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Policy Response

Finance and the Growing Urban-Rural Divide

Submission to the OECD's Working Party on Rural Policy

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About Scotianomics

In the 21st century data is everywhere but it is the analysis that transforms data into valuable, actionable knowledge that is key to success.

Organisations, both in Scotland's private and public sectors, lack access to useful, reliable data and value-added analysis of the kind that most advanced countries take for granted. This creates a hidden but real disadvantage for Scottish business, limits public policy and disrupts the pursuit of shared prosperity.

Scotianomics aims to spark a knowledge revolution and inform the decision-makers on Scotland's economy. We provide cutting-edge intelligence and strategic planning resources so that stakeholders can gain a wide view of the threats and opportunities in the world through our geopolitical, economic and policy analysis, unique historical datasets, risk and opportunity forecasts, Geographic Information System mapping solutions and strategic planning services.

Gordon MacIntyre-Kemp

Director

Contents

Executive Summary

Following the OECD's request to Scotianomics to respond to the Draft Principles on Rural Policy, we set out the following comments, findings and suggestions:

1. The OECD has taken some important steps in its rural research and policy agenda, recognising the complexities of different economic geographies and identifying many of the key global developments shaping rural communities.
2. We encourage the OECD to include in its analysis and policy framework what we consider to be one of the most significant developments, yet one that is currently missing from the Draft Principles: financialisation.
3. Financialisation is a critical mega-trend that affects other megatrends. It is a process that has created vast structural inequalities between urban and rural regions, as policies favourable to finance put pressure on rural economies. The effects of this are visible in our initial investigations, which suggest that financial sector growth is associated with greater degrees of urbanisation across OECD member-states.
4. The financialisation of OECD economies has created a number of challenges for rural communities, including a vulnerability to more frequent, cyclical crises, as well as problems in areas such as land and resource management.
5. Scotianomics recommends that the OECD include finance in its future research agenda on rural development, and that the OECD craft policy frameworks which will address the problems financialisation causes in rural economies.

Introduction

This paper is a response to the OECD's 'Draft Principles on Rural Policy'. The Draft Principles, and the past publications it builds upon[1], provide a comprehensive and positive framework for setting an effective agenda for rural development. Scotianomics recommends the addition of one more mega-trend to this document – 'financialisation' – a process that has been transforming the political economies of OECD member-states since the 1970s. The OECD should include shifts in the role of finance into its future considerations of rural development, if the challenges in this area are to be addressed.

The Draft Principles draw on several 'mega-trends', outlined in the Rural 3.0 framework, that will shape, or are currently shaping, the global economy. These mega-trends are: 'population ageing and migration'; 'urbanisation'; global shifts in production'; 'rise of emerging economies'; 'climate change and environmental pressures'; 'technological breakthroughs'.

Missing from this list is the most significant macro-development in the global economy in recent decades. Namely, the rise of finance and subsequent financialisation of the economy and economic actors, from non-financial corporations to individuals and households – even the state itself. Many of the 'mega-trends' identified by the OECD are being partly caused by this process of financialisation.

In what follows, some general propositions will be made about the rise of finance, some effects this has had on rural economies, and how this has set the tone for contemporary relations between urban and rural regions. This is intended to serve only as an initial basis from which to further explore empirically the rural question in relation to finance. The main objective here is to introduce finance as a factor of importance in the rural context, as well as in the broader economics of OECD countries. Including finance into the analysis will strengthen the policy framework on rural-specific social issues.

1 OECD (2018) 'Rural 3.0: A Framework for Rural Development', OECD Policy Note.

Urban-Rural Relations Under Financialisation

It is commendable that the OECD's work, in its own words, 'has focussed on the need to take a comprehensive view of how a wide range of policies – including sectoral and fiscal policies – impact different "places", stressing that all policies have spatial consequences. It has further underlined the importance of considering functional geographies – recognising that urban and rural areas are interconnected through different types of linkages that often cross traditional administrative boundaries'.

While taking an economic geography approach take the analysis in the right direction, there are nonetheless gaps in the OECD's work. Without taking finance into account, the growing spatial differences between urban and rural geographies cannot be registered, nor can a fundamental aspect of the (unequal) interconnections between urban rural areas be seen.

Financialisation – 'defined as the increasing role of financial motives, financial markets, financial actors and financial institutions in the economy'[2] – has created a situation in OECD member states in which those in command of financial resources have gained considerable influence over the political and economic management of states.

