

**OLIGOPOLY, REGIONAL DEVELOPMENT AND THE
POLITICAL ECONOMY OF SEPARATISM**

- with a case study of the United Kingdom and Scotland -

By

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The present thesis aims to increase our understanding of the causes of separatism. The inspiration for this topic comes from the fact that separatist conflicts can become extremely destructive, and thus a better understanding of why they emerge may help us prevent much human suffering by pointing to ways in which separatism can be avoided.

More specifically, the thesis aims to explain the link between separatism and regional development disparities. The argument presented is that inter-regional economic conflicts (such as about inter-regional fiscal redistribution) easily emerge between regions at different levels of development, and that under certain conditions, particularly prolonged recessions and austerity, such conflicts can become an important driver of separatist aspirations. This can happen in both poorer and richer regions. The thesis further argues that this entire process can only be fully understood if we analyse society through a class prism.

Given that regional development disparities often lie at the root of inter-regional economic conflicts, one of the ways of avoiding such conflicts – and thus also separatism – would be to equalize regional development levels. In order to do so, however, we first need to understand why regional disparities emerge and persist. Focusing on capitalist countries, the thesis argues that the disparities emerge as a natural consequence of the operation of oligopolistic markets, which are the dominant market form in capitalism. Regional development policies are explored at length, and it is argued that they are generally insufficient to overcome the tendency of markets to produce regional disparities.

All the topics in the thesis are explored at the general level and for a larger number of countries, but the main in-depth case study is of regional disparities in the United Kingdom and how they relate to Scottish separatism.

To my father

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Preface

This dissertation is the result of my own work and includes nothing which is the outcome of work done in collaboration except as declared in the Preface and specified in the text.

It is not substantially the same as any that I have submitted, or, is being concurrently submitted for a degree or diploma or other qualification at the University of Cambridge or any other University or similar institution except as declared in the Preface and specified in the text. I further state that no substantial part of my dissertation has already been submitted, or, is being concurrently submitted for any such degree, diploma or other qualification at the University of Cambridge or any other University or similar institution except as declared in the Preface and specified in the text

It does not exceed the prescribed word limit for the relevant Degree Committee.

1. Introduction

The main aim of the present thesis is to better understand why separatism emerges, in the hope that such an understanding can lead to actions that can preempt state dissolution. The reason for my interest in this topic is that I was born in a country that dissolved, Yugoslavia, and grew up in one of its successor states, Serbia. I have to an extent witnessed the devastation that state dissolution can bring. Around 140,000 people died in the Yugoslav wars (including the NATO bombing of Serbia), probably many more got injured, and some 4,000,000 got displaced at some point. As for the purely economic destruction, estimates vary, but they go to hundreds of billions of dollars. Even when state dissolution is not violent, it can still bring about all kinds of difficult institutional and economic readjustments in the affected countries, as has happened, for example, in parts of the former Soviet Union. Indeed, it seems that relatively easy secessions, such as when Norway separated from Sweden or Belgium from the Netherlands, are the exception, not the norm.

When we think of separatist conflicts, the typical explanations of their causes that come to mind are nationalism, religion, ethnicity or language. Political conflicts are also a common explanation. However, the focus of this thesis is different – it asks whether economic conflicts can be a major underlying factor for the desire of some regions to separate from their countries. It argues that that indeed can be, and often is, the case – inter-regional or center-region economic conflicts, rooted in regional development disparities, do regularly emerge and can become the basis for separatist aspirations. The most typical example of such conflicts is inter-regional fiscal redistribution between richer and poorer regions, but many other types of conflicts have emerged, such as around the regional impact of price controls, monetary policies, tariffs, and so on.

The thesis further asks under what conditions such conflicts become particularly sharpened, focusing on the role of recessions and austerity. It adopts a political economy framework for this analysis, that is, it studies the power and interests of different groups, in an attempt to determine what makes them support or oppose separatism.

However, the thesis goes further than this. If the mentioned conflicts are based on regional development disparities, then the fundamental way to solve this problem would be to equalize regional development levels. As long as regional disparities exist, conflicts based on them will potentially emerge. Thus, while one part of the thesis deals with separatism, the other part deals with the causes of regional development disparities, as well as with regional development

policies. It attempts to answer where regional disparities come from, and how likely it is that attempts to reduce them will be successful. Here, the focus is on the interrelations between oligopolistic market structures and regional development, an approach that has been severely neglected for decades.

In the remainder of the introduction (chapter 1), I present a brief overview of the remaining chapter structure and the contents of each chapter. While the line of thought that inspired the thesis was as described above – starting from separatism and moving onto regional disparities – for the thesis structure, it made more sense to start with regional disparities, because without understanding them it would not be possible to understand a number of arguments about separatism. Thus, the thesis starts by explaining what economic development is and discusses development policies and then moves onto adapting this analysis to regional development. This is then linked up to the emergence of inter-regional or center-region economic conflicts, and a deeper analysis of separatist aspirations. Finally, the entire analysis is applied to the case of regional development in the United Kingdom and the Scottish separatist movement. This case study was chosen not only because it is a current and live topic, but also because it allows for a straightforward testing of the developed framework, seeing as how the position of Scotland within the UK does not involve any repression, linguistic differences, or other such factors that are usually associated with separatism.

Chapter 2 is a background chapter, that aims to establish three points. First, by relying on traditional development economics, it argues that economic development is centered around the structural transformation of the economy, that is, around establishing at least a few economic sectors which can have high productivity growth, high economies of scale, and numerous linkages to other sectors. Second, by drawing on authors such as Edith Penrose, John Kenneth Galbraith, and Joseph Schumpeter, the chapter argues that the process of economic development is inextricably tied to the emergence of big firms and oligopolistic market structures. Third, the chapter shows that a consequence of the preceding two points for less developed economies is that they face extremely difficult challenges if they want to become developed. Namely, in order to become developed, they have to move into advanced sectors of the economy, but in doing so, they inevitably have to compete against already established oligopolistic firms, who are in a far stronger competitive position. This explains why successful late developers have had to use highly interventionist policies, in order to help their domestic firms for significant periods of time, until they could compete on an even footing against established market players.

Being a background chapter, there is little new research in it, although I have tried providing recent empirical data for the presented arguments, relying, for example, on OECD publications about productivity, or on various data sources for R&D investment. Still, in a way, the novelty of the chapter is in bringing back certain perspectives into the debates about development. First, the importance of structural transformation has to a large extent been neglected (Chang, 2010). Second, arguments about the link between economic development and big firms have not just been largely forgotten, but numerous currently widespread arguments run directly counter to them, such as that small and medium enterprises (SMEs) are the key to economic development. The chapter shows why such arguments do not square with reality. Furthermore, without establishing the link between development and big firms, it is not possible to understand why regional development disparities emerge, which is the topic of the next chapter.

Chapter 3 adapts the analysis from the preceding chapter to the study of regional development and underdevelopment. It draws on authors such as Myrdal (1964) and Hirschman (1970), who offered a macro-level analysis of regional development. They argued that trade, investment, and labor flows between richer and poorer regions on balance favor the richer regions. However, they did not link their arguments explicitly to market structure. Perroux (1971) and, in significantly more depth, Holland (1976a, 1979) did exactly that, but their arguments have mostly been forgotten – Perroux’s have been severed from his insights about the importance of oligopolies, while Holland has simply and almost completely disappeared from debates about regional development. The chapter draws on all four of the mentioned authors to make the argument that regional development disparities primarily emerge as the consequence of how big firms make decisions about where to locate what investment, as well as from their power to outcompete new market entrants (potentially from the poorer regions). Those regions that contain market-leading firms, or at least their high value-added activities, are more developed, while those regions that do not have such firms, or that house their lower value-added activities, are less developed. In order to develop, poorer regions would either have to attract high value-added investment or develop their own powerful firms, but both options are very difficult to achieve. Regional trade, capital, and labor flows are mostly a consequence of this situation.

The chapter does not present novel arguments *per se*, but linking regional development to market structure and the power of big firms has not been done since Perroux and Holland published their analyses several decades ago. Most of the chapter is devoted to analyzing these arguments in more detail, and showing in what ways they are still relevant today.

In addition, the chapter also looks at whether some regions are more suitable to being developed than others (for example, due to having abundant natural resources), arguing that evidence seems to show that that is generally not the case. Furthermore, it offers a short critical overview of location theory, regional science, new economic geography, and Marxian geography, focusing mainly on their methodology, and why they do not offer the same explanatory power as the authors I have relied on.

Chapter 4 focuses on regional development policies and builds on the insights from the previous chapters. Regional policies have followed the same trend as other economic policies in the post-WWII period, starting with a generally highly interventionist phase and then becoming more liberal from the 1980s onwards. The “old paradigm” regional policies generally comprised of building infrastructure in poorer regions and giving various incentives for investment there, aimed at attracting big firms to choose to locate their activities there. However, more interventionist policies, such as location controls on where firms could invest, or mandatory investment agreements between big firms and the government, were also used. The “new paradigm” regional policies still provide for infrastructure investment, but the firm-level focus has shifted towards support for local SMEs, skills, training, and other forms of “soft” capital.

The chapter analyses the two periods separately, both from the perspective of whether the policies took or take into account the power of big firms. While this has been done before by Holland for “old paradigm” regional policies, to my knowledge, a similar analysis of “new paradigm” regional policies has not been undertaken, which is one of the two main contributions of this chapter. The basic argument is that both old, and much more so the new regional policies, did not, and do not, take into account the power of big firms sufficiently or at all, particularly their power to outcompete or take over new market entrants from poorer regions. They also do not recognize fully that the gains from investing in poorer countries often tend to be much larger than any incentives to invest in poor regions of rich countries.

The other main contribution of the chapter is a short case study of the economic development of Nevada. Nevada was picked because it is the only region (states within the US are effectively regions within a larger country) that, to my knowledge, used to be underdeveloped, but has managed to develop based on an indigenous, new sector – gambling – and not due to the location decisions of market-leading firms happening to coincide with Nevada’s economic interests. It, therefore, seemed worth exploring in some more depth what Nevada did, and whether we can draw any lessons from its experience. As it turns out, what seems to have been different is that Nevada was extremely lucky, in that it effectively had

internal trade protection that allowed its gambling industry to develop without hindrance. This protection was the fact that gambling was illegal everywhere else in the US at the time. The chapter tries drawing some lessons from this for other poorer regions.

Chapter 5 moves the thesis into the study of separatism. As mentioned, the basic argument is that regional development disparities create inter-regional or center-region economic conflicts and that these can sometimes become particularly sharpened and fuel separatist aspirations in both richer and poorer regions. Some more systematic work has been done on this topic, notably by Bookman (1993), but the chapter takes the analysis further.

First, it critically assesses some of Bookman's arguments about the characteristics of typical separatist regions. It also mentions a number of potential conflicts that Bookman did not cover and offers a somewhat different categorization of these conflicts than Bookman did. Second, it explores under what circumstances inter-regional or center-region economic conflicts tend to escalate and become a major driving forces behind separatism, focusing specifically on the role of prolonged recessions and austerity and on how they corrode institutions set up to manage inter-regional or center-region economic conflicts. Third, the chapter analyses the class basis of support for separatism. Since it is individuals, acting either as individuals or as members of groups, that enter conflicts, understanding separatism is actually not possible without understanding the class structure of society. In particular, the role of recessions and austerity in fueling separatism cannot be understood without reference to the different impacts that they have on different classes. Finally, the chapter also critically analyses some of the typical economic expectations and claims by separatist movements, focusing on separatism in poorer regions. Specifically, it shows that, even if many such movements have economic grievances, their hopes that their economic situation will improve once they separate tend to be overoptimistic, because they seem to largely be unaware that the fundamental thing that is keeping poorer regions poor is the unintended consequences of the power of big firms, something that will not disappear merely because a region might become an independent country. This chapter represents a significant contribution to the literature, in that all of these topics have barely been explored thus far.

Chapters 6 and 7 apply the framework developed in the preceding chapters, linking regional development to separatism, to the case of regional development in the United Kingdom and the separatist movement in Scotland. This case study was picked primarily because it is one of the relatively few cases where the economic bases of separatism stand out very clearly, and where they are not interlinked with any sort of repression, historical grievances, ethnic

conflicts, and other causes more usually associated with separatism. This has made the analysis much easier and allows for a clearer testing of the presented arguments.

Chapter 6 examines regional development in the UK. It looks at the historical roots of the country's regional disparities, and at the various regional development policies that have been employed by UK governments in the post-WWII period to try to equalize regional development levels in the UK. A more detailed exploration is undertaken of "new paradigm" regional policies, relying, among other things, on a number of ONS regional data sources, as well as on the Business Population Estimates dataset from the Department of Business, Energy and Industrial Strategy. The latter dataset, in particular, is used in a novel way. Most studies tend to use it to see to what extent SME support policies (including regional ones) have been successful. While I have used it for that purpose, in addition, I have used it to estimate the regional importance of big businesses (relying on their share in regional output and employment) and compare that with regional prosperity, arguing that, contrary to conventional wisdom, data seems to show that those regions that rely more on big businesses than on SMEs are significantly more prosperous. This, together with other parts of the chapter, supports the argument that the key to understanding regional disparities and the success – or otherwise – of regional policies still lies with understanding oligopolistic markets. In addition, the chapter also looks more closely at cluster policies, at the recent suggestions to set up regional banks, and at EU regional policies (and EU constraints on regional policies and state aid) in the UK. All these have not been analyzed thus far from the perspective of the dominant position of big firms in modern capitalism, so this chapter contributes to current debates on regional development policies in that respect.

Finally, chapter 7 analyzes the recent Scottish separatist movement, culminating in the Scottish independence referendum in 2014. I argue that economic conflicts with Westminster have played the decisive role in the rise of support for Scottish secession and that they are fundamentally related to Scotland's relative underdevelopment compared to the richest parts of the UK, as well as on resistance to austerity measures pursued by UK governments. This has been widely recognized in the current debates, but the chapter goes further than this in two respects. First, it argues that class is an unavoidable factor in understanding how relative Scottish underdevelopment and the impacts of austerity have fueled the separatist drive. It is revealed that, even though the separatist movement is led by middle-class people, support for secession comes mainly from the lower classes and the petty bourgeoisie, while most of the middle classes and capitalist elites are firmly opposed to it. Second, it shows that most commentators, be they for or against Scottish independence, showed almost no understanding

that the fundamental reason behind Scottish underdevelopment is the operation of oligopolistic markets. The development policy suggestions for an independent Scotland reflected this lack of understanding.

2. Big firms, oligopolistic markets and economic development

The present chapter is built on the understanding that there is a stark discrepancy between modern capitalist reality and how this reality is ordinarily imagined. On the one hand, markets are dominated by a few big firms with very significant market shares – in many sectors the top few firms account for a quarter or more of total employment and turnover¹ – and extensive power to determine prices, influence customer preferences, influence legislation, etc. On the other hand, capitalism is imagined by many economists and policy-makers as an economic system based on small firms, engaged in price competition, and with no market power. The fact that such a discrepancy can even exist is baffling, given that the reality is otherwise widely recognized, for example in legislation,² language³ or even popular culture.⁴

These two visions inform very different understandings of how firms and markets relate to economic development. The imagined version of capitalism sees development as stemming from market efficiency produced by price competition between small firms. For that reason, when economists and policy-makers do recognize the actual reality of capitalist markets, the reaction is normally to say that markets should be changed to be more like the imagined version of capitalism, as it is thought that this would be more efficient. In reality, however, development is highly dependent on non-price competition between big firms, and the type of competition from the imagined version of capitalism would even be harmful. These topics are explored in sections 2.2, 2.3 and 2.4, on small firms and perfectly competitive markets, big firms and oligopolistic markets, and the relation of the latter to economic development. The

¹ For the US, the US Census Bureau's *Concentration Ratios: Business & Industry* dataset provides useful information. For the EU countries, look at Eurostat's *Structural Business Statistics* dataset. They all show phenomenal concentration of production and employment in a few firms out of hundreds of thousands.

(2007), for EU countries at Eurostat (2017), and the data in chapter 6 in this thesis for the UK.

² For example, laws governing mergers & acquisitions, competition law, and numerous others, would hardly be seen as necessary, if all they were being applied to were small firms.

³ For example, "Coca-Cola" is supposed to be the second most recognized word in the world, after the word "OK" (Pendergrast, 2013:8). It does not matter how reliable this claim is. The mere fact that it seems completely plausible is telling enough. It is quite probable that the global brands of international corporations are among the most recognized words and images in the world, together with the symbols and the names of the founders of the world's major religions.

⁴ For example, the trope of the giant evil corporation has become a staple in many parts of popular culture across the world. If giant corporations were not actually omnipresent, it could hardly have arisen.

implications of the two visions of capitalism for development policy are explored in section 2.5. And, prior to all this, section 2.1 sets out the definition of development adopted in this dissertation. Given how fluid the term has become,⁵ it is important to have a clear idea of what is meant by it.

2.1 Productivity increases, economic sectors, and development

I define development as the simultaneous attainment of high material living standards (both personal and collective consumption of goods and services) and increases in available free time. Fundamentally, this is enabled by productivity increases,⁶ because they are the only way to provide a large number of goods and services to a population. But, they are equally important for a number of other reasons.⁷

Productivity increases are the basis for simultaneously increasing production in several economic sectors. As productivity in one sector increases, instead of increasing production, the same production as before can be kept, but with fewer inputs. These can then be employed in other sectors in order to increase their production. If these other sectors are new, then we have economic diversification, which is itself important for a number of reasons. A diversity of goods and services are obviously necessary for consumption, but also for investment, as numerous economic sectors are interdependent and cannot exist without each other. Technological progress depends in part on synergies and spill-overs between different sectors, which can obviously only happen if an economy is diversified. Diversification also provides employment for those who lose jobs due to productivity increases in some sectors, or simply for an increasing population. Finally, a diversified economy is more resilient, as even if something goes wrong in some sectors, there are others to rely on.

⁵ See Chang (2010) for a comparison of the traditional meaning of this term, used in this thesis, and several more modern ones.

⁶ At this level of abstraction, it is sufficient to define productivity simply as some measure of output over some measure of input.

⁷ This following discussion is clearly based on capitalist economies, but with some modifications, it could be made relevant for any other institutional setting as well.

As an alternative to all of the above, we can take out productivity increases in the form of more free time – instead of increasing production anywhere, we can work less and have the same consumption as before.⁸

Productivity increases, being the basis of all of the above, are obviously important. But, where do they come from? Essentially, they are the consequence of technological and organizational improvements in production.⁹ The key thing here is that different sectors of the economy have very unequal potential for such improvements at any given time. This is why development is sector-specific – it matters what is being produced in an economy.¹⁰ It is for this reason that traditional development economists¹¹ primarily focused on industrialization. Namely, manufacturing had the greatest scope for productivity increases and the strongest linkages to other sectors. Today, the existing evidence suggests that knowledge-intensive services can be very propulsive too.¹²

It is also important to mention economies of scale. Improvements in technology and organization require investment. As these investments represent fixed costs, producers who have high fixed costs are forced to increase production volumes, so that they can realize economies of scale and make their products affordable. As it happens, sectors that have the highest scope for productivity increases are also generally the ones that require the highest investment and therefore can have the highest economies of scale. This has obvious positive effects on the wider society.

Productivity increases also usually entail improvements in the quality of existing products or the development of new products. Again, the most innovative sectors tend to be the ones with the highest economies of scale.

⁸ See the OECD *Average annual hours actually worked per worker* dataset. The average annual hours actually worked per worker are significantly lower in the richer OECD countries than in the poorer ones. Of course, productivity increases do not by themselves guarantee that there will be more free time – this is a matter of power relations and the institutional setting of an economy – but they at least create the possibility for it.

⁹ On the importance of technological development for economic development and growth, see Mowery and Rosenberg (1991). See also Reinert (2008).

¹⁰ On this point, see Reinert (2007).

¹¹ See Rosenstein-Rodan (1943), Prebisch (1950), Singer (1950), Lewis (1950, 1954, 2013), the collected texts of Ragnar Nurkse in Kattel, Kregel and Reinert (2011), Scitovsky (1954), Rostow (1956), Hirschman (1970), Myrdal (1964). For more modern authors, see Chang (2007, 2008), Reinert (2008), Amsden (1989).

¹² See OECD (2016), particularly chapter 3. As the publication notes: “Over the past 15 years, labour productivity growth was almost entirely driven by manufacturing and business sector services.” (OECD, 2016:62).

Finally, all these effects of productivity increases have feedback effects. Higher productivity results in more production and lower costs through economies of scale, thus providing more resources for further investment. Diversification also has beneficial effects on technological improvements (leading to productivity increases) through spill-overs between sectors.

The conclusion of all the above is that economic development is fundamentally based on technological and organizational improvements and is highly contingent on having at least a number of advanced economic sectors, in which productivity increases, diversification, spill-overs, employment and economies of scale interact and strengthen each other. Thus, if we wish to have a developed economy, it is essential to move into such sectors.

2.2 Standard theory of the firm and perfectly competitive markets

2.2.1 Standard theory of the firm

What I refer to as the “standard” theory of the firm is the set of explanations of how firms function that people generally encounter first when they start studying economics. The theory was first formulated in its modern form by Marshall (1997) and was later taken up (in much more mathematical form) in all economics textbooks.¹³ While it is far from the only theory of the firm that is taught in economics, it nevertheless exerts considerable influence over how people who have learned it understand firms. It is also taken as the benchmark of how firms should ideally function.

The standard theory assumes a firm that produces only one good, can sell as many goods as it can produce, is a price-taker, and maximizes profits.¹⁴ The behavior of the firm is then explained by looking at the relationship between fixed, variable and total costs of production, the quantity produced, the price and profits.¹⁵

¹³ See Samuelson and Mandel (2010), Mankiw (2004), Varian (2003).

¹⁴ Different authors sometimes list further assumptions, but the ones I listed are always present, and will suffice for my argument.

¹⁵ What follows is not a precise interpretation of the mathematical model with which this theory is presented. However, it is the way that the model is usually explained, and is thus what stays with people after they have studied the theory.

The firm, desiring higher profits, is increasing its production and is selling its products at a fixed price. The crucial assumption is that of the U-shaped cost curve.¹⁶ Variable costs per unit go up as production increases. Fixed costs per unit obviously drop, but since after a point, the variable costs per unit start increasing faster than fixed costs per unit drop, total costs per unit increase. The well-known consequence of these assumptions is that there is a *limit to how big a firm will grow*, as measured by the quantity of goods that it produces – a profit-maximizing price-taker firm will grow only until its total costs per unit become equal to the price.¹⁷ Consequentially, bigger firms are deemed to be less efficient.¹⁸

The conclusion that there is a limit to how big a firm will grow, reached by the most usual and widely taught theory of the firm, is rather peculiar given that in reality markets are dominated by gigantic firms. Because it is the assumption of rising variable costs per unit that lies at the core of this conclusion, the most pertinent question is why these costs would behave in this way? Provided that the prices of inputs do not change, the only thing that could lead to this is if more inputs were needed to produce product number 2 than product number 1. Why would this be the case?

The most well-known explanation is managerial diseconomies of scale (sometimes also called diminishing returns to management), namely, the assumption that the more the firm grows, the more complicated it becomes to run it, leading to more mistakes, wasted inputs, etc., all of which contributes towards increasing costs.¹⁹ There are other suggestions as well (for example, increased wear on machines as full capacity utilization is reached), but while they all do seem plausible, the real question is, are they true? Even more, do variable costs per unit increase at all in reality?

Evidence indicates that this is not the case. An early attempt to determine how variable costs behave is Eiteman and Guthrie (1952). The authors sent out a questionnaire to 1000 US manufacturing companies in 47 US states, all with between 500 and 5000 employees. The

¹⁶ For a history of the concept of the U-shaped cost curve, see Keppler and Lallement (2006).

¹⁷ These explanations pertain to firms that have fixed capital (“short-term”), but are normally followed up by a set of explanations that argue that the situation is essentially the same even if firms can expand their capital (“long-term”).

¹⁸ Exceptions to this, such as natural monopoly, are deemed interesting but not the norm.

¹⁹ This is the explanation given in any modern economics textbook. Interestingly, it is also the explanation used by Coase (1937), in the transaction costs theory of the firm, to explain why the reduction of transaction costs will not lead to the entire economy being concentrated within one firm. Namely, the costs of using management rise as the size of the firm increases, until they are equal to the costs of using the market system.

questionnaires contained 8 graphs. On each, the axes represented average costs and output (up to maximum capacity utilization), and each graph had a different line to represent different cost behaviors as output changed. The respondents were asked to pick the graph that best described how variable costs in their firm change when output changes.²⁰

Of the 366 firms that responded, 334 indicated that one curve applied to all their products, while the remaining 32 respondents said that different curves applied to different products. The first group accounts for more than 90% of all responses, so I will report those findings.²¹ Two graphs were chosen by an overwhelming majority of respondents. 203 firms chose the graph representing falling average costs, while another 113 firms chose the one that shows average costs falling all the way near to full capacity, and then rising slightly only as full capacity utilization is reached. Both these graphs do not conform to the assumption of rising average costs.²² This is a very important finding, because it undermines the assumption of rising average costs, and thus of this limiting factor to firm growth.

A much more recent and more encompassing research is Blinder (1998), who conducted interviews with a sample of companies representative of the US private, for-profit, unregulated, non-farm economy, which accounts for around 71% of US GDP. This was the part of the economy where firms are not price-takers, but price-makers to varying extents. Blinder was interested in how firms set their prices, in order to test various theories about price stickiness. For one of those, though, he had to ask questions about the behavior of costs.

The interviewees were offered a choice of five graphs showing various behaviors of variable costs, and asked how they would “characterize the behavior of your own variable costs of producing additional units as production rises”? (Blinder, 1998:216) Only 11% chose rising variable costs. Almost 50% chose constant variable costs, and the remaining 40% chose falling variable costs. In the words of Blinder (1998:218): “The answers are fascinating, especially when juxtaposed against the standard neoclassical assumption that [rising marginal costs are] the rule.”

²⁰ Eiteman and Guthrie explicitly asked the respondents to not do an accounting analysis before answering, as they were interested in seeing what businessmen think, the idea being that, businessmen will act on what they think is true, irrespective of whether it is or is not actually true. Nevertheless, it seems highly unlikely that the people making decisions on the scale of production in big firms would have no actual knowledge of how their costs behaved.

²¹ The conclusions from the other group are exactly the same.

²² Firms do not normally operate at completely full capacity, and if they consistently do, they would normally try to expand, so the second graph actually shows falling average costs for most relevant situations.

Thus, there seems to be very strong evidence against the assumption that variable costs per unit increase as output increases. Quite the contrary, they even seem to be falling for a sizeable proportion of firms. So, even if managerial diseconomies of scale or something else increases variable costs per unit, these increases apparently must be at least offset by something else that reduces costs. As we will see, management and other problems do indeed arise as firms grow, but they are solvable, and thus do not hamper the growth of firms. For now, though, let us look at how markets populated by small, price-taker, profit-maximizing firms are imagined to function.

2.2.2 The theory of perfectly competitive markets

Much like the standard theory of the firm, the theory of perfectly competitive markets is what people first encounter when they start studying how markets function. While many more people are aware that its assumptions and explanations do not match reality, it is still used as a sort of benchmark for comparing how other market types function (usually with the assumption that they would function better if they were more like perfectly competitive markets), but, more importantly, it is thought to point out supposedly essential mechanisms through which markets function.

In its modern form, the theory was first formulated by Marshall (1997),²³ with later authors taking it up in standard economics textbooks, just with less nuance and qualifications, and more mathematics. Marshall described two situations, one in which only the existing stock of goods can be sold, and another in which price changes affect output. In both cases, he wanted to point out price changes as the essential mechanisms through which markets adapt.

In the first case, price increases reduce the number of willing buyers, which pushes demand down and makes some sellers unable to sell their products. Some of them, therefore, reduce prices. This, however, threatens to attract away customers from other sellers, so they too are forced to reduce prices. The general drop in prices makes more buyers willing to buy again. However, while prices are still low, some sellers may prefer to hold out and wait for higher prices. This means that some buyers may not be able to get the goods they want, so they offer a higher price. However, this forces other buyers to do the same, pushing the price up again.

²³ See specifically chapter II and III of book V. Much earlier, the theory was expressed in nuclear form at the beginning of chapter X of Smith's *Wealth of Nations* (Smith, 2008).

More sellers will then sell. In this way, the price oscillates around an equilibrium level which will allow the market to clear.

In cases when output is affected by prices, Marshall argued that, if the price of a good goes up, it will be profitable for producers to employ more factors of production and produce more goods, and the opposite will be the case if the price goes down, that is, fewer factors of production will be employed and production will go down.

Marshall did not think his theory was a descriptively accurate representation of markets. It relied on a number of assumptions, such as free competition, goods being of equal quality, or sufficient knowledge about the prices that others are offering and accepting. But, Marshall thought that, by introducing these assumptions, he was able to “neglect those features which are special to particular parts of economic science”, so that he could devote “attention to those broad relations which are common to nearly the whole of it.” (1997:157) In other words, he thought that changes in relative prices were the essential mechanism through which markets operated. They are the signals that tell actors how much and what to produce, sell and buy, as well as which factors of production to employ and in what proportions. Normally, it is also assumed that the more freely prices are formed, the more efficient will the price mechanism be in telling actors what to do.²⁴ However, even if there are price distortions, say, due to the presence of powerful market actors, the price mechanism is merely assumed to produce less efficient outcomes, but it is still considered to be the most important causal mechanism through which markets operate.

But, is any of this true? Marshall only provided casual empirical evidence for his theories. As we will see, a more thorough exploration of how markets function provides a very different understanding. There is, however, a link between perfectly competitive markets and the standard theory of the firm. Namely, only price-taker firms with rising variable costs per unit need to decide on output levels based on the market price. Simultaneously, markets in which prices are formed according to supply and demand are what ensures profit-maximizing (i.e., efficient) levels of production in such firms. So, in order to understand how markets actually operate, we need to first get a more realistic understanding of how firms operate.

²⁴ This is an unavoidable element of the theory, at least as it is usually presented today. Marshall was actually more careful in expressing such claims, and was more interested in getting to an explanation of the price mechanism, than for arguing for the efficiency of free markets.

2.3 Big firms and oligopolistic markets

Contrary to theories that postulate that small firms are more efficient than big firms, there is a long line of thought in economics, generally ignored by the mainstream, that sees big firms (in absolute terms, and in relation to the total market) as the normal outcome of the operation of markets. Marx (1990) was perhaps the earliest author who clearly saw the tendency towards market concentration, and his insights were taken up by later Marxists (Lenin, 2010; Baran and Sweezy, 1977; Foster, McChesney and Jonna, 2011). A number of non-Marxist authors also saw big firms as the basic economic agent in capitalism (Schumpeter, 2008; Galbraith, 2007; Sylos Labini, 1969). Some Post-Keynesians, like Eichner (2008), built their macroeconomic analyses taking big firms, who behave very differently to small firms, as the main economic agent. Finally, major texts in business studies (Berle and Means, 2000; Penrose, 2009; Chandler 1994; Nolan, Zhang and Liu, 2007a) are devoted to studying big firms and their effects on the economy. We shall first look at why and how firms grow, and then explore how markets dominated by big firms function.

2.3.1 The emergence of big firms

Penrose (2009)²⁵ has analyzed at length how and why big firms grow. The first question that she asks is whether firms have a motivation to grow? For various reasons – loss of control, too much work, being averse to risk, etc. – owners of small firms may not wish their firms to grow. However, as long as some small firms wish to grow, we need to ask how they grow and if there is a limit to how big they can become.

Penrose sees firms as a collection of resources, which she defines broadly to include both material and immaterial things under a firm's control (machinery, the skills and knowledge of employees, patents, etc.). Not all resources are fully utilized at any time, and a firm with a strong entrepreneurial drive will always try to find ways to use unused resources. However, every change made in order to do so will create further unused resources. For example, wood chippings in a furniture factory are a waste product, but an entrepreneur may “convert” them into a resource if she starts selling them to a plywood factory. However, the earned cash

²⁵ Penrose based her analysis on industrial firms, but while many of the details of her arguments are applicable only to them, the general thrust of her book is of much broader interest.

becomes a new unused resource. The newly established contacts with the buying firm are also a new resource that may be useful for future expansion. Effectively, every change and expansion creates new possibilities, and if it creates problems, then solving these problems can also end up yielding new opportunities, knowledge, capabilities, and resources. If at any point the firm ends up in the unlikely situation with all resources being fully utilized, it can still make a conscious effort to move out of it and expand further. In other words, as long as a firm wishes to grow, it should be able to do so. Additionally, the bigger it grows, the more its drive to grow becomes institutionalized in the firm's organizational structures, and it becomes less a question of individual desire.

Is there a limit to how big a firm can grow, though? Penrose explored several possible limitations and concluded that none of them are hard limits.

Penrose argued extensively why managerial diseconomies of scale do not have to be a factor limiting growth. Managerial problems do indeed arise as a firm grows, but it is possible to solve them. This is done through various techniques for decentralizing management, and through introducing new procedures and technology. This overcomes the limited capacities of individuals to control what is going on in a firm. Penrose (2009:16) argues that:

The conclusion that the limited capacity of the individual will limit the size of firms has not ... been supported by events ... The techniques for decentralizing administrative organization have been developed to a fine point... With increasing size both the managerial function and the basic administrative structure have undergone fundamental changes ... The differences in the administrative structure of the very small and the very large firms are so great that in many ways it is hard to see that the two species are of the same genus...

In a similar vein, Galbriath (2007) pointed out that it is simply not possible for individuals to run modern production since its complexity far surpasses the knowledge that an individual can have. Developing modern decentralized management techniques is thus not just a possibility – without them, a modern economy could not even exist. Penrose argued that management capacities only limit the maximum *rate* of growth, as it takes time to build them up and adapt them. However, even this problem is mitigated through the possibility to expand through mergers & acquisitions, in which case a firm is buying already existing management structures.

The second possible limitation is the demand for a firm's products and the supply of its factors of production. If these are limited, then a firm cannot grow. However, economies generally grow all the time, but even if that is not the case, or if the specific market that an individual firm is in is stagnant or declining, a firm can still grow at the expense of other firms, or it can diversify into other markets.

Risk and uncertainty are the final possible limitation. Expansion itself involves risk and uncertainty, and a larger firm with more operations will be facing more risks on more fronts. However, as a firm grows, it also becomes more able to both reduce risks and uncertainty and to deal better with the inevitable instances when things do go badly, as we will see in the next section.

The conclusion of the above analysis is not that all firms will both want to grow and manage to do so, but rather that some firms will. As long as that is the case, we will have an economy with at least some large firms. We now move onto what effect that has on markets.

2.3.2 Competition and planning in modern capitalism

Since some firms will grow and others will not, when talking about competition, we need to differentiate between how small firms compete against each other, how small and big firms compete, and how big firms compete among themselves.

With regards to competition between small firms, Galbraith (2007:34, 58) notes that it resembles price-based competition in perfectly competitive markets. In other cases, it may resemble monopolistic competition as presented by Robinson (1969) and Chamberlin (1962). The Austrians (see, for example, Hayek, 1945) focused on the role of entrepreneurship in adapting to market signals. The reality depends on the specific market we are looking at, but the essential characteristics are that there are few barriers to entry and exit, no firm has decisive power in influencing prices or other relevant trading conditions, firms take consumer preferences as given, and generally cannot influence the institutional framework. In such conditions, the market is split among many roughly equal small firms.

Regarding competition between big and small firms, the question comes down to whether size provides competitive advantages, which it indeed does. In markets for complex products and services – the majority of markets in modern capitalism – small firms may simply be unable to enter them at all, because of cost and other barriers to entry. In cases where small firms are present in the market, they are simply not big enough to have the necessary resources to make

the large investments, such as in R&D²⁶ or in commercializing their products,²⁷ that are needed to effectively compete in them. Big firms have higher productivity, better technology, a finer division of labor, larger economies of scale (and thus lower costs per unit), better brand recognition, higher cash reserves, easier access to financial markets, and numerous other competitive advantages. If it does look like a small firm may become a threat through future growth, a big firm is normally able to either buy it or otherwise draw it under its influence, or simply use its superior market position to outcompete it, for example through undercutting its prices (which the big firm can do, because it has lower costs and a stronger financial position), or even by engaging in illegal activities, such as forcing its own suppliers to not deal with the firm in question or by using price dumping. Of course, we do know that even in advanced sectors small firms can and so survive, but Penrose (2009) argued that they do so in “interstices”. These can be markets which big firms have not yet come to dominate, niche markets that are too small to be of interest to big firms, or it may simply be the case that big firms are letting small firms survive for public relations reasons. However, we should not mistake the existence of these interstices for a genuine competitive advantage of small firms – in principle and in most cases, big firms could come to dominate these interstices as well, if they so wished.

It is for these reasons that most markets are split among a few big firms, as it is only big firms that can withstand the competition from other big firms. Even if a market starts with many small firms, a few of those will grow faster than others and thus become more

²⁶ For example, the 2016 EU Industrial R&D Investment Scoreboard (European Commission Joint Research Centre, 2017), apart from tracking the top 1,000 EU companies by R&D investment, also tracks the top 2,500 world companies by R&D investment. The total R&D investment of the 2500 in 2015/16 was almost €700 billion. (This is over 50% of total world R&D investment, when compared to total world R&D investment according to World Bank data). The companies it tracks in, say, the automobiles & parts industry invested a total of €107 billion. One company, Volkswagen, accounted for €13.5 billion, so, 12.5%. This is many times higher than the total sales of many smaller automobile producers. Not incidentally, in 2015, Volkswagen accounted for almost 11% of total world motor vehicles production (OICA, 2017). Volkswagen is also the biggest investor in R&D overall, at almost 2% of the total of these 2500 companies. Of the entire 2500 companies, the top 50 accounted for 40% of all R&D investment. See also the various data on R&D done by US companies broken down by firm size at National Science Foundation (2016), which shows a huge concentration of R&D in the top few firms by size.

²⁷ For example, Amison and Bailey (2014) note how local firms in automotive design in the West Midlands in the UK do have enough state support for early stage R&D, but have significant problems in commercializing their products.

competitive, and it will not take long before the market becomes dominated by a few big firms, that is until it becomes oligopolized. However, we should note that markets do not need to ever have a phase dominated by small firms. It is quite possible that existing big firms are the ones that move into, or create, a new market from the start. Actually, today this is the norm. As pointed out by Chandler and Hikino (1999:33), it was mostly the dominant firms of the second industrial revolution (say, in steel, machine tools, oil, automobiles, etc.) that ended up dominating the third industrial revolution (petrochemicals, pharmaceuticals, electrical appliances, etc.), with the very significant exception of software. This is because most new technologies and products today are more complex than an individual or a small group can create.

Competition between big firms is vastly different from the above descriptions of competition between small firms, and between them and big firms. Growth comes from investment, which creates illiquid material and immaterial assets, often highly specific to their planned use. If whatever the plan for them was does not happen as intended, they cannot be easily repurposed or sold, and the firm stands to make considerable losses. For that reason, the overarching concern for big firms is risk reduction and ensuring stability.

Risk comes from various sources, but market changes, and particularly price changes, are one of the foremost ones. Firms can invest in market research to be better able to plan and reduce risk in that way. But, Galbraith (2007:24-41) explored how big firms, due to their size, have numerous options for suppressing markets and replacing them with planning. They can integrate vertically, thus completely replacing markets with internal planning. Alternatively, their size as both buyers and suppliers makes them very important to other firms, so they can use that to dictate prices and other conditions. They can also enter long-term contracts which stabilizes market conditions.²⁸ When it comes to ordinary consumers, a big firm can devote substantial resources to advertising, making it likely that consumers will want to buy the products that the firm wishes to sell.²⁹ Finally, given that advanced sectors, often crucial to an economy, are the ones that are most dominated by big firms, governments are often willing to guarantee purchases and prices to big firms.

Big firms, though, face the biggest risks from other big firms. However, it is widely understood that they avoid price competition (Galbraith, 2007, Schumpeter, 2008, Penrose,

²⁸ Obviously, any firm can do that, but only big firms are ordinarily stable enough to be able to keep to the bargain.

²⁹ According to the Forbes (2017b), companies with the most valuable brands in the world spend billions of dollars on advertising. The top 10 companies by advertising spending spent almost \$54 billion in 2016.

2009, Cowling, 1983).³⁰ If one firm reduced prices, due to its sheer size, this would be known to those concerned, and the firm could make the needed adjustments to meet the increased demand. Its competitors could reduce their own prices, but this would return everyone to where they were relative to each other, just with lower revenues. If a price war ensued, everyone involved would suffer losses. It is also possible that, due to other firms having long-term contracts or strong brand loyalty, a price cut would not generate sufficient extra demand to justify it, so it could happen that the firm doing the cuts merely ends up with lower revenues and no particular competitive gains. For these reasons, big firms ensure they do not engage in price competition, either through active collusion or simply by observing what everyone else is doing and sticking to similar pricing.³¹

Instead, as explored extensively by Schumpeter (2008), Penrose (2009), Cowling (1983), Cowling and Sugden (1987), and numerous others, oligopolistic markets are characterized by non-price competition. This is based on developing new and improved products, new technologies, entering new markets, cutting costs, improving branding, introducing new management techniques, and a host of other actions – this type of competition, as Schumpeter (2008:84-85) noted:

commands a decisive cost or quality advantage and which strikes not at the margins of the profits and the outputs of the existing firms but at their foundations and their very lives. This kind of competition is as much more effective than [price competition] as a bombardment is in comparison with forcing a door, and so much more important that it becomes a matter of comparative indifference whether competition in the ordinary sense functions more or less properly; the powerful lever that in the long run expands output and brings down prices is in any case made of other stuff.

Such competition normally entails further growth. Still, this competition is in a way routinized – for example, big firms are not really taken by surprise when a competitor puts out a new product – and in that sense, it does not pose the same type of unpredictable risk that price changes would.

³⁰ See particularly chapters 16 and 17 in Galbraith (2007) on the role of prices in modern capitalist markets.

³¹ Of course, if a big firm does actually manage to get a decisive cost advantage over its competitors, then it may reduce prices, but in this case, if other firms follow suit, they will suffer losses.

2.4 Big firms and development

As is evident, there are striking similarities between oligopolistic non-price competition and economic development. Economic development is based on moving into advanced sectors of the economy, where technological and organizational innovations lead to productivity increases, economies of scale, diversification, increases in employment, and create the potential for increased free time. These things are the effects of competition between big firms. In other words, economic development is partially the effect of such competition.³²

Baumol (2004) explored another way in which big firms' business behavior has beneficial effects on development. He showed that big firms often treat technology just as another resource, and are therefore willing to sell it or license if that fits into their plans. They also often engage in joint research projects, patent swaps, and a host of other arrangements for mutually beneficial technology sharing.³³ In some cases, even distributing technology for free may be a part of the core strategy of the firm – Google's development of the Android operating system under open license is probably the best-known example. The benefits for society of faster technological spreading are clear.

There is another benefit that comes to society from oligopolistic markets. Namely, unlike in competition between small firms, in which those who are not doing well generally disappear, big firms that fail do not normally disappear completely. Instead, entire firms or at least some of their parts are usually bought out by their competitors in order to acquire valuable assets. Cowling (1983) and Cowling and Sugden (1987) have, for example, noted the massive extent of mergers and acquisitions in modern capitalism, with Nolan, Zhang and Liu (2007b) providing more recent evidence. This does not mean that no one suffers from a firm's closure, but it does often ensure that accumulated knowledge and capital do not disappear. Stability is important to any economy, and big firms are themselves very stable, due to their ability and need to plan, but by buying up failing competitors, they provide another source of stability (and incidentally grow further in the process).

Of course, development does not come only from big firms. Infrastructure, education, or healthcare are usually provided directly or indirectly by government. Much technology,

³² For a very thorough account of the key role that big firms have played in the development of a number of today's advanced capitalist countries, see the relevant chapters in Chandler, Amatori and Hikino (1999).

³³ While this may not change the relative position of firms engaged in such arrangements, these firms will all achieve an advantage compared to firms outside of such arrangements.

particularly basic research, is developed in government and non-profit institutions and universities. Also, it is possible for the government to operate a big firm which is not exposed to oligopolistic competition, but is nevertheless highly innovative and run efficiently. We should also not forget that the dominance of big firms has plenty of negative effects too, from their undue political influence, to unproductive competition, to the fact that they rarely pay much attention to how their business decisions affect anyone's interests but their own, which, due to their size, can have enormous impacts on society.³⁴ Still, while we should be mindful of these things, if we wish to understand development, we have to acknowledge the positive effects as well.

2.5 Development policies

If development is tied to big firms, then those economies that have more market-leading big firms should be more developed than those who have fewer or none. At the global level, that is what we observe. Both the Fortune 500 (Fortune, 2017) and Forbes 2000 (Forbes, 2017a) list of the largest companies in the world show that they are hugely concentrated in the world's rich countries.

However, this means that the entire above analysis has a flip-side. Namely, if an economy wishes to become developed, it has to move into advanced sectors of the economy by building up big firms in them. But, these sectors are already dominated by existing big firms. I already argued that small firms are at a huge disadvantage compared to big firms, so starting small and gradually building up a competitive position is not really an option. Besides, in many sectors technologies that allow viable small-scale production simply do not exist anymore. Of course, it is possible to gather enough resources to immediately set up big firms with advanced technologies, but they will still be at a disadvantage against existing market leaders, because there are numerous other sources of competitive advantage apart from pure size, such as proper

³⁴ For a well known recent criticism of various negative effects of large corporations, see Klein (2005). On various forms of unproductive competition, such as massive advertizing, preventive patenting, or keeping large excess capacity, see Cowling (1983). Cowling (1983) also explores oligopolistic competition in detail, as well as the power of management over workers, and concludes that markets dominated by large corporations will end up stagnating, due to the potentially falling rates of profits and the falling shares of wages in income. See also Cowling and Sugden (1987, particularly chapter 4) and Cowling (1994) for a criticism of the political power of large corporations.

management, branding, or established business connections. This puts less developed economies that wish to develop in a very problematic position (Nolan, Zhang and Liu, 2007b).

It is here that our understanding of how firms and markets function becomes essential. If we believe that small firms are more efficient than big firms, and that markets operate through the price mechanism, and that the freer they are, the more efficient they are, then our suggestions for proper development policies will revolve around setting up an economic system that resembles these theories. We will also miss the fact that development is sector-specific. But, in reality, development comes from big firms and oligopolistic non-price competition in advanced sectors of the economy. Prices in such a system are not determined freely on the market as the unintended consequence of the actions of many actors, but are set by price-maker firms, and are generally not an important signaling mechanism. From this perspective, development policies should help firms to achieve efficient scale of production, and to build up other competitive advantages.

Both types of policies have been tried. We can generally call those policies based on the idea that markets operate through the price mechanism, that firms are constrained in how big they can grow, and that small firms are more efficient than big firms, as Washington Consensus policies.³⁵ They have been applied throughout the world, but for this thesis, their effects in former communist countries are particularly interesting, given that many of these countries did actually have numerous advanced economic sectors with big domestic firms.

A paradigmatic article discussing Washington Consensus policies in former communist countries is Lipton et al., (1990). The authors espouse the erroneous belief that SMEs are the main driver of growth in capitalism, claiming that SMEs are: “the kind of firm that plays such a vital role in growth in the Western industrialized economies.” (Lipton et al., 1990:82). The authors blame the situation in Eastern Europe on the fact that “the absence of markets and *meaningful relative prices* in the economy means that it is difficult, if not impossible, to distinguish between enterprises that should and should not survive.” (Lipton et al., 1990:85, emphasis mine). In the same vein, they also contrast central planning and the market system in the following way: “The organization of industry is designed to facilitate top-down planning, *rather than market competition*, with a heavy orientation toward large firms integrated both horizontally and vertically.” (Lipton et al., 1990:82, emphasis mine). The authors’ policy

³⁵ This term was coined by Williamson (1990). The types of policies that have become associated with the term are not completely those that he proposed. This is discussed in Williamson (2004). Nevertheless, I am using the term the way it is usually used today.

suggestions were deregulation, liberalization, free trade, and breaking up of state monopolies, quite in line with trying to make the real world resemble more how they imagine capitalism to function.

As should be clear, the authors' description actually fits both advanced capitalist and former centrally planned economies. The results of applying the policies they suggested were as should have been expected. The communist countries had advanced economies, but not as advanced as those in the West, and when they were exposed to competition from stronger foreign firms, their own firms were generally outcompeted, with negative effects on their economies. They never recovered from this shock, and have moved into less advanced sectors, or serve as sources of cheap labor for Western companies.³⁶ The same effects happened even when middle-income capitalist countries, such as those in Latin America, prematurely engaged in competition with far stronger competitors. Truly underdeveloped countries suffered even more from the application of such policies.

Conversely, as shown by numerous authors,³⁷ those countries that directly helped their domestic firms to develop, with the understanding that it would take a long time before they became competitive against already established market leaders, fared much better. Chang (2007) calls the policies used to support them activist ITT (industrial, trade and technology) policies. They generally included:

a) protection of domestic markets in order to reserve them for domestic firms, so that they could survive, and achieve minimum efficient scales of production and develop supplier networks,

b) various forms of financial support for firms so that they could undertake the large investments needed to enter markets for complex products and services,

c) help to achieve export competitiveness, such as through tariff rebates and export subsidies, both because domestic markets were not large enough to achieve economies of scale and because there was much need for foreign currency,

d) diverse technological policies, to help domestic firms import and adapt foreign technology and/or develop their own,

³⁶ This has been discussed by Reinert and Kattel (2004), Rajic (2011). For a comparison with the different policies pursued by China, see Nolan (1996).

³⁷ See, in particular, Chang (2007, 2008), Johnson (1982), Amsden (1989), Reinert (2008).

e) setting up various institutions to reduce risk and uncertainty, such as guaranteed purchases by the state, credit guarantees, and the like,

f) numerous policies to control foreign investment so that foreign firms would create backward and forward linkages in the domestic economy,

g) general macroeconomic policies that put high investment as the main goal, and subordinated other goals, like inflation control, to it.

Werner (2003) has presented extensive evidence of another important policy, namely, directed credit through new money creation supported by the central bank. He argues this was a key ingredient in Japan's development during the Second World War and after it. Leading Japanese policy-makers, such as Osamu Shimomura, the author of Japan's successful income-doubling plan in the 1960s, "knew well that the credit control mechanism was the core of the successful system of a mobilized economy and the key tool to create high noninflationary growth." (Werner, 2003:66).³⁸

Activist ITT policies have not always achieved their goals, but this was due to the political economy of the countries that failed, not due to the policies themselves. As Evans (1995) argued, what is needed for successful late development is a state that has built up the skills to lead an industrial policy, but that is also autonomous enough from various interest groups so that it can continue pursuing such policies, even when there are opposing forces. At any rate, notwithstanding a few very specific cases, such as Hong Kong, only activist ITT policies have managed to help late developers catch up to the leading countries. However, as we will see in chapter 4, a number of these policies cannot be used for regional development purposes, as by design they cannot be used within countries.

There are other development policies that only partially rest on the assumptions about firms and markets that have been discussed thus far. For example, the World Bank's influential *Doing Business* reports³⁹ are based on the idea that markets should operate freely, but that there are transaction costs that should be reduced. They argue for regulatory reform that makes it easier for firms to enter and exit markets, for more transparency in corporate governance, for setting up "one-stop shops" where firms can do all the administration they need in one place,

³⁸ For an argument about the interplay between economic growth and the need to maintain price stability, see Prebisch (1961). Also, note that centrally planned economies, with their monobanks, practically by definition used this approach to monetary policy.

³⁹ The latest one is World Bank (2017).

and various other policies. The reports do have an implicit neoliberal bias in some areas (for example, less protection for workers is seen as being better for doing business), but, in many others, they do point towards quite reasonable improvements. This sort of thinking seems to have been influential in newer regional development policies, so it is worth noting that, whatever the merits of such policies on their own terms, they do not address the underlying causes of underdevelopment, namely, that poorer economies have fewer and weaker big firms than more developed economies. Unless the regulatory framework is of a severely predatory nature, a determined firm can find ways to deal with regulatory hurdles, but it is much harder to deal with dominant market players.

Similar criticisms can be raised against micro-credit policies, as has been done by Chang (2010). Essentially, while they may help some people secure a somewhat better existence, they do absolutely nothing in terms of structurally transforming an economy and pushing it towards developing big firms in advanced sectors.

Various policies to stimulate entrepreneurship are also usually pursued together with reforms such as the ones suggested in the *Doing Business* reports or with micro-credits. This may be helpful for individuals, but since most innovation today requires big investments, small-scale entrepreneurship does not offer scope for structural transformation. The situation is different if entrepreneurs are working within big firms, or if we are focusing on those sectors where innovation can still be done by small teams, who can then integrate their firms into the value chains of big firms, but neither of these is what policies to promote entrepreneurship focus on.

The present chapter has argued that development depends on productivity increases and their various positive effects, such as diversification or economies of scale. It was also argued that development is sector-specific, that is, that at any point in time, only some sectors of the economy have the potential for significant productivity increases and that if an economy is to be developed, it has to have at least some such sectors.

In addition, development is inextricably tied to big firms and oligopolistic competition. It is generally only big firms that have the capacity to make the significant investments in technological and organizational upgrading that productivity increases are based on. They are forced to make these investments due to competition from other big firms. On the other hand, small firms have little chance to compete successfully against big firms, as they suffer

numerous competitive disadvantages. This means that markets in advanced capitalist markets are highly oligopolized, divided between a few giant market-leading firms.

The negative side of this for less developed economies is that, if they want to become developed, they have to develop their own big firms in advanced sectors or attract high value-added investment from existing market-leaders. Neither thing is easy to do because they are facing competition from already highly developed economies. This explains why successful late developers have had to use highly interventionist economic policies, in order to counter the operation of markets, and give their own firms time to become internationally competitive.

This chapter is an essential background chapter for the rest of the thesis. It established what it means to be economically developed, it tied this to market structure, and explored the hurdles that less developed economies face in their development, and the appropriate development policies that they have to pursue. The next chapter adapts this analysis to regional development within countries, while chapter 4 adapts the analysis of development policies to the regional context. As we will see, there are numerous parallels between country-level and region-level analyses, and understanding regional development and underdevelopment cannot be understood without the arguments presented in the current chapter.

3. Regional development and oligopolies

The previous chapter established what development is, how it is related to big firms and oligopolistic non-price competition, what problems this creates for underdeveloped economies, what development policies have been used, and how successful they have been. This chapter adapts that analysis to regional development within countries. Are the same mechanisms that keep some countries underdeveloped also keeping regions within countries underdeveloped? And what development policies can be used to foster the development of poorer regions?

The first step is to define a region. A functional economic definition of a region could be that economic agents within it have stronger connections between each other than with agents outside of the region, or that certain types of economic activities are predominant in the entire region. The administrative definition is that a region is whatever is defined as such by a relevant authority, for example, the central government. Administrative regions often, but not always, have regional authorities, which can have widely varying levels of power. Obviously, administrative and economic regions do not have to coincide. While for the purposes of this thesis it would be preferable to use the functional economic definition, statistical data is normally gathered according to boundaries of administrative regions, so this is the definition I use throughout.

We can conceptualize regional economies as separate but interlinked, much like we do with national economies. Those regions where the operations of oligopolistic firms, such as production, administration or R&D, are located, are likely to be developed because the beneficial effects of their presence (employment, technological advances, economic stability, etc.) are located there. In contrast, those regions which have fewer big firms, or less competitive big firms, are likely to be less developed. Alternatively, since big firms normally have operations in numerous places, it may be the same firms that are present in both poorer and richer regions, but the internal distribution of value added may be such that operations in poorer regions receive less than operations in richer regions. Although a firm could, in principle, choose to distribute its value-added in any way it wants between its operations, almost without exception it is routinized production and simpler services that are low value-added activities, while prototype and pilot production, headquarters functions, R&D, and other knowledge-intensive services are high value-added.

Poorer regions find it difficult to develop because they would either have to attract big firms to invest in higher value-added activities in their territories, or they would have to develop their

own big firms. However, market-leading firms do not often choose to locate their more advanced activities in poorer regions – if they did, they would not be underdeveloped – and, as argued in the previous chapter, it is next to impossible for new firms to go up against established market leaders. For these two reasons, poorer regions need to be supported through regional redistribution and/or helped in their development through regional development policies. Regional development policies are explored in the next chapter, while the rest of this chapter examines more closely the economic mechanisms that keep some regions underdeveloped.

The rest of the chapter is structured as follows. Section 3.1 examines the mechanisms of regional development and underdevelopment. Section 3.2 asks if some regions are simply inherently more suitable for development than others. Section 3.3 looks at some theories of regional development that, in my opinion, have not contributed too much to our understanding, but are nevertheless prominent enough to have to be addressed, even if only briefly.

3.1. Mechanisms of regional development and underdevelopment

Substantial work has been done on how the situation described above – the power of market-leading firms and where they choose to locate their higher and lower value-added activities – plays out internationally. Notable examples looking at the macro-picture include Hymer (1975) and Cowling and Sugden (1987). Hymer argued that a small number of corporations from developed countries would come to dominate the world economy and that the international division of production will reflect the internal division of labor within these firms – their higher level activities will be located in the developed countries (specifically in a small number of global cities), their mid-level activities will be spread across subordinate cities, while the lowest level activities will be spread across the world. This development has indeed happened. Cowling and Sugden (1987:90-91), on the other hand, focused on explaining the location choices of market-leading firms from the perspective of the attempts of management to curb the power of workers. Spreading production over a number of locations reduces the power of workers in every individual location, as the firm can threaten to use production from a different location if its demands, say for wage reductions, are not fulfilled. This creates low pay economies, except where more complex activities are located, for which wage costs are not necessarily the main consideration. Cowling and Sugden do note that this happens even when the production is spread regionally within a country, but focus almost their entire analysis on

the international spreading of production, because workers find it particularly difficult to present a common front across borders.

