

DEMOCRACY AND HUMAN RIGHTS

# LEVELLING UP?

Lessons from Germany

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In recent years, UK policymakers have sought to learn from Germany's relatively successful attempts to rebalance regional growth since reunification.



But the UK must learn the right lessons from Germany, to address its severe regional inequalities.



Despite our two countries' many differences, there are some important transferable lessons for UK policymakers to take onboard.



# Contents

	<b>Introduction</b> .....	2
<b>1</b>	<b>COMBINE DEVOLUTION WITH FORMALISED COLLABORATION BETWEEN TIERS OF GOVERNANCE</b> .....	4
<b>2</b>	<b>SET OUT LONG-TERM PLANS AND INVEST AT SCALE</b> .....	9
<b>3</b>	<b>DEVELOP THE ECONOMIES OF A DIVERSE RANGE OF PLACES, NOT JUST CITIES</b> .....	12

# Introduction

## THE UK HAS A SEVERE PROBLEM WITH REGIONAL INEQUALITY AND CENTRALISATION

In the UK, regional inequality and centralisation are closely related. For 150 years, centralised government allowed regional inequality to accelerate – and this problem has been particularly acute since the 1980s.<sup>1</sup> Centralised governments have mismanaged deindustrialisation outside of London. On the one hand, some large employers in sectors such as automotive and bio-pharma have had significant state support. But on the other, the capital's financial sector has enjoyed unrivalled advantages as a result of a range of government policies, from deregulation to investment in London's transport infrastructure.<sup>2</sup> The so-called ›north-south‹ divide in fact describes economic under-performance of most of the south west, the midlands, the north of England, Wales, Scotland and Northern Ireland. Many UK towns and cities now have levels of development closer to southern Italy, Alabama and eastern Europe than to Germany, France and other high-income countries.<sup>3,4</sup> The ›non-core‹ regions of the Midlands and North of England, Wales and Northern Ireland – representing half of the UK population – are today poorer than the Czech Republic and equivalent to Slovakia.<sup>5</sup> Meanwhile, London's overheating housing market traps its own residents in the highest rates of poverty in the country.<sup>6</sup> Evidence from across the developed world links regional inequality with centralisation, particularly fiscal centralisation, and the UK is an international exemplar of worst practice – we are both the most centralised and

the most regionally unequal of all high-income countries.<sup>7,8</sup>

Previous governments have made largely tokenistic attempts to resolve this regional inequality. There is a long history of high-publicity, low-impact regional policies, against a far stronger current of ›anti-regional‹ policy.<sup>9</sup> While the Attlee and Wilson governments did regenerate and intervene in regional economies, these were the exception not the rule – and despite good intentions, their policies were often misguided. More recently, the last Labour government undertook a number of initiatives to regenerate northern cities, while devolving power to Wales, Scotland, Northern Ireland and London. The post-2010 coalition government spent small amounts of money, proposed directly elected mayors, presented the Northern Powerhouse as a top priority and allowed directly elected mayors to govern major city regions. We now have a government committed to ›levelling up‹ – a vague election slogan from 2019 that has only recently taken form in the government's White Paper and a Bill before parliament.<sup>10</sup> The future of this agenda is now uncertain, because it is based on a slogan closely associated with a now disgraced, former prime minister. Meanwhile, since 2010, the government has been centralising, both in public spending, and in actions which have undermined governance, both in the devolved nations, and England's mayoralities – in the way lockdowns and post-Brexit development funding were handled, for example. The Labour opposition has now expressed firm support for devolution and reducing regional inequality and has tasked former prime minister Gordon Brown with leading a commission to look into the future of the UK.

1 Martin, Ron; Pike, Andy; Tyler, Peter; Gardiner, Ben (2016): Spatially Rebalancing the UK Economy: Towards a New Policy Model?, *Regional Studies*, 50:2, 342-357.

2 Raikes, Luke (2019): Power and prosperity: A strategy for the North to take control of its economy, IPPR North. <http://www.ippr.org/research/publications/power-and-prosperity>.

3 McCann P (2019): Perceptions of regional inequality and the geography of discontent: insights from the UK, *Regional Studies*. <https://www.tandfonline.com/doi/full/10.1080/00343404.2019.1619928>.

4 Raikes Luke (2020): The devolution parliament: Devolving power to England's regions, towns and cities, IPPR North. <http://www.ippr.org/research/publications/the-devolution-parliament>.

5 McCann (2019).

6 Ibid.

7 Ibid.

8 Blöchliger, Hansjörg; Bartolini, David; and Stossberg, Sibylle (2016): Does Fiscal Decentralisation Foster Regional Convergence?, OECD Economic Policy Paper, No. 17, OECD Publishing.

9 Garretsen, Harry; McCann, Philip; Martin, Ron; Tyler, Peter (2013): The future of regional policy, *Cambridge Journal of Regions, Economy and Society*, Volume 6, Issue 2, July 2013, Pages 179- 86, <https://academic.oup.com/cjres/article/6/2/179/367020>.

10 DLUHC (2022): Levelling Up the United Kingdom. <https://www.gov.uk/government/publications/levelling-up-the-united-kingdom>.

## GERMANY IS OFTEN REFERRED TO BY POLICYMAKERS AS A GOOD EXAMPLE

UK policymakers are increasingly looking to Germany for solutions. Germany is another large, high-income, north-west European country. But Germany has handled a severe problem of regional inequality in a way that has demonstrated some success, during the same period that the UK's regional divides have worsened. This success can be seen in west Germany's post-industrial regions, such as the Rhine-Ruhr, which have fared better than similar regions in the UK. And it can also be seen post-reunification, in East Germany – where very stark regional inequalities in productivity and health have narrowed significantly.<sup>11</sup> Challenges remain in the East, but on some measures it is now as ›rich‹ as the UK.<sup>12</sup> UK policymakers and academics often attribute this success to a combination of decentralised, federal governance and infrastructure investment.<sup>13, 14, 15</sup>

Before setting out some of the lessons we can learn from Germany, it is important to recognise the clear and significant differences between the two countries. All comparative studies must be wary of path dependency, and there is no suggestion that policies or structures should be copied wholesale. Specifically for the purposes of this paper, it is important to set out how Germany and the UK have very different histories, that have shaped both the way they are governed and their approach to economic development.

- The UK has developed as a post-imperial, ›Anglo-centric‹ unitary state, with England dominant and the UK parliament ›supreme‹.<sup>16</sup> Since 1997, Wales and Scotland have been on a progressive path toward what some would describe as a ›quasi-federal‹ position, meanwhile Northern Ireland has its own complex and increasingly fraught situation. In England, London has a mayor and a weak assembly, while prominent but relatively powerless metro mayors have been elected to govern with their constituent councils in nine other city regions since 2017. In economic policy, the UK also has a tradition that is mostly laissez-faire, particularly from the 1980s onward, and no strong tradition of social partnership between the state, trade unions and business. There are some exceptions: the UK was, before the 1940s, far more decentralised: Sidney and Beatrice

Webb, writing in the 1920s, claimed that ›the characteristic English preference for local over central administration has hitherto always proved too strong to be overcome‹.<sup>17</sup> And there was a period of notable civic entrepreneurialism, even ›municipal socialism‹ in the early 20th century, exemplified by Joseph Chamberlain in Birmingham and Herbert Morrison in London – when municipal government had far more power.<sup>18</sup>

- By contrast, Germany came together as a confederation of states in the 19th century. The 19th century Prussian state was notable for taking a catalytic role in economic development, building infrastructure and developing new industries in Berlin and Brandenburg. Prussia dominated Germany, particularly during the inter-war Weimar Republic. Germany then endured fascism, lost the second world war and was broken apart into East and West. This led to the division of Prussia, and in the West a new constitution (Basic Law) which prioritised checks and balances on centralised political power. East Germany existed under top-down Soviet economic policies for 45 years. Germany then reunified in 1990 and founded its ›new Länder‹ (very quickly) in the East. This saw the almost immediate demise of previously state-owned enterprises that had existed in East Germany's command economy. This was then followed by a period of significant infrastructure investment. In Germany, there is a stronger tradition of state and trade union involvement in economic development, in a ›social partnership‹ model.

