may warrant tailored economic policies. In reality, many policy challenges will incorporate both people and place dimensions, with compositional and place-specific factors interacting to drive the diversity in the economic performance of places.

These issues highlight the need to consider how to tailor policies to take account of the characteristics of particular areas; the Local Government White Paper (Communities and Local Government, 2006) sets out proposals to provide freedom and space for councils to respond with flexibility to local needs and demands. In recognition of this, the Government has taken a number of steps to decentralise economic responsibilities and the SNR (HMT et al, 2007) recommended empowering local authorities to take a greater role in promoting economic development and regeneration. It is emphasised that the Government expects RDAs to delegate responsibility to local authorities or sub-regions wherever possible, unless there is a clear case for retaining spending at the regional level. However, national government still retains significant power through funding and control of the public institutions involved in economic development and the SNR (HMT et al, 2007) recommended strengthening the role of regional and local authorities in economic development.

...and there is greater scope if policies are co-ordinated across functional economic areas...

However, most people and economic flows overlap local authority boundaries and most economic policies will impact over a greater area than the local authority. While uniform national or regional policies may not be sufficiently flexible to reflect intra-regional differences, many local authorities are 'under-bounded' in the sense that they cover too small a geographical area to encompass most economic markets (such as labour, product and housing markets) and so are too small to effectively tackle many economic challenges.

This gap between administrative and economic boundaries inhibits strategic decision-making and creates co-ordination challenges for economic policy-making, risking policies that are not in the wider regional or national interest or the loss of policy opportunities that could make all places better off.

Therefore, co-operation between local authorities across the wider area in which key economic markets operates increases the economic role they can play and enhances the scope to grasp the benefits of decentralisation. In recognition of these issues, the SNR (HMT et al, 2007) emphasised the importance of supporting local authorities to work together at the sub-regional level. In particular, the Government will:

- Allow sub-regions to strengthen sub-regional management of transport – including the possibility of giving greater long-term certainty of funding for transport where suitable governance arrangements exist as part of the Local Transport Bill.
- Develop Multi-Area Agreements (MAAs) to allow groups of local authorities to agree collective targets for economic development issues. Last autumn the Secretary the Secretary of State announced the 13 areas that are working towards an MAA. A number will sign agreements in June. In addition a number of other sub-regions have come forward to discuss entering into an MAA in subsequent years. The overwhelming focus of those sub-regions coming forward has been on driving economic prosperity through coordinated activity on worklessness and skills, transport and housing.
- Work with interested sub-regions to explore the potential to allow groups of local authorities to establish statutory sub-regional arrangements which enable pooling of responsibilities on a permanent basis for economic development policy areas beyond transport.

...but with the regional and national role remaining important

However, the reality that many economic policies impact over a wide geographical scale implies a continued important role for regional and national agencies in setting policy frameworks and standards. The ability of higher levels of government to consider these wider impacts and co-ordinate policies over a wider area, combined with economics of scale and scope in some policy areas, means that a number of policy functions are best undertaken at the regional or national level. For example, decisions on strategic infrastructure, which will be located in a particular locality but will benefit a much wider area, need to be made at higher levels of government. The SNR (HMT et al 2007) also highlighted that diversification in business support schemes across places may create confusion and extra costs for businesses which operate across local authority boundaries.

The best level to tackle a problem is not always the spatial level at which it manifests...

Furthermore, the best level to tackle a problem is not always the spatial level at which it manifests. In some cases, the underlying problems or market failures that lead to concentrations of deprivation in particular neighbourhoods, may actually operate at higher spatial scales. For example, the existence of concentrated pockets of worklessness within economically successful cities may reflect the 'sorting effect' of the housing market resulting in the most vulnerable living in lower-cost areas. While individuals living in those areas may face significant constraints on the distance over which they can commute, they are still operating within a wider spatial labour market where jobs within their area attract competition from contenders from outside the area. As recognised by the SNR (HMT et al 2007), this highlights that tackling neighbourhood deprivation requires recognising the connections between neighbourhoods and a wider economy and understanding the factors that constrain people in disadvantaged areas from taking advantage of opportunities in the wider labour market.

...but flexibility in the delivery of policies can support integrated solutions

However, while the causes of deprivation may not be essentially spatial, or may be generated at higher spatial levels, problems do come together in different ways at very local levels to reinforce and perpetuate disadvantage. Once concentrated in particular neighbourhoods, deprivation may be reinforced through neighbourhood and area-based effects. While there is mixed evidence of such effects per se, the interactions between the different dimensions of deprivation, and with place-specific factors, do create varied and complex challenges across neighbourhoods.⁴ These interactions highlight that tackling problems of spatial deprivation requires a tailored and integrated response across policy areas. While such policies need to be integrated into regional or sub-regional strategies, there are benefits from local flexibility in taking an integrated approach to the different ways problems interact at the local and neighbourhood levels.