However, this sort of analysis – tying the location of development to the intra-firm conflicts between capital and labor, to internal location choices, and to the power of big firms – has been adapted to intra-country regional development by only a few authors. Two authors stand out in putting big firms and oligopolistic competition at the center of their analyses of regional development: François Perroux (Perroux, 1971, 1988) and Stuart Holland (Holland, 1976a, 1979). Their analyses are based on exploring how oligopolistic competition plays out in space, so they essentially see regional development and underdevelopment as side effects of big firms' actions. Additionally, Myrdal (1964) and Hirschman (1970), while not exploring market structures and firms in detail, nevertheless had a clear understanding that competition between regions at different levels of development puts the less developed regions at a disadvantage, much like competition between rich and poor countries puts the latter at a disadvantage. All four authors also analyzed broader regional economic interactions, such as migration, trade and capital flows. Together, they provide a thorough understanding regional development and underdevelopment.

It should be noted here that Perroux's and Holland's insights about oligopolies have been almost completely forgotten. Perroux is best known for his theory of growth poles, but, as we will see below, he criticized the fact that too often people have talked about them while completely neglecting the fact that they are inextricably tied to oligopolies. Similarly, on one of the rare occasions that Holland is even mentioned, Gardiner et al. (2013:900-901) say that his basic argument revolves around regional labor and capital flows and how they increase the maximum potential growth in richer regions. This, however, was simply not Holland's basic argument. Factor flows between regions were for him first and foremost a consequence of how oligopolistic competition plays out in space.

3.1.1 Growth poles

Perroux (1971) introduced the concept of the “growth pole”. This has mostly been associated with geographical growth poles – regions or single cities in which economic activity is concentrated and stimulates economic activity in other areas or in the cities' hinterlands – but Perroux actually starts with explaining the importance of structural transformation. He notes that structural change consists of things such as the appearance and disappearance of

industries, the varying rates of growth of different industries, the establishing of links between industries, and the stimulating effect that some industry's products have on inventions in other industries (1971:278-279). However, some industries, which Perroux calls propellant, have a greater ability to effect structural change than others. He recognizes that such industries are "large modern industr[ies]" in which "the separation of the factors of production from each other, the concentration of capital under one control, the technical separation of tasks and mechanization" are more advanced than in other industries (1971:280s). He also notes that competition in them is that of monopolies and oligopolies (1971:284), and remarks on how the dominance of large firms over small firms, oligopolistic competition, and state policy, can change the structure of markets (1971:286) and the entire economy.

Only after establishing this does Perroux add a spatial dimension to his analysis. A geographically concentrated urban-industrial pole – an area containing propellant and "impelled" industries – produces a number of effects. On the consumer side, it "produces consumers with more varied and progressive consumption patterns than those of rural agricultural environments" (1971:287). This consumer demand stimulates further industrial improvements. Urban-industrial poles, however, do not only increase individual needs and wants but also collective ones. Accommodation, transportation and various public services become complex to satisfy, and finding ways to do so spurs further development of the industrial pole. From the side of producers, an industrial pole concentrates and creates "various types of producers, entrepreneurs, skilled workers and industrial labour [which] influence each other, create their traditions, and eventually share common interests" (1971:287). What Perroux is talking about is what we would today call agglomeration economies in the broadest sense – positive effects for consumers and producers arising from their geographical concentration. This idea is hardly new,⁴⁰ but Perroux was the first to connect it to oligopolies.

Urban-industrial poles affect their immediate surroundings, by stimulating food production in the rural areas around them. They can also stimulate the emergence of other industrial poles. For example, the concentration of steel production and associated activities stimulates the establishment of industrial poles built around the extraction of coal and iron. Perroux concludes that the actual geographical growth of markets "is quite the opposite of growth equally shared; it operates through concentration of the means of production in points of growth from which then radiate arrows of exchange." (Perroux, 1971:287).

⁴⁰ According to Reinert (2008), the recognition of such effects has existed for centuries, although economists tend to associate the idea with Marshall.

This provides an explanation of how development spreads geographically, but what about *underdevelopment*? Perroux looks at the issue very briefly, and from only one angle. He says that techniques of production, trade or political factors can change in ways that “favour or otherwise the various poles of concentration. The concentration of men and fixed capital, the rigidity of the structures which accompanied the development of the pole also make their consequences felt when it starts to decline; the pole which was a seat of prosperity and growth, becomes a centre of stagnation.” (Perroux, 1971:287). This is basically the geographic aspect of a decline of big firms located in a region. Big firms have significant resources, and even though they require stability, they are able to adapt and change. However, sometimes conditions change too much even for them. Still, although this account provides a satisfactory explanation of regional economic decline, it does not explain why some regions never get to develop in the first place. In fact, Perroux does not even mention this latter question, even though it is as important as industrial decline for understanding regional disparities.

Perroux’s analysis did not change much over the later decades. In Perroux (1988), he essentially set out the same theory and devoted much attention to criticizing how the concept of the growth pole had been (mis)interpreted, particularly in policy discussions. Namely, people had ignored that it is based on an understanding of oligopolies and merely focused on its geographical aspects – as if the emergence or decline of poles could be understood without looking at the underlying market structure and the emergence or decline of propellant industries.

With regards to regional disparities, Perroux did elaborate somewhat more on them. He noted that an industrialized country “is made up of economically *active* and surplus-producing regions, and ... *less active* and deficit-producing [ones]” (Perroux, 1988:54). The surpluses and deficits refer to the flows of raw materials and people, which go from less active to more active regions. This may empty some regions of their resources, but it is necessary if the economies of the active regions are to expand. However, Perroux argues that we cannot stop the analysis at this “attraction” phase, but have to also look at the “expansion” phase which comes afterward. By this, he meant the propulsive effects that active regions exert on other areas, and, in the aggregate, on the entire economy (Perroux, 1988:58-59). Furthermore, it is not necessarily the case that the resources that are drawn from less active to more active regions were employed before, so it is not clear whether the less active regions lose out even in the attraction phase.

Here we see a basic theory of regional development *and* underdevelopment – during certain periods some regions have to lose out so that others can develop, but in later periods they too

will receive investment and attain higher living standards, exactly because other regions have become developed and are now producing positive effects for the whole economy.

3.1.2 Interactions between richer and poorer regions

Myrdal (1964), Hirschman (1970) and Holland (1979) explored these interactions between poorer and richer regions in more detail, looking at migration, capital flows, and trade. Myrdal and Hirschman, whose analyses are nearly identical in almost all respects, predominantly stayed at the theoretical level. They divided the interactions between poorer and richer regions into those that favor the latter and those that do not. Myrdal calls the positive mechanisms “spread” effects, while Hirschman calls them “trickle-down” effects. Myrdal’s term for the negative effects is “backwash” effects, while Hirschman’s calls them “polarization” effects. Holland tried mustering as much empirical evidence as possible about these mechanisms. I will focus only on the effects on the poorer regions since I am interested in the possibility for structural transformation there.

Migration

Myrdal (1964:27-28) and Hirschman (1970:188-189) argue that on average young, active, enterprising, educated and skilled people emigrate from poorer to richer regions. This denudes the poorer regions of exactly those people who are essential for development, while simultaneously leaving behind those who need more support, such as children, the old and the sick. Hirschman noted that the net effect at the aggregate level is uncertain – it is possible that the gains in the richer regions are smaller than the losses in the poorer ones. An additional negative effect that neither Myrdal nor Hirschman mention is that investment made in the poorer regions for the benefit of the future émigrés (for example, in their education) is effectively lost from the point of view of those region. This may be particularly problematic if the investment was made into something that will continue to incur costs even after the people who benefited from the investment emigrate, for example, empty houses which still need fire protection.

Hirschman did note that emigration may also help a poorer region by reducing (often disguised) unemployment.⁴¹ If unemployed people emigrate, there is no reduction in the income of the poorer region (due to the fact that the unemployed have zero or negative marginal productivity), but a reduction in population leads to an increase in income per capita. However, the crucial (implicit) assumption here is that the unemployed are supported by incomes generated in the poorer region. But, if they are at least to an extent supported by incomes generated in the richer regions – for example, through unemployment benefits, provided state revenues do not derive only from the poorer region – then Hirschman’s argument does not necessarily hold. At the very least, the increase in income per capita will not be as large as it would have been in the first instance.

Strangely, neither Hirschman nor Myrdal mention that those who emigrate often send remittances back to their region, which would be another way through which emigration could help poorer regions. Still, this additional income would have to be measured against the losses incurred by the emigration. Furthermore, the gains may be temporary. A person may emigrate to a richer region and send money, say, to his family, but if they emigrate as well, the remittances could stop, which might have further negative effects by removing demand from the local economy.

The strength of the negative effects and the balance between these and any positive ones cannot be determined at the level of theory. Holland (1979)⁴² offered an empirical assessment by drawing on research for the United States and Italy. He concludes that there is a definite flow of labor from the poorer to the richer regions. In terms of age and gender selectivity, there is a clear bias towards young males. There was insufficient evidence about skills selectivity, but lots of concern that poor regions were being denuded of skilled workers.

Holland also argued that the positive effects of emigration through a reduction in unemployment in the poorer regions do not necessarily happen. He noted that there is significant reluctance to move far in search of higher wages and employment. In fact, migration tends to have intermediate steps. If people live in deprived rural areas, they usually first move to regional urban centers, where they often linger in unemployment, underemployment or poorly paid jobs. Because of this, agricultural areas get depopulated, while poor cities, which

⁴¹ Hirschman was writing in the 1950s, so he must have had in mind poor agricultural regions. The common understanding was that these had high levels of disguised unemployment – agricultural laborers with zero marginal productivity, who were effectively supported by their families and communities.

⁴² See in particular his chapter 4.

have little resources to deal with a population influx, simultaneously get over-populated and pockets of severe urban deprivation are created. Meanwhile, the population of the poorer regions does not decrease, and its income per capita obviously cannot increase based on that. The move to more developed regions tends to come afterward. Once it finally happens (if it does), it is also not irreversible, since many people do not succeed in their new region and return home. Due to these and other reasons, in the period that Holland examined, the respective “souths” of the US and Italy had an outmigration approximately equivalent to their population increases, which means that their population actually remained approximately the same throughout the post-war period.

The other problem is that even if population decreases and there is an increase in income per capita, there is no guarantee that what is usually assumed will happen, namely that the additional income will be used for productive investment. Looking primarily at Italy’s Mezzogiorno, Holland noted that the extra income per capita resulting from emigration, in the form of higher agricultural surpluses, may not be large enough to enable investment. Furthermore, the nature of the production that is yielding the surpluses may be such that investment is anyway impossible. In the case of the Mezzogiorno, emigration was mostly coming from poor mountainous areas, where substantial increases in productivity cannot be achieved due to the terrain and the types of crops grown. Even in better terrain, it is possible that there are no cash crops that can be grown there that are also in demand. Or, agricultural production in such terrain may already be well capitalized, and under the control of capitalist producers, and no further gains in productivity can be made.⁴³ The type of land ownership may also prevent investment. For example, if it is landless peasants who are emigrating, it is not likely that their remaining families would use their extra income to invest in the landlord’s land, not least because the landlord could easily increase the rent and appropriate the extra income the investment would bring. Even for farmers with their own land, it is not guaranteed that they will be entrepreneurial enough to undertake investment – many people are too set in traditional ways of doing things or do not wish to take on the risk associated with investment. Or, they may simply need the increased consumption.

It is not difficult to adapt this analysis to non-rural deprived areas. The picture is even bleaker. Productivity increases in agriculture may often be obtained fairly easily – some simple machinery, fertilizer, and basic irrigation systems can increase productivity by a large margin.

⁴³ In that case, the advanced agricultural activity in question is obviously insufficient to lift the entire region out of poverty.

In contrast, productivity increases in urban activities, and particularly in those that are actually needed for development – manufacturing and advanced services – happen in big firms, and there is no direct way in which these can benefit from remittances or increased per capita incomes due to emigration. Perhaps this extra income could be captured through some financial mechanisms, but it is questionable whether it would be large enough to enable the needed investments.

Trade

Myrdal (1964:28-29) and Hirschman (1970:188-189) argue that trade between richer and poorer regions can have negative effects. Firms in richer regions may be strong enough to outcompete firms in poorer regions. Hirschman also notes that, if a country is trying to industrialize – with the efforts being concentrated in the richer regions – and there are tariffs in place, then poorer regions may be forced to buy more expensive domestic products from richer regions rather than cheaper foreign ones.

With regards to potential positive effects, the expanding economy of a richer region may stimulate demand for products from poorer regions. This can increase production in poorer regions, or the prices for their products, or both, all of which is clearly favorable to the poorer regions. However, Hirschman notes that things can work out differently as well. The elasticity of production in poorer regions may not be high, and this may slow down growth in richer regions, or it might force them to turn to other (including foreign) suppliers, or even develop their own resource base. This can effectively sever many economic links between the regions and lead to a “prolonged split of the country into a progressive and a depressed area” (Hirschman, 1970:189). He cites the Mezzogiorno in Italy, Nordeste in Brazil and Oriente in Colombia as examples.

The balance of these effects can only be determined empirically. Holland (1979) presented much empirical evidence that firms in poorer regions do indeed get outcompeted. As for the positive effects, they are best understood as part of investment flows, which is the topic of the next section.

Capital flows

Myrdal (1964:28) noted that the need for investment in the expanding economies of the richer regions will tend to outstrip the available savings in those regions. In the poorer regions,

there is little investment, and even the low savings resulting from low incomes will not be used up fully. He argues that studies have shown that the banking system siphons off savings from poorer regions, and channels them to the richer regions unless regulated to do otherwise.

This argument is based on an erroneous understanding of how banks function. Some financial institutions are indeed intermediaries, and they may be doing what Myrdal described, but deposit-taking institutions (mainly banks) create new deposits when they make loans. No money moves between accounts, and banks thus do not move any savings around when giving loans (though they do move money when making payments).⁴⁴ A more accurate way of expressing Myrdal's argument would be that banks create more money in richer regions through extending more loans there. Nevertheless, the final effect is the same – markets will not furnish poorer regions with sufficient investment finance.

Contrary to Myrdal, Hirschman (1970:188-189) sees capital flows as a mechanism that can actually help poorer regions. If the economies of the richer and poorer regions are compatible to some degree, there is bound to be some investments in the latter that firms from the richer region will undertake in their own interest.

Holland (1979) relied on research on post-war Britain, specifically on Brown (1972), to assess these claims. Because data on intra-country capital flows is scant, Brown had to rely on numerous assumptions. He did conclude that capital in the aggregate seems to flow from more to less developed regions, but Holland noted that this reflects not only the workings of the market but also of extensive public investment. Without that, the flow of capital would be from the poorer to the richer regions. This is due to the fact that investment opportunities are less profitable, smaller, fewer, and riskier in the poorer regions, which runs counter to the mainstream arguments that returns on capital are higher where there is less of it.

But, where Holland really added to Myrdal's, Hirschman's and Perroux's analyses is that he explored in much more depth what lies behind investment decisions. The argument is split into two parts. First, are there any advantages to being located in a poorer region, that firms from those regions may exploit in competition against firms from richer regions? Second, why do firms from richer regions not invest in higher value-added activities in poorer regions?

With regards to the first question, there are some advantages of being located in poorer regions, such as higher labor availability, lower wages, lower levels of unionization, lower rent and land prices, and various government investment incentives. Are they enough, though, to substantially increase the competitiveness of firms from poorer regions? Holland (1976:144)

⁴⁴ On how banks actually function, see McLeay, Radia and Thomas (2014), Werner (2014a, 2014b).

argues that this is a possibility, but presents extensive evidence that it does not happen often in practice. The advantages that established market leaders have, and the market tactics that they can use against potential threats, most often represent an insurmountable obstacle for the growth of weaker firms, the more so the longer this sort of a market structure has existed. Besides, the advantages of poorer regions must be seen against the advantages of richer regions (the agglomeration economies that Perroux described). The problem is that the advantages from agglomeration economies are of the type that strengthens advanced economic activities, whereas the advantages of poorer regions matter the most for cheaper, simpler production.

What about attracting investment by market leaders to poorer regions? If only simpler investment is attracted, perhaps due to the advantages of poorer regions mentioned above, they may get jobs and incomes, but not really undergo structural transformation. If, however, they got investment into more advanced activities, then they too may become highly developed. Even a simple look at the world shows that the latter case is not happening – if it were, less developed regions would not be less developed. Actually, firms routinely locate lower value-added activities in poorer regions, and higher value-added activities in richer regions, exactly to exploit the different location factors in both.⁴⁵ However, even the location of lower value-added activities in the poorer regions can be in question. To understand why we have to look at how big firms make their location decisions.

Looking at manufacturing industry, which was the most mobile sector at the time and thus could choose its investment locations most freely, Holland argued that if firms “maximised locational benefits arising from higher labour availability or lower labour costs ... the result could be a situation which had no significant regional dimension”, at least in terms of employment (1976:139). However, as he showed, big firms do not necessarily maximize locational benefits. The main reasons are (1976:151-159):

a) Firms do not always seek to maximize profits, and thus will not seize every locational benefit simply because it would increase profits. Managers do not have unlimited capacity to make decisions and may be focused on something else at the moment. They may also be comparing their firm’s profits to competitors’ profits, not to potential maximum profits which could be obtained, among other ways, through locating new plants in poorer regions or relocating existing ones there. Managers may also want to avoid a price war, which could ensue if they reduced costs by locating in poorer regions and then transmitted that reduction to lower

⁴⁵ For a thorough example (of the HDD industry) of how the location choices function at the international level between richer and poorer countries, see Gourevitch, Bohn and McKendrick (2000).

prices. Besides, if wages are determined at the firm instead of the plant level, then they will not be lower in the poorer regions anyway, which takes away one of the more important reasons for locating there. Managers may also prefer expanding and improving existing plants, rather than opening new ones, especially if good transport connections allow them to easily supply the less developed regions from their existing plants. Actually, given that manufacturing was rapidly becoming more and more capital intensive and that transport infrastructure was improving, most investment did, in fact, go into existing plants. When it comes to relocating existing plants from richer to poorer regions, this may not be possible due to union opposition. And, whatever the nature of investments in the poorer regions, it may be difficult to get middle management to move there.

The advantages of locating in poorer regions may be more important for smaller firms that are supplying the bigger firms, because the benefits of cost reductions may be more important for them. However, smaller firms have a harder time moving, and also have incentives to stay close to their main buyers.

b) At least as important as the above reasons is the fact that big firms can locate in poorer *countries* as opposed to poorer regions in rich countries. Wages there are much lower than in the poor regions of rich countries, even taking into account the wage subsidies that some rich country governments were giving for wages in poorer regions, such as the Regional Employment Premium in the UK. For labor-intensive production, this may very well be the determining factor in the choice of plant location.⁴⁶ Additionally, firms located in more than one tax jurisdiction can use transfer pricing to obtain massive profits, dwarfing any fiscal and financial incentives they may obtain from rich country governments for locating in their poorer regions.

Finally, even if big firms do invest in the poorer regions of rich countries, this does not necessarily only have positive effects. A firm may simply take over an existing firm, instead of creating new plants and jobs. Actually, it may even cut jobs, disrupt local supply chains, strip the local economy of its capacity to make decisions, and so on (Cowling and Sugden, 1987:119).

Overall, the general point is not that big firms from richer regions never locate in poorer regions, and that they never produce positive effects. Rather, the point is that this often does

⁴⁶ Here Holland spotted a trend that was just beginning in his time. The shift of labor intensive production to poorer countries did later take place on a massive scale.

not happen and that we cannot without further consideration count on this mechanism to remedy regional development disparities.

3.1.3 Regional redistribution in favor of poorer regions

It seems that Perroux was overoptimistic: there do not seem to be distinct attraction and expansion phases in the geographical development of growth poles. Rather, the positive and negative effects of the interactions between richer and poorer regions are always present, and on balance, it appears the negative effects are stronger. Of course, positive effects may prevail in some poorer regions and some regions may even develop into growth poles themselves, but in most cases that does not happen.

For Perroux, what was important is that “unbearable” disequilibria between regions are avoided. They occur when the growth in region A imposes such strains on region B “that the growth rate of the aggregate declines, or the vital level of consumption in the population of B is threatened.” (Perroux, 1988:55). Perroux thought that this could be avoided through a combination of private and public planning of development. He argued that such planning is essential because oligopolistic firms develop in line with their own interests, and do not take into account the needs of other actors. As we will see in chapter 4, regional development policies have generally not been too successful, so the “vital level of consumption” in poorer regions is normally threatened.

This problem is mitigated through redistribution from richer to poorer regions. Such redistribution can come from many sources, but that done through the public sector is the most important. If we have two regions, redistribution happens if expenditures per capita in both regions are the same, but one region pays a larger share of its income in taxes, or if both regions pay the same share of their incomes, but one gets higher expenditures per capita. Of course, some combination of these two things is possible as well.

On the revenues side, it is the income tax that is usually progressive, effectively taxing a higher share of the income in richer regions. However, other taxes may be either proportional, or even regressive, so the net effect has to be determined empirically.

On the expenditures side, there are numerous expenditures that may be the same in per capita terms in all regions (though this is by no means necessarily the case). For example, governments often provide the same level of public services, such as healthcare and education, in all regions, and they invest in infrastructure throughout the entire country. But even if such

policies result in the same per capita expenditures in all regions, the absolute sums might still be higher than what poorer regions could muster on their own, so in that sense, they are redistributive. Other expenditures, however, may be higher in per capita terms in poorer regions, such as various social benefits or expenditures on regional policies. Like with revenues, the exact situation can only be determined empirically for every case.

Looking at statistical data, substantial regional redistribution must be taking place in most countries. For example, differences between regional incomes per capita tend to be much smaller than between regional GDP per capita. Actually, in some developed European countries, their poorer regions do not have much higher GDP per capita than East European countries (for example the former East German states), and yet they undoubtedly enjoy much higher living standards than them. This can obviously only happen through redistribution from the richer regions.⁴⁷ As we will see in chapter 5, regional redistribution can be an important factor in interregional economic conflicts.

3.2 Are some regions more suitable for development than others?

Whether a region is developed depends on the location of various types of activities of big firms, but why is it certain regions and not others that get to be developed? If it is because of some innate regional characteristics, then the important implications for policy are that it should focus on redistribution, and have modest and realistic plans when it comes to regional development. Conversely, if regional characteristics that are important for development can be changed, then regional development policies should know what these characteristics are.

Historically, it was primarily natural regional characteristics that determined where different economic activities emerged. For example, trading centers could emerge at estuaries or confluences of larger rivers, while production which required bulky and heavy raw materials emerged near the sources of these materials. Myrdal (1964:26) pointed out, though, that for many activities there is no particular reason why they emerged in one place, rather than another, apart from chance. The crucial point, however, is that once certain activities are established in an area for whatever reasons, powerful forces – various agglomeration economies – tend to concentrate further development there, even if the original reasons for locating there have disappeared. For example, pottery production could emerge near sources of clay, but even if

⁴⁷ Look at various data in any of the EU Cohesion reports, for example, European Commission (2014).

these are exhausted, the concentration of knowledge and skills in the area might mean that pottery continues being produced there, while clay is imported. If other trade links are established in the same area, and then perhaps complex administrative structures, the area might continue developing even if clay production completely disappears at some point. Indeed, many of today's more developed regions have been more developed for centuries.

With advancements in transportation and communication technology, natural characteristics have become far less important. Many economic activities today could be equally located almost anywhere in the world. It seems that this conclusion is borne out by empirical research into the location factors that influence firms' location decisions.

Broadly, there are two ways to assess empirically which location factors are important: econometrically or through company surveys and interviews (Carlson, 2000). In the former case, variables like building permits or new firm openings are taken to represent new business activity (whether by new or existing firms), and are then regressed against a variety of variables taken to represent location factors, such as income levels, wages, working-age population, road density, and so on. In the latter case, respondents, normally executives tasked with choosing appropriate locations, are asked about the factors that have influenced their decisions. Usually, they estimate the importance of various factors that they are asked about or merely indicate whether they have been important or not.

Carlson (2000:2) argues that both surveys and statistical methods offer certain advantages. Surveys can ask about variables that are difficult or impossible to quantify, such as "we wanted to locate near the owner's home' or 'quality of life' factors". Another advantage is that data used in econometric models is usually too aggregate in nature to capture industry-specific factors, such as specific needed skills, which can easily be learned about through surveys or interviews. Similarly, surveys can also contain open-ended questions.

Conversely, statistical methods can take into account factors that an individual firm may not be readily able to answer. For example, if we are interested if population density is an important location factor, it would be difficult to ask directly about it, because the respondent might be aware of some of the consequences of population density (for example, high rent), but not the underlying cause. Similarly, respondents may not be aware of some of the factors that have influenced their location decisions. Finally, a possibility that Carlson does not mention, but that may be important, is that respondents may lie. We can be fairly certain that issues like racism or tax avoidance will not be readily reported.

Irrespective of how we assess location factors what comes out clearly is that almost all of them are aspects of the economic structure of specific locations, rather than facts of nature.⁴⁸ Location factors that regularly come up as important are, for example, labor costs, skills availability, proximity to markets and transportation links, transportation costs, access to finance, utilities, the presence of suppliers and competitors, taxes, the regulatory framework, and so on. Broader social factors can also be important, such as various aspects of the quality of life. Of course, some natural factors also come up, such as the availability of raw materials and climate, but overall, there are far fewer of those, and for many sectors of the economy they are obviously irrelevant. Besides, even some of these natural factors are not completely immutable – rainfall, for example, can be affected by cloud seeding, while what is considered a raw material is not defined outside of the economic system, but depends on what our technology allows us to use.

The policy implications of the above are ambivalent. On the one hand, most location factors can be affected by policy and in that sense the situation is positive. On the other, many attractive location factors are actually aspects of economic development that has already taken place. For example, if big firms have emerged or located in a certain region, they will train up a workforce there, which will attract even more firms. What this means, however, is that to attract investment, a region needs a skilled workforce, but in order to have a skilled workforce, it needs to attract investment. It is not impossible for a poor region to break out of such a situation through conscious policy effort, but we should bear in mind how powerful the forces that create regional development disparities are, and thus be mindful that improving location factors in a poorer region is not at all easy and certainly not guaranteed to succeed.

3.3 Other theories of regional development

There are a number of past and current prominent theories of regional development that I have not found too illuminating, but due to their importance, they merit mentioning.

⁴⁸ For some examples, see Armstrong and Taylor (2000:374-377).

3.3.1 Location theory, regional science, and new economic geography

Location theory and regional science

One set of theories, often collectively called “location theory”, was started by von Thünen (1910), and later continued by Launhardt (1993), Weber (1929) and Lösch (1954).⁴⁹ Location theory was somewhat modified by Isard (1956), who started what is called “regional science”.

The most defining characteristic of these theories is the development of mathematical models of firms’ location choices. The essential element of their models is a uniform plane, with transport costs equal in all directions, and proportional to distance and weight. A further assumption is that economic agents wish to maximize profits, and they do this by choosing the place on the plane that allows them to produce their output and transport it where needed with minimal transport costs. With von Thünen (1910), this was a flat plane surrounding a town. Farmers choose freely where and what to grow, and have to sell their produce in the town. They choose where to locate based on the rent they have to pay for the land, the weight of their products, and the price they can get for them. Launhardt (1993) instead put a market outlet and two sources of raw materials on the plane and assumed a producer who needs the raw materials to produce a product that is sold at the market outlet (the so-called “three-point problem”). He then found mathematical solutions to how the producer can find the least-cost point on the plane to locate in. Weber (1929) took the same plane, but added points of low labor costs, and used lines called *isodopanes* to determine whether they will draw away the producer from the least cost point.⁵⁰ Isard’s (1956) modifications of the three-point problem revolve around dropping the assumption of the ability to move in any direction, rather assuming that movement is possible only between certain points on the plane that are connected by transportation lines.⁵¹

There are, of course, many further details and variations of the described models, but I have generally not found location theory illuminating. The basic underlying ideas – for example,

⁴⁹ See Holland (1979:1-35) and Blaug (1990:614-631) for reviews.

⁵⁰ Weber does not mention Launhardt’s work at all in his book. Blaug (1990:621) argues that he was not aware of it, and that the “three-point” problem seems to be a genuine case of multiple discovery.

⁵¹ Today regional science has mostly moved away from theoretical models and into econometric modelling (see, for example, Nijkamp, Rose and Kourtit, 2015). Their insights are as useful as their methods allow, but since the analyses are mostly not based on an explicit theory, I will not explore them here. For a history of regional science, see Boyce (2003), Isard (2003), Isserman (2009). See Lawson (2006) for a thorough argument why theoretical and econometric modelling are very limited in terms of the insights they can provide.

that transportation costs are important – are not problematic, but they are not developed further. Instead, the focus is on imagining a set of very contrived conditions and then making mathematical models of them. It is not clear what insights can be gained from this. The authors themselves were aware of this issue, but while most of them also provided more realistic commentary about location choices and regional development, the bulk of their analyses were their models, and in my opinion they never provided satisfactory arguments for how they help us understand the real world. This leaves the underlying ideas as a potential contribution, but since they are mostly trivial, not new, and have anyway been explored thoroughly within much more realistic frameworks, the usefulness of location theory as a whole is questionable.

New Economic Geography

A very prominent approach today is New Economic Geography (NEG). Fujita, Krugman and Venables (2001) give a good overview of its development, with part II focusing on regional NEG models. Like location theory and regional science, NEG builds mathematical models in order to explain the patterns of regional development.

The models are centered around the notion of increasing returns to scale, transportation costs and labor mobility. The gist is that there is a constant returns sector which pays the same wages to all its laborers and an increasing returns one that pays out higher wages the more laborers it employs or that offers an increasingly diversified range of products the more it grows. This increasing returns sector attracts laborers to itself, and as their number increases, agglomeration economies arise, creating further attraction. One of the key points in the models is that even if the geographical distribution of constant and increasing returns activities is even, due to any sort of random shock or even pure chance, some areas may get some more increasing returns activities. The models show that, due to self-reinforcing effects, these regions will eventually get more and more of these activities, leaving the other regions only with constant return activities. Thus, a split into a core and periphery emerges.⁵² There are also transportation costs and a number of other factors, which pull in the different direction, namely, towards a dispersal of economic activities in all regions. The final effects (the extent of agglomeration or dispersal) depend on the set-up of the individual models.

⁵² Although some of the models also have the possibility for sudden changes in the regional distribution of economic activities.

Just like with location theory and regional science, the basic underlying ideas are not problematic, but what is is that NEG does not develop these ideas further. Rather, it puts them into very contrived settings and then makes mathematical models of them. How this is useful for understanding regional development is not argued. As a matter of fact, Fujita, Krugman and Venables even admit, after enumerating some of the unrealistic assumptions that they are going to use, that they “are aware that this lends the analysis a certain air of unreality, that this book sometimes looks as if it should be entitled *Games You Can Play with CES Functions*. Nonetheless, we regard the advantages ... as overwhelming for our purposes.” (Fujita, Krugman and Venables, 2001:6). The issue is, their purpose is not to illuminate the real world, but to build models.

Martin (1999) has offered a much more thorough criticism of NEG⁵³ than I can do here. He notes that NEG deals with abstract, not real, space, ignores numerous important factors that contribute to uneven regional development and deals with unrealistic assumptions. As for the underlying ideas, Martin argues that not only are they not new, but there is already copious existing and ongoing empirical research on elaborating and examining them further. He contrasts this with empirical research in NEG, which is both more limited in number, and conceptually problematic.

There is no need to go further than this. Overall, I have not found NEG to be a useful approach, but its prominence has meant that I needed to explain at least briefly my choice not use it at all.

3.3.2 Marxian geography

Marxist geographers (Harvey, 2007; Smith, 2010) are primarily interested in explaining the changing geographical patterns of regional development based on a Marxian analysis of overaccumulation and economic crises. According to their understanding, firms choose where to locate based on a series of factors. Smith points out that they go to where the profit rate is the highest, while Harvey (2007:388) lists a larger number of factors, such as the costs of capital, transportation to markets, interest rates, land prices, existing services, natural resources, labor costs, the power of organized labor, and so on. However, due to overaccumulation and a falling profit rate, a devaluation of capital occurs, and entire regions can get devastated as investments, particularly fixed ones, are abandoned. The destruction of existing capital is seen

⁵³ Although later he softened his criticism substantially (see Garretsen and Martin, 2010).

by Harvey and Smith as necessary for starting a new round of accumulation, where also new regions may be drawn into the cycle of investment, overaccumulation and devaluation. Smith calls this the “see-saw” of capital.

Unfortunately, I have found Marxian geography to be too abstract. There is in principle nothing wrong in interpreting industrial decline in certain regions as a consequence of “overaccumulation”, the ensuing bankruptcies and the like as a “devaluation of capital”, and the business decisions of firms as being based on “exchange value”, as opposed to the “use value” of the investments made, although to me it is not clear why we would ever want to use more rather than less complicated terms. The real problem, though, is that however we decide to call events, they still need to be thoroughly empirically researched, but, as noted, Marxian geography remains mostly abstract.⁵⁴

Furthermore, I do not believe that either Harvey or Smith provided sufficient evidence for a *cyclical* movement of capital between regions. Had they done this, it would have been a very important finding. Due to the abstract nature of their texts and their sparse use of examples, it is not always easy to know what Harvey and Smith have in mind when setting out their arguments. Still, it does often seem plausible that they are thinking of traditional industrial regions in advanced capitalist countries when talking about overaccumulation and devaluation of capital, or, say, of raw material producers stripping out a region of resources and then moving away. However, these are discrete events that need to be explained, but they do not seem to happen cyclically. For financial capital there may be more reason to think it might be moving cyclically, but even there what would be important to know is why and how decisions to move it are made, not simply to note that the movement is cyclical. Smith and Harvey both refer to financial capital in their analyses, but there too they remain mostly abstract.

Like with the other schools of thought explored in this section, there is no need to go further than this. It was simply necessary to briefly explain why, even though I have taken a heterodox approach to regional development, I have not integrated into my work a well known example of it.

⁵⁴ Smith, in addition, drew heavily on postmodern geography (specifically Lefebvre, 1991), so his analysis is also very convoluted, as he has clearly been influenced by postmodernism’s predilection for complicated and invented words, unclear arguments, and dabbling in mathematics and physics. More than half of his book is actually devoted to the “production of space” and the “production of nature”, where even the relativity of time, curved space and Einstein are present, topics obviously “relevant” for understanding regional development in capitalism. For a critical review of postmodern geography, see Unwin (2000).

4. Regional development policies

In the post-WWII period concern about poorer regions – their lower employment and incomes, worse infrastructure, high emigration, worse public services (if they were funded from local revenues), etc. – grew substantially. This pushed numerous governments to enact policies aimed at helping them develop. These regional development policies have been very diverse, and can be classified according to various criteria, such as whether they are aimed at capital or labor, according to what tools they use (fiscal, monetary, financial or regulatory), whether they are incentives or disincentives, whether they are aimed at poorer or richer regions, etc. The classification used in this chapter is whether the policies employed are generally interventionist or not. Like with other economic policies, there was a shift from the former to the latter in the 1980s and 1990s, so sections 4.1 and 4.2 roughly correspond to the pre-1980s and post-1980s periods.

As we will see, the interventionist policies were generally aimed at attracting or directing manufacturing investment to poorer regions, either from richer regions or from abroad. The main, but far from only, policy tool were financial incentives, although location controls on big firms' investment were extensively used as well. The policies were successful to an extent, but they mainly attracted investment in routinized production, not in higher value-added activities. This provided jobs, but did not lead to full structural transformation in the poorer regions.

The non-interventionist policies are mostly aimed at helping the development of indigenous small and medium enterprises (SMEs) in poorer regions. While they may be successful in stimulating the growth in their number, and providing jobs through that, they seem to have had no success in creating structural transformation. This is not surprising, given that they do not take into account that it is the oligopolistic nature of capitalism that is fundamentally responsible for regional underdevelopment, and SMEs cannot change that.

One case of genuine structural transformation coming from within a region is the US state of Nevada, which was a mining economy prone to boom and bust cycles, but became the leading gambling center in the world. This transformation is explored in section 4.3, which shows that the circumstances that enabled it were extremely specific and dependent to a significant extent on luck. They are thus obviously hardly replicable. Several more general implications are drawn for regional policies, but the main argument is that, rather than providing hope, the case of Nevada rather highlights the dismal prospects of poorer regions.

All the policies discussed in this chapter need to be differentiated from policies such as centrally funded healthcare, education, defense, social benefits, and the like. These provide higher levels of such public services than poorer regions could afford on their own, and some can be an essential ingredient for development. However, since they are not directly developmental themselves, while noting their importance here, I will not consider them in this thesis.

Also, it should be noted that there are a number of negative effects for richer regions that stem from regional development disparities. Perhaps the foremost one is the steady stream of immigration, which, particularly in the first few decades after the Second World War, created significant urban congestion problems. These were manifested in, for example, problems in providing adequate public services and housing or in rising rents and inflation. Thus, some regional policies were actually aimed at ameliorating the consequences of regional disparities in rich regions and their cities. I will not look at the mentioned effects (or policies) here, but they are important to mention, because, as we will see in the next chapter, they have been a source of inter-regional economic conflicts.

4.1 Pre-1980s interventionist period

Yuill, Allen and Hull (1980) is a comparative study of regional policies in the then members of the European Community. In the first decade or so after the Second World War, the primary focus of economic policy was on reconstruction, not on reducing regional disparities. Additionally, the gap between the more and less developed regions was still not as high as it would later become. Thus, regional policy, to the extent that it existed, was primarily based on building and upgrading infrastructure in the poorer regions (Yuill, Allen and Hull, 1980:217).

By the late 1950s, however, reconstruction was over and regional disparities had also become more pronounced. Yuill, Allen and Hull (1980:13) identified unemployment as the most pressing problem in the poorer regions, and argued that its cause was an overreliance either on agriculture or on slow-growth or declining industries, “like coal mining, iron and steel, textiles or ship building” (1980:214). The reason for the decline of some heavy industries was that the high demand for their products due the reconstruction effort was over. Later these and other industries, such as textiles, also started facing increasing foreign competition from newly industrializing countries, which had both the latest technology and much lower labor costs. An

additional reason for the rising unemployment was that the labor intensity of manufacturing was decreasing, so fewer new jobs were being created, and even existing jobs were lost. Those regions most heavily dependent on manufacturing were obviously the hardest hit by this.

To counter these developments over the next two decades European Community states increased the coverage of assisted areas, the range of regional policies, and expenditures on them (in addition to continuing infrastructure investment). The geographical extent of the assisted regions, measured by the percentage of total national population they contained, was between 17% and 45% depending on the country and period, but mostly hovered around 35% (Yuill, Allen and Hull, 1980:216). Expenditures were also high. For example, at their height in the UK in 1975, expenditures just on direct regional policies⁵⁵ amounted to 0.7% of GDP (Scott, 2009:354). Yuill, Allen and Hull (1980:219) call this period the heyday of regional policy, both due to the extent of the covered areas, the range of policies, the high expenditures, as well as the attempts in some countries to link up the policies to general development planning.

Demko and Fuchs (1984:88-92) divided the policies employed in Western European countries⁵⁶ according to whether they provided incentives or disincentives, and whether they were aimed at employing organizations or individuals and families. Their overview is given in Table 4.1.

⁵⁵ So, including policies such as investment subsidies given for investments in certain areas, but excluding policies such as subsidies directed at shipbuilding irrespective of where it is located (even though it was heavily regionally concentrated, thus making such subsidies effectively a tool of regional policy).

⁵⁶ A broader focus than in Yuill, Allen and Hull (1980), but with no essential differences either in the types of policies or the problems they were meant to address.

Table 4.1. Regional policy tools in Western European countries

Directed towards	Policy emphasis	
	Incentives	Disincentives
<i>Employing organizations</i>	Special promotional and co-ordinating agencies	Permits and licences or other controls on new industrial plant construction
	Public infrastructure development for industry, including new towns and industrial parks	Permits and licences for office building construction
	Agricultural infrastructure programs	Tax or other financial penalties for investments in congested areas
	Grants and loans for industrial development, including capital investment subsidies	Rationing of building materials
	Tax incentives, including special depreciation allowances for industrial development	Dispersal and relocation of government, industries, offices, agencies
	Tax rebates and concessions for industrial relocation	Disclosure of major new industrial investment or expansion plans for approval
	Tax and manpower subsidies for relocation of tertiary sector	Compulsory government supply contracts to companies and industries in lagging regions
	Rent subsidies	
	Land expropriation and reclamation	
	Technical assistance	
	Employment or labor-cost subsidies to industries	
	Transport adjustments and subsidies	
	Preferential government procurement policies	
	Social security payment concessions	
	Municipal and community loans for buildings, sites, etc.	
Export profit tax relief		
<i>Individuals and families</i>	Job training and human resource programs	Imposition on metropolitan residents of full costs of water and sewage facilities
	Relocation and settling-in grants	Zoning practices
	Social infrastructure investments (hospitals, universities, cultural services)	Discriminatory treatment of non-residents, e.g. local government employment, education, etc.
	Housing (public and loans for private)	
	Physical planning and environmental amenity improvement programs	

Source: Demko and Fuchs (1984:89-90)

Of this large number of regional policies, the most significant were the numerous fiscal and financial incentives given mostly to manufacturing companies (manufacturing being the most

mobile sector of the economy) to open new plants in, or relocate existing plants to, problem regions (Yuill, Allen and Hull, 1980:14; Demko and Fuchs, 1984:92). Virtually all countries had such incentive packages, and they variously included capital grants for investment, subsidized loans or subsidies for interest payments, tax concessions, depreciation allowances, or labor cost subsidies, all of which could be automatic or discretionary (Yuill, Allen and Hull, 1980:228-232). In order of importance, Demko and Fuchs rank them similarly: “capital grants, interest subsidies or discounts, tax concessions and depreciation allowances” (1984:92).

Another policy tool used by a number of countries (Yuill, Allen and Hull, 1980:218) were location controls.⁵⁷ Firms that wished to invest in areas designated as developed had to apply for permission, the idea being to deny them these permissions and steer their investment towards poorer areas. Demko and Fuchs (1984:91), however, argue that these were less common than the fiscal and financial incentives and less well enforced. A heavy use of state-owned enterprises, particularly in Italy, to invest in poorer areas was also present. Governments also moved some of administrative functions to poorer areas.

Interestingly, no authors mention regional banks, which were important at least in Germany. Werner (2013) argues that Germany has long had a very large number of local private banks, which are legally limited to lending only to local companies. This has kept these banks small, and thus focused more on SMEs, which might otherwise have been deprived of credit. I have already argued that SMEs are not the backbone of any developed economy, but they nevertheless do provide many jobs, and a few may grow or play an important role in big firms’ supply chains. At the very least, keeping them supplied with credit can help prevent extreme regional deprivation. In addition to the local banks, Germany also has an extensive system of public development banks – the KfW and the Agricultural bank at the federal level, while each federal state also has its own development bank. The latter have ensured a steady supply of credit even in the less developed regions.

The interventionism of this period shows also in the size of expenditures on regional policies. But, more importantly, as we can see, numerous policies that were used – location controls, mandatory negotiations with the state about large investment projects, the use of state-owned enterprises to invest in poorer regions, subsidies and export subsidies, favoring certain companies through public procurement, etc. – would today either be very difficult to do legally, be straight out forbidden, or simply be outside of the imagination of policy-makers.

⁵⁷ For a very detailed exploration of such policies in the European Community, see Wettman and Nicol (1981).

One thing that stands out, though, is that the policies did not include tariff protection, import quotas, preferential exchange rates and other measures that operate at the national level. That such policies cannot be used internally was pointed out by Hirschman (1970:196). Given how important they have been for late developers (Chang, 2007), however, we would expect that the inability to use them would be a significant impairment for poorer regions. Even if they could somehow be used,⁵⁸ a government would probably not easily decide to use them, as it would effectively be directing them against domestic firms from richer regions. The political economy of such an action would be very different than when they are directed against foreign firms.

How successful have these regional policies been? Holland (1979) showed persuasively that they were unable to foster the development of firms from poorer regions, because they were insufficient to overcome the power of established oligopolies. As for stimulating established firms to invest in poorer regions, the problems described in the previous chapter and this one were making themselves felt. Since manufacturing was becoming more capital intensive, most investment went into upgrading established plants, not in opening new ones, and some industries were even shedding jobs.⁵⁹ Firms capable of international investments were increasingly choosing to locate in poor countries. And, when they did choose to locate in one of the developed capitalist countries, they often preferred to locate in the richer regions, and the threat of choosing another country was often enough to make governments allow them to do that. This was especially the case during recessions, when governments would rather have growth anywhere than nowhere, even if it meant giving up on their regional goals.

Holland argued that there was no way out of these problems unless the nature of capitalism were changed.⁶⁰ He suggested that several things needed to be done in coordination. Location controls should be enforced more rigorously. It should be obligatory for big firms to plan their investment in coordination with state planning institutions, in order to steer investment towards poorer regions. Fiscal and financial incentives should be kept under control, and possibly lowered so that they only cover the actual (in fact not so large) extra costs incurred by locating in poorer regions. The threat of nationalization (explicit or implied) should also be used, if

⁵⁸ It would likely be possible to come up with some sort of institutional setting which would allow the use of such policies within a country, at least in some modified form, but, to my knowledge, this has never been attempted. Multiple exchange rates have been used, but for different sectors of the economy or different categories of imports, not for firms from different regions.

⁵⁹ As a response to this, an attempt was made in some countries to direct regional policies at service sectors, but this did not prove particularly successful (Yuill, Allen and Hull, 1980:221).

⁶⁰ He set out his argument mostly in chapter 8.

companies too firmly oppose the government's regional development goals. Finally, public enterprises should be used to invest in poorer regions where the private sector is reluctant to do so. This would induce private companies to do the same, as it would both give an example that such investment is possible and threaten them because public companies would have access to regional aid and possibly cheaper labor. Also, such public investment would itself be a part of the solution to regional problems.

Holland's arguments fit into the broader context of the sorts of policies proposed at the time by more radical leftists in Europe, including by the left wing of the Labour Party, of which Holland was one of the leading proponents. They advocated more decisive steps towards socialism.⁶¹ However, what came in the 1980s was not a move towards socialism, but a period of deregulation and liberalization.

4.2 Post-1980s deregulation period

Yuill, Allen and Hull (1980:220) argue that the oil shock in 1973-1974 and the ensuing recession made many governments cut back on regional policies. For one, there was less money for them. Also, any investment was seen as desirable, so location controls fell into disuse because governments were afraid that using them might prevent investment from being undertaken at all. Additionally, governments mostly stopped moving administrative functions to poorer areas because unemployment was rising even in the richer regions. The immigration to richer regions also declined, and some of them even started seeing outmigration, so fears of over-congestion subsided. This eliminated an immediate pressing reason for bringing investment to poorer regions. Finally, anti-interventionist arguments were anyway increasingly heard, and were targeted at regional policies as well. In parallel with all this, partially to counter the recession, there was rapid growth in aids at the national and sectoral levels, which "had the effect of cutting down on the net advantage conferred by regional incentives" (Yuill, Allen and Hull, 1980:223).

There was an additional problem specific to European Community countries. Namely, the Treaty of Rome sets limits to actions that distort trade between the member states. This particularly includes state aid. There is an exemption for regional policies, but Yuill, Allen and Hull (1980:224) argued that there were a number of issues with how the Regional Policy

⁶¹ For Holland's wider views on these issues, see Holland (1976b).

Directorate and the Competition Directorate were interpreting these exemptions, with the effects not always being favorable to poorer regions. Many such limitations were later imposed by the WTO and other multilateral and bilateral trade and investment agreements on other countries as well.

Overall, the latter part of the 1970s saw the beginning of a trend towards reducing the coverage of assisted areas, reduced expenditures, and less interventionist policies. Eventually, throughout the 1980s and 1990s, location controls, mandatory planning of investment with relevant authorities, direct subsidies, the use of state-owned enterprises to invest in poor regions (to the extent that they at all remained state owned), and such “heavy-handed” policies were all abandoned. They were replaced by what OECD (2010:13) calls “new paradigm regional policy”.

We can identify several important characteristics of these new policies, apart from the abandonment of interventionism. First, while some “old” paradigm policies are still in place – investments in infrastructure and the use (though much less than before) of financial and fiscal incentives – more and more policies are now focused on helping indigenous SMEs in poorer regions through measures to develop “soft” capital and make business easier. For example, there are policies for training entrepreneurs, or for simplifying regulations in order to improve the business environment. As OECD (2010:19) says: “In the past, aid was focused on bringing in foreign direct investment (FDI) and providing subsidized facilities for outside investors and/or new firms. More recently, the focus has moved to making domestic firms more competitive, which has led to an interest in cluster policies and similar instruments to build co-operation and share knowledge among firms, particularly SMEs”.

Second, it is no longer only the central government, but also lower levels of government, as well as the private sector, NGOs and other actors that are now involved in regional policies. Various bodies have been accordingly set up so that these more numerous actors can coordinate.

Third, the term *regional* policies has become a bit misleading. Up until the shift to new paradigm policies, it referred to policies aimed at poorer regions. However, now many policies that are aimed at *all* regions are called regional policies (OECD, 2012). But, what they really are is national policies implemented regionally, and only some of them are offered on somewhat more favorable terms in poorer regions. Examples include help for business innovation or for the establishment of new firms. This is also reflected in the sorts of sectors that are supported through these “regional” policies. For example, OECD (2010:20) mentions a desire to: “promote innovation in industries that are traditionally associated with urban areas (*e.g.* ICT, bio-technology and other scientific and medical industries). As a consequence, innovation

policy has re-invigorated the idea of urban growth poles which are expected to endogenously develop their hinterland.” A poor region with sufficient strengths in these industries for a growth pole to emerge would not actually be poor. What such policies are revealed to be is support policies for advanced sectors, which are located in rich regions, but they are called regional policies because they are partially implemented by regional or city-level bodies.

Finally, and most importantly, the basic understanding underlying the new paradigm policies is different from that underlying the old paradigm policies. The idea behind the old policies was that poorer regions were poor because markets produced regional inequality. The way out was for them to somehow get the benefits of having more advanced economic sectors. The new policies, however, wish to increase “regional competitiveness”. They do acknowledge that the regional competitiveness of poor regions is low partially due to market failures, but the way these are conceptualized is problematic. Namely, what they have in mind are things like a lack of coordination and information, low levels of entrepreneurship, or banks being risk averse and not wanting to lend to SMEs. The idea is that if such problems are overcome, then markets will operate more efficiently and lead to more growth in the poorer regions. This is fundamentally different to the understanding that normally functioning markets create regional inequality, and that therefore they have to be repressed or heavily influenced so that the behavior of market agents is modified so as to produce the desired regional outcomes.

The evaluation of new paradigm policies is more complicated than that of the old ones, both because the former often have more numerous goals, and because some of them are hard to quantify (for example, improving coordination between local economic agents). However, things like the number of jobs created through certain policies, the cost per job created, grant money paid out and similar measurements are still used. On average, it seems that there have been positive effects on these fronts.⁶² What seems to be missing, though, is the sort of broader analysis that Holland (1979) did, that tries to assess whether the policies offer scope for structural transformation.

Overall, it seems that new paradigm regional policies aimed at helping SMEs fail to see the role of oligopolies. The policies may help increase the number of small firms, and perhaps help some of them to grow to medium size, but there is nothing to then help them make the transition to market-leading firms. For that, the power of existing market-leaders would have to be curbed

⁶² As examples, see European Commission (2016a), Department for Business, Enterprise & Regulatory Reform (2009a, 2009b).

in some way, which even old paradigm policies did not do, let alone the new non-interventionist ones.

When the role of market-leading firms is recognized, this often comes in tandem with the recognition that development is sector-specific, and results in a focus on cluster policies. These are often centered around attracting key investment by big firms, and then stimulating them to interlink with local SMEs, in the hope that urban growth poles will emerge.⁶³ What is supposed to provide the attraction is essentially attempts at improving the location factors deemed important by market leaders, such as boosting the skills of the local workforce, providing good transport links, etc. But, as I argued in the previous chapter in section 3.2, having good location factors is an aspect of development – to be attractive for the kinds of investment sought, a region has to be developed, but to be developed, it has to be attractive. Many regions are attempting to break out of this chicken and egg situation, but there seems to be little evidence that it is working. Not only do they have to compete with each other, but, more importantly, they have to compete against actually developed regions. And in that last context, a point made by Holland is extremely pertinent – to attract advanced investment to poorer regions it is not enough to provide *some* investment opportunities, but they have to be *better* than the opportunities in the richer regions. This is a very unlikely proposition.⁶⁴

At other times, though, it is not recognized that development is sector-specific. New regional policies often aim at tapping “underutilized regional potential” and using “endogenous local assets and knowledge” in the poorer regions. But, the “regional potential” of a poorer region almost by definition cannot be in an advanced sector – the “local assets and knowledge” needed to be good in advanced sectors are mostly created by having those sectors. They do not exist prior to them. Of course, some areas (though not whole regions) may do well based on some simpler economic activity. For example, a beautiful natural landscape, combined with a low population, may bring in enough tourism revenues to provide sufficient income per capita for comfortable living standards. But, for how many areas is that a possibility?

Finally, decentralizing regional policy may bring some benefits, such as being able to base policies on better knowledge of local conditions which central government departments do not necessarily possess to the same degree. However, Holland (1979) was quite clear about the fact that even national governments of developed countries could no longer assume that they were

⁶³ For examples, see European Commission (2016b), OECD (2013). Sometimes, though, the role of leading firms is also not recognized, and clusters are supposed to emerge from within the region.

⁶⁴ See Hospers (2006) about the numerous regions that are all trying to become the next Silicon Valley and failing.

more powerful than big firms when attempting to influence their location decisions. If anything, this is even more true today. For one, due to globalization, market-leading firms have become bigger and more powerful than ever, and have moved from being national to global giants (see Nolan, Zhang and Liu, 2007b). Equally importantly, in the past companies could not easily invest in communist countries, and even in the part of the world where they could invest, they were normally expecting interventionist policies. Today, not only is virtually the entire world open to investment, but most governments also pursue largely non-interventionist policies. A government trying to pursue more interventionist regional policy would certainly find companies much less willing to accept “meddling” in their business, as their management is not accustomed anymore to “heavy-handed” intervention, and the companies could always choose to go somewhere else. In this context, it is questionable whether big firms should be made relatively even more powerful by transferring regional policies from central governments to less powerful entities at lower levels of authority (Hymer, 1975:54-55). This comes on top of the problem of inter-regional competition, which can lead to both a waste of resources and a race to the bottom in terms of what benefits are offered to big firms. Indeed, it is not just regions that can on their own decide to compete against each other, but it is also big firms that actively play cities and regions off against each other in order to extract the most benefits.⁶⁵

With all of the above taken into account, it should not be surprising that data on regional economic and social indicators shows that regional disparities still exist within countries, and that they can be even bigger than the differences between country averages.⁶⁶ In more than a few cases, regional disparities have grown, despite the regional policies that are in place. But, most tellingly, it is still exactly the same regions as before that are problematic – the Italian Mezzogiorno, the south of the United States, Wallonia, the North East and North West in England, Wales, Andalucía, the east part of Germany whose economy was essentially crushed by the more advanced West German economy after the reunification, and entire East European countries (also crushed by free trade with more developed countries) which can be seen as regions within a common EU market. There are many other examples, but the basic picture is abundantly clear – the drift towards regional disparities in capitalism seems to be at least as strong as ever, and at least as difficult to counter.

⁶⁵ Bailey, Cowling and Tomlinson (2015) refer to such cases of interregional competition and of market leaders playing regions off against each other in the UK.

⁶⁶ See, for example, OECD (2014), European Commission (2014).

4.3 Nevada: a case of successful indigenous regional development

One poorer region that has managed to undergo structural transformation based on developing an indigenous sector, that even started with small firms, is the US state of Nevada. The sector is obviously gambling. Nevada is therefore an extremely interesting example, and it would be very useful to ascertain how it has managed to develop. As we will see, and as noted at the beginning of this chapter, it managed to do so due to an unusual amount of luck and a set of very specific circumstances.⁶⁷

Prior to becoming the center of gambling in the US from the 1950s onwards, the Nevadan economy was dependent on mining and limited agriculture (primarily livestock). Now, the implicit view of mining as a temporary bonanza is not necessarily correct. Mining is a complex economic activity, offering enormous scope for firms to build up competitive advantages (Wright and Czelusta, 2004). Indeed, today it is one of the most oligopolized sectors of the economy. However, individual mining sites can get exhausted, and if the firms exploiting them are located elsewhere, then the longer-term benefits will not be where the mining sites are. This was the case with Nevada, which experienced numerous mining rushes, booms and busts, and felt the full effects of swings in the demand and prices for gold, silver and copper, from the 1860s until the 1930s.

Some more stable economic activities did exist. For example, due to more liberal divorce laws – shorter waiting times before a divorce is granted – many people came from California to Nevada to get divorced. Their spending while they stayed in Nevada and the fees they paid did benefit the local economy. However, in 1927 several other states US made divorce quicker, so Nevada had to make its laws even more liberal (Elliott and Rowley, 1987:284-285). This shows how “economic” activities in which it is not possible to maintain a competitive advantage cannot really be the basis for stable development. After all, the furthest any state can go is to make it possible to get a divorce immediately.

As would be expected from an underdeveloped state, Nevada was reliant on central government aid. The federal government was a substantial investor in road construction, irrigation, some military facilities, and, most importantly, for the building of the Hoover Dam. Such investment was of course useful, but it did not move Nevada into advanced sectors.

A sign of what was to come, however, coincided with the beginning of the construction of the Hoover Dam in 1931. That year gambling was relegalized in Nevada, after being banned

⁶⁷ This section relies heavily on Elliott and Rowley (1987).

since 1910, and it started growing. Of course, gambling was never gone, but legalization meant that the state could gather revenues from it. Nevertheless, it did not become big in the 1930s, and there is no indication that anyone expected that it would become particularly important, and certainly not that it would turn into Nevada's economic mainstay within 20 years.

