

URBAN ECONOMIC CHALLENGES AND THE NEW URBAN AGENDA

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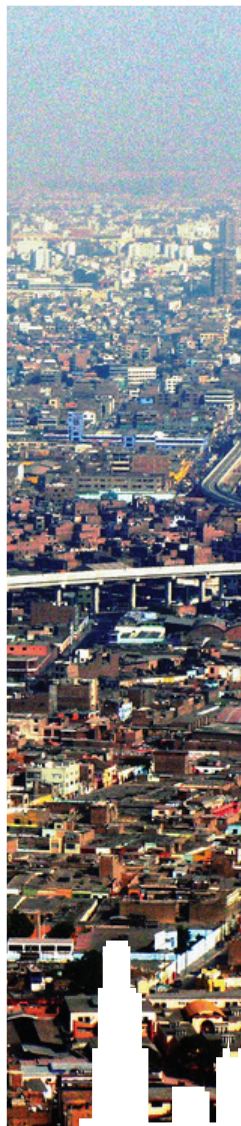
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I wish to acknowledge the assistance of Martha Susana Jaimes in the preparation of this paper and the comments of Gulelat Kebede, Marco Kamiya, and Liz Paterson of UN Habitat, and Lena Simet.

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Urban Economic Challenges and the New Urban Agenda



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By Michael Cohen¹

¹ Professor of International Affairs, The New School, New York. I wish to acknowledge the assistance of Martha Susana Jaimes in the preparation of this paper and the comments of Gulelat Kebede, Marco Kamiya, and Liz Paterson of UN Habitat, and Lena Simet.

Abstract

This paper focuses on the growing urban economic challenges facing both developing and industrialized countries. Cities are clearly the engines of growth for most national economies. The paper identifies the dynamic conditions of urban economies and suggests areas deserving policy attention and increased research. It focuses on three foundational components of the urban economy: employment, productivity, and urban finance and emphasizes the need for studies of the economic structure of cities in order to identify priority sectors for development. It also highlights the tradeoffs which exist between employment and productivity and the need to develop a broader definition of urban productivity which is multi-scalar and which relates to sustainability. This broader perspective suggests that the productivity of the urban economy might be considered as a public good in terms of its essential attributes which will ultimately determine the sustainability of specific urban areas. This contrasts sharply to the narrower notion of maximizing the competitiveness of firms and cities as a strategy for urban economic development. The paper further suggests the need for a broader analytic and multi-level perspective on these issues which includes the macro-economy, the city, the neighborhood, the firm, and the household. Part I frames the challenges, while Part II proposes components of an analytic framework for the urban economy. Part III suggests a policy agenda for the urban economy. Part IV identifies questions for further research and some possible work program activities which might be undertaken by UN Habitat.



Part I:

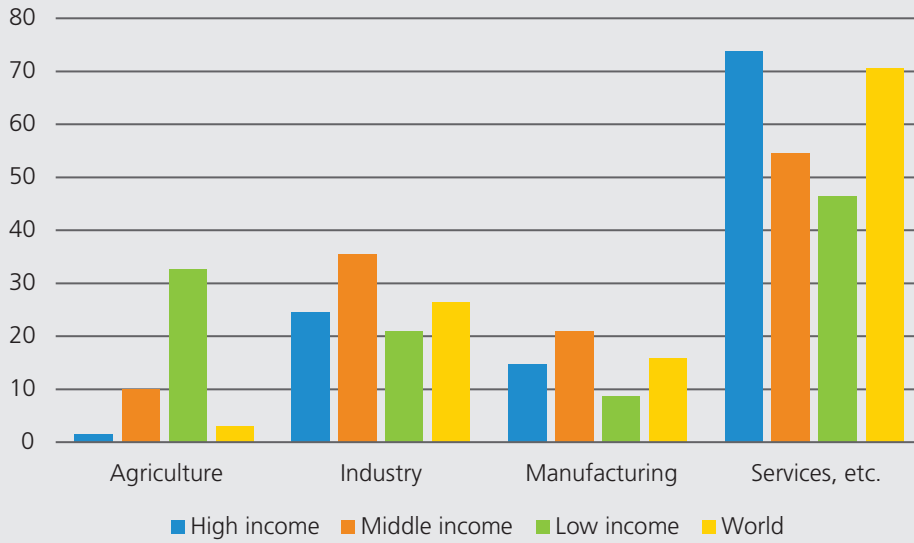
Framing the Challenges

The convergence of the framing of the new urban agenda in the preparatory process for Habitat III and the adoption of new Sustainable Development Goals offers an opportunity to place the urban economy in a central place for the success of both political and substantive agendas. There is growing official acknowledgement that cities are the engines of growth in most economies in both industrialized and developing countries. They generate over 80 percent of global GDP and over 60 percent of GDP in most countries, with the share in industrialized countries reaching 80-90 percent.² As shown in Figure 1, the high and growing share of GDP attributed to services as income increases, coupled with the declining share of agriculture, demonstrate the transformation of economies through the process of economic growth. This process is clearly evident in Africa where the service sector has become the largest contributor to GDP. This pattern is also fuelled by the role of outsourcing in the global economy.

In reality, for all countries, urbanization is driving economic growth, with higher per capita incomes and higher productivity being outcomes of urbanization and the process of economic agglomeration. Urban economy therefore is a subject of national and macro-economic importance.

² World Bank, Urban Development Overview, (Washington: The World Bank, 2015)

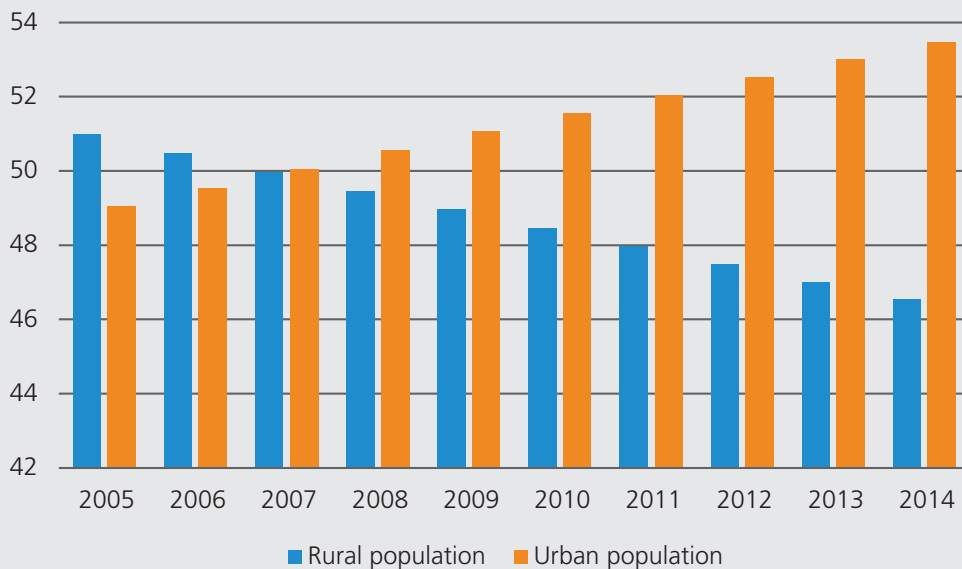
Figure 1: Value added per sector (% of GDP).
Country income level. 2013.



Source: World Development Indicators – World Bank

All countries now depend heavily on the productivity of urban economic activities for economic growth, with some 75% of future GDP growth now expected to come from cities and towns.³ This process of planetary urbanization is further demonstrated by Figure 2 which shows that even after the global financial crisis of 2008, urban growth continued at an even faster rate. This suggests that urbanization rates are not correlated with business cycles but are part of a longer term pattern.

Figure 2: Rural-Urban world population. Percentage of total population.



Source: World Development Indicators – World Bank

3 World Bank, Reshaping Economic Geography: World Development Report 2009, (Washington: The World Bank, 2009)



Women enterprise in Ushafa Clinton village Abuja, Nigeria © UN-Habitat/Julius Mwelu

Within these global patterns, however, there are important regional differences, with the emergence of Northeast Asia (China, Japan, and Korea) now accounting for 24 percent of global GDP and 35 percent of global manufacturing. Asia generates 34.8 percent of global exports in contrast to 5.7 percent coming from Latin America. This performance results from many factors, but one important component is the value of public capital stock as a share of output, with real capital stock per capita in Japan and Korea at US\$27,500 per person compared to US\$5,000 for all of Asia and US\$6,000 for Latin America.⁴ This performance relates to the high levels of savings in Asia, the process of structural change in Asian economies, and their high level of economic integration through value and supply chains with other countries in the region.

These new developments have determined and been affected by a new economic geography which includes megacity regions, subnational patterns of cities, and economic growth corridors.⁵ New patterns of production affect the paths of national development, not just urbanization, and also determine both their aggregate levels of output and the distribution of income within and across countries.

While subjects such as housing, infrastructure, community development, and environmental protection continue to deserve policy attention, achieving goals in these areas ultimately depends on whether sufficient incomes and public revenue are available in cities. Both incomes and public revenue in turn depend on two critical factors: employment and productivity.