## THIS PAPER DRAWS OUT THREE BROAD LESSONS FROM GERMANY

These are major differences, but this should not prevent us learning important lessons. It is very common – and incredibly important – for countries that are generally at very similar levels of development to learn from one another in this way.

This short think piece summarises what the UK can learn from German devolution and regional rebalancing. It draws on the policy literature, a roundtable held in September 2021 and a series of interviews with specialists in the UK and Germany. This is a joint project by the Fabian Society and FES-London. This paper is split into three broad ›lessons‹.

<sup>11</sup> Raikes (2020).

<sup>12</sup> OECD (2022): Regional Economy, OECD Regional database. [https://stats.oecd.org/Index.aspx?DataSetCode=REGION\\_DEMOGR#](https://stats.oecd.org/Index.aspx?DataSetCode=REGION_DEMOGR#).

<sup>13</sup> Raikes (2020).

<sup>14</sup> UK 2070 Commission (2020): Make No Little Plans: Acting at scale for a fairer and stronger future. Final report of the UK2070 commission. <https://uk2070.org.uk/2020/02/26/uk2070-final-report-published/>.

<sup>15</sup> McCann, Philip; Ortega-Argilés, Raquel; Sevinc, Deniz; Cepeda-Zorrilla, Magda (2021): Rebalancing UK regional and industrial policy post-Brexit and post-Covid-19: lessons learned and priorities for the future. Regional Studies. 1-13. [https://www.researchgate.net/publication/352435589\\_Rebalancing\\_UK\\_regional\\_and\\_industrial\\_policy\\_post-Brexit\\_and\\_post-Covid-19\\_lessons\\_learned\\_and\\_priorities\\_for\\_the\\_future](https://www.researchgate.net/publication/352435589_Rebalancing_UK_regional_and_industrial_policy_post-Brexit_and_post-Covid-19_lessons_learned_and_priorities_for_the_future).

<sup>16</sup> A notion which is sometimes contested.

<sup>17</sup> White, Jerry (2004): From Herbert Morrison to command and control: the decline of local democracy, *History & Policy*, 2 April 2004. <http://www.historyandpolicy.org/policy-papers/papers/from-herbert-morrison-to-command-and-control-the-decline-of-local-democracy>.

<sup>18</sup> Tomaney, John (2021): Labour tradition outside big cities, *Constitutional change: rediscovering localism*, *Renewal*: 29,3.

## 1

# COMBINE DEVOLUTION WITH FORMALISED COLLABORATION BETWEEN TIERS OF GOVERNANCE

## UK ECONOMIC GOVERNANCE IS CENTRALISED AND DYSFUNCTIONAL

The UK is more centralised than any other comparable country.<sup>19</sup> In England, little power is held either at the vital functional economic area (eg city regions) or at the regional scale (eg the North). Core council funding is largely decided by central government at short notice, mostly directed toward public services. The costs of these public services swallow the vast majority of revenue, borrowing is tightly controlled, and councils can not raise council tax significantly without a (politically risky) referendum. This leaves little capacity for economic regeneration, although many entrepreneurial councils do their best. Within England, local and regional identities persist and can be significant, but they are not politically mobilised in a way that has an impact.<sup>20, 21</sup> Metro mayors and the mayor of London now govern the major city regions, but with limited power – and mostly exist at the pleasure of Westminster politicians. Arrangements in Wales, Scotland and Northern Ireland are highly devolved, but this accounts for 15 per cent of the UK population and the UK government has repeatedly undermined these settlements in recent years – for example, with its handling of the pandemic, the Internal Markets Act and Shared Prosperity Fund. The UK exists in a state that is difficult to define precisely: public services are highly devolved to the Celtic nations, in a way which is almost ›federal‹, or ›quasi-federal‹. But these are only a small slice of the UK, and even these countries have little control over key economic and fiscal powers, while councils are highly constrained by central government.

Relationships between the nations and regions are currently fraught. Relationships between UK and sub-central governments are poorly managed, with no formal mechanism for the first ministers and UK prime minister to even to meet regularly, let alone make binding, joint decisions.

Even during the pandemic, these relationships remained dysfunctional. In England, councils and mayoral combined authorities (MCAs) are often treated as the delivery vehicle for central government policies, while being pitted against one another to bid for relatively small pots of economic development cash. Unlike in other countries, our second chamber is not a forum for reconciling the tiers of governance. Instead, it reinforces centralisation and the overheating of London and the south east: members are appointed at the discretion of the prime minister and membership draws disproportionately from these wealthier regions.<sup>22</sup>

The UK's centralised and poorly coordinated economic governance has exacerbated pre-existing and global trends for regional economies in the UK. Deindustrialisation, globalisation, and technological change have regionally uneven consequences in all countries, but the UK's centralisation has stopped places adapting to their own experiences. The UK's precarious state has been disguised by a small, but highly productive concentration of highly specialised business services in the capital. High-quality devolved governance and fiscal devolution are both associated with stronger economic performance, economic resilience and more inclusive labour markets across OECD countries.<sup>23</sup> Devolved governance and fiscal devolution enable places to have control over the processes of economic development that affect places differently, and seem to facilitate a ›race to the top‹ competition between places – meaning regions converge at a higher level of resilience, growth, inclusion, and equality (both inter-personal and inter-regional).<sup>24, 25</sup> By contrast, in the UK, tax, spend and regulatory decisions are made without considering differential impacts on places, and have led to an unsustainable and exclusive housing boom in the place where such decisions are made – London and, in the case of R&D spending, the ›golden triangle‹ (London Oxford and Cambridge). This is ›lose-lose‹ situation for low-income people in all regions,

<sup>19</sup> McCann et al (2021).

<sup>20</sup> Henderson, Alisa; Wyn Jones, Richard (2021): *Englishness: The Political Force Transforming Britain*. Oxford University Press.

<sup>21</sup> Hayton, Richard; Giovannini, Arianna; Berry, Craig (Eds) (2016): *The Politics of the North: Governance, territory and identity in Northern England*. White Rose Consortium for the North of England <http://speri.dept.shef.ac.uk/wp-content/uploads/2019/01/Politics-of-the-North-Hayton-Giovannini-Berry.pdf>.

<sup>22</sup> Raikes (2020).

<sup>23</sup> Di Cataldo, Marco; Rodríguez-Pose, Andrés (2017): What drives employment growth and social inclusion in the regions of the European Union? *Regional Studies*, 51 (12), December 2017, 1840-1859.

<sup>24</sup> Raikes (2020).

<sup>25</sup> Bartolini, David; Stossberg, Sibylle; Blöchliger, Hansjörg (2016): *Fiscal decentralisation and regional disparities* economics department, OECD.

creating poor job opportunities outside of London and the south-east, but high poverty within London due to housing costs. Despite the fanfare, the government's Levelling Up white paper does little to fundamentally change any of these dynamics.

