Lecture 1a. RELOCE (09-02-10)

Introduction to the Course and Some Important Questions

Aim:

- To review fundamental questions concerning the study of regional/local economies (Why, What & How)

Outcomes:

- Students should be able to argue the rationale for regional and local economic analysis.

Introduction

You will find the study of economics at a local scale referred to in 2 different ways - Economic Development and Economic Regeneration - but what's the difference?

Blair (1995) attempts to separates economic growth from development, he argues that growth can be beneficial or detrimental. For instance; **growth** might occur if a new factory were opened but if it paid very low wages, imported all its raw material and sent its profits overseas, the result may be that **average incomes fall** in the region where it locates, thus although the **population and income of the region may have grown** the **quality of life has fallen**. He suggests that **developmen**t implies that the welfare of residents is improving either, on average, or the more disadvantaged are gaining more than the rest (an equity argument). He sees community development as being particularly important.

Regeneration suggests that something is not quite right with the local economy and needs to be improved (made better). Roberts (2000) concentrates on urban regeneration and suggests that it is a wide-ranging and integrated vision backed up by action that leads a resolution of urban problems in a way that brings about a lasting improvement in the **economic, social, environmental and physical condition** of an area. The impression is given that **regeneration** is a more holistic approach than **development**. It is not just about physical planning and inward investment it is about building communities and providing opportunities for individuals. The reality is that most of the effort is driven by the public sector. Significant amounts of public money are earmarked for regeneration before private investment is forthcoming and the jargon has drifted away from development and is directed more towards regeneration.

Question 1 - Is regional economic a pure science?

Regional and local economics is a study of political economy. Therefore, it cannot be separated from the political questions of the day. Thus, it can be argued that regional and local economics, at the macro level, is conditioned as much by political ideology, as by the science of economics itself. The main theories that underpin the analysis are rooted in the various political economy schools of thought: interventionist (Mainstream or Keynesian); free market (Conservative or Monetarist); and Marxist. Not surprisingly, the policy prescriptions usually also fit the relevant political/economic ideologies. Thus local economies are seen as working in a similar fashion to a national economy – they are just smaller

At the micro level, the divide is not so evident. Traditional demand/supply theory is used coupled with theory of the firm, etc. There are indications that a consensus has been building for several years about the types of policies that ought to be employed, particularly as there is increasing acceptance that a range of tools rather than one or two policy prescriptions are needed to address regional problems. For instance, the solution to chronic unemployment is not just about the level of demand and/or capital investment, it includes supply-side questions such as vocational training, life-skills, education, mobility and migration, technological advancement and entrepreneurial activity.

Question 2 - Is it relevant?

Given the above it is not surprising that regional and local economic analysis is concerned with real questions about the real economy. Whilst there is a theoretical underpinning (and much debate about the merits and de-merits of particular theories and models), practitioners use a range of available and emerging tools to try and answer the questions for which policymakers seek solutions. Such as: -

- Forecasting the impact of an event such as the start-up or closure of a significant enterprise on a local economy (i.e. the new Rolls Royce production plant at Goodwood, near Chichester or the closure of the naval base at Portland in Dorset).
- Quantifying the direct and indirect benefits of an existing enterprise on the local economy (i.e. the impact of the University of Portsmouth on the local economy by Professor Richard Harris) or determining the spatial impact of the decline of a whole industry on a regional economy.
- Identifying significant clusters of economic activity within a locality (i.e. City Growth Portsmouth).
- Tracking the progress of a local or regional labour market or benchmarking a region's competitiveness.

Question 3. - Why is regional/local analysis important and who is interested?

Regional and local economic analysis is important to a number of groups in society, some of which are detailed below. In addition, it has a strong tradition in the academic community and has spawned a number of successful research centres and units, one is located at Portsmouth Business School. The **Centre for Local and Regional Economic Analysis**, carries out academic research and commercial consultancy work. Clients include businesses, government, (local and national) and other institutions (such as, Learning and Skills Councils, not for profit organisations and national industry bodies).

Armstrong and Taylor suggest there are 6 important questions that economists might be interested in:

- What factors determine output and employment levels in a region?
- Why are living standards higher in some regions than others?
- Why does labour productivity vary so much between regions?
- What factors determine regional specialisation and interregional trade?
- Whether the migration of people between regions be explained by economic factors?
- Why some regions have persistently high levels of unemployment?