⁴ Brian Roberts and Marco Kamiya, *The Competitiveness of Asian and Latin American Cities*, (Manila and Caracas: Asian Development Bank and Corporacion Andina de Fomento, 2014)

⁵ *Ibid.*, p.10

Foundational Challenges for Urban Policy

Without employment there are no incomes and thus no possibility for households or firms to invest and improve their conditions. If employment is at a low level of productivity, it does not matter whether much energy is devoted to work; the results will not be sufficient to meet the needs of growing urban populations. In the case of Sub Sahara Africa the large informal economy underscores the challenges of both shortage of decent jobs and low productivity whilst the phenomenon of middle income trap in Latin America highlights the stagnation or slow growth in productivity.⁶ *Increasing both employment and productivity are thus essential and foundational challenges for urban policy and macro-economic development.*

At the same time, it is also evident that neither employment nor productivity can grow by themselves. They are highly dependent on other enabling conditions within national economies and cities. *Employment* requires the demand for goods and services from the population, infrastructure, investment capital, labor markets, and rules governing work and compensation. *Productivity* requires that these inputs - capital, labor, land, and technology - are available in appropriate quantities, qualities, and forms as well as markets for goods and services and prices for these outputs. In addition, policy and institutional support for small and medium start-up enterprises, and the process of innovation are necessary enabling conditions to allow sufficient profits to permit the sustainability of firms. Whilst the availability and expansion of capital and labor is important to expand production and create employment, the type and nature of technology and the way in which capital and labor are combined in the production process determines the level of productivity. When key inputs are not available, productivity of capital and labor suffer, with firms unable to generate profits and thus unable to generate more jobs.⁷

These macro-economic processes drive productivity at the national level, generating both GDP per capita and value-added of specific goods and services. Their location and interaction with urban areas is a major contributor to the profits and growth of enterprises and thus to the generation of public revenue at the local level.

The generation of productive employment, therefore, also depends on the existence of public goods such as infrastructure, a clean environment, public space, and an institutional framework required to regulate economic and social activities. These public goods are essential for both employment and productivity. *All of the above depend on a third foundational element in the urban economy which is the capacity to generate public revenue.* Public goods require financial resources for investment and maintenance. The lack of reliable sources of public revenue and a financial system to permit long term finance are major constraints to investment in needed assets, whether for public infrastructure, private firms, or housing for urban families. Local taxes account for only 2.3 percent of GDP in developing countries, while this number is 6.4 percent in industrialized countries.⁸ A legal and policy framework that empowers urban authorities to expand their tax base, improve their tax administration, and tap their local or endogenous resources is crucial. This is critical to building the capacity to leverage public investment through effective partnership with private sector and ability to coordinate investment for maximum social and development outcomes.⁹

This situation, however, is made much more complicated by the fact that there are also *tradeoffs between employment and productivity*. For example, street cleaning vehicles are more productive than people cleaning the streets, but the latter provides more employment. So-called “labor saving technologies” are heralded as being more productive, as in agriculture where much higher levels of productivity have been achieved through mechanization, but employment is reduced. Agriculture which relies heavily on fertilizers may also achieve higher crop yields, but the environmental effects of some fertilizers may reduce productivity of the soil in the medium and long term.¹⁰ When considered in the African context, it is apparent that the size, diversity, and sophistication of industrial sectors declined between 1975 and 2005, suggesting the need for more focus on infrastructure, skills, and the organization of industrial clusters.¹¹

When considered at the city level, these concerns about increasing productivity imply that *the definition of productivity itself must change, going beyond the narrow definitions of the productivity and competitiveness of the firm and the city towards a broader evaluation of the impact of firms and sectors on the urban area in which they operate.* This call for a wider

6 Inter-American Development Bank, *The Age of Productivity: Developments in the Americas*, (Washington: IADB, 2011)

7 Alex Anas and K.S. Lee, “Infrastructure Investment and Productivity: The Case of Nigerian Manufacturing A Framework for Policy Study”, *Review of Urban & Regional Development Studies*, Vol. 1, No.2, pp. 65–76, July 1989

8 Richard Bird and Roy Bahl, “Subnational Taxes in Developing Countries: The Way Forward”, Institute for International Business, Working Paper Series IIB Paper No.16

9 The Addis Ababa Action Agenda on Financing Development (July 2015, Ethiopia) identified strengthening the role of local authorities and municipalities in public finance as one of the important elements of expanding domestic finance and implementing the sustainable development.

10 See for example the work by Calestous Juma on agricultural innovation in Africa, http://belfercenter.ksg.harvard.edu/publication/20504/new_harvest/html

11 John Page, *Should Africa Industrialize?* (Helsinki: UN Wider Working Paper No.2011/47)



A street in Vientiane, Laos © Flickr/Thanate Tan

definition of productivity has been articulated before, but it needs re-emphasis in order to be taken seriously.¹² Rather it needs to include the positive and negative externalities which firms and sectors generate at the city level, whether industrial pollution or contributing to the health of its surrounding community through the services of a community clinic. These externalities need to be identified and also quantified to the extent possible in order to assess the total productivity of firms and sectors which includes their effects on the city in which they operate. It should be noted that these broader effects of productivity are not included in conventional economic notions of total factor productivity.

It would be important, therefore, to try to assess all of the effects of the behavior of firms and sectors on a city and higher scales, indeed even on a country's system of cities, as done recently by Hsieh and Moretti.¹³ This suggests first that the definition of productivity needs to include its effects at different scales. In addition, the productivity of firms can have both private and public components: the private relates to a firm's internal costs and benefits of production and sales and may be measured by profits. But the public component, at a city level, may include a wide range of externalities as suggested above. The impacts of these externalities affect urban public goods, such as air quality, water pollution, as well as traffic levels. From this perspective, productivity may be considered *as in part an urban public good*. This is similar to the argument that urban density is a proxy for a set of necessary urban services and interactions which makes cities attractive places to live and work and therefore urban density is also a public good.¹⁴ A key policy priority, therefore, must be to find the optimal density to maximize productivity and employment while minimizing or mitigating negative externalities.

The role of urban finance in this wider understanding of productivity of cities consists of both playing its traditional role of raising public revenue and managing public spending in the public interest, but also actively contributing to a virtuous cycle of local taxation, investment, and economic growth. But if economic activity, and specifically the productivity of firms, has both positive and negative externalities, urban finance should also play a regulating function in encouraging behaviors by firms to seek positive externalities and multipliers while avoiding negative externalities. Simply put, the challenge is to support activities which support sustainability while discouraging those which do not.

¹² See for example the World Bank's Doing Business ranking and reports as well as by Michael Porter his work on Competitiveness.

¹³ Chang-Tai Hsieh and Enrico Moretti, "Why Do Cities Matter? Local Growth and Aggregate Growth", National Bureau of Economic Research Working Paper No.w21154, May 2015

¹⁴ Paul Collier comment referred to in Robert Buckley, Achilles Kallergis, and Laura Wainer The Housing Challenge: Avoiding the Ozymandias Syndrome, (New York: The Rockefeller Foundation and the New School, 2015)



Busan, the Republic of Korea's second largest city © United Nations

The Urban Economy and Development Strategy

This understanding of the linkages and tradeoffs between employment, productivity, and the role of urban finance is not new. At the macro-economic level the centrality of employment and total factor productivity have been studied for many years and incorporated in macro-economic policies and strategies for specific developing countries. The role of the domestic economy within development strategies and particularly the link between industrialization and development itself has also been a subject of considerable controversy for over 50 years. Historically the rise in the share of manufacturing in output and employment increases as GDP per capita increases. At the same time there has been a decline in the agricultural share of GDP. This has been widely identified as part of the urbanization process in developing economies.¹⁵

But this process also should be understood within a wider developmental context. Hollis Chenery framed this question, “how does this transformation of the structure of production affect the rate of growth and the distribution of benefits?”¹⁶ Going further he asked: “How essential is industrialization for development? What is the importance of changes in demand in comparison with changes in such supply-side factors as capital accumulation and comparative advantage?”¹⁷ He raised the issue of the relation between growth and structural change, which in turn led him to pose the question of the contribution of specific policies to this structural change. For example, the much-debated issue of import substitution from the 1950s has been shown to have specific effects on patterns of urbanization, helping to spatially concentrate economic activities and populations in the pursuit of agglomeration and scale economies.