## GERMAN GOVERNANCE SEES POWER SHARED BETWEEN CENTRAL GOVERNMENT AND LÄNDER AND REQUIRES COLLABORATION BETWEEN TIERS

German governance is notable for the prominent and relatively autonomous role of the 16 Länder (states or regions), but in a system which combines autonomy with cooperation. Under the German model of 'executive federalism', much policy is set at the federal level, but the federal government has little executive role, which is undertaken by the Länder, often including relevant secondary legislation.<sup>26</sup> Additionally, the Länder enjoy significant autonomy to set their own policies in certain areas, notably education, municipalities and internal security. Regional prime ministers (minister presidents) and Länder governments are very powerful, as is the Bundesrat, the second chamber where they are represented at federal level. The federal government has no primacy over the Länder, and the Länder supervise the municipalities.<sup>27</sup> One in-depth study synthesised an index from a range of self-rule and shared-rule measures (from ability to borrow, to policy scope for example) and found that German sub-central government 'power' is nearly four times that of the UK.<sup>28</sup>

Crucially, economic development is led by German Länder. Länder have control of the key economic powers, such as regional transport, and innovation – though power is sometimes exercised concurrently with the federal government. Länder, often working with their municipalities, give such policies a high priority, especially due to the incentives provided by the design of the German tax system. This has enabled German policymakers to manage economic change more effectively at the regional level, particularly since deindustrialisation and then reunification.<sup>29</sup> They set out regional industrial strategies, make planning policies and invest in economic development funds. Perhaps the most visible example is transport: there is more light rail (ie metro) just in

Cologne than in all of the UK put together.<sup>30, 31</sup> Beyond public spending, regional leadership in the Rhine-Ruhr brought private sector and other actors together to manage deindustrialisation in a less antagonistic way than the UK.<sup>32, 33</sup>

Germany is also far more fiscally decentralised than the UK and this enables regional development and convergence. While 5 per cent of UK taxes are raised sub-nationally, in Germany it is close to 50 per cent.<sup>34</sup> But crucially, to protect against divergence and tax competition, Länder agree tax policies, including rates, via the Bundesrat, whose finance committee meets every four weeks. And to ensure budgetary discipline, the Länder and Federal budgets are also now reviewed by a joint committee of the federal government and states – the Stability Council (Stabilitätsrat). Each level collects some taxes separately: the federal level collects customs duties, insurance tax, tobacco tax, and solidarity income tax; Länder collect the inheritance tax and automobile tax; and the local governments collect the taxes on real estate and local businesses.<sup>35</sup> Some features are similar between the two countries: at the municipal level, Germany has a local businesses tax, local taxes and property tax, which are roughly comparable with UK business rates and council tax.<sup>36</sup> Länder and municipalities receive a share of the value added tax and personal income tax.<sup>37</sup> Länder and municipalities can also change the 'multiplier' of certain taxes to self-fund projects of regional or local need, which can incentivise local participation and collaboration with local businesses.<sup>38</sup>

German fiscal arrangements lean heavily on transfers between the federal government and states (vertical), and between the Länder (horizontal), in a system which is cooperative or 'compounded', not competitive. Three-quarters of all overall tax revenues, such as VAT and income taxes, are shared between units of government through vertical (federal-state) and horizontal (inter-state) trans-

<sup>26</sup> Fuhr, Harald; Fleischer, Julia and Kuhlmann, Sabine (2018): Federalism and decentralization in Germany: Basic features and principles for German development cooperation, Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ).

<sup>27</sup> Fuhr et al (2018).

<sup>28</sup> Hooghe, Liesbet; Marks, Gary (2021): Regional Authority Index (RAI) – Country. <https://garymarks.web.unc.edu/data/regional-authority-2/> via McCann, Philip; Ortega-Argilés, Raquel; Sevinc, Deniz; Cepeda-Zorrilla, Magda (2021): Rebalancing UK regional and industrial policy post-Brexit and post-Covid-19: lessons learned and priorities for the future. Regional Studies. 1-13. [https://www.researchgate.net/publication/352435589\\_Rebalancing\\_UK\\_regional\\_and\\_industrial\\_policy\\_post-Brexit\\_and\\_post-Covid-19\\_lessons\\_learned\\_and\\_priorities\\_for\\_the\\_future](https://www.researchgate.net/publication/352435589_Rebalancing_UK_regional_and_industrial_policy_post-Brexit_and_post-Covid-19_lessons_learned_and_priorities_for_the_future).

<sup>29</sup> Raikes (2019).

<sup>30</sup> This comparison includes the Metrolink, Tyne and Wear metro DLR and other 'tram' light rail services, but excludes the London Underground, which is classed as 'heavy rail' or 'mass rapid transit'.

<sup>31</sup> Raikes, Luke (2016): Connecting lines: How devolving transport policy can transform our cities, IPPR North. <http://www.ippr.org/publications/connecting-lines-how-devolving-transport-policy-can-transform-our-cities>.

<sup>32</sup> Bross, Ulrike and Walter, Gunter H (2000): Socio-economic Analysis of North Rhine-Westphalia. [http://www.1aufbau.de/isi-wAssets/docs/p/de/arbapap\\_unternehmen\\_region/ap\\_r2\\_2000.pdf](http://www.1aufbau.de/isi-wAssets/docs/p/de/arbapap_unternehmen_region/ap_r2_2000.pdf).

<sup>33</sup> Prologis (2019): 'Rhine-Ruhr, Industrial Capital of Western Germany', website. <https://www.prologisgermany.de/en/industrial-logistics-warehouse-space/europe/germany/rhine-ruhr-industrial-capital-western-germany>.

<sup>34</sup> Organisation for Economic Co-operation and Development [OECD] (2018): Subnational governments in OECD Countries: Key data 2018 edition. <https://www.oecd.org/regional/regional-policy/Subnational-governments-in-OECD-Countries-KeyData-2018.pdf>.

<sup>35</sup> Local Government Association (LGA) and Localis (2020): Fiscal devolution: Adopting an international Approach. [https://www.local.gov.uk/sites/default/files/documents/4.104%20Fiscal%20Devolution\\_05%20%28002%29.pdf](https://www.local.gov.uk/sites/default/files/documents/4.104%20Fiscal%20Devolution_05%20%28002%29.pdf).

<sup>36</sup> LGA and Localis (2020).

<sup>37</sup> LGA and Localis (2020).

<sup>38</sup> Fuhr et al (2018).



fers.<sup>39, 40</sup> Taxes gathered at the federal level go through a process of equalisation based on the constitutional leitmotif of the »equivalence of living conditions«. The burden of equalisation has recently shifted heavily toward more vertical (federal-state) transfers.<sup>41</sup> Then further special grants are given – such as the Solidarity Fund, directed toward East German states. This means that German regions have relatively long-term, stable, non-ringfenced funding streams. This helps Germany to invest more than twice as much as the UK in sub-central economic development as a proportion of GDP, and to do so much more equally across its regions.<sup>42</sup> Around 55 per cent of all public investments in Germany are made by the municipalities alone.<sup>43</sup>

Collaboration is vital in this system, and there are three things which enable it to take place. First, collaboration is formalised by the constitution (Basic Law): German governance is geared toward delivering equivalent living conditions, as well as ensuring transparency, checks and balances, participation, the rule of law, and other outcomes.<sup>44</sup> This applies especially to tax decisions, where all tiers are required to work together to avoid too much divergence. Second, German governance requires cross-party political collaboration – which takes place at all tiers of government, and with almost all combinations of parties, due to proportional voting systems. And third, a culture of collaboration both reinforces, and is reinforced by, these arrangements: German state leaders meet very regularly – UK national and regional leaders don't currently meet in any comparable way. Officials of different tiers and different Länder also meet formally and know each other informally – for instance, even in education policy, which is reserved for the Länder, there is institutionalised horizontal co-operation through the »Standing Conference of the Ministers of Education and Cultural Affairs of the Länder in the Federal Republic of Germany«: so in practice there is extensive voluntary co-ordination.<sup>45</sup> These cooperation structures are so pronounced that the German discussion is dominated by an intensive debate on these forms of joint

decision-making (»Politikverflechtung«).<sup>46, 47</sup> This often means an individual's career path, whether political or non-political, involves moving between places and tiers. There are disputes, but these remain legalistic and relatively slow-moving (in contrast to the UK's more erratic, unpredictable constitutional ruptures). States compete with one another, but arguably within boundaries that facilitate a »race to the top« in terms of levels of development and, crucially, there is no »race to the bottom« in terms of tax competition (as noted above, this is largely prevented).

There are some inevitable downsides to German governance. Consensus-based politics can create gridlock and decisions can take time; veto players can create a »lowest common denominator« problem (or »joint decision-making traps«, Scharpf); there can be a lack of transparency and lines of accountability can be blurred. These structures can also cause bureaucracies to proliferate to a level that hinders modernisation, or is wasteful.<sup>48, 49</sup> Some of this has improved since the 2006 reforms, though challenges remain.<sup>50</sup> Finally, when standards diverge, it can cause problems.<sup>51</sup> This has been apparent for some time through divergent education systems where, despite voluntary coordination, different curricula inhibit student and teacher mobility and, in practice, qualifications aren't always seen as equivalent. More specifically, during the Covid-19 pandemic, different restrictions led to a situation that many found too complex.