It was the Second World War that really changed things for Nevada. Most importantly, it boosted the economy of Southern California where numerous defense activities were established. After the war, the westward population drift in the US continued, which, combined with natural population increases and foreign immigrants, eventually made California the most populous state in the US. Thus, after the war, Nevada found itself right next to an economically very prosperous and very populous economy. An expansion of gambling and connected activities was made possible due to the large market that they could cater to.

The first important thing to note is that technological change and upgrading, and the consequent increase in incomes, did not primarily happen in Nevada, but in California. The fortuitous circumstance for Nevada was that it was geographically near California (particularly important before the rise of cheap air travel), and that, at the time of the post-war boom, it could offer a combination of services, with gambling at the center, that the increasingly affluent population of California wanted to buy. A similar development could not have happened in a location more remote from a large economic and population center.

The importance of geographical proximity can be seen clearly even within Nevada – the center of the (rapidly increasing) population moved from the west of Nevada to the south, which was nearer to California. Even within the south, proximity to large population centers in California played a huge role. In the past, Reno was bigger than Las Vegas. As a matter of fact, while Reno had existed as a city since the 1870s, Las Vegas was founded as a city only in 1911, and was more or less completely unimportant until it got a boost from the building of the Hoover Dam. However, Reno is close to San Francisco, while Las Vegas is close to the much bigger Los Angeles. By 1960, Las Vegas had a larger population than Reno, and continued growing at a faster pace in the later decades.⁶⁸ The proximity to Los Angeles was important enough to counteract even the fact that Reno had a head start in gambling compared to Las Vegas, both because it used to be bigger, and because it licensed gambling businesses more freely after gambling was relegalized. It goes without saying that attempts to make gambling into a big

⁶⁸ Las Vegas had a population of only 5000 in 1931 when gambling was relegalized and the construction of the Hoover Dam started. Reno was at nearly 20,000. Las Vegas grew to around 65,000 by 1960, surpassing Reno around that time. Today, its population is around 650,000, while Reno's is around 225,000.

business in the east of Nevada, in Ely, the capital of White Pine County and still an important town because of copper mining, met with little success. With an extra several hundred kilometers of distance from California compared to Las Vegas and Reno, Ely might as well have been on the Moon.

However, there are other poor regions that are close to large and prosperous economies. Nevada may have been on the doorstep of a particularly important one, but it is not unique in its geographic position. Its enormous luck lay elsewhere. Namely, at the time, barriers to entry in gambling were low – it did not require substantial capital, technology or organizational skills. But, simultaneously, what prevented other regions from trying to compete with Nevada was that gambling was banned everywhere else in the US. It was this combination of geographic proximity, easy entry, and, crucially, *protection*, that ensured that Nevada could develop its gambling without the constant threat of new entrants and of price competition (which characterizes simpler economic activities) driving wages, profits and investment down.

And yet, legal restrictions are fairly easy to remove compared to many other competitive disadvantages. With the rise of cheap air travel, the market which a gambling center can cater to also increases. Could another state also remove restrictions on gambling, and hope to build up a big business in it? Things are not as straightforward.

While gambling may have started small, it did not take long before phenomenal market concentration occurred – by 1968/1969, there were more than one thousand casinos licensed in Nevada, of which a mere 10 did 46% of all gambling, and just 30 did 96% (Elliot and Rowley, 1987:337). Today, the 334 casinos in Nevada have combined gaming revenues of more than \$11 billion. The 40 casinos on the Las Vegas Strip alone account for \$6.4 billion of that, or 56% (Nevada Gaming Control Board, 2017a).⁶⁹ Nevada Gaming Control Board (2017b) reports numbers only for casinos with more than \$12 million in revenues. There are 273 of them (they account for 95% of all gaming revenues in Nevada). Of those, 70 make 80% of the revenues, and are owned by only 24 corporations.⁷⁰ The 273 casinos make another \$14 billion from rooms, food, beverage and other activities.⁷¹

⁶⁹ Unfortunately, no disaggregated data within that group is available.

⁷⁰ There is unfortunately no data available for within this group of 70.

⁷¹ Prostitution is another “economic” activity that always seems to go with gambling. Legal prostitution in Nevada is valued at \$75 million, but illegal prostitution – mostly concentrated in Las Vegas and Reno – is estimated to be worth \$5 billion (Flowers, 2011:42). Ignoring here the wider questions about prostitution, this is a very significant source of revenue in Nevada.

Nevada actually fought to prevent its gambling companies from investing outside of Nevada, once some other states started legalizing gambling, fearing that its incomes would be siphoned away (Faiss and Gemignani, 2011). This strategy started failing in the late 1970s, but the fears of money flowing out of Nevada proved unnecessary. Nevada had had several decades to build up its competitive position. One regulatory change with extremely far reaching consequences was introduced in 1969, when a new corporate licensing act was passed. Prior to that, all stockholders of a company that applied for a gambling license had to undergo a background check. After 1969, this changed to only those stockholders with a 5% or greater share of ownership (Elliot and Rowley, 1987:336), allowing large corporations to far more easily buy up gambling businesses in Nevada, because their countless small stockholders did not have to undergo background checks. This “eventually prompted several large and respected companies to begin buying and building hotel-casinos. Hilton, MGM, Holiday Inns, Ramada, Hyatt, Del Webb, and others suddenly got into the gaming business. Ownership of the casino resorts by Hughes and these other well-known companies legitimized the industry. Investments in casino properties soared after passage of the 1969 law” (Faiss and Gemignani, 2011:5).⁷² By the time gambling started being legalized in other US states, nearly a decade later, these companies had firmly established themselves in Nevada, and from there took the leading role in expanding gambling elsewhere in the US.

Today, gambling is dominated by large resort hotels, which combine accommodation, gambling, food and drink, and various other activities. In other words, large-scale gambling, the sort that really brings in incomes, now requires substantial investments and skills to run it. This means that any other entrant to the gambling market has to start big, at least if one wants to build up a strong economic base in it like Nevada has done. This is certainly not impossible, particularly because, despite everything that has been said, gambling is still much easier to move into than other more technologically and organizationally complex economic activities. Nevertheless, it is a very significant hurdle to overcome. Las Vegas has also had the time to go

⁷² Incidentally, the large investments required for this sort of business contributed significantly to reducing mafia type crime in gambling. Criminals, after all, cannot make people go to their establishments instead of to resort hotels, nor can they easily match the money that large corporates can put into the gambling business. Furthermore, they cannot employ the same criminal tactics (extortion and the like) against large corporations as they can against local small casino owners. Finally, large corporates will generally not risk their entire business by cheating in gambling. The additional gains to be had are too small compared to the risks. However, the entry of large corporates into the market did usher in the era of corporate, particularly financial, crime. On that, see Farrell and Case (1995:57s).

unchallenged in building up such a successful brand, that it has basically become almost synonymous with gambling. Any new region trying to enter the gambling market thus starts off with a disadvantage that Nevada never had. Cheap air travel is then also seen to be a double-edged sword – it allows a new entrant to cater to a larger market, but it also allows consumers to more easily reach Nevada.

The competitive advantage of Nevada is reflected in the data on gambling in the US. Total gaming revenues in the US are nearly \$40 billion. Nevada accounts for 28% of that. (The 40 casinos on the Las Vegas Strip alone account for 16%.) The next closest state is Louisiana, at 9.5%. Nevada also accounts for 48% of all jobs in commercial gaming, and pays out 56% of the wages (American Gaming Association, 2017).

So, we cannot conclude from Nevada's success that any underdeveloped region can develop simply because it is near a populous and prosperous region. Rather, it has to be able to enter an economic sector that:

- a) has low entry barriers,
- b) is not already oligopolized
- c) established market leaders in other sectors should not be diversifying into this new sector, because, with their full power behind this expansion, they can easily overwhelm new small market entrants,
- d) the sector's products or services have to be in demand,
- e) and have good growth prospects,
- f) it must be possible to build up a strong competitive advantage in the sector,
- g) crucially, the region that is setting up the new sector has to be afforded protection from competition until it builds up its competitive advantage.

If the last crucial condition is not fulfilled, what is likely to happen is that numerous regions will try entering the same sector, but, due to the nature of markets and oligopolies, only a few will succeed.

It is obviously extremely unlikely for all these conditions to be simultaneously fulfilled. Nevada was, indeed, beyond lucky. Of course, one could argue that regions should nevertheless try to move into newly emerging sectors that fulfill all the conditions except protection, because, if every time a couple of regions succeed in building up a competitive advantage in a new sector, eventually all regions will be developed. However, there are also very few newly emerging sectors that simultaneously fulfill all the other conditions except protection. As I noted in

chapter 2, with a few exceptions, it is market leaders in existing sectors that diversify into adjacent new sectors, and when they do that, they normally replicate existing regional disparities. And even when it is new firms establishing a new sector, there are still location factors, such as skills availability or quality of life concerns, that make it likely that the sector will be much stronger in the rich regions.⁷³

What are the lessons for regional policies that can be drawn from the preceding analysis? Gambling was not planned to happen in Nevada. Once it became apparent that it was becoming important, though, the state did start nurturing it in various ways. None of what it did involved the high interventionism of the old paradigm of regional policies, and certainly none of the socialist suggestions of the type that Holland was making. What Nevada did could be classified under new paradigm regional policies as improvements to the business environment, but also as concern for the public interest. For example, the state started fighting crime, cheating, corruption, tax evasion and attempts by gambling interests to exert control over various levels of government (Elliot and Rowley, 1987:326-337). But, as we saw, the biggest impact came from a regulatory change that was aimed squarely at big firms, not SMEs like in new paradigm regional policies.

The decentralization of regional policies that new paradigm policies advocate seems to have worked extremely well in Nevada's favor. It is highly unlikely that the federal government would have been as focused on Nevada's needs as its state authorities (effectively regional authorities in the US) were. Still, what was crucial was the market opportunity that Nevada had. Prior to it, despite having state authorities for nearly a century, Nevada did not undergo structural transformation.

So, it would appear that the one major case (at least that I could identify) of true structural transformation coming from within a poorer region, based on its own efforts, depended first and foremost on more than a healthy dose of luck, only later followed by reasonably well thought out policies. From this perspective, barring a move to the sort of socialist planning that Holland was arguing for, it seems that the best an underdeveloped region can do is to keep an eye out for the sort of opportunity that Nevada had, and have a general idea of what sort of

⁷³ For example, after Apple started the App Store in 2008, there has been an explosion in the number of companies producing games for the iOS system in the UK (NESTA, 2014:21) – the comparatively low barriers to entry, the ability to access the entire world market, and the lure of striking it big made sure there would be an entrepreneurial boom. But, from a regional perspective, the vast bulk of the new iOS companies have opened in London (NESTA, 2014:35).

policies it should pursue if one arises. Unfortunately for poor regions, based on the evidence thus far, it seems that most of them will be waiting for such an opportunity for a long time to come.

5. Regional disparities and separatism

The preceding chapters have established that the drift towards regional inequality in capitalist countries is very strong, and that regional development policies have had only limited successes in countering it. The result is that poorer regions rely on redistribution from the richer ones, primarily through the public sector. This redistribution can create dissatisfaction in both richer and poorer regions – in the former because it takes away their resources, and in the latter because it may be seen as insufficient to help them develop or as too small a compensation for their underdevelopment. Various other inter-regional economic conflicts that are rooted in regional development disparities can emerge, such as conflicts about tariffs. In addition, regions may also come into conflict not with each other, but with the central government.

When talking about separatism, it is not economic, but nationalist, religious, linguistic or ethnic conflicts that first spring to mind. Indeed, as Bookman (1993:36) noted in her review of the literature on separatism, the economic causes of separatism are mostly relegated to the side, if they are analyzed at all.⁷⁴ She even mentions that some scholars go so far as to imply that separatism based on economic grievances is inferior and less genuine than ethnic separatism. What this chapter tries to establish is that inter-regional or center-region economic conflicts have often been important or even key factors in separatist conflicts. The chapter explores how and under what circumstances such conflicts can escalate and why some regions perceive that they cannot get what they want except by seceding from their country.

One thing that is different in this chapter compared to the previous ones is that, up until now, I have focused on (primarily advanced) capitalist countries. However, here I will also look at cases of separatism in less developed capitalist countries, as well as in former communist ones. This is because, while the mechanisms that create regional development disparities may be quite different in each of these groups of countries, the economic conflicts that emerge from those disparities are remarkably similar. On the other hand, I have mostly excluded long-standing violent separatist conflicts from the analysis, because normally such cases have far more lying at their root than economic conflicts (for example, ethnic repression). Still, I have included some cases – notably Yugoslavia – which ended up in violent state dissolution, but did not have any violence or repression at the outset, because these cases can be explained using the framework developed in this chapter.

⁷⁴ As an example, see Spencer (1998), where the most economically focused of the articles is Bookman's.

The chapter is structured as follows. Section 5.1 looks at whether separatist regions have common economic characteristics. Section 5.2 looks at the types of inter-regional and center-region economic conflicts that emerge, establishes that they have been important and even key issues leading to separatism at recessions and austerity as significant factors contributing to their escalation. In section 5.3, I look at the role of class and nationalism in separatism. While nationalist conflicts are the first that spring to mind when discussing separatism, I argue that nationalism is mostly used as a propaganda tool by certain classes engaged in separatist conflicts. It is then also shown that, while the term “region” can be an adequate short-hand, it conceals the social dynamics that drive separatism, by implicitly assuming that entire regional populations have the same ideas and interests. Section 5.4 explores in some more detail the common problems in separatist claims.

It is worth noting that the major authors writing on regional development (Myrdal, 1964; Hirschman, 1970; Holland, 1979) saw to an extent the potential for conflicts emerging from regional development disparities. For example, Myrdal (1964:45) notes that national parliaments are a platform through which regional grievances can be heard, and as suffrage was expanded, including more and more of the poor population (partially concentrated in the poorer regions), the more such grievances had to be addressed. One important way of doing that was through the redistributive policies of the welfare state. He does note that such redistributive policies entail at least temporary sacrifices for the richer regions (1964:40), but points out that they interact with feelings of national solidarity, mutually strengthening each other (1964:47-48). However, he does not explore what happens if the redistributive policies are weak, and how that may weaken the feelings of national solidarity, in turn weakening the support for the policies, in a process of cumulative causation that may lead to dissatisfaction and separatism in the poorer regions. Nor does he mention that there are limits to how long national solidarity can keep the richer regions willing to pay for the poorer ones, particularly when, as should be evident from the preceding chapters, the redistribution is not likely to be temporary.

Hirschman (1970:195-201) wondered if a poorer region might be better off if it separates from a richer one. It would lose the inter-regional trickle-down effects, but it would also be rid of the inter-regional polarization effects, which Hirschman saw as being stronger than the polarization effects between countries. The reason why the total net effect of separation may be more beneficial than staying within a country is because the poorer region, now an independent state, could use those development policy tools that are available to countries, but not to regions (for example, exchange rate controls or tariff protection).

Hirschman argued that the benefits of inter-regional trickle-down effects were greater than the harm coming from the inability to use these development policy tools and from the inter-regional polarization effects. However, he based this conclusion on supposed political decisions to enact policies that would strengthen the trickle-down effects, and weaken the polarization effects. As we have seen, redistributive and regional policies have not been sufficient to fundamentally transform the economies of lagging regions. In any case, Hirschman was clear that few, if any, regions were in a position to choose their sovereignty status, so he thought his discussion was mostly relevant for thinking about how to design proper institutional settings for regional development. But, as we will see in this chapter, there are actually more than a few regions that both wish and potentially can choose independence, and the question of the potential economic benefits has been important in these cases.

Holland did not talk about autonomy and separatist movements, but he is clearly aware of the potential link between regional development disparities and inter-regional or center-region conflicts. As he says:

If modern capitalist governments are to accept continuing responsibility for regional employment and welfare rather than face regional disintegration, it will mean one of two main outcomes: either more people are paid for not working in job-less regions, or more jobs are brought to those regions. In either case modern capitalism as we know it is bound to be considerably changed. There not only is the fact that many people in L.D.R.s [less developed regions] prefer paid work to less well-paid unemployment, but also there is resistance to massive unemployment benefit from those in M.D.R.s [more developed regions] who see themselves as paying for them. In a federal structure such as the United States this could give rise to increasing strains ... It could also intensify pressures against further interregional migration to decrease pressure on labour inflow areas, with the distinctly unliberal overtones of racial discrimination in both the United States and the main immigrant areas of Western Europe... (1979:59)

This chapter can be seen as an attempt to connect the insights about the causes of regional disparities and separatism, which these mentioned authors merely broached on.

5.1 Common economic characteristics of separatist regions

Bookman (1993) looked at 37 separatist regions. They were very disparate, being of various sizes, in different continents, at varying levels of development, with different economic and political systems (capitalism, central planning and self-management), different ethnic structures, different levels of violence, and with conflicts being either inter-regional, center-region, or both. Examples included the former Yugoslav and Soviet republics, Scotland, Catalonia, Northern Italy, Flanders, Quebec, Katanga, Bougainville, and numerous others. Bookman was interested in whether these regions, despite their many differences, shared some common economic characteristics. She looked at the:

- a) absolute levels of development of the regions and their countries,
- b) level of development of a region relative to its country,
- c) trade dependency of the separatist regions on local, national and international markets,
- d) level of decentralization.

5.1.1 Absolute levels of development of a region and its country

Bookman notes (1993:36) that we can look at the level of development either of the entire country or of the separatist region. When looking at the entire country the well known argument from various modernization theories is that development helps erase ethnic differences, and raises the level of education, leading people to act as members of civic society, rather than ethnic groups. This should make separatism less likely. Conversely, people can actively resist the cultural changes brought about by development through reinforcing their ethnic identities. This can increase the chances of separatism.

At the regional level, highly developed regions can feel that their economic viability as an independent state would be high, which could increase separatist aspirations. This is particularly the case if the region has valuable natural resources that it could exploit. However, an underdeveloped region can also feel that its economic situation would improve if it were a separate country, for example, because it would be able to pursue economic policies that would allow it to tap some unused regional economic potential (Bookman, 1993:62-63). This is particularly the case if central government policies, or the policies of other regions, are seen as somehow impeding the realization of this potential. This sort of feeling can, however, emerge

even in highly developed regions, if they feel that they could be even more developed provided they were freed of the influence of the central government. Chapter 7 shows this for the case of Scotland, while Jacobs (2011) has set out a similar argument for Quebec in the 1980s. Bookman (1993:108-109) has argued this as well for Quebec.

Bookman's position on the balance between these opposing tendencies, either at the country or region level, is not completely clear. She focuses on the regional level, and argues that both rich and poor regions have attempted secession, that high levels of regional development contribute to secessionist aspirations, but also that few secessionist regions are highly developed (Bookman, 1993:45, 62). Looking at her data, though, there are indeed both rich and poor separatist regions, but what seems to be the most common regional characteristic with regards to absolute levels of development is that the majority of separatist regions are located in middle or low income *countries*, and, although some of them may be more developed than the average for their country, they are nevertheless not highly developed in absolute terms.⁷⁵ The link thus seems to be that the more developed a country, the less likely it is that separatism will emerge. However, as the arguments in sections 5.3 will show, this does not seem to work primarily through the effects of development on erasing ethnic differences, but rather through the fact that higher levels of development mean that there are more resources to go about, and thus conflicts about them are less likely to happen. To the extent that economic development contributes to amalgamating different ethnicities into a single nation, that too is likely to reduce the probability of separatism emerging. Still, as evidenced by the case of Switzerland – with the French, Germans and Italians coexisting as both distinct ethnic groups and as a Swiss nation – ethnic homogeneity is not a necessary condition to prevent separatism. And, as the case of separatist aspirations in Northern Italy and some Russian regions in the 1990s show, having a single ethnicity is no guarantee that separatism will not emerge.

5.1.2 Regional level of development relative to the country average

According to Bookman (1993:44) both relatively richer and poorer regions may feel that they are getting a bad deal from being a part of the same country. Poorer regions may feel that they are underdeveloped due to unfair economic policies, or because they are not getting enough resources through redistribution. Richer regions may be dissatisfied if they, as is

⁷⁵ Here I am including the separatist regions in former communist countries, because even though many of the regions and countries were developed, they were still substantially behind their advanced capitalist counterparts.

usually the case, are net contributors to the central government budget, thus effectively subsidizing the poorer regions. Section 5.2 analyses in more depth the specific conflicts that arise, but the important thing to note here is that such conflicts would be unlikely to arise if there were no significant regional disparities, since no region would feel dissatisfied with its development level, and there would also be no need for much inter-regional redistribution.

It is also possible for regions at the average level of development to become separatist, although that is much rarer, with Scotland and Quebec being the main examples. In these cases, the conflicts are center-region and the feeling is that, if the region were not held back by central government policies, it would be doing much better. However, these conflict then do not tend to revolve around redistribution. Bookman also argues that expectations about the post-independence economic situation influence separatist aspirations. While poorer regions may be dissatisfied with their situation, they may also be concerned about their prospects as an independent economy. However, a region at the average level of development may feel that its prospects as an independent economy are no worse, and possibly better, than if it stays in the country it is part of.

It should be noted that economic conflicts can also arise about issues that are not directly related to regional disparities, no matter what the relative level of regional development is. For example, the Scottish government is dissatisfied with Westminster for, among other things, allowing inequality to grow (see chapter 7).

5.1.3 Trade dependency

Bookman (1993) argues that the less dependent a region is on its state for its inputs and outputs, the more likely it is to aspire to secession, since it has reason to believe that independence would not have a large negative impact if it disrupts trade. However, since data on intra-country trade is limited, Bookman focused on exploring in some more depth a number of cases where data was available, categorizing them into high dependency and low dependency groups. Bookman studied Lombardy and the separatist republics of the Soviet Union as regions highly trade dependent on their states. Lombardy depends on Italy for the sale of its output and partially for the supply of its labor, while the various Soviet republics were highly specialized and economically integrated with each other in all respects. Regarding regions with low trade dependency, Bookman focused on Slovenia, Quebec, Bougainville, and a few Indian states.

It is not entirely evident that her case studies bear out her argument that low trade dependency increases the likelihood of separatism. First, there are not that many fewer separatist regions with high trade dependency than those with low trade dependency. Second, there are problems with data, and the somewhat arbitrary choice of how to categorize a region, which Bookman herself notes (Bookman, 1993:69). For example, in Slovenia equal shares of its industrial output were destined for the local, national and international markets, so whether this constitutes high or low trade dependency is unclear. (The situation is clearer with regards to inputs, where Slovenia was dependent on its local and international markets, although even here some data suggests that there may have been partial dependence on immigration of laborers from the rest of Yugoslavia.) Another unclear case is Punjab, the major grain producer in India, which was mostly self-supplied with agricultural inputs, but exported almost its entire wheat production (its principal crop) to Indian markets. So, on the side of inputs it has low trade dependency, and on the side of outputs, it has extremely high trade dependency. What then is its overall dependency? To complicate matters further, Bookman noted that there was a central government ban on the export of food grains. We cannot know where Punjab would have been selling its grain if that had not been in place.

Overall, while trade dependency seems important, it appears that it has to be viewed in relation to some other factor. As we will see in section 5.4.2, this may be what separatist regions *believe* that their post-independence political and economic links to the rest of their former country will be.

5.1.4 Decentralization

Bookman (1993:48-50) look at how much autonomy regions have in their economic decision making. To the extent that separatist aspirations arise because a region feels that it cannot protect or pursue its interests, a transfer of authority to the region could mitigate that problem. However, it is also possible for decentralization to make it more likely for a region to demand secession. Decentralization involves building regional institutions that can muster resources and take actions towards secession. Also, the institutions that are created can themselves become a part of a future state's administrative apparatus, making the post-

secession period potentially easier, which can boost the separatists' confidence and increase their aspirations.⁷⁶

There are two additional things that Bookman does not mention in terms of how decentralization can increase secessionist aspirations. First, a decentralized administration can actually be essential in creating regional interests in the first place. Namely, assessments of regional economic conditions, and the interests based on them, need to be created; they do not pre-exist in people's minds. They can be created without regional institutions, but these make the process much easier. Second, similar to Anderson's (2006) arguments about nations being socially constructed (explained more in section 5.3.1), a regional administration can be something around which a regional identity can be formed. As I already noted, identities are not essential for separatism, but they can certainly be a strong contributing factor.

What sort of economic decisions can be decentralized? Today central authorities normally retain for themselves monetary policy, at least a part of fiscal policy (usually taxes on highly mobile tax bases, customs proceeds, and, on the side of expenses, regional redistribution, social security, defense, and similar expenses that pertain to the entire state), foreign economic relations (the setting of tariffs and other trade barriers, the negotiation of trade and investment agreements), some price controls, and the laws defining the basic structure of the economic system (for example, types of ownership that are allowed, the fundamentals of spatial planning, and so on). Other than that, depending on the level of decentralization, most other policies and institutions can be devolved to various sub-national levels, although in most cases the central government retains more for itself than just what is noted above.⁷⁷

Demands for more decentralization can be formed around any of these policies. However, one of the most usual demands is when richer regions wish to gain more fiscal autonomy. In practice, this amounts to a desire to reduce their net regional contribution to the central budget.

Bookman (1993:80-92) provides evidence that decentralization has sometimes satisfied the demands of separatists, and sometimes provided a boost for further aspirations. For example, for several decades after the democratization of Spain, Catalan separatism was reduced by Catalonia's increased autonomy. The ever increasing decentralization in Yugoslavia also satisfied the various demands of its constituent republics. The situation was similar in Quebec for a while after the initial decentralization in the 1960s. However, in all these cases,

⁷⁶ See Bakke (2015), for example, for studies of decentralization and its effects on separatism in Chechnya, Punjab and Québec.

⁷⁷ On the trends in decentralization, see OECD (2010:23-41).

decentralization also made separatist demands easier later on. In the case of the extreme decentralization in Yugoslavia, for example, there were not many additional institutions that any of its constituent republics had to build if they wanted to become independent. This clearly made a drive towards independence far more viable than it otherwise would have been.

So, it seems that decentralization on its own is not an independent factor, but it can either strengthen or weaken separatist demands depending on whether it helps solve the problems it is meant to solve or not.

5.2 Inter-regional economic conflicts

The previous section showed some common characteristics of many regions in which separatism has emerged, but what are the exact center-region or inter-regional economic conflicts that can happen? Regional redistribution has already been mentioned, but, in principle, any economic policy has the potential to impact the interests of some regions adversely, while being neutral or beneficial for others. Additionally, the unintended consequences of regional disparities, such as immigration to richer regions, can also create conflicts. Thus, on the one hand, economic links between regions bind them together through the flows of goods, services, capital and people, but, on the other, they can also create conditions for economic conflicts which may fuel separatism and, ultimately, state dissolution.

The next three sections analyze state economic policies, the unintended consequences of the functioning of markets, and recessions and austerity⁷⁸ as sources of inter-regional or center-region economic conflicts.

5.2.1 Sources of separatist conflicts: economic policies

Inter-regional fiscal redistribution

Perhaps the most common inter-regional or center-region economic conflict is about fiscal redistribution. Indeed, among the five issues that Bookman (1993:94) found to come up consistently in separatist conflicts, two fall into this category: “the share of central budget and

⁷⁸ Recessions may be largely an unintended consequence of the functioning of markets, while austerity policies are obviously “state economic policies”. However, since these two things, particularly when they go in tandem, seem to be a key factor in spurring separatism, I have decided to put them in a separate section.

capital investment allocated to the regions” and “the proportion of input in the form of taxes that the region contributes to the center”. These are two sides of the same coin; in practice, poorer regions are often dissatisfied with their share of investment and spending, while the richer regions are dissatisfied with the fact that they are (or think they are) net contributors to the government budget. The issue of fiscal redistribution has been brought up in Quebec, Northern Italy, Flanders, Catalonia, Scotland, in Yugoslavia, the USSR, and in many other cases of separatism.

Bookman was, of course, not the only author to notice this. For example, Hansen (1984) explored various regionalisms in both Western and the then communist Eastern Europe, and in most of the cases that he looked at, richer regions have claimed that they are being exploited because of having to subsidize poorer ones. Kęstutis (1991) and Plotniekis (1991) made the same arguments in relation to the Baltic republics of the former USSR, which were substantially more developed than the USSR average, and were subsidizing the central budget (though, due to their size, the absolute amount of subsidies was obviously very small),⁷⁹ and claiming that they were being exploited. Seliverstov (1991) also pointed out that such redistribution mechanisms deprived some regions within soviet Russia of income, and that this was leading to inter-regional tensions. Jacobs’ (2011) analysis of Quebec is another interesting case, where she documents vehement arguments about whether Quebec was a net contributor or not to the central budget. Bookman (1993:76) similarly notes that the evidence for Quebec goes both ways, but that it seems that, whatever the net effect, it was not large. Still, given Montreal’s economic decline, and the rise of Toronto as Canada’s major economic hub, the possibility that Quebec was subsidizing the federal budget at all was politically explosive.

Conflicts about fiscal redistribution do not come up only in established states. In some cases, attempts to constitute a new state failed partially because of conflicts about fiscal redistribution. Hicks (1978) focused on successes and failures in building federations. She looked at a number of failed attempts to create a federation (attempts to constitute South Africa as a federation, a failed attempt to create a federation of Kenya, Uganda and Tanzania, British attempts to build a Central African Federation), as well as a number of federations that were set up, but proved short-lived (the West Indies Federation of several of the former British Caribbean colonies and the federation of Malaysia and Singapore). While many factors contributed to these failures, economics played a role as well. For example, one of the impediments to the survival of the

⁷⁹ Of course, the extent to which “subsidies” in a centrally planned system are the same thing as “subsidies” in a market one is debatable, given the different nature of price formation.

West Indies Federation was the unwillingness of any of the islands to pay for common institutions, which would have ended up with the richer islands paying more. Federal taxation was actually prohibited. Similarly, in the case of Singapore and Malaysia, in addition to various problems that were more serious than economics, conflicts came up in relation to the more developed Singapore's contribution to the financing of federal institutions, as well as a development loan that Singapore was supposed to extend to Borneo.

A point worth making is that both in the case of Singapore and Malaysia and the West Indies Federation, the conflicts about financing administrative institutions cannot be seen separately from the generally low absolute levels of development of the countries involved. Very poor countries often have problems paying for their own state administration, let alone for additional supranational institutions, whereas for more developed countries, the entire state apparatus constitutes a very small share of total government expenditures.

Price controls

Another set of policies that has often been a source of conflict are price controls (Bookman, 1993:94). Capitalist countries do have them and some have used them extensively in certain periods, but it was in the final days of former communist countries that price controls really became significant points of contention between regions.⁸⁰

Bookman (1993), Woodward (1995), and Madžar (1995) noted this for Yugoslavia, where prices of raw materials were controlled, but prices of manufacturing products were freely formed, resulting in relative prices moving against the raw material producers and the (poorer) republics that depended on them. Seliverstov (1991:124-127) focused on the Soviet Union and noted that, on top of the persistent regional inequalities between the USSR republics, some economic policies did not take into account specific regional characteristics, thus leading to tensions in inter-regional and center-region relations and disintegrative processes. Here he focused on eastern and northern parts of Russia, and pointed out, among other things, the low prices set for the products of raw material industries, which made it almost impossible for enterprises to be profitable and local budgets to form. Bronstein (1991), in his analysis of the collapse of the Soviet economy, documented the same situation, except not within Russia, but

⁸⁰ Given that, except Yugoslavia, these were centrally planned economies, price "controls" is not the most adequate term, since all prices were set by the state anyway, but I have decided to stick with it to avoid an unnecessary proliferation of terms.

between Russia and the rest of the Soviet Union, with Russia claiming that it was being exploited by the other republics because of the low prices of raw materials. Identical accusations were made by the Central Asian republics; one of their primary products was cotton, the price of which was also kept low. In the case of communist countries, such dissatisfaction with specific policies quickly turned into animosity against the “system” (Bronstein, 1991:151-152). Given that economies based on the production of raw materials tend to be less developed than those based on manufacturing and advanced services, these well known “price scissors” actually even entailed a transfer of resources from poorer to richer regions.

As noted, capitalist countries do have price controls and price supports. The most important ones are for agricultural products, and they are usually combined with other policies that support the incomes in that relatively non-oligopolized sector, protecting it from price competition and instability. It is not inconceivable that, if these policies were not in place, we would see much more dissatisfaction coming from agricultural regions which, for that matter, would then also be significantly poorer, since relative prices would often move against their producers.

Distribution of foreign currency

Bookman (1993:94) identifies “the share of foreign exchange and external funding” as one of the most common interregional conflicts that arises. This was again an issue primarily in communist countries. In Yugoslavia, for example, conflicts about reforming the system of foreign currency allocation were amongst the first to arise. Foreign currency earnings could partially be retained by the companies that earned them, and partially had to be sold to the central bank.⁸¹ Attempts by the federal government to reform this system towards a more market based one (where foreign currency could not be held by companies, and had to be bought on the market) were strongly opposed by Slovenia and Croatia, which were the main earners of hard currencies.

Advanced capitalist countries have not generally experienced such conflicts, because they usually do not centrally allocate foreign currency. Nevertheless, some have done this, either during wars or in periods of reconstruction. Conversely, developing capitalist countries, including those that have managed to join the core of the world economy, have extensively

⁸¹ For an explanation of how the system worked, see Bookman (1991:206).

rationed foreign currency for extended periods of time as part of development plans. It would be interesting to see if this had ever caused inter-regional conflicts, but unfortunately it was not possible to undertake this research for this thesis.

Tariffs

Tariffs are another policy that is set at the national level, but impacts different regions differently. Hirschman (1970) noted that the “South” (underdeveloped region) may be forced to buy more expensive “Northern” (more developed region) goods behind tariff walls, instead of cheaper imports. If the South pushes for lower tariffs on these grounds, while the North wishes to protect its industries, this may create a conflict. According to Chang (2003:27-28), this was exactly one of the major reasons for the American Civil War. Hicks (1978) documented the same conflict in the short-lived West Indies Federation – one of the major obstacles to its survival was the reluctance of Jamaica to give up the protection of its infant industries.

Poorer regions may also wish to separate so that they can employ tariffs against the richer region, and thereby provide their own industries with a chance to grow. Reinert (2008:59-60) notes that this was one of the things that Norwegian separatists wanted during the time Norway was a part of Sweden.

The composition of tariffs can also cause conflicts. Madžar (1995) pointed out that the poorer Yugoslav republics were dissatisfied with the fact that, in order to help industrialization, tariffs on raw materials were much lower than on manufactured goods. This meant that their industries were exposed to more competition than those of the richer republics.

Monetary and banking policies

Monetary policy can also have different impacts on different regions (Carlino and DeFina, 1996), particularly because most nations states (if any) are not actually optimal currency areas. (McCann (2016) makes this point for the UK.) For example, an attempt to reduce inflation through restrictive monetary policies will have a worse effect on those regions which rely more on SMEs than on those that rely more on big firms. This is because SMEs rely to a large extent on external financing, while big firms can rely more on self-financing. Effectively, this means it will have a worse impact on poorer regions. This has been brought up in the case of Scotland and the United Kingdom (Cairns, Cooper and Morgan, 2014), although admittedly the issue

has not been taken up by the Scottish government itself in the arguments it has set out against the UK government.

It is not only restrictive monetary policies that can cause conflicts. The case of Yugoslavia is instructive in this sense. Throughout the recession in the 1980s, many firms were facing bankruptcy, but were supported by banks through loans, which were, in turn, supported by the Yugoslav central bank. By the late 1980s, this had led to hyperinflation. However, firms in the poorer republics, and particularly agricultural producers, were more dependent on this sort of support, thus leading to conflicts between the Yugoslav republics about controlling inflation.

Exchange rates

Exchange rates can also become contentious. In the United Kingdom, for example, there is a long-standing argument that a strong pound works to the benefit of the financial sector and against manufacturing.⁸² Given the regional division of industries in the United Kingdom, this means that a strong pound works in favor of the Greater East and against most of the rest of the country.

5.2.2 Sources of separatist conflicts: unintended market consequences

Economic policies seem to become a source of conflict more easily than unintended market consequences, probably for several reasons. First, actors who decide on economic policies are more easily identifiable than individual market actors, and can thus more easily become a target for dissatisfaction. Second, economic policies can be thought of as having desired regional effects, whereas the actions of market actors normally do not have any such effects as their goal (though they do have them as a consequence). Thus, any negative consequences that the market produces are less likely to cause dissatisfaction than economic policies that are thought of as being intentionally harmful. Third, government policies are more straightforward to understand than the functioning of markets, and thus easier to criticize. Indeed, in capitalist countries it is only the radical left that consistently criticizes markets as the main source of various problems. Finally, policies can be changed more directly than market outcomes, so the aspiration to change them can form more easily.

⁸² See, for example, IPPR North (2012:76-77).

Nevertheless, migration from poorer to richer regions (an unintended market consequence) has often created significant dissatisfaction in the latter. Such migration creates pressure on social services, infrastructure and housing in richer regions, and it can push up rents and inflation. It can also create dissatisfaction because of the cultural influence of the immigrants.

A current example is what is happening in the EU today. For many purposes, we can treat the EU as a state, and its member states as regions, in which case some of them are experiencing a marked rise in separatism, and the UK, after the result of the Brexit referendum, will soon start its exit negotiations. The anti-immigrant rhetoric in the richer member state that has been adopted by a whole slew of new right-wing parties, established center-right ones, and even some center-left ones, is exactly based on a concern about the cultural and economic impact of migrants.

It is interesting to note, though, that the migration from richer to richer EU member states and from richer to poorer ones has not created any widespread resentment. This is despite the fact that such migration too can have at least some negative effects for the inflow countries – for example, it can push up the prices of housing in poorer countries, as the prices adapt to the higher purchasing power of people from richer countries, leaving the local population worse off. Similarly, while concern is often expressed in poorer EU member states that they are losing educated people to the richer member states, this has never been brought up as a reason to potentially leave the EU.

In terms of autonomous capital flows, Jacobs (2011) noted that there was concern about Quebec losing capital to the rest of Canada. This related not just to the flow of new investment, but also to the actual relocation of some companies' headquarters from Montreal to Toronto. Nevertheless, this seems to be an exception; as I already noted, separatist movements pay far more attention to the inter-regional flows of public funds.

Of course, regional underdevelopment itself is largely a consequence of how markets function, but this is generally not recognized by separatist movements. Rather, the focus is on government policies that are seen as being the main culprit for the underdevelopment. Besides, it is anyway the case that, at least in advanced capitalist countries, strong separatism seems to emerge more in richer regions which do not have cause to be dissatisfied with market consequences.

5.2.3 Sources of separatist conflicts: recessions and austerity

The importance of recessions and austerity does not seem to have been recognized much in the literature on separatism. This section uses the example of Yugoslavia to show the kind of corrosive effects a prolonged recession combined with austerity measures can have on state institutions designed to manage inter-regional and center-region economic conflicts – it is one thing to manage them when the amount of economic resources is increasing, but the situation fundamentally changes when it is constantly decreasing over a prolonged period of time. Indeed, it appears that the Yugoslav recession and IMF-imposed austerity in the 1980s may have been *the* key factor in destroying the country.

Bookman (1994) explored the link between economic decline and separatism in the Balkan countries in the 1990s. She argues that (1994:6):

In multiethnic societies, especially those in which substate divisions are drawn according to ethnic, religious or linguistic lines, regional economic competition is easily interpreted as interethnic competition. ... When economic conditions deteriorate, competition becomes more ferocious and fuels nationalist ideology. The [economic] problems may become exacerbated as interethnic bickering imperils economic functioning and paralyzes economic institutions...

Yugoslavia is the most interesting country she looked at, because it is the only one that has actually dissolved. However, Bookman primarily focused on the extreme economic crises in during the 1990s, only mentioning a few times the recession that Yugoslavia was in in the 1980s, which is what was actually important in creating the situation in the 1990s. To understand its impact, we need to first note the regional disparities that existed in Yugoslavia.

Flaherty (1988) explains that up until the 1960s, the Yugoslav federal government maintained substantial price controls and directed investment through controlling the banking sector and the investment decisions of firms, among other ways through taxing about 60% of the firms' net income. This ensured that relative prices did not move against raw material and agricultural producers, sectors on which the poorer regions of the country relied,⁸³ and that the poorer regions got a share of investment, particularly in infrastructure. Regional disparities did increase during this period, but not too much. However, dissatisfaction in the richer regions

⁸³ Montenegro, Bosnia and Herzegovina, Kosovo and Macedonia.

with these controls, plus the fact that they were seen by many as incompatible with socialist self-management, led to pro-market reforms in 1961, which eliminated most import and price controls, allowed firms to make their own investment decisions, reduced taxes on firms' net income to 15%, and reformed the banking sector to a market-based model.

The pro-reform arguments were that this would allow the concentration of investment where it would be the most productive and allow for greatest efficiency and economies of scale (i.e. in the richer regions of the country), and that the establishment of growth poles there would have trickle-down effects on the rest of the country. The anti-reformists were concerned that relative prices would turn against the poorer regions, that they would be deprived of investment,⁸⁴ and that growth poles might only become beneficial for the poorer regions once they were completely saturated with investment themselves (i.e. at some undefined point in the future).

Flaherty sums up the effects of the reforms thus:

The effects of reform were immediate and dramatic. In the first four months of 1962 retail prices increased by 25%, prices of agricultural products by 18% and the balance of payments deficit continued to grow despite devaluation. As domestic terms of trade turned against agriculture and international terms against domestic producers in general, the less developed regions suffered disproportionately due to their greater reliance on agriculture for income and imports for production. Unemployment rose in these areas as 'countless enterprises in Bosnia-Herzegovina, Montenegro, and Macedonia had to let workers go in the face of shortages of both operating and investment capital'. Planned levels of investment were not reached in the country as a whole, because decentralisation led to 'evasions of the laws and directions requiring contributions to the federal government in the form of taxes and the investment and development funds of enterprises'.

Finally, receipts of the General Investment Fund, the source of supplementary federal funds, fell precipitously ... The inability of the fund to meet its obligations was much more

⁸⁴ This would be particularly problematic for the entire nation when it comes to slowing down improvements in agriculture in the poorer regions, because the need to import food was draining foreign currency reserves needed for industrialization.

*damaging to the underdeveloped regions owing to their greater dependence on the fund for working as well as investment capital (1988:102-103).*⁸⁵

The reforms did include one important provision to help the poorer regions, namely, the establishment of the Federal Fund for the Development of Underdeveloped Regions that firms from all regions would contribute to proportional to their incomes, but that would be used solely to finance investment in the poorer regions. Nevertheless, as would be expected in a basically market-based system, this did not prove sufficient, and regional disparities started rising much faster after 1961.

Yugoslavia, like many other countries, accrued substantial foreign debts in the 1970s, and by the end of the decade had run into a balance of payments crisis. Woodward (1995b) argues that Yugoslav federal policy-makers could not choose to default, because of Yugoslavia's specific international position and the need to maintain good relationships with both the Western and Eastern blocs. Nor could they turn to more direct control over the economy in order to steer it out of the crisis (as they had done on previous occasions when facing similar crises), because the more market-oriented approach to socialism was by then firmly institutionalized. The federal government therefore did the only thing it could, namely, turn to the IMF, which demanded austerity measures and a currency devaluation in exchange for new loans and debt rescheduling. Several further IMF programs followed throughout the 1980s, all having recessionary effects. Additionally, the federal government started rationing foreign currency, and imposed import restrictions, which hit importers and non-priority import-dependent industries. Finally, the banking system was used to credit failing enterprises, which led to hyperinflation by the end of the 1980s. What is crucial, though, is that all these measures did not impact all parts of Yugoslavia equally. For example, Woodward (1995:208) notes that in 1984, registered unemployment was 1.7% in Slovenia, 7.2% in Croatia, 19.1% in Montenegro, 21.1% in Macedonia and 33.3% in Kosovo.

This set the stage for serious economic conflicts between the republics and between them and the federal government. In essence, the richer republics, particularly Slovenia, were not as harmed by the recession and austerity as the poorer ones, and they did not want to share their resources, nor did they want to be harmed by those reforms pursued by the federal government that were harmful for them. For example, Slovenia and Croatia insisted that firms should be allowed to retain more of their foreign currency earnings, and resisted reform proposals to set

⁸⁵ On regional development patterns in Yugoslavia, see also Bookman (1991:131-145).

up a market for foreign currency. The counter-argument was that Slovenian firms were often the intermediaries for the export of goods made by firms in the other republics, who should therefore get their share of foreign currency earnings. With regards to Croatia, the tourism industry benefited from federal investment when it was being set up in the 1960s (Bookman, 1992:79-80), so it was not seen as fair that Croatian firms should retain all the benefits of that investment.

Numerous other conflicts could be mentioned, but the main point is that it was the recession and austerity that were the key factor that put Yugoslavia on the path to dissolution. Linguistic, national, ethnic and religious differences had always existed in Yugoslavia, but there is simply no serious evidence that they ever brought the country anywhere near dissolution on their own, or that they were even a particular problem to begin with.⁸⁶ Hence, the usual narrative that Tito was the “unifying” factor whose death spelled the end of Yugoslavia (a full decade later) also does not make sense. Nor does it make sense to say that it was the communist repression of nationalities that kept the country together. Nationalism (in the chauvinist sense) was repressed, but national identities were not. As Woodward (1995a:90-91) says: “Yugoslavia was held together not by Tito’s charisma, political dictatorship, or repression of national sentiments, but by a complex balancing act in the international arena and a mixed economic and political system that provided governmental protections of social and economic equality and of shared sovereignty among its many nations”.

Yugoslavia did have substantial regional disparities and conflicts based on them. There were market factors that favored the richer regions, such as relative prices and the competitive advantages of their firms. There were also state policies that (unintentionally) favored them, such as the federal export credit fund. As Madžar (1995) reports, in 1970 the value of its allocations just to capital goods and ship exports (industries primarily located in the richer republics) was equivalent to 76% of the entire allocations of the above mentioned Fund for the Development of Underdeveloped Regions. But, Yugoslavia did also have some mechanisms to help the poorer regions, such as foreign currency sharing, and transfers through the federal budget and federal funds. Madžar (1995) notes that the poorer republics were always concerned about the effects of (socialist) markets on their development, while the richer ones were always arguing against fiscal redistribution. Still, this had been going on for several decades before

⁸⁶ As a matter of fact, how “loyal” people were to their group is shown, for example, by the fact that, when attempts were made in Serbia to draft men to fight in Croatia in 1991, draft dodging was between 50% and 85%. Additionally, about 50,000 reservists that were sent to the front deserted (Lowinger, 2009:17).

Yugoslavia dissolved, and there does not seem to be evidence of separatism purely based on the regional disparities, even if they were increasing.

What seems to have pushed the country towards dissolution were the decade-long recession and austerity, which kept sharpening the inter-regional and center-region conflicts, and putting the institutions for managing them under such strain that they could no longer cope. Of course, without regional disparities, the recession and austerity would not have had this effect, but the regional disparities were the enabling factor, while the recession and austerity were what actually started the chain of events ending in dissolution and war. By the time multi-party democracy was introduced in the late 1980s, the republican political and economic elites were already in continuous sharp conflicts with each other and with the federal government. Faced with the need to win elections, they started employing extremely nationalist propaganda, with accusations of exploitation exploding on all sides. This propaganda fell on fertile soil – in the richer republics on a population which could be convinced that its living standards were endangered by exploitation by the poorer republics, and in the poorer republics by a population which was feeling the effects of a severe recession and austerity for a decade, and was generally susceptible to being offered a scapegoat for this.

Two things seem worth speculating on briefly with regard to recessions, austerity and separatism. First, recessions and austerity may be an important factor in determining if it is richer or poorer regions that want to secede. In good times, the poorer regions might think that their prospects as an independent country would be good, and the richer regions may not mind any interregional transfers as much. Conversely, during times of recession, the poorer regions may not be too keen on losing support from the richer regions, while at the same time the richer regions may become less willing to share their resources, both because they may be shrinking and because the poorer regions might actually need *higher* levels of support than before (say, due to a larger number of unemployed people).

Second, Madžar (1995) pointed out that if a richer region is not particularly large in comparison to the entire state and other regions, then it would have to transfer a sizeable portion of its income for that to matter in *per capita* terms in the poorer, bigger regions. In relation to the current discussion, the implication is that in times of recession, when resources are tighter and the need for transfers (such as for unemployment benefits) bigger, rich regions that are not large compared to the rest of the state might become particularly dissatisfied. We have certainly witnessed a sharp rise in secessionist aspirations in, for example, Northern Italy, Flanders and Catalonia during the current recession. In the Soviet Union, which had been in stagnation since the Brezhnev era, with additional economic problems coming from the botched reforms under

Gorbachev, the small, but more developed, Baltic republics were the first to become separatist. Also, if we look at the EU as a state-like entity, with separatism in its “regions”, then there has been a significant increase in separatism in the richer states over the last several years of recession – they are large “regions”, but not overwhelmingly large compared to all the poorer member states combined.

Third, a special case of the effects of recessions and austerity may be regions that recognize that austerity is a bad policy choice, want to escape it, and feel that the only way to do it is to become independent and gain control over their economic policy. We will see in chapter 7 that this is a part of the story of Scottish separatism, and, as I mentioned before, it was one of the things that drove Quebec’s dissatisfaction with being a part of Canada.

5.3 Class, nationalism and separatism

Thus far, I have been using the term region as a short-hand. This has been useful in order to more easily focus on regional economic characteristics and the types of inter-regional and center-region conflicts that emerge. However, it is obviously not regions that act. We have to actually look at the relevant actors if we want to explain how economic conflicts influence separatism. This section focuses on a class analysis of separatism, but it also allows us to explore how class and nationalism interact, or, more precisely, how the construction of nations and national interests by certain classes is a tool they use in separatism.

To understand that, though, we first have to give a short overview of how nations have emerged. The important point to take away is that nationalism cannot be viewed separately from political economy.

5.3.1 A short overview of nationalism

Most people implicitly hold the view that national belonging is primordial to human nature. However, it is well established in the academic literature (Anderson, 2006; Gellner, 2009; Hobsbawm, 2014) that even the oldest nations are no more than a few hundred years old.

The feeling of national belonging is actually a puzzle that needs to be explained – how can so many people who have never even met each other feel a strong sense of belonging to the same group? Anderson (2006:6-7) calls nations *imagined* communities – they exist only in the

minds of their members, and have several characteristics. They are imagined as *limited*, as having boundaries, beyond which lie other nations. They are also imagined as *sovereign*, as having (or they should aspire to have) self-rule. Since the idea of the nation definitively emerged during the Enlightenment, this self-rule is often legitimized as stemming from the people – the members of the nation. Finally, a nation is imagined as a *community*, “a deep, horizontal comradeship” (2006:7), despite the fact that societies are composed of different classes of unequal power, and that relations of exploitation abound.

According to Anderson: “What ... made [nations] imaginable was ... [the] interaction between a system of production and productive relations (capitalism), a technology of communication (print), and the fatality of human linguistic diversity.” (2006:42-43). At the time when the bases for the idea of a nation started forming – during the 16th century in Europe – capitalist relations were starting to develop with increasing speed. As capitalists involved in printing saturated the Europe-wide market for books in Latin, which was the common language of the learned classes, they started turning to where they could make further profits, namely, to printing in vernaculars, which were used by those who were literate, but did not know Latin (merchants, state functionaries in those states that used vernaculars instead of Latin, etc.). This had far-reaching consequences.

Those literate in Latin were mostly the clergy of the Catholic Church, or lawyers, doctors and similar learned professions. Some of these people travelled throughout Europe, and met others who shared similar life experiences (knew Latin, read the same books, were of the same religion, visited the same places). They formed a sense of community, but, crucially, the boundaries of this community were not territorially limited, at least within Europe.

The situation was very different with vernaculars. Their orthography was standardized in large part by the printers, in an effort to expand their markets by making sure that as large a section of the literate population as possible could read their books. But, this still meant only people in a limited territory, because, unlike Latin, there was no single vernacular that was spread all over Europe. Furthermore, most people were monoglot, so most readers of one vernacular could not read another. In addition, the people who read vernaculars were more likely to move within the boundaries of their state, rather than all over Europe. This was particularly the case with state bureaucrats, whose career progression at the time often involved moving around the country. All of this meant that a sense of territorially limited, sovereign community – a nation – could emerge.

What is important to note is that in the initial phases of the formation of nations – roughly from the 16th to the late 18th century in Europe – the whole concept had little to do with the vast

majority of the populations that ended up as modern nations. The creation of national consciousness was something happening at the top of the social hierarchy, among merchants, bureaucrats, lawyers, top military officers, etc.⁸⁷

From the late 18th to mid-19th century, the elites had what Hobsbawm (2014:18ss) calls the “revolutionary” concept of the nation. This involved territoriality, sovereignty and community, but, unlike today, in principle all people living in a certain territory were, or at least could be, a part of the same nation – their ethnicity, mother tongue, religion, or any other cultural trait, were unimportant, as long as they also acquired the official language of the state⁸⁸ and obeyed its laws. Compared to the situation today: “... in this period, nations and nationalism were not major domestic problems for political entities which had reached the status of ‘nation-states’, however nationally heterogeneous they were by modern standards” (Hobsbawm, 2014:43).

This changed dramatically from mid-19th century and onwards, when the concept of the nation started encompassing non-elites as well, and started including various ethnic characteristics. This happened for two interrelated reasons. First, mass schooling needed to be done in a common, standardized language, if it was to be of use in a state-wide administrative apparatus, and in increasingly internally connected national economies.⁸⁹ Given that most nation states in Europe had people with different mother tongues, whichever language was chosen for mass schooling would leave large numbers of people disadvantaged, because they would have to learn an additional language. Second, democratization meant that it was possible to organize politically and vie for the control of the state, including for determining what languages were to be important. These two reasons explain why politics within nation states started partially revolving around languages – namely, languages determined access to

⁸⁷ In truth, it is not really possible to know with certainty what the great number of illiterate people thought, given that they could not leave any written records, and those who did know how to read and write were not often concerned with them or their political ideas. Hobsbawm (2014, chapter 2) did actually try to determine in various ways what this great mass of people felt about nations, if anything. He concluded that, in many cases, there were some elements in the cultures of the various peoples in Europe that could be built upon to create a popular feeling of a national community, or that could even create some feeling of a larger community on their own. He calls this “popular proto-nationalism”. However, Hobsbawm concludes that, while these elements could end up as building blocks of modern nations, they were not the same as modern nations. Most importantly, the idea of a shared language and a common ethnicity was lacking.

⁸⁸ Which was not always the dominant vernacular in the state, and could even be a foreign vernacular.

⁸⁹ More precisely, in most cases it needed to make most of the population use a standard language. More than anything, it was this process which started eliminating spoken local dialects, many of which were mutually unintelligible, and replacing them with the spoken languages we know today.

education, state administration and jobs. This also meant that there was a strong class element overlapping with what language was used – those on the losing side were often excluded from the best social and economic opportunities. It was in this period that, as part of these struggles, various national myths were simply invented, when people sought to strengthen the unity of their groups (Hobsbawm and Ranger, 2013). Cultural characteristics apart from language, such as religion, also started being included in these nation building projects, until finally the concept of the nation took its modern form – a combination of ethnicity, language, religion, shared invented national myths, territoriality, and self-rule. This is, not incidentally, the period which saw the rise of national separatism for the first time, particularly after the end of the First World War.

What we can conclude from the above analysis is that ethnic, religious and linguistic differences do not lead to conflicts by themselves, nor are they set in stone, nor even essential for the formation of nations. Thus, in the context of separatism, even if it appears that many cases are driven by nationalist conflicts, we have to go deeper than that, and look at the underlying economic, political and class structures, and analyze how they interact with nationalism.

5.3.2 The interplay between class and nationalism in separatist conflicts

In this section we will use several examples – separatism in the Soviet Union and Russia, former Yugoslavia, and Catalonia – to illustrate the importance of class and its interplay with economic interests and nationalism in fueling separatist conflicts.⁹⁰ As we will see, in general, it is broadly defined elites (intellectuals, business leaders, politicians, members of leading civil society organizations, journalists, etc.) that express views about regional conditions and interests, and undertake actions at the regional level. What is interesting is to see is how some sections of these elites form separatist interests, and how they in turn influence sections of

⁹⁰ A few days before the submission of the present thesis, I was made aware of an article by Michael Keating (Keating, 2014). It matches the arguments in this section closely. Keating provided a rare comparative class analysis of several European separatist movements (in Scotland, Catalonia, the Basque country, Flanders and Northern Italy), focusing on class support among ordinary people, trade unions, and business organizations. Due to time constraints, it was not possible to integrate it into the text, as it would have required rewriting, but I nevertheless felt it was important to reference it, as it is an excellent article.

ordinary people when building up support for separatism. Ordinary people are, of course, not merely tools, but they can be said to be caught up in events more than influencing them.

Soviet Union and Russia

Let us first look at the Soviet Union and Russia. Herrera (2005:120-142) argues that it was difficult for regional interests to form at all in the Soviet Union, given the centralization of the political and economic systems (through the Party *nomenklatura* and central planning), in combination with strict controls on the public debate. But, the Gorbachev reforms in the second half of the 1980s saw significant decentralization. Several laws gave greater autonomy to firms and managers in making business decisions, for example on prices. In the political sphere, Gorbachev wanted greater decentralization and separation of the Party and the state. Among other measures, Party organs that fulfilled the same function as various state ministries, including those dealing with economic affairs, were abolished, and the influence of the Party on appointments in the ministries themselves was lessened. Additionally, numerous institutions that were reformed or created in the Gorbachev era were now staffed through sub-central selection processes.