Bringing together policy functions at lower levels of government may facilitate integrated and place-specific policies. However, co-ordination across policies does not necessarily require policy functions to be located at the same level of government and may not always be feasible. In particular, responsibility for economic strategies, policies and delivery will always be split across government levels. This highlights the importance of clarity as to the role of different levels of government and effective mechanisms for vertical co-ordination between government levels. Horizontal co-ordination across jurisdictions and economic policy areas is also a continuing challenge. For example, the Leitch (2006) Review has highlighted the importance of better integration between skills and employment policies.

⁴ For example, an increased risk of disease and poor health is associated with unfit housing, overcrowding, and poor conditions in general (see Martin et al, 1986) and can also have a very direct impact on mental health (Gabe and Williams, 1993 and Platt, Martin and Hunt, 1990). Poor health can also be a factor in worklessness, while the causes and effects of crime are closely linked to the presence and prevalence of worklessness (for examples, see Carley et al, 2001 and Speak and Graham, 2000).

4.3 Planning

What are the implications of the levels of intervention principles?

The application of the levels of intervention principles to planning is summarised as the following key issues:

- **Benefits from spatially targeted policies.** The planning system aims to tackle a number of inter-related market failures and equity issues, which impact at a variety of spatial scales. A number of these have widespread impacts that can best be captured at the national level, such as large-scale environmental issues, the preservation of sites of particularly high natural or cultural importance, basic design and safety standards, and planning for large infrastructure projects. However, many of the negative externalities from housing and employment land developments, such as noise, disruption, loss of greenfield land, blight on the landscape, increased traffic and congestion, air pollution, etc, are largely realised at the sub-regional, local or neighbourhood level. There are benefits from enabling sub-national flexibility in managing these market failures as the impact and cost of these externalities is likely to vary between places, depending on the different supply and demand conditions in different localities. Greater local flexibility may enable more innovation in spatial strategies and avoid the miscalculation of costs and benefits at higher spatial levels which do not have access to local information and preferences.
- **Spatial spillovers.** However, there are significant limits to decentralisation to local authority level because planning decisions impact across local authority boundaries. While the costs of physical development tend to be highly localised and are significant for those that bear them, the benefits of new housing and employment land developments – such as an increased supply of workers, more job opportunities, access to new infrastructure, more affordable housing, and income generation – are likely to be spatially widespread. As a consequence, planning decisions taken at the local level are likely to have a greater focus on the costs than the benefits of physical development, so will tend to be biased in favour of those who lose from development (this is reinforced by local taxation equalisation arrangements which further weaken incentives for economic development). As we need policy decisions at a scale which includes both losers and beneficiaries of development, this highlights the relevance of functional economic markets as the area which captures the significant benefits and costs for housing.
- **Economics of scale and scope.** We have not identified any significant economics of scope issues for planning. However, there are some economics of scale issues, with specialist knowledge perhaps needed for health and safety (particularly around hazardous or polluting industries) and also with regard to high-end environmental risks. There may also be economics of scale issues in terms of providing consistency in planning approaches to businesses operating across a wide geographical area. Significant differences in planning regimes could impose significant costs on businesses.

- **Co-ordination issues.** As announced in the SNR (HMT et al, 2007), the co-ordination of spatial strategies with economic strategies, encompassing policies such as transport, employment and skills will be critical to the contribution of planning to economic development. Two particularly important co-ordination issues are the need to co-ordinate funding and planning decision making so that local authorities have incentive to enable development and to coordinate infrastructure funding and planning decision making.

What are the potential reform issues?

Comparing the current system with these principles, suggests some potential areas for reform or further analysis:

- Given the significant spatial spillovers involved, the Barker and Eddington reviews (2006) highlighted the benefits of a clearer national framework for strategic infrastructure and proposed an independent Planning Commission to decide projects of national importance once Ministers have set a strategic framework. The Planning White Paper and Planning Bill set out government's proposals for National Policy Statements on Infrastructure and the introduction of an Infrastructure Planning Commission to determine nationally significant schemes.
- The benefits of co-ordinating strategic planning policy emerge from the level of intervention analysis, as reflected in the SNR (HMT et al, 2007) and was also emphasised by the Barker (2006) review. Much is already happening to encourage co-operation on planning across functional areas, with a sub-regional dimension to many Regional Spatial Strategies and a number of local authorities already collaborating on planning issues. A recent study (Arup 2008) found a number of examples of good practice. However, it identified a need to strengthen advice and incentives in relation to sub-regional inputs into Regional Spatial Strategies and for co-operation between local authorities on the production of Local Development Framework. Barker (2006) also suggests that local authorities should be encouraged to work together in assessing planning applications of strategic importance.

4.4 Transport

What are the implications of the levels of intervention principles?