The physical planner might be interested in:

- Land requirements for new homes, commercial and industrial use and social capital.
- Re-use of derelict land, refurbishment of infrastructure etc.
- Transport routes, congestion, waste disposal, natural resource consumption and environmental degradation.
- Facilitating foreign direct investment and encouraging entrepreneurship and indigenous industrial growth.

Governments and other public policy makers are interested in:

- The policy prescriptions that enable more efficient use of resources and economic assets (is the economic potential of the country/region/local area being realised or is it being held back)
- The affect on public expenditure and social cohesion of economic under-performance (i.e. crime, transfer payments (benefits) and urban/rural decay).
- Ameliorating the effect of integrated markets (European single market) by attempting to narrow the gap between the **leading** and the **lagging** regions (i.e. the EU is earmarking Euro 213bn for structural policy in period 2000 – 2006). It is the second most important policy sphere after agriculture, accounting for over one third of EU expenditure.

- Putting in place policy to enable individuals to realise their economic potential (i.e. local and national training initiatives, encouragement of entrepreneurial activity).

Industry and commerce need to be aware of relative performance because:

- It has an effect on market demand (i.e. is the region a growing or declining one).
- They need to know the availability and price of inputs (i.e. labour, materials, supply chain etc.).
- The costs of congestion, the ease of access to markets.
- The availability of subsidies and advice to counter disadvantage.

Question 4 - What is a regional or local economy?

There are a number of definitions, but fundamentally the regional and local economy is all economic activity taking place in a specific geographically defined area. This suggests that the regional/local economist is concerned with the both the broad and particular aspects of the regional/local economy such as the labour market, factor markets, industrial activity and productivity. Most are concerned with the differences in the performance of these markets between different regions or localities.

Definitions in the economic text

Armstrong and Taylor adopt a pragmatic approach - in its broadest sense a regional economy is a geographical sub-set of the national economy. It may be as large as a state or province or as small as a local authority area. The choice, in terms of analysis is often governed by the availability of data.

McDonald, J, Fundamentals of Urban Economics, 1997. American view
"The field of urban (local) economics is closely related to its sister field, regional economics. Both urban and regional economists are interested in the variety of economic experience that can occur within a single nation. Both study economic units that are defined geographically, as opposed to industry units, demographic groups, occupational groups, or any other possible disaggregations of the entire economy. Indeed because both fields study geographic sub-units of the national economy, urban and regional economics makes use of some of the same economic models and methods."

Marion Temple, Regional Economics (1994), depicts the regional and local economies graphically as a series of concentric circles with the local economy at the centre and the international economy at the extremity. She concedes that in both the UK and EU: *"the definition of a region remains essentially complex and qualitative in many respects, influenced by convention and custom as well as by administrative convenience or even – sometimes – economic cohesion"*

Griffiths and Wall, Applied Economics 1999, define a region thus: "*a region is a portion of the earth's surface that possesses certain characteristics (physical, economic, political, etc) which give it a measure of unity and differentiate it from surrounding areas, enabling us to draw boundaries around it.*" They then go on to describe how the geographical boundaries of regions in the UK have changed over time with the latest revision in 1994.

Concept of regional and local economies in the UK

Most people will be more familiar with their local area be it a city, town or village. They may also identify with a larger spatial area e.g. county, particularly if it has tax raising powers. Standard planning regions are often less familiar and represent the spatial aggregation at which government tends to work. Clearly the regional and local economy are part of the larger economic system. Regions viewed from "top down" are subdivisions of the nations economic space; Viewed from the "bottom up" they are aggregations of urban and rural areas.

Local and regional economies are usually defined by administrative boundaries. At the lowest level these are local authority wards and which make up districts, metropolitan boroughs, unitary districts. County Councils are aggregations of local districts (13 in Hampshire, 7 in West Sussex, and 6 in East Sussex) and regions are aggregations of counties SE Region = 12.

Question 5 – So what are the functions at the standard planning regions (in the UK)?