These issues are central to our understanding of urbanization which can also be viewed as a form of structural change in demographic distribution and concentration and the differentiation of economic opportunities within specific geographical areas. This wider perspective is also essential to the argument that urbanization is part of these structural changes, both in terms of production and distribution. As noted by Cimoli, Dosi, and Stiglitz, the structure of industries is reflected in the distribution of income through remuneration policies. The production of goods and

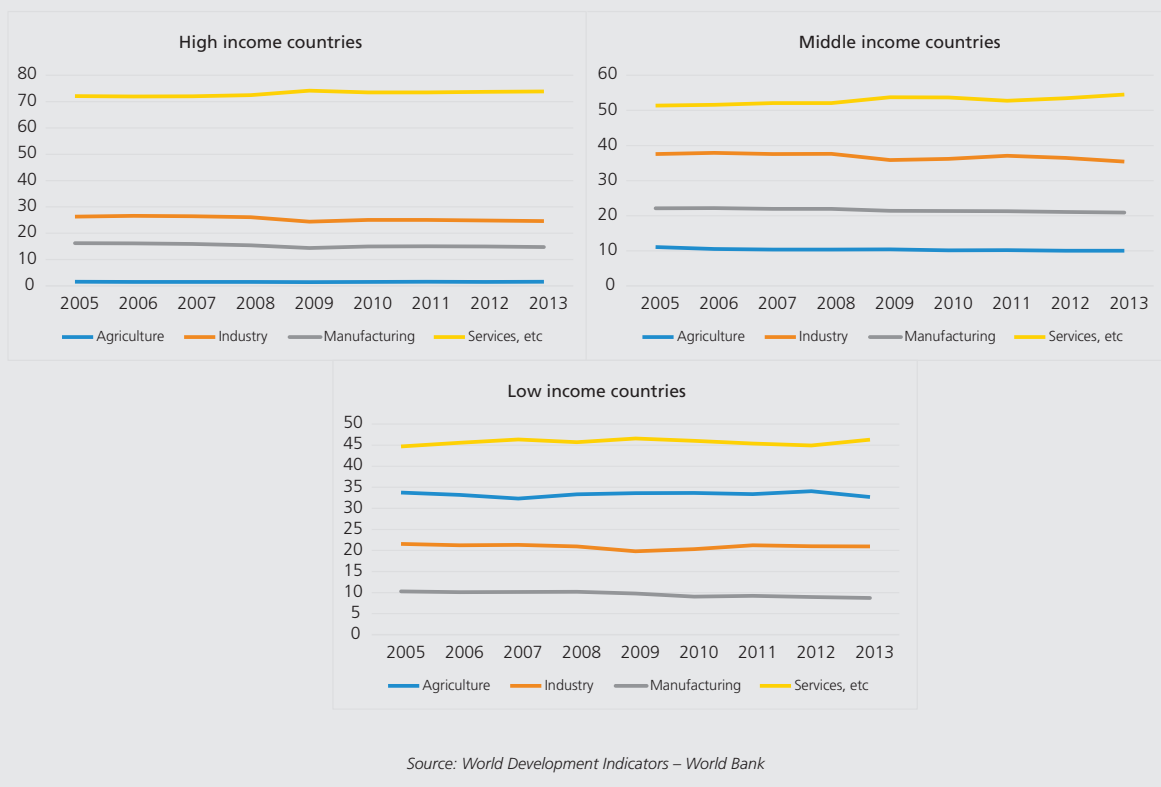
15 Mark Montgomery, Richard Stren, and Barney Cohen, eds. *Cities Transformed*, (Washington: National Research Council, 2003)

16 Hollis Chenery, Sherman Robinson, and Moshe Syrquin, *Industrialization and Growth: A Comparative Study*, (New York: Oxford University Press for the World Bank, 1986), p.1

17 *Ibid.*, p.4

services and the distribution of salaries and benefits are closely related and interdependent.¹⁸ The industrial structure of a city produces a specific level and distribution of salaries which is in turn reflected in the pattern of social stratification. The question for cities in developing countries is whether this industrial structure is dynamic enough to evolve and grow fast and whether the required quality of labor is available to integrate increasing urban populations or whether these population increments can only find jobs in the informal sector. At the same time there has been a decline since the 1980s in the labor share of national production in all countries.¹⁹ Figure 3 shows that the value added per sector, as a percentage of the GDP, varies by country income levels and gives an account of the differences in the structure of the economies that leads to such income differences.

Figure 3: Value added per sector (% of GDP).
Country income level. 2005-2013



While these issues have long been debated in development policy circles, they are relatively new in the world of international urban policy where there has been more focus on housing and infrastructure and a reluctance to regard urban areas as sites of value creation and employment generation. Value creation includes goods, services, investments, as well as less tangible forms such as culture and information which now account for a growing share of urban economies.²⁰ While lip service is given in fiscal policy debates to increasing local public revenue, this issue has not received the priority it deserves even though more than a quarter of public revenue is generated at the local level in OECD countries. Urbanization should be acknowledged as a driver of development. At the moment urban is largely missing from the global development policy debate and national development discourse, and economy is missing from urban and this needs to change.²¹

18 Mario Cimoli, Giovanni Dosi, and Joseph Stiglitz, *Industrial Policy and Development: The Political Economic of Capabilities Accumulation*, (London and New York: Oxford University Press, 2009)

19 Roberts and Kamiya, op.cit.

20 Center for an Urban Future, *Growth by Design: The Powerful Impact and Untapped Potential of NYC's Architecture and Design Sectors*, (New York: Center for an Urban Future, June 2011.)

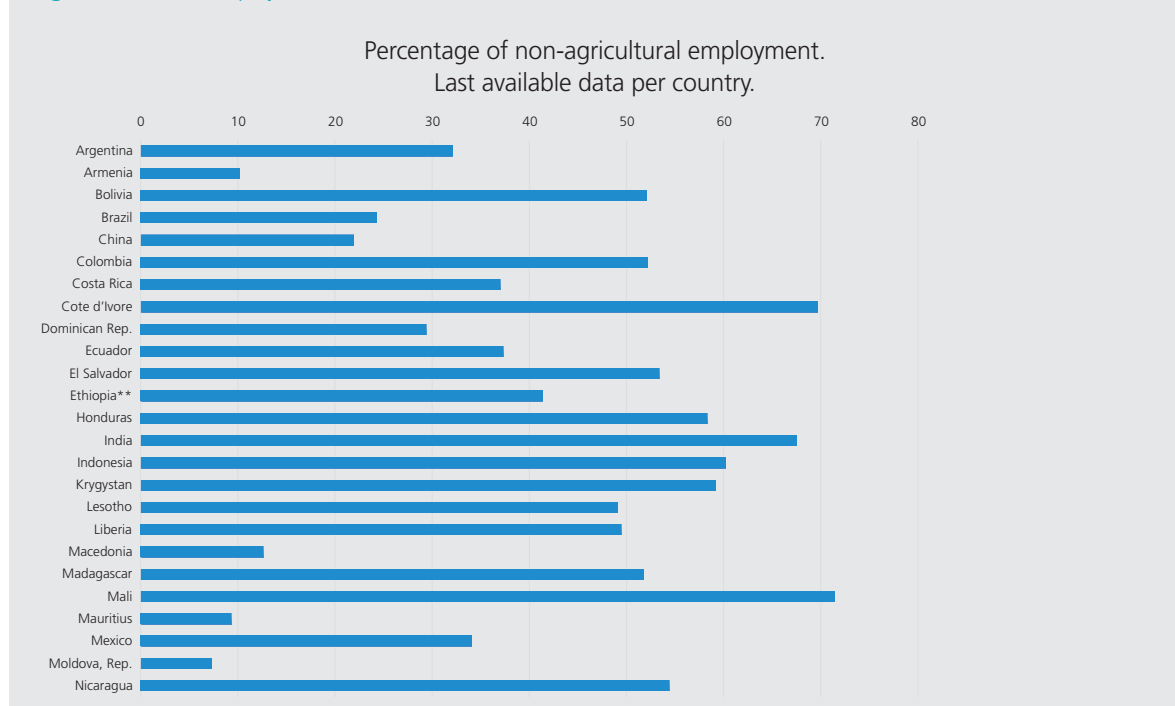
21 Ivan Turok 2015. *The Evolution of National Urban Policies*. UN-HABITAT & Cities Alliance.

The Broader Significance of the Urban Economy

If the urban economy accounts for 80 percent of global GDP and 75 percent of future GDP growth, the macro-economic significance of the urban economy should be clear. But in fact the urban economy is even more important than that, indeed it is at the core of politics and cultures as well. The 17th century German saying that “city air makes men free” was not just a statement about politics, but also about economic and cultural opportunities. And it is truer than ever before. If we believe Amartya Sen’s assertion that “development is freedom”,²² we need to understand that as economies become more urban, generating both value and opportunities, urban economies are creating wider and wider ranges of choice. This process is the essence of social transformation. The urban economy, therefore, is the site not just of economic transformation but also political and cultural change as well.²³

We also know that processes of transformation are highly uneven or unbalanced. Sectors, opportunities, and benefits grow at different rates, depending on the value they produce and the markets where goods and services are sold. Necessarily sectors may provide benefits for some, but others are frequently left behind. For example, globally about 13 percent of youth²⁴ are currently unable to find employment, with the number even higher in many developing countries. The resulting low levels of productivity and income of many potential contributors to society lead to the growth of the informal sector in national economies.²⁵ Informal employment now makes up over half of non-agricultural employment in most developing regions, and is often a greater source of jobs for women than men.²⁶ Countries such as India have almost 80 percent of their labor force in the informal sector, underlining the need to focus clearly on the constraints to formal sector employment growth. In West African cities these numbers reach 76 percent in Niamey and 83 percent in Lome.²⁷ Higher levels of informality reduce aggregate rates of growth.²⁸

Figure 4: Persons employed in the informal sector.