The application of the levels of intervention principles to transport was undertaken by the Eddington Study team, using the three strategic priorities for transport policy as identified by Eddington (2006). These are: congested and growing urban areas and their catchments; key inter-urban corridors; and key international gateways that are showing signs of increasing congestion and unreliability.

In summary, applying the levels of intervention principles to transport identified the following key issues:

- **Benefits from spatially targeted policies.** There is a strong economic case for transport policies to be tailored to regional and local conditions. This is because the market failures underlying transport policy interventions impact differently, both within and between different area types.
 - (i) **Urban areas.** While the types of journey suffering congestion is similar across urban areas, the nature of congestion varies greatly across urban areas, for example, congestion in London is different both in terms of magnitude and profile to congestion in Birmingham. The impacts of local environmental pollution also depend on the geography and population density of the urban area. In addition, the value people place on ‘fixing’ externalities, such as the value of time saved from reducing congestion, will vary with income. The positive economic benefits from transport investments and the range of possible interventions will also reflect differences in the size and scope of an area, differences in the size and access of the labour pool to employment, and differences in the mix of transport assets across cities.
 - (ii) **Inter-urban.** The inter-urban network will vary in terms of the layout and extent of the road network as well as the quality and coverage of competing rail and air services. In some regions there will be substitutes for inter-urban roads and some connecting corridors will be served by more reliable rail and extensive services than others. Forecasts of traffic and congestion growth vary by area which means that congestion will impact differently on strategic links across the country and different policy solutions will be appropriate depending on the regions and links involved.
 - (iii) **International gateways.** With international gateways, the congestion, air quality and noise pollution will generally impact at a localised level around the port or airport, with some congestion impacts spreading further onto the inter-urban roads leading to ports and airports. The nature of these externalities will be specific to each port or airport and will impact differently depending on the existing network and geography of the local area and size of the gateway.
- **Spatial spillovers.** Transport policies have considerable spillovers which differ by policy type. In particular, transport has the potential to affect the accessibility of an economic area, effectively increasing the size of the area. This may generate impacts associated with agglomeration and greater spatial spillover effects.
 - (i) For variable and fixed transport infrastructure within **urban areas**, Eddington (2006) notes that the transport decisions of existing levels of local government will not reflect the functional economic area as, for example, commuter journeys are likely to cut across local administrative boundaries. Although spillovers will not be contained within an economic region, the majority of the impacts may well be contained within the functional economic area or city-region.

- (ii) The nature of **inter-urban links** means they often cross a number of local authority areas, and often different regions, although specific pressures are likely to be relatively localised. This suggests the need for a national framework with an emphasis on regional prioritisation and an effective process for identifying multi-regional/national schemes. Despite the cross regional focus of inter-urban links, there is still significant scope for transport infrastructure to impact on the spatial economy, including influencing the location of business activity and the markets served.
 - (iii) The impacts of international gateways may fall over a large spatial scale: locally, nationally and internationally. Where there are concentrated local costs from **international gateways**, many of the positive economic benefits from additional capacity will be spread much more widely. The asymmetry of the costs and benefits of policies relating to international gateways suggests that national intervention may be required, with effective and transparent mechanisms for engaging with relevant local bodies.
- **Economics of scale and scope.** There is considerable potential for economics of scale in inter-urban road building and rail infrastructure. There is also potential for economics of scale with transport options which rely on technology, including road pricing.
 - **Co-ordination issues.** Eddington (2006) argues that the current framework for sub-national decision making in transport is highly complex, with a number of different structures and organisations and a number of different bodies, often with responsibilities for specific modes, playing a role in decision making within a single functional economic area. Eddington (2006) also emphasises that the decision-making process for transport must fit alongside a broader policy context, particularly in areas such as housing, employment, skills, planning, physical regeneration, and economic development.

What are the potential reform issues?

There are benefits in managing transport at the level of functional economic areas to ensure that economic impacts can be properly taken into account, and to gain some benefits of economics of scale and scope, while allowing targeting at the specific problems of local economies. Eddington (2006) and the SNR (HMT et al 2007) focused on the need for transport decisions to be made in line with economic impacts, including the ability to join up across modes and to implement demand management measures as well as development of infrastructure. In particular, Eddington suggests that powers could be vested in a single decision-making body at the sub-national level (a reformed and extended PTA), including, for example, highways and traffic powers over strategic local roads, road pricing; and powers for buses. In line with this, the Local Transport Bill – which is currently going through Parliament – allows for reform of local and sub-regional transport governance arrangements including the bringing together of powers to enable

more joined up decision making. In addition, in line with Barker, Eddington also supports the creation of an Independent Planning Commission for major infrastructure projects of strategic importance (see section 4.3).