- Main Government departments work through regional offices e.g. Government Office of the South East (GOSE) it co-ordinates the work of 10 government departments in each region. These are
    - Department for Communities and Local Government
    - Department for Transport
    - Department of Trade and Industry
    - Department of the Environment, Food and Rural Affairs
    - Department for Education and Skills
    - Home Office
    - Department of Culture, Media and Sport
    - Department of Work and Pensions
    - Cabinet Office
    - Department of Health
- Regional development agencies were set up in 1999 these business-led agencies are funded by government but can also generate profits from land development. They are arms-length organisations, answerable to government but not directly controlled by them. For instance, the South East England Development Agency (SEEDA) recycled around £200m (2005/6) mainly in the form of grant in aid much of this from the DTI but also money from the EU. Of this 31% spent on infrastructure, 29% on competitive business and 14% on learning and skills.
- Health Care was organised on a regional basis (until advent of health trusts) There are now 28 Strategic Health Trusts in England (5 in London)
- Regional physical planning is generally undertaken by Regional Offices in conjunction with local authorities.
- Local government sometimes organises regionally e.g. North West Regional Association.
- The EC use standard regions as a vehicle for resource redistribution; EC Committee of the Regions
- Education and housing are not organised on a regional scale these are the responsibility of local government although the Department for Education and Skills does release information on a regional basis.

Question 6 – What are the features of a Regional/local economy?

Regional analysis is mostly based on the theories and analytical tools developed for national economies. Many models are based on the assumption that similar sorts of fundamental components and relationships exit at the regional/local level as are present at the national level. This is often a second-best option brought about by the lack of hard data at the sub-national level. Researchers are well aware that regional dynamics will be different from national dynamics. For example, the production of one unit of output in a given industry may involve a greater proportion of imported inputs in one local economy (a) than an adjacent local economy (b). Thus increases in demand for the given product nationally will be more beneficial in income and employment terms to local economy (b) than local economy (a).

Whereas national governments and policy makers are able to exercise a degree of control over external trade, domestic consumption, private domestic investment and government expenditure, regional or local government (in the UK) is not. (Not even in any meaningful way in devolved Scotland or Wales). **External trade plays a more important part in the economic life of a regional/local economy than the national economy. For a start, by definition, region/local firms may be exporters (and importers) both *within* the UK and *outside* it. Viewed in national terms only external trade is classified as imports or exports. Therefore regional/local economies are much more *open* than national economies.**

Regions also tend to be much more specialised than national economies. For instance, the defence industry is highly regional with significant activity in the South East, South West and North West; yet the UK as a whole is recognised as having a highly developed defence industrial base.

Factors of production also flow more easily between regional and local economies than they do between national economies for the following reasons:

- Barriers to trade are missing at the local level.
- Distance to market is shorter - transportation costs (lower).
- Labour and capital are more mobile within the region than between countries.
- There are no defence or political considerations.
- Cultural and language differences do not exist.
- Legal tools - tariffs - quotas etc. (restrictions to trade) are not present.

In the region - income is largely determined by what happens outside the region e.g. government spending, taxation, national wage rates etc.; import/export flows are large; factors of production are mobile; taxes and savings may be lost to the region; thus leakages are higher, and consequently multipliers lower.

Regional/local economies are thus unique entities - ***smaller* and *more open* than the national economy**, more ***specialised*** and less hampered by ***political, legal and cultural diversity***.

Question 7 - How do we analyse the Regional/local economy?

Highlighting and differentiating regional and local economic performance requires an understanding of the **processes** and **inter-connections** of the various markets that comprise the economy and often, significant amounts of data. The economist job is to inform policy makers, so that they can make policy decisions based on sound, impartial analysis, free from vested interest. The researcher has basically three different perspectives from which to view the economy – Past, Present and Future.

Past:

This is probably the most used (sometimes referred to as driving forward whilst looking in the rear-view mirror), the reason for this is that data is usually readily available. To the researcher, examination of long-run time-series data is helpful in understanding why some economies persistently out-perform or under-perform against the national average, and why these trends persist. They may also wish to examine the effectiveness of policy with the benefit of hindsight under the assumption that past patterns (under realistic assumptions) will probably repeat themselves into the future. Past data can be used to extrapolate trends as a basic tool for forecasting. For more sophisticated forecasting time-series data may be used to examine the relationship between variables usually using some form of regression analysis (e.g. interest rates and unemployment) and/or to construct models of economic behaviour.