In this context, urban economies have gained even greater precedence over rural economies, especially the cities that house larger financial institutions and maintain a privileged position in local and global financial markets. Financial actors and institutions, as a consequence of their influence, have redirected scarce state resources towards them in the forms of subsidies and bailouts.[3] The majority of the benefits from this state support has been shared only across a small number of cities with significant financial sector activity. As finance is a distinctly urban commercial activity, this has meant less state spending is available to be distributed to rural areas, and indeed many urban areas too, compounding their experience of austerity, a policy further intensified after the bailouts that followed the 2007-2008 financial crisis.

As OECD governments have found it increasingly hard to raise the money for state expenditure through taxation, a result of historically declining economic growth, internationalisation of capital, and stagnating wage growth, they have turned to borrowing. This has contributed to the financialisation of an increasingly indebted state, further reinforcing the power of lenders and financial markets.

States have attempted to maintain the confidence of financial markets, so that the latter will continue to lend to the former without fear that debt will be unpaid, by attempting to limit public debt to sustainable levels through austerity.[4] Austerity, in the long-term, will most negatively impact peripheral rural communities, who, facing systemic

2 Blakely, G. (2018) 'On Borrowed Time: Finance and the UK's Current Account Deficit', Institute for Public Policy Research, IPPR Commission on Economic Justice.

3 Cournède, B., Denk, O. and Hoeller, P. (2015) 'Finance and Inclusive Growth', OECD Economic Policy Paper, No.14.

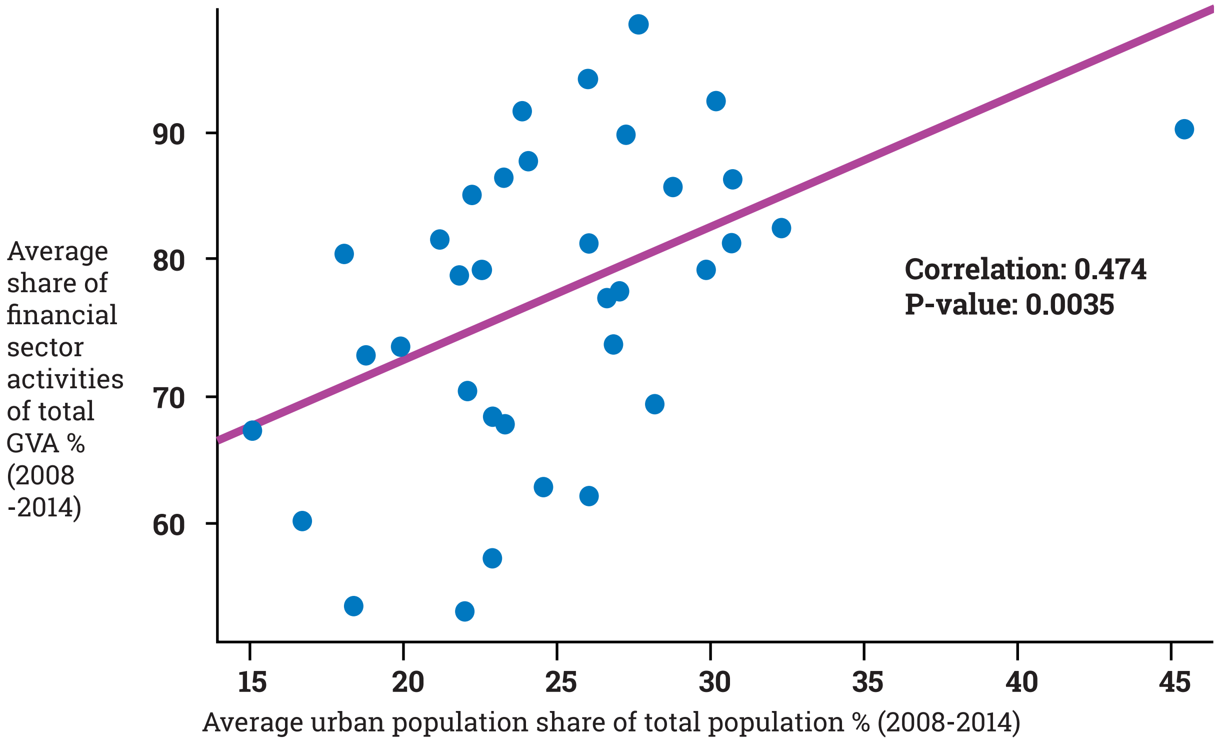
4 Wolfgang, S. (2015) 'The Rise of the European Consolidation State', Max Planck Institute for the Sutdy of Societies, Discussion Paper 15/1.

population decline, have a greater dependency on state spending.[5] And, in any case, austerity has failed to keep public debt from rising.

This new dynamic of power could arguable be intensifying urbanisation in OECD states. Rising urban populations in major OECD economies has corresponded with the growth of the financial sector. Statistical analysis of the entire population of OECD member-states reveals that growth in the GVA of finance and related sectors as a percentage of total GVA is correlated with an increased urban population. The association is stronger than the relationship between variations in per capita GDP across OECD member-states and the size of urban populations, which is statistically insignificant.