This combination of economic and political decentralization made it much more possible than before to first at all form the idea of regional interests, and then to actually define specific ones. The political liberalization made it safe, and potentially politically and economically profitable, to pursue them. All this was combined with the fact that the perestroika did not really reverse the long economic stagnation from the Brezhnev era, and, as far as the ordinary people were concerned, it even introduced some problems that were not widely present before, such as profiteering on scarce goods. Once free(er) elections were introduced, it was only to be expected that some of the new or reformed elites would seek support on a regionalist platform, and push for secession. We already mentioned some of the economic conflicts that emerged, and noted it was the Baltic republics that were the first to become separatist. The USSR is thus an example of decentralization in combination with an economic crisis leading to dissolution, and in this broad sense the country parallels the Yugoslav case.⁹¹

The processes that dissolved the Soviet Union continued within the Russia. Herrera (2005) looked at the Sverdlovsk and Samara *oblasts* between 1990 and 1993. These were picked

⁹¹ Nolan (1996), comparing China and the USSR, made the point that maintaining strong authority seems to have been a better choice for a large and diverse country facing profound economic changes.

because of their similar size, history (both have been at the core of the Russian state for centuries), ethnic composition (overwhelmingly Russian) and, most importantly, economies (manufacturing-based), but a striking difference in the fact that Sverdlovsk had one of the strongest regionalist movements in Russia at the time, pushing for being turned into a republic,⁹² whereas there was almost no regional activism in Samara. Herrera tried answering why this was the case.

Herrera (2005:52-54) noted that even talking about objective economic facts was problematic in that period in Russia, since the Russian statistical office was only starting to build up the concepts and measurements needed for a market economy, with numerous problems and errors along the way. This was combined with a very unclear and constantly shifting institutional structure for center-region relationships, and with constant inter-regional and center-region conflicts about fiscal redistribution, inter-regional trade barriers, prices, production allocations, and numerous other issues (Herrera, 2005:151-159). In other words, the situation was perfect for regional elites to imagine their regions' situation essentially however they desired.

Herrera showed, through a content analysis of local newspapers in Sverdlovsk and Samara, that the economic problems of the two regions were consistently framed in a different way. In Sverdlovsk the center was seen as the source of the economic problems more often than in Samara, and Sverdlovsk was being represented as being treated unfairly. In Samara the regional economic problems were generally presented as part of the Russia-wide economic decline, and not as being the effect of unfair treatment of Samara itself. This obviously fed into a very different idea about what regional interests were – the political and economic elites in Sverdlovsk wanted to attain republic status and take more control over regional affairs, while in Samara there was no corresponding desire for greater autonomy. This was so despite the fact that, for example, Samara seems to have been a bigger net contributor to the central budget than Sverdlovsk (Herrera, 2005:179).

At least a part of the reason for the different perceptions of the economic situation of Sverdlovsk and Samara came from the composition of their executive elites. In Samara, the executive was heavily dominated by people from the Communist party who had entered local politics through first being appointed to the region by the central Party organs. The central

⁹² Herrera sets up a “centralization – status-quo – independence” line, where a region may desire to stay where it is, or move towards one of the ends of the spectrum. Being turned from an *oblast* to a republic, that is, more decentralization, is towards the independence end.

administration also helped local elites consolidate their power. In Sverdlovsk, there was a significantly higher influence of politicians who entered politics for the first time in the 1990s (Herrera, 2005:173, 175-176).

Herrera's study shows several of the points I noted thus far. Understanding where separatism comes from is impossible without looking at how regional elites – in this case regional political leadership and the media – form their interests and influence public opinion. Second, interpretations of a region's economic situation, and even more the interests based on this interpretation, are something that needs to be constructed. Indeed, Herrera called her book *Imagined Economies*, to point out that, just like Anderson (2006) argued that nations are imagined communities, ideas about the economy are also something that needs to be imagined and shared with others. Her case studies also confirm that nationalism, or its constituent parts, are not necessary for separatism (or, in this case, regionalism) to arise. Nationalism was used as a propaganda tool in the dissolution of the Soviet Union, but it played no role in Sverdlovsk's drive for more autonomy.

Yugoslavia

Lowinger (2009) looked at Yugoslavia, and thus, unlike Herrera, had to account for how class and nationalism interacted. He also offered a closer look than Herrera at how the elites manipulated ordinary people in their pursuit of secession.

Lowinger focused on the wave of labor strikes and unrest in 1980s Yugoslavia, during its recession and IMF-imposed austerity. Like Herrera, he based his analysis on newspaper articles. He argued that they clearly showed that the strikes were non-violent and cross-ethnic, and aimed against the federal government. The workers were in most cases demanding a restoration of their real incomes, which were constantly being eroded by the government's austerity measures and high and increasing inflation.⁹³ In a number of cases, they were also defending their rights in the management of enterprises (Lowinger, 2009:2). Lowinger tries to explain how the elites managed to turn this wave of worker dissatisfaction into violent inter-ethnic conflicts.

He argues that regional political elites often allied with the striking workers in order to bolster their own position in their conflicts with the federal government. But, from the end of

⁹³ The declines came both from direct and indirect cuts, wage freezes, and soaring inflation. Inflation could happen together with fiscal austerity, because firms were being saved from bankruptcy through bank credit.

the 1980s, political elites, both the republican and provincial communist parties⁹⁴ and the new nationalist parties that were created after multi-party democracy was introduced, were increasingly trying to divide the workers along ethnic lines. The purpose was to break the power of the working class and hold on to or gain power at their expense. In some republics – notably Croatia and Slovenia – this was done in order to more easily pursue separatism. In all republics it was also done in order to more easily destroy the system of worker self-management, so that economic assets could be seized by what were to become the new capitalist classes.⁹⁵

Nationalist propaganda worked best with those groups that had higher intolerance levels. As Lowinger (2009:13) notes, intolerance was higher among the young than the old, and absolutely the highest among the unemployed (with youth unemployment being a particularly big problem in Yugoslavia). In other words, intolerance was high among those who had either lost the privileges and living standards they had (due in large part to the federal government's austerity measures), or who never attained the standards promised by socialist self-management.

The fomenting of inter-ethnic conflict was done in numerous ways. For example, in Slovenia there was heavy propaganda about how Slovenian workers were being exploited by the poorer republics, with the clear intent of building up a mood supportive of secession. In Croatia, the media equated bureaucratic control with Serbian control. In Kosovo, the regional authorities (mostly Albanian) were actually not allying with the workers, but trying to subdue the labor unrest (which was cross-ethnic between Serbs and Albanians) by pressuring Albanian workers to not strike. The authorities were implying that the strikes were nationalist, and due to the repression of nationalist Albanian protests in 1981, this tactic worked to an extent, as the Albanian workers knew that there was a passable pretext to crack down on them. The occasional lack of support from Albanian workers created some resentment amongst Serbian workers, who were a minority in the province. Simultaneously, the authorities were actually cracking down on the strikers. But, in those cases where Albanians did not strike, this meant a regional authority with a heavy Albanian representation cracking down on Serbian workers. While this was not done due to any ethnic hatred, it nevertheless created the opportunity for

⁹⁴ There were nine communist parties in Yugoslavia – one for each of the six republics, two for Serbia's autonomous provinces of Vojvodina and Kosovo, which were all formally a part of the Communist Party of Yugoslavia. The sub-central parties had great autonomy, both as parties, and in actually influencing republican or provincial politics, due to the extreme decentralization of the Yugoslav federation.

⁹⁵ Needless to say, the amount of corruption in the privatization processes that were started in the former Yugoslav republics after dissolution was enormous, as was the outright plunder during the war.

Slobodan Milosevic, by then the leader of the Serbian Communist Party, to present himself as someone who will save Serbs from Albanian repression.⁹⁶

Nevertheless, creating inter-ethnic hatred was not in any way easy. Indeed, as Lowinger points out multiple times, this took massive propaganda in the media, which actually came under stricter control after multi-party democracy was introduced.⁹⁷ The last federal prime minister, Ante Marković, tried countering this by launching a Yugoslav wide television network, Yutel. It did not manage to achieve much. It is ironic that Marković was both an honestly staunch Yugoslav, and a supporter of IMF “structural adjustment” programs. Lowinger (2009:20, 25) actually argues that many federal policy-makers were simply not realizing that the reform measures they were implementing in the 1980s were destroying the fabric of the Yugoslav economy and society.

Even the massive propaganda in the media was not always enough to destroy inter-ethnic cooperation and the primary identification of workers with their class. This was particularly the case in heavily multi-ethnic towns and areas. In such cases, brute force was applied. The usual tactic was for paramilitaries of one ethnicity to perform some act of violence against another ethnicity. This “‘proved’ on the ground that ethnic co-existence was no longer safe” (Lowinger, 2009:112-113). It was also, as intended, invariably presented in the media of the “opposing” side as acts of violence of one ethnicity against another, not of paramilitaries and criminals against ordinary people.

Lowinger’s analysis provides further evidence that the recession and austerity measures in Yugoslavia played the key role in the country’s dissolution. But, what it also shows is that their effects cannot be fully understood just in terms of elite conflict. Rather, we have to acknowledge that they create among ordinary people a feeling of insecurity, a fear of a decline in living standards or dissatisfaction if they have already declined, and that it is these things that are exploited by the elites in pursuit of their interests.

⁹⁶ Up until that time, Milosevic was presenting himself as a savior of *both* Albanian and Serbian workers against the regional authorities, in his attempts to reduce the power of the Communist Party of Kosovo. In other words, Milosevic was a skilled opportunist politician mainly interested in increasing his own power.

⁹⁷ The republican communist parties were actually quite tolerant of critical media reporting in the 1980s, whereas when control over media was seized by the new nationalist, or the reformed communist parties, it became increasingly difficult to counter their propaganda.

Catalonia

Orientalizing narratives of separatism, often focused on supposed “ancient ethnic hatreds”, are very common when discussing non-Western countries, including former communist ones. As we have seen, they are wildly incorrect. Separatism in the West is not normally couched in such extreme terms. Still, nationalism is the typical explanation given, such as in the Belgian case.⁹⁸ Even when this is not the case, the class aspect is usually not looked at. Martínez and Miley (n.d.) study of Catalan separatism, though, puts precisely class at its center.

Martínez and Miley note that support for independence in Catalonia was mostly stable at around 30% from 1991 until the summer of 2012, but then saw a sudden surge, rising to about 50%. They show through survey evidence that, contrary to widespread beliefs, this was not a grassroots development. Rather, the support for independence started among political elites, before promulgating to other groups, and it is still higher among the elites. There has always been strong support for Catalonia’s secession among the elites, but in the entire post-Franco period, the more powerful section of the Catalan nationalist movement favored constitutional loyalty. This changed some 5 years ago due to the realignments in the party system in Spain caused by austerity policies of the Spanish government (Miley, 2016).

Martínez and Miley (n.d.) describe the separatist movement as “mesocratic” – it is led by Catalan political elites and the heavily subsidized Catalan civil society (the two groups are intertwined through financial and organic links), as well as by the regional media which is heavily influenced by these two groups. The movement has as its core constituency the Catalan-speaking middle classes (school teachers, regional bureaucrats, etc.) residing mostly in the semi-urban hinterland of Barcelona. It has made headway among other groups in recent years, but it is still far less appealing to the lower classes of all ethnicities, though more so to those who are also non-Catalan speakers (for example, first-generation immigrants).

Martínez and Miley (n.d.) argue that it does not seem that identity was the major force behind the increased levels of popular support for independence. For example, support for independence has risen markedly more than the percentage of people who identify as strictly Catalan, or more Catalan than Spanish. There was, however, a major change in the rhetoric

⁹⁸ Professor Vandebussche (2011) made the point that, in the conflicts between Wallonia and Flanders, there are literally only a couple of issues that are genuinely linguistic (language being one of the most defining elements of nationalism in Belgium), such as the lack of Dutch speaking nurses in A&E departments in Brussels. Almost all the other conflicts are actually about economic transfers between Flanders and Wallonia.

employed by Catalan separatists, with a very marked increase of economic arguments (in addition to the more long-standing cultural and linguistic ones), specifically of accusations that Spain was exploiting and even “plundering” Catalonia (Miley, 2016:13). It has been argued that if Catalonia separates, it could stop subsidizing the central budget and increase spending at home. This, however, is a problematic claim, given that the greatest damage to living standards in Catalonia has come from the current crisis and the austerity measures pursued by both the Spanish and Catalan governments. Nevertheless, what counts is what people are convinced of, and the much higher increase in support for independence than in Catalan identity, despite the massive propaganda by the separatist movement, indicates that the appeal of secession for ordinary people comes less from nationalist ideology, and more from the prospect of reducing current or future pressure on jobs (by ensuring that the regional bureaucracy, schooling, the media, etc. remain Catalan dominated), and from potentially retaining more economic resources in Catalonia, with the hope that they will be used to improve living standards there.

Interestingly, but not unexpectedly, the link between the political and capitalist classes in Catalonia is not clear cut. Namely, representatives of big businesses view secession rather unfavorably, given that they rely on the entire Spanish market, and desire certainty of access to EU markets. This, as we will see in the next chapter, is identical to the Scottish case. Also, we should note the difference between the Catalan case, and the Yugoslav and Soviet one, where the economic elites were more regionally based.

The Catalan case confirms yet again that, from a class perspective, what seems to trigger an upsurge in support for secession among ordinary people are promises of reducing the hardships imposed by recession and austerity.⁹⁹ And as the case of Yugoslavia, Catalonia, and (as we will see in chapter 7) Scotland confirm, nationalism and the construction of national myths are a tool used by elites in the pursuit of their separatist aspirations, and the efficacy of this tool cannot be understood apart from in relation to class.

Finally, when taken together, what Herrera’s, Lowinger’s and Martinez and Miley’s studies show is that the same basic analytical apparatus of class analysis (with other aspects included as needed) can and must be used when explaining regionalist or separatist movements, whatever the economic and political system is. In this way, their studies provide a strong argument against any sort of simplistic or orientaling explanations of secession.

⁹⁹ How realistic and honest these promises are is a different matter. Miley (2016:17-18) argues that in the Catalan case the chances of an independent Catalonia actually pursuing anti-austerity are very small.

5.4 Common problems in separatist claims

As should be quite evident by now, propaganda plays a big role in separatism. In this section, I look at the most common problems in the economic claims made by separatists. These relate to the accusations of exploitation through regional redistribution and overoptimism about post-independence economic prospects.

5.4.1 Accusations of exploitation through regional redistribution

The arguments that a region is exploited through regional redistribution are most commonly made by richer regions. They can be problematic for several reasons.

Calculating net contributions to the central budget

First, it is not straightforward to determine who is a net contributor to the central budget. On the revenue side, it is not possible to completely objectively determine where some taxes come from. For example, the profit tax may be assigned to where the taxed business is registered, but the profits may be made in numerous regions simultaneously. Various methodologies are used to calculate regions' contributions to central government revenues, but a different methodology can always be applied, and we would expect a separatist region claiming that it is a net contributor to the central budget to make higher estimates of its contributions than those who are arguing against separation. That is, for example, the case with Scotland – the Scottish government's estimates of Scotland's contribution to total VAT receipts, the corporation tax and the petroleum revenue tax, are higher than the estimates done by the HMRC.¹⁰⁰

There are similar problems on the expenditure side. For defense, for example, it is not possible to make objective regional allocations. Rather, regions' shares are usually assigned based on their population shares or shares in the area of the country, which can yield very different results.

Of course, the very fact that it is impossible to calculate regions' contributions to revenues and shares in expenditures in a completely objective way means that there can be multiple reasonable methodologies to do that. The motivation of separatist regions to use those

¹⁰⁰ The HMRC was not changing its methodology, but the Scottish government used different methodologies than the HMRC. See HM Revenue & Customs (2016a:11-12).

methodologies that give them a higher share is clearly based on politics, but in principle, as long as the methodologies are sound, it is impossible to say that using one over the other is wrong in some objective sense. However, it is a different matter when the truth is stretched, or when outright lies are made in order to garner support for secession. We saw that most recently in the Brexit referendum, when the Vote Leave campaign claimed that the UK is paying £350 million per week to the EU budget, where that was the gross, not the net, figure – technically not a lie, but very close to one given how people would interpret the figure.

Ignoring favorable redistributive mechanisms

It goes without saying that redistributive mechanisms that actually favor the separatist regions are ignored. This goes both for state policies and institutions, such as export credit agencies that give more credit to firms from richer regions, and for market mechanisms, such as relative prices that move in favor of the rich regions' firms.

What is also never mentioned is that access to poorer regions' markets is itself a benefit, particularly if the richer region is not internationally competitive and its firms need the domestic market. Rather, internal free trade is simply taken as the normal situation. In most cases, it is not even consciously considered.

There is actually a deeper issue here. Even if we could calculate that a region is a net contributor in some broad sense, taking into account all the different redistributive mechanisms, it would still not necessarily mean that this is bad for the region in question. What really matters is how the resources are used, and how they would be used if they had not been redistributed. The implicit assumption is always that, had they not been redistributed, they would have been used in a way more beneficial to the richer region. But, it may very well be the case that the redistribution ends up also favoring the region that is the net contributor, perhaps even more than the beneficiary region. In the above example, redistribution may provide the richer region with demand for its products that may otherwise not have been there. Perhaps the demand for its products even prevents competitors from the poorer regions from emerging.

We could easily think of many other examples where the region that is the net contributor actually also ends up benefitting from the redistribution. The point is that such considerations are virtually never taken into account (at least publically) by regions claiming that they are being exploited.

Lack of evidence for exploitative intent

Accusations of exploitation are not just about numbers, but also about intent – the term “exploitation” implies calculated malice. The presence of exploitation, however, is not something to be asserted; rather, it has to be proven. There are cases where actual exploitation is going on, but this is normally combined with the repression of the exploited population, and the exploited regions are the poorer ones. This was the case in the internal colonial situation of Northern Ireland, for example. However, when richer regions make an accusation of being exploited, there is virtually never any evidence presented for this claim. In such cases, these accusations merely represent highly inflammatory propaganda.

Mencinger (2004:73) put it in the following way for Slovenia:

As the general public and many politicians continued to recite popular slogans about how badly Slovenia was being ‘exploited’ within SFR Yugoslavia, the Slovenian government was already calculating what the true cost and benefits of independence would be. The liabilities included a reduction in the size of the domestic market (and thus reduced interest on the part of foreign investors, among other things), a diminished supply of raw materials from the rest of SFR Yugoslavia, the termination of foreign trade links that Slovenia had through Yugoslav enterprises (and vice versa), and a likely loss of property in other parts of SFR Yugoslavia. ... The benefits, in contrast, were more potential than actual: as an independent state, Slovenia could steer clear of SFR Yugoslavia’s continuing political turmoil, improve the prospects of its own transition, undertake appropriate economic policies, and ease its entry into the European Union.

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Still, we should not make the mistake of thinking that poorer regions cannot also make baseless accusations. In the case of the Soviet Union, von Beyme (1991) argued that significant regional differences in development have persisted throughout the 1970s and 1980s (although

¹⁰¹ It is worth noting that here we see an explicit recognition of access to poorer regions’ markets as a benefit that a richer region enjoys. This is not something that richer regions normally acknowledge as a benefit built into the union, but rather simply take it for granted. The specific situation in Yugoslavia – where the dissolution was likely to be extremely acrimonious, and where Serbia had already imposed an embargo on Slovenian products in the run up to dissolution (often evaded by routing the products through a third republic) – made sure that no one could assume that free trade would be set up after dissolution.

considering how vast the differences were in the Soviet Union when it came into existence, the differences in its last two decades were comparatively small). On the other hand, indicators of welfare were substantially more similar across the republics. Von Beyme (1991:107) concluded that:

In periods of upheaval the indicators for the objective situation tend to be forgotten. The neutral observer from abroad, however, has to take the long-term trends of the objective social situations more seriously than the nationalistic propaganda in the centrifugally behaving Republics. The indicators show, that the Soviet Union has never managed to give the nationalities an equal share in investment, but for reasons which had little to do with deliberate discrimination against particular regions or ethnic groups, but rather with cultural traditions and the scarcity of resources. The 'economic imperialism' of the Slavic republics – so criticised by the other ethnic groups these days – was, however, accompanied by a kind of 'welfare imperialism' which has had quite positive effects on the social conditions of the non-Slavic groups, a fact which most of the people tend to forget in the heat of ethnic conflict.

One particularly common accusation made in the context of exploitation is that the population in the poorer region is lazy. If we treat the EU as a state for the purposes of this analysis, then it serves as an excellent example, with all the accusations of laziness, early retirement and high pensions hurled at the Greek population by the media and some politicians in the richer member states. But, since we do have various data for the individual EU member states that we do not normally have for regions within countries, we do know that these claims are wrong – Greek workers actually work longer hours than workers in the richer member states, and while they do retire somewhat earlier, spending on pensions per person older than 65 is actually lower than the EU average.¹⁰²

The situation is very similar with the extremely common accusations that migrants are coming to the richer regions to steal jobs and not work and live on benefits. A joke has been present for some time now in the UK, that the immigrants from poorer EU member states would have to be “Schrödinger immigrants”, who can simultaneously not work and steal jobs. Nevertheless, the situation is not funny, since the extent of dehumanization that happens through accusations of laziness and stealing is enormous.

¹⁰² For an effort in the media to counter the narrative of the lazy Greeks, see Coleman (2015).

These accusations also reveal a strong class basis for separatist appeals in the richer regions – the poor are denigrated as lazy, responsible for their own situation, and unworthy of help. If the poorer region where they are coming from is also in some way (in terms of culture, ethnicity, language, race or religion) different from the richer region, the situation is essentially perfect for fostering extreme hatred. Even the poor in the richer regions can join in on this (on top of being the ones to whom the propaganda about jobs is directed), because, as Miley (2017, forthcoming) has argued, the lower classes can project onto others the abuse that they themselves are otherwise receiving.

5.4.2 Overoptimism

Bookman (1993) argued that support for secession and the willingness to pursue it is influenced by what people think the post-independence economic prospects are. We would then expect that there would be considerable overoptimism on this point – either honest, or for propaganda purposes. There are several notable examples.

One revolves around public finances. When calculating the fiscal benefits of eliminating transfers to the central budget, it is implicitly assumed that the taxes that a region generates will stay the same after secession. Estimates of the future in themselves obviously cannot be completely objective, but far more so if the future entails an enormous break with the present – the secession itself.

Another widespread example is the assumption that trade and other economic links with the former country will continue more or less as before, except those links that the secessionist region wants to get rid of, and that these arrangements will be easy to negotiate. We can observe this in the case of Catalonia, Scotland, Flanders, the former Soviet Union republics, the UK (in relation to the EU), and numerous other cases. In essence, this amounts to an assumption that the secessionist region will be able to get rid of the (real or perceived) costs of union, while retaining the benefits it considers useful. While this is quite understandable as a desire, it is rather more questionable how realistic it is. Usually the argument by separatists is that it would be in the interest of both sides to come to such an arrangement, but this ignores both political problems and the fact that the economics of the situation might change after secession.¹⁰³

¹⁰³ Admittedly, this may not be an actual expectation, but rather rhetoric meant to shore up support for secession, by making it seem less risky. It is also often used as a propaganda tool to represent the secessionist side as reasonable, and the other side as unreasonable. Namely, it is reasonable to continue with what is framed as useful

One extreme example of how the previous economic links are not maintained are the Yugoslav wars. Mencinger (2004:74) notes how various calculations of the effect of supposed future customs on trade between Slovenia and the other former Yugoslav republics proved pointless – trade simply ceased due to the war.

Free trade, or the prospects of it, seem to also exert an influence on the imagination of separatists. In numerous cases, the plan is for the seceding region to join a free trade area, whether or not it also retains its economic links to its former country. A free trade area is then seen both as an opportunity and potentially as a safety net. This is perhaps tied to the specific case of the EU, but it is repeated in numerous cases of separatist regions hoping to join it, or to retain their membership in it: the Baltic republics of the former Soviet Union, Slovenia and Croatia, Catalonia, Scotland, Flanders and Northern Italy. In the case of the former Baltic republics of the Soviet Union and Slovenia and Croatia, they did indeed join the EU. However, we can look at the way the EU was seen in order to show a near total lack of understanding of the oligopolistic nature of capitalism, which is probably the biggest implicit case of overoptimism in separatism.

Plotniekis (1991) is a good example. In the appendix to his article on Latvian secession from the Soviet Union, he enumerates various Latvian industries and their potential for further development, provided sufficient investment is made. But, when the needed investment is added up, we come to billions of dollars; astoundingly, no analysis whatsoever is made of where this huge capital is to come from. However, the general optimism clearly relies on the idea that the transition to a market economy and access to the free trade area of the then European Community would provide the conditions for Latvia's economic advancement. Plotniekis did not explain how exactly Latvian firms were supposed to withstand competition from far stronger competitors from the advanced European countries. Indeed, there is no indication that he was even aware of this problem. The underlying idea, though, is clearly that markets create a level playing field, where everyone has a chance to succeed. This is at odds with reality of oligopolistic markets. Technically, of course, the playing field *is* level in the sense that everyone is allowed to try to compete, but that is irrelevant – technically, I have the right to try to outrun an Olympic sprinter; whether I have even the remotest chance of winning is a different matter. As it happened, the Latvian economy was expectedly devastated.

links, while seceding to get rid of “clearly unfair” policies of the center or other regions is also reasonable. Opposition to both can then be presented as unreasonable.

This lack of understanding of the oligopolistic nature of capitalism was not present only in the former communist countries. We will see in chapter 7 that it characterizes the Scottish separatist movement. Here we can mention Greece.

Lapavitsas et al. (2012) present an argument for Greece leaving the euro. This is not separatism, but regaining monetary sovereignty is a demand for (far) greater “regional” autonomy from a state-like entity. The authors argue that the way the EU economy and the euro are structured and governed is damaging for EU peripheral countries (and also for the working class of the core countries). Reintroducing a domestic currency and nationalizing the banking system would, according to the authors, allow Greece to reflate the economy, devalue, and provide credit for investment. They understand development as structural transformation, and note throughout the book that the core EU countries have a big technological and competitive lead over the poorer member states. However, they do not offer or refer to any deeper market analysis of the hurdles that Greek firms would have to overcome to close that gap, and thus implicitly maintain the assumption that the policies they are suggesting would be sufficient.

It is not impossible for macroeconomic and banking policies alone to be sufficient to increase the competitiveness of an economy. For example, if Greek firms were close behind their competitors, a push provided by cheaper and stable bank credit and devaluation might enable them to catch up. This was the situation in, say, Slovenia. Significant sections of its industries, such as in white goods, were quite advanced and already exporting to the West. After Yugoslavia’s dissolution, Slovenia did not have an industrial policy, but it mostly prevented foreigners from buying up Slovenian companies, rejected shock therapy and did not deal with international financial institutions, it maintained a macroeconomic environment conducive to investment, including preventing the appreciation of the currency, and it kept the banking system under state influence.¹⁰⁴ Today, it is the most successful transition country. But, there is little to indicate that Greece is in the same position as Slovenia was.¹⁰⁵

Even if Greece left the euro, it would still be a region within the EU economy. The policies that Lapavitsas et al. are suggesting are a step up compared to regional development policies

¹⁰⁴ See the relevant chapters in Mrak, Rojec and Silva-Jáuregui (2004).

¹⁰⁵ Mencinger (2004:81f) notes that shock therapy policies destroyed “*domestic manufacturing and transform[ed] many countries, notably Russia, into providers of raw materials, and most of the other countries of the former Soviet Union, lacking raw materials, into a hopeless situation.*” However, he does not consider whether better macroeconomic policies alone would have been sufficient to lead to a different outcome.

discussed in the previous chapter, because these, as we have seen, cannot include things like devaluation. But, at the fundamental level, what monetary and credit policies do is equivalent to subsidies – cheap and stable credit reduces costs, while a currency devaluation increases exporters’ revenues expressed in the domestic currency or allows them to keep the same revenues but reduce prices abroad and increase their market share.

We have already seen that subsidies through fiscal and financial incentives were not enough to help the development of indigenous firms in poorer regions. It is true that the “subsidies” given through devaluation and credit expansion can easily be much higher than those that can be given through fiscal measures, because the costs of these “subsidies” are imposed on everyone through inflation, and such “inflation taxes” are, for whatever reason, more tolerated than fiscal taxes.¹⁰⁶ But, the competitive advantages of market-leading firms in core EU countries extend far beyond costs. Besides, if Greece does not have firms in advanced sectors of the economy, then there is no one important for economic development to benefit from these “subsidies”.

As for the possibility that the sort of policies suggested by Lapavitsas et al. could attract market-leading firms to locate higher value-added activities in Greece (something which the authors do not actually discuss) that too would not work – we have seen that what subsidies attract to poorer regions are lower value-added activities (if they manage to do even that).

Greece, like other member states of the EU, is a specific case – it is both a country and a region within a well integrated larger market. In its pursuit of development it does, or at least could, have advantages over poorer regions within countries, because of the possibility to use macroeconomic, monetary and banking policies. But, these are not enough. For a country/region like Greece, they have to be combined with activist ITT policies (which are forbidden in the EU). There is no other way to bounce back from being a loser in the oligopolistic competitive game. It is rather perplexing that Marxist authors, such as Lapavitsas, do not see this, given that they otherwise must be familiar with the arguments about the concentration of capital. As noted, we will see that Scottish separatists have made even worse mistakes in their suggestions for development policies for an independent Scotland. And, in

¹⁰⁶ Alternatively, it is possible to use financial repression and price and wage controls to hold inflation in check. However, in terms of the effect on real incomes, this approach is actually equivalent to inflation – both it and inflation keep real incomes down. In that sense, those who do not benefit from “subsidies” provided by devaluation and credit expansion pay the costs for them, irrespective of whether they do so through inflation reducing their real incomes, or through their real incomes being held in check by various controls.

the next chapter, we will see that suggestions for establishing regional development banks in the UK in essence mirror parts of Lapavitsas et al.'s arguments, in the sense that they can be reduced to a desire to provide subsidies to poorer regions' firms through cheap bank credit.

6. Regional development in the United Kingdom

In this chapter I apply the framework and arguments from chapters 2-5 to the case of regional development in the UK. This will provide the background to the analysis of Scottish separatism in the next chapter, which cannot be understood without taking into account the regional development disparities in the UK. The present chapter also provides an opportunity to look in some more detail at how successful or not new paradigm regional policies have been.

Section 6.1 gives an overview of the history of regional development in the UK, while section 6.2 assesses the current regional situation. Section 6.3 gives a short account of the old paradigm regional policies pursued by UK governments in the post-war period, together with an assessment of their effects. The period covered is roughly up until 1997, when Labour came to power. Section 6.4 does the same for new paradigm regional policies, going up to the present. Section 6.5 is devoted to EU regional policies in the UK. The chapter builds up the argument that the UK has long had substantial regional disparities, and that they are still very pronounced. The old paradigm regional policies have only been able to reduce them a little, but they did not lead to a structural transformation in the poorer regions. Under the new paradigm policies, regional disparities have even widened.

6.1 History of UK regional development

The United Kingdom is well recognized as having some of the widest regional disparities among developed countries (McCann, 2016). These actually go back at least a century and a half, and their roots are even older.

Prior to its industrial decline, the major disparities in the United Kingdom were between England and what Hechter (1999) called the “Celtic fringe”: Scotland, Wales and Ireland. Hechter (1999:81-95) argues that the political incorporation of the Celtic fringe (Wales in 1536, Scotland in 1707, and Ireland in 1801) deprived these lands of economic sovereignty, including the ability to protect their economies. When English interests came into conflict with those of the Celtic lands, the former were favored by the state. Since this included favoring English producers, manufacturing ended up being concentrated in England, while the Celtic fringe mostly specialized in supplying raw materials. Such specialization brought with it the usual problems, such as high vulnerability to price swings and trade policy changes.

Nevertheless, until the mid-19th century, regional disparities were not particularly large across the UK. Industrialization changed this, however, and Hechter (1999:137-142) shows that regional economic and social differences started increasing from 1851 and continued to steadily widen for the next century. Building on the previous concentration of manufacturing in England, industrialization became geographically widespread there. Most industries were initially fairly widely spread across England, but this changed, as increasing specialization and the emergence of oligopolies made most industries regionally concentrated. Still, England as a whole remained widely industrialized, since most of its regions ended up with some significant industries, although Martin (1988) does point out that London and the South East of England were ahead in development, even compared to what are usually considered the former industrial heartlands of England (for example, Manchester, Liverpool, Leeds and their surrounding regions). Conversely, the Celtic fringe resembled colonial countries in that it had a few relatively industrialized enclaves, oriented towards trade with England and foreign countries, and large backwards hinterlands that were supplying agricultural products and raw materials to England, and, through emigration, labor.

Scotland was somewhat different compared to Wales and Ireland – it was significantly more diversified due to its broader industrial base in the Scottish lowlands. Still, this was primarily composed of heavy industry,¹⁰⁷ coal mining, and textiles. While this did put Scotland far ahead of Wales and Ireland, it was nevertheless not nearly as diversified as England. Crucially, it generally lacked mass production industries, such as those producing new consumer goods, so the Scottish economy experienced repeated problems once the domestic market for heavy industrial products was saturated (Hechter, 1999:148-149). This specialization was to haunt Scotland until the 1980s, when it was “solved” through deindustrialization. In this sense, the Scottish lowlands were similar to areas of England that were reliant on heavy industry, mining, or textiles, such as Cumbria, or Tyneside.

The geography of the UK economy at the time of the original publication of Hechter’s book (1975) was thus one composed of regions with diversified industrial and commercial activities (the East, South East, London, and the Midlands), regions reliant on heavy industries, mining, and textiles (the North, the Scottish lowlands), and regions reliant on agriculture or mining, though also containing a few administrative or industrial enclaves (the Scottish highlands, Wales, Cornwall, Northern Ireland). These are, of course, broad brushstrokes, but they point out the most important aspect for our purposes here, namely, that any negative sector-specific

¹⁰⁷ Shipbuilding, locomotives, steel.

changes would have pronounced *regional* impacts. In particular, if heavy industry, mining, and textiles were hit, this would be a serious blow to exactly those large areas of UK territory which were anyway less economically developed.

In this context, it is most important to look at the UK industrial decline, which is usually defined as the United Kingdom failing to keep up with the productivity growth of other major capitalist countries, despite its earlier industrialization. The trend started already in the last quarter of the 19th century. The immediate cause was that British firms from the first industrial revolution were slower than their foreign competitors to adopt many new technologies, even when they were invented and being produced in Britain (Kilpatrick and Lawson, 1980). Britain was also slower to establish the industries of the second and third industrial revolutions, such as chemicals, cars, electrical appliances, electronics, and numerous others.¹⁰⁸ All this resulted in the UK gradually losing its competitive position vis-à-vis other industrialized countries.

Numerous explanations have been given of the UK industrial decline. Kilpatrick and Lawson review a large number of them, such as a lack of proper technical education, or the failure of entrepreneurs to adapt to market changes, but argue that the most important reason was missing from these explanations, namely, labor relations.¹⁰⁹ Specifically, they show that the basic structures of labor organization in the UK were formed before the era of mass production, and that the labor movement was quite powerful, but highly decentralized and had a strong tradition of factory level negotiations. This was different from the more centralized labor organizations in Britain's competitors, where labor movements had generally formed after the advent of mass production and after capital had become substantially concentrated in fewer firms and larger, more efficient factories. What this meant was that in the UK, workers would very often take defensive stances at the factory-level against technological upgrading and consolidation for the purpose of achieving economies of scale, in order to preserve manning levels, pay grades, and other norms and benefits that were acquired under a less advanced production structure. Had negotiations taken place at the industry or national level, perhaps it would have been possible to both safeguard the interests of workers and allow for technological upgrading, simply because more tools are available to do that at a wider level. Or, if negotiations had taken place at the firm level, but with the unions already reflecting the structure of fewer, larger, and more efficient factories, that situation too may have been more

¹⁰⁸ For a comparison of the industrialization of European countries until 1914, see Trebilcock (1981).

¹⁰⁹ On the UK industrial decline, see also Kitson and Mitchie (1996), Singh (1977), Comfort (2012). On UK manufacturing from the 1930s, including the decline, see Broadberry (2009).

conducive to technological upgrading. But, this was not the case, and the UK was falling further and further behind its competitors. On top of that, from the 1970s onwards, newly industrializing countries in East Asia were generally starting to compete not only in textiles and similar low-tech industries, but were setting up heavy industries, such as shipbuilding, with the latest technologies. All of these countries had cheap labor, and in some labor was repressed as well. This threatened all the older industrialized countries, but particularly the UK, due to the way labor was organized.

Cowling and Sugden (1987, particularly chapter 5) agree with Lawson and Kilpatrick, but focus on the propensity of UK firms to invest internationally. They provide evidence that UK firms tended to invest internationally significantly more than firms from other advanced capitalist countries, but this meant that the productive structure in the UK itself was not being upgraded as heavily as it could have been.

Whatever the specific order of importance of factors that brought about the UK industrial decline was, the UK could avoid the worst effects of this while it had access to its colonial markets, and at its at times protected domestic market. However, the 1970s saw a perfect storm – the United Kingdom joined the European Community, and was thus exposed to more competition in the domestic market, it had lost most of its colonies, the oil shock had increased inflation and pushed the country into a current account deficit and into an IMF austerity program, and newly industrializing countries in East Asia were becoming a threat. In other words, the United Kingdom was in a make-or-break situation: it would either have to find a way to significantly increase its competitiveness, or resort to permanent and increasing import controls. What was certain was that without a solution, it would lose many of its industries.

Numerous proposals were made on how to improve the situation. Perhaps the most extensive one was the Alternative Economic Strategy (AES). AES was an approach to economic recovery promoted by the then left-wing of the Labour Party¹¹⁰ and other radical leftists, such as the UK Communist Party. Apart from reflation, the AES included “public ownership, economic planning, price controls, industrial democracy and import controls” (Wickham-Jones, 1996:73). Rowthorn (1981) notes that it contained reflation, import controls, price controls, compulsory planning agreements between big firms and the government, nationalization of key industries, public ownership of financial institutions, withdrawal from the Common Market (because it prevents many of the policies proposed in the AES), a reduction in military expenditures, expansion of social services and redistribution. In a nutshell, the AES can be

¹¹⁰ Sometimes also called the “Benn” strategy, due to Labour’s Tony Benn being one of its main architects.

interpreted as a set of policies and institutional changes that would have given the United Kingdom the tools to pursue state capitalism/corporatist planning (in the hope that this would solve its economic problems), but also a route to socialism. In terms of its regional impacts, it would have been beneficial for the UK's poorer regions, because that was where the industries with the most severe problems were located, but even for the Midlands, because much of UK manufacturing badly needed consolidation and technological upgrading.

Kilpatrick and Lawson (1980) argue that the AES did not take into account labor relations sufficiently. It recognized that workers would have to be brought on board for it to work, because it entailed technological upgrading and consolidation. It also recognized that the workers would not see any immediate improvements to their living standards, as such upgrading was a medium-term project. But, in order to get the unions to agree to wage restraint, technological upgrading, and the consolidation of production, the AES was to offer them industrial democracy. Kilpatrick and Lawson argue that this would have hardly been seen as satisfactory by the unions in general, but particularly so in the 1970s. Namely, workers had been experiencing a severe decline in real incomes for years, and the labor unrest in the second half of the 1970s, culminating in the Winter of Discontent, was mainly fueled by a desire to restore real incomes to previous levels. Industrial democracy, unless it was extremely extensive, would hardly have been seen as an acceptable alternative to wage increases. Besides, it is also questionable how capital, and particularly multinational corporations, would have reacted to a strategy that would obviously be setting the UK on a path to socialism. Kilpatrick and Lawson argue that at the very least investment would go down. Rowthorn (1980) considered far more severe reactions, such as a military coup.

We cannot know what effects the AES would have had, since it was never implemented. The 1974 Labour government only brought in a few token measures. Had Labour won the 1979, or particularly the 1983 general election, it is likely that many more elements of the AES would have been turned into policy. However, this did not happen, and the UK took a very different turn.

When the Conservatives took power in 1979, with Margaret Thatcher as Prime Minister, the well-known shift in economic policies took place – trade unions were mostly repressed, and any ideas about industrial democracy, protectionism, economic planning, and incomes and price policies were out of the picture.

The effects of the Thatcher reforms on UK manufacturing were mixed. Employment in manufacturing went down 40% by 1999 (Broadberry, 2009). The share of manufacturing in

the GDP fell from 30% in 1978 to 21% in 1996.¹¹¹ Technological upgrading did happen, and productivity in what remained of manufacturing did increase substantially by 1989 (by around 50%). However, Kitson and Mitchie (1996:198-199) argue that that this increase was partially due to (a) decreases in employment, rather than increases in output, (b) unacknowledged increases in labor inputs (e.g. shortened break times, increased production-line speeds), and (c) inadequate price deflators used in calculations of productivity. When this is taken into account, the growth was smaller, at around 35%. Furthermore, the productivity growth that did take place resulted disproportionately in increased profits (which went disproportionately into dividend payments, not investment), rather than decreased prices. Had prices gone down, that may have enabled UK firms to get a higher share of the domestic, but also international markets. The opposite happened – the UK surplus in manufacturing trade became a deficit already in 1983 and has there since. However, what is particularly relevant for regional development is the effect of the UK industrial decline and the Thatcher reforms on specific industries, because, as we have seen, the UK economy showed a significant degree of regional specialization.

It was exactly the areas that were less developed to start with, and reliant on traditional industries – shipbuilding, mining, textiles – that were hit the hardest, mainly due to cuts in various subsidies. These industries essentially disappeared, with very adverse effects on the Scottish lowlands, the North East, Cumbria, Merseyside, Cornwall, and west Wales.

Other industries, such as engineering, motor vehicles, steel, utilities, and others, did consolidate and survive, though most were eventually sold off, primarily to foreign corporations. Nevertheless, due to their survival, some parts of the UK, such as the West Midlands, are faring better than the more deindustrialized areas. However, technological upgrading and consolidation did cause a reduction in employment, which was neither always compensated by increased employment elsewhere, nor, when it was, did the other employment always offer equally good living standards. There was, for example, a large increase in the number of small firms in the 1980s (from 2.4 to 3.7 million from 1980 to 1989), but Armstrong and Taylor (2000:269-272) note that many firms were established due to push factors – basically, a person having to find a way to survive after losing a job in manufacturing. This is sometimes called “employment of last resort”.

Finally, those areas that had anyway been more advanced – the South East, London and the East of England – and boasted industries that were internationally competitive, such as

¹¹¹ Based on the Office for National Statistics *Historic economic data for regions of the UK (1966-1996)* dataset.

pharmaceuticals, food and beverages, knowledge-intensive services, finance, and others, have continued doing well. In the case of finance and accompanying services, they actually benefited enormously from the Big Bang reforms of the Thatcher government.¹¹² The regional disparities have not disappeared since. Let us look at the current situation.

6.2 Current UK regional situation

6.2.1 Widening regional disparities

The UK regional disparities can be seen from several types of indicators. We will look at those reflecting the absolute and relative levels of development of the UK's regions, as well as some evidence on internal trade and migration.

Absolute and relative levels of development

There are consistent time series for a number of indicators relevant for regional development generally going back some 20 years. This is also the time during which the UK has pursued new paradigm regional policies, so this section will not only give an overview of the current regional situation, but can also partially serve as an assessment of the success of these policies in narrowing regional gaps in the UK. On that account, there has been little success.

Table 6.1 show the regional GVA per head indices (UK=100) for the regions and countries of the UK. The disparities have not only not been reduced, but have actually widened, as evidenced by the increasing coefficients of variations for 1997, 2007 (the last year before the start of the global financial crisis) and 2015. Several things stand out. There are now just two regions that are above the UK average: London, the obvious outlier, that is now even further ahead of every other region than it was before, and the South East, which is still better off, although its position is a little worse than it was. The East of England has fallen below the average in the observed period. Second, Scotland is the only region that has maintained its position. Finally, apart from London, there are only two regions that have improved, the North East and the North West, although their improvements were marginal, far smaller than

¹¹² On the geography of UK deindustrialization, see Martin and Rowthorn (1991), Foresight - The Government Office for Science (2013:123-131).

London's, and, unlike London, their position has worsened after the onset of the recession, whereas London's has continued improving.

Table 6.1 GVA per head (UK=100)

<i>Region/country</i>	<i>1997</i>	<i>2007</i>	<i>2015</i>	<i>GVA per head, annualized growth rate (%), 1998-2015</i>
North East	73	75	75	3.4
North West	85	87	86	3.4
Yorkshire & The Humber	85	86	80	3.0
East Midlands	90	84	83	2.8
West Midlands	90	84	82	2.7
East of England	100	97	95	2.9
London	159	166	172	3.7
South East	112	109	110	3.1
South West	94	92	91	3.0
Wales	74	73	71	3.0
Scotland	93	94	93	3.3
Northern Ireland	82	83	73	2.7
<i>coefficient of variation</i>	<i>0.24</i>	<i>0.26</i>	<i>0.29</i>	

Source: Office for National Statistics, *Regional Gross Value Added (Income Approach)* dataset, own calculation for annualized growth rate

Behind the differences in GVA per head are regional differences in productivity (GVA per hour worked and GVA per filled job), as shown in Chart 6.1. Only London and the South East are above the UK average, and the East of England is almost exactly at the average. Scotland is also very close to it, but an inspection of sub-regional data shows that the high productivity in Aberdeen and to an extent in Edinburgh¹¹³ are largely responsible for Scotland's relatively favorable position. Most other Scottish areas are below the UK average, some drastically so. All other regions are below the UK average, with Wales and Northern Ireland being as much

¹¹³ Aberdeen (at 115% of UK average productivity) is, of course, where a large part of the oil industry is located, while Edinburgh (108% of the UK average) is one of the successful UK cities.

as 20% worse off. Furthermore, there have been few changes in the relative rankings of regions in terms of their productivity since 1997, and the gaps have even widened a bit.

Chart 6.1 GVA per hour worked (UK = 100)



Source: Office for National Statistics, *Subregional Productivity: Labour Productivity (GVA per hour worked and GVA per filled job) indexed by UK NUTS2, NUTS3 subregions and City regions* dataset

Many other indicators show the wide UK regional economic disparities. For example, according to ONS data,¹¹⁴ London, the South East and the East account for 52% of total R&D spending in the UK, while accounting for 36% of the UK population and 46% of total UK GVA. Patent applications per million inhabitants are also higher in the South East and East than in the rest of the country (European Commission, 2014, map 1.15). Additionally, neither R&D expenditures nor patent applications fully reflect the type of innovation that goes on in the advanced service sector in London (Adams, Robinson and Vigor, 2003:62), so the concentration of innovative activity in the richer regions is probably even higher. The general picture of wide disparities is also confirmed by various composite indices of regional competitiveness, which consistently show areas in London, the South East and East as being more competitive than areas in the rest of the UK (Annoni and Dijkstra, 2013, Huggins and Thompson, 2016). Firms in the richer regions are also more productive than firms in the same

¹¹⁴ Based on the *Business Enterprise Research and Development* dataset.

sector but located in the poorer regions (Office for National Statistics, 2017). This either implies that the poor regions have weaker firms, or that it is the same firms located in both richer and poorer regions, but they keep lower value-added activities in the latter.

Internal migration

In terms of migration, there are no particularly large internal population movements between regions, as shown by Table 6.2.¹¹⁵ This is confirmed in more detail by McCann (2016:272ss). Actually, London has the biggest outflow of internal migrants, probably reflecting congestion and rents. However, it also has more than three times higher net long-term international migration flows than the second and third highest regions, the East and the South East.

The data does show that most internal migrants move in early adulthood, so for the regions (or areas within a region) that are losing population, this may be an economic problem. There is no official ONS data on the education and skills of internal migrants, but research shows, for example, that the North East and North West are losing over 30,000 graduates per year net (Homes for the North, 2016).

¹¹⁵ Unlike in the past, females are actually more likely to move, albeit only slightly, at 52% of all internal migrants.

Table 6.2 Migration in the UK regions (mid-2014 to mid-2015)¹

	<i>Net internal migration</i>	<i>Net long-term international migration</i>
North East	-0.01%	0.24%
North West	0.05%	0.31%
Yorkshire & The Humber	-0.04%	0.39%
East Midlands	0.20%	0.47%
West Midlands	-0.04%	0.42%
East	0.24%	0.45%
London	-0.89%	1.54%
South East	0.18%	0.40%
South West	0.54%	0.28%
Wales	0.03%	0.19%
Scotland	0.16%	0.36%
Northern Ireland	-0.04%	0.15%

Source: Own calculation based on Office for National Statistics, *Migration Indicator Tools* and *Population estimates* datasets.

1) The percentages were calculated by taking the number of net migrants and putting them in relation to regional populations.

Internal trade

Data on intra-UK trade is very limited, but some information does exist in regional input-output tables. Estimates for Northern Ireland are that in 2012 it had a trade deficit with the UK, equivalent to almost 30% of Northern Irish GVA. Also, 74% of Northern Irish imports came from the rest of the UK (rUK), and 50% of its exports went to rUK, indicating high trade dependency on the rUK.¹¹⁶ Scotland too ran a deficit with the rUK in 2013, but much smaller than Northern Ireland, at 5.5% of Scottish GVA. However, its trade dependency on the rUK was very high, with the rUK being the source of 60% of Scottish imports and the destination for 60% of Scottish exports. The more widely used Global Connections Survey, which the

¹¹⁶ See Northern Ireland Statistics & Research Agency (2016).

Scottish government runs to estimate Scottish exports, produces very similar results.¹¹⁷ McCann (2016: 295-296) references Welsh input-output tables, noting that Welsh exports to the rUK amounted to 65% of Welsh regional GVA, while its imports from the rUK accounted for 76%, resulting in a trade deficit of over 10% of regional GVA.

Data for trade within England is even more limited. McCann (2016: 295) references South West Input-Output tables, which show that the South West has balanced trade with the rUK, with both its imports from, and exports to, the rUK amounting to about 60% of its regional GVA. Interestingly, though, he also notes that estimates are that London runs a trade deficit with the rUK (although a surplus internationally). This probably reflect the location of most manufacturing in the UK being outside of London (and obviously does not account for any income flows back to London).

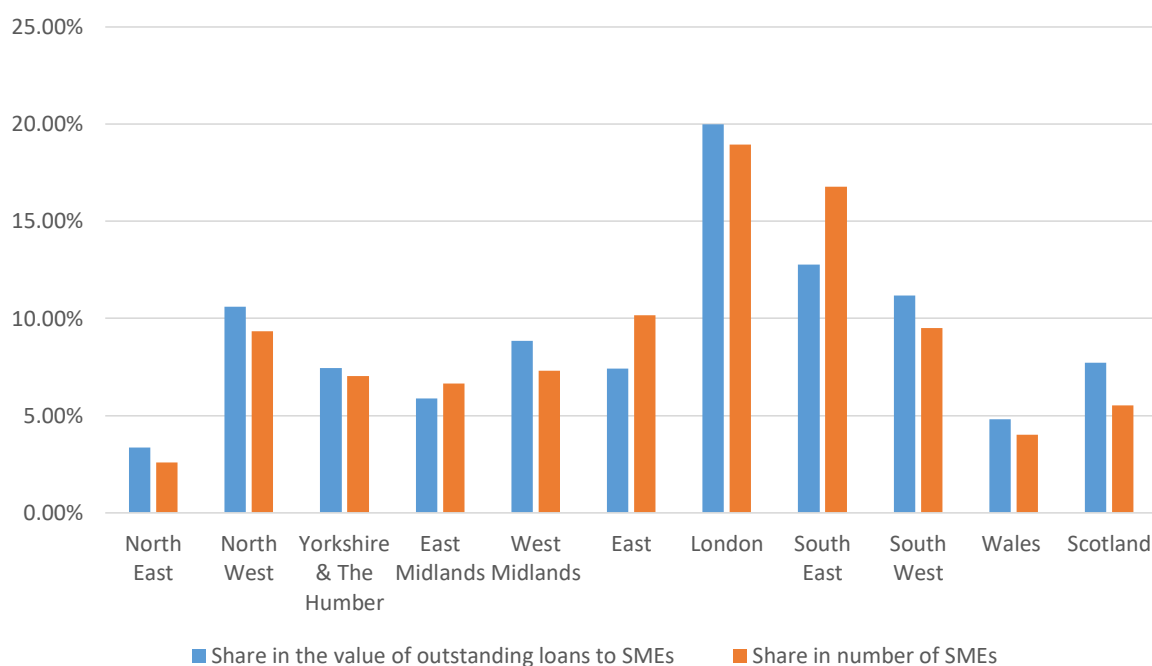
Overall, the data that does exist suggests that internal trade is as we would expect in a situation with high regional disparities – less developed regions are running trade deficits with the more developed ones. Still, only when and if internal trade data estimates are produced for within England can we make any firmer conclusions.

Capital

To my knowledge, there exist no recent attempts to estimate regional capital flows within the UK. The only regional monetary and credit data that we seem to have is the value of loans and overdrafts to SMEs in the different regions of the UK, except Northern Ireland. To determine if the banking system extends more or less credit to certain regions than their share should be, we can compare regional shares in the number of SMEs and the total value of outstanding loans and overdrafts to SMEs. The data is presented on Chart 6.2.

¹¹⁷ The Scottish input-output tables are available at www.gov.scot/Topics/Statistics/Browse/Economy/Input-Output, while the Global Connections Survey can be accessed at www.gov.scot/Topics/Statistics/Browse/Economy/Exports/ESSPublication.

Chart 6.2 Outstanding value of overdrafts and loans to SMEs (Q1 2016) and regional shares in total UK GVA (2015)



Source: Own calculation based on: a) British Banking Association, *SME Statistics* data, b) Department of Business, Energy and Industrial Strategy, *Business Population Estimates* dataset

As we can see, the shares match almost exactly. This indicates that the banking sector is not giving extra support to either poorer or richer regions, at least when it comes to SMEs. This is in line with McCann’s (2016: 297s) reference to, among other things, studies that show that credit availability seems to be fairly equal across UK regions. Still, we should be extremely careful in drawing any conclusions about capital movements from these very limited observations, and also be particularly mindful that the definitions for SMEs used in the two datasets that underlie Chart 6.2 are not the same.¹¹⁸

Assessment

The picture of significant regional economic disparities is clear. Still, a few arguments are sometimes made that the relative position of UK regions and countries is not as bad as it appears

¹¹⁸ For the loans and overdrafts, they are defined as companies with up to £25 million in yearly turnover, whereas for the number of SMEs, the definition is companies with 0-249 employees.

at first glance. For example, the North East, North West, Yorkshire & The Humber, Wales and Scotland have had equal or higher growth rates of GVA per head than the East of England and the South East, and they were not far behind London. Also, some regions were doing better prior to the financial crisis, particularly Northern Ireland. Nevertheless, while there is something to such arguments, we should not read too much into them.

It is true that reducing disparities between regional *growth rates*, not the regional disparities themselves, has been the objective of Labour governments' regional policy (HM Treasury, 2007, Adams, Robinson and Vigor, 2003). Subsequent governments have also not committed to reducing absolute regional economic gaps. But, reducing *growth rate* disparities is admittedly not a very ambitious objective. For example, achieving that goal is completely compatible with the continued widening of regional disparities, just as long as they widen less quickly than before. With the actual regional GVA per head growth rates that we have witnessed over the last 20 years (see Table 6.1), it would literally take decades, or even centuries, for some of the regions to close the gap with the East and South East. As for decades, we should remember that there are entire *countries*, such as South Korea and Taiwan, that have been able to develop into world class economic powerhouses in that time, on par with the old core of developed countries, while starting from positions much worse than those of the poorer regions of the UK. With regards to centuries, that is not even worth discussing. Other regions would never close the gap with the South East and the East. All the while, London would keep pulling more and more ahead of all the other regions. This certainly does not sound like a solution to the UK regional problem.

Two additional remarks should be made. First, the reported numbers are for the NUTS 1 level of aggregation and can be misleading, in that in a number of regions there are very significant intra-regional disparities, with one or a couple of areas being significantly above the regional average, and most or all others significantly below it. As we will see in the discussion about regional policies, such intra-regional differences have been used to argue that there is no broader regional problem, but that what we are dealing with is localized deprivation. However, I would argue that, quite the contrary, the intra-regional disparities clearly show the extent of the wider regional problem. What we are observing is usually a few urban centers doing well,¹¹⁹ through a combination of successful economic activities and public spending, whereas the rest of their regions have suffered due to deindustrialization or a lack of development in the first place.

¹¹⁹ Though most also have pockets of extreme deprivation.

The North West is perhaps the most interesting example in terms of its NUTS 1 and NUTS 2 data.¹²⁰ The region contains both prosperous areas (parts of Manchester, Cheshire), areas that used to be reliant on heavy industries and mining but lost them (Cumbria), and areas that have undergone deindustrialization (parts of Manchester, Lancashire and Merseyside). This is almost like a mini-version of the UK, and is clearly visible in the data. The GVA per head in the North West in 2015 was almost £22,000 (compared to the UK average of £25,600). But, in Cheshire and Manchester it was £30,000 and £32,000 respectively, while, for example, in Cumbria and Liverpool it was around £22,500, and in both Wirral and Sefton it was as low as \$14,500, one of the lowest in the UK. What this shows is not that we are dealing with local problems, but that parts of Manchester and Cheshire are hiding the extent of the regional problem by pulling up the regional averages.

Second, the numbers also reflect the influence of the global financial crisis, recession and austerity. Kitson, Martin and Tyler (2011) have shown that the financial crisis, the ensuing recession and austerity have impacted the poorer regions more adversely than the richer ones in numerous countries. And, indeed, a number of UK regions were faring better in 2007 than in 2015, so it could be argued that, had it not been for these negative developments, things would have gone better for the poorer UK regions. However, an adverse economic event can either impact a poorer or a richer region, or it can impact both, but with one region suffering more. The reason why it is consistently poorer regions that suffer more and are impacted by more negative events is not because they are unlucky, but because their weaker economic structures make them more susceptible to negative events, and make them less able to deal with them. Thus, it makes little sense to consider negative economic events as something external to regional development. Rather, they are one of the mechanisms that keep the less developed regions in their position. Therefore, saying that “but for the crisis/austerity, the poorer regions would be better off” is really like saying “if the mechanisms that cause regional disparities were weaker, then regional disparities would be smaller”.