22 Amartya Sen, *Development as Freedom*, (New York: Alfred Knopf, 1999)

23 This point was well made by Joseph Stiglitz in an address, “Democratic Development as the Fruits of Labor” to the Industrial Relations Research Association in Boston in January 2000, in which he focused on “development as democratic transformation.”

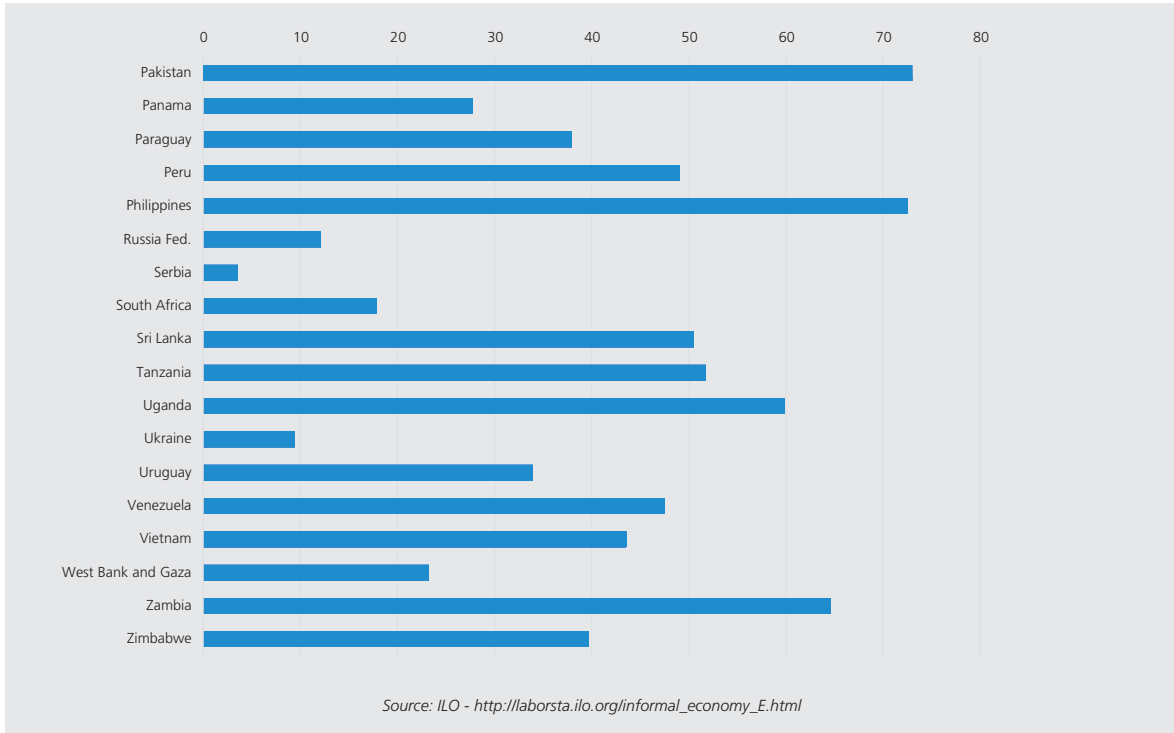
24 International Labor Organization, *World of Work Report 2014 Developing with Jobs*, (Geneva: ILO, 2014)

25 As defined by the International Labor Organization, the informal economy or informal sector, is “(...) broadly characterized as consisting of units engaged in the production of goods or services with the primary objective of generating employment and incomes to the persons concerned. These units typically operate at a low level of organization, with little or no division between labor and capital as factors of production and on a small scale. Labor relations - where they exist - are based mostly on casual employment, kinship or personal and social relations rather than contractual arrangements with formal guarantees.” Taken from <http://stats.oecd.org/glossary/detail.asp?ID=1350> on Dec. 3, 2014

26 WIEGO reports

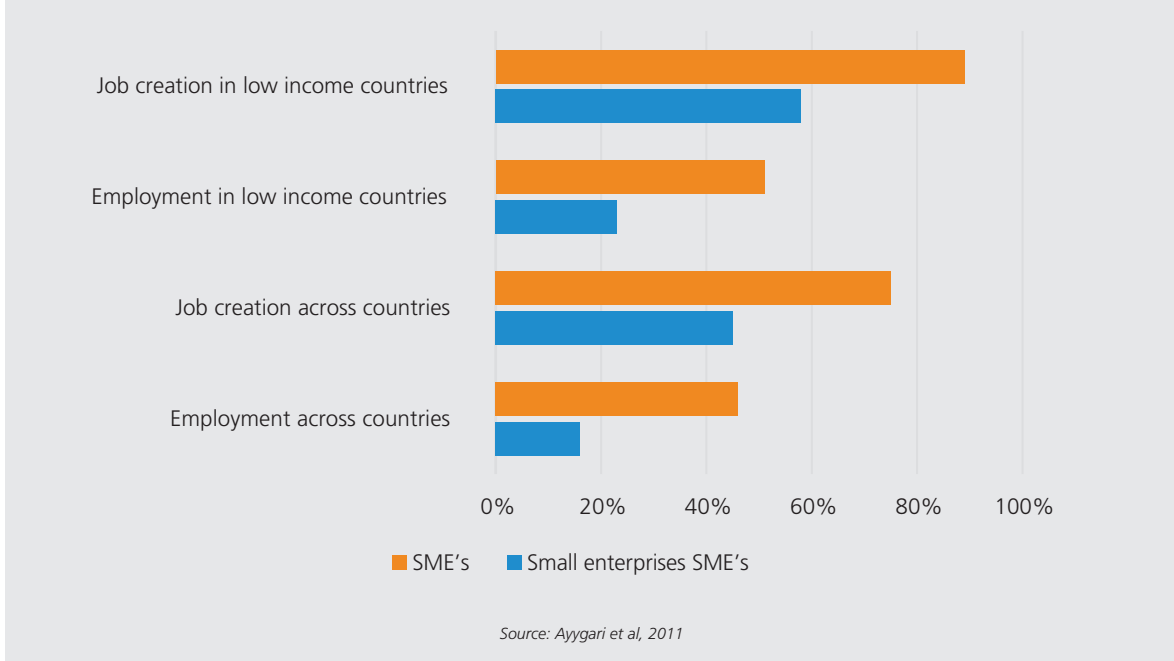
27 J. Herrera and others, “Informal Sector and Informal Employment: Overview of Data for 11 Cities in 10 developing Countries”, Working Paper No.9, (Cambridge, Mass.: Women in Informal Employment: Globalizing and Organizing (WIEGO), 2012)

28 Norman Loayza, “The Economics of the Informal Sector: A Simple Model and Empirical Evidence from Latin America”, Policy Research Working Paper No. 1727, (Washington: World Bank, 1997)



At the city level this dominant presence of the informal sector translates into lower productivity, weaker protection of working conditions, and constrained access to markets. It also contributes to unregulated environmental pollution and inefficient energy use. Critically, it weakens the potential base for public revenues and thus for public spending on needed inputs such as public goods.

Figure 5: Employment and job creation by firm size.
Low income countries and across countries 2011



On the formal sector side, small and medium size enterprises (SMEs) provide two thirds of formal sector jobs in developing countries and up to 80% in low-income countries.²⁹ The low number of employees per enterprise, as in the case of Bogotá where 90 percent of enterprises have less than 10 employees³⁰, is a good indicator of this disturbing self-reinforcing negative cycle whereby the scale of activity is too small to generate economies of scale, thus assuring low levels of profit if any, reducing investment, limiting the acquisition of technology, and not surprisingly assuring stagnation within the informal sector. This pattern of cumulative causation undermines the prospects for employment growth. For the city as a whole, both capital and labor are severely constrained.

One clear constraint is the interaction between urban form and informality, where difficulties in access to employment limit the growth of formal sector jobs. Studies of Buenos Aires, Johannesburg, and other cities show that access to employment is a key factor on labor productivity.³¹ Mobility, therefore, must be considered a factor in this wider definition of productivity of urban areas.

Other important consequences of low levels of productivity and therefore income are high levels of urban poverty and increasing intra-urban inequality. Households with assets in the urban economy, such as housing or occupational training, are able to obtain lifetime economic benefits and thus over time are differentiated from the mass of low income population.³² At the aggregate level, this dynamic is reflected in the growing inequality documented by Thomas Piketty in his study of inequality when he demonstrates that if the return of private wealth exceeds the rate of GDP growth, inequality will increase.³³ This process of accumulation exists at many levels of income, but its differentiating effect is a central dynamic in urban economies.³⁴

This paper, therefore, focuses on the growing urban economic challenges facing both developing and industrialized countries. It identifies the new dynamic conditions of urban economies and suggests areas deserving policy attention and increased research. It brings together four different policy perspectives: jobs and livelihoods under the categories of employment and productivity, the particular challenges of the informal sector, the urgent need to strengthen municipal finance, and how these can combine to generate local economic development.³⁵ These four perspectives have frequently been addressed in individual studies, but rarely have they been considered together and particularly in terms of the potential tradeoffs between what are frequently considered complementary and consistent policy objectives. This paper will take on that challenge.