This suggests that it is not economic modernisation itself that drives urbanisation, but specific developmental strategies – namely finance and service sector driven growth. The OECD should take this into consideration and conduct its own research into the links between urbanisation and financialisation.

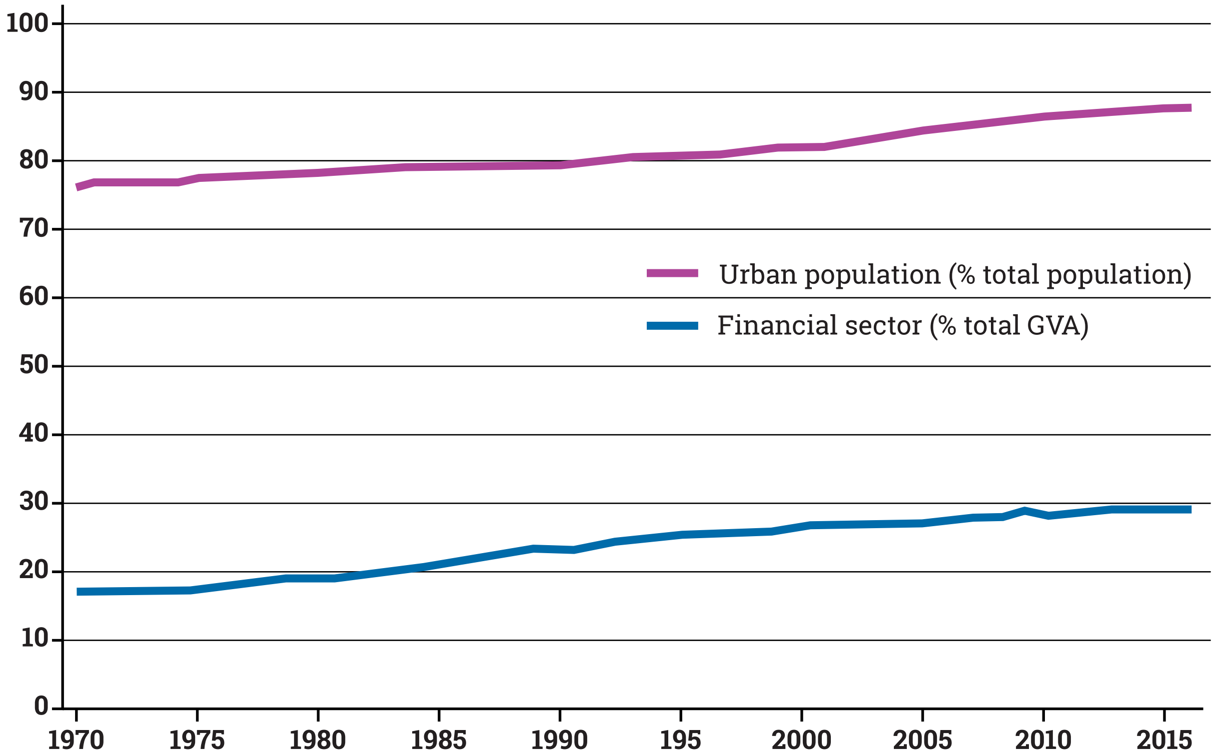
Figure 1. Financial Sector in Relation to Urban Population



Source: OECD (2018); World Bank (2018)
Note: the financial sector is considered in the broad sense: financial and insurance activities, as well as real estate, renting, and business services.

5 OECD (2018) 'Rural 3.0: A Framework for Rural Development', OECD Policy Note.

Figure 2. Historical Financial Sector Growth in Relation to Urbanisation



Source: OECD (2018); World Bank (2018)

Note: States included are the Netherlands, France, Belgium, Denmark, the United States (1970-2016); Japan (1973-2016); United Kingdom (1985-2016).

Finance, Instability and Growth

The emphasis for profit-making in many OECD economies has shifted from the sphere of production to financial flows,[6] with sectors engaged in the latter located mainly in urban areas. As such, whatever advantages in rural regions have in terms of a monopoly over resources valuable as manufacturing inputs, as well as the advantages of particular manufacturing facilities,[7] economies are not calibrated in a way that maximises the benefits for rural regions. Thus, while 'the common emphasis of rural policy on stimulating manufacturing and other tradeables has considerable merit' (OECD, 2018: 18), doing so will require that OECD economies as a whole shift rebalance their focus between finance/service sector activities and productive activities.