Fiscal redistribution has thrown up some significant challenges. Horizontal redistribution between Länder is particularly controversial: the wealthier regions have pushed back against subsidising poorer regions. This has included bringing a series of cases before the federal constitutional court, which has recently led to the Solidarity Fund being significantly curtailed while equalisation transfers are increasingly borne by the federal government, through the vertical processes of equalisation. Since the financial crisis, austerity and fiscal conservatism has dominated in Germany, manifested in the form of the »debt brake« – which severely limits both federal and state borrowing outside of emergencies (such as the Covid-19 pandemic).<sup>52</sup> This has resulted

39 Fuhr et al (2018).

40 Scheller, Henrik (2005): Politische Maßstäbe für eine Reform des bundesstaatlichen Finanzausgleichs. Berlin: Freie Universität, Dissertation. In: Reihe »Forum Öffentliche Finanzen«. Lüdenscheid: Analytica Verlagsgesellschaft.

41 Bury, Yannick; Feld, Lars P (2020): Fiscal federalism in Germany, Freiburger Diskussionspapiere zur Ordnungsökonomik, No. 20/04, Albert-Ludwigs-Universität Freiburg, Institut für Allgemeine Wirtschaftsforschung, Abteilung für Wirtschaftspolitik und Ordnungsökonomik, Freiburg i. Br. <https://www.econstor.eu/bitstream/10419/222976/1/1726719405.pdf>.

42 Raikes (2020).

43 Raffer, Christian; Scheller, Henrik (2022): KfW-Kommunalpanel 2022, KfW Research, Frankfurt am Main.

44 Fuhr et al (2018).

45 Scheller, Henrik (2018): Educational Federalism in Germany: Tensions between the Länder's autonomy and cooperative unitarization, in Wong, Kenneth (ed.) 2018: Federalism and Education: Governance, Standards, and Innovation for the 21st Century, Age Publishing.

46 Source: Fritz W. Scharpf: Die Politikverflechtungs-Fälle: Europäische Integration und deutscher Föderalismus im Vergleich. In: Politische Vierteljahresschrift. 26. Jg. (1985), Heft 4, S. 323–356.

47 Fritz W. Scharpf, Bernd Reissert, Fritz Schnabel: Politikverflechtung: Theorie und Empirie des kooperativen Föderalismus in der Bundesrepublik. Scriptor Verlag, Kronberg/Ts. 1976.

48 Fuhr et al (2018).

49 Scheller, Henrik; Schmid, Josef (Hrsg.) (2008): Föderale Politikgestaltung im deutschen Bundesstaat – Variable Verflechtungsmuster in Politikfeldern. In: Schriftenreihe des Europäischen Zentrums für Föderalismus-Forschung, Band 32. Baden-Baden: Nomos Verlagsgesellschaft.

50 Fuhr et al (2018).

51 Turner, Ed and Rowe, Carolyn (2015): A race to the top, middle or bottom? The consequences of decentralisation in Germany, IPPR North <https://www.ippr.org/files/publications/pdf/decentralisation-in-germany.pdf>.

52 Scheller, Henrik (2015): Policy-Transfers und Policy-Diffusion in der Finanzpolitik der Bundesrepublik: Zur Rolle einflussreicher »epistemic communities«, in: Zeitschrift für Staats- und Europawissenschaften (ZSE), Heft 2, 2015.



in many Länder offloading cuts, and accountability, onto municipalities – not too dissimilar to how the UK government has behaved toward councils.<sup>53, 54</sup> There has also been a proliferation of small programmes of federal funding grants, and there is a lack of capacity in the construction industry resulting in a public investment backlog of €150bn.<sup>55</sup> Again, some of these are problems often shared by the UK.

Governance is also less ›neat‹ and symmetrical than is often assumed. Länder are very different in size (North Rhine Westphalia is home to 18 million people; Bremen is home to just 700,000); and alongside the ›regional‹ states, there are also city states, namely Berlin, Bremen and Hamburg. Below the Länder level, governance is far ›messier‹, with multiple and overlapping two-tier, three-tier and meso-tier structures of government.<sup>56</sup> But in itself, this is no bad thing – policymakers would be mistaken to pursue a rigid, one-size-fits-all approach to governance.

## THE UK SHOULD COMBINE DEVOLUTION WITH FORMALISED COLLABORATION BETWEEN TIERS OF GOVERNANCE

The UK needs to develop a model of governance that works for its own purposes and it can learn a great deal from Germany. Like in every country, the German governance model has been forged in unique circumstances. But these circumstances have often been unfavourable, which should encourage, not discourage devolution in the UK. Most importantly, Germany serves as an important example of a point that is evident across OECD countries as a group – that ›good‹ regional governance and strong institutions help to build and sustain greater regional equality, labour market inclusion and aggregate prosperity.<sup>57, 58</sup>

Lessons for the UK include:

- **Devolve sub-central governance in England to be stable, collaborative and integrated.** The UK government needs to devolve significant economic power within England, but this should be in a way that learns from Germany's successes and shortcomings. That means the UK should allow England's different tiers to exercise significant autonomy, and not subordinate any one tier to any other tier, while ensuring robust accountability, requiring collaboration, and fostering a collaborative culture. This collaboration needs to happen horizontally and vertically. England needs to thoroughly explore the trade-offs between sub-central legislative powers and sub-central executive powers, to try and mitigate problems such as gridlock and lack of accountability, while making sure checks and balances are robust.
- **Build formal and informal pan-UK collaboration.** Since devolution to Scotland and Wales, the UK has never had a consistent process of formalised collaboration between the nations (except, of course, in Northern Ireland). Within England, the relationship between central and local government is more ›master-servant‹ than collaborative. In Germany, the Länder and federal government work collaboratively and on a more respectful basis and this seems to facilitate both the policies and long-term relationships that foster regional development (though municipalities often do not enjoy the equivalent relationship with their Länder). This suggests the UK needs formal, constitutionally defined roles and modes of collaboration across all nations and regions, but should also facilitate informal mechanisms through which good relationships can be built. This will mean tackling a very challenging, but not insurmountable issue: how to respect the nationhood of England, while making sure all England's regions are represented, and not allowing its overwhelming size to override the other nations.
- **Build pan-regional collaboration in England from the bottom-up.** The UK does not have the basis in history or regional identity on which to build regional assemblies that might look similar to Germany's Länder – not yet, at least. But this level of geography is vital for economic development, as it enables cities and towns to collaborate, and smooths out sub-regional fiscal imbalances. Furthermore, in the UK, it is the inequality between ›large regions‹ that sets us apart from other countries (the UK doesn't particularly stand out in its ›intra-regional‹ disparities).<sup>59</sup> The most practical solution is to build on the pan-regional transport bodies that are accountable to mayors and councils, like Transport for the North and Midlands Connect. These could form a strong basis for pan-regional economic development, if converted into ›regional combined authorities‹ that govern regional economic policies and industrial strategies, accountable indirectly to constituent elected leaders and mayors.<sup>60</sup>
- **Construct a system of fiscal devolution and transfers that embed long-termism, collaboration and fairness.** Regional funding inevitably involves something

<sup>53</sup> Fuhr et al (2018).

<sup>54</sup> Fuhr et al (2018).

<sup>55</sup> Raffer, Christian and Scheller, Henrik (2022): KfW-Kommunalpanel 2022, KfW Research, Frankfurt am Main.

<sup>56</sup> Fuhr et al (2018).

<sup>57</sup> Di Cataldo, Marco; Rodríguez-Pose, Andrés (2017): What drives employment growth and social inclusion in the regions of the European Union? *Regional Studies*, 2017, vol. 51, issue 12, 1840-1859. [https://econpapers.repec.org/article/tafregstd/v\\_3a51\\_3ay\\_3a2017\\_3ai\\_3a12\\_3ap\\_3a1840-1859.htm](https://econpapers.repec.org/article/tafregstd/v_3a51_3ay_3a2017_3ai_3a12_3ap_3a1840-1859.htm).