Of course, we should also not forget government policy during economic shocks. Governments are often willing to help what are considered key sectors, but these are mostly located in richer regions. Thus, not only do adverse events affect poorer regions more often, and these regions are less able to deal with them, but, on top of that, they can expect to receive less help during difficult times. London is the perfect example of this. It too was affected by

¹²⁰ See ons.gov.uk (2017) for an explanation of the changes in regional boundaries for statistical and administrative purposes.

industrial decline, but it also had numerous successful sectors it could rely on. In addition, it contains most of the UK's financial sector, which effectively has several institutions dedicated to keeping it afloat whatever happens (most notably the Bank of England). And, in the recent financial crisis, the financial sector received enormous state aid to keep it afloat – at its peak, cash outlays and guarantees totaled over £1tn (National Audit Office, 2011). This is far in excess of any help ever offered to any other sector.

6.2.2 Regional disparities in living standards

The differences in regional living standards in the UK are well known. On most social and health indicators, there is a clear North-South divide. However, at least according to one of the main indicators of material living standards, the regional Gross Disposable Household Income (GDHI),¹²¹ the differences are not as large as would be expected based on disparities in economic development. Table 6.3 shows regional GDHI per head, relative to the UK average, for 1997 and 2013, the latest year for which data is available. The coefficient of variation in 2013 was 0.14, less than half of the 0.29 for regional GVA. Furthermore, regional disparities in GDHI have barely grown since 1997, unlike GVA per head disparities.

The actual differences in regional household incomes might even be somewhat smaller than the GDHI figures imply, because they include imputed rents, which are not an actual money income. Unfortunately, no data which excludes them is available. However, since they are calculated based on regional market rents, they must be higher in London, the East and South East. Thus, if they were excluded, the regional disparities in GDHI would be even somewhat smaller. It is also worth mentioning that, even though there are intra-regional disparities (at the NUTS 2 level) in GDHI per head, they are much smaller than the corresponding disparities in GVA per head.

The GDHI data does not deny that living standards are worse in the poorer parts of the UK. They are, but a question does arise – why are we not observing larger regional disparities in

¹²¹ GDHI measures the disposable income of the household sector (individuals, sole traders, and non-profit institutions serving households, such as trade unions, charities, or universities). The GDHI is a net of: a) on the “resources” side, mixed income of owners of businesses, compensation of employees, received income from property (including imputed rents), social benefits and other transfers, and, b) on the “use” side, of payments for the use of property, interest rates, taxes, social contributions and other benefits paid, and other transfers.

incomes? The answer seems to be because of regional redistribution, primarily through the public sector, which is the topic of the next section.

Table 6.3 Gross Disposable Household Income per head (UK=100)

<i>Region/country</i>	<i>1997</i>	<i>2013</i>
North East	87	85
North West	91	88
Yorkshire & The Humber	90	87
East Midlands	92	90
West Midlands	91	89
East of England	106	105
London	122	128
South East	116	113
South West	102	101
Wales	86	88
Scotland	94	97
Northern Ireland	81	82
<i>coefficient of variation</i>	<i>0.13</i>	<i>0.14</i>

Source: Office for National Statistics, *Gross Disposable Household Income* dataset

6.2.2 Regional redistribution between UK countries and regions

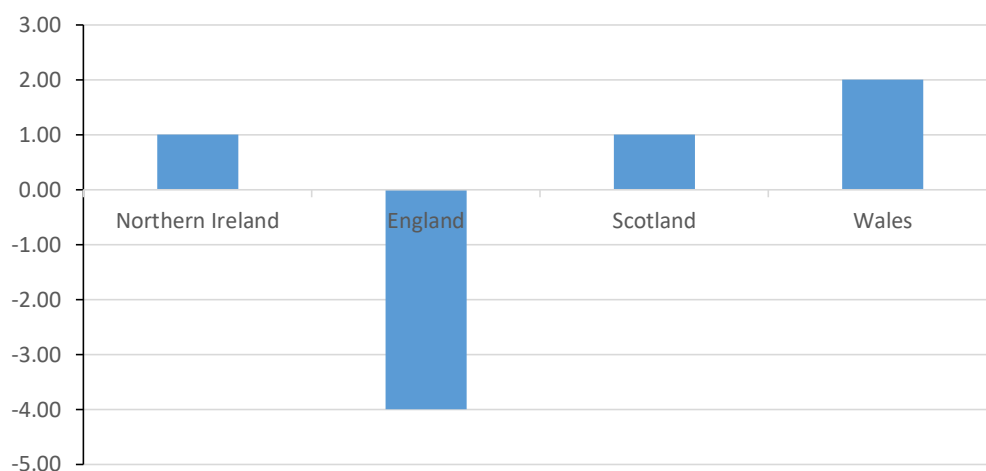
To determine if there is regional redistribution going on in the UK, we would need to compare the regions' shares in total UK public revenues and expenditures. Unfortunately, this is not so easy. Although the UK does produce detailed statistics for public expenditures broken down by UK countries and regions, regional breakdowns of public revenues are much more limited.

Redistribution between UK countries

Full data on all types of HMRC receipts exists only for Scotland, Northern Ireland, Wales and England, back to 1999, but not for the English regions.¹²² Chart 6.3 shows the differences between the countries' contributions to HMRC receipts and their shares in total public expenditures. What it implies is that there is regional redistribution going on in favor of Northern Ireland, Scotland and Wales. Whether the existing redistribution is large or small can be debated. Still, it is important in relative terms, because, due to the small populations of the three beneficiaries, even a percentage point of redistribution ends up being significant in per head terms.

¹²² For the four countries, the numbers vary a bit, depending on whether the Petroleum Revenue Tax and the Corporation Tax (offshore) are allocated based on territory or population. For Scotland, allocating them based on its population share gives a lower estimate for its contribution to HMRC receipts, while doing the allocation based on territory gives a higher estimate. This is because Scotland accounts for about 8% of the UK population, but for the vast majority of UK oil and gas fields. In England, given its dominant population share (84%), but a far smaller share of the oil and gas field, allocating the taxes based on population gives a higher estimate for its contribution. In both England and Scotland, changing the method of allocation results in their contributions changing by around 0.5pp-2pp depending on the year. However, given that in the last two years oil prices fell drastically, the changes resulting from using different methodologies first became smaller (0.3pp) and then almost non-existent. Wales and Northern Ireland only show a negligible contribution if the allocation is done based on population (due to their very small populations), and no contribution if the allocation is done based on geographical share, because they do not have any oilfields. For the methodology of how tax receipts are disaggregated between the UK countries, see HM Revenue & Customs (2016a).

Chart 6.3 Percentage point difference between a country’s contribution to public revenues and its share in public expenditures, 2015-16



Source: Own calculation based on a) HM Treasury, *Country and Regional Analysis*, b) HM Revenue & Customs, *A disaggregation of HMRC tax receipts between England, Wales, Scotland & Northern Ireland*, and c) Office for National Statistics, *Population Estimates* dataset

- 1) Total public expenditures were calculated by taking the total identifiable public expenditures for each country, and then adding to them non-identifiable expenditures, expenditures outside the UK, and accounting adjustments, and allocating them to each country based on their population shares (mid-year 2015 estimates).
- 2) The contribution to HMRC receipts was done based on population.

However, a different picture emerges if we look just at the revenue side. We can compare countries’ contributions to HMRC receipts with their shares in total UK GVA. This is given in Table 6.4 below. The numbers are nearly identical, implying that the total UK tax system taxes regions proportionately to their incomes. This conclusion is consistent with Office for National Statistics (2013) which analyses the total effects of the UK tax system on household incomes, and shows that, when direct and indirect taxes are taken together, the whole tax system directed at households ends up being proportional, if not slightly regressive. Since income taxes, National Insurance Contributions, the capital gains tax, the VAT, and various duties on alcohol and fuel, all directed at households, together make up almost 80% of total HMRC receipts,¹²³ the Office for National Statistics (2013) analysis can be taken as quite representative of the entire tax system. All in all, the evidence seems to suggest that, regionally, the tax system is proportional, but expenditures favor the poorer countries of the UK.

¹²³ According to the HM Revenue & Customs *HMRC Tax & NIC Receipts* dataset.

Table 6.4 Countries' contributions to UK public revenues (2015-16), share in total UK GVA (2015), %

	<i>Contributions to UK public revenues</i>	<i>Share in total UK GVA</i>
Northern Ireland	2.1	2.1
England	86.4	86.0
Scotland	8.0	7.6
Wales	3.3	3.3

Source: Own calculation based on a) Office for National Statistics, *Gross Value Added (Income Approach)* dataset, and b) HM Revenue & Customs, *A disaggregation of HMRC tax receipts between England, Wales, Scotland & Northern Ireland*

Redistribution between UK countries and regions

For the English regions, public expenditures per head do favor the poorer regions, although they also favor London, as can be seen from column 1 in Table 6.5.¹²⁴ Furthermore, as is evident from columns 2 and 3, the incomes in the poorer regions rely more on contributions and transfers than do the incomes in the richer regions.

¹²⁴ Identifiable public expenditure is expenditures which can be regionally allocated more or less unambiguously, such as infrastructure, healthcare, education, etc. It comprises about 85% of UK public expenditures. The remainder, non-identifiable public expenditure, is that which benefits the entire UK, such as defense or international representation. It would make no sense to add the non-identifiable expenditures on a per-head basis, as it would not change the per-head ratios.

Table 6.5 Public expenditures (2013-14) and transfers in the UK regions (2013)

	<i>Total identifiable public expenditure per head (UK=100)</i>	<i>Social contributions and benefits, share in total resources</i>	<i>Other current transfers received, share in total resources</i>
North East	104	23.4	4.8
North West	103	22.8	4.1
Yorkshire & The Humber	97	21.7	4.3
East Midlands	91	20.5	4.3
West Midlands	96	21.6	4.3
East of England	90	18.2	3.7
London	112	12.6	2.6
South East	88	17.6	3.3
South West	92	21.2	4.0
Wales	110	24.1	5.0
Scotland	116	20.2	3.9
Northern Ireland	121	22.5	5.6

Source: a) Office for National Statistics, *Gross Disposable Household Income* dataset, b) HM Treasury, *Country and Regional Analysis*

The importance of public spending for poorer regions can be seen from a few more indicators. Table 6.6 shows data on public sector earnings, private sector earnings, their difference, and on public sector employment.¹²⁵ Private sector earnings are higher in the richer regions and lower in the poorer ones, which is as we would expect based on their productivity

¹²⁵ Data for Northern Ireland was not available for 2013 either for public or private sector earnings. The available data shows considerable growth of 7.5% in public sector earnings there for 2014-2015, so, assuming the same growth in 2013-2014, it would mean that the annual public sector earnings per employee in 2013 in Northern Ireland were around £23,700, much more in line with all the other regions. Doing the same calculation for the private sector, except with a growth rate of 6.8% which was the growth rate in 2014-2015, gives the annual private sector earnings per employee in 2013 of around £19,000, again more in line with the other regions. As is the case with almost all other indicators, it also puts Northern Ireland squarely at the bottom of the UK.

differences. Conversely, public sector earnings are much more similar across the regions. This too is as we would expect. The effects of this are shown in column 3 – effectively the public sector counteracts the effects created by the market, providing poorer regions with higher incomes than they otherwise would have had. The effect is compounded by the fact that poorer regions rely more than the richer ones on public sector employment, as shown in column 4. (McCann (2016:312), though, does point out that while public sector wages have long been higher than private sector wages in the poorer regions, it is only recently that the share of public sector employment in total employment there has grown to beyond what it is in the richer regions. As a matter of fact, until the 1990s, it was always lower.)

Table 6.6 Public sector earnings vs. private sector earnings and public employment

	<i>Public sector, mean</i>	<i>Private sector, mean</i>	<i>Public - private</i>	<i>Share of public sector employment in total employment (December 2013)</i>
Wales	25,200	21,000	4,200	23.8
Northern Ireland	27,300	21,600	5,700	27.3
North East	25,600	22,200	3,400	22.7
Yorkshire & The Humber	24,500	23,500	1,000	20.1
South West	24,900	23,700	1,200	17.7
North West	26,400	23,700	2,700	19.9
East Midlands	25,200	24,200	1,000	17.4
West Midlands	25,000	25,000	0	19.1
Scotland	26,800	25,500	1,300	22.3
East of England	24,800	25,600	-800	16.1
South East	25,800	28,900	-3,100	16.0
London	35,900	44,500	-8,600	16.1
<i>coefficient of variation</i>	<i>0.12</i>	<i>0.24</i>		

Source: a) Office for National Statistics, *Annual Survey of Hours and Earnings* and *Public Sector Employment* datasets, b) Northern Ireland Department for the Economy, *Annual Survey of Hours and Earnings* dataset

1) Figures for the salaries have been rounded to the nearest one hundred pounds.

2) Data for salaries for Northern Ireland is for 2015, for the other regions for 2013. If the numbers for Northern Ireland were adjusted to 2013 (see footnote 125), the coefficient of variation for the public sector would be a bit lower, and for the private a bit higher.

However, as noted, the revenue side is much harder to determine for the English regions. Still, there are some partial sources, and inferences can be made from some indirect data as well. The evidence seems to suggest that, like with the UK countries, the tax system within England is taxing the same proportion of all regions' incomes.

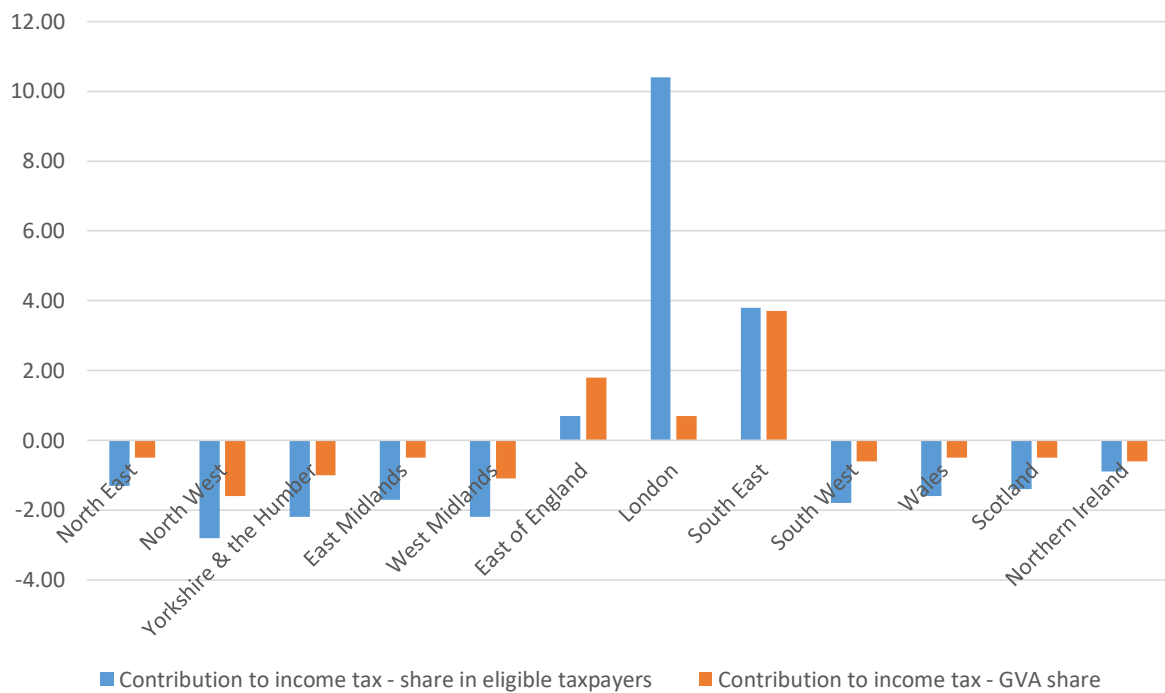
The only official data on the contribution of the English regions to HMRC receipts is on the income tax. Income tax rates are progressive,¹²⁶ so we would expect that richer regions, which

¹²⁶ See the section on the income tax in Pope and Waters (2016).

have more rich households, would make a higher contribution to these taxes than the poorer regions. This is indeed what we observe in Chart 6.4, where London in particular makes a much higher contribution to the income tax than its share in the total number of taxpayers eligible to pay them. The South East and the East are the only two other regions for which this is the case.

However, a different picture emerges if we compare regions' shares in GVA and their contributions to the income tax, also shown on the same chart. As we can see, there is very little difference between the two shares.

Chart 6.4 Percentage point difference between contributions to the income tax and a region's share in the number of taxpayers

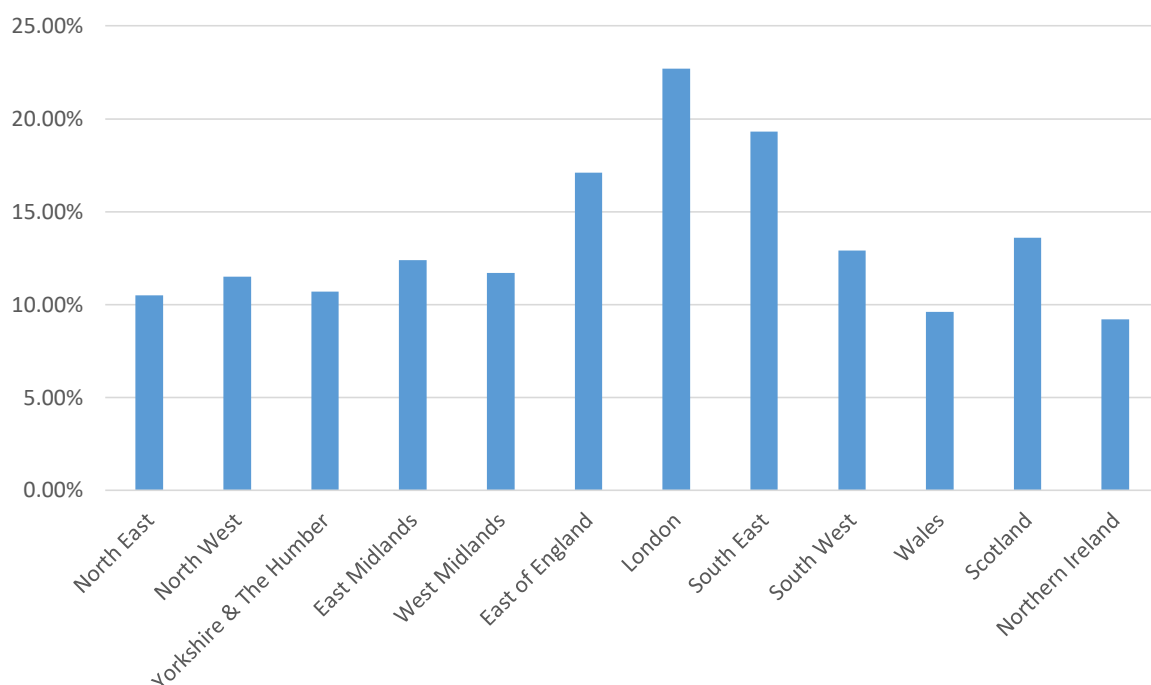


Source: Own calculations based on: a) HM Revenue & Customs, Table 2.2 *Number of individual income taxpayers by marginal rate, gender and age, by country and region, 2013-2014*, Table 3.13, *Income and tax by country and region*, and b) Office for National Statistics, *Gross Value Added (Income Approach)* dataset

What the above chart seems to imply is that, while direct taxes are progressive, for the effects of that to show up in the regional aggregates, the richer regions would have to have a very high share of taxpayers who are liable for the higher and additional income tax rates. Chart 6.5 shows that, while indeed in the richer regions a higher share of taxpayers are liable for these rates, the difference between the regions is not that large. There is also the fact that many well-

off taxpayers are not so well off that a large share of their incomes is taxed at the higher rates, and, of course, there is also tax evasion by the super rich (Syal, 2016; HM Revenue & Customs, 2016). When all of that is combined, the income tax system seems to be largely proportional to regions' incomes.

Chart 6.5 Share of regional taxpayers liable for the higher and additional income tax rates



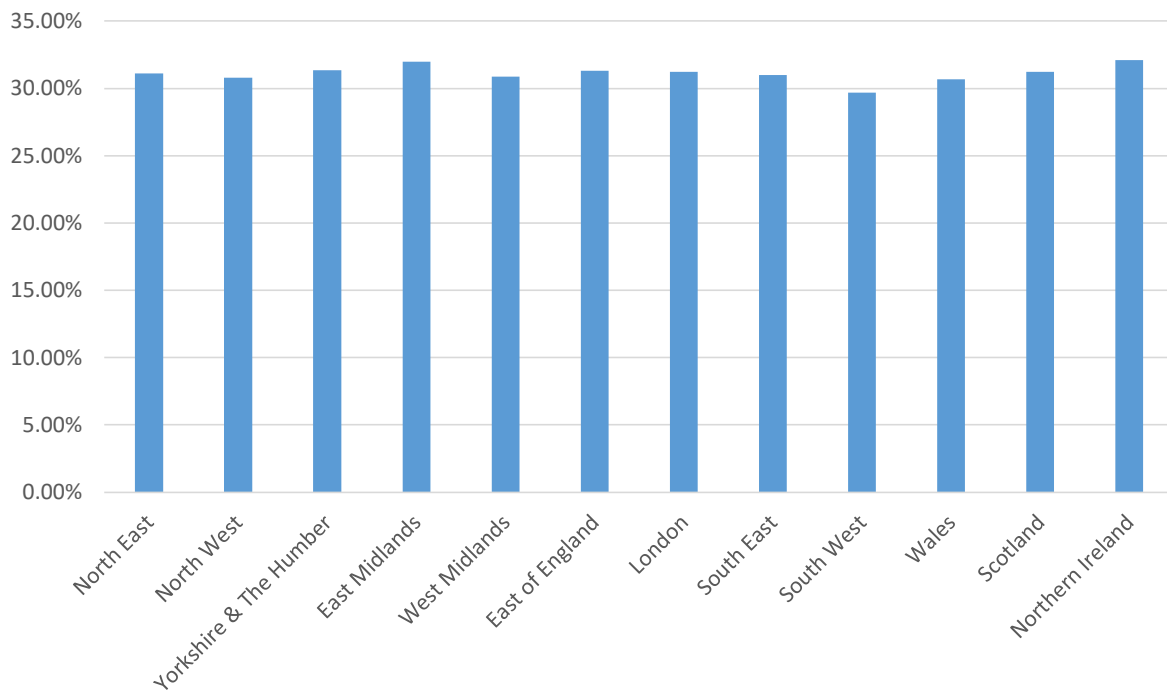
Source: Own calculation based on HM Revenue & Customs, Number of individual income taxpayers by marginal rate, gender and age, by country and region, 2013-2014

Looking at GDHI components provides more evidence on this. Chart 6.6 shows the ratio of total secondary uses (see footnote 121) to total resources, or, roughly, what part of all the incomes of the household sector are paid out in taxes on incomes, and in contributions and other transfers.¹²⁷ The ratios are remarkably similar across the UK. Of course, the secondary

¹²⁷ Various taxes make up 40% of the total secondary uses, with the most important being personal income taxes, taxes on unincorporated enterprises, on capital gains, and the Council Tax. Employers' and employee's social contributions account for another 47% of total outgoings (Office for National Statistics, 2014:41s).

uses do not encompass all the taxes paid to the HMRC, but they may be fairly representative of the entire tax system, given that they account for about 50% of them.

Chart 6.6 Ratio of secondary uses to total resources in GDHI



Source: Own calculation based on Office for National Statistics, *Gross Disposable Household Income* dataset

There is some counter-evidence that points to richer regions paying more than their share in UK GVA. For example, McGough and Piazza (2016) calculate that London alone contributes 30% of total UK taxes, well above its share in total UK GVA of around 23%. They do not explain the basis for their estimates in detail, however. Morrill (2017) does explain his methodology for estimating various taxes that London generates, and ends up showing a very proportional tax system.¹²⁸ McCann (2016:297-310) references a number of studies that show different results, though most agree that most UK regions (and countries) run fiscal deficits. In the end, only when and if official estimates are made will we be able to say with some certainty how much regional redistribution there is between the English regions, but the bulk of the evidence we do have seems to imply that public redistribution from the richer to the poorer regions is happening, though only through public expenditures.

¹²⁸ For a summary table, see Table 7 on p. 24 in Morrill (2017).

6.3 Old paradigm regional policies

This section explores how various UK governments have attempted to apply old paradigm regional policies to help the development of the poorer UK regions. Section 6.3.1 gives an overview of the evolution of policies from the perspective of the areas that were covered, the policies pursued, and total expenditures. It should be noted that this does not exhaust all efforts at regional development, because a number of policies that are not primarily regional nevertheless do have pronounced regional effects, such as infrastructure investment or subsidies to certain industries. These have been mentioned to the extent possible. Second, in section 6.3.2, an evaluation of the policies is given.

6.3.1 The evolution of regional policies

Pre-WWII period

The first regional policy measure in the UK was undertaken in 1928, when the Industrial Transference Board was established. It was an example of the workers-to-work approach, its purpose being to provide financial assistance to workers to move away from jobless areas to areas where there were vacancies. Its establishment was prompted by the over-capacity and unemployment in heavy industries and mining (Armstrong and Taylor, 2000:214), its target regions being the North, Scotland and Wales (Scott, 2009:344). By 1938, when the Board was terminated, around 20,000 workers had moved per year, but this could not make a big dent in either total or regional unemployment, given that, for example, total unemployment in 1933 stood at 3,000,000. The workers-to-work approach has never again played a big role in regional development policies in the United Kingdom.

A different, work-to-workers, approach was taken with the 1934 Special Areas Act. It designated South Wales, West Cumberland, and Clydeside/North Lanarkshire, all depressed coal-mining areas, as Special Areas (Yuill, 1980:187). A number of policy instruments were envisaged, specifically “loans to private industry, the provision of factories on industrial estates, and subsidies to offset firms’ tax, rent and rates (local-tax) liabilities” (Yuill, 1980:193). This reflected the idea that the more developed parts of the country had an advantage because of the development of industrial estates and the availability of capital (Scott,

2009:345). However, expenditures under the Special Areas Acts were small, and not many new jobs were created (Yuill, 1980:193, Armstrong and Taylor, 2000:214, Scott, 2009: 345). More importantly, the policies from the Special Areas Act were to form the basis of many future regional development policies.

1945-1964

The basis for post-WWII regional policies in the UK were set in the first few years after the war. In 1945, the Distribution of Industry Act was passed (Armstrong and Taylor, 2000:215, Scott, 2009:345), establishing a number of assisted areas (called Development Areas). They covered the same areas as the previous Special Areas: South Wales, West Cumberland, and Clydeside/North Lanarkshire, and their coverage was 18% of the British population in 1953 (Scott, 2009:345).

Except the tax concessions, the same policy measures from the Special Areas Acts were envisaged: the building of factories, loans to industrial-estate companies, and capital subsidies in the form of loans and grants to commercially viable projects (Yuill, 1980:193-194). The Distribution of Industry Act also provided for government investment in transportation and infrastructure in the Development Areas, though this was not undertaken to any large degree.

Another important policy tool, the Industrial Development Certificates (IDCs), were introduced in 1948.¹²⁹ These were location controls in the form of licenses, and were a part of British regional policy until 1981. Manufacturing firms that wanted to invest had to apply for an IDC with the Board of Trade and its successors. An IDC was only needed if the investment involved the creation of new factory floor space above a certain size. The stated purpose of the IDCs was to ensure “the proper distribution of industry, bearing in mind the need for providing appropriate employment in the assisted areas” (Wettman and Nicol, 1981:51). The idea was to refuse IDCs if the planned investment was to be made in already developed parts of the country (the Midlands, London, East and the South East), and to approve them otherwise, thus steering investment to the Development Areas. The reason why manufacturing was chosen was because it was considered to be generally mobile, and, as Wettman and Nicol (1981:88-89) argue, the

¹²⁹ Office Development Permits (ODPs) were also introduced in 1965. They functioned similarly to the IDCs, but related to investment in new office floor space, not manufacturing floor space, and they were primarily meant to limit the expansion of office space in London, and to divert this expansion intra-regionally, not to other regions (Wettman and Nicol, 1981:52s).

mobility criterion was indeed the most important one when IDC applications were being considered – if the investment project was planned for the developed parts of the United Kingdom, but could be moved elsewhere, then the IDC application would generally be refused.

Still, the stated intent behind the IDCs was purposefully vague, as neither the “proper distribution of industry” nor “appropriate employment” were ever defined. This allowed the government¹³⁰ significant discretion when deciding when to approve and when to reject IDC applications (Wettman and Nicol, 1981:51). For example, it could approve more IDCs in times of recession, when any investment was seen as desirable. It could also approve them for projects in New Towns,¹³¹ even when these were not in Development Areas. Finally, it could approve them if the investment was considered important enough, wherever it happened to be located.

Throughout the post-war period, British regional policy essentially revolved around modifying the coverage and definition of assisted areas, the types of incentives offered, the strictness of the use of IDCs, and, of course, around how much was spent on regional policies.

Cutbacks were made to regional policies already in 1947, because of a balance of payments crisis. The Conservative governments in the 1950s did not acknowledge a broader regional problem, but insisted that what was being observed were cases of localized high unemployment (Scott, 2009:349-351). Expenditures on regional policies stayed low, and there were almost no IDC refusals.

This changed somewhat in 1958, due to rising unemployment, particularly in the Development Areas. Expenditures on regional policies were increased somewhat, and a few additional grants and depreciation allowances were introduced. The IDCs also started being used much more actively again, the refusal percentage going up from some 2% in 1957 to almost 15% already in 1958, and then rising to around 25% by 1964. Furthermore, the government intervened in the location of some very large-scale projects. A giant new steel factory was split between Ravenscraig in Scotland and Llanwern in Wales, and leading car manufacturers were forced to undertake major expansions in the Development Areas. However, while this may have tackled unemployment problems to an extent, it also contributed

¹³⁰ Specifically, and in most cases, the regional offices of the Department of Industry, except for very large, or politically sensitive projects, in which case the decisions were made at the headquarters (Wettman and Nicol, 1981:93-94).

¹³¹ These were towns built throughout the post-war period around major existing urban centers, such as London, Manchester, or Glasgow, to help decongest them.

to the UK industrial decline, because it led to production being broken up between too many factories to achieve efficient scales of production, despite the fact that the new plants were very advanced for the time (Scott, 2009:351).

1964-1979

When Labour came to power in 1964, it started introducing some important changes to regional policies. The previous Conservative government had defined the assisted areas based on local unemployment rates, but the 1966 Industrial Development Act replaced them with 5 broader Development Areas which included “declining localities and localities of potential growth [leaving] more scope for natural economic forces to operate, as well as giving firms ... a wider locational choice” (Yuill, 1980:188). There was an element of growth pole thinking in this (Scott, 2009: 352).

In 1967 Special Development Areas were introduced, for places expected to suffer high unemployment due to colliery closures,¹³² and in 1970, Intermediate Areas were also introduced, which bordered the Development Areas. They were offered some level of aid, due to the fear that they neither had the locational advantages of the developed regions, nor were they receiving any assistance, thus making them potentially unattractive for investment. Together, all the assisted areas covered some 40% of UK territory, and around 20% of the population (Scott, 2009:353), making the coverage significantly higher than in most other European Community countries (Yuill, 1980:189). These areas continued being the basis for UK regional policies for the next two decades.

With some modifications, capital subsidies remained the mainstay of the policies directed at the assisted areas. However, an innovation was introduced in 1967 with the Regional Employment Premium (REP), which was a straightforward wage subsidy payable to manufacturing firms in the assisted areas. Together with the capital subsidies, the REP provided, on average, a 5% annual operating cost reduction for manufacturing firms in the assisted areas (Scott, 2009:353).

The biggest change that Labour introduced was in total expenditures on regional policies. Combined with the continued building of factories and industrial estates, expenditures on regional policies increased sixteen-fold in real terms from the 1962/63 fiscal year (the last

¹³² The expected “high” unemployment rate was 8%. It is interesting to observe that such an unemployment rate used to be considered unacceptably high not so long ago.

before Labour took power) to the 1969/70 one (the last before Labour lost power) (Thorpe, 1997:166). Investment in infrastructure also increased substantially, and subsidies were given to numerous industries. The only reduction was in the use of IDCs, where after the refusal rate initially jumped to around 30%, it dropped to around 10% by 1970 (Armstrong and Taylor, 2000:217).

The Conservative government that came to power in the summer of 1970 initially announced a cutback in interventionism, including in regional policies, but made a U-turn already in early 1971 due to rising unemployment, particularly in the problem regions (Yuill, 1980:195, Scott, 2009:353).

The Special Development Areas were extended to include Glasgow and Clydeside, Tyneside, Wearside and more of South Wales. A month later, the Intermediate Areas were extended as well.

The 1971 budget contained provisions for extensive public works projects in the assisted areas, while the 1972 Industry Act provided significant additional aid to assisted areas and problem industries. Apart from introducing a virtually automatic 20% investment grant, called the Regional Development Grant (RDG), it also introduced the Regional Selective Assistance (RSA), discretionary, project-related finance in the form of a soft loan or an interest relief loan. The RDG was later reduced and then abolished by the Conservative governments in the 1980s, but the RSA remained the main policy tool for assisted areas until 2010, and still exists in Scotland, Wales and Northern Ireland. The 1972 Industry Act also provided for extensive aid to the shipbuilding industry, which was concentrated in the assisted areas, and allowed the government to provide financial aid to any other industry as well, which it soon did, for example, for coal and steel (Armstrong and Taylor, 2000:354, Yuill, 1980:195).

The 1974-1979 Labour governments initially made no significant changes to regional policy, but they did increase expenditures, which came to around 0.7% of GDP. However, in a replay of 1947, a balance of payments crisis and a recession forced a cut back on regional policies. The REP was eliminated in 1976, and other expenditures were reduced, so that the total fell to 0.3% of GDP by 1979, with the bulk of the cuts moreover coming in one go in 1976-77 (Scott, 2009:354, Taylor and Wren, 1997:841).

1979-1997

Like in other areas of economic policy, the coming to power of Margaret Thatcher in May 1979 heralded drastic cuts in regional policy, both in terms of its coverage, measures and expenditures.

The assisted areas, which due to various increases covered 45% of the population by 1979, were reduced to 30% of the population over several years, and again became focused on local areas of high unemployment. Compared to other countries of the European Economic Community at the time, the United Kingdom ended up with a less than average coverage of assisted areas, although it had greater than average regional disparities.

Most existing policy measures were reduced or eliminated by 1988. The RDG was abolished in 1988, while eligibility criteria for the RSA were tightened already in 1979 (Scott, 2009:355), by introducing the criterion of *need*, namely, the applicant had to show that the funding was *necessary* to enable the project to go ahead (Yuill, 1980:197). IDCs were abolished in 1982, though admittedly they had seen little use for a number of years. Still, their abolition did mean that potentially important investment projects were no longer being brought to the government's attention, which was the reason why they were kept at all until that point (Yuill, 1980:197).

All this effectively left only the RSA and government building of factories and land reclamation as important parts of UK regional policy. The effect on expenditures was a steady decline, from around 0.3% of GDP in 1979 to less than 0.1% by 1990 (Taylor and Wren, 1997:840-841), with this level being maintained since, even though, for example, in the 1996-98 period, it was 70% lower than the EU average (Scott, 2009:356).

But, on top of all the mentioned cuts to regional policies, a subtler change was taking place as well. Namely, the causes of the regional problem were starting to be redefined in the second half of the 1980s, with the focus shifting from a weak industrial structure and lack of infrastructure, to supposed supply-side market rigidities, and a lack of entrepreneurial skill and innovation in the deprived areas. This then also implied a change in policies, from building infrastructure and attracting inward investment, to deregulating and fostering the development of small indigenous firms (Armstrong and Taylor, 2000:219; Scott, 2009:355-366). Then, in the late 1980s and the first half of the 1990s, the Conservative governments also started arguing that the goal of regional policy was to improve the competitiveness of *all* regions (seen as a part of a policy of improving national competitiveness). All of this was consistently couched in "help people help themselves" terms, and policies such as the Regional Enterprise Grant,

“designed to improve managerial skills, business strategies and innovation” (Scott, 2009:220), were introduced.¹³³

Now, this entire approach was primarily a change in rhetoric. First, it was still the assisted areas, not all regions, that were the recipients of aid. Equally importantly, the RSA remained the main policy tool, and its funding did not at all reflect the new rhetoric about small indigenous firms. For example, in the 1991-1994 period, of the total value of RSA grants, around 63% went to firms with more than 250 employees. Moreover, of the entire value across all size categories, around 41% went to foreign firms. Actually, large foreign-owned firms were the single biggest recipient of the RSA, at 35.5% of the entire value of RSA grants paid out in this period (Taylor and Wren, 1997:843). This shows that the real change from the preceding period, apart from the drastic cuts, was a shift towards relying more and more on FDI for regional investment, and not on small indigenous firms. Nevertheless, while the rhetoric had no large immediate impact, and was even diametrically opposed to what was actually being done, it did have the important effect of changing the vision of policy-makers and politicians across the political spectrum. As we will see in section 6.4, this had a profound impact on the types of regional policies that Labour started pursuing after it won the general election in 1997.

6.3.2 Evaluation of old paradigm regional policies

The discussed policies have either supported industries clustered in the poorer regions, or attempted to get existing companies from elsewhere to invest in the development areas. In either case, the main focus was on creating or safeguarding jobs. How successful have the policies been?

Pre-Thatcher period

Some assessments have been negative. Broadberry and Leunig (2013) are a good example, and are representative of a general anti-interventionist stance applied to traditional regional policies. The authors note that post-war regional policy was based on the work-to-workers approach, and was “determined primarily by unemployment, not by industrial needs” (Broadberry and Leunig, 2013:35-36). While they do mention the policies that supported regionally clustered industries, they focus on those that tried stimulating investment in the

¹³³ For details on the Regional Enterprise Grant, see Taylor and Wren (1997:841).

development areas by outside firms. Their argument is that getting firms to disperse their production harms agglomeration economies, thus reducing the firms' efficiency. So, even though they do admit that there have been successes in getting firms to move to assisted areas, noting a study that shows that some 500 firms relocated to the assisted areas in the 1960s, they question such successes by saying that they need "to be seen at best in the context of a trade-off between industrial efficiency and regional equity" (Broadberry and Leunig, 2013:37).

However, their argument about the loss of efficiency through harming agglomeration economies is not backed by empirical research, but by references to New Economic Geography. As I noted in section 3.3, NEG is a problematic approach to understanding regional problems. But, even if Broadberry and Leunig had referenced other theories, that would still have not been enough – empirical claims require empirical evidence. Which specific agglomeration economies are important for which specific industries? Are they tied to close geographic proximity of different producers, or will ease and cheapness of communication and transportation negate any negative effects of dispersion? How close is close enough for agglomeration economies to arise, and how far is far enough for them to start disappearing? Are plant-level economies of scale important, but can individual plants operating at efficient scale be dispersed geographically? These are just some of the questions that would need to be answered – for particular industries at particular times – to be able to claim that dispersing an industry will adversely affect it. But, Broadberry and Leunig do not even ask such questions, let alone answer them.¹³⁴

Actually, at the time it was questioned whether it was even possible to quantify the extra costs imposed on firms by making them move, but on the available evidence, policy-makers at the time were doubtful that the costs were large (Wettman and Nicol, 1981:65). Holland (1979:151-159) also looked at the available evidence, and concluded that it seemed that dispersal was not really detrimental at least to big firms, and if there were extra costs, they were not high.

The arguments of Broadberry and Leunig seem to be based more on an anti-interventionist position, than on empirical evidence. This is clearly shown when, at one point, they change their argument mid-way in a paragraph, from talking about the adverse effects of dispersal on agglomeration economies, to saying that "persuading firms to locate in areas other than those in which the firms wish to expand would be likely to adversely affect industry in some way"

¹³⁴ For an exhaustive attempt to try to ascertain the importance of different agglomeration economies, see Holland (1979:196-235).

(Broadberry and Leunig, 2013:36). These two arguments may look similar at first glance, but are actually quite distinct. Namely, persuading firms to locate their new investments somewhere where they do not wish to locate (dispersal) does not have any necessary logical implications for agglomeration economies. If new investments are located away from existing capacities, the effect on agglomeration economies at the already existing locations will depend on the specific configuration of those agglomeration economies – there may be positive, negative or neutral effects, or some combination thereof. Additionally, new agglomeration economies can be created in the areas where firms are being persuaded to invest. The point is that we cannot know any of this without empirical research, and neither can Broadberry and Leunig.

Furthermore, the authors' argument that firms are persuaded to locate where they do *not* wish to locate is not logical, at least when it comes to persuasion through incentives. Without incentives, a firm may locate in region A, but with incentives, it decides to locate in region B. In both cases, it *is* locating where it wishes to locate, but in the latter case, its decision has been influenced by government policy, which is apparently what Broadberry and Leunig have a problem with. When it comes to IDCs, it does make logical sense to say that firms were being forced to do something against their will, but that is a problem *per se* only if we adopt an anti-interventionist stance.

Interestingly, Broadberry and Leunig do refer to empirical research when assessing the effects of IDCs, concluding that they were unsuccessful, but they misused their only source (Wettman and Nicol, 1981), which in fact shows that the IDCs were fairly successful in getting firms to move to development areas. Discussing this in detail is not necessary here, but, in a nutshell, Broadberry and Leunig point to the fact that only 18% of the firms that had their IDC applications refused actually moved their projects. A full 50% of projects proceeded in their originally intended area, by exploiting loopholes in IDC regulations.¹³⁵ However, Wettman and Nicol (1981:119-123, 169s) note that a formal IDC refusal was not the only way that IDCs could steer investment to the assisted areas. Actually, this was among their least important effects. One other possibility was that a firm would expect a refusal for various reasons, and then simply plan the project from the beginning outside of the Midlands and the Greater East.

¹³⁵ Since IDCs were required only for investment above a certain size of *new* floor space, firms could either build smaller new floor space, or use existing floorspace. Holland (1979:270) notes a particular use of the first loophole – building new floor space below the controlled size next to existing floorspace, and later connecting the two spaces.

An IDC application outside the richer regions would almost always be approved, but that would obviously not show up in the refusal statistics. Most importantly, the officials deciding on IDC applications could use the process to notify the firms about available incentives in the development areas, leading many firms to voluntarily switch their planned locations, and withdraw their original IDC application. The limited research that was conducted actually shows that such “verbal steering” (which, admittedly, did not always happen during the application process for an IDC) was the most important reason why firms chose to invest in the development areas.

Unlike Broadberry and Leunig, Scott (2009) and Armstrong and Taylor (2000) provide an overview of the existing empirical research on the effects of the old paradigm regional policies. Armstrong and Taylor (2000:216) show that the number of firms moving to the development areas varied from around 20 to around 140 moves per year from 1945 to 1978, and the upswings and downswings happen at times of more and less active regional policies. Scott (2009) has given an overview of the existing evidence on job creation in the assisted areas, and concluded that it seems that the various regional policies – factory building and land reclamation, IDCs, free depreciation, various capital and labor subsidies – were successful. Estimates are that they created around 450,000 net manufacturing jobs in the assisted areas between 1960 to 1981. Assuming a multiplier effect of 1.4, a further 180,000 service sector jobs should be added to that figure (Scott, 2009:362-363). Admittedly, not all policies were equally effective, nor equally cost-effective, with labor subsidies (basically, the REP) turning out to be the least cost-effective by a large margin.

Macroeconomic aggregates seem to confirm that the regional policies have been successful to an extent. Table 6.7 shows that some of the poorer regions prospered, although the decline of the West Midlands is striking.

Table 6.7 GDP and personal disposable income per head (UK = 100)

	<i>GDP per head</i>		<i>Personal disposable income per head</i>	
	<i>1966</i>	<i>1979</i>	<i>1972</i>	<i>1979</i>
North	84	92	90	94
Yorkshire & Humberside	97	94	94	94
East Midlands	97	96	98	98
East Anglia	96	94	93	94.6
South East	115	--	119	118
Greater London	--	128	107	107
Rest of South East	--	106	98	98
South West	92	93	100	96
West Midlands	108	96	97	96
North West	96	96	91	95
Wales	84	87	93	94
Scotland	89	95	77	82
Northern Ireland	63	73	90	94

Source: Office for National Statistics, *Historic Economic Data for Regions of the UK (1966-1996)* dataset

However, Scott is completely right to not stay focused just on jobs, but to look at the broader effects of the regional policies on structural transformation. From that perspective, the results have not been particularly good. The focus on quickly getting jobs to the development areas meant that all post-war governments were far less committed to trying to get higher value-added activities there. For example, from 1944 to 1948, all but one application to open corporate R&D plants in the already developed areas were approved. Sometimes, firms would be allowed to do pilot production and R&D around London, on the condition that later standardized production took place in the assisted areas. It was these sorts of choices that, although being helpful in generating jobs in the short-term, merely reinforced the regional disparities in the UK. They helped entrench a spatial division of labor, with high-skill jobs, high value-added activities, and dense linkages between firms being located in one part of the country, and routine, branch plant production in another (Scott, 2009:366). This not only created less potential for development in the assisted areas, but at any time made them

vulnerable to plant closures, because it is normally peripheral branch plants, doing standardized production, that are closed first when firms cut costs and production, say during a recession. A reliance on branch plants combined with the regional concentration of traditional, declining industries, meant that the situation was essentially hopeless for the long-term structural transformation of the poorer regions of the UK.

The Thatcher period

The deregulations, privatizations, and cuts to regional policies and industrial subsidies under the Thatcher government have already been discussed. They did not lead to an improvement in the economic situation of the poorer regions. Table 6.8 shows the evolution of regional GDP and personal disposable incomes during this period compared to the UK average. The North, Yorkshire & Humberside, North West, and West Midlands, all hit hard by industrial decline, have fared particularly poorly, while London, the South East and the East of England have increased their leads. We can also see the benefits that Scotland has had due to the development of the oil industry and the Barnett formula. The only poor region whose situation has substantially improved is Northern Ireland, but that has been a long-term trend, only broken recently, and Northern Ireland always kept special arrangements for regional policy, due to its political situation.

Table 6.8 GDP and personal disposable income per head (UK = 100)

	<i>GDP per head</i>		<i>Personal disposable income per head</i>	
	<i>1980</i>	<i>1994</i>	<i>1980</i>	<i>1995</i>
North	94	89	95	89
Yorkshire & Humberside	93	89	95	93
East Midlands	97	96	97	96
East Anglia	96	102	97	100
South East	115	117	120	123
Greater London	128	126	106	107
Rest of South East	107	111	100	96
South West	94	96	95	96
West Midlands	93	93	96	92
North West	97	90	93	86
Wales	86	84	95	98
Scotland	95	100	81	94
Northern Ireland	73	82	95	89

Source: Office for National Statistics, *Historic Economic Data for Regions of the UK (1966-1996)* dataset

The role of foreign direct investment

The shift towards FDI helped mitigate the effects of what was happening. As already noted, by the early 1990s over 40% by value of RSA funding for manufacturing firms was given to foreign-owned businesses,¹³⁶ and in some sectors this was even higher. For example, in the case of electrical engineering, the number was 72% (Taylor and Wren, 1997:843). Yet, while large FDI projects did create thousands of jobs (though they certainly did not halt the decline in manufacturing employment as a whole), they mostly did not establish strong linkages to the domestic economy (Scott, 2009:362; Brand, Hill and Munday, 2000; Turok, 1993). Branch plant managers do not generally have too much autonomy in choosing their suppliers, and in less developed regions, they would anyway find it difficult to make more complex connections

¹³⁶ In services, the amount going to foreign-owned companies was much lower, at only 13%, but of all RSA funding, services received less than 8%.

to the local economy.¹³⁷ In other words, a regional economy dependent on footloose foreign firms that have been attracted by cheap labor and incentives, may seem better off than it actually is, given the constant risk of firms choosing to leave if better conditions spring up elsewhere.

A particularly cautionary tale is that of the Silicon Glen, a triangular section of Scottish territory, with the points roughly in Edinburgh, Dundee and the estuary of the Clyde. The Silicon Glen was home to a growing electronics industry in the post-war period. The industry grew particularly in the 1980s, its gross output increasing fourfold, due to inward FDI, which primarily revolved around assembly operations. However, Turok (1993) showed that it was not strongly embedded in the Scottish economy. For example, firms sourced only around 12% of material inputs by value from Scotland, with foreign firms (who accounted for 80% of the gross output) sourcing half as much as UK firms. He argued that this was akin to a dependent development model found in developing countries, rather than a self-sustaining one, and that it posed the risk of these companies moving away. Mccann (1997) argued that the situation was not as bad as Turok suggested, and that it was possible that the industry was slowly becoming more embedded in the Scottish economy.

History, unfortunately, proved Turok to be overwhelmingly right. A recent new article noted an array of troubling official Scottish data (Fraser, 2016). In 2002, the value of Scottish electronics exports was £5.6 billion, or 28% of total Scottish exports. By 2014, the numbers were down to £1.1 billion and 4%. In real terms (at 2013 prices), the output of the sector had dropped from £16 billion in 2000 to £2 billion in 2013, and its share in total Scottish manufacturing had dropped from 32% to 8% in the same period. Employment had dropped from 16% of all manufacturing jobs, or around 50,000 jobs in 1999, to 9%, or around 28,000. There is some indication that some firms have moved up the value chain, but these are obviously the exceptions. In other words, the Scottish electronics industry underwent a steady and large contraction over the course of a decade due to foreign firms deciding to move away. This started, not incidentally, around the same time that China entered the WTO, and when a number of East European countries joined the EU. Both events opened up the prospect of

¹³⁷ With the global business revolution, the reduction in the number of suppliers and an increase in their size, and the ever increasing demands made by leading systems integrators (Nolan, Zhang and Liu, 2007b), the relative position of less developed areas has become even worse.

producing in countries with labor far cheaper than in Scotland, and then exporting fairly securely to developed countries.¹³⁸

Overall, it seems that old paradigm policies before the cuts in the 1980s have been successful in maintaining or even somewhat improving the economic situation of the poorer regions, and in generating jobs there. However, they did not engender a structural transformation. After the cuts, the position of the poorer regions worsened. As regards the role of FDI, they have mitigated the job losses to an extent, but have also not helped poorer regions fundamentally develop. Thus, the poorer UK regions never really had a chance to become self-sustainable.

6.4 New paradigm regional policies

As noted, the Conservative governments in the 1980s and 1990s changed the perception of the underlying causes of the UK regional problem. But, while this was mostly a rhetorical matter for them, Labour actually put this rhetoric into practice after the 1997 general election. It moved the UK into an era of new paradigm regional policies, which are still dominant today.

By 1997, Labour had shifted so significantly rightwards that it could easily define the regional problem as being due to a lack of “knowledge, skills, innovation and enterprise” (Scott, 2009:356), essentially a rephrasing of the Conservative governments’ position. The policies they designed for this revolved around support for the development of SMEs, entrepreneurship, and R&D. Additionally, Labour started a process of decentralization and devolution. (It should be noted that, after more than 20 years of this, the UK is still the most centralized state in Western Europe. See McCann (2016). Within England, nine Regional Development Agencies (RDAs) were established in 1999 and 2000, covering the entirety of England (see map in Appendix A). At the same time, the Scottish and Welsh Parliaments were created, and Home Rule was reinstated in Northern Ireland. Control over most regional policies was transferred to the devolved authorities. Thus, regional policies were implemented on an *all-region* basis. This too is characteristic of new paradigm policies, with all regions being eligible for support, but the poorer ones perhaps getting more favorable terms. A few words will be said about the devolved administrations in section 6.4.4, but let us first look at what happened in England, as there are no fundamental differences to the rest of the country.

¹³⁸ For the influence of the EU enlargement, see Danson, Helinska-Hughes and Hughes (2003).

6.4.1 Regional Development Agencies

The RDAs were tasked with developing their own regions. In order to do so, they had control over a number of policies (Allen, 2002:31s). These were divided into several categories: regeneration, business competitiveness, and skills and other.

The first, “regeneration”, initially accounted for the bulk (87%) of RDA expenditures. These policies consisted mainly of urban regeneration projects. If we see development as structural transformation, such policies may sometimes be enabling for development, but they are not developmental themselves. They were actually just a transfer of existing departmental programs to RDA administrations.

Policies related to “business competitiveness and skills” – funding of innovation, provision of venture capital, various training programs, management of Business Links (one-stop shops for business support policies), etc. – can be considered developmental, and there was a whole plethora of them. It was not just the RDAs pursuing them. Indeed, at one point, when the RDAs, local authorities, central government departments, and others are taken together, there were nearly 3000 different policies in place aimed at SMEs, innovation and training (OECD, 2010:297). Adams, Robinson and Vigor (2003:74) note that regional development was fundamentally expected to happen through SMEs, and when all the different sources of funding for SME’s were added up, they totaled almost £8 billion per year. The RDAs themselves all had a strong focus on SMEs and entrepreneurship as the key driver of regional growth.¹³⁹ Nevertheless, as argued in chapter 4, such policies are likely to help further the development of already developed regions, not help create structural transformation in the poorer ones.

Finally, the “other” policy category included a few policies that could be of some more direct help to poorer regions, such as through the promotion of inward investment (for example, organizing tours and visits to the region, or providing information about investment opportunities) and management of RSA¹⁴⁰ grants of up to £2 million (Allen, 2002:31s). But, given the limited funding for promotion, and the fact that the RSA was the only remnant of old paradigm regional policies, this “other” category could not achieve much. Besides, as we have

¹³⁹ See the strategies of the various RDAs, accessible at their individual websites. The links to their websites can be found at <http://www.nationalarchives.gov.uk/webarchive/regional-development-agencies.htm>. All the strategies focus broadly on SMEs, skills, innovation and the business environment. None talk about oligopolies.

¹⁴⁰ The name was later changed to Selective Finance for Investment and then to Grant for Business Investment.

seen, even the old paradigm policies were not successful in creating structural transformation in the lagging regions.

As we can see, it was Labour, through the RDAs, that actually implemented and institutionalized the all-region approach and firmly shifted the focus towards “tapping regional potentials”,¹⁴¹ as if the regional potential of, say, London or the South East is the same as that of deindustrialized Wales or the North East.

The decentralization that the RDAs represented was in itself supposed to be useful for regional development, because they were supposed to have better knowledge of their regions’ conditions than central government departments. We should not underestimate this claim, as well as the institutional continuity that can be provided by regional bodies. Furthermore, perhaps the RDAs had an effect that Hirschman (1970) speculated about, namely, that regional institutions increase the confidence of policy-makers and reduce the feeling of despondence in poorer regions. Adams, Robinson and Vigor (2003:96), for example, note that the RDAs became quite good at organizing amongst each other in their negotiations with the central government. They certainly got more and more autonomy in spending priorities as time went by, and moved further from being merely a conduit for central government policy. Still, as valuable as this may be, it is only really relevant if there is an opportunity for structural transformation to be seized. But this did not materialize.

The Coalition government abolished the RDAs in 2010. During the time they existed, they did receive what seems like quite substantial funding at first glance. From 1999/2000 to 2006/2007, for example, they received a total of over £15bn. Their annual funding increased from £825 million in 2000/2001 to £2.3 billion in 2006/2007. Furthermore, as their funding increased, a smaller percentage of it went to regeneration. In the period from 2002-03 to 2006-07 period, only 32% went to regeneration, whereas spending on business development and competitiveness increased to 17%. For people and skills the number was 8% (Department for Business, Enterprise & Regulatory Reform, 2009a:17).¹⁴² Additionally, per capita funding was much higher in the poorer regions, for example, six times higher in the North East than in London (OECD, 2010:297). However, all this was actually equivalent to a bit less than 1% on average of total identifiable public expenditures in each region (Department for Business, Enterprise & Regulatory Reform, 2009a:7), and, as noted, was certainly dwarfed by the state support for, say, the financial sector (and thus London) during the recent global financial crisis.

¹⁴¹ Expressions such as these are used liberally in documents related to the RDAs.

¹⁴² The RDAs were also delivering programs on behalf of the central government.

6.4.2 Assisted areas

The RDAs were responsible for their entire regions, but the UK governments still defines specific assisted areas, in accordance with EU rules, which makes them eligible for regional aid-related exemptions to EU state aid rules.¹⁴³ The exemptions mostly relate to the ability to give investment incentives, though the latest rules have generally made it more difficult for large firms to receive aid.

It is fairly obvious that the assisted areas are defined according to the view that their problems are those of localized deprivation. First, they are defined at the ward level. Second, the criteria used for choosing the areas¹⁴⁴ show that structural transformation is not on the agenda. For example, when defining the areas in 2007, the criteria used were the employment rate, adult skills, incapacity benefits claimants, and manufacturing share of employment. Those areas that were significantly worse off than the UK average on one of these indicators, or somewhat less worse off on at least two, were considered for being given assisted area status (Department of Trade and Industry, 2006:12-13, also Annex F). Now, there is little doubt that poorer areas will generally be worse off on the selected indicators than more developed ones, but it is abundantly clear that the indicators do not directly bear on the question of industrial structure¹⁴⁵ or the potential for economic development. The focus is squarely on local unemployment and deprivation. This is quite visible on the map (see Appendix B), where there are few larger regions covered, and some wards are not even in the poorer regions of the UK.

The assisted areas were changed again in 2014, and they now cover 27% of the UK population, up from 24% in the previous period (Department for Business Innovation & Skills, 2013:6). As before, there are several categories – “a” areas, which are the most disadvantaged, “sparsely populated ‘c’” areas, and “other ‘c’” areas (see map in Appendix C). The criteria used for the designations were, however, not explained clearly in the consultation papers, and changes from the previous map are evident. Nevertheless, the focus is still clearly local.

In terms of policies aimed at assisted areas, the Grant for Business Investment, a successor to the RSA, was discontinued in 2014 (Gov.uk, 2015a). It was the last major policy tool aimed

¹⁴³ For the latest guidelines, see European Commission (2013).

¹⁴⁴ Except for Northern Ireland, which is always included in its entirety due to its political situation.