For now, financialisation has shifted the economic balance in favour of urban geographies that command financial mechanisms and resources. At the same time, the vast expansion of finance has destabalised OECD economies and been detrimental to national economic growth. As Cournede et al. highlight, 'further expansion of an already large financial sector could slow economic growth in particular by: generating boom-and-bust cycles that slow long-term growth; increasing vulnerabilities to shocks and international financial contagion'.[8]

For instance, '[a] rise in intermediated credit from […] 100 per cent to 110 per cent of GDP is linked to a 0.25 percentage reduction in economic.[9] At present, credit to GDP stands at an average of 97 per cent across the OECD.[10] While large, this figure does not reflect the huge levels of credit to GDP across some of the major economies.

Table 1.
Domestic Credit to Private Sector Across Selected OECD States (% of GDP)

Country	Credit to GDP
United States	192.1
Denmark	165.6
Japan	161.7
Norway	146.3
Korea	144.8
Australia	140.9
United Kingdom	**136.2**
Sweden	132.2

Source: OECD (2018)

6 Lapavitsas, C. (2013) 'The Financialisation of Capitalism: "Profiting Without Producing"', City, 17:6, 792-805.
7 OECD (2018) 'Rural 3.0: A Framework for Rural Development', OECD Policy Note.
8 Cournède, B., Denk, O. and Hoeller, P. (2015) 'Finance and Inclusive Growth', OECD Economic Policy Paper, No.14.
9 ibid
10 ibid

Particularly important is that financialisation has integrated boom and bust cycles as an ordinary, frequent sequence in advanced economies. As the rural 3.0 notes, remote rural economies are especially vulnerable to 'booms and busts'.[11] This being the case, it is arguable that financialisation is therefore more destabilising for rural economies in the long-term. Data included in the Rural 3.0 reinforces this, where rural regions were much less resilient in the aftermath of the 2008 financial crisis, after a period of sustained growth during the wave of speculative activities that preceded the crash.

Table 2. Annual Average Per Capita GDP Growth, OECD (%)

Type of region	2000-2007	2008-2012
Predominantly urban	2.39	-0.70
Intermediate	2.20	-0.28
Predominantly rural (total)	2.29	-1.11
Predominantly rural close to cities	2.29	-0.28
Predominantly rural remote	2.30	-2.45
All regions	**2.29**	**-0.70**

Source: OECD (2018)

Table 3. Annual Average Labour Productivity Growth, OECD (%)

Type of region	2000-2007	2008-2012
Predominantly urban	1.65	0.24
Intermediate	1.57	0.65
Predominantly rural (total)	1.97	0.12
Predominantly rural close to cities	2.15	0.56
Predominantly rural remote	1.69	-0.61
All regions	**1.74**	**0.34**

Source: OECD (2018)

11 OECD (2018) 'Rural 3.0: A Framework for Rural Development', OECD Policy Note.

Financial Motives and Immobile Assets

Depopulation and underdevelopment have meanwhile been amplified in rural economies as a result of immobile assets being mobilised under financial motives, with such things as land being treated as a purely financial asset subject to supply and demand. With this considered, caution must be urged about the proposal to 'offer guidance to OECD and partner countries on how to valorise recreational, ecological, agricultural and cultural resources in rural areas'.[12] If the means for doing so is provided without taking into account how financial motives and institutions affect valorised assets, this could generate unforeseen crises in rural communities.

For instance, owners of land are increasingly beginning to privilege land's value as a financial asset over its productive usage. In other words, landowners have preferred to trade land, add value to it through the planning system, and to artificially increase land value by deliberately restricting the quantity of land on the market.[13] These activities have gained landowners fare more profits on land than, for example, farming or homebuilding – reducing the incentive to undertake the latter activities.

In Scotland, farmland supply fell by 71 per cent between 2000-2015,[14] with a persistently low supply to date.[15] Moreover, since financialisation began in the 1970s, there are signs of an increasing concentration of rural land. Liberalisation of capital markets may also be driving an increasing ownership of land among foreign investors, particularly registered in tax havens. By the latest available estimates, around 740,000 acres of land in Scotland is owned by companies in offshore tax havens[16] – serving to disguise the owners of land. The Panama Papers leak alone revealed that over 60,000 acres of Scottish land was held by companies in Panama.[17]

12 OECD (2019) 'Draft OECD Principles on Rural Policy', OECD Working Party on Rural Policy.

13 Hetherington, P. (2015) 'Britain's Farmland Has Become a Tax Haven: Who Dares Reform It?', The Guardian, 02/09/15, Available Online: [https://www.theguardian.com/society/2015/sep/02/britain-farm-land-tax-havenreform].

14 Savills (2015) 'Scotland's Farms and Estates Remains Active', Savills News, 01/07/15, Available Online: [https://www.savills.co.uk/insight-and-opinion/savillsnews/189612-0/scotland-s-farms-and-estates-market-remains-active].