In October 2007, the Department for Transport published a discussion document, *Towards a Sustainable Transport System*. It describes how the Government is responding to the recommendations made in the Eddington study to improve transport's contribution to economic growth and productivity, and how it is ensuring that transport will play its part in delivering the overall level of reductions in carbon by the Stern Review of the Economics of Climate Change (HMT et al 2006). It also proposes a new approach to longer term transport strategy, building on the model recommended by Sir Rod Eddington. It explains how the Department will engage with passengers, users, the transport industry and other stakeholders to develop and implement that process.

4.5 Employment

What are the implications of the levels of intervention principles?

Joint work between Communities and Local Government and the Department for Work and Pensions (DWP) in the application of the levels of intervention principles to employment highlighted the following:

- **Benefits from spatially targeted policies.** The case for spatially tailored employment policies is contested. There are persistent differences in employment rates between and within regions and worklessness tends to be concentrated in particular neighbourhoods. However, much of this difference may be explained by compositional factors (differences in characteristics of people, such as in skills, demographic makeup etc) rather than spatial market and government failures.

Not all of the difference may be compositional. For example, employment rates in inner London are lower than expected for some groups given the observable characteristics of their residents (HMT, 2007). While there is little evidence of substantial area effects at the neighbourhood level on worklessness, there is some evidence of educational impacts which will have a dynamic impact on employment rates (see Paper 1 in this economic series for a summary of the evidence on area effects).

Compositional differences in themselves may provide some rationale for spatially tailored policies, at least in delivery, as government policies will impact differently in places with different demographic, skill and industry mixes. The way problems come together at very local levels to create specific constraints to employment may benefit from some local flexibility to provide integrated and tailored support (see section 4.8 on neighbourhood renewal). However, even national employment policies, which are targeted at the individual, have a spatial dimension as areas with a high concentration of specific individuals have a higher level of resource allocated to them.

This has led to the greatest improvements in labour market outcomes over recent years being found in the areas that started in the worst position.

- **Spatial spillovers.** There is not a single integrated national labour market, nor a series of segregated spatial sub-markets. Instead the labour market is a continuous spatial field within which probabilities of interaction fall off steadily with distance and with every area having its own unique, but overlapping, commuting and migration hinterlands. The pattern of commuting and migration processes drives the size and shape of spatial labour markets. As financial and social costs and risks are greater for long distance moves, there is likely to be more rapid adjustment at the intra-regional scale, with inter-regional shifts in labour often being achieved indirectly, as the aggregate outcome of sets of shorter-distance moves (Gordon, 2003). In terms of commuting flows, travel to work areas tend to operate at the sub-regional level, although they vary significantly by skill level (see section 4.6 on skills).
- However, Gordon (2005) argues that labour markets are larger than suggested by travel to work areas. According to Gordon, the effective range of a market has to be seen in the context of the interactions between choices of individuals, where vacancy and displacement chains initiated by creation of a new job or by a redundancy may stretch well beyond the areas from which they started. That is, when a job (in one field) is filled by a worker who has a current job (in another), leaving a vacancy to be filled by a worker who has a current job (in yet another) and so on, until a job in the chain is filled by an unemployed worker. Particularly in and around major cities, these fields overlap with a number of others, suggesting labour markets are much larger than suggested by individual search fields. Empirical evidence is that the effective labour market area can be very extensive, stretching well beyond the bounds of the city or even OECD-style 'metropolitan regions' (Gordon, 2005). The extent and effectiveness of linkages provided by vacancy chains appears to be conditioned on the extent of cross boundary commuting; for example labour markets in London Boroughs are broadly the same, but the Norwich labour market is separate to a significant extent from the Cambridge one.
- **Economics of scale and scope.** There are scale economies in terms of the visibility of national programmes facilitating individual's awareness of them and their eligibility for support. This is true for national policies on unemployment and inactivity and on other policies that operate at a national level that may affect these (eg the National Minimum Wage).
- **Co-ordination issues.** Employment crosses over with a number of other policy areas at different spatial levels, with integration with skills policy particularly relevant for job retention and advancement, as well as to making the transition to work. Other linkages are deprivation and neighbourhood renewal, enterprise and innovation, links with infrastructure investments, such as transport systems, which play a role in enabling people access job opportunities and the national tax and benefit system has significant impacts on incentives to work.

What are the potential reform issues?

While there have been rapid improvements in most deprived areas, worklessness remains persistent in some local communities (Communities and Local Government and DWP 2007). As part of a concerted drive to get people off welfare and into work the Government has decided to establish a new Working Neighbourhoods Fund. The new fund will replace Communities and Local Government's Neighbourhood Renewal Fund and incorporates the Department for Work and Pension's Deprived Areas Fund in England to create a single fund.