¹⁴⁵ The last indicator, manufacturing employment, is a partial exception, but it is too broad. Besides, a higher than average share in manufacturing employment is considered problematic.

specifically at assisted areas.¹⁴⁶ A different scheme, running from 2010 to 2015,¹⁴⁷ was the Regional Growth Fund (Gov.uk, 2015b). It offered discretionary grants, loans or loan guarantees for all types of costs and projects, in all regions of England, but with better conditions for the assisted areas, graded according to how disadvantaged they were. Over 5 rounds of funding, the total amount disbursed was £3.4 billion, of which only some 10%-15% went to the more developed South East, Greater London and the East of England (Ward, 2016). Some tax breaks are also offered in the assisted areas – allowances on expenditures for converting or renovating unused business premises, and the enhanced capital allowances in Enterprise zones (section 6.4.3).¹⁴⁸ Overall, as is evident, the policy toolbox for assisted areas has become rather small.

6.4.3 Local enterprise partnerships

The Coalition government set out its vision of what should now be called local, rather than regional, development in HM Government (2010) (and the current Conservative government has continued with the same approach). After abolishing the RDAs in 2010 it established Local Enterprise Partnerships (LEPs).¹⁴⁹

LEPs are organizations whose relationship to the UK governance structures is not entirely clear. They are business-led organizations of businesses and local authorities, usually formed as companies limited by guarantee or voluntary partnerships. They are not a part of the state administration, nor are they state funded,¹⁵⁰ but they can apply for government, EU and other funds, while aiming to attract private investment. They are sub-regional, although the 39 LEPs in existence do cover the whole of England (see map in Appendix D), and some local authorities even belong to more than one LEP. LEPs have a minimal number of permanent staff (on average 8 full-time equivalent staff), and thus they rely heavily on local authorities for staff and expertise.

¹⁴⁶ See its in guidelines Department for Business Enterprise & Regulatory Reform (2008).

¹⁴⁷ When it was included in the Local Growth Fund. See section 6.4.3 of this thesis.

¹⁴⁸ See more detailed explanations of the aid available in the assisted areas in Department for Business Innovation & Skills (2014a).

¹⁴⁹ See National Audit Office (2016) for a detailed review of the LEPs.

¹⁵⁰ Except £500,000 for every LEP for administrative costs.

Between 2010-2015, LEPs received around £1.5 billion in central government funding. Between 2015-16 and 2020-21, they are planned to receive far more, specifically £12 billion from the government's Local Growth Fund established for this purpose,¹⁵¹ through so-called Growth Deals signed between the government and the LEPs. £7.3 billion have already been allocated.

It seems that the policies they are pursuing are not directly developmental. Around 60% of their expenditures thus far have been allocated to transportation projects, although they do also have a range of business support projects, through training, and support for innovation. Overall, it does look like they fall into the new paradigm of regional policies. Nevertheless, it is probably too early to try and assess their impact, given that the LEPs have only recently gotten significant funding. Still, for now, it does not seem like there is anything unexpected going on – ONS data for productivity in the different LEPs,¹⁵² for example, shows that those LEPs in the poorer areas of England are doing worse than those in the richer areas.

An institution that has existed since the 1980s are Enterprise zones¹⁵³ that currently offer a 100% tax break for business rates, quicker planning permissions and a promise of fast broadband for firms that locate in them. For the Enterprise zones located in the assisted areas, there are additional tax breaks in the form of 100% capital allowances (the above mentioned enhanced capital allowances). The enterprise zones are currently under LEP responsibility.

6.4.4 Regional policies in Wales, Scotland and Northern Ireland

Finally, a few words need to be said about Wales, Northern Ireland and Scotland. The reason I have left this until now is that there has not been anything fundamentally different between them and England throughout the post-war period in terms of regional policies. The main difference has always been in who was implementing them.

In Scotland, in the first several decades after the end of the Second World War, it was the central government that was responsible for regional policies. In 1965 the Highlands and Islands Development Board was founded, and a decade later the Scottish Development Agency

¹⁵¹ This is not extra funding, but a rechanneling of various existing funding sources, including from the Regional Growth Fund.

¹⁵² *Subregional Productivity: Labour Productivity (GVA per hour worked and GVA per filled job) indices by Local Enterprise Partnership* dataset.

¹⁵³ See information about them at <http://www.enterprisezones.communities.gov.uk>.

(called Highlands and Islands Enterprise and Scottish Enterprise since 1991). The two institutions basically implemented government policies. After devolution, authority over them was passed to the Scottish government. Together with institutions such as Skills Development Scotland, and the policies of the Scottish government, the two Scottish Enterprises form the development apparatus of Scotland.

It would not be incorrect to view the two development agencies as the equivalent of the English RDAs, at least in terms of the latter's business support programs, and we should not underestimate the institutional continuity and expertise that they have provided to Scottish development efforts. For example, Scottish Enterprise has a range of support policies for different industries (grants, loans, equity financing, and so on, but also "soft" support, such as networking events), and still provides the RSA grant for assisted areas. Several Enterprise zones also exist in Scotland, with very similar policies to the English ones, except that each zone is meant as a cluster for firms in the same industry, whereas in England the Enterprise zones are not planned with only one industry in mind.

In Wales, the situation was the same as in Scotland, with the central government first directly implementing regional policies, before passing a part of the implementation onto the Welsh Development Agency that was founded in 1965. The authority over it was transferred to the Welsh government after devolution, but the Agency was abolished in 2006, with its functions passing to the Welsh government. The Welsh government has a range of development policies similar to the rest of the country, including Enterprise zones, and still has the RSA for its assisted areas (called Welsh Government Business Finance).

In Northern Ireland, regional policies were first conducted by its government. Scott (2009) notes that Northern Ireland actually had more generous and consistent regional policies, though the type of policies were the same as in the rest of the UK. After home rule was abolished in the early 1970s, regional policies were passed back to Westminster and then devolved back to Northern Ireland in 1998. The situation is now essentially the same as in Wales, with a range of development policies as elsewhere and a version of the RSA (called Selective Financial Assistance) still in existence. One enterprise zone was also recently established.

6.4.5 Assessment of new paradigm regional policies

Assessments have been made of the numerous new paradigm regional policies.¹⁵⁴ Generally, they have been able to create jobs and help the formation of new enterprises. However, the assessments do not focus on whether the policies have led to structural transformation. As we saw in section 6.2, there are wide and in some respects growing regional disparities in the UK, the poorer regions are not particularly innovative, and their firms are less productive, so there has clearly been little in the way of structural transformation. This section explores in some more detail why that has been the case. There are essentially two questions we can ask: a) has there been more SME growth in the poorer regions, and b) does this matter for development? The answer to the first question is mixed, while the answer to the second is mostly no.

Regional SME growth

Table 6.9 shows that the number of private businesses in the UK grew by 58% from 2000 to 2016 (the period for which we have comparable data), outpacing both the 32% real GDP growth in the same period and the 10% population growth. Moreover, the entire growth was accounted for by SMEs (conventionally taken to be businesses with 0-249 employees). It is highly likely that the policies to support SMEs and entrepreneurship, including those pursued as part of regional development initiatives, have played a role in this growth.

¹⁵⁴ See Ward (2016a, 2016b), National Audit Office (2016), Department for Business, Enterprise & Regulatory Reform (2009a, 2009b), Department for Business Innovation & Skills (2014b).

Table 6.9 Number of private businesses in the UK

<i>Size (no of employees)</i>	<i>2000</i>	<i>2016</i>	<i>% of total growth</i>
No employees (unregistered)	1,497,500	3,044,000	76.16%
No employees (registered)	858,400	1,128,200	13.29%
1	199,100	156,700	-2.09%
2-4	512,600	683,100	8.40%
5-9	202,600	241,600	1.92%
10-19	109,400	133,400	1.18%
20-49	53,500	70,100	0.82%
50-99	16,100	22,000	0.29%
100-199	9,000	9,400	0.02%
200-249	1,700	1,900	0.01%
250-499	3,500	3,700	0.01%
500 or more	3,700	3,500	-0.01%
<i>All businesses</i>	<i>3,467,200</i>	<i>5,497,700</i>	<i>100%</i>

Source: Department of Business, Energy and Industrial Strategy, Business Population Estimates

1) Own calculation for % of total growth.

However, a closer look at this growth from the regional perspective shows a somewhat different picture. Table 6.10 shows the increase in the number of SMEs per 10,000 resident adults across the regions of the UK for two periods, 1999-2009 and 2010-2015. The two periods are not comparable, because of a change in methodology.¹⁵⁵ However, the periodization is extremely convenient in that comparisons between regions are possible within the two periods, and the break happens a few years after the start of the recession, and in the same year when the Coalition government abolished the RDAs and started pursuing austerity measures, all of which impacted poorer regions more (Kitson, Martin and Tyler, 2011; Experian, 2009). Thus, we can see the regional effects of austerity, and, within England, also of the elimination of the RDAs.

¹⁵⁵ While total enterprise counts have been recalculated according to the new methodology back to 2000, for regional SME counts this goes back only to 2010.

Table 6.10 Increase in the number of SMEs per 10,000 resident adults

	<i>1999-2009</i>	<i>2010-2015</i>
North East	50%	18%
North West	32%	16%
Yorkshire & the Humber	26%	14%
East Midlands	20%	15%
West Midlands	22%	11%
East of England	31%	11%
London	15%	30%
South East	15%	16%
South West	18%	17%
Wales	33%	11%
Scotland	34%	8%
Northern Ireland	33%	-2%

Source: Own calculations based on Department of Business, Energy and Industrial Strategy, *Business Population Estimates* and *SME Statistics* datasets

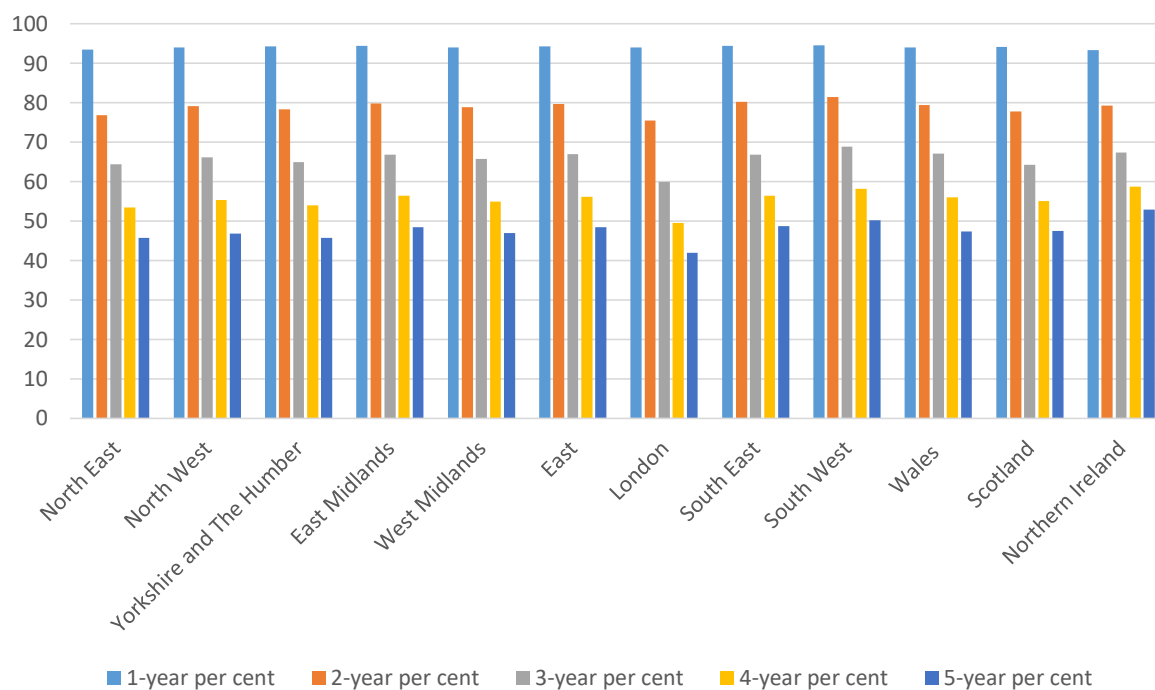
The abolishment of RDAs, the recession and the austerity measures seem to have played a role in how well regions were doing in terms of the growth in SME numbers. In the 1999-2009 period, the poorer regions generally had a higher increase than the richer ones. London and the South East actually had the lowest growth. In the 2010-2015 period the opposite is true, namely, it was the richer regions that generally saw better growth, and London in particular outstripped all the other regions. The Spearman correlation coefficient¹⁵⁶ for the two arrays is -0.48, confirming that there was a switch in the regions that were doing well in terms of SME growth. Thus, the most active period of new paradigm policies seems to have helped poorer regions to an extent to establish more SMEs than they otherwise would have managed to.

Of course, both regional and national SME policies are far from blind to the fact that it is important not just to get new firms, but also to ensure their survival. The policies prior to 2010 (and probably the lack of a recession and austerity measures) seem to have had an effect in that

¹⁵⁶ The Spearman correlation coefficient is done on ranks, not on the data itself. In this case, each region is assigned a rank, depending on its relative position among all the regions in terms of its SME growth rate. Then, an ordinary Pearson correlation coefficient is done on the rankings for the two periods. A positive value means that the the ranks correlate directly, while a negative one means that the correlation is inverse.

respect. As we can see from Charts 6.7 and 6.8, the survival rates for firms¹⁵⁷ established in 2004 are higher than for those established in 2010. But, new paradigm policies have not generally been successful in helping poorer regions more – regional differences in the survival rates are almost non-existent in both periods. London actually fares the worst, but not much worse than other regions, and there is very little difference between these other regions.

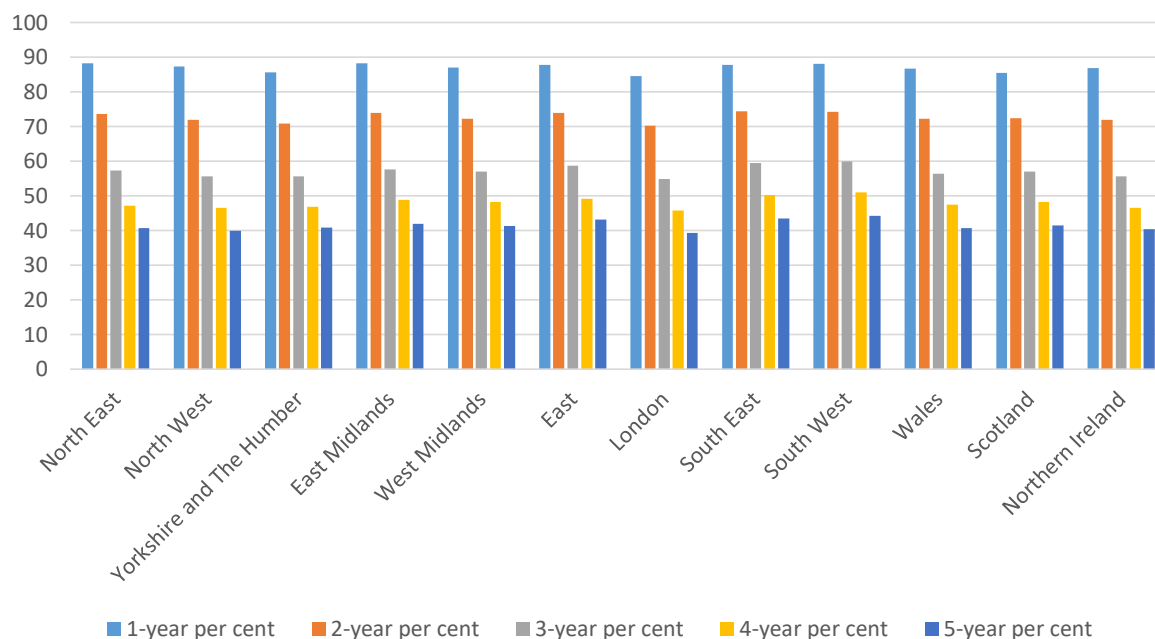
Chart 6.7 1, 2, 3, 4 and 5-year survival rates of firms established in 2004



Source: Office for National Statistics, *Business Demography* dataset

¹⁵⁷ How many firms established in a year are still in existence after a set period of time.

Chart 6.8 1, 2, 3,4 and 5-year survival rates of firms established in 2010

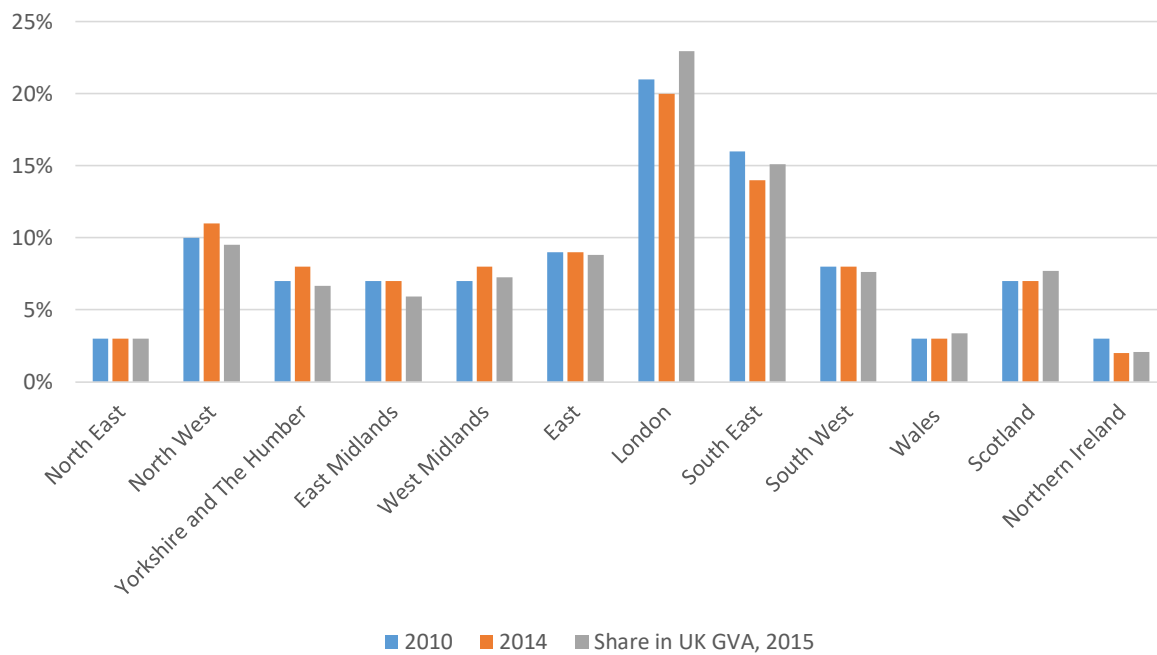


Source: Office for National Statistics, *Business Demography* dataset

We get the same picture if we look at the regions’ shares in high-growth enterprises.¹⁵⁸ The analysis is limited only to firms with 10 or more employees, so as to avoid smaller firms distorting the results by adding on a couple of people, or even just one person. There is only a small number of high growth firms – in 2010, only 5% of the existing stock of firms with 10 or more employees was high growth, and in 2014 that percentage was 6%. These specific years were picked because the RDAs were abolished in 2010, so the numbers for 2010 reflect the effects prior to their abolishment, and the numbers in 2014 to after. As we can see in Chart 6.9, the numbers for the two years are nearly completely identical, and they also correspond almost exactly to regions’ share in total UK GVA. This is in line with the findings in NESTA (2009).

¹⁵⁸ Defined in this data as enterprises which have had an annualized growth rate in employment of at least 20% for the past 3 years, which translates to a bit more than a 70% increase.

Chart 6.9 Regions' share in the number of high-growth enterprises and in UK GVA



Source: Own calculation based on Office for National Statistics, *Analysis of High Growth Enterprises from 2010 to 2013* and *Gross Value Added (Income Approach)* datasets

Overall, it seems that SME policies have generally been able to promote SME growth and survival, but have had limited success in helping poorer regions more than the richer ones. Thus, just like in the past, presently the richer regions have a larger stock of firms per 10,000 resident adults in all size-bands, as can be seen from Table 6.11.

Table 6.11 Number of firms per 10,000 resident adults (mid-2015)

	<i>None</i>	<i>1-49</i>	<i>50-249</i>	<i>250+</i>	<i>All sizes</i>
North East	498	175	5	1	679
North West	669	221	6	1	896
Yorkshire & the Humber	670	218	6	1	895
East Midlands	728	236	6	1	972
West Midlands	659	226	6	1	892
East of England	863	259	6	1	1,130
London	1,145	309	8	2	1,464
South East	967	267	7	2	1,243
South West	877	260	6	1	1,144
Wales	659	207	5	1	872
Scotland	515	206	5	1	728
Northern Ireland	616	223	6	1	845

Source: Department of Business, Energy and Industrial Strategy, *Business Population Estimates* dataset

Are SMEs important?

A bigger problem than the limited success in promoting higher SME growth in the poorer regions is that this promotion seem to be the wrong tool for improving regional growth. To determine this, we need to somehow compare the importance of big firms and SMEs to a region's economy.

Thus far we have been using the number of firms as a proxy for their importance. However, here we cannot do this for two reasons. First, these counts are based on where firms are registered. We should not underestimate the importance of employment and expenditures generated by the headquarters of big firms (mostly located in rich regions), but we know that that this is not their only presence in the UK, and that many of them have various operations across the country and abroad. Focusing only on where their headquarters are would be insufficient. Second, we cannot use counts for purely arithmetical reasons. Namely, the number of SMEs and the number of big firms are not opposed to each other. We need an indicator that shows the importance of big firms and SMEs relative to each other, that is, if one group is more important, the other one is less so.

Two indicators seem to solve both these problems – the share of private sector employment and the share of private sector turnover accounted for by big firms in a region. First, these indicators will pick up big firms’ operations anywhere in the country, not just in the region where their headquarters are located. Second, since all businesses are divided into big firms and SMEs, these indicators move in different directions for SMEs and big firms – the higher the shares for one category of firms, the lower they are for the other. The data is presented in Table 6.12, together with two measures of regional prosperity. The relevant Spearman coefficients of correlation are given in Table 6.13.

Table 6.12 Importance of big firms to regional economies

	<i>% of private sector employment accounted for by big firms</i>	<i>% of private sector turnover accounted for by big firms</i>	<i>GVA per head (UK=100)</i>	<i>GDHI per head (UK=100)</i>
North East	28	42	75	85
North West	28	46	86	88
Yorkshire & the Humber	38	49	80	87
East Midlands	40	53	83	90
West Midlands	37	58	82	89
East of England	42	54	95	105
London	44	54	172	129
South East	33	60	110	113
South West	22	42	91	101
Wales	21	41	71	88
Scotland	32	52	93	97
Northern Ireland	20	27	73	82

Source: Own calculations based on: a) Department of Business, Energy and Industrial Strategy, *Business Population Estimates* dataset, b) Office for National Statistics, *Gross Value Added (Income Approach)* dataset, *Gross Disposable Household Income* dataset.

1) GVA per head values are for 2015.

2) GDHI per head values are for 2013.

3) Employment and turnover shares are for the start of 2016.

Table 6.13 Spearman correlation coefficients

	<i>GVA per head</i>	<i>GDHI per head</i>
<i>% of employment</i>	0.61	0.58
<i>% of turnover</i>	0.68	0.67

Source: Own calculations based on data in Table 6.12. Regions were assigned a rank for the four different variables, and a correlation coefficient was calculated for each pair of ranks.

As we can see, there is a strong correlation between the economic importance of big firms in a region and relevant indicators of household incomes and economic development. Of course, the correlation is not perfect. The numbers would even be lower, at around 0.5, if the correlation were done on the actual shares, not on regions' rankings. So, it is clear that reliance on big firms is not some sort of magic solution to regional prosperity. This is consistent with what we know about the regional distribution of high and low value-added activities of big firms in the UK. Still, it shows that big firms provide benefits – enormous ones in the richer regions, due to the direct and spill-over effects from their headquarters and R&D departments, and more modest ones in the poorer regions, through employment and salaries in branch plants, distribution centers, call centers, and the like.

Those regions that rely more on big firms are also more successful in ensuring a share of high-growth firms. If we rank regions according to the share of turnover and employment accounted for by big firms, and according to their share in the total number of UK high-growth firms, we will see that these number correlate. For turnover shares the number is 0.68, while for employment shares it is 0.61. That is, on average, if a region is more reliant on big firms, it also has a higher share of high-growth firms. This is consistent with arguments set out in Adams, Robinson and Vigor (2003:74-75). The authors provide evidence that entrepreneurship does not quite work how it is usually imagined. The most successful entrepreneurs seem to be people in their 30s and 40s, with skills and work experience, not young inexperienced people. Getting relevant work experience and skills is, of course, easier when there are big firms with established training structures and regular uptakes of inexperienced workers. Furthermore, if some of the entrepreneurs wish to enter the supply chains of big firms, that is going to be easier in regions where there are more such firms, particularly if the entrepreneurs actually worked in those firms before and retained links to their former employers.

Another, and perhaps starker way, to look at all of this would be to show the same coefficients of correlation, but with shares of employment and turnover accounted for by

SMEs. Since SMEs and big firms' shares are arithmetically tied and add up to 100%, the correlation coefficients would be identical to the ones above, just with a negative sign. In other words, if a region wants to *not* do well economically, it should rely more on SMEs than on big firms.

Is the UK oligopolized?

Of course, it could be argued that there is something else behind all of this. Perhaps the UK does not have an oligopolized economy, and it is not the dominance of established giant firms that has prevented the emergence of successful new market entrants in the poorer regions. Perhaps it is not the decision of big firms to keep high value added activities in some parts of the country, and branch plants and the like in another, that is responsible for the correlation between the regional importance of big firms and regional measures of prosperity. However, the evidence convincingly shows that this is not the case.

Table 6.14 is instructive in this sense. As we can see, truly large business, those with 500 or more employees, of which there are a mere 3,500 (0.07% of all UK businesses), accounted for 35% of total private sector employment and 42% of total private sector turnover at the start of 2016. If we include firms with 250-499 employees (another 0.07% of all UK businesses), the numbers go up to 40% and 53% for employment and turnover, respectively. Of course, there are considerable variations between sectors, but there is no sector where firms with 250 or more employees make up more than 0.5% of all firms, and less than 6% of employment and 8% of turnover.¹⁵⁹

¹⁵⁹ Even these figures, both for agriculture, forestry and fishing, are clear outliers.

Table 6.14 Businesses by employment size in the UK (start 2016)

	<i>No</i>	<i>% of no.</i>	<i>Employment</i>	<i>% of empl.</i>	<i>Turnover</i>	<i>% of turn.</i>
<i>With no employees (unregistered)</i>	3,044,025	55.4	3,306	12.6	104,554	2.7
<i>With no employees (registered)</i>	1,128,160	20.5	1,230	4.7	149,991	3.9
<i>1</i>	156,690	2.9	350	1.3	27,575	0.7
<i>2-4</i>	683,095	12.4	1,972	7.5	234,256	6.1
<i>5-9</i>	241,640	4.4	1,656	6.3	201,590	5.2
<i>10-19</i>	133,430	2.4	1,839	7.0	242,850	6.3
<i>20-49</i>	70,120	1.3	2,132	8.1	317,938	8.2
<i>50-99</i>	22,005	0.4	1,517	5.8	227,012	5.9
<i>100-199</i>	9,375	0.2	1,304	5.0	248,795	6.4
<i>200-249</i>	1,930	0.0	429	1.6	70,138	1.8
<i>250-499</i>	3,695	0.1	1,282	4.9	407,157	10.5
<i>500 or more</i>	3,505	0.1	9,188	35.1	1,629,015	42.2
<i>All businesses</i>	5,497,670	100.0	26,204	100.0	3,860,870	100.0

Source: Department of Business, Energy and Industrial Strategy, *Business Population Estimates* dataset

However, even the above table does not really describe the level of market concentration in the UK, because it does not show the concentration within the “500 or more” size band. We can go to a far higher band – those with 10,000 or more employees.¹⁶⁰ There are only 250 such businesses in the UK (0.0045% of all businesses). If each of them had only 10,000 employees they would account for almost 10% of total UK private sector employment. But, they of course employ more people than that. In lieu of official statistical data, we can surmise something about the importance of such super-big businesses from the annual reports of some of the biggest UK companies. For example, Tesco’s annual report for 2016 (Tesco, 2016:168) notes that the group’s UK and Irish operations had 225,000 full-time equivalent employees (of which

¹⁶⁰ The argument is based on data from the Office for National Statistics *Analysis showing the count of VAT and/or PAYE based Enterprises in the United Kingdom by UK SIC2007 Section Letter and Employee Size Band* dataset.

almost the entire number is certainly in the UK), meaning that the number of individuals employed must have been higher.¹⁶¹ The UK operations also had a total revenue of £41 billion (Tesco, 2016:163), equivalent to 1% of total UK private sector turnover. These numbers indicate that it is very probable that, if we were to start adding up the revenue and employment numbers for the very biggest UK private sector firms, probably only a few hundred firms would account for a substantial proportion of the totals for the entire UK private sector,

The dominant position of big firms can be seen in numerous other ways. For example, R&D expenditures and employment, both very important elements of competitiveness, are phenomenally concentrated among the top firms in the UK. The top 5 private enterprise groups by R&D expenditures, so, less than one millionth of all UK private sector businesses, accounted for 20% of total UK business R&D expenditures and 25% of total private R&D employment in 2015. For the top 100, the numbers were 60% for expenditures and 43% for employment.¹⁶²

There is other data on the advantages of big firms over small ones. For example, Awano, Heffernan and Robinson (2017) show that firms with better management practices are more productive, and that bigger firms have better management than smaller ones. We also know that big firms are significantly more likely to be exporters (ons.gov.uk, 2015).

However, instead of adding on data and research to show what we already know, perhaps we can draw the obvious dismal implication for the UK poorer regions. We would either need to get big firms to invest massively in the poorer regions, and not just in assembly and such simpler activities, or we would somehow have to overcome their market power to help actual indigenous development in the poorer regions. Without fundamental changes to the political economy of the UK, both possibilities seem at least as unlikely today as they were when Holland first made this argument 40 years ago.

These points seem to have been missed in current debates about UK regional disparities. This is the case even with an author such as McCann, who wrote (McCann, 2016) what is easily an encyclopedic work on the UK regional problem. For example, he writes extensively about the regional location of advanced sectors, but does not really go into too much depth on market

¹⁶¹ We can perhaps infer the number of individuals in the following way. Tesco reports the total number of full-time equivalent employees for their entire group at 358,000, while the number of individuals employed is 482,000, i.e. 34% higher. If we assume that the ratio is the same for the UK and Ireland, then this would imply a workforce of some 300,000, or more than 1% of all employees in the private sector. Given the prevalence of part-time employment in low-skilled service sector jobs in the UK, it is quite possible that the number is higher.

¹⁶² The data is based on the Office for National Statistics' *UK Business Enterprise Research and Development* dataset.

structure, and certainly not on the power of big businesses. Most of his policy analysis is then also focused on regional governance, public investment, and “light-touch” industrial policy, not on the political economy framework of current capitalist markets. If the UK regions are to have any hope of significantly upgrading their productive structures, the debate needs to be broader than this.

6.4.6 A note on cluster policies and regional banks

Clusters

Apart from SME promotion, some RDAs, LEPs, city authorities, and academics have argued for, or actually pursued, cluster policies. Martin and Sunley (2003) have criticized the concept of clusters as being vaguely defined, empirically problematic and of questionable policy relevance. But, let us define cluster policies here very broadly, as basically a focus on attracting big firms to establish higher value-added activities in a city or a region, and then attempting to create strong links to domestic companies, most often SMEs. This definition should encompass a broad set of attempts to strengthen domestic innovativeness and supply chains. The way that big firms are to be attracted is not necessarily through fiscal and financial incentives (though these may play a role), but rather through providing skills, infrastructure, and various forms of “soft” capital, such as institutions to foster close links between universities, local companies and the market leaders. We shall look at three examples to see how this approach generally recognizes the importance of market-leading firms, but not necessarily their power. That is, it focuses primarily on what regional policy-makers can do to foster clusters, but it does not say much about how the prospects of success in poorer regions are affected by having to compete against already developed regions.

A good example is IPPR North (2012). The focus of the report is on setting out the economic strengths and weaknesses of the North of England,¹⁶³ and on giving suggestions for how the region can prosper. Its analysis of the importance of innovation and the business environment is the most interesting (2012:57-97). A number of priority sectors for the North are presented, some general, such as “low-carbon”, others specific, such as “orthopedic manufacturing”. Their potential contributions to the Northern economy are generally measured by how quickly the sectors are growing globally, and how quickly some of the markets that the North is exporting

¹⁶³ In the report, the North is defined as the North East, North West and Yorkshire & The Humber.

to are growing. While this makes sense as an analysis of growth opportunities, the report does recognize that the North could be much stronger in creating local supply chains and innovation, so that it could benefit more from this growth. In other words, it recognizes that the market-leading firms that are located in the North need to link up to the local economy. But, how exactly that is to be done is problematic.

The report juxtaposes traditional and modern industrial policy, saying that “The purpose of industrial policy ... is to work *with* the market to overcome barriers to growth, rather than for government to dictate its operation. ... industrial activism today is very much based on the premise that government can support the market without actually owning firms or necessarily making investment decisions” (IPPR North, 2012:57-58). In other words, firms are to be asked and incentivized to make investments that are beneficial to the North. The incentives should come from improving skills, creating institutions that link up universities and businesses, attuning local institutions’ policies to the needs of investing firms, and building other sorts of “soft” capital. This effectively amounts to improving the Norths’ location factors.

These are not bad suggestions *per se*. However, as Holland (1979:239) pointed out a long time ago, attracting advanced private investment to poorer regions does not hinge on simply creating some investment opportunities, but on creating *better* investment opportunities than exist elsewhere, particularly in the richer regions. IPPR North (2012) recognizes that English regional institutions have not only competed, but even undermined each other, in attempts to attract investment, but it does not really recognize the full implications of the far greater problem, namely, that all these poorer regions have to compete against London, the South East, the East and rich regions in other countries. Exactly how good would “soft” capital and skills have to be in the North to make it *more* attractive than those regions?

Adams, Robinson and Vigor (2003) is another interesting example. In chapter 6, the authors point out that regional policies should not be focused so much on SMEs, and that firms of all size are important. They also note (in chapter 5) that most new and cutting edge technology is created in a few countries, and at that by a few world-leading companies and research institutions, and then disseminated to other users. However, lacking an analysis of the actual market power of big firms, their suggestions fall short of what would be needed to fundamentally alter the UK regional situation.

For example, it is argued that the government should increase its R&D investment in the poorer regions by reserving a part of its R&D funding solely for projects conducted in those regions, and by transferring some government R&D centers there. This would be valuable in raising employment and incomes, but would also create a basis for further development, say

by creating a regional skill base. In this sense, the suggestions are a bit more radical than in IPPR North (2012), recognizing the need for larger scale government action to change the location factors in the poorer regions. However, it is questionable what the final results would be. Unless the transfer of R&D to the poorer regions were very large indeed, market-leading firms would still probably find it more attractive on average to invest in the established clusters around, say, Cambridge, Oxford and London. And if the more realistic smaller transfers are enough to spur the development of some firms in the poorer regions, what is to prevent market leaders from destroying them if they feel threatened, or from buying them up and potentially hollowing them out?

Finally, Bailey, Cowling and Tomlinson (2015) is not just an interesting, but also a perplexing example. The authors argue for an industrial strategy for lagging UK cities and also see that as the key to regional development. Unlike the above texts, though, they fully recognize not only the importance, but also the power of big firms. However, there is a strange contradiction in their arguments.

The authors note the dominant position of big firms within their supply chains and the fact that they are often footloose and can switch locations if there is enough incentive to do so. A consequence of this is that such firms follow their own strategic interests, and are not particularly interested in the effects that that has on their smaller suppliers or on the localities into and from which they move. They also play off city and regional authorities against each other when trying to get as many incentives as possible. The bigger and more global a firm is, the more power it has. The authors also note the example of the much lauded Italian industrial districts, which they argue are no longer so characterized by diversification, technology sharing between firms, and equal relationships between authorities, big firms and small firms, as they used to be. This is due to the globalization and centralization of production. The districts have become more specialized, and the big firms have become the dominant players.

However, the authors see the key to city development exactly in establishing in them structures similar to how the Italian industrial districts used to be. How is that to be achieved?

First, there is the usual set of proposals for supporting private and public R&D, building “soft” capital, and supporting SMEs. There is even the suggestion of funding for SMEs and micro-enterprises “perhaps along the lines of the Grameen bank tailored to the needs of the European city” (Bailey, Cowling and Tomlinson, 2015:279), and having lots of SMEs which, while operating at small scale individually, together have large scale. Paradoxically, this suggestion is made in the same article in which the authors clearly recognize that the increasing complexity of modern production has led to increasing centralization of production, and to

large firms pressuring their suppliers to cut costs and increase quality. If SMEs (and micro-enterprises) were somehow able to jointly fulfill such demands, or compete on equal footing against market-leading firms, it is highly likely that they would have done so already somewhere. But, they have not.¹⁶⁴ Actually, the direct opposite has happened – a reduction in the number, and an increase in the size, of individual suppliers in the supply chains of market-leading firms, and a vast centralization of production in a few global market leaders (Nolan, Zhang and Liu, 2007a, 2007b).

Second, the authors suggest a “reform of underlying economic governance structures” and “more democratic frameworks to include wider ‘public interests’ within the hierarchical structures of large corporate firms” (Bailey, Cowling and Tomlinson, 2015:277). They argue that this can be achieved partially because the proposed diffuse and SME-heavy economic structure would by its nature be more democratic than structures heavily dominated by large corporates. However, as argued, such a proposed structure is progressively less and less likely to materialize in capitalism, as the concentration of capital progresses further. As for the more important question of how large corporate firms could themselves become more democratic, one does not get the impression that the authors fully appreciate the enormity of their suggestion. They note that this democratization of large corporates would require: “a degree of monitoring to ensure compliance” (Bailey, Cowling and Tomlinson, 2015:277). I would argue that it would require far more than that.

Unless we are talking about fundamental changes to capitalism,¹⁶⁵ then these “more democratic frameworks” would at the very least have to entail nationalizing some companies and introducing heavily interventionist laws. This would not be impossible. Nationalizations have been done in the past, state owned enterprises have been used to make investments in lagging areas, and some countries did have location controls and mandatory investment agreements between big capital and the state (though, to repeat, even all this was not enough to develop the poorer regions). We could also imagine introducing capital controls to prevent the transfer of profits around the globe, and then taxing firms’ incomes very heavily, so that they simply do not have the resources to make large investment decisions. This would

¹⁶⁴ One possible example is Lloyd’s. It is not an insurer itself, but rather a group of around 150 insurance “syndicates” (themselves groups of individuals and corporations) which partially mutualize risk. However, none of the syndicates are small, and the top 10 of syndicates by value of insurance account for around 45% of the value of the underwritten insurance of Lloyd’s as a whole, while the top 20 account for 65% (Standard & Poor’s, 2016).

¹⁶⁵ Say, by introducing joint management of companies by workers and city authorities.

automatically give the state a large say in how investment is made. All of these, and probably many other policies could be conceived and potentially implemented. But, what we can be certain about is that, without some such form of heavy-handed intervention combined with public ownership, big firms will simply never pay much attention to anyone else's interests but their own. From their perspective, why would they? At a more general, economy-wide level, this argument has been made in significant detail by Cowling (1983, 1994) and Cowling and Sugden (1987), who argued that only introducing some form of economic democracy could overcome the power of big businesses. What specific combination of local, national and worker control this would entail is up for discussion, but far-reaching reforms would certainly be needed. There is no reason why this should be any different in relation to city or regional development. Since such changes are likely not forthcoming any time soon, the position of poorer regions and cities is extremely bad, because their interests routinely end up being at odds with the self-interest of large corporates.

We have to understand that democracy is not the normal state of affairs in systems where actors have vastly different amounts of power. One actor's power is limited by another actor's power, not by asking the more powerful actor to be nice.¹⁶⁶ In the case of attempts to develop lagging cities and regions, the only real power available to weaker actors (local firms and authorities) is legal force. No amount of asking large corporates to be nice will help.¹⁶⁷ Thus, democratizing city and regional development means either curbing the power of large corporates through legal means, or by setting more powerful actors against them, which can only mean giving central governments the leading role.

¹⁶⁶ On the evolution of political democracy, see Rueschemeyer, Huber and Stephens (1992), Moore (1993). Today's political democracy is based on past (often literally bloody) struggles of the weak (workers, peasants, women, etc.) to organize and collectively fight the powerful (mainly, but not solely, capitalists, the landed class, the state, and men). A crucial aspect was the fight to remove the possibility of the powerful to indiscriminately use force, for example, to break strikes. By now, political democracy is partially maintained by the fact that its power balance has been internalized as "values", as well as by institutional inertia. But, it is maintained much more by the actual power balance between the different actors. Incidentally, this power balance is currently being skewed more and more in favor of capitalists, exactly because of some of the issues that Bailey, Cowling and Tomlinson (2015) identify, such as the ability of firms to relocate production, which puts those dependent on it in a weak position to make demands.

¹⁶⁷ Besides, even if some large corporates actually wanted to be nice and make the substantial effort and outlays needed to help poorer regions truly develop – say, by taking the time to nurture local suppliers, even if they already have suppliers elsewhere – it is likely that competition would sooner or later force them to cut costs and abandon such goals (at least temporarily).

Regional banks

One final suggestion that needs to be addressed briefly is the fairly recent and increasingly heard suggestion that regional development banks should be set up (Martin et al., 2015, Werner, 2013). This has even been picked up in politics, and was recently suggested by the team of the current leader of the Labour Party, Jeremy Corbyn (Elgot, 2016).

The suggestion is based on several facts. First, the UK bank market is more concentrated than in some other countries, notably Germany. Second, only some 35% of total bank lending in the UK goes to SMEs according to Bank of England data,¹⁶⁸ again lower than in many other countries. Finally, Germany's system of regional public banks and the KfW are brought up repeatedly as a model that supports lending in all regions, across sectors, and particularly to SMEs. The argument goes that all these facts point to setting up public banks with a mandate to provide loans to SMEs, and to serve only their regions. There is nothing wrong with these suggestions, but, they need to be put into perspective.

First, Germany's state public development banks, in particular the KfW, actually engage massively in selective industrial policy. They do this by picking sectors that they wish to support, and navigating EU state aid rules to be able to provide cheaper financing to them than the private sector is willing to provide. (This, however, is of more use to already developed regions.) They also provide cheap export credit that ultimately benefits large German exporters (Naqvi, Henow and Chang, n.d.). Billing them as fitting into light-touch industrial policy, which does not pick sectors or winners, only makes sense if we consider the obfuscation of heavy interventionism, something which all these banks attempt to do, to be "light-touch". Second, providing cheap money to SMEs is not sufficient to help them go up against established market players. Whatever loans they are given are going to be smaller than the funds that large firms have access to. Besides, large firms often self-finance, and thus have no interest to pay, so no matter how subsidized the loans to SMEs are, some interest and a principal to repay is still larger than no interest and no principal. Most importantly, though, the competitive advantage of big firms is not based solely on their access to finance. So, even Germany, with long-existing regionally based finance for SMEs, is as oligopolized as the UK. Looking at registered firms and employees covered by social insurance, in Germany only

¹⁶⁸ Bank of England Bankstats (Monetary & Financial Statistics) *Monetary financial institutions' loans to non-financial businesses, by size of business* dataset. SMEs are defined as those businesses with less than £25 million annual turnover on their main debit account.

0.38% of firms are big (defined as having 250 or more employees), but they account for nearly half of the turnover, and just under 45% of employment, according to data from the German Federal Statistical Office. Also, German poorer regions are still failing to catch up to the richer ones, despite the regionally based finance. So, the German model cannot really be used as an example of how regional banks funding SMEs help the development of poorer regions.

6.5 EU regional policies in the UK

A discussion of regional policies in the UK would be incomplete without looking at the EU. However, as we shall see, there is nothing qualitatively different that the EU adds to the picture.

The UK joined the EU in 1973. It has since had access to various EU funds, which are either explicitly regional in nature, or simply have regional effects. The European Social Fund (ESF) funds worker training, mobility, and other labor market policies. Soon after joining the EU, the UK actually started receiving a full third of total ESF funds. The UK also gained access to the European Agricultural Guidance and Guarantee Fund (EAGGF), the Guidance part giving loans for diversifying into non-farming activities, and the Guarantee part for price support. Funding from the European Coal and Steel Community (ECSC), obviously targeted at regions dependent on those industries, was important for the UK. ECSC support consisted of favorable loans for investment and restructuring of coal and steel industries, for the development of new industries in its target regions, and aid for redundant workers as wage supplements, for retraining or rehousing. UK organizations could also receive loans from the European Investment Bank (EIB), offered on favorable terms to industrial and infrastructure projects in depressed areas. In 1975, the European Regional Development Fund (ERDF) was created, offering grants and interest rebates for investment projects in poorer areas, in industry, services, infrastructure, and for small firms (Scott, 2009:221, 324).

The growing funding from these various sources proved important throughout the 1980s, because it partially compensated for the cuts made by the UK government. By 1990, UK government funding for regional policies had become practically equal to the funding from a number of EU funds, and due to further cuts in the UK, and increases in EU funding, by the

1995/96 fiscal year, EU funding was almost double that of the UK government (£922 million vs. £474 million) (Taylor and Wren, 1997:841).¹⁶⁹

It was not just the UK that got increased funding. As a matter of fact, in the 1989-1993 period, the ERDF, ESF and the Guidance section of the EAGGF were brought together under the name Structural Funds, and their funding was no less than doubled in real terms. Then it was doubled again for the 1994-2000 period (Armstrong and Taylor, 2000:222) and continued to grow since. But, we have to understand the reasons why these funds were increased so massively. Let us first analyze these, before briefly looking at the current situation.

It was recognized that the creation of the Single European Market (SEM) in the 1989-1993 period would adversely impact some regions. Armstrong and Taylor (2000:309) offer a good summary of why that could happen:

Regions at the geographical centre of the EU are able to exploit their natural positional advantage of being closest to the main population centres. ... this positional advantage may be being reinforced by advantages flowing from the economies of scale which have resulted from the increase in market size. ... Other economic processes may also favour the central regions ... [they] contain the majority of the major urban concentrations as well as the financial and administrative capital cities. A whole series of agglomeration economies and external economies favour the further concentration of firms and industries in these central regions. ... the central regions may become the principal beneficiaries of a process of cumulative growth as capital and labour are attracted into these areas from the periphery. ... [Conversely] the peripheral regions are characterized by small uncompetitive microeconomic firms, which are simply unable to compete with the large multinational firms located in central regions. The freer trading conditions of the EU pose a severe threat to [them].

Similarly, when the European Monetary Union (EMU) was being planned, it was recognized that the loss of monetary and fiscal sovereignty – for example, the loss of ability to set exchange rates and only limited ability to use fiscal deficits – could adversely impact some countries, and particularly their depressed regions. This was one of the reasons for the doubling of the

¹⁶⁹ The EU funding refers to its then Structural Funds (ERDF, ESF and Agricultural Fund), while the UK funding refers to the Regional Development Grant, Regional Selective Assistance, Regional Enterprise Grant, expenditures on land reclamation and factory construction, and industrial assistance in Northern Ireland.

expenditures of the Structural Funds in the 1994-2000 period (Armstrong, Taylor, 2000:310-311). Finally, there are European policies that actually favor the richer regions, such as the agricultural support, which mostly goes to large firms and certain types of crops, so “the already prosperous agricultural regions of northern Europe have been the principal beneficiaries” (Armstrong and Taylor, 2000:317).

I have already discussed in chapter 4 the disadvantages that poorer regions have, so there is no need to go through them here again. What needs to be explored, however, is whether the type of policies that the EU Structural funds support offer much hope for the structural transformation in poorer regions. In other words, the benefits of the policies have to be set against the disadvantages that poorer regions suffer.

As Armstrong and Taylor (2000:222) note, throughout the 1980s and 1990s, the focus of much of the EU funds was on indigenous development. What is meant by that, though, is *not* the development of robust, diversified economies based on large indigenous firms, but rather the development of SMEs. The proportion of funds going towards that goal is substantial. Ever since the Structural Funds were created, they have operated on the basis of the “multi-annual financing framework” – a number of objectives are chosen for each 7 year period, and the Structural Funds pursue them by giving grants for projects that fit into one or more of the objectives. The development of SMEs has been the most important one. For example, in 1997-1999, all British areas eligible for the then Objective 2 of the Structural Funds (“Converting regions seriously affected by industrial decline”, Armstrong and Taylor, 2000:326) had the highest proportion of funding going towards SME development, ranging from 27% in Industrial South Wales, to 44% in the East Midlands (Armstrong and Taylor, 2000:255).

The situation has not really changed since then. The European Structural Funds are now called the European Structural and Investment Funds (ESIF), and include the ERDF, ESF, the European Agricultural Fund for Rural Development (EAFRD, the former Guidance section of the EAGGF), the European Maritime & Fisheries Fund (EMMF), the Youth Employment Initiative (YEI), and the Cohesion Fund (CF). For the 2014-2020 period, the UK has been allocated almost €16.5 billion from the ESIF,¹⁷⁰ with roughly a third coming from the ERDF, EAFRD and ESF each, with the remaining few percentage points divided between the EMMF and YEI. Of the entire sum, the “competitiveness of SMEs” theme (this is the current name for ESIF objectives) is the single biggest funding category, at 15% of the total. “Sustainable & Quality Employment”, “Environment Protection & Resource Efficiency”, and “Educational &

¹⁷⁰ More developed EU member states absorb almost 100% of their allocated funds.

Vocational Training” are close behind, at 14%, 13% and 13% respectively. There are many individual projects funded under these themes, but they are essentially the same as the new paradigm regional policies pursued by UK governments, i.e. most are not directly developmental.¹⁷¹ Those that are, are more likely to be of help to already developed regions.

There is an additional problem in that for the purposes of ESIF funding, the EU divides all regions (at the NUTS 2 level) into more developed regions (more than 90% of average EU GDP per capita), transition regions (between 75% and 90%), and less developed regions (less than 75%). It provides various sources of funding for all of them, and it is just that some of the funding, in particular from the ESIF, is given on more favorable terms in the poorer ones. Since the UK is a highly developed country, most of its regions fall into the more developed category, and they account for around 95% of UK GVA (see map in Appendix X). This does not acknowledge that some of them may actually have severe structural problems, and the only reason why they have high GDP per capita is because of state support. For example, it does not really make sense to include Northumberland and Tyne and Wear into the same category as Berkshire, Buckinghamshire and Oxfordshire.

The picture for the 2007-2013 period is essentially the same. In that funding period, regions were divided into convergence regions (at less than 75% of the average EU GDP per capita), transition regions (at 75%-90%), and competitiveness regions (more than 90%) (see map in Appendix F). Like today, most regions were in the competitiveness category, even though many do not have similar economic structures at all. For the ERDF, for which European Commission (2016a:13, 16) reports the numbers,¹⁷² support for innovation accounted for 33% of total spending, and support for entrepreneurship and enterprises accounted for 21%. There was a heavy focus on SMEs.

The entire situation is made more problematic by the fact that the EU has very restrictive state aid rules, which set particularly severe limits on the types of industrial policies that can be pursued (Armstrong and Taylor, 2000:317).¹⁷³ For example, local content requirements, reserving public purchases for firms from a certain region, and a host of other policies that would be of use to poorer regions cannot be done. On the other hand, what are claimed to be

¹⁷¹ All data is from the European Structural and Investment Funds website, at <https://cohesiondata.ec.europa.eu/>.

¹⁷² The operational programs for the English regions for ERDF funding can be seen at <https://www.gov.uk/guidance/erdf-programmes-and-resources#contacts-for-the-erdf-programmes>. All of them focus on SMEs and entrepreneurship.

¹⁷³ For extensive arguments on this problem and on why the EU in general favors the already developed countries and regions, see Holland (1980, 1993), Nicol (2010).

non-interventionist policies, that supposedly do not target specific sectors or firms, such as R&D support, tax rebates on R&D investment, aid for renewables (for example, guaranteeing purchases of electricity generated from renewable sources), and so on, are allowed. Such policies are, of course, anything but non-targeted, as they are primarily of use to developed countries and regions. Thus, they end up unintentionally reinforcing regional disparities. Being designated as an assisted area does provide some exemptions from state aid rules, but these still do not even remotely allow any policies that could be transformative. They generally revolve around allowing more investment grants, and giving some tax breaks.

None of this, of course, means that EU regional policies are useless. Quite the contrary, the various projects provide positive effects. For example, it is estimated that in the UK in the 2007-2013 period, they created some 150,000 jobs (European Commission, 2016a:20). Nevertheless, to expect structural transformation from them seems unjustified.

Of course, following the result of the Brexit referendum, it remains to be seen what sort of agreement the UK will make with the EU, and how many of the constraints imposed by the common market and state aid rules will remain. Still, lest we become too optimistic, three things need to be noted. First, having increased possibilities for more radical regional policies does not mean that the possibilities will be seized. Second, there will likely be negative economic effects from leaving the EU. Third, the UK will be subject to other international treaties, particularly the WTO, that also set constraints on industrial policy. As things stand now, the prospects for the poorer regions do not seem particularly bright.

7. Scottish separatism

On September 18th, 2014, the Scottish independence referendum was held, resulting in a 45% vote for Yes (pro-independence) and 55% for No (anti-independence). No won by a significantly larger margin than polls had been predicting. As a matter of fact, a few days before the referendum, a poll (BBC News, 2014b) even predicted a win for Yes, leading to a “pledge”, signed by the leaders of the three main Westminster parties (Labour, Conservatives and the Liberal Democrats) that more powers will be devolved to Scotland and its funding preserved, if it chooses to stay in the UK (BBC News, 2014a).

Only a few years earlier, the chance of the Yes vote winning seemed remote. When the Scottish National Party (SNP) formed a (slim) majority government in Scotland in 2011, it did so on a platform that included organizing an independence referendum. The UK and the Scottish governments signed the Edinburgh Agreement¹⁷⁴ in October 2012, obliging both sides to respect the referendum result and work together, whatever the outcome. There is no indication that the UK government actually expected the Yes side to come close to winning. Rather, the expectation was that there would be an easy win for No, and that the matter would be put to rest. However, the Scottish government took the long campaign for independence seriously, and when the short campaign started picking up pace in 2014, it proved to be quite successful, with polls showing a gradually increasing support for a Yes vote.¹⁷⁵

But, it was not just the SNP that was engaged in campaigning. Together with the Scottish Greens and the Scottish Socialist Party, it formed the Yes campaign in late 2012, which was soon after registered as the lead campaigner for the Yes side with the UK Electoral Commission. A further 20 organizations and individuals registered as official campaigners. On the No side, Better Together, composed of the three main Westminster parties, became the lead campaigner, with a further 20 campaigners registered (UK Electoral Commission, 2014, Appendix 2). In addition to the official campaigners, there were numerous other organizations engaged in the debates about Scottish independence, such as, for example, the Common Weal project, a network of researchers setting out their vision for a better Scotland (independent or otherwise).

Ordinary people were very interested in the referendum as well. The voter turnout of 84.6% was the highest ever in any Scotland-wide poll since universal suffrage was introduced (UK

¹⁷⁴ Available at <http://www.gov.scot/About/Government/concordats/Referendum-on-independence>.

¹⁷⁵ For analyses of the impact of the Yes campaigns, see ScotCen (2014), Curtice (2016).

Electoral Commission, 2014:1). And, as was clear to anyone spending time in Scotland in 2014, this was not merely a response to the top-down debates taking place, but rather reflected a genuine interest and passion about the issue from both sides.¹⁷⁶

What did the debates revolve around? The Yes campaign's arguments can be generally divided into two parts.

The first revolved around the narrative that the Scottish nation is distinct from England in its identity and values. It was asserted that Scotland is more egalitarian and open (including to immigration) than England, that it respects the right to education more, is more peaceful, and has a host of other characteristics that we could generally call left-wing.¹⁷⁷ For these reasons, it was argued, Scotland should pursue its own future, without being ruled by Westminster and parties that it did not elect (in the Scottish context, this first and foremost means the Conservatives).

The second part revolved around specific policies based on these Scottish national values. Here it would be difficult to understate the importance of economic issues. In 2013 the SNP government published *Scotland's Future: Your Guide to an Independent Scotland* (Scottish Government, 2013f), colloquially known as the *White Paper*, setting out its arguments for independence, and these more or less formed the backbone of the Yes campaign's arguments. The main part of the *White Paper* consists of ten chapters, analyzing various policy areas. All are structured in the same way. First, they analyze the current state of whatever area they cover (economics, health, education, social welfare, democracy, etc.) and the policy limitations that Scotland faces as part of the UK. Second, they set out the policy options that an independent Scotland would have. Third, they lay out the vision of the then Scottish Government of what policies it would pursue, if the SNP got elected post-independence.

Even at first glance, the economy appears to be considered more important than other areas – two chapters (on Scottish public finances and the Scottish economy) are devoted to it, while other areas got one chapter each. But, the full importance of economic arguments becomes apparent when reading the other chapters, because most of them also focus primarily on the economic aspects of their topics. For example, Chapter 8 on the “Environment, Rural Scotland, Energy and Resources” talks primarily about funding for rural development, about agricultural and fisheries policies of the EU and why Scotland has missed out on their economic benefits, about the regulation of the energy market, the impact of rising energy bills on households,

¹⁷⁶ For an analysis of the grassroots of the Yes campaign, see Black and Marsden (2016).

¹⁷⁷ These national myths are nothing new. See Maxwell (2013a) for a criticism of prevailing Scottish myths.

investment in renewables, numerous economic aspects of oil extraction, etc. Similarly, Chapter 4 on “Health, Wellbeing and Social Protection” is focused on funding for pensions, social protection, housing (especially social housing), sports, NHS Scotland (where the report also criticizes the marketization of NHS England), etc.

In general, the arguments are not so much focused on grievances against Westminster, but on how an independent Scotland would be able to build a more prosperous economy and a fairer society. This is contrasted with the current model, in which inequality and insecurity have grown, development is concentrated in London and the South East, the economy is prone to crises, and the government is pursuing austerity. So, the Yes campaign’s arguments can be broadly called left-wing or social-democratic.

