THE METROPOLITANISATION OF GAINS, THE NATIONALISATION OF LOSSES

feature

Adam Leaver

The prosperous South East can no longer afford to subsidise the rest of the United Kingdom. Or so runs the conventional wisdom. The facts, on the other hand, are rushing headlong in the opposite direction.

A recent 800 page report highlighted just how unequal the UK regional economic landscape has become.[1] In ratio terms, the UK's largest 2nd tier city generates around 10% of the output of London – the second highest capital to 2nd tier city output inequality within the EU. In terms of the regional concentration of GDP creation, we have more in common with a Hungary, Bulgaria, Romania or Greece than a Germany, Netherlands or Sweden. And while there is evidence to show that the UK's 2nd tier cities were growing faster than the capital pre-crisis (from a lower base), that trend is now being undone as austerity cuts bite into the non-metropolitan North and West.

At one level it is no surprise that the UK coalition government's immediate post-election rhetoric about rebalancing has been abandoned, to be replaced by a new, morally-laden discourse about the unfair subsidies received by the regions and the rights of Londoners to keep more of 'their' income.[2] UK recessions encourage internecine squabbles over resources and London's position as both political and economic centre mean there was only ever likely to be one clear winner. But as Londoners and their informal representatives look on jealously as the bank notes seem to disappear to the non-metropolitan North and West, it is perhaps worth revisiting how we got here. This is a complex issue that requires balance and open-mindedness if we are to understand the diversity of flows in a national economy.

In terms of the UK national growth model, two processes have cemented London's dominance within the economy. First we now rely less on the manufacture of things and more on the manufacture of credit. We have bought into a growth model that depends on the ability of our banks to lend against assets, and for households (and businesses) to convert the capital gains from those rising asset prices into expenditure. It is a startling fact that the real value of housing equity withdrawal under Thatcher and Blair was marginally higher than the real value of GDP growth.[3] This national model significantly empowers London's form of 'gentlemanly capitalism': the historically entrenched culture and interests of land and finance within the UK which prioritise the making of money from money over the making of money from industrial enterprise. The political and economic spheres mutually reinforce each other: finance has access to the charmed circle of policy formation because of the great wealth and prestige bestowed upon them by a credit-fuelled, asset based growth regime.

Second, the broader process of privatisation and the extension of public-private partnerships disproportionately benefit a global city like London. London does attract capital, but it does so because it is a kind of conversion machine, taking national and international assets, converting them into revenue streams from which well-placed individuals skim high pay. In other words: London attracts capital because it is also extractive. Let's take the UK's Private Finance Initiative (PFI)[4] as an example. The PFI is a form of Public Private Partnership (PPP) where public infrastructure projects are funded, built and managed by the private sector to a public specification. Generally PFI contracts last

Is credit expansion driven by the City of London a drag on growth? Image: Jan van der Crabben, some rights reserved.

> *"The flipside to the revenue streams clipped by metropolitan elites is a series of costs and liabilities passed on to non-metropolitan areas."*

a minimum of 25 years, during which the private sector receive payments in exchange for bearing the project risk. Notionally private sector participants are paid only if services are delivered according to the negotiated concession agreement. The decomposition of activities around a contracted-out infrastructure project leads to a fragmentation of corporations around specialised functions, so that one company may provide the finance, another may build the school or hospital, another may manage the services. In theory some of these functions need not be located on the site of the project. And certainly the revenue streams do not all circulate regionally: the finance company probably has its operating office in London, as might the service management office. Even the building firm might be co-ordinated from London using local contractors on site. Overseas companies that invest in infrastructure funds are also likely to have an office in London, and those senior workers are likely to be extremely well paid.

Fragmentation has led to a concentration of certain functions like financing and asset management in London. This has diminished capacity in the regions through the withering of broad competences, the destruction of joined up supply chains, and skills drift as talent is forced to relocate down South to find a job. State-sponsored investment projects across the country have benefited private sector growth in London and the South. The obvious counterfactual – a publicly funded and organised infrastructure development programme – would result in a greater proportion of project revenue streams accruing to the region around the development site, kicking in multipliers that would further benefit the local economy.