More analysis and evidence would be needed to draw conclusions about the scope for greater decentralisation of employment policies. In the meantime, DWP strategy has been to focus on getting the national level policies right and then designing more disaggregated spatial policies where there are identified needs. In particular, the proposed Skills and Employment Boards in core city-regions and DWP's Cities Consortium policy reflect recognition of the worklessness problems in cities. DWP have launched 15 city pilots, through which local partners have been tasked with assessing, designing and delivering local initiatives to help alleviate worklessness. DWP has enabled bottom-up identification of the spatial level in these pilots, allowing local consortia to select the most appropriate spatial scale.

While the SNR (HMT *et al* 2007) recognised that benefits of scale and scope may favour standardised products and services aimed at particular types of individuals and businesses, it identified a role for local delivery and prioritisation in the matching of supply and demand. The case for flexibility in the delivery of employment policies at very local levels is more clear cut. Jobcentre Plus is a national organisation that delivers principally through its local network of offices and advisers. Many aspects of this service are determined nationally, to ensure that customers who use it can expect a certain level of service and access to additional support wherever they live. However, scope for local flexibility exists through innovation by local managers, supported by discretionary money such as the deprived areas fund and policies like Employment Zones that offer opportunities to innovate and tailor support to the needs of individuals at a local level.

There may be constraints on the extent to which agencies like Jobcentre Plus can engage with local authorities and neighbourhood organisations to flex service delivery to meet local needs or to connect people to mainstream services. This may be particularly important in places where a single Jobcentre Plus district overlaps with a number of local authorities. The National Evaluation of Local Strategic Partnerships (2006) found that only 37 per cent of LSPs counted Jobcentre Plus as a Core member of their partnership, and only 53 per cent the LSC. The development of initiatives such as DWP's city strategy in part reflects recognition that particular approaches may be needed to overcome administrative or other barriers to stronger cross-agency partnership. This is supported by the conclusions of the Leitch review (2006) which recommended greater integration of the skills and employment systems. This might, for example, look to provide stronger links between

policies such as the New Deal that help benefit claimants move back into work, and wider measures like Train to Gain that can help individuals to progress and improve their skills once in employment. The recently announced Local Employment Partnerships are an early outcome of the drive towards achieving this greater integration.

4.6 Skills

What are the implications of the levels of intervention principles?

The application of level of intervention principles to skills, undertaken in co-operation with the Department for Children, Schools and Families (DCSF), highlights the following:

- **Benefits from spatially targeted policies.** Education and skills outcomes are spatially very unequal with significant regional, local and ward disparities. Despite this spatial variation, individual and firm characteristics are generally more important than place in driving educational and skill outcomes (Frontier Economics, 2003). However, as with employment, more analysis is needed to understand the role which spatial market and government failures may play. These may be dynamic, not just static, market and government failures that compound over time or interact with compositional factors. For example, given the limited regional mobility in the UK, to what extent do regional sector compositions drive regional skill investment and, in a vicious cycle, constrain transition to more knowledge intensive sectors? At the neighbourhood level, there is some evidence of an area effect on education although this remains fairly modest relative to family background and impacts on child, rather than adult, educational attainment given the greater vulnerability of children to neighbourhood and community influences (see summary of area effects in Paper 1 of this economic series).

Also, as with employment, compositional differences in themselves may provide some rationale for spatially tailored policies. An impetus for decentralisation may come from the potential benefits of tailoring skill strategies to different local situations, including different business skill needs and different starting levels of human capital. For example, high level skills may be more important for places with a predominance of industries at the forefront of innovation, while strong basic education may be more important for those places focused on adoption of new technologies, rather than their creation (Aghion and Howard, 2005). However, the argument for aligning government skill investment with business needs is less convincing given the recognition of the Leitch (2006) Review that the market failures which lead to under-investment in skills tend to be most significant for basic and generic skills. There is a stronger argument for allowing some flexibility in delivery in order to reach vulnerable groups and integrate with other policies for tackling worklessness. Even if personal characteristics are more important in driving skill outcomes, the concentration of low skilled in particular areas may make place an effective mechanism for targeting such groups.

- **Spatial spillovers.** As the analysis of spatial labour markets in section 4.4 highlights, migration and commuting over local authority boundaries means there could be substantial spillovers from decentralising responsibility for skills to lower levels of government. However, these spillovers are likely to be less at more basic skill levels. Commuting distances tend to increase with skill levels, with the travel to work area significantly greater for professional and managerial workers than for unskilled workers (SURF, 2005). While this may suggest greater scope for a role for lower levels of government in lower level skills, there is a risk that this could reinforce spatially constrained labour markets and miss opportunities for skill investments that could enable people to take advantage of opportunities in the wider functional economy.
- **Economics of scale and scope.** There are relatively large fixed costs in the development of curriculum and materials and there may also be some economics of scope, in terms of specialised knowledge of adult education frameworks and tools, as well as the content of vocational training schemes. There may also be economics of scope issues from the perspective of the consumers of the service. Cremer et al (1996) argues that it is very costly for citizens to judge the quality of the curriculum or the appropriateness of locally set standards, suggesting only delivery aspects which consumers can understand best be devolved to lower levels. Common standards across places may also be important to service users so that training is recognised in other jurisdictions.
- **Co-ordination issues.** There are clear synergies and co-ordination challenges between skills policies and policies relating to employment, health, crime and the wider economy. Skill investment brings wider social benefits including public health, increased political stability, lower homicide and property crime rates, increased civil participation, etc (Owen, 2004, Feinstein et al, 2003 and Lochner, 2004). There is also significant interaction between skills and the other drivers of productivity. For example, increased use of technology may require a higher skilled workforce to operate it (Nickell and Nicolitsas, 1997) and education and informal training have been found to increase substantially a worker's ability to be innovative on the job (Blundell et al, 1999).