<sup>58</sup> Rodríguez-Pose, Andrés; Di Cataldo, Marco (2015): Quality of government and innovative performance in the regions of Europe, *Journal of Economic Geography*, Volume 15, Issue 4, July 2015, Pages 673–706, <https://doi.org/10.1093/jeg/lbu023>.

<sup>59</sup> McCann Philip (2016) *The UK Regional–National Economic Problem: Geography, Globalisation and Governance*, Routledge.

<sup>60</sup> Raikes (2019).

of a compromise between regional autonomy and regional equity. Germany has come to a compromise which, contrary to myths around fiscally devolved countries, skews strongly toward equity. Horizontal collaboration and regional representation in the centre are crucial elements to this settlement. The UK could feasibly move to a position where places are more autonomous and funding is more equitable than it is now. The current system – which includes the Barnett formula, settlement funding for councils, and business rate retention schemes – is a crude and unfair way to distribute public money while ad-hoc, short-term grants embed uncertainty and prevent sub-central government from being able to plan and deliver. The priority for fiscal devolution must be to provide: long-term stability, collaboration between tiers of government, and fairness in contribution and distribution (something that will always be contested).<sup>61</sup> That means a long-term funding settlement must be agreed between all tiers of government, while allowing scope for amendment and challenge over time. In addition, the UK should enable places to levy their own smaller taxes, such as ›hotel bed taxes‹, and also investigate assigning a local share of income tax.

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**61** A lot will depend on different definitions of ›fairness‹, with the primary conflict between level of contribution vs level of need.

## 2

## SET OUT LONG-TERM PLANS AND INVEST AT SCALE

### THE UK SUFFERS FROM SHORT-TERMISM AND A RELUCTANCE TO INVEST IN REGIONAL DEVELOPMENT

UK regional policy is horrendously short-termist. In just the last ten years, we have had tens of different centralised funding pots and policy programmes, including the Regional Growth Fund (RGF) and City Deals under the coalition, then the Northern Powerhouse, 2017 industrial strategy and now 'levelling up'. Unlike other countries, we have no consistent long-term economic strategy, industrial strategy or spatial plan – we have just had short-term, very light-touch versions of each, which change every few years, either through new legislation, or at the whim of ministers and civil servants. There is no guiding philosophy, or cross-party agreement – let alone any constitutional aim to 'equalise living conditions' (as in Germany). There are very few enduring and independent institutions or funding mechanisms. This chopping and changing is in itself a major obstacle to rebalancing. It is disruptive, saps officials' capacity and inhibits planning and investment – from the public, private and voluntary, community and social enterprise sectors.

The UK is also reluctant to invest the required funds in regional development. Compared to other countries, the UK underinvests in vital areas of economic development, such as government R&D (research and development) and transport infrastructure.<sup>62, 63</sup> What investment there is, is channelled by central government into overheating the already prosperous regions: historic transport spending in London has been twice as high per capita as in the rest of the country, and current plans indicate this trend will continue – with the government renegeing on its commitments to northern infrastructure, while encouraging discussions around Crossrail 2 to proceed.<sup>64</sup> Government R&D spend-

ing is similarly directed towards the 'golden triangle' of London, Oxford and Cambridge. Notably, this spending is unlikely to alleviate the poverty that exists in these prosperous regions – and may even exacerbate it by driving up housing costs. The UK also has an underfunded and poorly configured skills system, which has been strained by perpetual tinkering and reform. There is a British Business Bank (which lends to businesses), a UK Infrastructure bank (which finances infrastructure) and there are also development banks in Wales and Scotland, but they are all relatively young and remain quite small. Evidence shows that regional convergence and economic resilience requires significant, long-term investment; diversity of funding sources; and intervention in lagging regions, and so it should be no surprise that, having failed to do any of these things in the UK, we remain regionally divided.

### GERMANY HAS FAR STRONGER LONG-TERM PLANS AND DOES INVEST AT SCALE

Germany benefits from the kind of long-term strategies and plans that the UK lacks. The constitution (Basic Law) sets the long-term ambition, a touchstone for policymaking across all tiers of government: 'establishing equal living conditions in all parts of Germany'. On spatial planning, there is a logical configuration of roles between the tiers of government, which again reserves a strong role for the Länder. State and federal ministers meet to agree an approach to spatial development (Leitbilder) but the Länder specify aims which have legally binding status and approve plans from municipalities, leading to significant divergence in policy between Länder, to match different contexts.<sup>65</sup> Industrial strategy is also long-term and collaborative – in 2019, the 2030 framework was set out. In support of these objectives, major spending programmes are sustained across parliaments – sometimes for 20 years.<sup>66</sup> These poli-

<sup>62</sup> Hutton, Georgina (2021): Research & Development Spending, House of Commons Library. <https://commonslibrary.parliament.uk/research-briefings/sn04223/#:~:text=non%2Dprofit%20organisations,-International%20comparisons,in%20France%20it%20was%202.2%25.>

<sup>63</sup> OECD (2022): Investment (GFCF). <https://data.oecd.org/gdp/investment-gfcf.htm>.

<sup>64</sup> Cox, Charlotte (2022): London's £19bn Elizabeth line opens today – but where's the Crossrail for the North? Manchester Evening News. <https://www.manchestereveningnews.co.uk/news/greater-manchester-news/londons-19bn-elizabeth-line-opens-24026826>.

<sup>65</sup> Scharman, Ludwig (2020): Introduction to the German spatial planning system, Saxon State Ministry for Regional Development [https://rainman-toolbox.eu/wp-content/uploads/2020/06/RAINMAN\\_Spatial-Planning\\_Germany.pdf](https://rainman-toolbox.eu/wp-content/uploads/2020/06/RAINMAN_Spatial-Planning_Germany.pdf).

<sup>66</sup> Enenkel, Kathrin (2021): 'What can German reunification teach the UK about levelling up?', Centre for Cities. <https://www.centreforcities.org/blog/what-can-german-reunification-teach-the-uk-about-levelling-up/>.

cies and strategies are refreshed every few years, but provide long-term guidance and policy certainty.

Germany also invests in economic development at scale. Germany invests significantly more in R&D (all sources) and has a skills system which is widely regarded as performing extremely well. The core economic development initiative is the Joint Task for the Improvement of Regional Economic Structures (GRW), which has been in place since 1969 and is funded 50:50 by the Länder and federal government and specified jointly too.<sup>67</sup> In addition, since reunification, the Solidarity Fund has invested primarily in the East to upgrade infrastructure and help its regional economies catch up. According to one estimate, € two trillion had been invested by 2014 – much of this on unemployment benefits and pensions, as well as infrastructure and business support.<sup>68, 69</sup> In addition, as discussed above, fiscal decentralisation enables different tiers of government to mobilise complementary funding streams. This has been successful: Bavaria was once a net recipient of solidarity funds, but became the biggest contributor (until recent reforms shifted away from horizontal transfers).<sup>70</sup>

In addition, Germany has a particular form of capitalism that incorporates state intervention, cooperativism and decentralisation. Germany has a national infrastructure bank, the KfW, in which the Länder are collectively 20 per cent shareholders, which lends to SMEs (via banks) and offers funds of up to 50 per cent for infrastructure projects.<sup>71</sup> There are also significant levels of investment from the private sector, and the public and cooperative banking system, the Landesbanken and Sparkassen. The result is a financial system which is more diversified and therefore resilient to financial shocks – which benefited German businesses after the financial crisis, for example.<sup>72</sup>

But Germany isn't always as strong on investment and long-termism as it appears. Germany actually underinvested in the 2000s and 2010s because of an extreme adherence to fiscal prudence, known as the ›black zero‹ – in practice, this has meant missing opportunities to borrow at very low rates, to invest in infrastructure that is in dire need

of improvement. Some contend that the Solidarity Fund has been misspent, or overly focused on infrastructure, as opposed to training and education.<sup>73</sup> And, as noted above, it has been challenged by the states that contribute the most, leading to significant reform which has shifted the burden onto federal budgets. Infrastructure is now ageing, while there remains a significant backlog of projects due to lack of capacity.<sup>74, 75</sup> The plans and strategies themselves are challenged, while spatial planning and industrial strategy are also not as integrated as they should be.<sup>76</sup> There remain some conflicts in spatial planning between municipal governments and the Länder.