15 McCulloch, R. (2017) 'Scottish Farmland Market Review: Spring 2017', Strutt and Parker, Spring 2017, Available Online: [https://www.struttandparker.com/knowledgeand-research/scottish-farmland-market-review-spring-2017]

16 Wightman, A. (2015) 'Scottish Land and Secret Jurisdictions', Land Matters, 19/10/15, Available Online: [http://www.andywightman.com/archives/4361].

17 Hutcheson, P. (2016) 'Revealed: Over 60,000 Acres of Land in Scotland Owned By Panama Companies', The Herald, 10/04/16, Available Online: [https://www.heraldscotland.com/news/14417116.Panama_companies_own_more_than_60_000_acres_of_Scottish_land/].

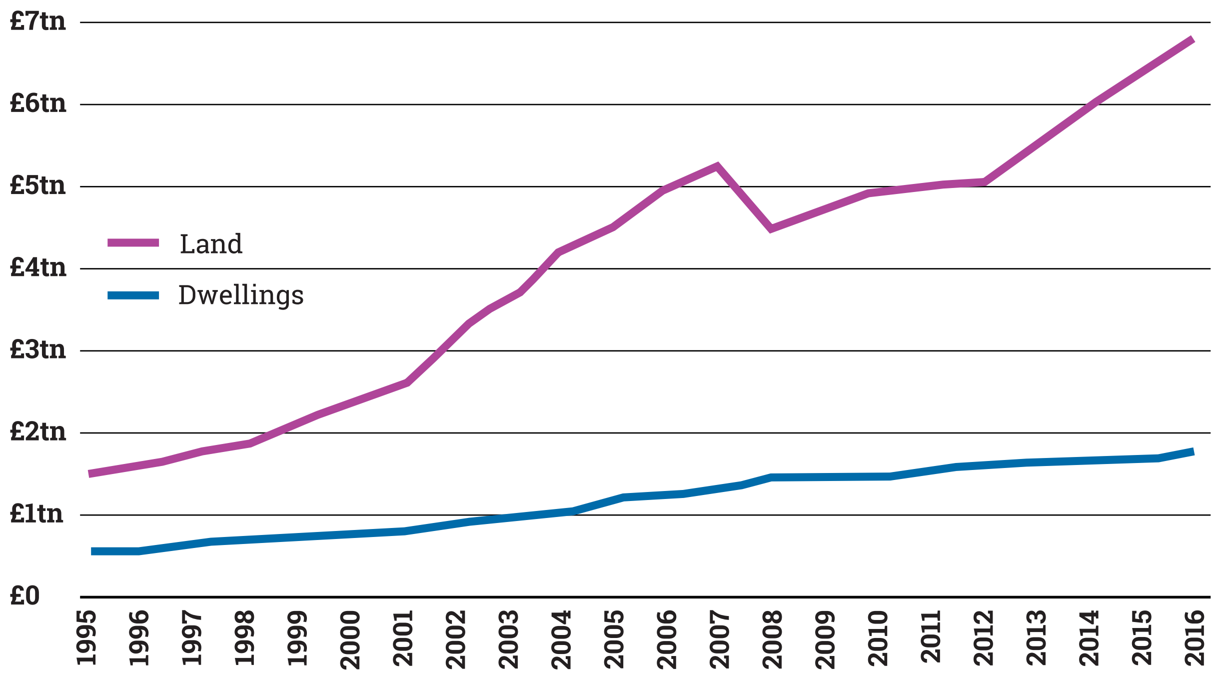
Table 4. Rural Land Ownership Patterns in Scotland (1970-2012)

Rural land	Number of land owners		
	1970	**1995**	**2012**
10%	18	17	16
20%	51	53	49
30%	110	116	110
40%	207	220	221
50%	370	412	342
60%	1,180	854	963

Source: Scottish Government (2014)