What are the potential reform issues?

Government has announced a separate consultation for 2008 on the options for devolving 14-19 education funding from the Learning and Skills Council to local authorities.

This analysis points to a continued important national and regional role in setting broad curriculum and standards as a framework within which sub-regional or local governments could perhaps tailor more specific elements in policy implementation.

Any changes to the role of government levels would need to be in the context of the Leitch (2006) review recommendations. Within the context of a demand-led system, Leitch provides support for a network of local Employment and Skills Boards (ESBs), to monitor the local labour market and raise employer engagement. While there should not be a one-

size-fits approach, Leitch recognises that they should operate at the level of the functional economic area level, although this not defined. Leitch also identified a role for local authorities to ensure an integrated approach for supporting disadvantaged groups.

4.7 Business support

What are the implications of the levels of intervention principles?

The application of level of intervention principles to business support was prepared by the Department for Business Enterprise and Regulatory Reform. It highlights:

- **Benefits from spatially targeted policies.** There are a wide range of business support policies (access to finance for SMEs, information, advice & best practice for SMEs, support for innovation, mobile investment, enterprise policy and international trade and investment) and there is no single optimal spatial solution across this wide range of interventions. However, while the relevant market failures may impact differently across places, with significant spatial differences in new firm formation, they are generally similar in nature across all spatial levels. Businesses face similar issues across the UK i.e. a small firm in Brighton faces the same information asymmetries, or access to capital problems as one in Barnsley. Market failures are more likely to be specific to industries, rather than specific to places.
- **Spatial spillovers.** As firms in a given locality are often competing with firms across the country, and internationally, there are potentially substantial spatial spillovers from business support policies. There are both positive and negative spillovers depending on the type of business support that makes it difficult to predict if sub-national governments are likely to under or over invest in business support. In general there is significant risk of over investment, or investment in zero-sum policies, by lower levels of government in interventions aimed at attracting new business, such as both domestic and international mobile investment, as they compete with each other to attract such investment. Schemes to assist businesses in implementing best business practice may also displace economic activity – the 1998 evaluation of Business Link suggested significant displacement of business activity across local and regional boundaries (PACEC, 1998). On the other hand, policies that are based on encouraging spillovers and growth in business such as innovation support or promoting best practice are likely to be under invested in by sub national government because they do not fully capture the benefits within their administrative area. These issues raise co-ordination problems that may be best solved nationally or regionally.
- **Economics of scale and scope.** There are strong economics of scale and scope for business support, which can play the dominant part in deciding the optimal level of intervention. To summarise:
 - *Expertise:* In many cases, including support for innovation, mobile investment, access to finance and trade development, a significant body of specialist skills

is required to develop and implement the policy. Replicating this expertise – in areas such as leading-edge technologies, world trade policy, corporate finance and international regulation – would be very inefficient.

- *National identity*: Policy development at a higher spatial level can also allow the profile of a particular policy or programme to be raised. For example the Knowledge Transfer Partnerships is widely recognised and the impact is enhanced by a national marketing strategy.
 - *Delivery costs*: There is always a cost for delivering smaller programmes because a higher proportion of the available resources are used in the fixed cost of delivery. Work on BERR Business Support suggests that once a fund reaches about £30m a year or more, benefits from economics of scale begin to kick in.
 - *Business experience*: There are also issues for businesses with diversification in schemes across places creating confusion and extra costs, which has led to the Government's Business Support Simplification Programme (BSSP). Businesses, in particular smaller firms, are often confused by multiple national, regional and local brands for similar interventions.
- **Co-ordination issues.** The problems experienced by business highlight the importance of increasing coherence, coordination and consistency of business support. One of the key aims of the Business Support Simplification Programme is to make government 'joined up' in the provision of Business Support across the spatial levels in order to provide the best support to businesses in a way that is easy to understand and access (see DTI, 2007). There are also potential synergies with many other policy areas, such as national tax policy, skills, planning and transport. There is a need for at least some coordination at national level to be aware of and build on synergies.