Finally, some might argue that, because significant regional inequalities persist even after this level of investment, it shows that these policies have not worked. But despite these qualifications, it appears that having long-term plans and investing at scale have borne fruit for Germany, compared to other countries – especially the UK.

## THE UK SHOULD SET OUT LONG-TERM PLANS AND INVEST AT SCALE

The UK has been held back by short-termism and an unwillingness to invest at scale. Germany's circumstances and history have led to higher levels of regional investment and its own particular model for financing that investment. But the UK has regional inequalities which more than justify higher regional investment and there is no excuse for our short-termism.

Lessons for the UK include:

- **Develop a long-term industrial and regional strategy.** The UK has failed to sustain a long-term economic plan. This is shocking in its own right, but especially compared to Germany, where long-termism is baked in to federal and regional strategies, and where regional, spatial and industrial policy is aligned (to some extent, at least). This should be rectified by drawing up a combined industrial and regional strategy, building up from the government's levelling up White Paper, and integrated with spatial planning at all levels.
- **Build a large, long-term economic development fund.** In addition to establishing long-term funding

<sup>67</sup> LGA and Localis (2021).

<sup>68</sup> Enenkel (2021).

<sup>69</sup> Fischer, Thomas B (2019): The use of infrastructure and regeneration investment to support stabilisation of Eastern Germany during the period of post-unification transition — a summary and lessons learnt. [https://uk2070.org.uk/wp-content/uploads/2019/06/UK2070\\_Fischer\\_Rebuilding\\_Of\\_The\\_GDR.pdf](https://uk2070.org.uk/wp-content/uploads/2019/06/UK2070_Fischer_Rebuilding_Of_The_GDR.pdf).

<sup>70</sup> Thöne, Michael; Bullerjahn, Jens (2018): Reform and future of federal fiscal relations in Germany, Benefits for development cooperation. [https://www.reformgestaltung.de/fileadmin/user\\_upload/Dokumente/GIZ\\_Standard\\_A4\\_hoch\\_en\\_Zukunft\\_Finanzausgleich\\_web.pdf](https://www.reformgestaltung.de/fileadmin/user_upload/Dokumente/GIZ_Standard_A4_hoch_en_Zukunft_Finanzausgleich_web.pdf).

<sup>71</sup> IPPR North and the Northern Economic Futures Commission [NEFC] (2012) Northern prosperity is national prosperity: A strategy for revitalising the UK economy, IPPR North. <https://www.ippr.org/publications/northern-prosperity-is-national-prosperity-a-strategy-for-revitalising-the-uk-economy>.

<sup>72</sup> Sensier, Marianne (2017) Financing Inclusive Growth with a GM Community Bank. IGau. <https://hummedia.manchester.ac.uk/institutes/mui/igau/briefings/IGAU-Briefing-3-Regional-Banks.pdf>.

<sup>73</sup> Fischer (2019).

<sup>74</sup> Krill, Ze'ev; Barker, Andrew (2020) Unblocking the bottlenecks: infrastructure investment to foster the recovery in Germany. <https://oecdoscope.blog/2020/12/08/unblocking-the-bottlenecks-infrastructure-investment-to-foster-the-recovery-in-germany/>.

<sup>75</sup> Scheller, Henrik; Rietzler, Katja; Raffer, Christian; Kühl, Carsten (2021): Nicht-monetäre Investitions-hemmnisse bei öffentlichen Infrastrukturinvestitionen. Studie im Auftrag der Friedrich-Ebert-Stiftung, Deutsches Institut für Urbanistik und Institut für Makroökonomie und Konjunkturforschung. Berlin.

<sup>76</sup> Federal Ministry for Economic Affairs and Energy (2019): Industrial Strategy 2030: Guidelines for a German and European industrial policy. [https://www.bmwk.de/Redaktion/EN/Publikationen/Industry/industrial-strategy-2030.pdf?\\_\\_blob=publicationFile&v=7](https://www.bmwk.de/Redaktion/EN/Publikationen/Industry/industrial-strategy-2030.pdf?__blob=publicationFile&v=7).

arrangements for councils and the devolved nations, the UK needs an economic development fund that supports places to develop over the long term, similar to the GRW and Solidarity Fund developed in Germany. The levelling up and shared prosperity funds are only a small contribution to the quantity of funding required, and this could come from a combination of sources, such as prudent borrowing, or a small surcharge on the main progressive taxes (eg income tax and corporation tax) as in Germany. Funding could be devolved completely, without ringfences, but with accountability mechanisms similar to the gateway reviews for gainshare and earn back deals, or simply improved local checks and balances – though these would need to be much more rigorous than they currently are. Or, as with Germany's GRW, there could be agreement between sub-central and central governments about the criteria on which to spend such money. If spent well, this should result in currently lagging regions becoming less dependent, or even net contributors, over time – as the example of Bavaria illustrates.

- **Set up regional banks.** German regions are supported by diverse and often regionally purposed funds and institutions, while in the UK, most funds are centralised and/or far too small. The UK can learn from Germany by reforming its government-owned banks so that regions and nations are represented on their boards, and by capitalising an autonomous network of regional banks, which would spin out into entities governed by regional stakeholders – though these should be protected from political interference, which has caused problems in Germany. The UK could also support councils and MCAs to set up their own banks, to give grants and to lend to business or to back infrastructure or R&D projects, and support credit unions to upscale and lend to businesses too.

## 3

## DEVELOP THE ECONOMIES OF A DIVERSE RANGE OF PLACES, NOT JUST CITIES

### UK POLICYMAKERS DO NOT UNDERSTAND THE FULL NATURE OF THE REGIONAL PROBLEM AND OPPORTUNITY

The UK's longstanding regional inequalities are often misattributed to one single factor: the underperformance of its cities. The argument runs that density or scale generate economies of agglomeration, and that this is the exclusive source of additional regional economic growth; that UK cities underperform compared to others overseas; and that this is the sole, exclusive cause of regional underperformance more generally. This view even explicitly attributes the underperformance of post-industrial towns to the shortcomings of their adjacent cities. This is in line with a simplistic and reductive interpretation of what makes cities grow and prosper, which city leaders often reject.<sup>77</sup> The government's White Paper implicitly, and often explicitly, regards density as the primary, even exclusive, driver of additional regional economic growth.<sup>78</sup>

Agglomeration theories offer only an incomplete picture: the reality is more complex. It is true that very sparsely populated areas struggle to grow, but on the other hand, many of the UK's most productive areas are not especially dense – places like Cheshire, the M4 corridor, and parts of Scotland – while many of the larger or denser areas aren't especially productive, such as Manchester, Leeds and Birmingham.<sup>79, 80</sup> One economic modelling exercise found that a UK city that is twice the size of another UK city will

only be 1.6 per cent more productive.<sup>81</sup> Across the developed world, ›intermediate‹<sup>82</sup> (non-metropolitan, non-rural) areas have grown more than cities (both before and after the financial crisis) and the evidence suggests that only a limited group of relatively small (albeit important) sectors actually benefit from the economies of agglomeration – digital and finance, for example.<sup>83, 84, 85</sup> In reality, cities cannot be separated from the wider region in which they operate – especially when that wider region includes other cities and towns which are larger in their own right than many German cities – Bradford in West Yorkshire is one clear example, but even Manchester and Leeds are so close as to have the ability to ›borrow‹ density from one another, mitigate the negative externalities of agglomeration (such as congestion), and to compete, collaborate or specialise in ways which are mutually beneficial (morphological polycentricity).<sup>86, 87</sup> The evidence points to many different factors which affect a place's capacity to grow, beyond simply agglomeration – and this is reflected in the regional policies of countries such as France and Germany.<sup>88</sup>

<sup>77</sup> Core Cities (2020): Enhancing productivity in UK core cities: Connecting local and regional growth. <https://www.corecities.com/publications/enhancing-productivity-uk-core-cities-connecting-local-and-regional-growth>.