Better Together and other No campaigners did run a positive campaign to an extent, arguing that Scotland is better and safer with the UK. But, it was rightly pointed out by many that most of its campaign was negative, that is, arguing that Scotland would be worse off if it left, and that it would at the very least face large risks and uncertainty. This was scornfully called “Project Fear” by the Yes campaign.¹⁷⁸ The Better Together campaign often relied on UK government analyses of the economic effects on Scotland of becoming independent.¹⁷⁹

However, all of these were debates between the campaigners. What were ordinary people concerned about? There is little doubt that the biggest debates ended up being about economics – who would fund pensions in case of a Yes vote, which currency Scotland would use, what economic impact independence would have, whether Scottish public finances would be sustainable in case of a drop in oil prices, could Scotland afford a bank bail-out in the future if it became necessary, and so on. Also, the polls that tended to be most discussed were when people were asked if they would vote for independence if on average they would be £500 per year worse or better off, or if their incomes stayed the same. Curtice (2014a) shows that economic issues, and people’s perceptions of how the economy and they personally would do after independence, did indeed play a decisive role in voting intentions. It is not that other topics, such as the argument that it is undemocratic for Scotland to be governed by parties that it did not elect, were not discussed. They were, and they were important, but still clearly secondary.

¹⁷⁸ Incidentally, this is the same as with Brexit, except there the pro-EU campaign mostly ran a negative campaign, pointing out the risks and uncertainty if Britain leaves the EU. This was dubbed “Project Fear” by the Leave campaigners.

¹⁷⁹ All the documents can be obtained at <https://www.gov.uk/government/collections/scotland-analysis>.

In this final chapter, I analyze three topics related to Scottish separatism. Section 7.1 asks to what extent is Scotland a “typical” separatist region in terms of its economy and its economic conflicts with Westminster, and whether these conflicts are related to the UK’s regional disparities. Based on a critical review of a number of Scottish government’s official documents, as well as some Scottish economic data, I argue that Scotland has a number of atypical characteristics, although it is not an isolated case. Section 7.2 analyzes why ordinary people supported separatism. Is it true that Scottish values are different to English ones? What role did identity, values and class play? To answer those questions, I partially rely on secondary literature, but first and foremost on data from the British Social Attitudes Survey (BSAS) and the Scottish Social Attitudes Survey (SSAS).¹⁸⁰ I argue that all three factors played a role, but that it was the combination of austerity, recession, class and the economic issues brought up in the campaign that were decisive for the support for independence. Finally, in section 7.3 I analyze to what extent the Yes campaign was aware that the cause of relative Scottish economic underperformance is oligopolistic competition, and consequently whether its suggestions for post-independence economic development policies make sense or not. Based on the Scottish government’s documents, a number of texts published by other people engaged in the debates, and several interviews, I argue that there was, in fact, minimal awareness of these issues, and that the policy suggestions were generally off the mark.

7.1 Scotland’s economy and economic conflicts with Westminster

Following the layout from chapter 5, we can ask how developed Scotland is in absolute terms, what its relative position within the UK is, what its trade dependency on its own markets is, the rest of the UK (rUK) and other markets, and whether decentralization has helped or hindered separatism? We will also mention some cases of overoptimism on the part of the separatist movement.

¹⁸⁰ These are considered to be the two most authoritative surveys of their kind for Britain and Scotland. The BSAS includes people from England, Scotland and Wales, but due to the far smaller population sizes of the latter two, it can be taken as quite representative of social attitudes in England.

Absolute level of development

In terms of its absolute level of development, Scotland is clearly highly developed. Scottish Government (2013a) provides a comparison of GDP per capita with a number of OECD countries, where Scotland ranks fairly well (8th place). Admittedly, such arguments, like most others made by the Scottish government, assign a geographic share of North Sea output to Scotland, but even without that, an independent Scotland would still be among the most developed countries in the world. Because of this, no one has seriously posed the question if Scotland could be viable as an independent country. Rather, the question has been if it would do better or worse than it is doing now. In this sense, Scotland's high level of development has made separatism more likely.

Trade dependency

According to Scottish input-output tables, Scotland ran a total trade deficit of around 7.7% of its GVA in 2013. Furthermore, it is highly trade dependent, with total exports amounting to 58% of Scottish GVA, and total imports to 66%. Scotland also ran a deficit with the rUK of 5.5% of Scottish GVA. Furthermore, Scotland is highly trade dependent on the UK, which accounts for 60% of Scotland's imports and exports.

Export numbers for Scotland can also be obtained from the more widely used Global Connections Survey. The export numbers for the rUK are very similar to the ones obtained from the input-output tables (62% of Scottish exports), but the survey also gives a breakdown of exports to the rest of the world into EU and non-EU parts. The EU accounts for 16% of Scottish exports, and the rest of the world for the remaining 22%.

Overall, Scotland is both import and export dependent, and primarily on the rUK. This has been clearly recognized by the Scottish government, and it has always insisted that after independence, Scotland would continue having a single market with the rUK, and that it would also remain in the EU. Its position was also that it would keep the pound in an official currency union with the rUK, insisting that this would be in both countries' interests (Scottish Government, 2013b).

Scotland clearly has a shared characteristic with other separatist movements in being over-optimistic about post-independence trade prospects, in that the UK government insisted that there would be no formal currency union, and that, even in a free trade area, borders do introduce transaction costs. The EU was also giving very problematic signals about Scotland's

potential membership. Countries like Spain were particularly concerned about the effects on their own secessionist movements. The Scottish government was insisting, of course, that post-independence everything would work out, and that an 18-month period would be sufficient to negotiate everything.

The clearly unrealistic nature of the position of the Scottish government was certainly partially due to the fact that that was the only response that could be given by a campaigner insisting that there were no particular risks from independence. Still, one cannot escape the impression that they also to a large extent believed what they were saying. It was particularly interesting that, much akin to Soviet and Yugoslav separatist republics, and Catalonia, Flanders and Northern Italy, the EU was seen as a safe larger market that could be accessed, in case negotiations with the former country do not work out, even though EU membership was not certain either, and even though the EU was the least important export market. Here we are observing how free trade agreements (or a belief that they will materialize) can boost separatist aspirations. A world more closed to trade would have probably seemed riskier.

Decentralization

As regards decentralization, there is little doubt that the devolution in 1999 made the current drive for independence far easier. It would have been much harder for the pro-independence supporters to develop their ideas and organize without official Scottish institutions (see Keating),¹⁸¹ and they certainly could not have had the resources that the SNP control of the Scottish government has provided them. However, as we will see in section 7.2, it cannot be said that the devolved institutions were what drove the call for independence. Their importance must be seen in relation to other factors.

Relative level of development

Scotland is doing relatively well within the UK. It is very close to the UK average on relevant indicators, such as GVA per head, productivity, employment, or disposable incomes. However, this does mean it is doing worse than London and the South East.

Scotland's average level of development relative to the rUK does seem to have influenced its conflicts with Westminster. The Scottish government has never accused Westminster of

¹⁸¹ See Mackay (2009) on how presence in Holyrood has transformed the SNP.

directly underdeveloping or exploiting Scotland. Rather, it argued that Westminster policies have prevented Scotland from doing even better than it has, particularly in comparison to other small European countries. What, according to the Scottish government, did Westminster do that has held Scotland back?

The grievances are that the UK government has: a) never established an oil fund, which is argued is a wasted opportunity to invest and to save for future generations, b) recently pursued austerity policies, including cutting capital spending, whereas the Scottish government thinks that promoting growth is both economically and socially a better option, c) allowed income inequality to grow substantially, d) allowed regional disparities to grow, and focused national economic policies on the needs of the South East and London (Scottish Government, 2013e:26s).

Scotland shares with a number of other separatist regions a desire to gain control over the revenues from an abundant natural resource. However, unlike in most such cases, and in most cases of separatism in general, the Scottish government has not accused the central government of fiscal exploitation, even though it argued that Scotland has been a net contributor to the UK budget over the last 30 years (Scottish Government, 2013c, 2013d). Instead, it mostly stuck to arguing that Scottish finances are sound and would be sustainable after independence, despite the reliance on oil revenues and the volatile price of oil. This is partially because the Scottish government was leading a positive campaign, but it was also likely a tactical move. Namely, it would not have made sense to base too many arguments on Scotland's finances – the Scottish budget at the time of the referendum was in a smaller deficit than the UK one, but in deficit nonetheless,¹⁸² the UK government had just bailed out the Royal Bank of Scotland with cash and guarantees several times higher than the entire Scottish budget (National Audit Office, 2011), and around 15%-20% of Scotland's revenues were estimated to come from oil, with its associated volatility. Unsurprisingly, the UK government focused on these fiscal risks in its counter-arguments.

Another way in which Scotland stands out from other separatist regions is its focus on austerity. In most cases, recessions and austerity contribute to separatism by making richer regions less willing to subsidize the poorer ones, but here we have direct anti-austerity

¹⁸² This is a notional deficit. The Scottish government receives a grant from the UK government and gathers some of its own taxes. It is generally not allowed to borrow, and, thus, its ability to run a deficit is very small. The notional deficit is the difference between what the Scottish government spends and its calculations of Scotland's share of UK tax revenues. See <http://www.gov.scot/Publications/2016/02/3623/0> for details.

arguments, and a desire for full sovereignty so that different policies could be pursued. This specific situation comes partially from the fact that, with the exception of London, there is no *regional* government in the richer UK regions to argue against regional redistribution. Furthermore, local taxation is very low in the UK,¹⁸³ and even for the local taxes that exist, the central government generally collects them and redistributes them back to local authorities. Because of all this, there is very little scope for inter-regional conflicts about redistribution to arise, and for recession and austerity to contribute to separatism in that way. But, the Scottish situation is also specific because there are simply very few separatist movements that talk at all about austerity and the need for investment. Quebec (see Bookman, 1993:108-109) and, to an extent, Slovenia are the two other major examples. There is little doubt that the Scottish government's anti-austerity platform contributed to the popularity of independence in Scotland, given that, prior to Jeremy Corbyn, the SNP was practically the only bigger actor on the UK political scene that was directly against austerity.

The Scottish government has also argued that the cuts to welfare, labor market reforms, and a number of other Westminster (Scottish Government, 2013f) policies have contributed to increasing inequality in the UK, including in Scotland, which it argues is both socially and economically damaging. In this, Scotland is reminiscent of earlier separatist movements in poorer regions of developed countries, often ethnic in nature. But, this should actually be viewed as a part of the Scottish government's generally left-wing arguments for independence. The arguments presented in favor of independence are that an independent Scotland would be a country which offers fair employment conditions, well paid jobs, free healthcare that is not being marketized, and proper social protection.

Thus far, the economic conflicts between Scotland and the central government have been a bit different than in other cases of separatism. But, where Scotland is very similar to most other cases is in seeing Westminster policies, not the operation of markets, as responsible for Scotland's relative economic underperformance. The only partial exception is the unstable financial sector, but even there, the blame was shifted to the UK government for allowing the banking sector to become unstable, so even here, markets escape the blame to an extent.

Like with other grievances, nothing is couched in terms of Westminster policies being directed against Scotland, but as being bad *per se*, or at least not aligned with Scotland's interests. Most importantly, the UK government (Scottish Government, 2014) is said to have

¹⁸³ According to Eurostat and OECD data, around 10% of all government revenue in the UK is accounted for by local governments.

allowed manufacturing to decline more than it had to, which has hit Scotland particularly hard. At the same time, Scotland did not get enough of “its” oil revenues to rebuild its economic base. The UK government is also accused of allowing the banking sector to develop in a risky way. So, the direct benefits and the spill-overs of the growth of the financial sector are concentrated in London and the South East, while everyone suffers from the fallout when crises happen. The Scottish government has also raised an issue that Scottish farmers have not received as much support as they could have from the EU because of how the UK government has negotiated (Scottish Government, 2013f:278). A number of other, comparatively smaller issues, have also been brought up, such as the high Air Passenger Duty, designed with Heathrow in mind, but hampering the growth of airports in Scotland. In all these cases, it is not really analyzed whether it is perhaps the operation of markets that are actually harming Scotland. For example, could Scotland ever become an airport hub, with London not too far away, even if the Air Passenger Duty were lower? Would the oil revenues have allowed a hypothetical independent Scotland to save its industries? Such questions are neither asked nor answered.

It is also interesting to see what arguments the Scottish government has avoided. For example, it did not mention monetary and exchange rate policy being determined by the needs of the financial sector, while perhaps damaging manufacturing, probably because it would have been problematic to simultaneously argue for a currency union and criticize the UK monetary authorities. But, also, the entire thrust of the argument for a currency union is based on a typical optimal currency area analysis – that Scotland and rUK have similar productivity, high trade and migration, and aligned economic cycles. As we will see in section 7.3, Scotland actually needs substantial development policies, and there is no recognition that, say, facilitating trade with rUK may actually be detrimental to Scottish attempts to develop domestic firms.

Not all of the discussed conflicts stem from regional disparities in development. For example, the anti-austerity argument is general, not based on austerity having a worse impact on Scotland. The argument is actually that Scotland is doing somewhat better than the rUK, because the Scottish government has acted to mitigate the impact of the recession and austerity. But, many of the other conflicts do have regional development disparities at their root, because, although Scotland is at the average level of development for the UK (and thus better off than most other UK regions), it wishes to attain the levels of development of the most developed regions of the UK. Still, this desire, and it leading to conflicts, could have arisen at any time before as well. Why now? And, equally, most other regions in the UK would have even more

reason to be dissatisfied with Westminster. So, why has Scotland been the one to pursue independence? The next section tries to answer these questions.

7.2 Identity, values and class as explanations of Scottish separatism

As noted in the introduction to this chapter, many in the Yes campaign argued that Scotland has a distinct identity from England. This identity is conceived primarily in terms of values, where Scotland is argued to be what we can broadly call left-wing. But, is it true that Scottish people differ from the English, and do they at all hold the values ascribed to them? Furthermore, did these values influence people's voting intentions in the referendum? These questions are explored in sections 7.2.1 and 7.2.2. Section 7.2.3 explores the role of class, because we would expect that the sort of arguments that were made would have a different amount of appeal for different classes. Section 7.2.4 offers a tentative analysis of the intersections of identity, values and class in Scotland, while section 7.2.5 argues that the Yes campaign was actually a nation building project.

Note that the entire section 7.2 does not ask whether economic issues – would the Scottish economy do better or worse, whether England or Scotland benefit more from the Union, whether personal finances would be improved or worsened, etc. – influenced voting intentions. Curtice (2014a) has shown that these were the most important immediate considerations. The section is rather trying to ascertain whether the more underlying attitudes of the Scottish people align with what the Yes campaign was claiming, and whether these attitudes made its messages more appealing.

7.2.1 Identity

Let us look first at the claims that Scotland has always had a national identity distinct from England.¹⁸⁴ Like every other nation, the Scottish one has not “always” been anything, simply because nations have not always existed.

In analyzing the emergence of Scottish national symbols, in particular the kilt and its supposed association with ancient clan history, Trevor-Roper (2013) uncovers some of the

¹⁸⁴ Here we are talking about a feeling of group belonging, not necessarily connected to any shared values by members of the group.

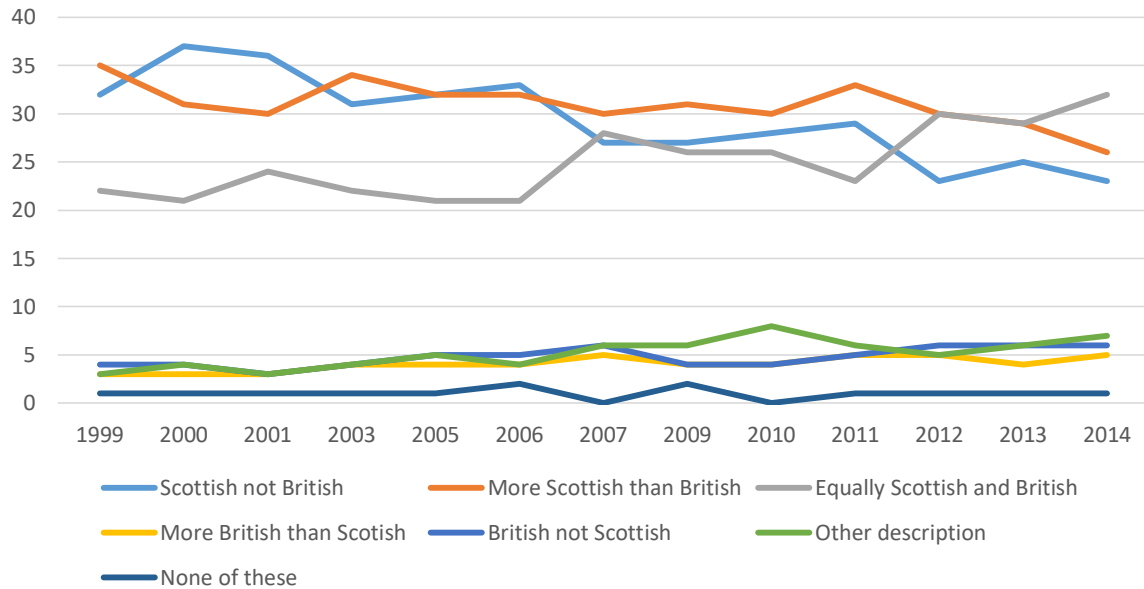
actual history of the emergence of the Scottish nation, and particularly about its class divisions. Namely, after the establishment of closer links with England, and particularly after the Union in 1707, the Scottish lowlands were anglicized to a large extent, in terms of language and culture. The Highlands however, remained outside of these developments. By the 19th century, the view among lowland Scots was firmly established that the Highlands were a backward part of Scotland, and it would have been unlikely for a member of the lowland elite to express that he or she were of the same nation as the Highlanders. Lowland Scots did develop a sense of Scottishness, but as part of the British nation. The relationship to the Highlanders started changing only throughout the 19th century, as numerous Scottish national myths were constructed, creating a glorified Scottish past partially based around mythologized Highland culture. Thus, the idea of one Scottish nation did not exist until well into the 19th century.

This account calls into question the most usual narrative, namely, that a separate Scottish identity has been maintained due to separate institutions – the church, education and Scottish law – that existed before the Union and have been kept after it. This is the position taken by Hechter (1999), and generally also Devine (1999) in their explanations of why Scotland did not get absorbed into the British nation, like most other ethnic groups in Britain were. However, Trevor-Roper's (2013) and Davidson's (2000) accounts offer a different story. Namely, the mentioned institutions did not *preserve* a separate Scottish identity, but helped *create* it, as part of a dual Scottish/British identity, and in such a way that it first encompassed only the Lowlands. Furthermore, if we are talking about a feeling of nationalism, what existed in Scotland was British, not Scottish, nationalism, and, contrary to the public imagination, it also included full participation in empire building. It was generally not until the 1930s that arguments were made about a Scottish nation separate from the British one. Maxwell even notes that many Scottish nationalists were complaining how effectively Scotland was integrated into the British nation and lamenting that Scotland had never been exploited by England, because: "If only history had treated Scotland with a less subtle cruelty, what a lion of a nation we might now be!" (2013c:81).

Today, most Scottish people still express a dual identity. This can be measured on the Moreno scale, which asks people about how much they feel they belong to two identities. Chart 7.1 presents the results for this question in the SSAS from 1999 onwards. As we can see, the sense of Scottish identity is certainly present, but close to 60% of people express some combination of British and Scottish identity. What is also interesting is that the feeling of Scottishness has actually *declined* from 2000 onwards. Thus, not only has the Scottish nation

never existed without its relationship to the British nation, but, if anything, people in Scotland have recently become *more* dual in their identities.

Chart 7.1 National identity in Scotland on the Moreno scale



Source: Scottish Social Attitudes Survey

Did identity play a role in people’s voting intentions? Not all who felt Scottish or more Scottish than British supported independence. Actually, of those who felt only Scottish in 2014, only 50% intended to vote yes, and 31% of those who felt more Scottish than British intended to do the same.

With regards to the mentioned Scottish institutions, we do not have data that splits people according to where they studied, but we do have information about religion. Those who identified with the Church of Scotland were more likely to vote No (59%) than any other religious group. The only other group that came close is “other Christian” (53%), with all others being around 35%. So, it seems that belonging to old Scottish institutions actually makes people favor the Union more, which is in line with these institutions’ historical role in helping create a dual Scottish-British identity.

Overall, it seems that identity does play some, albeit somewhat ambivalent, role in Scottish separatism, but it would clearly be incorrect to say that the separatism revolves around it, and it would certainly be wrong to say that Scottish and British identities are mutually exclusive.

7.2.2 Egalitarian values

What about values? During the referendum debate, as noted, it has been claimed many times that Scotland is more egalitarian and open than England and that it therefore should secede and pursue its own future, unhampered by Westminster policies, and particularly by the Conservatives. Overall, many of these claims have some truth in them, but not nearly as much as one would think based on what many in the Yes campaign were saying.

We can compare egalitarianism in Scotland and England based on several questions in the SSAS and BSAS.¹⁸⁵ For example, the proportion of people in Scotland in 2013 saying that the gap between the rich and the poor is too large was 83%. The number for the UK was 80%. In 2012, 43% of the people in Scotland thought that the government should redistribute income from the better-off to the less well off, while that number was 40% for the UK. In Scotland in 2013 76% agreed that “large numbers falsely claim benefits”, while in the UK (in 2012) this number was 81%.¹⁸⁶ A particularly interesting example are attitudes towards university tuition fees. Much has been made of the supposedly deeply engrained value in Scotland that education should be free.¹⁸⁷ This was particularly brought up in relation to higher education actually being kept free in Scotland, while fees were introduced by Labour in 1998, and have steadily increased since in England. But, in 2013, only 26% of people in Scotland thought that no one should pay tuition fees, while that number was 21% in England.

The comparisons could go on, but on practically every comparable question that measures egalitarianism in some way, there seems to be some difference between Scotland and England, but not nearly enough to argue that Scottish values are fundamentally different than British ones. Even the trends are similar, with, for example, a notable hardening of attitudes towards unemployment benefits in both Scotland and the UK as a whole over the last decade or more. Furthermore, this similarity between England and Scotland is not new. Contrary to popular myths, Maxwell (2013c), a left-wing Scottish nationalist himself, has argued that Scotland has always been as inegalitarian as England, if not more. Finally, it is not evident that Scottish values as a whole can be called egalitarian in some absolute sense, i.e. there are plenty of inegalitarian people.

¹⁸⁵ Both surveys produce a composite left-right index of values. However, it reflects not just egalitarian values, but also things like attitudes towards the death penalty, and thus it would not be useful for this analysis.

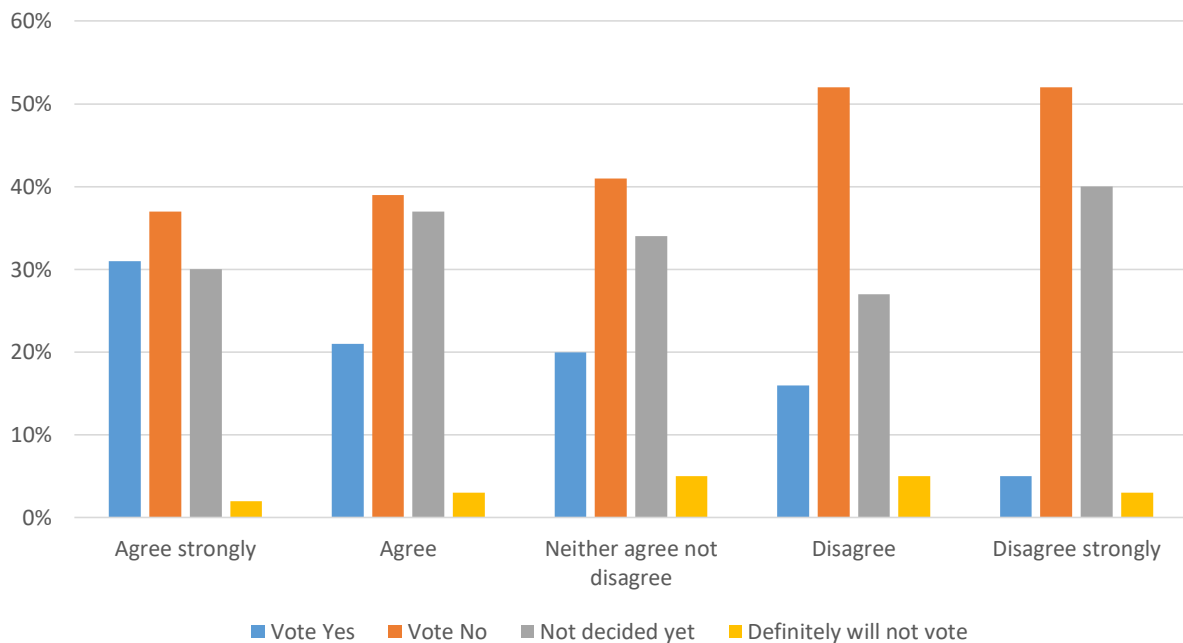
¹⁸⁶ In fact, in 2012-2013, only 0.7% of benefit spending was claimed fraudulently (Cowburn, 2016).

¹⁸⁷ Scottish Government (2013e) even manages to call its section on education “Education in our genes”!

Scotland's openness can be measured by attitudes towards immigration. In Scotland in 2014, 62% of people thought that immigration to Britain should be reduced. In Britain as a whole, this number was 77% (in 2013). Unfortunately, there are no further directly comparable questions between the SSAS and BSAS, but, based on this one, it would appear that there is some truth to the claim that Scotland wishes to be more open. However, saying that Scotland is open and favors immigration is wrong. As for cultural openness and immigration, in 2013 49% of people in Scotland agreed that if more Muslims come to live in Scotland, it would begin to lose its identity, while 37% disagreed. The numbers for East Europeans were 47% agreeing and 37% disagreeing, and for blacks and Asians 43% agreed and 38% disagreed. While we cannot compare this directly to England, the results are not indicative of a very open society, even though the positive attitudes have been increasing over the last decade.

A different matter is how much these values mattered to Yes voters. There are too many questions to list here, but we can give one example. Chart 7.2 shows people who gave different answers ("refused" answer are excluded) to the question "Do you agree or disagree that Government should redistribute income from better-off to less well off?". Within each group, we can look at what percentage of people intended to vote Yes in the referendum. As we can see, the more egalitarian people were, the more likely they were to vote Yes. The same pattern is repeated for practically all other similar questions, although, like in this example, there are always more people who intended to vote No in all groups.

Chart 7.2 Referendum voting intentions of people split into groups based on their answer to the question “Do you agree or disagree that Government should redistribute income from better-off to less well off?”

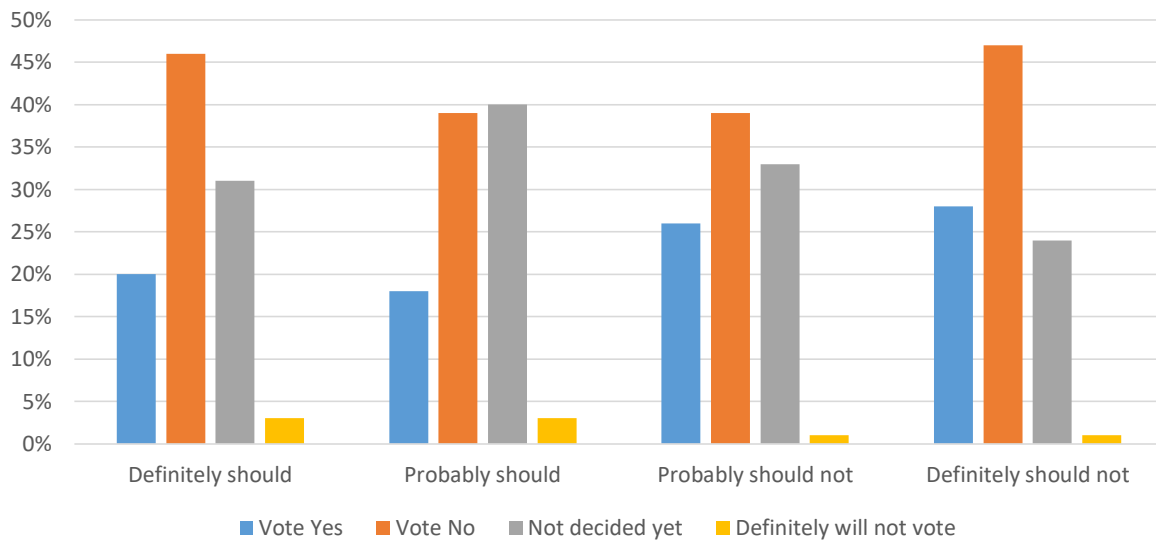


Source: Scottish Social Attitudes Survey

Another argument at the time of the referendum was that Scotland does not want to be taken out of the EU against its will, as it was expected that the Leave vote could win in the EU referendum (as has, indeed, happened). The EU referendum results certainly confirm that Scotland is more pro-EU than England, with 62% of Scottish voters voting to stay in the EU, as opposed to around 45% in all English regions. However, the one exception to this is London, where 60% of people voted in favor of staying (electoralcommission.org.uk, 2016). Thus, Scottish values towards the EU seem to be shared with at least some English people.

How much did the EU matter to Yes voters in the run-up to the 2014 Scottish referendum? In Chart 7.3, people are divided into groups according to what answer they gave to the question “If Scotland became independent should it be a member of the European Union?” (“don’t know” and “refused” answers are excluded), and the bars represent the percentage of people within each group with different voting intentions. What emerges is that those who thought that an independent Scotland should *not* be a member of the EU were more likely to vote Yes than those who thought that Scotland should be a member. This is the direct opposite of what the Yes campaign was arguing.

Chart 7.3 Referendum voting intention of people with different opinions on whether an independent Scotland should join the EU



Source: Scottish Social Attitudes Survey

All in all, there is some truth to the claim that Scotland has more egalitarian and open values than Britain as a whole, and these values have been important to an extent for the Yes voters. However, the values are not nearly as different from English ones as is sometimes claimed, nor where they so decisive for voting Yes or No. And, in the case of being pro-EU, the situation was the opposite of what many in the Yes campaign were claiming.

7.2.3 Class

To finalize the picture of the support for independence, we need to look at its class aspect. A person’s “objective” class depends on her socio-economic situation, while a person’s “subjective” class obviously depends on the individual’s opinion.¹⁸⁸ Table 7.1 classifies the Scottish population into different classes according to a number of definitions, and looks at how each class intended to vote in the 2014 referendum, looking only at Yes and No votes.¹⁸⁹

¹⁸⁸ These two definitions do intersect, of course, but not quite as much as one would expect.

¹⁸⁹ Almost all the remaining voters in all cases were in the “not decided yet” group.

Table 7.1 Class and % of people intending to vote Yes or No

Education	<i>Yes (%)</i>	<i>No (%)</i>
Degree/Postgrad	15	46
Higher education, below degree	24	45
Higher/A levels or equivalent	23	45
Standard grades 1-3/GCSEs or equivalent	22	37
Standard grades 4-7/CSE or equivalent	24	44
Foreign or other	29	38
No qualification	19	38
Income quartile	<i>Yes (%)</i>	<i>No (%)</i>
Fourth quartile	19	46
Third quartile	17	48
Second quartile	22	37
First quartile	27	36
Job hierarchy	<i>Yes (%)</i>	<i>No (%)</i>
Employers, managerial & professional occupations	18	46
Intermediate occupations	21	41
Small employers and own account workers	28	44
Lower supervisory and technical occupations	22	36
Semi-routine and routine occupations	20	41
No classification	23	44
Accommodation tenure	<i>Yes (%)</i>	<i>No (%)</i>
Owner occupier	17	47
Local authority renter	35	33
Housing association renter	25	28
Private renter	18	38
Rentfree/squatting, etc.	31	46

Main economic activity	<i>Yes (%)</i>	<i>No (%)</i>
Education/training full-time	19	48
In work/waiting to take up work	19	40
Unemployed	37	39
Retired	14	52
Other	32	30

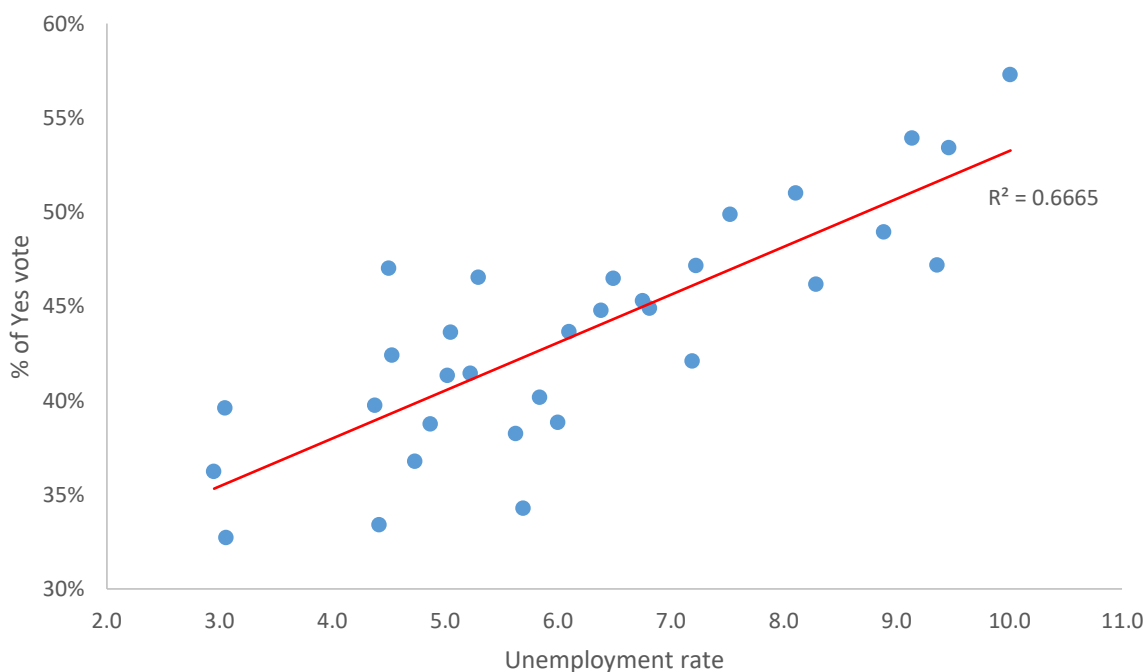
Self-identified class	<i>Yes (%)</i>	<i>No (%)</i>
Middle class	15	55
Working class	24	38
Other	25	42
None	20	42

Source: Scottish Social Attitudes Survey

As is clear, however we choose to define a person's class, support for independence was higher among the lower classes, although according to some definitions, the very lowest classes were not the most inclined to vote Yes. Among local authority renters there were even more people intending to vote Yes than No, and the numbers were almost even for the unemployed. This implies that, while the Yes campaign generally avoided class-based rhetoric, their left-wing policy suggestions seem to have struck a chord with many people who have suffered the most from deindustrialization and the free-market turn in the UK over the last 35 years.

Actual voting patterns confirm this. For example, the percentage of unemployment in local authority areas in Scotland actually correlates quite well with the percentage of people who voted Yes in the referendum, as can be seen from Chart 7.4 below. As Curtice (2014b) also noted, there is very substantial overlap between deprivation in general and the share of the Yes vote across Scotland.

Chart 7.4 Unemployment rates and % of people voting Yes in the referendum¹⁹⁰



Source: a) Office for National Statistics, *M01 Regional labour market: Modelled unemployment for local and unitary authorities* dataset, b) Electoral Management Board, Scotland

The above data shows that class did influence ordinary people’s voting intentions, but no class analysis would be complete without a closer look at capitalists. We can try to ascertain how businesses saw independence, and it would be particularly interesting to see the differences between big and small firms.

MacKay (2014) conducted interviews with 72 business leaders in medium and large enterprises about how they saw Scottish independence. Out of those, 43 saw no or negligible opportunities stemming from independence. Of the remainder who saw some opportunities, only 8 could identify an opportunity specific for their business. In contrast, risks tended to be more specific, although uncertainty was usually picked as the biggest risk. Of the total 72 interviewees, only 7 thought that the opportunities outweigh the risks, and they mostly pointed to general things, such as export support, rather than a specific business opportunity. Overall, the impression is that business leaders thought that independence was not a very good idea. Still, there was a difference between businesses that mostly traded within Scotland, with the

¹⁹⁰ The idea for this chart came from the slides available at <http://www.scottishreferendumstudy.com/publications/>. Unfortunately, for now, the slides seems to be the only output of the Scottish Referendum Study.

rUK, or internationally. Those focused on Scotland and international markets were less concerned than those trading mostly with rUK, although they still mostly saw problems with independence, rather than opportunities. Also, business leaders from smaller medium-sized companies were “the most sanguine about the opportunities” from independence (Mackay, 2014:12).

A survey done by Bell (2014) for the Scottish Chambers of Commerce can be taken as being representative of SMEs, given that its sample reflects the number of businesses, and it shows a very similar picture to MacKay’s interviews. Around half of firms did not see any opportunities with independence, and only around a quarter of firms saw no risks. Firms were also divided into groups according to where they trade the most – within Scotland, rUK, EU, or the rest of the world – and asked to identify the main risk from independence (including choosing no risk as an option). In all groups, around 30% to 40% of firms chose uncertainty as the main risk. But, of firms trading mainly within Scotland, the EU and the rest of the world, 20%-30% saw no risks, while the number for those trading mainly with rUK was only 9%. Similarly, those reliant on rUK markets were more concerned about access to and business links with rUK, where 21% of the firms picked that as their main risk, as opposed to some 10% in the other groups.

From the above studies, it would appear like there was no difference between people running big and small businesses. However, this is probably not true.

First, we know that more small businesses than big businesses are locally oriented (ons.gov.uk, 2015), so to the extent that business issues determined people’s voting intentions, we would expect more small businesses to have supported independence.

Second, we should not forget that individuals do not make decisions only based on their business interests. A survey conducted by the Federation of Small Businesses (Federation of Small Businesses, 2014) shows more or less the same results as the above two analyses when it comes to business concerns, but it also asked respondents whether non-business issues will impact their vote. 57% of respondents said that both business and non-business issues were important, 25% said that non-business issues will be of greater influence, while only the remaining 18% said that only business issues will be important. While we cannot compare this to any information about big businesses – MacKay’s did not ask his interviewees about non-business issues – it does not seem improbable that well-paid business leaders in big firms will not be as personally concerned with non-business issues, such as public services, as a small business owner. If both groups are equally concerned about business risks posed by

independence, but one of them is more open to considering other issues as well, then that other group is likely to be more in favor of independence on average.

This actually squares with the SSAS data in Table 7.1, where we can see that “small employers and own account workers” were the most likely among the social classes defined by job hierarchy to vote Yes (although most still intended to vote No), while “employers, managerial & professional occupations”, which are more associated with bigger firms, were the least likely. But, there is also more indirect evidence of a split between big and small businesses.

Some time before the referendum, an organization called Business for Scotland was formed, to gather small businesses that were supportive of independence. It soon registered itself as one of the official campaigners for Yes. It grew to a self-reported membership of several thousand businesses, and still exists. Conversely, there was no equivalent organization of big businesses in favor of independence. Actually, some large businesses were even campaigning for the No side. For example, Oxford Economics (Oxford Economics, 2014) did a report for the Weir Group and the report was clearly an anti-independence document. Keith Cochrane, the CEO of Weir, was also openly and publically against independence.

Additionally, one of the main business organizations in the UK, the Confederation of British Industry (CBI),¹⁹¹ was ostensibly politically neutral, and maintained formal neutrality in the run-up to the referendum as well. However, CBI was actually warned by the UK Electoral Commission in 2013 that its anti-independence statements were bringing it close to being included under the referendum campaign rules, most importantly the rules on campaign spending. Even more telling is that CBI actually registered with the UK Electoral Commission as an official No campaigner in April 2014. A scandal broke out, due to CBI’s supposed neutrality, but they managed to deregister (which is possible only under limited circumstances), claiming that an unauthorized CBI staff member in London made a mistake. Iain McMillan, the director of CBI Scotland, CBI’s Scottish branch, resigned, supposedly unrelated to the incident (Carrell, 2014a).¹⁹²

Finally, the Better Together campaign almost at the very start received significant donations from several important business leaders in Scotland (Gordon, 2013), while several weeks

¹⁹¹ The Confederation of British Industry does not represent only big firms, but they are certainly heavily represented.

¹⁹² I attended a lecture by Iain McMillan at the University of Dundee on March 19th, 2014, as part of its 5 million questions initiative. There was absolutely no doubt that McMillan was personally opposed to independence.

before the referendum, 133 business leaders, whose companies employed around 50,000 people, signed a public letter to argue against independence (Carrell, 2014b). It is not that no big business leaders supported independence – for example, Michael O’Leary, the CEO of Ryanair, and Willie Walsh, head of International Airlines Group, the owner of British Airways, were supportive because the Scottish Government said that it would reduce and eventually scrap the Air Passenger Duty (Bennett, 2014). But, these were clearly the exceptions.

What this entire section suggests is that class was right at the center of the independence debates. Keating (2014) did recognize the importance of class in Scottish separatism, but many other commentators seem to have missed it. McCrone (2013) and Brown (2014), for example, talk about the likely effects of independence or staying in the Union on poverty and inequality. However, the root causes of these things cannot really be understood if the powerlessness of the poor and unemployed is not recognized, i.e. if class is not explicitly brought in. McCrone does not discuss class, while Brown, expectedly,¹⁹³ approaches it in the circumscribed New Labour fashion. Curtice, basing his conclusions on a regression model, notes that social class, sex and age, were not significant independently of considerations mostly related to the economic questions of independence, concluding that “gender, age and class differences ... simply reflect differences between these groups in the incidence of identity and/or perceptions of the consequences of independence” (2014a:59). Perhaps this is so statistically, but from the perspective of social structures, it is turning things on their head – it is not class that reflects perceptions of economic issues, but the perceptions that reflect class. The importance of class cannot be dismissed just because a regression model says it can be.

What happened during the referendum debates was that the SNP and the Yes Campaign could represent secession as a way for some classes to improve their situation (even though their rhetoric was not couched in class terms),¹⁹⁴ and the reason they could do that was because the UK’s industrial decline, free-market turn, inequality and regional disparities hit right along class lines throughout the country, including in Scotland. Simultaneously, the resistance of some others to secession, in particular business leaders, cannot be understood except in relation to their class interests. In a nutshell, Scotland provides as clear evidence as possible that separatism is inextricably tied to class.

¹⁹³ Gordon Brown, the former Labour Prime Minister.

¹⁹⁴ It is, of course, a different matter how realistic the SNP’s platform was. This will be discussed below in section 7.3.

The analysis in this section also allows us to assess the two most well-known predictions about Scottish separatism, namely, those by Hechter (1999) and Nairn (1981). Hechter, in the first version of his book, argued that Scottish separatism would likely arise among the lower classes, due to their internal colonial position. But, in the preface to the second edition, he said that he may have been wrong, because Scotland was not as much of an internal colony as Wales and Northern Ireland, and that the separate identity maintained through the presence of Scottish institutions (the church, legal profession and education) meant that separatism would more likely arise among the middle classes. Nairn argued that a Scottish capitalist elite, desiring more success and bolstered by the prospects of retaining oil revenues, would lead the Scottish working class towards secession, much like anti-colonial movements were composed of elites leading ordinary people.

Neither author seems to have been completely right or wrong. An analysis done by Keating (2006) shows that in 2003 the majority of SNP, Scottish Greens and Scottish Socialist Party MSPs – the three major separatist parties in Scotland – had higher education and none had major work experience in blue or white-collar¹⁹⁵ occupations. This indicates that, like Hechter predicted, the locus of the separatist leadership is in the middle class. However, as we saw from the SSAS data, these middle-class separatists are not representative of their class, and the Yes campaign's appeal was higher among the lower classes. This then resonates with Nairn's predictions, but where Nairn was wrong is that there is no leadership of the separatist movement by the Scottish capitalist elites. Quite the contrary, big business is strongly against independence. This is much akin to the capitalist classes of semi-peripheral countries, such as in Latin America and Eastern Europe, who are well integrated into global supply chains, and do not seem to have a large desire to develop their countries. To the extent that the Scottish separatist movement has a basis among capitalists, it seems to be a basis in a (minority) part of the Scottish petty bourgeoisie, which perhaps sees greater potential for its own development from the sort of policies that the SNP was proposing for an independent Scotland.

7.2.4 Intersection of class and economic issues in the vote

Economic issues were dominant in the referendum debates. But, were they what people finally based their votes on? Furthermore, how did they interact with class?

¹⁹⁵ Here, white-collar excludes professionals.

Post-referendum polls, such as by Lord Ashcroft,¹⁹⁶ provide some information on this. Asked to pick two or three issues that were the most important in determining their vote, the most common choices for Yes voters were “disaffection with Westminster policies”, picked by 74%, followed by the “NHS” at 54%, and “tax & public spending” at 33%. For the No voters, the “pound” was picked by 57%, and the “NHS”, “tax & public spending”, “pensions”, and “defence & security” were all picked by around 30%-40%. Unsurprisingly, only 4% of the No voters picked “disaffection with Westminster policies” as an important issue. Few people in both camps picked benefits, jobs, the EU or oil as important issues. We can make some inferences from this from these results.

First, economic issues (dissatisfaction with Westminster policies revolved primarily about economic issues in public debates) and a concern for public services played the decisive role for Yes voters, while economic insecurity about the period after a potential Yes vote played a big role for No voters. Second, given that most people in Scotland are employed and do not receive benefits, the small number of people who picked jobs and benefits as important issues indicates that people were probably thinking mostly about the economic impact of independence on themselves and their close ones, not about the impact on other people.

As for the influence of class, the Lord Ashcroft poll divides people into four socio-economic groups – from highest to lowest, they are AB, C1, C2 and DE. The lower groups were more concerned about public services (NHS) and pensions, and less about bigger questions, such as disaffection with Westminster. Interestingly, of the DE group, 44% of people voted Yes, which is the second lowest share after the AB group at 40%. (In the two middle groups, around 50% of the people voted Yes.) This seems to indicate that the perceived risk of independence for public services played an important role for the worst off in Scotland, and is consistent with some of the SSAS data in Table 7.1, which shows that in some cases, the very lowest classes were less enthusiastic about independence than those who were somewhat better off.

These conclusions about the importance of economic issues, and the biggest role of class in how they are seen, accord with the historical patterns in support for Scottish secession.

The SNP, as the major flag-bearer of Scottish separatism, has existed since the 1930s. Electorally, it was completely negligible until the mid-1960, when it climbed to about 5% of the Scottish vote in general elections, and in 1970 it won 10%. But, in the February 1974 general election it jumped to 22%, and in the October of the same year it got 30% and 11 MPs, its best result for the next 40 years (Mitchell, 2009). However, support for independence seems

¹⁹⁶ Available at <http://lordashcrofthpolls.com/2014/09/scotland-voted>.

to have been very small at the time. We do not know what it was in 1974, but only a few years later, in 1979, it stood at a mere 7% (McCrone and Paterson, 2002). It is very unlikely that some sort of large swing happened in just 5 years. Even support for devolution was relatively low. In the 1979 referendum on devolution, the pro-devolution option won by only a small margin of 51% to 49% (Dewdney, 1997).¹⁹⁷ Instead of independence, what seems to have been responsible for the SNP vote was their “It’s Scotland’s Oil” campaign, namely, a promise that Scotland would use the revenues from North Sea oil and gas to bring prosperity.

McCrone and Paterson (2002) show that support for independence rose steadily from 1979 over the subsequent decades, until it came to around 30% in 2000 (where it has hovered since). What changed in 1979 was, of course, the advent of Thatcherism, with its devastating effect on the lower classes, particularly through the decline of manufacturing.¹⁹⁸ McCrone and Paterson argue that the relative support among different classes stayed mostly the same throughout this period, but their data does not actually support this. Table 7.2 shows the percentage of people in different classes who supported independence. As we can see, support for independence rose much more among the lower classes than among the higher classes, and the most in the skilled manual group, which is the one hardest hit by the decline of manufacturing.

¹⁹⁷ With a voter turnout of 63%, less than 40% of total eligible voters voted in favor of devolution, which was the other condition that had to be fulfilled apart from a majority vote in favor. The referendum was therefore repealed.

¹⁹⁸ We should be careful not to perpetuate myths here, though. Namely, there is an extremely powerful myth in Scotland that Scotland has always been against the Conservatives. This was completely deconstructed by Torrance (2009b). He showed that the Conservatives were actually quite popular in Scotland up until the Thatcher economic reforms started biting, with Thatcher personally being popular until then as well. Even in the 1980s, a section of the population continued supporting the Conservatives. For example, those who could afford to buy their council houses at hugely discounted prices due to Thatcher’s right-to-buy policy were quite satisfied with this opportunity. The long-term effects on egalitarianism seem to have been quite a remote consideration for them. Also, like in England, there was a jump in support when the Falklands war started. All that being said, though, there is little doubt that the economic reforms that the Conservatives did in the 1980s hugely reduced their popularity in Scotland in the long-run, and increased the support for parties that offered different policies. Still, political fortunes change – at the moment (March 2017), the Conservatives are the second biggest party in Holyrood, ahead of Labour, and the second most popular party in Scotland according to most polls (after the SNP).

Table 7.2 % in each class who supported independence

<i>Employment class</i>	<i>1979</i>	<i>1992</i>	<i>1997</i>	
			<i>(devolution referendum)</i>	<i>1997/1979</i>
professional	7	5	25	3.6
intermediate	8	19	25	3.1
routine non-manual	8	19	30	3.7
skilled manual	5	30	48	9.6
semi-skilled manual	8	30	49	6.1
unskilled manual	8	34	54	6.7

Source: Adapted from McCrone and Paterson (2002)

Throughout this time, the SNP had consistently argued that an independent Scotland would use its oil wealth in a way that serves the people, but also more generally attacked the major Westminster parties, including New Labour, for being right-wing. After 1999, it insisted that more devolution, particularly fiscal, was the only way to ensure increased spending on public services in Scotland (Cuthbert and Cuthbert, 2009). In 2007, the SNP managed to form a minority Scottish government, and in 2011, after being the only party with a direct anti-austerity platform, it formed a (slim) majority one. And, as if to further underscore that the biggest allure of independence for ordinary people in Scotland seems to be potential economic prosperity, the SNP led a pro-independence campaign in which around 60%-70% of people (in this case with (un)surprising similarity across classes) were consistently saying that they would vote No if independence would make people £500 worse off per year on average. Conversely, if it would make people £500 better off on average, than in general the lower classes tended to be more in favor than the higher ones (according to data from the SSAS).

So, it seems clear that economics issues, seen through a class prism, have played the biggest role in increasing support for independence in Scotland over the last several decades, and have had the biggest influence on how people actually voted in 2014. Perhaps the most important implication of this is that it is regional disparities that are the main underlying factor generating

support for Scottish separatism. Independence became most appealing to the lower classes, only after they were hurt by the decline of Scotland's industrial base, by the failure to rebuild around new economic sectors, and by other free-market reforms. However, these disparities were enough to create widespread support for separation only when combined with a recession and austerity. Given the evidence, it seems very unlikely that anything else would have been sufficient.

7.2.5 The Yes campaign's nation building project

Even if (personal) economic issues and class structure played the biggest role in the rise in support for independence, is there still some truth in the arguments about the existence of a Scottish identity, centered around egalitarian and open values?

To answer this, we can intersect the various questions on identity, values and class. Reporting all these results would take up too much space, so instead we can give a general comment. The picture that emerges is that Scottish identity, egalitarian values, and low class tend go together.¹⁹⁹ However, neither a stronger Scottish identity, nor low class, go with more openness or pro-EU stances. For example, those with an "only Scottish" identity (or "only British" for that matter) are significantly more anti-EU than anyone with a mixed identity. The lower classes are also generally more anti-EU, with one exception – "small employers and own account workers" were more anti-EU than those below or above them in the social hierarchy.

This shows that those on the Yes side talking about a combination of openness, egalitarian values and a Scottish identity were not actually representing Scotland, not only because plenty of people in Scotland do not even hold those values, but because there seem to be fairly few people whose attitudes align along *all* these lines simultaneously. What seems to have been happening is that some on the Yes side, whether they were aware of it or not, were engaged in a project of nation building to support the secessionist drive. They were trying to create a Scottish national identity based on all the values that they themselves held, and they did that by arguing that such an identity already exists. The Yes campaign even designated an external enemy of sorts, namely, England and the UK government. These are all the typical hallmarks of nation building projects. Of course, promoting civic nationalism, egalitarianism and openness is a much better nation building project than most separatist engage in, but it is still

¹⁹⁹ Of course, there is no complete overlap, but rather a tendency.

a project based on consciously or unconsciously stretching the truth, and it still runs the danger of branding those who do not fit into its vision as less worthy.

Furthermore, while class was apparently an important factor in the appeal of independence, the Yes campaign did not employ class-based rhetoric. This was partially a tactical attempt to not antagonize businesses. But, I believe it is indicative of something else as well, namely, that the Yes campaign was at best moderately leftist. Ignoring the class structure of society means ignoring power and oppression, which is not something a supposedly egalitarian movement should do.

7.3 Prospects for Scottish economic development

The neo-liberal economic reforms over the last 40 years, and the cut-back and then shift in regional policies, have made secessionism in the UK more likely. But, ironically, at least in the case of Scotland, the hegemony of neo-liberal ideas has simultaneously narrowed down the economic vision of the separatists sufficiently to make their policy suggestions for post-independence economic development essentially flawed. The arguments here do not relate to immediate matters, such as forecasts of the price of oil and Scottish public finances, but to the basic underlying ideas of the SNP economic strategy.

We noted before that Scotland is highly developed, but various Scottish government documents (Scottish government, 2010a, 2013b, 2013c, 2013d, 2013e, 2013f, 2014) correctly recognize that things are not as good as macroeconomic aggregate numbers alone suggest. Scotland's business density is the second lowest in the UK (see Table 6.11). According to ONS data, business R&D as a percentage of Scottish GVA is around 0.7%, one of the bottom three UK regions, and several times below OECD leaders.²⁰⁰ Scotland runs a trade deficit. Its public finances are almost always in deficit. They are also dependent on North Sea oil & gas revenues, which add, depending on the prevailing prices, between £0 and £10 billion pounds per year to the Scottish budget,²⁰¹ thus exposing Scotland to significant risks. The documents also

²⁰⁰ Excluding London, but, as IPPR argues, the type of innovation that service sector firms do can be very important, but is not captured by R&D expenditure or patent information. Therefore, London's business R&D of 0.5% of its GVA almost certainly understates London's innovativeness.

²⁰¹ At the maximum, according to Government Expenditure and Revenue Scotland, this accounts for a full 18% of the budget revenues.

recognize that more can be done to extend firms' supply chains in Scotland. All of this is consistent with the patterns of regional development in the UK (apart from the oil sector providing significant benefits to Scotland).

The Scottish government blames Westminster policies for this situation. It also believes that, despite the problems, Scotland has numerous strengths, and if given full sovereignty, it could build on them and become more prosperous. I already argued that, while government policies are important, it is oligopolistic markets that are the key factor behind UK's regional disparities. However, none of the Scottish government documents recognize this. Unsurprisingly, the analysis of what are deemed Scottish strengths and the development policy suggestions are then also off the mark.

The strengths that Scotland has are said to be a number of growth sectors, a skilled workforce, natural resources, world-leading university research, and a strong global brand. Acceptable evidence is provided for most of these claims, except for the most important, namely, growth sectors. Scottish Government (2013e) identifies life sciences, the creative industries, digital and ICT, oil & gas, food and drink, renewables, low carbon industries, manufacturing, financial and business services and tourism as sectors in which Scotland has strengths and which can bring prosperity to the country. It seems these sectors were picked mostly by how big a share of the Scottish economy they account for, and how fast the entire sector, or the sector's exports, are growing. This is acceptable as a first pass analysis, but there is no further examination of the market structure of these sectors. Thus, we do not know, for example, how dominated these sectors are by foreign companies, what their supply chains are or what competitive hurdles Scottish companies in them face (such as technological gaps or their power within global value chains). The underlying idea seems to be that, with the right policies and institutional framework, achieving success in promoting these sectors will happen, albeit it might not be quick and easy. So, what are these policies?

According to the vision of the Scottish government, Scotland would leave the UK, but retain very close links with the rUK, particularly maintaining the free flow of goods, services, capital and people. It would keep using the pound as part of a formal currency union. It would also stay in the EU. Within such a macroeconomic and institutional framework, the Scottish government would use a number of policies to foster development. It would first gain powers currently reserved for Westminster, such as taxation, welfare, or setting the regulatory framework for businesses, and then endeavor to create effective coordination between these new powers, and the ones it already has, such as in higher education.

A lot of suggestions are general and revolve around this better coordination, but more concrete suggestions have been made too. They include, for example, cutting the corporation tax by up to 3pp in order to attract businesses and counteract the pull of London and the South East, setting up institutions to foster cooperation between universities, the public sector, and businesses on innovation, offering capital allowances for R&D investment, coordinating training and employment policies with the private sector, setting up a Scottish Development Bank to fund manufacturing SMEs, preventing market concentration through better control of M&A activities, and a number of others. A whole paper is devoted to how such policies could more specifically help Scotland reindustrialize (Scottish Government, 2014). All of these are effectively typical new paradigm regional policies, for a country that would be a region integrated with the rUK market, and part of a wider EU market.

As discussed in previous chapters, there are issues with such suggestions. For example, some of MacKay's (2014) interviewees noted that a few percentage points difference in the corporation tax would be very unlikely to trigger a transfer of activities to Scotland, or to make firms stay there if they suddenly found themselves in a different jurisdiction to their 10 times larger rUK market. Besides, what the Scottish government did not discuss was that Scotland would naturally be competing with Ireland on taxes, and that is a hard thing to do. More importantly, Ireland has one of the most "competitive" tax systems among the OECD countries (Bilicka and Devereux, 2012), but according to OECD data it has, for example, one of the lowest R&D investment rates. So, it is at least questionable whether giveaways to corporates stimulate them to establish local innovation networks.

