

Regional wages - An expert submission for SSEN by Professor Ken Mayhew,¹ July 2022

Ofgem has published its RIIO-ED2 Draft Determinations and has proposed to apply a regional wage adjustment on DNOs' costs on the basis of three regional groupings—London, South-East, and the rest.²

SSEN, based on previous evidence from Oxera (2021),³ argue that Ofgem is wrong to use these three regional groupings.⁴ Instead, Oxera (2021), proposed that:

- Scotland should be grouped with the South-East; or
- there should be no regional groupings, and each region should be treated separately.

Using historical, occupationally weighted ASHE data, OXERA (2021) showed that wages in Scotland are consistently higher than elsewhere in the country with the exception of London and the South-East.

Ofgem reject this argument on the basis that there is “sufficient mobility of labour to mitigate wage differentials throughout GB; however, productivity and cost of living factors in London and, to a lesser extent, in the South-East, lead to persistent wage inequality across these regions”.⁵ In other words, Ofgem argues that, excluding London and the South-East, the UK can be regarded as a single labour market where there is sufficient geographical mobility of labour to drive wages towards equality.

In my expert opinion, I consider that Ofgem’s argument is flawed and there is a significant amount of evidence to demonstrate this.

There is general agreement among regional economists that **regional mobility is very limited**. As Phillip McCann, one of the leading scholars in this field, writes: “The majority of households do not relocate interregionally or internationally, such that when they do relocate, it

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² Ofgem (2022), “RIIO-ED2 Draft Determinations – Overview Document”, June.

³ Oxera (2021), “Company-specific and regional factors for RIIO-ED2”, November.

⁴ See SSEN's own response to the Draft Determinations.

⁵ Ofgem (2022), “RIIO-ED2 Draft Determinations – Overview Document”, June, para. 7.39.

tends to be within the same broad locality or region. Indeed, there is some evidence that over recent years interregional migration rates have actually been falling.”⁶

Such observations are consistent with the fact that wages in Scotland, along with those in London and the South-East, have remained persistently higher than in most of the rest of the UK since at least 2011.⁷

Recent labour market developments are highly likely to have reduced internal migration still further. With vacancy rates at historical highs in most parts of the UK, there is even less reason for individuals to relocate to seek employment or to move to higher-paying jobs. The most recent official (ONS) data for the UK show a seasonally adjusted vacancy rate of 1,294,000 per month averaged over April to June 2022.⁸ This is very close to the peak of 1,297,000 (the average in March to May 2022). These numbers stand in stark contrast to the figures immediately before the COVID pandemic—a monthly average of 820,000 in November 2019 to January 2020. In fact, going all the way back to the beginning of 2003, the highest monthly average was 862,000 (August to October 2018).

The latest ONS data show that the growth of vacancies between the first and second quarters of 2022 varied across industrial sectors. **The industry displaying the highest rate of growth was electricity, gas, steam and air conditioning supply (16%).**⁹ Scotland is no exception to this general shortage of labour. The Scottish Government’s Monthly Economic Brief (June 2022) remarked: “Business surveys signalled that labour market tightness continued to persist in May, with high vacancy rates and falling candidate availability.”

All this chimes with long-held findings of labour economists that any response of regional wages to regional migration rates “is slow and the long run is very long run indeed [...] it takes more than 20 years”.¹⁰.

The early years of this millennium have witnessed lower migration flows between Scotland and the rest of the UK than in the late 20th century.

⁶ McCann, P. (2013), *Modern Urban and Regional Economics*, second edition, Oxford: Oxford University Press.

⁷ See section 3.3 in Oxera (2021), “Company-specific and regional factors for RIIO-ED2”, November.

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<https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/bulletins/jobsandvacanciesntheuk/july2022>

⁹ <https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/bulletins/jobsandvacanciesntheuk/july2022>

¹⁰ Pissarides, C.A. and McMaster, I. (1990), “Regional migration, wages and unemployment: empirical evidence and implications for policy”, *Oxford Economic Papers*, 42 (4).

Indeed, Champion and Shuttleworth (2017) have shown a decline in internal migration rates generally between 1971 and 2011.¹¹ Amongst the possible reasons they suggest for this are population ageing and an increase in the number of dual-earner couples.

Scottish Government data show that 850,800 people moved from the rest of the UK to Scotland in the period 2001/02 to 2017/18—an average of about 50,000 per year, or less than 2% of the economically active population in Scotland. Most of the movers are in the 18 to 29 age range. There are two peaks—18- to 20-year-olds and late 20s to early 30s. The first of these peaks is largely accounted for by students. Far more women than men are in the second peak. Formal regression analysis, including a range of control variables, confirms these observations. The authors conclude: “The likelihood of moving from England and Wales to Scotland is highest among individuals aged 20 to 24, but also relatively high amongst those aged 16 to 19 and those in their late twenties and early thirties. As expected, the likelihood of moving significantly declines with age. Individuals with dependent children are less likely to move than those without children. University graduates have a significantly higher probability of moving.”¹²

This picture of limited geographical mobility is confirmed by a recent study for the Department for Education’s Skills and Productivity Board.¹³ Using longitudinal education outcomes (LEO) data,¹⁴ the authors estimate the mobility of individuals between the ages 16 and 30 across travel to work areas (TWAs) in England and across smaller geographical areas, Middle Layer Super Output Areas (MSOAs)—the end year is 2017/18. The critical point is that the probability of moving even across these small geographical areas is limited. For people whose highest qualification level is 4 or below,¹⁵ the probability of moving across TWAs is below 20%. For those whose highest qualification is level 5, the probability hovers around 20% and is around 25% for those who have level 6 qualifications (bachelor’s degree) or higher. The authors conclude that: “the vast majority of moves are very short distances – less than 10km (the median is around 7km) – and this is especially true for non-graduates for whom the median is only around 5km.”

¹¹ Champion, T. and Shuttleworth, I. (2017), “Is longer-distance migration slowing? An analysis of the annual record for England and Wales since the 1970s”, *Population, Space and Place*, 23 (3).

¹² Scottish Government (2020), “Internal Migration in Scotland and the UK: Trends and Policy Lessons”.

¹³ Advani, A., Cornish, J. and Crawford, C. (2022), “Would Additional Investment in Skills Benefit Areas of the Country that are Poorer Performing Economically?”, Skills and Productivity Board, London: Department for Education.

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¹⁵ The ranking is standard in the UK, namely: Level 6 is bachelor’s degree or equivalent; Level 5 is foundation degree or equivalent; Level 4 is a higher apprenticeship or equivalent; Level 3 is A level or equivalent; Level 2 is GCSE grades A* to C or equivalent; Level 1 is GCSE grades d - g or equivalent.

In sum, **regional mobility rates are low and adjustment times are long**. In my expert view this supports the argument for treating Scotland separately from the rest of the UK (excluding London and the South-East).