<sup>78</sup> Department for Levelling Up, Housing and Communities (2022): Levelling Up the United Kingdom <https://www.gov.uk/government/publications/levelling-up-the-united-kingdom>.

<sup>79</sup> Office for National Statistics (2022): Subregional productivity in the UK: July 2022. <https://www.ons.gov.uk/employmentandlabour-market/peopleinwork/labourproductivity/articles/regionalandsubre-gionalproductivityintheuk/july2022>.

<sup>80</sup> Martin, Ron; Bailey, David; Evenhuis, Emil; Gardiner, Ben; Pike, Andy; Sunley, Peter; Tyler, Peter (2019): The Economic Performance of Britain's Cities: Patterns, Processes and Policy Implications. <https://www.centreforcities.org/wp-content/uploads/2019/02/The-Evolving-Economic-Performance-of-Britain%E2%80%99s-Cities-Patterns-Processes-and-Policy-Implications.pdf>.

<sup>81</sup> Ahrend, Rudiger; Farhy Emily; Kaplanis, Ioannis; Lembcke Alexander C. (2014): What makes cities more Productive? Evidence on the role of urban governance from five OECD Countries, OECD regional development working papers. <https://www.oecd-ilibrary.org/docserver/5jz432cf2d8p-en.pdf?expires=1659717135&id=id&ac-cname=guest&checksum=4EA453C276343B974F3CE7F34532B46A>.

<sup>82</sup> OECD Directorate for Public Governance and Territorial Development (2011): OECD regional typology. [https://www.oecd.org/cfe/regionaldevelopment/OECD\\_regional\\_typology\\_Nov2012.pdf](https://www.oecd.org/cfe/regionaldevelopment/OECD_regional_typology_Nov2012.pdf).

<sup>83</sup> Dijkstra, Lewis; Garcilazo, Enrique; McCann, Philip (2013): ›The Economic Performance of European Cities and City Regions: Myths and Realities‹, European Planning Studies 21(3): 334–354.

<sup>84</sup> Dijkstra, Lewis; Garcilazo, Enrique; McCann, Philip (2015) ›The effects of the global financial crisis on European regions and cities‹, Journal of Economic Geography 15: 935-949.

<sup>85</sup> Gibbons, Steve; Overman, Henry and Tucci, Alessandra (2009) The Case for Agglomeration Economies, Manchester Independent Economic Review. [http://www.manchester-review.org.uk/project\\_718.html](http://www.manchester-review.org.uk/project_718.html).

<sup>86</sup> Seymour, Tom (2017) Urban polycentricity in northern England: Economic catalyst or chimera? no 190. <https://www.ucl.ac.uk/bartlett/development/publications/2017/aug/dpu-working-paper-no-190>.

<sup>87</sup> Champion, Tony; Coombes, Mike (2012): ›Is Pennine England becoming more Polycentric or more Centripetal? An Analysis of Commuting Flows in a Transforming Industrial Region, 1981-2001‹, SERC Discussion Papers 0105, Centre for Economic Performance, LSE.

<sup>88</sup> Raikes (2019).



UK policymakers also place too much emphasis on service sectors, while misunderstanding what these actually are and what they do in practice. UK policymakers, based in London, have doubled down on the sectors concentrated in the City of London, which are sometimes traded internationally – a small cluster of knowledge intensive business services (KIBS). UK economic policy, under successive governments, has prioritised deregulating services so that a small cluster of these can trade competitively overseas, severely limiting the scope of economic policy. The assumption, often explicit, is that growth in these sectors will drive up aggregate UK productivity and help fund public services across the country. This has two effects.

First, this approach misses an opportunity to support business services properly. Outside of a small group of companies concentrated in the City of London, KIBS mostly serve the domestic economy and their operations are relatively mundane, although important, components of a wider economy. This is a sector mostly made up of accountants management consultants and insurance brokers.<sup>89, 90, 91</sup> Business services serve businesses in the wider UK economy, in retail, hospitality and manufacturing industries – as well as serving other business services companies, and even the public sector (councils, hospital trusts, schools and universities for example).

Second, this approach has missed an opportunity to develop a thriving and diverse high-tech manufacturing sector. We no longer live in a world where high-income countries like the UK have heavy industry, and long, high-employment production lines. But high-tech, high-value manufacturing is still a significant, high-productivity component of the economy, and remains incredibly important – just as important as the high-value KIBS that policymakers give so much support. The UK has no strategy or policy toolkit to support these sectors, beyond ad-hoc financial transfers to keep manufacturers like Nissan in Sunderland, or research funding to support the biopharma and medical technology industries, headquartered largely in the research 'golden triangle' in the south, but with production facilities in other regions.

It is misleading therefore to simply reduce the UK to a services economy – and to draw a comparison with German

as a manufacturing economy. In fact, the UK has failed to adapt and diversify, and has wrongly shaped a broad range of economic policies to allow a relatively small and exclusive cluster of tradeable business services to thrive, alongside ad-hoc approaches to attract or retain selected manufacturers. It is also a mistake to contrast the UK with Germany by describing Germany as a manufacturing economy – yes German manufacturing is unusually large, but it is still a services economy and also has high-value traded services. Regardless, the distinction between services and manufacturing is far too simplistic given that definitions are rarely clear cut, and sectors are often highly integrated.

## GERMAN POLICYMAKERS OFTEN TAKE A MORE COMPREHENSIVE APPROACH TO DEVELOPING PLACES AND SECTORS

German regional development has its own unique history. Germany is made up of many smaller cities, which are more dispersed and tend to have their own hinterland – in part because the country came together as a confederation of states. Post-war, the physical reconstruction of major cities was a major task for some cities, such as Dresden, but less so for others. At this time, the country was also politically divided, with the East under Soviet rule and economic policy – which meant many large East German companies (such as Siemens) relocating to southern states in West Germany. More recently, Germany has endured two broad structural changes which have impacted on spatial development. The first is the culmination of long-term deindustrialisation, which impacted areas like the Rhine-Ruhr, in a similar way to many other post-industrial countries including the UK. The second is the shock of reunification which, in the immediate years afterward, meant three million people left the new Länder and one in three jobs were lost.<sup>92</sup>

This combination of factors has resulted in significant regional economic divergence, both between and within regions. Some places have crumbling infrastructure, while in some Eastern towns and cities the population is ageing and shrinking as young people leave. There is also relatively high poverty and unemployment in post-industrial regions, like North Rhine-Westphalia or Bremen, compared to southern states such as Bavaria and Baden-Württemberg. This leaves Germany with both a North-South and East-West divide – though the latter is more pronounced – as well as inequalities within regions.

But there is clear evidence that regional economic policies have helped many of these places to adapt. Eastern cities, such as Leipzig, have seen something of a revival, due in large part to interventions and investment from the Länder, the KfW and federal government as well as strong municipal

<sup>89</sup> Riley, Rebecca; Billing, Chloe; Bramley, George; Green, Anne; Hoole, Charlotte; Taylor, Abigail (2020): Professional & Business Services sector Creating further demand and growth outside London, Department for Business Energy and Industrial Strategy. [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/866329/professional-business-services-sector-growth-outside-london.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/866329/professional-business-services-sector-growth-outside-london.pdf).

<sup>90</sup> Green, Anne; Jones, Rebecca; Garrett, Richard (2012): Sector Skills Insights: Professional and Business Services, UKCES. [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/304188/Sector\\_Skills\\_Insights\\_Professional\\_and\\_Business\\_Services\\_evidence\\_report\\_56.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/304188/Sector_Skills_Insights_Professional_and_Business_Services_evidence_report_56.pdf).

<sup>91</sup> Raikes, Luke; Cox, Ed (2016): Business skills: Professional services in the northern powerhouse economy, IPPR North. <http://www.ippr.org/publications/business-skillsprofessional-services-in-the-northern-powerhouse-economy>.