Still, there is one situation in which the sort of suggestions that the SNP government was making could potentially work. If Scotland got lucky like Nevada did, striking on a sector that is not yet oligopolized, then perhaps the sort of suggested business support could help Scotland come out on top in the competitive struggle. However, the mentioned sectors are not like that. We can use the video games industry as an example.

The video game *Grand Theft Auto V*, made by Rockstar North, a video games studio in Edinburgh, was released in September 2013. Less than a month later, Guinness World Records confirmed that it broke no less than seven world records, including: best-selling video game in 24 hours, fastest entertainment property to gross \$1 billion, fastest video game to gross \$1 billion, highest grossing video game in 24 hours, and highest revenue generated by an entertainment product in 24 hours (Lynch, 2013). Specifically, *Grand Theft Auto V* grossed over \$815 million in the first 24h after it was released and \$1 billion in 3 days. By May 2014, it had grossed nearly \$2 billion (Thier, 2014). Even before this staggering success, but certainly

after, the video games industry has been brought up as a growth sector for the Scottish economy.

However, the video games market has little to do with how it is ordinarily imagined. Due to the relatively low barriers to entry, combined with the rise of digital sales over the last 5-10 years, there is an enormous entrepreneurial sector of small firms and start-ups, pushing each other's prices down, and jockeying for players' money. Many companies do not last and most of the few that become really successful get bought up by the market leaders, sometimes for astronomical prices. At the other end of the market, there are a few global leaders. The global market is growing very fast, and is currently valued at around £100 billion, of which the top 10 companies (which are diversified, and make their own games, publish other companies' games, organize e-sports events, etc.) account for about 25% (UKIE, 2017). Rockstar North is actually one of several studios owned in the UK by Take-Two Interactive, a giant American video games corporation.

A NESTA (2014) report on the UK video games industry puts things into perspective. Scotland accounts for 5% of all video game companies in the UK. London and the South East account for around 50% (and also house most major corporations' headquarters). This is the geographic distribution *after* the industry has become more evenly spread across the UK since the 1980s. Edinburgh and Dundee are among the 20 or so hubs of video games companies in the UK, but they are, for example, less consolidated (have more firms with fewer employees) than the hubs in Cambridge or Oxford. Now, as things stand, Scotland is not doing badly in the video games market, but if it wants to create a step-change in its position, at least some of its companies would have to become market leaders in at least some market segments (distribution, middleware software, publishing, design etc.), all of which are already dominated by global leaders. Alternatively, Scotland would have to convince some of the existing leaders to place more of their development activities, or their headquarters, in Scotland. There is little reason to believe that the sort of policies proposed by the Scottish government could do either.

Of course, this is just one sector, but in July 2014, I had a conversation with a high ranking official from Scottish Enterprise.²⁰² Of all the potential "high-growth sectors", the official could only think of tidal wave energy and digital health and wellbeing in old age as not yet being oligopolized. Scotland actually has a lead in the former.²⁰³ In the same interview, it was noted that Scotland has a number of "second-tier" successful domestic companies, but very

²⁰² The conversation took place on July 23rd, 2014, in Glasgow.

²⁰³ Scottish Enterprise has a strong program of support for tidal wave energy.

few “first-tier” ones, and that Scottish Enterprise is keenly aware of how difficult it is to get such “first-tier” companies to integrate into the Scottish economy.

This brings us to the main point of this section. Namely, it has not been recognized at all by most actors that the underlying cause of Scotland’s underdevelopment is the nature of oligopolistic markets, nor that the policy space that an independent Scotland would have – limited as it would be by EU state aid rules and free trade, by whatever restraints would be imposed because of the agreements Scotland would have with the rUK, and by the inability to use monetary policy for development due to a currency union²⁰⁴ – is simply insufficient for more radical development policies that Scotland would need to develop sectors other than the above mentioned two non-oligopolized ones. It is not impossible that independence would have some positive effects. The same interviewee noted, for example, that the UK government does not try to stretch EU state aid rules, like most other EU members do, and that representatives of Scottish Enterprise are often informally encouraged by people in the European Commission to push their policies as far as they can. Perhaps with an independent Scottish government more could be done. But, it seems unlikely that there could be any fundamental changes.

Separatists in the business community also do not seem to completely realize the power of oligopolies. Of course, they are fully aware of the importance and power of big firms simply because they are so unavoidable in business activities, but they do not necessarily see the full implications for regional development, and are also not immune to making a mistake and thinking that an economic sector is not oligopolized, where in reality it is massively so. For example, in 2014 I conducted an interview with Ivan Mackee,²⁰⁵ at the time director of Business for Scotland, and a very experienced businessman. He agreed that it was difficult to enter sectors that are already dominated by market leaders, and agreed that EU state aid rules do impose some unwanted restrictions, but thought that Scotland should build clusters where it has advantages and possibilities for future growth. Tidal wave energy was brought up as an example, but so were video games. Also, Mackee fully recognized that Scotland needed to build up stronger domestic supply chains, but the suggestions for how to do that were the same as those generally made in new regional policies – improving location factors, such as skills availability.

²⁰⁴ In an act of even greater anti-developmental folly, the Scottish government insisted that it would unilaterally use the pound, if the rUK did not agree to a currency union. This would put even more restraints on its ability to use monetary policy.

²⁰⁵ Interview conducted on July 21st, 2014, in Glasgow.

Interestingly, even commentators on the left do not seem to fully appreciate how markets actually work. Many people associated with the Jimmy Reid Foundation, and their Common Weal project, do advocate taking independence further than the SNP government was arguing for, for example by introducing a Scottish currency (for example, Cuthbert and Cuthbert, 2012). But, they simply do not reflect at all on the question of market power of big firms and the challenges that Scotland – independent or not – faces because of them.²⁰⁶ Actually, Paterson (2014) is the only article I have been able to find that talks about the policy constraints that an independent Scotland would face by being a member of international trade organizations and the EU.

Just how striking the lack of economic understanding is can best be seen if we compare the current situation with 35 years ago. At the time, the SNP had its left wing, called the 79 group,²⁰⁷ named after the year in which it was formed. Stephen Maxwell, one of the group's members, wrote a pamphlet in 1981 setting out some of the groups positions. On the economy, he wrote:

... Scotland today has many features of a 'neo-colony' ... The decline in Scottish manufacturing, the slow growth of Scottish services, the progressive takeover of Scotland's firms and natural resources by foreign capital, the integration of Scotland's financial institutions into an international system in which Scotland features chiefly as a location for high-yielding energy investments – all these are among the symptoms of a chronic sickness in the locally controlled private sector of the Scottish economy. The Scottish private sector is simply no longer large enough or independent enough to serve as the basis of a revived Scottish 'mixed' economy. Scottish controlled manufacturing firms now supply only 12% of total Scottish employment. Small firms will certainly have an important role in Scotland's economic revival but they cannot carry the burden of economic reconstruction. In any case without a determined policy of state support, the most successful of the small firms would succumb to takeover bids by multinational companies determined to defend their market dominance. Scotland's economic revival, therefore, depends on a major extension of the public sector in the form of improved public services, increased public finance for industry conditional on the adoption of co-

²⁰⁶ The pro-UK side of the debate also never considered the issue of oligopolies when arguing that Scotland benefits economically from being in the Union. See, for example, McCrone (2013), Brown (2014).

²⁰⁷ See Torrance (2009a).

operative ownership and other forms of industrial democracy, and public control of Scotland's financial institutions ... (Maxwell, 2013c:94).

Some in the 79 group, Maxwell included, were also advocating for an independent Scotland to not join the European Community due to the policy constraints it was imposing on its member states.

The 79 group was influential in the 3 years until 1982 when it was expelled from the SNP. (Most of its members, including Stephen Maxwell and, more notably, Alex Salmond, were later readmitted to the party). The group never managed to move the SNP towards becoming a radical party based on worker support, but the very fact that such debates were being had, where at least some people had a thorough understanding of how capitalism functions, is telling.²⁰⁸

Fast forward to today, and even leftist supporters of independence in Scotland do not have a word to say about oligopolies, nor about the need for heavy-handed interventionism if Scotland wants to have an economic revival. The SNP, in the meantime, is proposing that no monetary sovereignty is the best policy choice, it would never talk about neo-colonialism, the problems of foreign ownership, or the need for interventionist industrial policy, and is imagining capitalism as being based on SMEs, as well as on generally benevolent big firms that admittedly might need some incentivizing to help Scotland develop. Most people do not seem to see anything particularly problematic with this situation.

Perhaps Maxwell's own arguments prior to the 2014 referendum illustrate best this tectonic change in thinking. In *Arguing for Independence* Maxwell (2012) sets out a number of "cases" for supporting Scottish independence, including an "economic" one. His general economic case rests on a greater feeling of self-responsibility that independence would provide, the knowledge and experience that would stem from having Scottish state institutions, and the fact that the government of an independent Scotland would be more far more focused on Scotland's needs than current British ones. As more concrete arguments, Maxwell offers a few examples, such as greater oil revenues accruing to Scotland, the possibility to make public savings by getting rid of public-private finance initiatives, better fishing rights negotiations, reduced defense expenditures, the ability to set an own immigration policy, building off-shore renewables, and

²⁰⁸ Nor was the 79 group alone in this. For example, the left-wing of Labour, "Bennite" Labour, which briefly had tentative control over the party from 1979 to 1983 had leaving the EU in its policy manifesto, precisely because of the constraints it imposed on the ability to lead industrial policy. They also recognized the role of oligopoly in the economy. Indeed, Stuart Holland was one of the prominent members of Bennite Labour.

aligning education, welfare and other policies with economic needs more efficiently than can be done under the devolution arrangement. It has to be said that his analysis is much more careful than most similar analyses, but there is simply no inkling of the kind of analyses he offered 30 years earlier. The power of multinational corporations is not mentioned, how to counter it is not discussed, nor is the need for an industrial policy examined. There are passages in his book that suggest that Maxwell was consciously refraining from a more radical analysis,²⁰⁹ possibly in order to have a wider appeal. Even if that is the case, it is still quite indicative of a shift in political thinking, particularly so in comparison to the 1981 Maxwell who seemed to realize that for independence to actually matter for improving Scotland's economy and building a fairer society, it would have to come with an understanding of how capitalism functions and with policies built on this reality.

It is ironic that the neoliberal shift which Scottish separatists have been opposing for so long has managed to mold most of them in its own image, and to at least significantly affect even the most radical of them.

²⁰⁹ Particularly when discussing the “social” case for independence, which is underpinned by a class analysis.

8. Conclusion

This thesis has attempted to connect an analysis of regional development and separatism, and then apply it to the case of Scotland and the UK. Let us summarize the arguments on the three topics in turn.

Regional development

In chapter 2, I defined economic development as structural transformation – entering advanced sectors of the economy (mostly manufacturing and knowledge-intensive services), which have high potential for technological and organizational upgrading and consequent productivity increases. The benefits of such increases – higher consumption and investment, more free time, economic diversification, economies of scale – are useful in themselves, but also have positive feedback effects on productivity, creating a virtuous circle.

Since most production goes on in firms, the generation of this virtuous circle has to be explained by reference to their behavior. It was shown that the virtuous circle is inseparable from the size of firms and the way that big firms compete. Competition forces firms to upgrade their technological and organizational capabilities. Such upgrades give firms various competitive advantages, but since they require significant investment, they also increase firms' size, and size itself confers further competitive advantages. The effects of this process of ever increasing firm size are such that smaller firms are easily outclassed by larger competitors. Oligopolistic markets emerge, split up among a few large firms that can withstand each others' competition.

The emergent large firms, due to their size, have a greater need for stability. They therefore avoid competing against each other on prices, since price changes can easily disrupt business plans. Instead, they compete through oligopolistic non-price competition – the use of new resources, the creation of new products and improvements to existing ones, reductions in costs, the opening up of new markets, and so on. This competition can be fierce, but it is also routinized and generally predictable, and therefore suitable to the needs of large firms.

Here the link between oligopolistic competition and economic development becomes clear. It is oligopolistic competition that today produces what we call economic development – improvements in technology and organization and the consequent productivity increases, diversification, the achievement of economies of scale, improvements in the quality of existing

products, and a host of other effects beneficial to the broader society. Of course, as discussed, not all the effects of having oligopolies are good, nor does development stem only from oligopolistic competition, but its central importance in economic development cannot be understated.

The flip side of this analysis is that economies that do not have such large firms are less developed and face significant obstacles if they try to develop – to do that, they would have to enter the same sectors of the economy that are already dominated by established market-leading firms. This is an almost impossible prospect. Recognizing that, a number of countries have employed activist industrial, technological and trade (ITT) policies and have managed to help their domestic firms become competitive and have become developed in the process. This has not worked in all cases, but it is the only type of policies that have allowed late-developers to catch up.

The above analysis was compared to a more common understanding of firms, which I called the standard theory of the firm. According to this understanding, there is a limit to how big firms can grow, and large firms are generally considered to be less efficient than small ones. Such small firms are also conceived as competing through prices, and thus markets are seen as operating through the price mechanism. Development policies based on this understanding of firms and markets, however, have generally had disastrous effects.

In chapters 3 and 4, this analysis was adapted to regional development within countries. It was shown that, just as different countries can be at different levels of development, so can regions within a country. Rich regions have large concentrations of big market-leading firms, which provides them with numerous benefits such as high employment and salaries, economic stability or employment for people with high qualifications. Poorer regions either lack successful large firms, or house the lower value-added activities of the market-leaders from the richer regions. For poorer regions to develop, they would either have to build up their own market-leading firms or they would have to attract substantial investment into advanced activities from established market-leaders. Neither possibility seems likely to happen – the former because the power of market-leading firms is felt at least as strongly, if not more, within countries as between them, and the latter because the location factors drawing firms to richer regions are simply too strong to counteract easily.

Regional development policies have attempted to help poorer regions. In comparison to the development policies employed by countries, the main difference is that there are a number of tools that cannot be used – trade protection and exchange rates being the most important

examples. Particularly given how important trade protection has been for late-comers, these limitations are actually a large hindrance.

Old paradigm regional policies, employed generally until the 1980s and the 1990s, relied heavily on trying to attract investment by big firms to poorer regions, primarily through various financial incentives. They have had some success in generating jobs in the poorer regions, but have generally failed at stimulating firms to establish more advanced activities there. Additionally, as firms got more opportunity to invest in poorer countries, the relative attractiveness of marginally cheaper labor and financial incentives available in the poorer regions of rich countries went down.

New paradigm regional policies have had two focuses – one is on entrepreneurship and stimulating the formation of SMEs in the poorer regions, and the other is on cluster policies.

The first focus has been shown to rest on flawed ideas about how firms and markets function – this approach to regional development often does not recognize that development is sector-specific, and it certainly does not see development as being inseparable from big firms. Regional policies in poorer regions that support entrepreneurship and SMEs should thus be seen effectively as welfare payments in a different guise. They have virtually no chance of effecting structural transformation, although they may have the effect of increasing living standards while they last. Thus, they should not be compared to other development policies, but to welfare policies. I suspect they would come out worse in such a comparison. For example, they are not given based on needs and their duration for individual beneficiaries is limited. Besides, they implicitly perpetuate the notion that the way out of underdevelopment is through individual effort, not collective action.

The cluster policies are more realistic in their assessment of where development comes from, in the sense that they recognize that development depends on having advanced sectors of the economy. The importance of key investments by market-leading firms is also often recognized. In the context of regional development in poorer regions, cluster policies are mostly focused on improving their location factors in order to attract investments in advanced activities by big firms, the idea being to then link up those firms to local SMEs, thus embedding them firmly into the regional economy.

However, cluster policies have their problems too. Martin and Sunley (2003) have analyzed very well a number of them. The concept of clusters itself is poorly defined, empirically problematic, and of questionable analytic and policy usefulness. On an immediate practical note, many poorer regions proclaim that they have the basis to build clusters in very advanced sectors of the economy, which is a highly questionable proposition. It has also been pointed

out that poorer regions compete and even undermine each other in their attempts to attract investment and create clusters. But, the most fundamental issue that is missed too often is this – even if it can be shown that clusters (however defined) are important for a certain industry, what are the chances of a poorer region creating clusters when competing against richer regions? Where are market-leading firms more likely to choose to embed and link up with other firms?

The implications for regional development and regional development policy of a focus on oligopolies can be summed up thus: there is no escape from the harsh realities of capitalism, no safe place where the rules of the game do not apply. The concentration of production in a few market-leading firms, and their consequent market (and political) power, is a defining characteristic of capitalism, which always has to be kept in mind. If at any point we lose sight of it, chances are that we will end up with incomplete analyses and inadequate policy suggestions.

This paints a very bleak picture of poorer regions. Without severe curbing of what established market leaders are allowed to do, firms from poorer regions basically do not stand a chance in competition against them. Similarly, from the perspective of attracting advanced investments from established firms, poorer regions are in a bad position. Having regional economic strengths is first and foremost a consequence of having won in the competitive game in the past, but poorer regions were the losers, not the winners, and there is very rarely a chance for a rematch. Such are the rules of the capitalist game. From this perspective, arguments such as IPPR North (2012:96) makes – “It is easy to highlight the structural weaknesses of the northern [English] economy; its industrial legacy and heavy manufacturing base have continued to shape the recent fortunes of its workforce and its economic outlook. But its industrial past also provides something of a launchpad for a more sustainable future” – are revealed for what they unfortunately are: an overly optimistic assessment of a dismal situation. Capitalism creates and perpetuates inequalities of all sorts, between individuals, classes, firms, regions and entire countries. A positive outlook is not sufficient to counter this. To actually reduce any of these inequalities we cannot work *with* markets, but need to use concerted political action to work *against* them, all the while not losing sight of the fact that this would also inevitably involve class conflict.

Note that this does not mean that every single poor region is doomed to underdevelopment. Just like occasionally a poor individual is blessed by a stroke of luck and gets rich, so too the stars can align for a region, like they did for Nevada. Also, occasionally a region may succeed in getting substantial inward investment in advanced activities, when the interests of market

leading firms happen to coincide with the interests of a region seeking investment. Thus, none of the presented arguments mean that no poor region will ever develop. But they do mean that the majority will not. Regional policy making is too often focused on describing successful regions, with the hope of somehow copying what they did. It would be advisable to also look at all the failures – it would then be revealed that what may have differentiated the successful from the unsuccessful cases was luck.

I have generally refrained from making policy suggestions in this thesis, because the focus was on understanding the problem of regional underdevelopment, not on solving it. The analysis of regional underdevelopment is meant as one of the building blocks for the subsequent analysis of separatism, and for this purpose it was enough to explain why poorer regions are poor and likely to remain so. But, here I will make one general suggestion.

We need to resist the urge to see the silver lining where there is none. There is no reason to assume that regional policy-makers and academics interested in regional studies are any less competent or committed than policy-makers and academics in other areas. And yet, for more than half a century, they have been trying to help poorer regions develop, with very limited success. Compare that to the massive successes of post-WWII development policies in a number of formerly poor *countries*, such as South Korea. Thus, paradoxically, it is possible that the best course of action for regional policy-makers is to first admit their impotence, to say that they will do their job, but that they know they will fail, not because of any inability, but because of the constraints they are operating under. This would not entail giving up on doing whatever can be done to mitigate the consequences of regional underdevelopment. But, it might help refocus attention in the right direction, namely, towards a struggle to change the constraints themselves. This would add an additional task for academics, namely, to better explain the underlying causes of regional underdevelopment, to suggest appropriate changes to the institutional framework of capitalism, and to identify the forces that would be opposed to them and suggest how they can be tackled.

How likely it is at the present time for fundamental changes to happen in how capitalism is governed is open to debate. Furthermore, there is the issue of how much a single country could do. The power afforded to capital in the current international trade and investment framework is very substantial. Still, it may be better to try to effect some changes rather than simply accept the situation as it is. However, for now, we can probably safely assume that regional disparities will continue to characterize virtually all capitalist countries for the foreseeable future. The implications for separatism are not good.

Separatism

I argued that many separatist movements are driven substantially by inter-regional and center-region economic conflicts, which are largely rooted in regional development disparities. The prime example are conflicts about fiscal redistribution between richer and poorer regions, but, as chapter 5 has shown, numerous others can and do emerge as well. If regional disparities persist, as in all likelihood they will, then there will always be a potential for separatism to emerge on economic grounds.

As I further argued, separatism cannot be understood without seeing it through a class prism. Actually, in terms of methodology, a class framework is indispensable. Just like losing sight of oligopolies leads to incomplete economic analyses, so too ignoring class leads to misunderstandings of the political economy of a society. In the case of separatism, a classless analysis makes us imagine common interests where there are none and it easily focuses our attention on the supposedly homogenous characteristics of regional populations, such as culture, language, religion, ethnicity or nationhood, while we ignore the actual struggles for economic and political power of different classes. Put more succinctly, ignoring class makes us do bad social science.

The use of a class-based framework enables us to see that in a situation with wide regional disparities, class divisions are also regional divisions – on average, the lower classes are more concentrated in the poorer regions, while the higher classes are more concentrated in the richer regions. As I have shown, in the context of separatism this is a particularly explosive situation if there is a prolonged recession and austerity measures. The lower classes bear the brunt of their costs, making them susceptible to separatist propaganda, which tends to promise a better life to them. More commonly, it is the higher classes in the richer regions who become particularly unwilling to fund transfers to the lower classes, which in the described situation means an unwillingness to fund regional transfers. The fact that separatist arguments are often couched in nationalist terms should not make us blind to the fact that they strike right along class lines – their potency cannot be understood without this fact. What is more, as I have argued, separatism can emerge even when there are no national differences, and nations are anyway a social construct, so they can be reshaped.

The fact that the contribution of recessions and austerity to separatism have not really been recognized too much in the literature is probably due to the fact that advanced capitalist countries have not had a prolonged recession or stagnation since the 1930s. But, at least in the EU today, we are approaching almost 10 years of austerity, low growth and high

unemployment, with the unemployment, of course, being concentrated among the lower classes and generally being worse in the poorer EU member states. It is no coincidence that we have seen a massive rise in separatism.

First, we have rising separatism in entire (primarily rich) countries. Interestingly, and not unexpectedly, the Brexit referendum has shown that support for leaving the EU comes mainly from the lower classes – they have been told that their own situation would improve if the UK leaves the EU. It does not matter that such claims are of questionable veracity, seeing as how they have been made by right-wing, pro-market parties that are not exactly known for fighting for the improvement of the position of ordinary people. What matters is what people believe.

Second, we have seen a marked rise in regional separatism within countries. Scotland is a somewhat specific case, but the other examples – Flanders, Northern Italy and Catalonia – are clearly richer regions within their countries. As argued in chapter 5, in Catalonia the class basis of the support for secession is more complex and interlinked with ethnicity, but the effects of the recession and austerity measures in Spain have clearly played a decisive role in the rise in support for secession over the recent years. In Scotland there is clear support from the lower classes for leaving the UK. Ironically, this is the same situation as with Brexit, except that in the case of the Scottish referendum, it was the UK that was blamed for the misfortune of the lower classes, while in England it was the EU.

There has been no secession in the homelands of democratic core capitalist countries since the Irish secession in 1922.²¹⁰ But, what the above analysis implies is that developed countries can be susceptible to separatism, given the right conditions. And, at least in the EU, for the time being austerity seems to be the entrenched policy choice, and it will continue hitting European society along class lines. With the massive regional disparities between EU member states, and within many of them as well, more and more conflicts between countries and of regions within countries are likely to emerge.

At least in the case of Catalonia, we should not underestimate the potential for violence. The Catalan president has announced that Catalonia will hold a binding referendum on independence in September 2017, with or without the consent of Madrid (Berwick and Cobos, 2016). If this actually happens, and the result is pro-independence, the situation could get extremely problematic, both due to the ethnic and class divisions within Catalonia and due to how Madrid would react. The Catalan government would have to start creating an independent

²¹⁰ And Algeria in 1962, if we count it as a part of home French territory, which is, at the very least, a questionable proposition.

state, which would mean stopping to pay its contributions into the Spanish central budget, setting up a central bank, a separate army, and so on. Madrid would have to respond to this in some way, say by cutting Catalan banks from the payments system and freezing assets in Spain of whomever it sees as a tax debtor. What if the Catalan government seized assets belonging to Madrid that are in Catalan territory as a response? Is it really unimaginable that, at some point, one of the sides would decide to use force to assert some of its claims? In a multi-ethnic environment charged with nationalist propaganda, and with half the Catalan population not even supporting independence, is it really unimaginable to think that things could get out of hand? This is not an argument that violence will necessarily happen – indeed, I think it is far more likely that it will not – but it would be a grave mistake to think that these sorts of developments are reserved only for the Balkans, the Soviet Union, or some other non-Western part of the world.

United Kingdom

Finally, what about the UK? Its poorer regions were in a precarious position even before 1979. The Thatcher government reforms then dealt them a blow from which they have not recovered. The optimistic outlook maintained by some regional policy-makers seems unwarranted, and is more reflective of the sometimes very subtle dominance of neo-liberal ideas than of the actual regional situation.

The UK leaving the EU is unlikely to afford it the policy space to pursue more activist regional policies, given that at the very least the UK will still be bound by WTO rules. But, apart from that, for the time being, the political situation is such that it is hard to imagine where the drive for more radical policies could come from. Certainly the Conservative party cannot be expected to become more interventionist. The Liberal Democrats are also not particularly interventionist, and are anyway unlikely to ever govern on their own. Jeremy Corbyn's leadership of Labour is fraught with difficulty, and an attempt to more decisively push the party to the left, including in regional policy, would potentially lead to an eerie replay of the 1983 split in Labour. Besides, it is questionable whether the role and the extent of the power of oligopolies is truly realized even by Jeremy Corbyn and his team. The first-past-the-post electoral system, firmly entrenched for now, is likely to prevent any other party apart from these three from becoming electorally important. Finally, any notion that the regional problem can be solved in some bottom-up way is simply incorrect. Thus, it seems it is highly unlikely that there will be a major shift in policy-making in the UK any time soon, so the UK's poorer

regions are likely to continue being underdeveloped, and the consequent regional/class divisions will continue providing the potential for separatism to emerge.

We could ask why similar developments to the ones in Scotland have not happened in other parts of the UK, given that many of them have been economically at least as hard hit as Scotland over the past several decades, but without an oil sector to mitigate the effects. It is only here that identity, long-existing Scottish institutions, and particularly the devolved administration (and the Scottish Office before it), come into play. The long-existing Scottish institutions allowed a dual national identity to be formed, which made it much easier for politics to be imagined at all as separate from Westminster. The devolved administration allowed secessionist interests to coalesce and organize. These possibilities do not exist in the English regions.

But, of course, identities can change, and regional institutions can be formed. As a matter of fact, perhaps a joke, but nevertheless telling, an online petition (Stu Dent, 2014) was started before the Scottish referendum in 2014, for the North of England to join Scotland if it secedes. The reason given was that “The deliberations in Westminster are becoming increasingly irrelevant to the north of England. The northern cities feel far greater affinity with their Scottish counterparts such as Glasgow and Edinburgh than with the ideologies of the London-centric south. The needs and challenges of the north cannot be understood by the endless parade of old Etonians lining the frontbenches of the House of Commons.” The petition quickly gained some 5,000 signatures, which exploded to 40,000 after the Conservatives won the 2015 general election. It is true that the electorate in the North East resoundly rejected a devolved North East assembly in a 2004 referendum, but, then again, the first devolution referendum in Scotland in 1979 also returned a No result.

In the same vein, but this time on the side of the richer regions, immediately after the Brexit referendum. some media published articles saying that London should leave the UK (Baxter, 2016).²¹¹ There was also an online petition (O'Malley, 2016). A humorous one, but currently (March 2017) with about 180,000 signatures. A few years ago, in 2014, a poll showed that 20% of Londoners think that London should be independent (Moore-Bridger, 2014). On a more serious note, right after the Brexit referendum we witnessed demands from the one devolved administration in England, London, for increased autonomy, given that they saw their (economic and other) interests as different to those of the rest of England (Crerar, 2016).

²¹¹ For a more critical take on this idea, see Moore (2016).

Ironically, while the Coalition and later Conservative governments' austerity policies have made separatism more likely, the Conservatives' antagonism towards regional institutions, and the abolishment of the RDAs, has probably made sure that there would be no strong regional institutions in England – apart from, for now, the devolved London administration – around which separatist interests could form. But, we should not think that there is no potential for such developments in the future. New institutions can be formed, and the case of Northern Italy shows that even minor regional institutions (the regional councils there do not hold much power) can serve as a locus of separatism. Northern Italy, together with Sverdlovsk, the separatist Russian region discussed in section 5.3.2, also shows that a distinct national identity is not a necessary prerequisite for separatism.

The regional problem in the UK, the recession and austerity measures, combined with class divisions, have been a key factor in increasing support first for devolution and then for independence in Scotland. The Brexit referendum also clearly reflected the stark class and regional divisions in the UK. Finally, there has already been a call for a second independence referendum in Scotland (Carrell, 2017), which, if it happens in 2019, would make it the third separatist referendum in the UK in just 5 years. Economists sometimes quip that predicting is hard, especially when it is about the future, so I do not wish to make any predictions. Still, the UK must be setting some sort of new international record in terms of its output of separatist referendums per year.²¹² It does not seem impossible at all that separatism could emerge within England as well at some point in the future. The political map of the British isles might well change significantly within our lifetimes.

One sometimes hears that the sort of class-based analyses and criticisms of big capital that were common on the left in the post-WWII period no longer apply, that somehow the world has moved on. This view is even held to a large degree by those who otherwise reject such end-of-history thinking, which is shown by the fact that even when conflicts are acknowledged in society, it is often assumed that they can be solved through better communication and cooperation. It is very rarely acknowledged that direct confrontation between mutually incompatible interests must also sometimes take place, and that in such cases there have to be winners and losers.

This thesis has hopefully shown that nothing has really changed since more radical analyses were being made. Class is as salient as ever, and big capital is at least as powerful and callous

²¹² Although neither the UK nor any other country are likely to top former Yugoslavia and the Soviet Union in this contest.

about other people's interests as it has always been. If anything, from the 1980s onwards, capitalism has become more brutal than before. This applies not just to the UK, but to most of the world. Perhaps it is time we stop treating a victory by the powerful as the *status quo*, and try changing some of the institutional setting of the economies we are living in. Only then will we be able to significantly increase the chances of regional equalization through the development of poorer regions, and thus significantly reduce at least one potential source of separatism, with the consequence of reducing the chance of human suffering when regions secede or states dissolve.

Contribution of the thesis and potential future research directions

In the thesis itself, I have focused on setting out a coherent argument, combining existing work with my own original research without spending too much space on signposting what exactly is novel, apart, obviously, from proper referencing. Thus, at the end, a brief reflection is required on this. This also provides a good opportunity to note some possible future research directions.

Chapter 2, on economic development, the role of big firms, and development policies, does not offer any arguments that have not been made before in the literature. Nevertheless, the connection between development and big firms is severely neglected, and thus bringing it back into the debate is important. This is particularly the case when we compare this understanding of development with, for example, the very dominant Human Development Approach (Sen, 2001), which severely underplays the importance of economic growth and structural transformation (Nolan and Sender, 1992). However, even in much of the traditional development economics literature the link between development and big firms is not sufficiently appreciated. For sure, authors such as Amsden (1989) are an important exception, but, in general, development economics tends to focus more on macro phenomena and industrial policy, not on firms and market structures. This is a completely valid approach for many purposes, but not always. For example, the concentration of production in global value chains, with every part of the value chain being dominated by global market leaders (Nolan, Zhang and Liu, 2007a, 2007b), means that we need to question some of the typical conclusions and recommendations in traditional development economics. Just one of many consequence is that moving up the value chain in some sector over time, with substantial state support along the way, is no longer as valid a strategy as it used to be for late-comers, because even the lower

parts of the value chain in many sectors are now extremely oligopolized and not easy for new entrants to break into. But, the only way to learn this is to look more closely at firms and market structures. A macro analysis will likely not suffice.

Chapter 3, on regional development, has contributed to the literature in several ways. For one, the situation with ignoring the importance of firms and oligopolistic market structures is even more pronounced in regional development than is the case with development in general, and the need to bring this analysis back into the debate is even greater. One of the contributions of the chapter is that it does precisely this. The other is that it has shown that an understanding of regional development disparities that is grounded in an understanding of oligopolies is at least as valid today as it was several decades ago when authors such as Stuart Holland and François Perroux made their arguments. The fact that their insights have mostly been forgotten, or, in the case of Perroux, disconnected from an understanding of oligopolies, is a great loss to the literature on regional development, which needs to be remedied.

The novel arguments in chapter 4 are those related to new paradigm regional policies and, of course, to Nevada's development. With regards to the former, they have not been assessed against the backdrop of oligopolistic markets. This is probably due to the fact that his kind of analysis went out of favor during the neoliberal reforms of the 1980s and 1990s, before new paradigm policies really started becoming applied. With regards to the short case study of Nevada, that is a novel attempt to understand why some poorer regions may have managed to develop based on their own, indigenous efforts, despite all odds. To my knowledge, defining the characteristics of newly emerging sectors that can be the basis for indigenous development of poorer regions, and the conditions that need to be fulfilled for such development to take place, in particular some form of internal trade protection, has not been done before.

This is also one of the possible future directions of research. I have only been able to identify Nevada as an example of a poorer region within a developed capitalist country that has managed to develop a successful indigenous economic sector. It is certainly possible that there are other cases, current or historical ones, that should be included, albeit there cannot be many of them – otherwise, we would not have pronounced regional problems. A more systematic and comparative approach to analyzing successful indigenous regional development in poorer regions could yield very useful policy lessons. In similar vein (although this has not been discussed in the thesis), a comparative study of regions or countries that have managed to attract substantial external investments into advanced activities could prove useful. The focus should be in particular on whether the success was based on luck (e.g. a unique location, or political

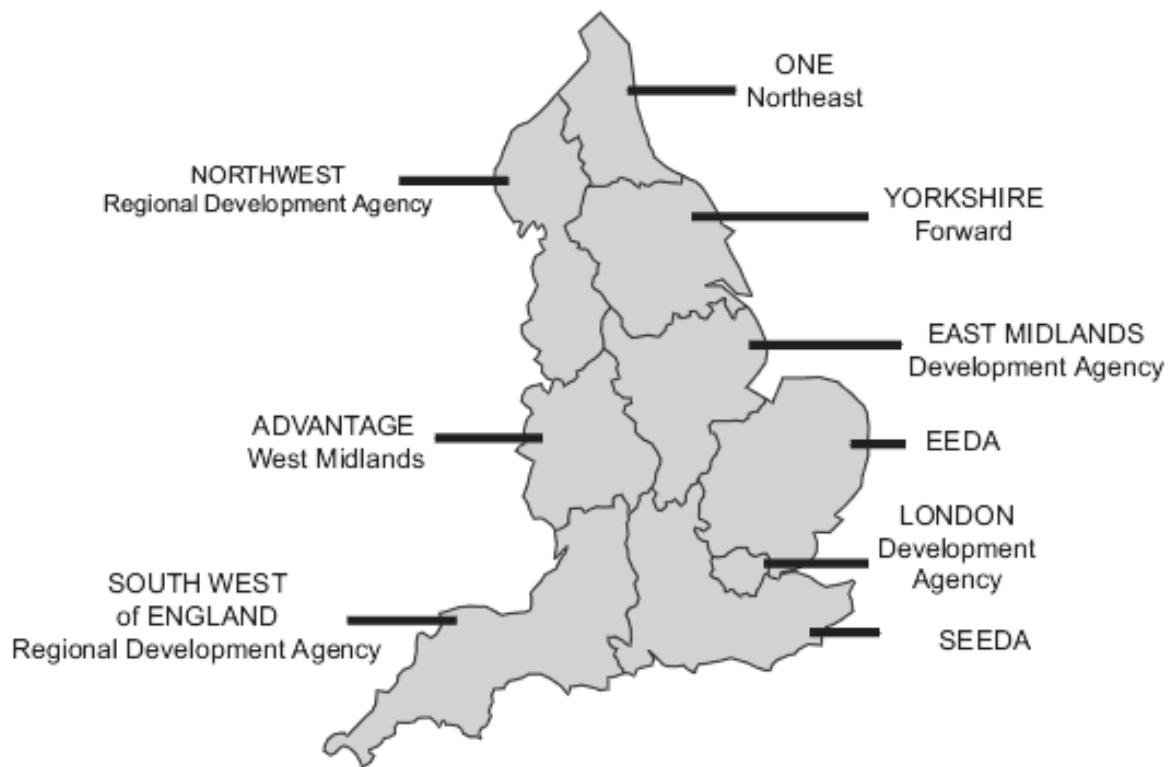
context), or on something that the regions or countries did. My expectation is that luck played a bigger role, but that is something to be empirically determined.

One of the novel contributions of chapter 5 at the more general level is the linking of the literature on regional development with the (limited) literature on the economic bases of separatism, thus showing that capitalist market integration both binds regions within countries together through the flow of goods, services, people, and capital, but also creates powerful forces that can pull regions apart. In Marxist terms, one could call this a dialectical movement. At a more concrete level, the chapter offered a novel class-based analysis of separatism, tied the use of nationalist propaganda to class and economic interests, and also explored the role of recessions and austerity in contributing towards state dissolution. Very little work has been done on these topics. They would thus offer fruitful areas of future research. For example, a more systematic and comparative analysis of the effects of recessions and austerity on destroying the institutions for managing internal economic conflicts would be a very interesting research undertaking, and so would a broader comparison of the class-basis of support for secession, covering a larger number of countries.

The contributions of the final two chapters mirror those of the preceding chapters, except they do so in much more detail for the case of UK regional development and the Scottish separatist movement. Perhaps the biggest contribution of chapter 6 is the analysis of new paradigm regional policies, of EU regional policies, and of cluster policies and regional banks, from the perspective of market structure. A few exceptions notwithstanding, there is very little work done from this perspective. Most of these topics could be fruitfully extended, for example, by combining a sectoral and regional analysis at a higher level of detail than I have done in the thesis.

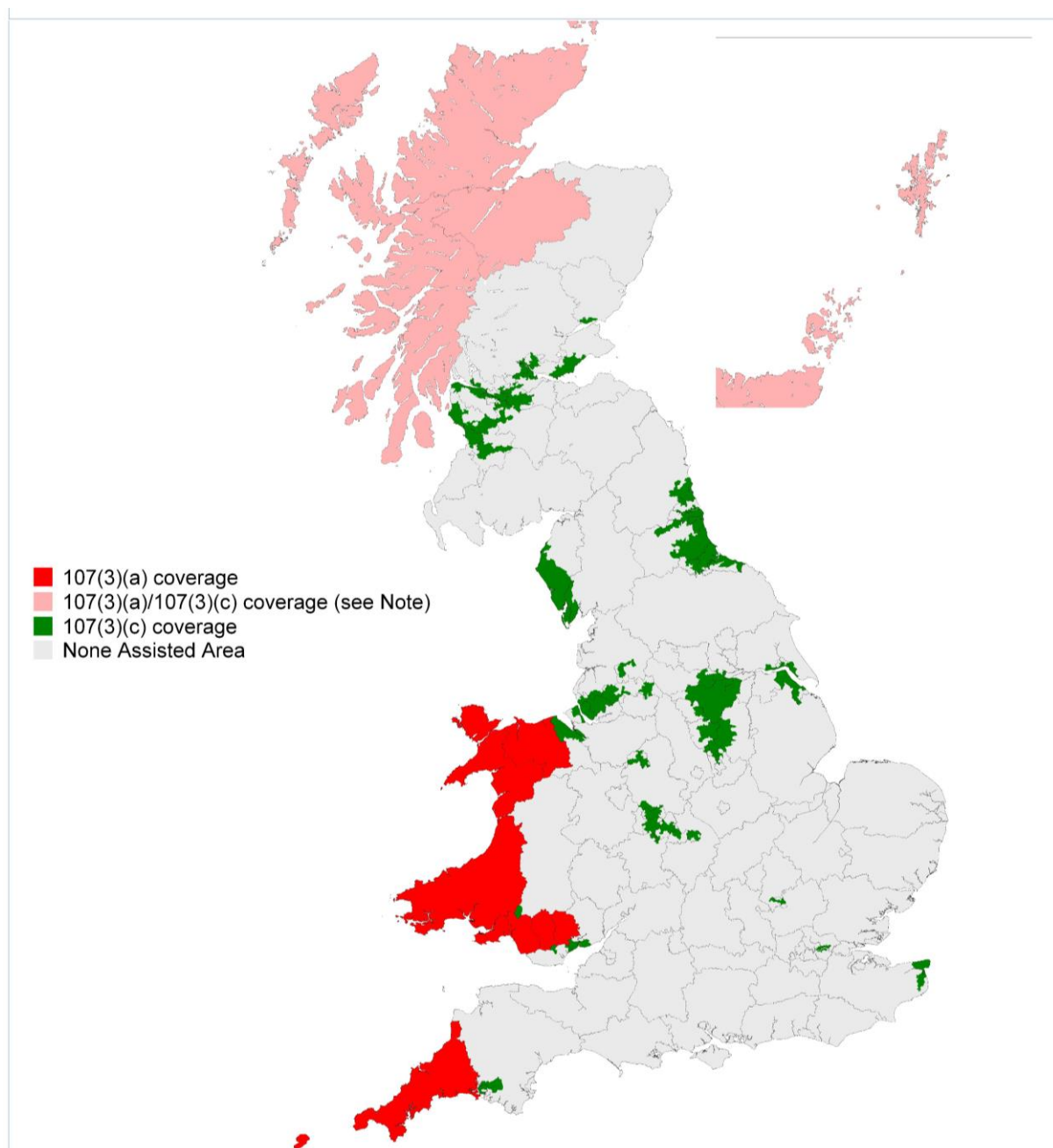
As for chapter 7, arguing for the centrality of class, in relation to recessions and austerity, for understanding Scottish separatism is to an extent a novel contribution. Also, apart from Paterson (2014) and the Scottish Socialist Party, no one has pointed out the constraints on policy space that would be imposed on Scotland if the SNP government's proposed economic policies and free-market agreements with the rUK and EU would be put in place for an independent Scotland. Similarly, I have not been able to find anyone whose analysis of Scotland's post-independence economy is underpinned by an understanding of oligopolies. The same type of analysis could be applied to numerous other cases of separatism.

Appendix A – Regional development agencies map



Source: <https://www.publications.parliament.uk/pa/cm200809/cmselect/cmberr/89/89we135.htm#note239>

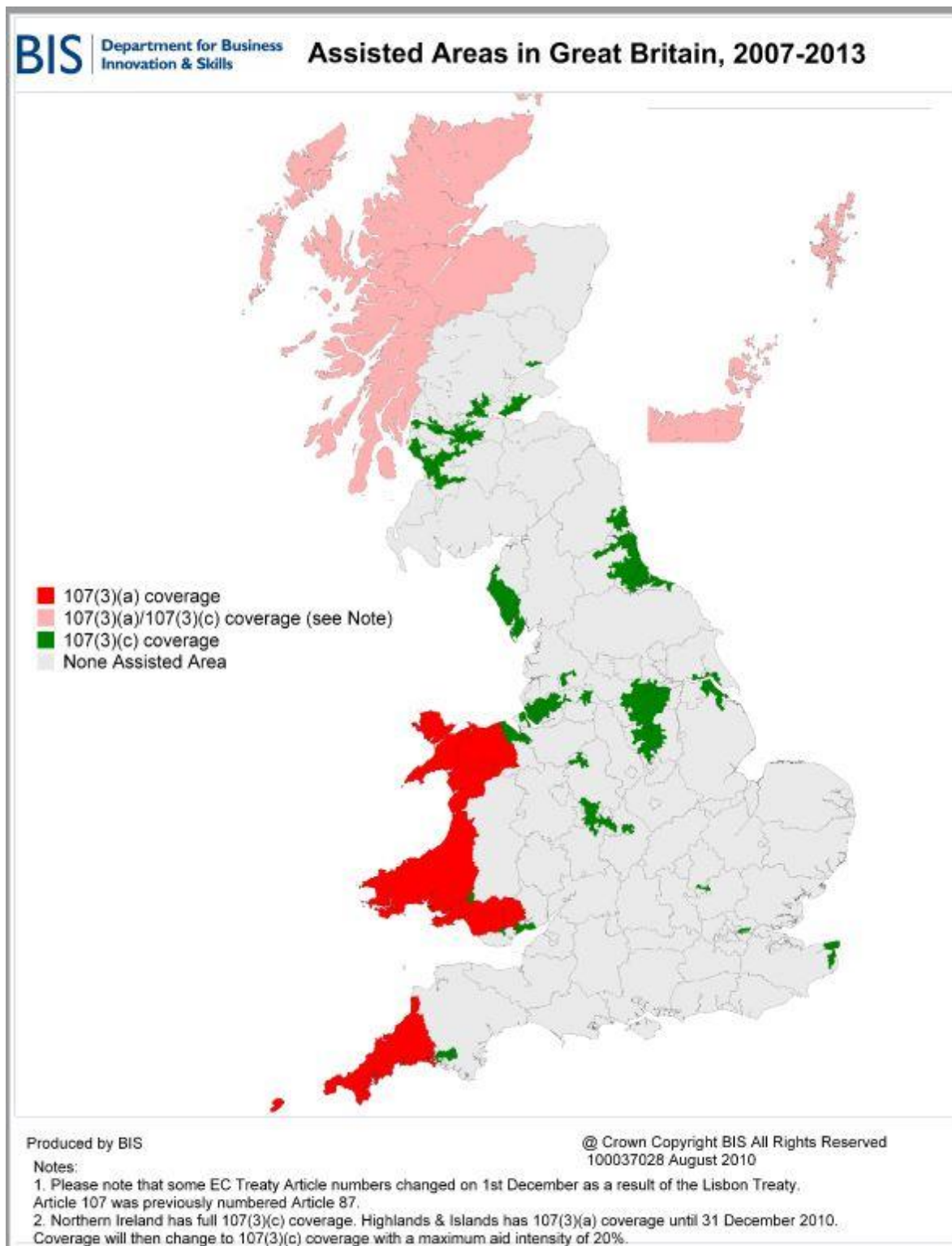
Appendix B – Assisted areas 2007-2013 map



Source: <https://www.gov.uk/government/publications/assisted-areas-in-great-britain-2007-2013>

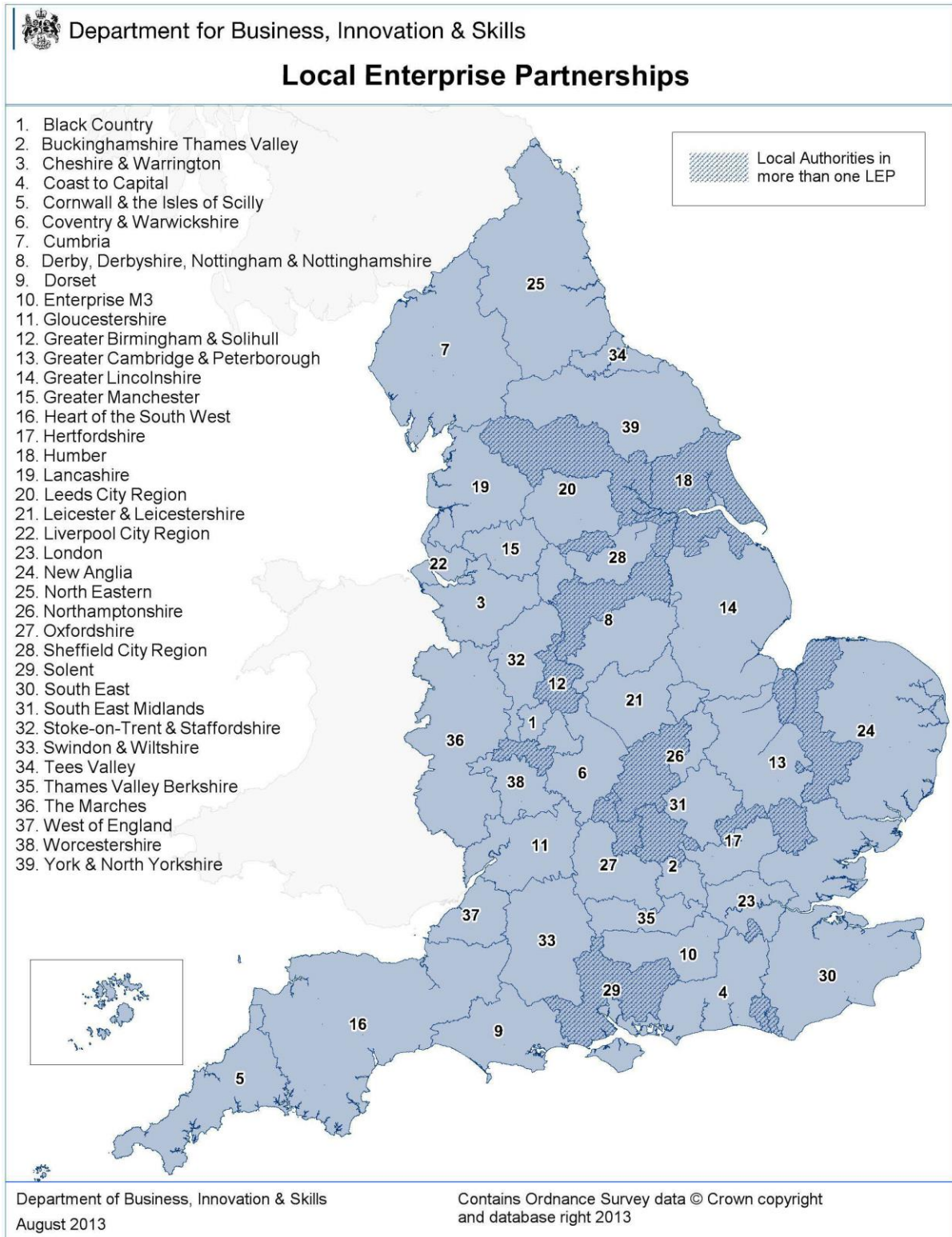
Note: Areas under (a) coverage were entitled to the highest level of aid, the mixed coverage of the Highlands allowed a gradual reduction of aid to the lowest (c) level. Northern Ireland is included under (c) coverage in its entirety.

Appendix C – Assisted areas 2014-2020 map



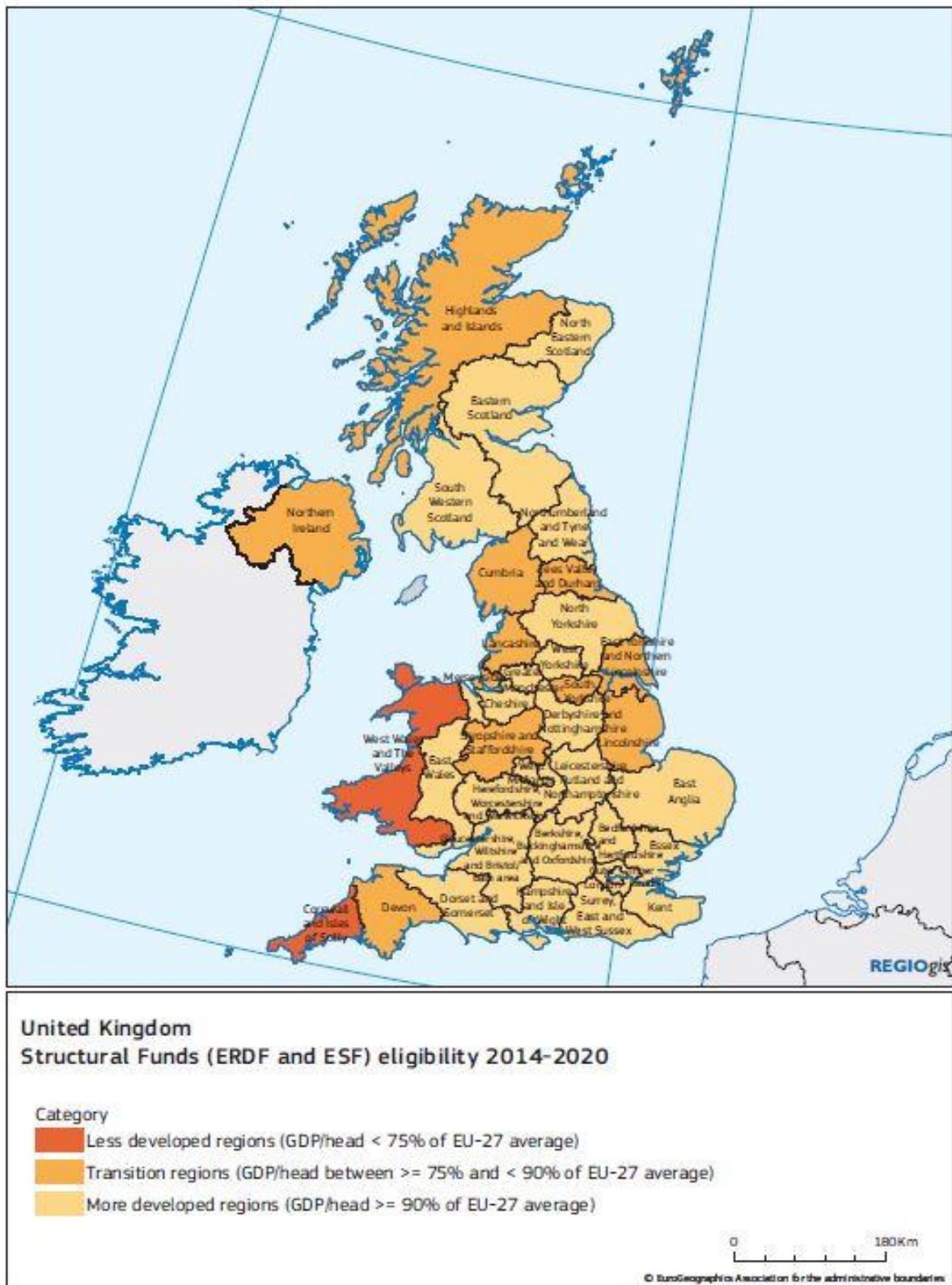
Source: <https://www.gov.uk/government/consultations/assisted-areas-map-2014-to-2020-stage-2>

Appendix D – Local enterprise partnerships map



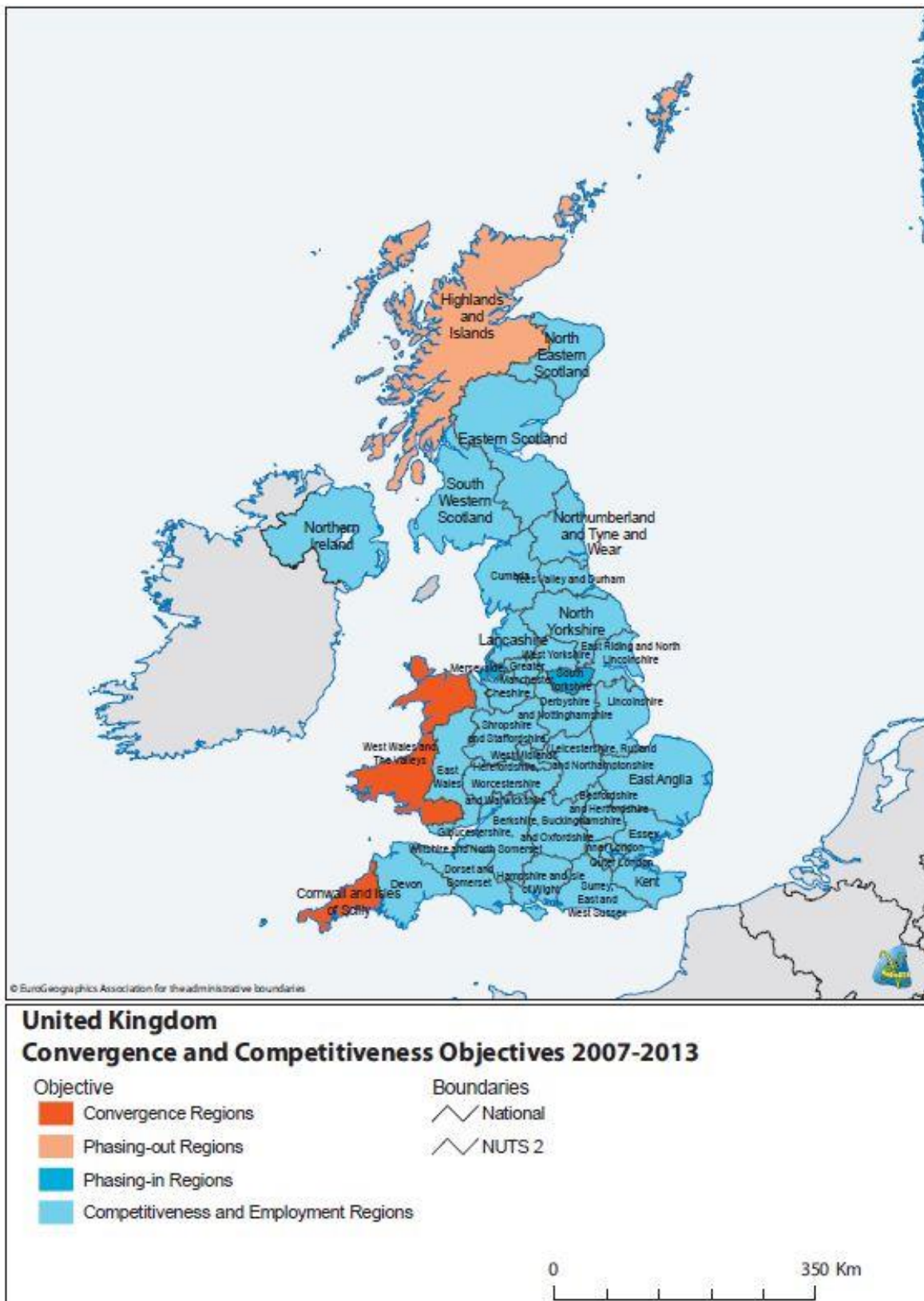
Source: <https://www.gov.uk/government/publications/local-enterprise-partnerships-map>

Appendix E – ERDF regions 2014-2020



Source: http://ec.europa.eu/regional_policy/en/information/maps/#1

Appendix F – ERDF regions 2007-2013



Source: http://ec.europa.eu/regional_policy/en/information/maps/#1

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