What are the potential reform issues?

In design of business support, a more standardised national portfolio could give opportunities to improve value for money by realising economics of scale and sharing lessons learned, and to make it easier for businesses to understand and access the support they require.

The Business Support Simplification Programme, led by the Department for Business, Enterprise and Regulatory Reform, is leading on this issue at the national level, working in partnership with Other Government Departments, RDAs, local government, business and others. The Government envisages all publicly-funded business support being delivered from a portfolio of no more than 100 products and services which target business needs, have a clear rationale based on economic efficiency or equity objectives, and offer strong value for money. Business Link will act as the primary access channel to all publicly funded business support (see HMT et al, 2007).

In procurement and provision of business support, there will be variation in the appropriate level of intervention, depending on the balance to be struck between opportunity for achieving economics of scale and scope, and the extent to which local variation requires tailoring of support to local needs.

There would also be benefits in greater coordination between local authorities and between local authorities and RDAs. This would help enable: allocation of delivery responsibility to the appropriate tier; account to be taken of the impacts across the relevant economic areas; duplication to be avoided; make the process clearer and simpler for business; and better prioritisation of limited resources in line with need. The SNR (HMT et al, 2007) clarified the roles and responsibilities of local authorities and RDAs: RDAs will lead on business support; while local authorities have an economic development role, part of which will involve business support. RDAs and local authorities should work together where regional and local business support priorities align. But that won't happen everywhere and, local authorities will still be able to offer support where there are regionally unimportant but locally significant pressures.

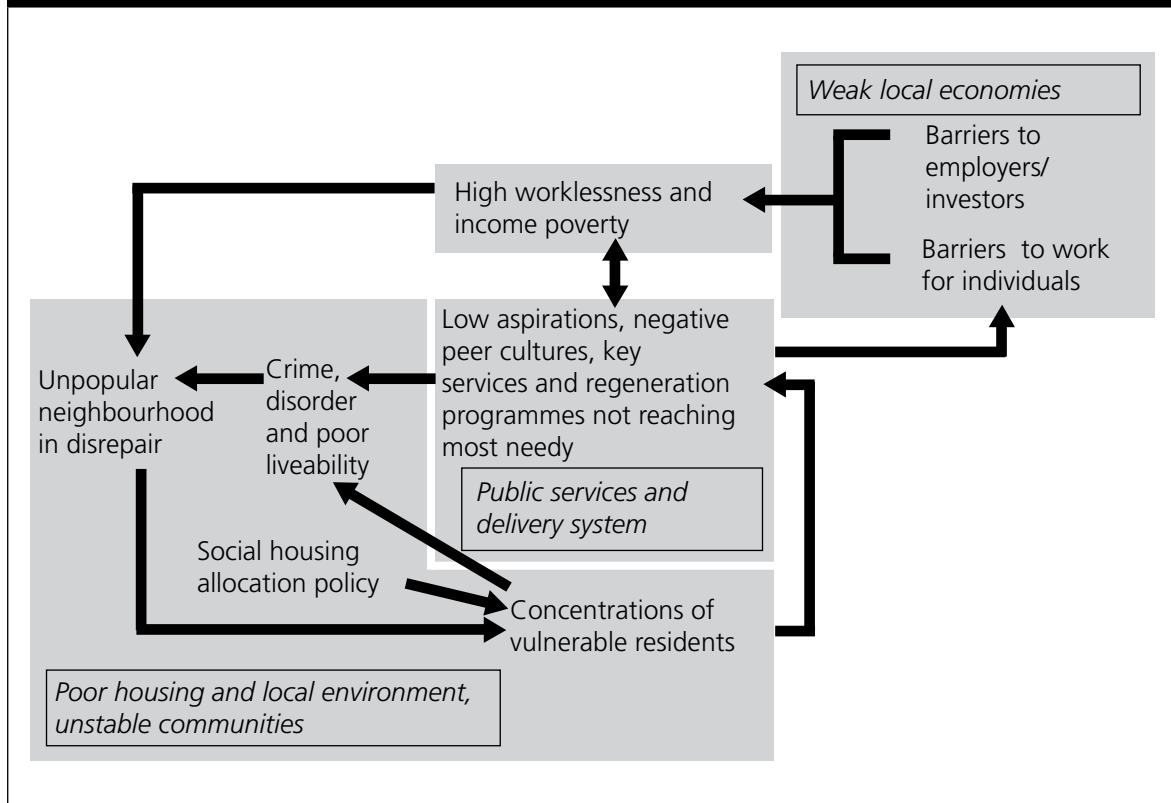
4.8 Neighbourhood regeneration and renewal

What are the implications of the levels of intervention principles?