Bus Rapid Transport Station in Johannesburg, South Africa © Flickr_AfricanGoals2010

29 ILO, *Is small still beautiful?* (ILO: Geneva, 2013)

30 Based on information by the Observatorio de Desarrollo Económico de Bogotá: <http://observatorio.desarrolloeconomico.gov.co>

31 See for example studies by Remy Prud'homme in Buenos Aires, (Washington: IADB, 2004) and Alain Bertaud in Johannesburg.

32 Caroline O. N. Moser, *Ordinary Families, Extraordinary Lives: Assets and Poverty Reduction in Guayaquil, 1978-2004*, (Washington: Brookings Institution, 2009)

33 Thomas Piketty, *Capital in the 21st Century*, (Cambridge: Harvard University Press, 2013)

34 David Harvey, *Spaces of Global Capitalism: Towards a Theory of Uneven Geographical Development*, (London and New York: Verso, 2006)

35 See Policy Notes on these subjects prepared for Habitat III.



An Analytic Framework for the Urban Economy

As outlined in Part I, the urban economy presents both analytic and policy challenges. Part II outlines the elements of an analytic framework which explains how these diverse components and interactions actually work. This framework can be specified at five levels: *the macro-economy*, *the city*, *the neighborhood or cluster*, and the region. Each level interacts with the others through aggregation and through parametric conditions which can either facilitate or constrain exchange or flows. Each level is also susceptible to “spillover effects” from other levels. At the same time each level also contains existing stocks of resources and/or characteristics which affect their ability to function in the wider context. A May 2015 research study demonstrates that high housing costs in New York, San Francisco, and San Jose, affect the productivity of the United States’ economy as a whole, thus showing how costs of urban living and production in a few urban areas can have wider nation-wide effects.³⁶ This reinforces the argument that the productivity of cities, and importantly specific cities, should be considered as a macro-economic policy issue.

Macro-economy

As noted in Part I, increasing shares of macro-economic product comes from urban areas. These include construction, real estate, information technology, insurance, leisure, health, and education. The growth of these urban shares of GDP is shown above in Figure 1. These global trends strongly demonstrate the correlation between cities and GDP growth and the dependency of macro-economic performance on the productivity of cities. In addition, the wage share of national investment and its growth both affect consumer demand. These are integral parts of national economies. Over time, a growing urban economy also means more urban consumption, income, and assets, all of which contribute to the growth of societies of consumption and the middle class. Finally these processes also feed public revenue which can finance growing urban infrastructure needs which in turn affect urban economic performance.

36 Hsieh and Moretti, *op.cit.*

Despite these well-known relationships, there is nonetheless a frequently heard narrative suggesting that many developing countries are still highly dependent on the export of commodities. While it is true that in recent years many countries have experienced an increased production and trade of commodities and raw materials, these increases have not upset the basic urbanization of economies in all regions. Even when the absolute quantities of exports of commodities have increased, the shares of these largely agricultural or mineral shares of the economy have not grown appreciably as a proportion of total economies. This is illustrated by the case of Argentina and Brazil as well as other countries, which have had more than a quadrupling of production and export of soya and other vegetable oils over the last decade yet there has been no change in the agricultural share of GDP. This shows how the expansion of the urban economy, even with effects of global economic volatility, has kept up or even exceeded agricultural production.³⁷

This growing role of non-agricultural shares of economic output in many countries depends heavily on sectors such as finance, insurance, and various knowledge-based sectors, as well as increasing levels of construction and services fueled by the growing demand of larger urban populations. While the global economy activates some of these sectors, much of the growth of urban goods and services reflects the density of domestic urban economic multipliers which, when aggregated, have become major forces in macro-economies.³⁸

One indicator of the importance of these multipliers is what happens when they are disrupted, for example by global economic crises or natural disasters such as earthquakes or flooding. The economic losses from the September 11, 2001 terrorist attack on the World Trade Center in New York proved to be greater in the metropolitan area as a whole than the loss of the buildings themselves.³⁹ Studies of informal labor in Chile and India during the 2008-2011 global economic crisis show how the effect of constrained credit at the global level are felt through the contraction of household production and even the quantities of materials to be recycled in developing economies.⁴⁰ Whether reeling from monsoon rains and flooding in Mumbai in 2005-2006 or an earthquake in Chile in 2010, urban economies have proven to be highly sensitive to disruptions in infrastructure and this sensitivity is observable in the changing quantitative indicators of macro-economic performance.

Another important indicator of the linkage between the urban economy and the macro-economic level is the total share of national income going to labor versus capital. This reflects the labor intensity of the economy and the share of wages in income versus the profits earned by financial assets. As the share of wage and salaried workers in the labor force increases, productivity also increases.⁴¹ This share has a direct impact on the distribution of household incomes and the pattern of consumption.

Finally, the global financial crisis of 2008 demonstrated the high level of interdependency between macro-financial performance and cities, with the subprime mortgage crisis able to initiate cascading effects which ultimately negatively affected all countries in the world. If bad housing loans in one major market can upset the global economy and national economies, it suggests that urban economies deserve much greater attention than they now currently receive from national and international policymakers.

The City

As suggested in Part I, the performance of the urban economy does not depend solely on economic factors. The availability and condition of infrastructure at the city level, for example in Lagos or Dhaka, affects the costs of production and the profitability of many manufacturing enterprises and service sectors. Similarly, the economic costs of different spatial forms of the city, including density, scale, centralities, and absolute spatial area, affect both the costs of land and different economic activities. These spatial forms also generate specific forms of congestion and pollution. Patterns of spatial and social exclusion also encourage crime.

The cost of land is a central factor in the functioning of urban economies, with the costs of using different types and quantities of land having major consequences for the nature of housing and other buildings as well as for the taxation of residential, commercial, and industrial property. Regulations governing density such as floor area ratios or minimum areas reserved for streets or public space affect the overall supply of land and thus its cost for every other purpose. The “economics of urban form” therefore deserve policy attention as new urban extensions are under consideration.

37 See for example Michael A. Cohen, *Argentina's Economic Growth and Recovery: The Economy in a Time of Default*, (London and New York: Routledge, 2012)

38 Enrico Moretti, “Local Multipliers.” *American Economic Review*, (2010) Vol. 100, No.2: pp. 373-77

39 See City of New York, Office of the Comptroller; *The Impact of the September 11 WTC Attack on NYC's Economy and Revenues*, October 4, 2001

40 WIEGO,...

41 International Labour Organization (ILO), *World of Work Report 2014 Developing with Jobs*, (Geneva: ILO, 2014)

Similarly, the costs of land and land use policies determine where cities can benefit from urbanization economies – benefits accruing to firms in close proximity to one another or to the scale of demand– or from localization economies – benefits accruing to co-located firms in the same sector – is very much related to spatial and physical factors. Clustering of economic activities and increased connectivity and accessibility can help to reduce costs and thereby enhance productivity, but land has to be available for these purposes.

These relationships are well-illustrated in a UN Habitat paper on productivity which argues that value-added per hectare is a good indicator of productivity and reflects these characteristics such as connectivity and accessibility, as well as the availability of other needed infrastructure.⁴² These values, however, shift over time, depending on the costs of production processes and their markets, as demonstrated by the de-industrialization resulting from the liberalization of trade in the 1990s whereby many firms left industrialized countries to seek lower labor costs in then developing countries such as China, Indonesia, or Vietnam.⁴³ The new urban geographical patterns reflect what Enrico Moretti has described as “the new geography of jobs”,⁴⁴ with some urban areas able to adjust and prosper while others decline when factories are closed and jobs are lost. Competitiveness is not just about external market conditions, but rather originates in the costs of local production including the prices of land, labor, and capital. When the needed factors of production are present, there are extraordinary examples of concentration such as Ludhiana in India, which has 14,000 firms in the formal and informal sectors generating some 400,000 jobs.⁴⁵

The Neighborhood or Local Cluster

The third level of analysis is at the neighborhood level or local cluster area of the city where the physical and spatial features of the area affect the productivity of specific economic activities, such as the historic Garment District in New York, the Dharavi slum in Mumbai, or Silicon Valley in California, all of which offer proximity to firms within specific sectors. These areas are neighborhoods which have become industrial clusters. The first example also had high density so it facilitated accessibility and low transport costs. If a garment manufacturer needed buttons or zippers, they were available close by. As the costs of labor and social benefits proved to be high in New York, these firms were



Dharavi slum in Mumbai, India © Flickr/Jon Hurd

42 Loeiz Bourdic & Marco Kamiya, “Habitat’s ‘Three-Legged Approach’ and Productive Cities”, unpublished paper, (Nairobi: UN Habitat, forthcoming 2016)

43 William Milberg and Deborah Winkler, *Outsourcing Economics: Global Value Chains in Capitalist Development*, (Cambridge: Cambridge University Press, 2013)

44 Enrico Moretti, *The New Geography of Jobs*, (Boston and New York: Mariner Books, 2013)

45 Roberts and Kamiya, *op.cit.*, p.28

not competitive with firms in low wage cities around the world, with the result that firms moved, while seeking to retain some of the locational advantages and low costs of horizontal integration of firms within industries. The second example, the Dharavi slum centrally-located in Mumbai, demonstrates that many industries can take advantage of low wage costs as well as high density and low transportation costs. In this case there are firms from different sectors all working closely together and benefiting from an informally regulated labor market and distribution system. The third example, Silicon Valley, shows how proximity to innovation can stimulate more innovation, as well as unique enterprises and platforms to develop new technologies.