Present

The researcher is often required to compare and contrast a regional or local economy against some benchmark. Essentially this means building a profile of the local economy using the most up-to-date data available (although in practice this may a little out-of-date e.g. census of employment data usually lags by two years). Because data is either not available or may be lagged researchers will often use surveys to obtain local primary data, this can be used in profiling, for fine-tuning forecasting models (determining inter-sector linkages) and providing the raw data for impact analysis (expenditure patterns).

Future:

This is the domain of the modeller. Researchers construct econometric, social accounting matrices and input-output models of regional and local economies to enable them to produce informed forecasts of future economic behaviour under tightly defined assumptions (e.g. expected growth in national GDP, interest rate parameters etc.). Models are used to forecast such variables as output, employment and occupational structures. Some models make point forecasts for the short-run (CLREA 2 years ahead) others make range forecasts for the longer-run (Cambridge Econometrics LEFM contains central, low and high forecasts for up to 12 years ahead). Whilst there is a certain amount of controversy surrounding the effectiveness of models (because it is claimed some assumptions are too restrictive and/or other factors are ignored), they represent the cutting edge of regional and local economic analysis. More importantly the output from them has a value in the marketplace with demand from government and business.

Question 8 What tools do we use?

Profiles: '*Snap-shot' views of the economy of an area based on secondary data. Essentially looking backwards at what has happened in an area, usually comparing the local economy with some reference point (e.g. the national economy). This could include relative indices and shift-share analysis and be used to drive SWOT analyses.*

Econometric models: *Used to forecast the outcomes to an economy, based on well laid out assumptions, that may themselves be derived from extensive analysis of primary and secondary data to determine the cause and effect of phenomena e.g. the affect of interest rate changes on local employment patterns.*

Input-output analysis: *Used to simulate the effect of a shock to the local economy and determine its full impact on output and employment after the inter-industry linkages are taken into account. e.g. closure of Portland naval base was shown to have far reaching negative effects to the whole economy of South Dorset.*

Cost Benefit Analysis: *Used to compare and contrast the expected outcomes of competing policy prescriptions or projects over time. e.g. rival bids to build a new factory in a given area.*

Surveys: *Although local data is often available for variables such as unemployment, and employment the researcher often requires more detailed knowledge of the local area and this has to be provided via local surveys. This is particularly important in determining the specification of models and the magnitude of sector inter-linkages e.g. expenditure patterns, location of suppliers and training penetration.*

Question 9 - What is the political background?

It is probably useful to define the main political policy responses to the problems of regional/local economies. Each of which is associated with a particular political ideology. McDonald Ch 2. pp 18 – 29, suggests that because differing ethical objectives are embedded in schools of economic thought, the type and range of data collected and the specification of models may differ. He concludes that urban/local economics is conditional analysis and he looks at three main schools; Mainstream, Conservative and Marxist.

Mainstream

The primary objective is the maximisation of utility for members of society, with utility dependent on consumption of goods and services and the usage of time. This is constrained by the availability of resources such as land, capital and time. Optimal outcomes are where marginal benefit (price) = marginal cost.
Its main features are that: allocation is generally by markets. Government intervention is only valid to ameliorate against monopoly, externalities, and to provide public goods. They acknowledge that the market economy produces an unequal distribution of income and favour public policy designed to reduce income inequality (tolerate some inefficiency as the price for greater equity). Monetary and fiscal policy is to be used in the short-run to ensure growth in the longer-run. Their research agenda concentrates on the costs and benefits of competing policy options.

Conservative

The underlying proposition is that the pursuit of social goals limits individual freedom (Hayek). They hypothesise that essentially arbitrary decisions are made (by government) with the force of law resulting in "administrative discretion rather than the rule of law" and this is then justified as judging cases on their merit. The goal of the conservative is to enhance human and economic freedom, which are the necessary pre-conditions for political freedom. They argue that the scope of government should be limited and that government power should be dispersed rather than concentrated at the centre. Government activity should be limited to actions that support the competitive market economy, such as the provision of pure public goods, law and order, enforcement of contracts, property rights and maintenance of a monetary system. The role of government is not to correct externalities or alleviate poverty, however, in the transitional stage the poor should be "compensated" by measures such as negative income tax.

Next lecture - Profiling the Local Economy

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