- **Benefits from spatially targeted policies.** While the factors affecting the extent and location of neighbourhoods of serious deprivation are complex and varied, the causes of deprivation, whether market failures, system failures or market outcomes perceived to be inequitable, operate at a variety of spatial scales. In particular, while deprivation is often concentrated in particular places, the underlying causes are often driven by personal characteristics rather than spatial factors. The concentration of deprivation may reflect the concentration of affordable housing in those neighbourhoods, with the 'sorting effect' of the housing market resulting in the most vulnerable living in poorer areas. If the causes of deprivation are not essentially spatial, is there any justification for spatially focused policies to target deprivation? There are three possible rationales for why spatially targeted policies might be effective or necessary.
 1. Firstly, once concentrated in particular neighbourhoods, deprivation may be reinforced through **neighbourhood and area effects**, which may operate through social networks, information failures, access to labour markets and discrimination. However, evidence on such effects is mixed. While there does appear to be some impacts on educational outcomes, the impact on worklessness is less clear cut.
 2. Secondly, even if the nature of the market failure is not spatial in origin, the **degree of market failure varies by geography**. An obvious example is provided by land markets where there are substantial geographical variations in the incidence of contamination and therefore the externalities associated with deindustrialisation.

3. Thirdly, **problems often interact and reinforce each other** in particular places to create complex problems, which require integrated and tailored solutions (see Figure 6). An area based focus may help to ensure coordination between organisations and interventions, which is essential for tackling deprivation.

Figure 6 – Overview of the drivers of the cycle of decline that affects deprived areas (PMSU 2005)



The ways in which the symptoms of deprivation interact with each other, and with place-specific factors, to perpetuate poor outcomes for a community suggests that tackling problems of spatial deprivation requires a tailored and integrated response across policy areas.

- **Spatial spillovers.** But decentralisation is limited by the reality that deprived neighbourhoods are part of the wider economic system. In particular, the economic problems of deprived neighbourhoods are typically rooted within wider processes of economic restructuring (Syrett, 2006). This is particularly relevant for policies to tackle worklessness, given that labour markets operate at a much wider spatial scale than the neighbourhood.

While individuals living in deprived areas may face significant constraints on the distance over which they can commute, they are still operating within a wider spatial labour market. As a consequence, job competition processes mean that policies to stimulate employment at the neighbourhood or local level may have significant leakages as they will attract competition from people in other localities (Gordon, 2005). Policies to stimulate employment could also create displacement (shift

economic activity and jobs from other places or close existing businesses). Storey's (2004) empirical analysis suggests that displacement may be particularly high in deprived communities, where one in four new business starts are in cars, hairdressing or beauty. There are also potential leakages from 'supply-side' policies, such as those to support skill development, as the trained may go to live and work in another area, creating the risk that local or neighbourhood agencies could under-invest, or invest in the wrong type, of skills.

- **Economics of scale and scope.** There are likely to be significant economics of scale that exist in policy formation at higher levels that deal with barriers to employment that are common to broad geographical areas. However, even when problems are more about personal, rather than place, characteristics, the spatial concentration of problems means area-based programmes may be an efficient way of targeting resources and reaching people who share similar challenges in breaking out of deprivation. There may also be scarce skills in appraisal of alternative neighbourhood level investments.
- **Co-ordination issues.** The interactions between symptoms of deprivation dictate that policy responses are coordinated and reflect the priorities that will be specific to each community. Tackling the problems of spatial deprivation requires an integrated approach and early intervention before the environment and service quality declines to a point where the economically active move out en masse. However, as deprived neighbourhoods are part of the wider economic system, it is crucial that policies that target deprived neighbourhoods are co-ordinated with economic development strategies which operate on the wider local, sub-regional and regional scales. There are clear synergies not only between policies to tackle the various inter-related symptoms of deprivation, but also between neighbourhood renewal strategies and the outcomes that national education, crime, health, housing and employment strategies are looking to produce.

What are the potential reform issues?

This initial analysis has tended to focus on the worklessness and economic development dimensions of neighbourhood renewal. It has highlighted two broad levels of intervention themes or issues:

- Neighbourhood renewal strategies need to be co-ordinated with strategies at higher spatial levels, with economic development/worklessness initiatives taking account of labour market geography. This requires closer alignment between the regional level, which focuses on maximising growth, and the neighbourhood agenda (led by local authorities), which focuses on social and economic exclusion. The SNR (HMT et al, 2007) highlighted the importance of co-ordinating neighbourhood renewal strategies with regional and sub-regional economic strategies.

- The benefits of enabling local areas, in collaboration with neighbourhood agencies, flexibility in the implementation of worklessness policies to provide integrated local solutions. The SNR (HMT et al, 2007) recommended reforming the local authority performance framework so that it includes a clear focus on economic development and neighbourhood renewal; and work with local authorities to improve their capacity to deliver on their new, enhanced role on economic development and neighbourhood renewal.

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