These two developments tell us something about modern day capitalism in the UK. Contrary to the fantasies of free-market proponents, the success of London has much to do with an active UK state and its willingness to take on or underwrite private sector liabilities. The banking sector, for example, is a net recipient of state funds which the whole country must pay for, even though the private gains are largely realised in London. By our calculations, the Treasury received taxes of £203 billion over five years up to 2006/7; substantially less than the cost of the UK bank bailouts, estimated at between £289 billion to £1,183 billion by the IMF.[5] If we factor in the impact of government bailout guarantees on bank borrowing rates, then the longer term subsidies are even higher.[6] And all this is before we consider the costs of mis-selling and other predatory habits

Liabilities are also underwritten at public expense in the case of PFIs. Typically PFI consortia leave the maximum contractual risk with the local state or cost at a premium any risks that cannot be offloaded. So the flipside to the revenue streams clipped by metropolitan elites is a series of costs and liabilities passed on to non-metropolitan areas. There are also many hidden, contingent liabilities – as when NHS Trusts cannot repay their PFI loans, or unwieldy contracts produce inefficiencies and exorbitant penalty clauses which are costly to renegotiate. And this is before we discuss the many contracts that overshoot their original estimates.

All of these interventions should be thought of as State subsidies; received mainly by private subsidiaries operating in the capital, and paid for by taxpayers the length and breadth of the country. This quiet cross-subsidy from North and West to South East has been running un-noticed for a long period of time. Its unanticipated result is a kind of regional moral hazard: the metropolitanisation of gains, and the nationalisation of losses.

But we have arguably reached the limits of that model. Despite the current political spin that a three per cent rise in house prices (driven mainly by an eight per cent rise in the capital) marks the end of our problems, there is a limit to how far asset prices can rise when wages and growth are stagnant. We just aren't growing fast enough to take on the liabilities to fuel the asset price rises, and we aren't paying people enough to allow them to take on larger interest repayments. If debt is a claim on our future growth, there comes a tipping point where the scale of debt repayments acts as a drag on growth, crowding out investment and consumption.

From this perspective, a genuine rebalancing of the economy to a more sustainable model will involve a lot more than devolution. It will involve a lot more than encouraging private sector growth in the regions. It will require a fundamental rethink of the corporate welfare apparatus that has so benefitted the London area in recent years.

Adam Leaver is a senior lecturer in Financial Innovation and Business Analysis at Manchester Business School. He is a co-author of After the Great Complacence: Financial Crisis and the Politics of Reform *and* Financialization and Strategy: Narrative and Numbers. *His current research focuses on the disruptive effects of crisis on national business models.*

Endnotes

1 Parkinson, M., Meegan, R.,Karecha, J., Evans, R., Jones, G., Sotarauta, M., Ruokolainen, O., Tosics, I., Gertheis, A., Tönkő, A., Hegedüs, J., Illés, I., Lefèvre, C., Hall, P. (2012) 'Second Tier Cities and Territorial Development in Europe: Performance, Policies and Prospects'; Scientific Report | Version 30/06/2012 for the European Observation Network on Territorial Development and Cohesion (ESPON), p.27. [online] **http://www.ljmu.ac.uk/EIUA/EIUA_Docs/SGPTD_Scientific_Report_-_Final_Version_03.10.12.pdf**

2 See for example Nick Clegg: Regions 'can rely on City no more' **http://www.channel4.com/news/clegg-regions-can-rely-on-city-no-more**

3 Froud, J., Johal, S., Law, J., Leaver, A., Williams, K. (2011) Rebalancing the Economy (Or Buyer's Remorse), Centre for Research on Socio-Cultural Change (CRESC) working paper 87, p.22 [online] **http://www.cresc.ac.uk/sites/default/files/Rebalancing%20the%20Economy%20CRESC%20WP87.pdf**

4 The PFI is a form of Public Private Partnership (PPP) where public infrastructure projects are funded, built and managed by the private sector to a public specification. Generally PFI contracts last a minimum of 25 years, during which the private sector receive payments in exchange for bearing the project risk. Notionally private sector participants are paid only if services are delivered according to the negotiated concession agreement.

5 CRESC (2009) 'An Alternative Report on UK Banking Reform', [online] **http://www.cresc.ac.uk/sites/default/files/Alternative%20report%20on%20banking%20V2.pdf**

6 For more detail on this, see Haldane, A. (2010) 'The $100 Billion Question', comments given at the Institute of Regulation & Risk, Hong Kong, 30 March 2010 [online] **http://www.bankofengland.co.uk/publications/Documents/speeches/2010/speech433.pdf**