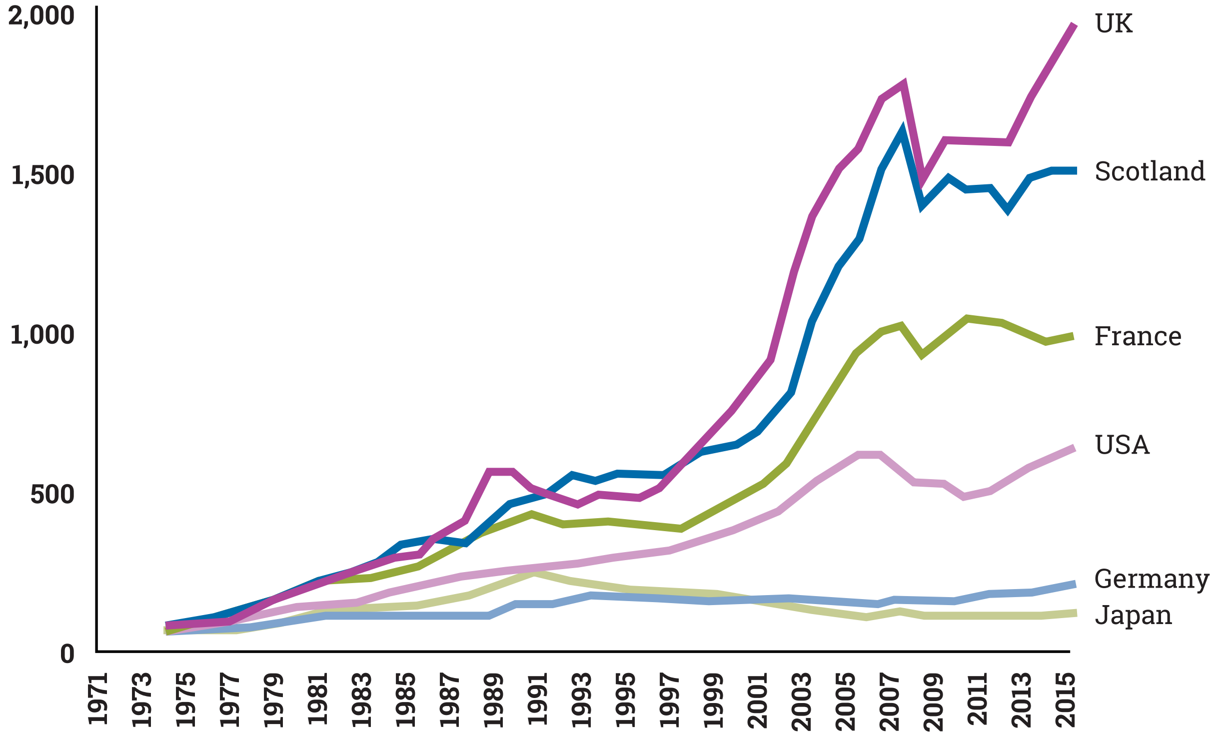
The artificial restriction of land supply, driven by financialisation, is arguable accelerating depopulation or low population growth by making land and housing unaffordable for people in rural communities. It also restricts the ability of local authorities to build new homes in order to tackle this issue. Instead, landowners keep land in order to obtain tax benefits associated with ownership of such assets. For example: tax breaks, exception from inheritance tax, and/or avoidance/deferment of capital gains tax. Moreover, subsidies can be won by using land as what have been called 'sham' farm businesses, where the motive is to extract value by attracting government resources as opposed to engaging in real production.

Figure 3.
Value of Dwellings (Excluding Land) and the Value of Land in the UK



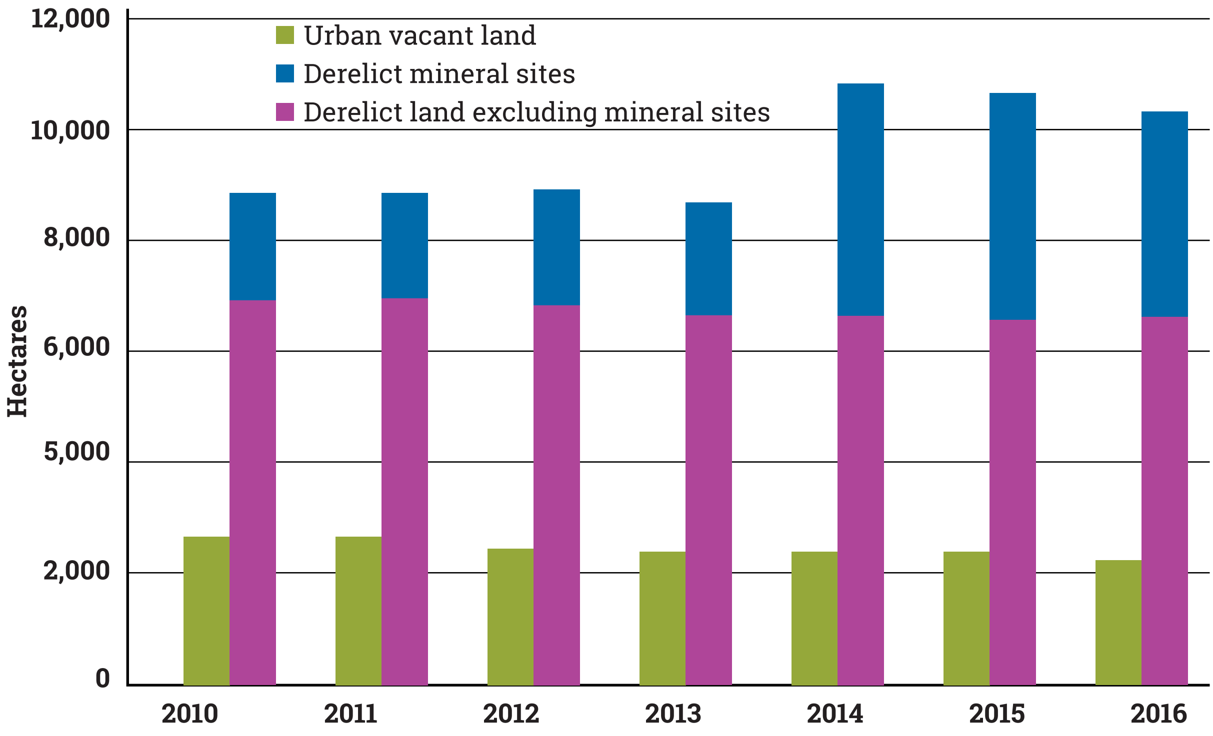
Source: Macfarlane (2017)