Clusters are composed of individual firms within sectors of economic activity, but they are nonetheless affected by wider global and macro-economic forces. As noted earlier, in order to be competitive, firms need to have a range of inputs including infrastructure services such as electricity, water, sanitation, and waste removal, as well as raw materials, credit, technology, a skilled labor force, and access to markets to sell their goods and services. Clusters organize these inputs in space and time. While both global and local market conditions affect firm performance, the dependence of firms on the availability and costs of all of these inputs is a good indicator of the embeddedness of economic activities in local contexts. The contrast between the example of Bogota with 90 percent of firms having less than 10 employees and the successful New York case where 60 percent of firms created since 2000 have under 5 employees demonstrates that firm size *per se* is less important than the availability of needed inputs in spatially specific supply chains, reliable infrastructure, and a skilled labor force. While Bogota accounts for 25 percent of Colombia's Value added and had an average growth of 5.1 percent between 2001 and 2011⁴⁶, the city's economy is nonetheless less productive than it otherwise might be, because its firms are unable to grow.

This contrast suggests that the local economy is not just about production processes themselves, but also about the positioning and organization of needed inputs within urban areas. The beneficiaries of agglomeration economies are, in the first instance, firms, which benefit from assured markets and nearby suppliers of inputs, and secondarily, and at the aggregate level, the sector within the economy of the city as a whole. The notion that firms can operate in a vacuum is fundamentally wrong. The context determines the costs of inputs, the efficiency of production, and the ability of firms to sell and/or export their products. These factors have been widely analyzed since the 1990 publication of the work of



Aerial view of Bogota, Colombia © Flickr_David Berkowitz

46 <http://observatorio.desarrolloeconomico.gov.co>

Michael Porter in which he distinguishes factor conditions, demand conditions, context for firm strategy and rivalry, and related and supporting industries.⁴⁷ The well-known infrastructure bottlenecks in Mumbai illustrate how the urban context can determine the end prices of goods. This appears for example in the production and export of T-shirt. The cost of export of T shirt from Dhaka to London is cheaper by 30 percent in comparison from Mumbai. This is largely attributed to the costs of infrastructure, assuming that labor costs are similar, but it also reflects the urban context itself, including the transport connectivity of the city to the port. This reinforces the argument that the definition of urban productivity needs to be widened to include both positive and negative externalities and how the behavior of firms affects other scales, particularly through value chains and at spatial level the supply chains

The Region:

Another aspect of firm behavior in the urban economy is the decision about firm location within the broader perspective of the region. Should firms locate in downtown areas to be close to markets and transport links or should they locate on the urban periphery where land values and rents may be lower? How should they evaluate these costs? These decisions have important consequences for the form of cities within metropolitan regions and the challenge of planning new urban extensions in the future. A large literature on industrial clusters and industrial estates identifies some benefits of firms being together in a single site – the modern version of the Garment District in New York – but the linkages of these sites to the rest of the urban region area also make a big difference. Intra-urban transport costs in time, vehicles, and energy have become major cost components of many firms in cities, particularly with the dramatic growth of traffic problems in many cities. This perspective again highlights the impacts of firms at the urban and regional scales. Urban agglomerations benefit from the value-added generated through clusters of activities in specific sectors.

The behavior of households within urban areas and broader regions also depends heavily on what might be termed the spatial structure of opportunities and costs. Most successful urban households have more than one wage earner, whether in industrialized or developing countries. This is reflected in locational decisions of households themselves.



Port of Dhaka, Bangladesh © Flickr/mariusz kluzniak

⁴⁷ Michael Porter, *The Competitive Advantage of Nations*, (New York: Macmillan Inc., 1990)

For example, in one of the few studies of the spatial distribution of income in cities in developing countries, a study in Davao, Philippines, showed that richer households lived closer to the city center because the costs of access to employment of multi-earner households were affordable. Households living on the periphery of the city could not afford the costs of urban transport.⁴⁸ This dynamic also appeared in Rio de Janeiro in the 1970s when the State Government relocated favela dwellers from the city to apartment blocks more than 40 miles from the city center. Their housing conditions improved, but they became poorer living on the edges of the metropolitan region because they had no access to employment.

The location of households therefore is a decision about spatial and neighborhood choice, with major economic significance. The spatial extension and decentralization of urban areas has resulted in household location decisions which frequently change over time, as households try to find the best alternative to maximize access to employment, security of occupancy, rental cost, and amenities including security. The rapid growth of squatter settlements and other residential areas lacking adequate infrastructure services on the peripheries of cities has placed a premium on being able to generate income from the place of residence. This has led to mixed use of structures in most cities in developing countries, as shown in the Kibera slum in Nairobi or Dharavi in Mumbai. It has also resulted in some strictly residential squatter areas in central locations, such as Villa 31, a slum in central Buenos Aires, where 30,000 people live in rooms which are rented for 8 hour shifts so people can sleep while they are not working.⁴⁹ The critical attribute of this option is its close accessibility to downtown employment, demonstrating that access to employment is the first priority; housing quality is far behind. In the case of Buenos Aires, workers go back to their homes and families living in less expensive locations on the weekends.

Together, these five levels of analysis affecting the urban economy: *the macro-economy, the city, the neighborhood/cluster*, and the *region* demonstrate how the urban economy is a dynamic set of actors and interactions with multiple, simultaneous decisions and tradeoffs, each having effects at different scales. The next step is to translate this complexity into a policy agenda which identifies issues and priorities and, while respecting the patterns of causation mentioned above, suggests steps to be taken at the international, national, and urban levels.



Villa 31 housing in Buenos Aires, Argentina © Flickr/Christoph Wesemann

48 Robert A. Hackenberg, *A Developing City in a Dual Economy*, (Davao: Davao Action Information Center, 1974)

49 Raquel Kismer Olmos, "The Economics of Low Income Housing in Villa 31 in Buenos Aires", Universidad Torcuato di Tella, 2000



Setting a Policy Agenda for the Urban Economy

Part III of this paper will present a set of policy issues and priorities deserving attention at the international, national, and urban levels.

International Level

The first issue which must be addressed at the international level is *the lack of recognition of the crucial importance of the urban economy for the future of the Earth and countries* by international organizations, governments, and the media. Despite growing understanding of the urban-based component of global GDP, helped for example by the McKinsey report declaring that 60% of global GDP comes from 600 cities, the urban economy has not been included in global discussions, either at the G20 level over the past decade, or the annual meetings of the IMF or World Bank. The 2009 World Development Report on *Reshaping Economic Geography* raised the issue, but this report has a very short shelf life and an even shorter media life. Its audience has mostly been the academic world and policy research. It is of utmost importance that this issue be treated as a critical dimension of global and national economic performance.

A second dimension of this issue is the fact that *the IPCC has now confirmed that cities account for more than 70 percent of greenhouse gases, thereby placing the energy use of cities as the central cause of climate change.*⁵⁰ Changing urban energy use means changing urban economies, both through new urban form but also from the pricing of goods and services produced within the urban economy. Urban energy use and the urban economy are absolutely intertwined and interdependent. Efforts to either strengthen the productivity of the urban economy, as suggested in Part I and II of this paper, or to reduce greenhouse gases will depend on how the urban economy is managed. Much of the resistance to measures to combat climate change reflects the economic interests which will be affected by higher energy efficiency or conservation measures. All of this occurs within the urban economy. This is another globally compelling reason to assert the centrality of the urban economy.

⁵⁰ Intergovernmental Panel on Climate Change, The 2014 Report includes findings which represent a major shift in the explanation of the origins of greenhouse gases which previously came from a combination of sources. Now it is understood that emissions result from the use of energy in the construction of buildings, the operations of buildings, and also from transportation.

A third dimension is *the issue of inequality* which has received much more attention in the last two years than in earlier periods. The publication of Thomas Piketty's book and other evidence of inequality such as the housing affordability crisis in many cities or the Occupy movement in many countries have increased public awareness of the issue of inequality. This inequality is essentially urban. If governments say they wish to reduce inequality, the arena must first be the city. An interesting feature of inequality is the recent discovery that despite progress at the national level to reduce inequality in various Latin American countries, intra-urban inequality actually increased.⁵¹ This finding reinforces the importance of income differences at the urban level.

Taken together: *urban productivity and its central role in macro-economic performance, the impact of cities on climate change, and pervasive and growing inequality*, these three issues are all high on the international agenda, but they need to be understood as essentially driven by urban policies and city-level economic and social behavior. In policy terms, while some of the levers for change in these areas are located at the national level, the impact of policy change will be within urban areas.

National Level

The second level of policy reform which has to occur is at the national level where most countries have not effectively developed "national urban policies" which consider their impact on the productivity of urban economies. The critical policy question here is how the relationship between city-level production and macro-economic performance can be better understood and appreciated at the national level. A secondary, but also important question is whether that productivity should be considered within a policy framework which prioritizes "competitiveness" *per se*. This is a major policy issue because it raises the question of an appropriate balance in the composition of GDP between trade and domestic needs, including employment generation and sustainability.