<sup>92</sup> Fischer (2019).



leadership and innovation.<sup>93, 94, 95</sup> The Rhine-Ruhr region was able to adapt to economic change with less financial support than in the East, because the Land convened and worked with businesses to modernise over time.<sup>96</sup> Regions in both the East and West are mostly more productive than post-industrial UK regions, and German regions have retained high-value positions in global value chains, while UK regions have slipped further behind.<sup>97, 98</sup>

In general, German regional policy supports a broader range of places and sectors, though approaches vary between states. German regional policy is highly varied because economic development is primarily within the remit of the Länder, and different Länder have adopted different approaches. There are three broad observations.

- First, many German Länder do invest in smaller cities and towns – not out of charity, but because these are often the places that show the best prospects. Small cities such as Jena, Dresden, Leipzig, Ingolstadt, and Rostock are thriving.<sup>99</sup> Even smaller towns, such as Guben or Grünheide, have attracted large scale investments in recent years.<sup>100</sup> Regional and industrial strategies often draw on concepts such as smart specialisation – which means building up from the assets and advantages already within a place, including in towns or smaller cities. This has finally started to favour parts of East Germany: space is often and increasingly seen as an asset, not a hindrance;<sup>101</sup> and renewable energy availability is increasingly an asset for manufacturers – again this is often produced outside of cities, in places like Brandenburg.
- Second, and relatedly, German governments actively and strategically support a wider range of sectors – explicitly manufacturing – meaning more places stand to benefit: major manufacturers are actively enticed to the small cities of the new Länder – such as BMW in Leipzig, Tesla in Grünheide, Audi in Ingolstadt or Intel in Magdeburg – the largest FDI investment in Germany

history. Many of these companies are large German or foreign multi-nationals, which shows that the scope of German manufacturing goes beyond family-owned ›Mittelstand‹ tier of medium-sized, family-owned companies that attract the most foreign attention. The advantages of the German approach are increasingly evident in race to build new ›giga factories‹ to support EV manufacturing – many international companies are now setting up such factories in the East.

- Third, many regions have succeeded by banding together cities and towns into ›polycentric‹ regions. This is particularly clear in the Rhine-Ruhr area – where de-industrialisation has left its scars, but productivity is far higher than it is in the North of England. The focus, as set out in the latest ›Leitbild‹ agreed between state ministers, is on »diverse cooperative systems‹ managing transitions in a diverse range of places, and on facilitating cooperation, interaction and networks between them«. The concept of the metropolitan region encompasses a wider regional role too, including the hinterland – ›Metropolregionen‹.<sup>102</sup> German policymakers have also harnessed the concept of a ›Regiopolen‹ – a smaller centre with an important regional role, often with a university and concentration of innovative potential – Rostock is seen as the pioneer of the concept.

There are some shortcomings to Germany's regional policies. Some German Länder have adopted a narrow focus on cities, although German cities are notably far smaller.<sup>103</sup> The geographical footprint of the regional economy and the geography of policy making often don't align: some Länder are too small, which has held back Berlin's interactions with Brandenburg for example; others are too large, which has held back collaboration between the Rhine-Ruhr's cities and towns. Mergers and restructures that appear to make sense are held back by institutional stasis. While de-industrialisation has been less abrupt in the West, this has come at a significant financial and environmental cost – with coal mines and coal-fired power stations remaining active to a much larger extent than in the UK, even when uncompetitive. The high-value activity – especially R&D, and the headquarters of larger firms – tend to be undertaken in already wealthy regions, while lower value production takes place in the new Länder – though this is changing, as with some of the investments noted above. Finally, though unprecedented progress has been made in very difficult circumstances, severe challenges remain, particularly in the East.

<sup>93</sup> Falk, Nicholas (2014): Postcard from East Germany – Just do something! <https://postcardfromthefuture.wordpress.com/2014/05/29/postcard-from-east-germany-just-do-something/>.

<sup>94</sup> Power, Anne (2010) Phoenix cities: The fall and rise of great industrial cities. <https://policypress.universitypressscholarship.com/view/10.1332/policypress/9781847426833.001.0001/upso-9781847426833>.

<sup>95</sup> Hall, Peter (2013): Good Cities, Better Lives: How Europe Discovered the Lost Art of Urbanism, Routledge.

<sup>96</sup> Raikes (2020).

<sup>97</sup> ONS (2018): Regional and subregional productivity comparisons, UK and selected EU countries: 2014. <https://www.ons.gov.uk/economy/nationalaccounts/uksectoraccounts/compendium/economicreview/april2018/regionalandsubregionalproductivitycomparisonsukandselectedeucountries2014>.

<sup>98</sup> Los, Bart; Chen, Wen (2016): Global Value Chain Participation Indicators for European Regions, report for the OECD.

<sup>99</sup> Falk (2014).

<sup>100</sup> Chazan, Guy; Miller, Joe (2022): The surprising revival of eastern Germany, Financial Times. <https://www.ft.com/content/f1d0e732-d523-40db-b753-ae404498dc7a>.

<sup>101</sup> Chazan and Miller (2022).

<sup>102</sup> Secretariat of the Standing Conference of Ministers responsible for Spatial Planning Federal Ministry of Transport and Digital Infrastructure (2016): Concepts and Strategies for Spatial Development in Germany, Decision of the 41st Standing Conference of Ministers responsible for Spatial Planning in Berlin on 09 March 2016. [https://www.bbsr.bund.de/BBSR/DE/themen/\\_alt/Raumentwicklung/RaumentwicklungDeutschland/Leitbilder/leitbildroschueere-englisch.pdf?\\_\\_blob=publicationFile&v=1](https://www.bbsr.bund.de/BBSR/DE/themen/_alt/Raumentwicklung/RaumentwicklungDeutschland/Leitbilder/leitbildroschueere-englisch.pdf?__blob=publicationFile&v=1).

<sup>103</sup> IPPR North and the NEFC (2012).

## THE UK SHOULD DEVELOP A DIVERSE RANGE OF PLACES, NOT JUST CITIES

The UK can learn a great deal from the various different approaches to regional development in Germany. Our thinking and our policies are currently held back by an intellectual framing that doesn't allow many places to thrive – and even holds politicians back from doing things that it is in their political interest to do.

Lessons for the UK include:

- **Ensure the industrial and regional strategy is comprehensive in terms of place and sector.** Different places have different things to offer, and any strategy should reflect that, instead of assuming that only denser, larger places can thrive – which, especially in the UK, is clearly not true. The levelling up White Paper needs to evolve into a much more comprehensive strategy, in terms of sector and geography.
- **Set out a devolution proposal that non-metropolitan areas can adopt and support their capacity building.** Currently, metropolitan areas have an outsized advantage in capacity and leadership. While this benefits the cities in the competition for cash, cities are not islands and all places will be held back if the advantages of non-metropolitan regions go underutilised. The government's White Paper opens the door to devolution to non-metropolitan areas and North Yorkshire has an emerging devolution deal. But this needs to be developed much further, in order for a full range of places to benefit.
- **Reform funding criteria and decision making to reflect a more diverse range of places.** Various UK funds are geared toward cities, either explicitly (as in the Transforming Cities Fund) or implicitly, in ministers' and civil servants' application of 'Green Book' value for money assessments. This needs to change in order to allow all places that can thrive to do so. Funding pots and funding decisions could be more transparent and designed in partnership with local government.

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## LEVELLING UP?

### Lessons from Germany



Combine devolution with formalised collaboration between tiers of governance. Lessons for the UK include: reform sub-central governance to be stable, collaborative and integrated; build formal and informal pan-UK collaboration; build pan-regional collaboration in England from the bottom up; and construct a system of fiscal devolution and transfers that embed long-termism, collaboration and fairness.



Set out long-term plans and invest at scale. Lessons for the UK include: develop a long-term industrial and regional strategy; build a significant, long-term economic development fund; and set up regional development banks.



Develop the economies of a diverse range of places, not just cities. Lessons for the UK include: ensure the regional-industrial strategy is comprehensive in terms of place and sector; set out a devolution proposal that non-metropolitan areas can adopt and support their capacity building; and reform funding criteria and decision making to reflect a more diverse range of places.

Further information on the topic can be found here:

<https://uk.fes.de>