Figure 4. Nominal House Prices, 1971-2015



Source: Macfarlane (2017)

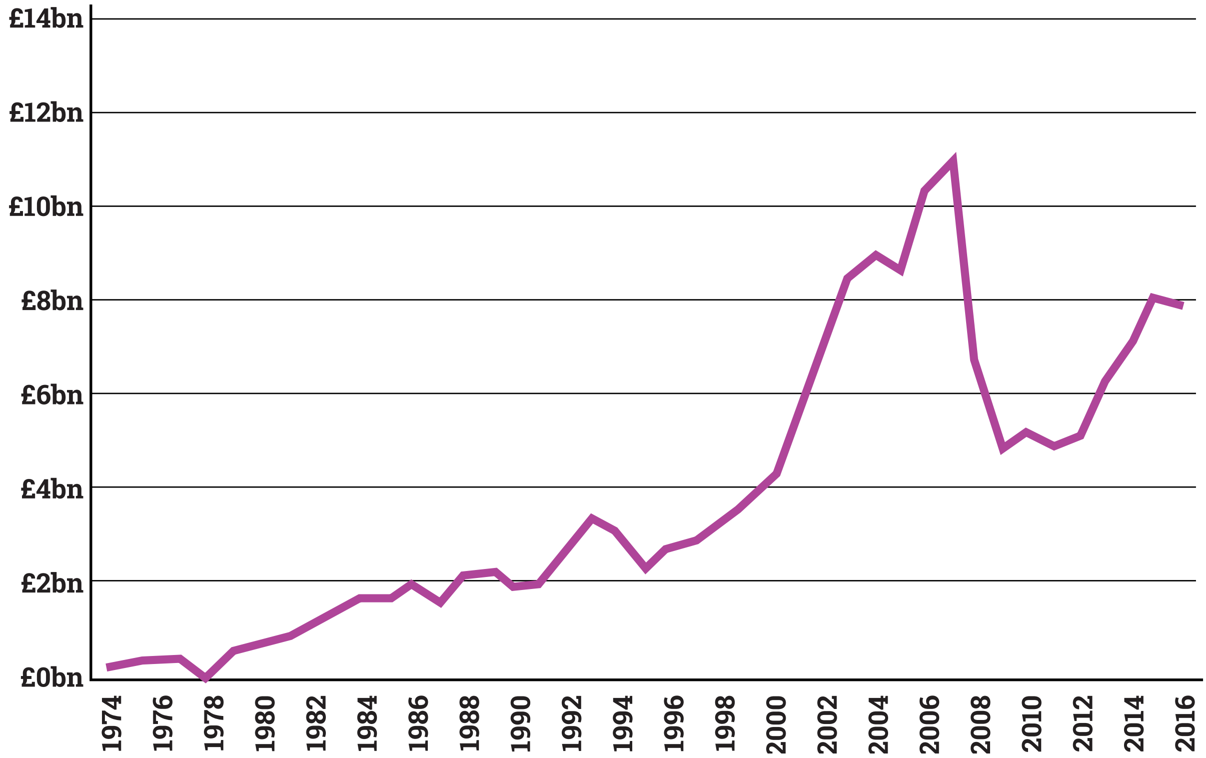
Figure 5. Total Derelict and Urban Vacant Land, 2010-2016



Source: Macfarlane (2017)

The huge expansion of credit, characteristic of financialisation, has contributed to this land and housing crisis in rural communities.[18] Where credit is obtained for purchasing land and housing in rural communities, much of the benefit has gone to upper-income individuals. 'Greater financial depth can widen income gaps if it enables the better-off to obtain more or cheaper funding for profitable projects that they can identify, compared with lower income people who would lack access to credit. This effect could arise in particular because the better-off typically have more collateral and better credit histories.[19]