For the purposes of this paper, competitiveness could be considered a reasonable policy objective in the sense that its components, i.e. its use of land, labor, capital, and technology has important implications not just for trade but also the domestic and local character of the city. That is to say that good urban economic policy should not be faced with a tradeoff between competitiveness for trade and local needs because their requisites are not mutually exclusive.

The caveat to this statement, however, is whether insistence on productivity at the firm or industry level implies a decline in local employment. This in effect is the core of the policy problem. If a narrow definition of the productivity of firms is used, a tradeoff will exist. For the purpose of this paper, the conventional notion of productivity is defined as total factor productivity, including labor, capital, and knowledge. Productivity is defined by labor, capital and knowledge where other components are residual. However, if productivity can be understood as reflecting a wider set of needs of an urban area at different scales and in different time frames, then the tradeoff is less significant. This issue also relates to the meaning of sustainability at the urban level. If sustainability is understood at the neighborhood level, its effects on the city as a whole would not be considered. In both cases: productivity and sustainability, there is a need for a clear and positive articulation and a multi-scalar coordination of national and city level policies. Such an articulation would also need to include indicators by which to measure both productivity and sustainability.

Nonetheless, many conventional notions of city competitiveness tend to focus on specific sectors of the economy or segments of the labor force. This is well-illustrated in the reports of the World Economic Forum and includes the following partial list of attributes which are assumed in a 2011 UN Habitat paper to be part of a competitive economy:

1. The jobs should be high-skill, high income jobs;
2. Production should evolve towards environmentally benign goods and services;
3. Production should be concentrated in goods and services with desirable characteristics such as high income elasticity of demand;
4. The rate of economic growth should be appropriate to achieve full employment without generating the negative aspects of overstressed markets.⁵²

51 Eduardo Lopez Moreno, *Construction of More Equitable Cities: Public Policies for Inclusion in Latin America*, (Nairobi: UN Habitat, 2015)

52 UN Habitat, *The Economic Role of Cities*, (Nairobi: UN Habitat, 2011), p.21

This conventional definition is very partial to high value production and completely ignores the urban economy as a whole as well as most of the urban labor force. It also confuses the analytic and normative voice in asserting that a competitive economy would have a set of desirable features without considering the actual characteristics found in many cities. These mistaken assumptions are unfortunately frequently part of the competitive cities literature and fail to take into account the wider negative externalities and distributive effects generated by the activities of high value sectors.

In practical terms, individual sector policies such as those for housing, urban transport, or pollution standards need to be coordinated as a set of highly inter-dependent rules and programs which together have an aggregate effect on urban areas. As noted earlier, the recent study by Hseih and Moretti demonstrates that inefficiencies in one sector in one city, such as housing in New York, San Francisco, or San Jose, have system-wide consequences for the macro-economy of the United States as well as for the levels of productivity in other cities.⁵³ National urban policies need to take these effects into account and seek to formulate and implement coherent and consistent policies across national systems of cities. This policy function is particularly relevant when one considers the resolution of tradeoffs to be made between maximizing the productivity of individual firms versus the managing the negative externalities that this productivity may generate.

One approach to the formulation of national policies which could strengthen the support to the urban economy from the national level would be *a systematic set of urban impact indicators* which could be applied to all national policies. For example, national credit policies are formulated most frequently in central banks and also in ministries of finance. But these institutions are rarely required to explicitly report their estimates of the impact of credit policies on real estate markets or small businesses. Requiring urban economy impact indicators, much like environmental impact statements, would have the potential to significantly focus policy-makers on how such national policies have very important local impacts.



Housing project in New York, USA © Flickr/Axel Drainville

⁵³ Hseih and Moretti, *op.cit.*

A similar type of “*urban policy screen*” to assess public spending might also be developed in order to predict the impact of spending in specific local economies and to estimate how local economic multipliers might be activated. The lack of such analysis was an important part of the disappointment of the stimulus packages which were applied by national governments after they felt the impact of the 2008 global financial crisis. Very few governments actually did any analysis of the likely impact of these packages on cities. As a result, spending was not effectively targeted and did not have significant impacts.⁵⁴ Both Stiglitz and Krugman criticized the Obama administration’s stimulus package as being too small, but the real critique should have been its lack of specific targeting to cities where local multipliers exist, as in New York, Chicago, Los Angeles, or Atlanta, where they might have been activated, not to speak of cities like Detroit or Cleveland which badly needed such a targeted stimulus.

An interesting example of inappropriate fiscal stimuli was China where the government provided funds to local governments, but most of these were unable to spend the money quickly because they did not have either “shovel-ready” projects or the technical capacity to design them. Instead many Chinese municipalities used the funds to pay off their loans and thus improve their municipal balance sheets. In the end there is not much difference between throwing too much money at a problem or throwing it at the wrong target. Neither works very effectively. _____

These examples suggest the important need for more awareness of urban impacts at the national level and more coordination in the use of policy instruments. While it is hard to argue for an optimal urban policy in the sense that there are many tradeoffs and possible outcomes, particularly in quantitative terms, there is no question that more awareness and coordination between the national and urban levels could generate more productive outcomes. This would include more national attention to the characteristics of production and specialization of individual cities and how national policies and investments could enhance productivity at the urban level. In effect, a national urban productivity strategy needs to be grounded in many local conditions affecting individual cities.

City Level

While the international and national levels are complicated and involve the interactions of many sectors and institutional actors, this level of complexity is actually much smaller than what actually occurs at the city level because the latter includes the dimension of space and variation in the behaviors of micro actors. Neither economics nor the study of social behavior alone can explain these urban interactions and the many kinds of externalities which can result. This makes the formulation of urban policy much more complicated

A policy agenda for the urban economy at the urban level needs to be situated within this complexity and the many changing features of the city. On one hand, the policy agenda should focus on the productivity of the urban economy and its distributional consequences for poverty and inequality. At the same time, policies affecting this productivity must take into account the multiple externalities which can result.

A useful starting point for assembling this policy agenda at the city level is suggested by the concepts of *stocks* and *flows* which focus policy first of all on what exists in the form of installed capacity and relevant assets. The distinction between stocks and flows also provides a prism to help think about urban “balances”, which is the basis of sustainability. *Stocks* include existing economic activities, infrastructure services, environmental resources, the components of the built environment, cultural heritage, existing policies and regulations which are in place at local, national, and global levels, as well as the scale of populations and settlement patterns. *Flows* represent new additions and subtractions from these stocks, partly fueled by absolute growth in population, economic activity, or availability of natural resources. Flows can also be negative in the sense that stocks depreciate and decline over time, when finite quantities of resources are consumed, or when significant technological or climatic change may reduce the value of the stock of resources. These processes are at the core of sustainability.

The application of the notion of stocks to the urban economy forces policy makers to consider the entire existing structure of economic activities and not just the formal sector. It suggests the need for an inventory of existing economic activities including sectors and firms, including installed capacities and capital stock, as well as an assessment of the kinds of land, labor, and capital are needed to develop each sector. With this as a base the next step is to assess the productivity of each sector in terms of its valued added, cost structure, and production function, as well as the international, domestic, and local market structures within which it sells its products⁵⁵.

54 Michael A. Cohen, “The city in the global crisis: understanding impacts and strengthening the performance of stimulus packages”, in Michael Cohen, ed., *The Global Economic Crisis in Latin America: Impacts and Responses*, (New York and London: Routledge, 2012)

55 Observatory of Economic Complexity by Harvard-MIT <https://atlas.media.mit.edu/en/>

Urban economic studies which do not compare the profitability of individual sectors are too general and frequently not helpful in suggesting policy directions. The key point is that different economic sectors, for example shoe production versus construction materials, have completely different opportunities as well as constraints. Shoe manufacturers need leather or rubber, while the construction industry requires cement and steel. Similarly, shoe manufacturers require indoor factories and spaces for the evacuation of waste, while brick suppliers need open spaces far from residential areas where the dust and other residuals from their production processes will cause environmental hazards. Both sectors may require credit, but their uses of funds are on different cycles, with different returns⁵⁶.

In policy terms, therefore, each city has its own profile economic activities by sector and the number of firms within each sector. Lima and Bogotá are different, as are Accra and Abidjan. While the broad sector composition may be similar across two cities, the relative importance of firms and the constraints they face differ. Understanding the detailed composition of economic structure is a needed first step towards deciding how to improve productivity of individual sectors, firms, or the city as a whole. It is interesting to note that rarely do urban planning exercises or city development strategies carry out such detailed industrial surveys⁵⁷. As a result, their recommendations for city economic development are too general and not specific enough to be truly operational.

There is an important analogy to this problem which is the focus of studies of urban sustainability. Many sustainability proposals are very general, with recommendations for conservation, for improving energy efficiency, or for reducing the energy requirements of urban transport. But without examining in detail the levels of aquifers over time or the biomass within surrounding areas, these kinds of sustainability strategies are also not operational. In both the cases of analyzing urban economic structure and urban ecologies, common professional practice is far too general to be meaningful. In the end, both urban economy and urban ecology are absolutely context specific. They cannot be meaningfully addressed at a general level. The implication of this conclusion is to assure that adequate up front resources are made available to assemble a realistic picture of what exists on the ground. This might be summed up by the difference between saying “Ready, aim, fire” versus saying “Ready, fire, aim”. In the latter case it should be no surprise that national economic stimulus packages missed their target. They were not aiming at the right target, if in fact they were aiming at all.