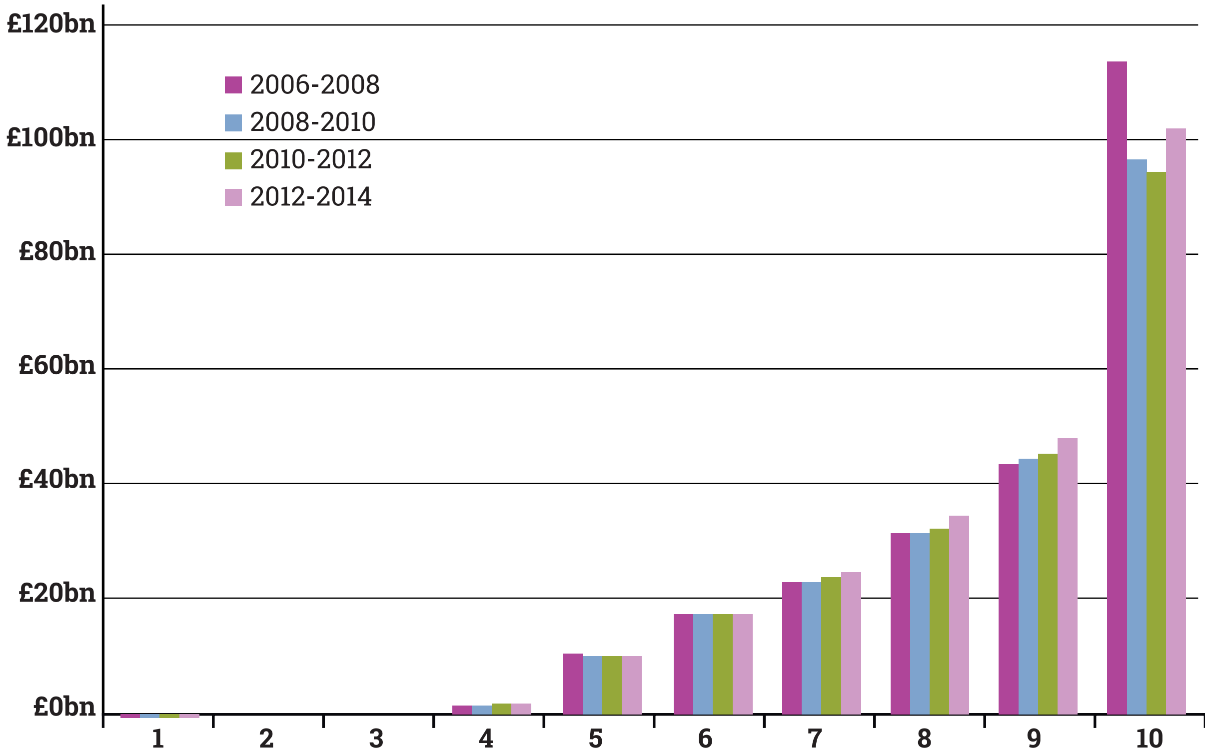
Figure 6.
New Mortgage Loans in Scotland (First Time Buyers and Home Movers)



Source: Macfarlane (2017)

18 Macfarlane, L. (2017) 'The Housing Market in Scotland: A Discussion Paper', Scottish Land Commission.
19 Cournède, B., Denk, O. and Hoeller, P. (2015) 'Finance and Inclusive Growth', OECD Economic Policy Paper, No.14.

Figure 7. Value of Household Net Property Wealth in Scotland by Decile



Source: Macfarlane (2017)

Conclusions and Future Directions

1. We agree with the OECD in that rural areas are places of opportunity. The OECD's research to data has highlighted how to understand the relationship between urban and rural economies, the growing rural-urban inequalities in OECD economies, and provided worthwhile proposals on how to counter them.

2. We encourage that the OECD expand this positive research agenda to include the role of finance in modern economies. In order to obtain the opportunities visible in rural communities, financialisation should be put on the policy agenda in order to get a more precise picture of the challenges to rural development and how to overcome them.

3. As a starting point, the above findings can used to further develop the Draft Principles, and the Rural 3.0. These include the ways in which finance impacts upon urban-rural relations and drives urbanisation, how it can act as an obstacle to growth in rural economies and makes them more prone to crises of various kinds.

4. This should serve only as a starting point and is certainly not the full story. At present, there is a considerable lack of empirical macro-data regarding the effects of financialisation on rural communities, especially its relationship to issues such as urbanisation and underdevelopment. The OECD should begin by recognising finance as a 'mega-trend', including it on the research and policy agenda for future development work.