Accra, Ghana © Flickr/jbdodane

⁵⁶ Ricardo Hausmann (2008), “The Other Hand High Bandwidth Development Policy” Center for International Development, Harvard University http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1314799

⁵⁷ Value Chain analysis is also a useful tool <http://www.gds-llc.com/index.php?competitive,africa,the,value,chain,and,feasibility&art=92>

Components of a Policy Agenda at the City Level

Within the above perspective, urban economic policy has to focus on its foundational elements: *employment*, *productivity*, and *urban finance*. They are central to success, but they also occupy key spaces where patterns of cumulative causation converge.

Employment

As noted in the introduction, cities cannot exist without employment, because employment through value creation is the way by which individuals, households, and firms can generate income to meet basic necessities. But all employment is not equal, because some jobs generate higher incomes and provide larger economic multipliers which feed demand for other goods and services. There is thus first a policy need to identify *priority sectors within individual cities* which generate higher returns and incomes while also feeding the economic multipliers which in turn promote more demand for goods and services and fuel further growth. This approach does not mean to only benefit high return sectors, for example technology or finance, but rather to consider a combination of sectors with different demands for land, labor, and capital. This cross-sector analysis, which should include *an inventory of firms in each sector*, is a first step towards identifying measures which could increase the demand for labor and thus address the problem of increasing youth unemployment. Young people cannot be told to find a job. *They must be trained in sectors where jobs are likely to develop and where there are reasonable expectations of productivity growth and income growth over time.*

If this scenario seems like an ideal approach in an ideal world, it must also be complemented by a *detailed analysis of the informal sector*: its organization, the goods and services it produces, the skills and other inputs which are used, and how informally produced goods and services find their way into wider markets. Similar types of questions need to be asked for both the formal and informal sectors. This approach in effect says that the physical planning components of many urban planning exercises need to be the results of prior analysis of the inventory of current formal and informal economic activities and not the starting point. *Physical and spatial arrangements must be designed to serve economic and social objectives*, not the other way around.

This policy point is of course of *great relevance to the notion of planned urban extensions where planning metrics* such as the share of space devoted to roads or residential density *should not be considered as ends in themselves but rather as guideposts to desired social, economic, and environmental outcomes in a spatial frame*. This approach is reminiscent of the design strategies used in sites and services projects financed by many development institutions during the 1970s when the unsubsidized affordability of sites determined their physical standards: their area, their level of water supply and electricity service, as well as the size of the units which were being built. In this case, *an assessment of the environment and factors affecting firm success should be an essential step towards defining regulations and the availability of needed inputs such as licenses, credit, and environmental regulations*.

This policy approach also provides some guidance with regard to policy and investments which directly affect urban form. If a city government has a limited amount of investment funds for the transport sector, it should consider which alternative transport investments would have a greater positive effect on employment generation. More jobs would mean more public revenue in the medium term, so focusing on jobs can also be seen to be revenue positive.

Productivity

As noted in Part I, employment by itself does not guarantee the productivity of land, labor, or capital. There are many jobs in all economies which have low levels of productivity which are in turn reflected in low wages. *The challenge for local economic policy is how to assure that employment can generate the highest possible productivity with the least amount of negative externalities*. This means putting in place a wide range of inputs from skilled manpower to technology to reliable infrastructure to management of natural resources so that production processes are not undermined by the absence of water or electricity or by poor quality resources. The meaning of productivity necessarily varies across industries and is more than just the value-added per hectare for a given jurisdiction. Productivity also involves the prices of the goods and services produced and how they enter domestic and international markets. But it also means balancing the need to achieve levels of productivity with the need to generate urban employment.

Formulating a “productivity policy,” therefore, is much more than a set of rules governing the behavior of firms, but also requires capital and recurrent expenditures to assure that enabling conditions, such as reliable infrastructure services, and the balancing of tradeoffs are met.⁵⁸ An intriguing example is the fact that in some cities with excellent educational institutions, these same institutions have little or no linkages to the labor market. They train university graduates in medicine, law, or the social sciences, but they ignore most of the technical skills which most firms require to do their business. Such a vocational orientation towards skill training is considered not sufficiently academic. A productivity policy would directly include a manpower training component in which educational institutions would be strongly encouraged to broaden their offerings and find ways to train men and women for the priority sectors mentioned above as well as other activities. Indeed the multipliers from a trained and engaged urban labor force can be very great as well as an essential input for innovation in many fields. Is this part of urban economic policy? The answer is a resounding yes if we believe that productive employment requires a trained labor force.

Urban Finance

The third foundational component of the urban economy is urban finance, the capacity to mobilize financial resources to permit both capital and recurrent expenditures. Urban finance is both the revenue and expenditure side, with heavy responsibilities on both sides, first to assure that revenue is generated to allow government to provide needed services and secondly to assure that the quality of expenditures is high, thereby justifying the enormous and sustained efforts to maintain local revenue streams. An important set of questions about the revenue side in all countries is whether central-local financial transfers are at the appropriate level, whether they are reliable and timely, and whether their flow is consistent with the necessary calendar of expenditures which local jurisdictions have to make. While these questions are framed in technical terms, in fact they are highly political because they are also politically determined relationships which assume political loyalty and support from recipient jurisdictions.



Salmiya skyline, Kuwait © Flickr/Bob McCaffrey

58 See Inter-American Development Bank, *The Age of Productivity*, (Washington: IADB, 2014)

Here it is useful to distinguish between endogenous and exogenous sources of finance. On the domestic side, it is possible to imagine the application of technology to the process of tax collection, valuation, and land value capture, all of which would generate immediate gains.

Exogenous sources of finance are the next step, with bonds, public private partnerships and even loans from commercial and development banks. This are steps in a continuum rather than mutually exclusive.

These multiple dimensions require a broad perspective on the issue of urban finance. Urban finance is not necessarily “local finance” in the sense that sources of revenue may be located beyond local jurisdictions, yet it is local as the site of expenditure and immediate impact, i.e. whether the drains are clogged or not during the monsoon rains. Revenue approaches which rely heavily on land value capture may appear to be “local” in the sense that the land lies within the relevant local jurisdiction. But there are significant limitations to the taxation of land, including the lack of buoyancy of land taxes as local economies grow. It may be possible to capture land value increases, but only in the medium to long term due to the labor intensive character of land appraisal and valuation by municipal authorities. The inertia of this approach can result in significant revenue losses over time in contrast to value-added taxes or sales taxes which are highly sensitive to changes in the level and productivity of economic activity. Sales taxes, however, can also be quite regressive in relation to the urban poor who spend a large share of their small incomes on food.

Politically acceptable local revenue strategies can only be identified in specific localities. Their need for political endorsement is always problematic, but explicitly linking urban finance strategies to a public inventory of sectors and firms within a city and strategic decisions on how to support the productivity of high priority sectors can provide one way to build support for a local economic development strategy rather than just for a set of revenue sources and rates.



“China Town”, one of the commercial areas of Honiara © UN Habitat



Towards Building an Operational Agenda for the Urban Economy

This paper has suggested that an effective approach to the urban economy requires a multi-scalar perspective through which the effects of one level can be detected and understood at other levels. It also suggests the need for tools to analyze the composition of the productive units of the urban economy in order to assess priorities for policy attention and investment resources. These tools, however, must go beyond what has been used to assess competitiveness in the last two decades, because the productivity of the urban economy cannot only be assessed by evaluating the competitiveness of individual firms or productive sectors. Rather it requires a fuller valuation of the positive and negative externalities in the broader urban, metropolitan, regional, and indeed national economies as well. The possibility for doing such valuation has been exemplified by the recent work by Hsieh and Moretti referenced earlier in this paper.

Beyond econometric analysis, however, is the more mundane exercise of collecting meaningful data which can allow the identification of the externalities of the productive side of the city and their consequences for sustainability. This suggests the need for *new data tools* which could be designed by UN Habitat to try to capture these multi-scalar consequences.

In addition, the Hsieh and Moretti work suggests that policy makers also need to know which “local” characteristics of their cities can have wider spatial and macro-economic effects. This suggests the need for some research to test the Hsieh-Moretti approach in terms of the role not just of housing, but other city level inputs which local and therefore broader productivity as well. There is a rich and extensive literature on competitiveness, productivity, and productivity policies in this field. The challenge is include productivity into urban growth policies in the short term.

With these analytic and policy considerations in mind, a next step would be the identification of specific assessment tools which could support operational policy-making for the urban economy, whether applied at national, regional, or city level institutions. These would include revisiting industrial cluster analysis to assess how and whether this work can be done and lead to specific economic and financial benefits, assessment of the revenue side in municipal finance including opportunities for land value capture, and much more analysis of urban employment patterns themselves, going much more deeply than the formal versus informal sectors. The potential payoffs to more informed approaches to the urban economy are very large and indeed, it might be said are necessary to develop more effective policies which allow countries to fully benefit from the power and multiplying forces of the urban economy.

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